

Reg. Section 1.385-2

Treatment of certain interests between members of an expanded group

(a) In general.

(1) Scope. This section provides rules for the preparation and maintenance of the documentation and information necessary for the determination of whether certain instruments will be treated as indebtedness for federal tax purposes. It also prescribes presumptions and factors as well as the weighting of certain factors to be taken into account in the making of that determination. For definitions applicable to this section, including the terms "applicable interest" and "expanded group interest" (EGI), see paragraph (d) of this section.

(2) Purpose. The rules in this section have two principal purposes. The first is to provide guidance regarding the documentation and other information that must be prepared, maintained, and provided to be used in the determination of whether an instrument subject to this section will be treated as indebtedness for federal tax purposes. The second is to establish certain operating rules, presumptions, and factors to be taken into account in the making of any such determination. Thus, compliance with this section does not establish that an interest is indebtedness; it serves only to satisfy the minimum documentation for the determination to be made under general federal tax principles.

(3) Applicability of section. The application of this section is subject to the following limitations:

(i) Covered member. An EGI is subject to this section only if it is issued by a covered member, as defined in §1.385-1(c)(2), or by a disregarded entity, as defined in §1.385-1(c)(3), that has a regarded owner that is a covered member.

(ii) Threshold limitation-

(A) In general. An EGI is subject to this section only if on the date that an applicable interest first becomes an EGI-

(1) The stock of any member of the expanded group is traded on (or subject to the rules of) an established financial market within the meaning of §1.1092(d)-1(b);

(2) Total assets exceed \$100 million on any applicable financial statement (as defined in paragraph (d)(1) of this section) or combination of applicable financial statements; or

(3) Annual total revenue exceeds \$50 million on any applicable financial statement or combination of applicable financial statements.

(B) Non-U.S. dollar applicable financial statements. If an applicable financial statement is denominated in a currency other than the U.S. dollar, the amount of total assets is translated into U.S. dollars at the spot rate (as defined in §1.988-1(d)) as of the date of the applicable financial statement. The amount of annual total revenue is translated into U.S. dollars at the weighted average exchange rate (as defined in §1.989(b)-1) for the year for which the annual total revenue was calculated.

(C) Integration and combination of multiple applicable financial statements-

(1) In general. If there are multiple applicable financial statements that reflect the assets, portion of the assets, or annual total revenue of different members of the expanded group, the aggregate amount of total assets and annual total revenue must be used to determine whether the threshold limitation in paragraph (a)(3)(ii)(A) of this section applies. For this purpose, the use of the aggregate amount of total assets or annual total revenue in different applicable financial statements is required except to the extent that two or more applicable financial statements reflect the total assets and annual total revenue of a member of the expanded group.

(2) Overlapping applicable financial statements. To the extent that two or more applicable financial statements reflect the total assets or annual total revenue of the same expanded group member, the applicable financial statement with the higher amount of total assets must be used for purposes of paragraph (a)(3)(ii) of this section.

(3) Overlapping assets and revenue. If there are multiple applicable financial statements that reflect the assets, portion of the assets, or revenue of the same expanded group member, any duplication (by stock, consolidation, or otherwise) of that expanded group member's assets or revenue may be disregarded for purposes of paragraph (a)(3)(ii) of this section such that the total assets or annual total revenue of that expanded group member is only reflected once.

(4) Coordination with other rules of law.

(i) Substance of transaction controls. Nothing in this section prevents the Commissioner from asserting that the

substance of a transaction involving an EGI (or the EGI itself) is different from the form of the transaction (or the EGI) or treating the transaction (or the EGI) in accordance with its substance for federal tax purposes, which may involve disregarding the transaction (or the EGI).

(ii) Commissioner's authority under section 7602 unaffected. This section does not otherwise affect the authority of the Commissioner under section 7602 to request and obtain documentation and information regarding transactions and instruments that purport to create an interest in a corporation.

(iii) Covered debt instruments. If the requirements of this section are satisfied or otherwise do not apply, see §§1.385-3 and 1.385-4T for additional rules for determining whether and the extent to which an interest otherwise treated as indebtedness under general federal tax principles is recharacterized as stock for federal tax purposes.

(5) Consistency rule.

