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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-123112-19]

RIN 1545-BP51

The Treatment of Certain Interests in Corporations as Stock or Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Advance notice of proposed rulemaking.

SUMMARY: This document announces that the Department of the Treasury (Treasury Department) and the IRS intend to issue proposed regulations regarding the treatment of certain interests in corporations as stock or indebtedness and requests comments from the public regarding the contemplated rules. This document also announces that, following the expiration of the 2016 Temporary Regulations (described in the Background section of this advance notice of proposed rulemaking), a taxpayer may rely on the 2016 Proposed Regulations (also described in the Background) until further notice is given in the **Federal Register**, provided that the taxpayer consistently applies the rules in the 2016 Proposed Regulations in their entirety.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: Submit electronic submissions via the Federal eRulemaking Portal at https://www.regulations.gov (indicate IRS and REG-123112-19) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking

Portal, comments cannot be edited or withdrawn. The Treasury Department and the IRS will publish for public availability any comment received to its public docket, whether submitted electronically or in hard copy. Send hard copy submissions to: CC:PA:LPD:PR (REG-123112-19), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

FOR FURTHER INFORMATION CONTACT: Concerning the proposals, Azeka J. Abramoff at (202) 317-6938; concerning submissions of comments, Regina Johnson at (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

I. Overview

Section 385 authorizes the Secretary of the Treasury or his delegate (Secretary) to prescribe rules to determine whether an interest in a corporation is treated as stock or indebtedness (or as in part stock and in part indebtedness). On October 21, 2016, the Treasury Department and the IRS published T.D. 9790 in the **Federal Register** (81 FR 72858), which included final regulations under section 385 and temporary regulations under section 385 (Temporary Regulations). On the same date, the Treasury Department and the IRS also published a notice of proposed rulemaking (REG-130314-16) in the **Federal Register** (81 FR 72751) (2016 Proposed Regulations) by cross-reference to the Temporary Regulations, which include §§1.385-3T and 1.385-4T. Technical corrections to the final regulations and the Temporary Regulations were published in the **Federal Register** (82 FR 8169) on January 24, 2017.

The final regulations under section 385, the Temporary Regulations, and the 2016 Proposed Regulations address the classification of certain related-party debt as debt or equity for Federal tax purposes. Treasury Decision 9790 included rules set forth in §1.385-2, which establish minimum documentation requirements that ordinarily must be satisfied in order for debt obligations among related parties to be treated as debt for Federal tax purposes (Documentation Regulations). Treasury Decision 9790 also included §§1.385-3, 1.385-3T, and 1.385-4T, which treat as stock certain debt that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result (the Distribution Regulations). The Distribution Regulations are applicable for taxable years ending on or after January 19, 2017.

The Temporary Regulations set forth rules regarding the treatment under the Distribution Regulations of certain qualified short-term debt instruments, transactions involving controlled partnerships, and transactions involving consolidated groups. The Temporary Regulations apply to taxable years ending on or after January 19, 2017. The Temporary Regulations expired on October 13, 2019. See section 7805(e); §1.385-3T(l); §1.385-4T(h).

The 2016 Proposed Regulations cross-referencing the Temporary Regulations are proposed to apply to taxable years ending on or after January 19, 2017; in contrast to the Temporary Regulations, the 2016 Proposed Regulations do not expire.

II. Executive Order 13789

Executive Order 13789 (E.O. 13789), issued on April 21, 2017, instructed the Secretary to review all significant tax regulations issued on or after January 1, 2016, and to take concrete action to alleviate the burdens of regulations that (i) impose an undue financial burden on U.S. taxpayers; (ii) add undue complexity to the Federal tax laws; or (iii) exceed the statutory authority of the IRS. E.O. 13789 further instructed the Secretary to submit to the President within 60 days a report (First Report) that identifies regulations that meet these criteria. Notice 2017-38, 2017-30 I.R.B. 147, which was published on July 24, 2017, included the final section 385 regulations in a list of eight regulations identified by the Secretary in the First Report as meeting at least one of the first two criteria specified in E.O. 13789.

E.O. 13789 further instructed the Secretary to submit to the President a report (Second Report) that recommended specific actions to mitigate the burden imposed by regulations identified in the First Report. On October 16, 2017, the Secretary published in the **Federal Register** the Second Report (82 FR 48013), which stated that (i) the Treasury Department and the IRS were considering a proposal to revoke the Documentation Regulations as issued and (ii) the Treasury Department will reassess the distribution regulations in light of impending tax reform and the Treasury Department and the IRS may then propose more streamlined and targeted regulations. On September 24, 2018, the Treasury Department and the IRS issued proposed regulations that, if finalized, would remove the Documentation Regulations from the Code of Federal Regulations. See 83 FR 48265 (September 24, 2018). The Treasury Department and the IRS are publishing in the Rules section of this issue of the **Federal Register** final regulations that remove the Documentation Regulations.