(i) In general. If an issuer (as defined in paragraph (d)(4) of this section) characterizes an EGI as indebtedness, the issuer and the holder are each required to treat the EGI as indebtedness for all federal tax purposes. For purposes of this paragraph (a)(5)(i), an issuer is considered to have characterized an EGI as indebtedness if the legal form of the EGI is debt, as described in paragraph (d)(2)(i)(A) of this section. An issuer is also considered to have characterized an EGI as indebtedness if the issuer claims any federal income tax benefit with respect to an EGI resulting from characterizing the EGI as indebtedness for federal tax purposes, such as by claiming an interest deduction under section 163 with respect to interest paid or accrued on the EGI on a federal income tax return (or, if the issuer is a member of a consolidated group, the issuer or the common parent of the consolidated group claims a federal income tax benefit by claiming such an interest deduction), or if the issuer reports the EGI as indebtedness or amounts paid or accrued on the EGI as interest on an applicable financial statement. Pursuant to section 385(c)(1), the Commissioner is not bound by the issuer's characterization of an EGI.

(ii) EGI characterized as stock. The consistency rule in paragraph (a)(5)(i) of this section and section 385(c)(1) does not apply with respect to an EGI to the extent that the EGI is treated as stock under this section or § 1.385-3, or it has been determined that the EGI is treated as stock under applicable federal tax principles. In such case, the issuer and the holder are each required to treat the EGI as stock for all federal tax purposes.

(b) Documentation rules and weighting of indebtedness factors.

(1) General rule. Documentation and information evidencing the indebtedness factors set forth in paragraph (c) of this section must be prepared and maintained in accordance with the provisions of this section with respect to each EGI. If the documentation and information described in paragraph (c) of this section are prepared and maintained as required by this section, the determination of whether an EGI is properly treated as indebtedness (or otherwise) for federal tax purposes will be made under general federal tax principles. If the documentation and information described in paragraph (c) of this section are not prepared and maintained with respect to an EGI in accordance with this section, and no exception listed in paragraph (b)(2) of this section applies, the EGI is treated as stock for all federal tax purposes. If a taxpayer characterizes an EGI as indebtedness but fails to provide the documentation and information described in paragraph (c)(2) of this section upon request by the Commissioner, the Commissioner will treat such documentation and information as not prepared or maintained.

(2) Exceptions from per se treatment.

(i) Rebuttable presumption rules-

(A) General rule. If documentation and information evidencing the indebtedness factors set forth in paragraph (c) of this section are not prepared and maintained with respect to a particular EGI but a taxpayer demonstrates that with respect to an expanded group of which the issuer and holder of the EGI are members such expanded group is otherwise highly compliant with the documentation rules (as such compliance is described in paragraph (b)(2)(i)(B) of this section), the EGI is not automatically treated as stock but is presumed, subject to rebuttal, to be stock for federal tax purposes. A taxpayer can overcome the presumption that an EGI is stock if the taxpayer clearly establishes that there are sufficient common law factors present to treat the EGI as indebtedness, including that the issuer intended to create indebtedness when the EGI was issued.

(B) High percentage of EGIs compliant with this section as evidence that the expanded group is highly compliant with the documentation rules. The rebuttable presumption in paragraph (b)(2)(i)(A) of this section applies if an expanded group of which the issuer and holder are members has a high percentage of EGIs compliant with paragraph (c) of this section. For this

purpose, an expanded group is treated as having a high percentage of EGIs compliant with paragraph (c) of this section if during the calendar year in which an EGI does not meet the requirements of paragraph (c) of this section-

(1) The average total adjusted issue price of all EGIs that are undocumented (as defined in paragraph (b)(2)(i)(B)(3) of this section) and outstanding as of the close of each calendar quarter is less than 10 percent of the average amount of total adjusted issue price of all EGIs that are outstanding as of the close of each calendar quarter; or

(2) If no EGI that is undocumented during the calendar year has an issue price in excess of-

(i) \$100,000,000, the average total number of EGIs that are undocumented and outstanding as of the close of each calendar quarter is less than 5 percent of the average total number of all EGIs that are outstanding as of the close of each calendar quarter; or

(ii) \$25,000,000, the average total number of EGIs that are undocumented and outstanding as of the close of each calendar quarter is less than 10 percent of the average total number of all EGIs that are outstanding as of the close of each calendar quarter.

(3) Undocumented EGI. For purposes of paragraph (b)(2)(i)(B) of this section, an undocumented EGI is an EGI for which documentation has not been both prepared and maintained for one or more of the indebtedness factors in paragraph (c)(2) of this section by the time required under paragraph (c)(4) of this section.

(4) Anti-stuffing rule. If a member of the expanded group increases the adjusted issue price of EGIs outstanding on a quarterly testing date with a principal purpose of satisfying the requirements of paragraph (b)(2)(i)(B)(1) of this section or increases the number of EGIs outstanding on a quarterly testing date with a principal purpose of satisfying the requirements of paragraph (b)(2)(ii)(B)(2) of this section, such increase will not be taken into account in calculating whether a taxpayer has met these requirements.

(5) EGIs subject to this section. For purposes of determining whether the requirements of paragraph (b)(2)(i)(B)(1) or (b)(2)(i)(B)(2) of this section are met, only EGIs subject to the rules of this section are taken into account. Thus, for example, an

EGI issued by an issuer other than a covered member is not taken into account.

(C) Application of federal tax principles if presumption rebutted. If the presumption of stock treatment for federal tax purposes under paragraph (b)(2)(i)(A) of this section is rebutted, the determination of whether an EGI is properly treated as indebtedness (or otherwise) for federal tax purposes will be made under general federal tax principles. See paragraph (b)(3) of this section for the weighting of factors that must be made in this determination.

(ii) Reasonable cause-

(A) In general. To the extent a taxpayer establishes that there was reasonable cause for a failure to comply, in whole or in part, with the requirements of this section, such failure will not be taken into account in determining whether the requirements of this section have been satisfied, and the character of the EGI will be determined under general federal tax principles. The principles of §301.6724-1 of this chapter apply in interpreting whether reasonable cause exists in any particular case.

(B) Requirement to document once reasonable cause established. If a taxpayer establishes that there was reasonable cause for a failure to comply, in whole or in part, with the requirements of this section, the documentation and information required under paragraph (c) of this section must be prepared within a reasonable time and maintained for the EGIs for which such reasonable cause was established.

(iii) Taxpayer discovery and remedy of ministerial or non-material failure or error. If a taxpayer discovers and corrects a ministerial or non-material failure or error in complying with this section prior to the Commissioner's discovery of the failure or error, such failure or error will not be taken into account in determining whether the requirements of this section have been satisfied.

(3) Weighting of indebtedness factors. In applying federal tax principles to the determination of whether an EGI is indebtedness or stock, the indebtedness factors in paragraph (c)(2) of this section are significant factors to be taken into account. Other relevant factors are taken into account in the determination as lesser factors, with the relative weighting of each lesser factor based on facts and circumstances.

(c) Documentation and information to be prepared and maintained.

(1) In general.

(i) Application. The indebtedness factors and the documentation and information that evidence each indebtedness factor are set forth in paragraph (c)(2) of this

section. The requirement to prepare and maintain documentation and information with respect to each indebtedness factor applies to each EGI separately, but the same documentation and information may satisfy the requirements of this section for more than one EGI (see paragraph (c)(2)(iii)(B) of this section for rules relating to documentation that may be applicable to multiple EGIs issued by the same issuer for purposes of the indebtedness factor in paragraph (c)(2)(iii) of this section and paragraph (c)(3)(i) of this section for rules relating to certain master arrangements). Documentation must include complete copies of all instruments, agreements, subordination agreements, and other documents evidencing the material rights and obligations of the issuer and the holder relating to the EGI, and any associated rights and obligations of other parties, such as guarantees. For documents that are executed, such copies must be copies of documents as executed. Additional documentation and information may be provided to supplement, but not substitute for, the documentation and information required under this section.

(ii) Market standard safe harbor. Documentation of a kind customarily used in comparable third-party transactions treated as indebtedness for federal tax purposes may be used to satisfy the indebtedness factors in paragraphs (c)(2)(i) and (c)(2)(ii) of this section. Thus, for example, documentation of a kind that a taxpayer uses for trade payables with unrelated parties will generally satisfy the documentation requirements of this paragraph (c) for documenting trade payables with members of the expanded group.

(iii) EGIs with terms required by certain regulators. Notwithstanding any other provision in this paragraph (c), an EGI that is described in this paragraph (c)(1)(iii) is treated as meeting the documentation and information requirements described in this paragraph (c), provided that documentation necessary to establish that the EGI is an instrument described in this paragraph (c)(1)(iii) is prepared and maintained in accordance with paragraph (b) of this section. An EGI described in this paragraph (c)(1)(iii) is-

(A) An EGI issued by an excepted regulated financial company (as defined in §1.385-3(g)(3)(iv)) that contains terms required by a regulator of that company in order for the EGI to satisfy regulatory capital or similar rules that govern resolution or orderly liquidation of the excepted regulated financial company (including rules that require an excepted regulated financial company to issue EGIs in the form of Total Loss-Absorbing Capacity), provided that at the time of issuance it is expected that the EGI will be paid in accordance with its terms; and

(B) An EGI issued by a regulated insurance company (as defined in §1.385-3(g)(3)(v)) that requires the issuer to receive approval or consent of an insurance regulatory authority prior to making payments of principal or interest on the EGI, provided that at the time of issuance it is expected that the EGI will be paid in accordance with its terms.