Some taxpayers submitted comments in response to E.O. 13789 and the September 2018 proposed regulations recommending that the Treasury Department and the IRS revoke the Distribution Regulations in addition to the Documentation Regulations, while another comment recommended that the Treasury Department and the IRS issue more streamlined and targeted Distribution Regulations. This advance notice of proposed rulemaking announces that the Treasury Department and the IRS intend to propose more streamlined and targeted Distribution Regulations.

III. The Distribution Regulations

Under the Distribution Regulations' general rule, the issuance of a debt instrument by a member of an expanded group to another member of the same expanded group in a distribution, or an economically similar transaction, may result in the treatment of the debt instrument as stock. See §1.385-3(b)(2). The Distribution Regulations include a funding rule that treats as stock a debt instrument that is issued as part of a series of transactions that achieves a result similar to a distribution of a debt instrument. See §1.385-3(b)(3)(i). Specifically, §1.385-3(b) treats as stock a debt instrument that was issued in exchange for property, including cash, to fund a distribution to an expanded group member or another transaction that achieves an economically similar result. Id. Furthermore, the Distribution Regulations include a per se rule, which treats a debt instrument as funding a distribution to an expanded group member or other transaction with a similar economic effect if it was issued in exchange for property during the period beginning 36 months before and ending 36 months after the issuer of the debt instrument made the distribution or undertook a transaction with a similar economic effect. See §1.385-3(b)(3)(iii). The Distribution Regulations also include several exceptions limiting their scope. See, e.g., §1.385-3(c).

The Distribution Regulations address debt instruments that do not finance any new investment in the operations of the borrower and therefore have the potential to create significant Federal tax benefits, including interest deductions that erode the U.S. tax base, without having meaningful non-tax significance. The Treasury Department and the IRS are cognizant that a complete withdrawal of the Distribution Regulations could restore incentives for multinational corporations to generate additional interest deductions without new investment. Accordingly, the Treasury Department and the IRS have determined that the Distribution Regulations continue to be necessary at this time.

Explanation of Contemplated Regulations

Pursuant to E.O. 13789, the Treasury Department and the IRS intend to issue proposed regulations modifying the Distribution Regulations. To make the Distribution Regulations more streamlined and targeted, the Treasury Department and the IRS intend to issue proposed regulations substantially modifying the funding rule, including by withdrawing the per se rule. The Treasury Department and the IRS intend that the proposed regulations would not treat a debt instrument as funding a distribution or economically similar transaction solely because of their temporal proximity; rather, the proposed regulations would apply the funding rule to a debt instrument only if its issuance has a sufficient factual connection to a distribution to a member of the taxpayer's expanded group or an economically similar transaction (for example, when the funding transaction and distribution or economically similar transaction are pursuant to an integrated plan). Thus, under the proposed regulations, a debt instrument issued without such a connection to a distribution or similar transaction would not be treated as stock. As a result, the proposed distribution regulations would be more streamlined and targeted while continuing to deter tax-motivated uneconomic activity. As part of the intended revisions of the funding rule, the Treasury Department and the IRS also are considering substantial revisions to, or removal of, certain exceptions in the regulations, consistent with the revised standard. The proposed distribution regulations would not alter materially the definition of a covered member (defined in §1.385-1(c)(2) as a member of an expanded group that is a domestic corporation).

Proposed Applicability Date

The Treasury Department and the IRS intend to provide that the proposed regulations would apply to taxable years beginning on or after the date of publication of the Treasury decision adopting those rules as final regulations in the **Federal Register**.

Reliance on the 2016 Proposed Regulations

For periods after October 13, 2019 (the expiration date of the Temporary Regulations), a taxpayer may rely on the 2016 Proposed Regulations until further notice is given, provided that the taxpayer consistently applies the rules in the 2016 Proposed Regulations in their entirety.

Request for Comments

The Treasury Department and the IRS request comments on all aspects of the rules described in part III of this advance notice of proposed rulemaking. In particular, the Treasury Department and the IRS request comments on the appropriate standard for determining the existence of a connection between a debt instrument and a distribution or economically similar transaction under the funding rule. For example, the funding rule could apply solely in cases in which a debt instrument is issued as part of an overall plan to fund the distribution or economically similar transaction. The Treasury Department and the IRS also request comments on whether the proposed regulations should include particular factors that indicate when the funding rule applies and factors that indicate when the funding rule does not apply. The Treasury Department and the IRS also request comments on what additional guidance, if any, should be issued (or which provisions should be eliminated from the final regulations) to reduce the compliance burdens associated with the Distribution Regulations. The Treasury Department and the IRS also request comments on how the Distribution Regulations may affect small businesses. All comments will be available at http://www.regulations.gov or upon request.

Effect on Other Documents

Notice 2019-58, 2019-44 I.R.B. 1022 (October 28, 2019), which addresses the status of the 2016 Proposed Regulations after October 13, 2019, is obsoleted.

Statement of Availability

IRS Notices and other guidance cited in this document are published in the Internal Revenue Bulletin and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at https://www.irs.gov.

Drafting Information

The principal author of this advance notice of proposed rulemaking is Azeka J. Abramoff of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in its development.

Sunita Lough,

Deputy Commissioner for Services and Enforcement.

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