(2) Indebtedness factors relating to documentation and information to be prepared and maintained in support of indebtedness. The indebtedness factors that must be documented to establish that an EGI is indebtedness for federal tax purposes, and the documentation and information that must be prepared and maintained with respect to each such factor, are described in paragraphs (c)(2)(i) through (c)(2)(iv) of this section.

(i) Unconditional obligation to pay a sum certain. There must be written documentation establishing that the issuer has entered into an unconditional and legally binding obligation to pay a fixed or determinable sum certain on demand or at one or more fixed dates.

(ii) Creditor's rights. There must be written documentation establishing that the holder has the rights of a creditor to enforce the obligation. The rights of a creditor typically include, but are not limited to, the right to cause or trigger an event of default or acceleration of the EGI (when the event of default or acceleration is not automatic) for non-payment of interest or principal when due under the terms of the EGI and the right to sue the issuer to enforce payment. The rights of a creditor must include rights that superior to the rights of shareholders (other than holders of interests treated as stock solely by reason of §1.385-3 and holders of interests with creditor's rights under commercial law treated as stock under this section) to receive assets of the issuer in case of dissolution. An EGI that is a nonrecourse obligation has creditor's rights for this purpose if it provides sufficient remedies against a specified subset of the issuer's assets. For purposes of this paragraph (c)(2)(ii), creditor's rights may be provided either in the legal agreements that contain the terms of the EGI or under local law. If local law provides for creditor's rights under an EGI even if such rights are not specified in the legal agreements that contain the terms of the EGI, such creditor's rights do not need to be included in the EGI provided that written documentation for purposes of this paragraph (c)(2)(ii) contains a reference to the provisions of local law providing such rights.

(iii) Reasonable expectation of ability to repay EGI.

(A) In general. There must be written documentation containing information establishing that, as of the date of issuance of the applicable interest and taking into account all relevant circumstances (including all other obligations incurred by the issuer as of the date of issuance of the applicable interest or reasonably anticipated to be incurred after the date of issuance of the applicable interest), the issuer's financial position supported a reasonable expectation that the issuer intended to, and would be able to, meet its obligations pursuant to the terms of the applicable interest. Documentation with respect to an EGI that is nonrecourse under its terms must include information on any cash and property that secures the EGI, including--

(1) The fair market value of publicly traded property that is recourse property with respect to the EGI; and

(2) An appraisal (if any) of recourse property that was prepared pursuant to the issuance of the EGI or within the three years preceding the issuance of the EGI. Thus, the documentation required by this paragraph (c)(2)(iii)(A) does not require that an appraisal be prepared for non-publicly traded property that secures nonrecourse debt, but does require that the documentation include any appraisal that was prepared for any purpose.

(B) Documentation of ability to pay applicable to multiple EGIs issued by same issuer-

(1) In general. Written documentation that applies to more than one EGI issued by a single issuer may be prepared on an annual basis to satisfy the requirements in paragraph (c)(2)(iii)(A) of this section (an annual credit analysis). An annual credit analysis can be used to support the reasonable expectation that the issuer has the ability to repay multiple EGIs, including a specified combined amount of indebtedness, provided any such EGIs are issued on any day within the 12-month period beginning on the date the analysis in the annual credit analysis is based on (an analysis date). An annual credit analysis must establish that, as of its analysis date and taking into account all relevant circumstances (including all other obligations incurred by the issuer as of such analysis date or reasonably anticipated to be incurred after such analysis date), the issuer's financial position supported a reasonable expectation that the issuer would be able to pay interest and principal in respect of the amount of indebtedness set forth in the annual credit analysis.

(2) Material event of the issuer. If there is a material event (as defined in paragraph (d)(5) of this section) with respect to the issuer within the year beginning on the analysis date for written documentation described in paragraph (c)(2)(iii)(B)(1) of this section, such written documentation may not be used to satisfy the requirements in paragraph (c)(2)(iii)(A) of this section for EGIs with relevant dates (as described in paragraph (c)(4) of this section) on or after the date of the material event. However, an additional set of written documentation described in paragraph (c)(2)(iii)(B)(1) of this section may be prepared with an analysis date on or after the date of the material event of the issuer.

(C) Third party reports or analysis. If any member of an expanded group relied on any report or analysis prepared by a third party in analyzing whether the issuer would be able to meet its obligations pursuant to the terms of the EGI, the documentation must include the report or analysis. If the report or analysis is protected or privileged under law governing an inquiry or proceeding with respect to the EGI and the protection or privilege is asserted, neither the existence nor the contents of the report or

analysis is taken into account in determining whether the requirements of this section are satisfied.

(D) EGI issued by disregarded entity. For purposes of this paragraph (c)(2)(iii), if a disregarded entity is the issuer of an EGI, and the owner of the disregarded entity has limited liability within the meaning of §301.7701-3(b)(2)(ii) of this chapter, only the assets and liabilities and the financial position of the disregarded entity are relevant for purposes of paragraph (c)(2)(iii)(A) of this section. If the owner of such a disregarded entity does not have limited liability within the meaning of §301.7701-3(b)(2)(ii) of this chapter (including by reason of a guarantee, keepwell, or other agreement), all of the assets and liabilities, and the financial position of the disregarded entity and the owner are relevant for purposes of paragraph (c)(2)(iii)(A) of this section.

(E) Acceptable documentation. The documentation required under this paragraph (c)(2)(iii) may include cash flow projections, financial statements, business forecasts, asset appraisals, determination of debt-to-equity and other relevant financial ratios of the issuer in relation to industry averages, and other information regarding the sources of funds enabling the issuer to meet its obligations pursuant to the terms of the applicable interest. For this purpose, such documentation may assume that the principal amount of an EGI may be satisfied with the proceeds of another borrowing by the issuer, provided that such assumption is reasonable. Documentation required under paragraph (c)(2) of this section may be prepared by employees of expanded group members, by agents of expanded group members, or by third parties.

(F) Third party financing terms. Documentation required under this paragraph (c)(2)(iii) may include evidence that a third party lender would have made a loan to the issuer with the same or substantially similar terms as the EGI.

(iv) Actions evidencing debtor-creditor relationship-

(A) Payments of principal and interest. If an issuer made any payment of interest or principal with respect to the EGI (whether in accordance with the terms of the EGI or otherwise, including prepayments), and such payment is claimed to support the treatment of the EGI as indebtedness under federal tax principles, documentation must include written evidence of such payment. Such evidence could include, for example, a wire transfer record or a bank statement. Such evidence could also include a netting of payables or receivables between the issuer and holder, or payments of interest, evidenced by journal entries in a centralized cash management system or in the accounting system of the expanded group

(or a subset of the members of the expanded group) reflecting the payment.

(B) Events of default and similar events-

(1) Enforcement of creditor's rights. If the issuer did not make a payment of interest or principal that was due and payable under the terms of the EGI, or if any other event of default or similar event has occurred, there must be written documentation evidencing the holder's reasonable exercise of the diligence and judgment of a creditor. Such documentation may include evidence of the holder's assertion of its rights under the terms of the EGI, including the parties' efforts to renegotiate the EGI or to mitigate the breach of an obligation under the EGI, or any change in material terms of the EGI, such as maturity date, interest rate, or obligation to pay interest or principal.

(2) Non-enforcement of creditor's rights. If the holder does not enforce its rights with respect to a payment of principal or interest, or with respect to an event of default or similar event, there must be documentation that supports the holder's decision to refrain from pursuing any actions to enforce payment as being consistent with the reasonable exercise of the diligence and judgment of a creditor. For example, if the issuer is unable to make a timely payment of principal or interest and the holder reasonably believes that the issuer's business or cash flow will improve such that the issuer will be able to comply with the terms of the EGI, the holder may be exercising the reasonable diligence and judgment of a creditor by granting an extension of time for the issuer to pay such interest or principal. However, if a holder fails to enforce its rights and there is no documentation explaining this failure, the holder will not be treated as exercising the reasonable due diligence and judgment of a creditor. See, however, §1.1001-3(c)(4)(ii) for rules regarding when a forbearance may be a modification of a debt instrument and therefore may result in an exchange subject to §1.1001-1(a).

(3) Special documentation rules.

(i) Agreements that cover multiple EGIs-

(A) Revolving credit, omnibus, umbrella, master, cash pool, and similar agreements-

(1) In general. If an EGI is not evidenced by a separate note or other writing executed with respect to the initial principal balance or any increase in principal balance (for example, an EGI documented as a revolving credit agreement, a cash pool agreement, an omnibus or umbrella agreement that governs open

account obligations or any other identified set of payables or receivables, or a master agreement that sets forth general terms of an EGI with an associated schedule or ticket that sets forth the specific terms of an EGI), the EGI is subject to the special rules of this paragraph (c)(3)(i)(A). A notional cash pool is subject to the rules of this paragraph (c)(3)(i) to the extent that the notional cash pool would be treated as an EGI issued directly between expanded group members.

(2) Special rules with respect to paragraphs (c)(2)(i) and (c)(2)(ii) of this section regarding unconditional obligation to pay a sum certain and creditor's rights. An EGI subject to the special rules of paragraph (c)(3)(i)(A) of this section satisfies the requirements of paragraphs (c)(2)(i) and (c)(2)(ii) of this section only if the material documentation associated with the EGI, including all relevant enabling documents, is prepared and maintained in accordance with the requirements of this section. Relevant enabling documents may include board of directors' resolutions, credit agreements, omnibus agreements, security agreements, or agreements prepared in connection with the execution of the legal documents governing the EGI as well as any relevant documentation executed with respect to an initial principal balance or increase in the principal balance of the EGI.

(3) Special rules under paragraph (c)(2)(iii) of this section regarding reasonable expectation of ability to repay-

(i) In general. If an EGI is issued under an agreement described in paragraph (c)(3)(i)(A) of this section, written documentation must be prepared with respect to the analysis date and written documentation with a new analysis date must be prepared at least annually to satisfy the requirements in paragraph (c)(2)(iii) of this section for EGIs issued under such an agreement on or after the most recent analysis date. Such written documentation satisfies the requirements in paragraph (c)(2)(iii) of this section with respect to EGIs issued under such an agreement on any day within the year beginning on the analysis date of the annual credit analysis. Such written documentation must contain information establishing that, as of the analysis date of the annual credit analysis and taking into account all relevant circumstances (including all other obligations incurred by the issuer as of the analysis date of the written documentation or reasonably anticipated to be incurred after the analysis date of the written documentation), the issuer's financial position supported a reasonable expectation that the issuer would be able to pay interest and principal in respect of the maximum principal amount permitted under the terms of the revolving credit agreement, omnibus, umbrella, master, cash pool or similar agreement. Notwithstanding the foregoing, written documentation

described in paragraph (c)(2)(iii)(B) of this section can be used to satisfy the requirements in paragraph (c)(2)(iii)(A) of this section with respect to such EGIs.

(ii) Material event of the issuer. If there is a material event with respect to the issuer within the year beginning on the analysis date for the written documentation described in paragraph (c)(3)(i)(A)(3) of this section, such written documentation may not be used to satisfy the requirements in paragraph (c)(3)(i)(A)(3) of this section for EGIs with relevant dates (as described in paragraph (c)(4) of this section) on or after the date of the material event. However, an additional set of written documentation as described in paragraph (c)(3)(i)(A)(3) of this section may be prepared with an analysis date on the date of the material event of the issuer or if subsequent EGIs are issued, with respect to those issuances.

(B) Additional requirements for cash pooling arrangements. Notwithstanding paragraphs (c)(2)(i) and (c)(2)(ii) of this section, and in addition to the requirements in paragraph (c)(3)(i)(A)(2) of this section, if an EGI is issued pursuant to a cash pooling arrangement (including a notional cash pooling arrangement) or internal banking service that involves account sweeps, revolving cash advance facilities, overdraft set-off facilities, operational facilities, or similar features, the EGI satisfies the requirements of paragraphs (c)(2)(i) and (c)(2)(ii) of this section only if the material documentation governing the ongoing operations of the cash pooling arrangement or internal banking service, including any agreements with entities that are not members of the expanded group, are also prepared and maintained in accordance with the requirements of this section. Such documentation must contain the relevant legal rights and obligations of any members of the expanded group and any entities that are not members of the expanded group in conducting the operation of the cash pooling arrangement or internal banking service.

(ii) Debt not in form. [Reserved]

(4) Timely preparation requirement.

(i) General rule. Documentation and information required under this section must be timely prepared. For purposes of this section, documentation is treated as timely prepared if it is completed no later than the time for filing the issuer's federal income tax return (taking into account any applicable extensions) for the taxable year that includes the relevant date for such documentation or information, as specified in paragraph (c)(4)(ii) of this section.

(ii) Relevant date. For purposes of this paragraph (c)(4), the term relevant date has the following meaning:

(A) Issuer's obligation, creditor's rights. For documentation and information described in paragraphs (c)(2)(i) and (ii) of this section (relating to an issuer's unconditional obligation to repay and establishment of holder's creditor's rights), the relevant date is the date on which a covered member becomes an issuer of a new or existing EGI. A relevant date for such documentation and information does not include the date of any deemed issuance of the EGI resulting from an exchange under §1.1001-3 unless such deemed issuance relates to an alteration in the terms of the EGI reflected in an express written agreement or written amendment to the EGI. In the case of an applicable interest that becomes an EGI subsequent to issuance, including an intercompany obligation, as defined in §1.1502-13(g)(2)(ii), that ceases to be an intercompany obligation, the relevant date is the date on which the applicable interest becomes an EGI.

(B) Reasonable expectation of payment-

(1) In general. For documentation and information described in paragraph (c)(2)(iii) of this section (relating to reasonable expectation of issuer's repayment), each date on which a covered member of the expanded group becomes an issuer with respect to an EGI and any later date on which an issuance is deemed to occur under §1.1001-3, and any date described in the special rules in paragraph (c)(4)(ii)(E) of this section, is a relevant date for that EGI. In the case of an applicable interest that becomes an EGI subsequent to issuance, the relevant date is the date on which the applicable interest becomes an EGI and any relevant date after the date that the applicable interest becomes an EGI.

(2) Annual credit analysis-

(i) In general. With respect to documentation described in paragraph (c)(2)(iii)(B) of this section (documentation of ability to pay applicable to multiple EGIs issued by same issuer), the relevant date is the date used for the analysis in the annual credit analysis that is first prepared and the annual anniversary of such date unless a material event has occurred in respect of the issuer.

(ii) Material event. With respect to the documentation described in paragraph (c)(2)(iii)(B) of this section, the date on which a material event has occurred in respect of an issuer is also a relevant date. If the precise date on which a material event occurred is uncertain, a taxpayer may choose a date on which the taxpayer

reasonably believes that the material event occurred. If documentation described in paragraph (c)(2)(iii)(B) of this section is prepared with the relevant date of a material event, the next relevant date will be the annual anniversary of that relevant date (unless another material event occurs in respect of the issuer).

(C) Subsequent actions-

(1) Payment. For documentation and information described in paragraph (c)(2)(iv)(A) of this section (relating to payments of principal and interest), each date on which a payment of interest or principal is due, taking into account all additional time permitted under the terms of the EGI before there is (or holder can declare) an event of default for nonpayment, is a relevant date.

(2) Default. For documentation and information described in paragraph (c)(2)(iv)(B) of this section (relating to events of default and similar events), each date on which an event of default, acceleration event or similar event occurs under the terms of the EGI is a relevant date. For example, if the terms of the EGI require the issuer to maintain a certain financial ratio, any date on which the issuer fails to maintain the specified financial ratio (and such failure results in an event of default under the terms of the EGI) is a relevant date.

(D) Applicable interest that becomes an EGI. In the case of an applicable interest that becomes an EGI subsequent to issuance, no date before the applicable interest becomes an EGI is a relevant date.

(E) Revolving credit, omnibus, umbrella, master, cash pool, and similar agreements-

(1) Relevant dates for purposes of indebtedness factors in paragraphs (c)(2)(i) and (c)(2)(ii) of this section for overall arrangements. In the case of an arrangement described in paragraph (c)(3)(i)(A) of this section for purposes of the indebtedness factors in paragraphs (c)(2)(i) and (c)(2)(ii) of this section, each of the following dates is a relevant date:

(i) The date of the execution of the legal documents governing the overall arrangement.

(ii) The date of any amendment to those documents that provides for an increase in the maximum amount of principal.

(iii) The date of any amendment to those documents that permits an additional entity to borrow under the documents (but only with respect to EGIs issued by that entity).

(2) Relevant dates for purposes of indebtedness factor in paragraph (c)(2)(iii) of this section for overall arrangements. The relevant dates with respect to the arrangements described in paragraph (c)(3)(i)(A) of this section for purposes of the indebtedness factor in paragraph (c)(2)(iii) of this section are-

(i) Each anniversary of the date of execution of the legal documents during the life of the legal documents; and

(ii) The date that a material event has occurred in respect of an issuer, unless the precise date on which a material event occurred is uncertain, in which case a taxpayer may use a date on which the taxpayer reasonably believes that the material event occurred.

(3) Relevant dates for EGIs documented under an overall arrangement. A relevant date of an EGI under paragraphs (c)(4)(ii)(A) through (C) of this section is also a relevant date for each EGI documented under an overall arrangement described in paragraph (c)(3) of this section.

(5) Maintenance requirements. The documentation and information described in paragraph (c) of this section must be maintained for all taxable years that the EGI is outstanding and until the period of limitations expires for any federal tax return with respect to which the treatment of the EGI is relevant. See section 6001 (requirement to keep books and records).

(d) Definitions. For purposes of this section, the following definitions apply:

(1) Applicable financial statement. The term applicable financial statement means a financial statement that is described in paragraphs (d)(1)(i) through (iii) of this section, that includes the assets, portion of the assets, or annual total revenue of any member of the expanded group, and that is prepared as of any date within 3 years prior to the date the applicable interest at issue first becomes an EGI. The financial statement may be a separate company financial statement of any member of the expanded group, if done in the ordinary course; otherwise, it is the consolidated financial statement that includes the assets, portion of the assets, or annual total revenue of any member of the expanded group. A financial statement includes-

(i) A financial statement required to be filed with the Securities and Exchange Commission (the Form 10-K or the Annual Report to Shareholders);

(ii) A certified audited financial statement that is accompanied by the report of an independent certified public accountant (or in the case of a foreign entity, by the report of a similarly qualified independent professional) that is used for-

(A) Credit purposes;

(B) Reporting to shareholders, partners, or similar persons; or

(C) Any other substantial non-tax purpose; or

(iii) A financial statement (other than a tax return) required to be provided to the federal, state, or foreign government or any federal, state, or foreign agency.

(2) Applicable interest.

(i) In general. Except to the extent provided in paragraph (d)(2)(ii) and (iii) of this section, the term applicable interest means-

(A) Any interest that is issued or deemed issued in the legal form of a debt instrument (including a draw or separate amount borrowed under an overall arrangement described in paragraph (c)(3) of this section regardless of whether a separate legal document is issued in connection with the draw or separate amount borrowed), which therefore does not include, for example, a sale-repurchase agreement treated as indebtedness under federal tax principles; or

(B) An intercompany payable and receivable documented as debt in a ledger, accounting system, open account intercompany debt ledger, trade payable, journal entry or similar arrangement if no written legal instrument or written legal arrangement governs the legal treatment of such payable and receivable.

(ii) Certain intercompany obligations and statutory or regulatory debt instruments excluded. The term applicable interest does not include-

(A) An intercompany obligation as defined in §1.1502-13(g)(2)(ii) or an interest issued by a member of a consolidated group and held by another member of the same consolidated group, but only for the period during which both parties are members of the same consolidated group; for this purpose, a member includes any disregarded entity owned by a member;

(B) Production payments treated as a loan under section 636(a) or (b);

(C) A "regular interest" in a real estate mortgage investment conduit described in section 860G(a)(1);

(D) A debt instrument that is deemed to arise under §1.482-1(g)(3) (including adjustments made pursuant to Revenue Procedure 99-32, 1999-2 C.B. 296); or

(E) Any other instrument or interest that is specifically treated as indebtedness for federal tax purposes under a provision of the Internal Revenue Code or the regulations thereunder.

(iii) Interests issued before January 1, 2018. The term applicable interest does not include any interest issued or deemed issued before January 1, 2018.

(3) Expanded Group Interest (EGI). The term expanded group interest (EGI) means an applicable interest the issuer of which is a member of an expanded group (or a disregarded entity whose regarded owner is a member of an expanded group) and the holder of which is another member of the same expanded group, a disregarded entity whose regarded owner is another member of the same expanded group, or a controlled partnership (as defined in §1.385-1(c)(1)) with respect to the same expanded group.

(4) Issuer. Solely for purposes of this section, the term issuer means a person (including a disregarded entity defined in §1.385-1(c)(3)) that is obligated to satisfy any material obligations created under the terms of an EGI. A person can be an issuer if that person is expected to satisfy a material obligation under an EGI, even if that person is not the primary obligor. A guarantor, however, is not an issuer unless the guarantor is expected to be the primary obligor. An issuer may include a person that, after the date that the EGI is issued, becomes obligated to satisfy a material obligation created under the terms of an EGI. For example, a person that becomes a co-obligor on an EGI after the date of issuance of the EGI is an issuer of the EGI for purposes of this section if such person is expected to satisfy the obligations thereunder without indemnification.

(5) Material event. The term material event means, with respect to an entity-

(i) The entity comes under the jurisdiction of a court in a case under-

(A) Title 11 of the United States Code (relating to bankruptcy); or

(B) A receivership, foreclosure, or similar proceeding in a federal or state court;

(ii) The entity becomes insolvent within the meaning of section 108(d)(3);

(iii) The entity materially changes its line of business;

(iv) The entity sells, alienates, distributes, leases, or otherwise disposes of 50 percent or more of the total fair market value of its included assets; or

(v) The entity consolidates or merges into another person and the person formed by or surviving such merger or consolidation does not assume liability for any of the entity's outstanding EGIs as of the time of the merger or consolidation.

(6)Included assets. The term included assets means, with respect to an entity all assets other than-

(i) Inventory sold in the ordinary course of business;

(ii) Assets contributed to another entity in exchange for equity in such entity; and

(iii) Investment assets such as portfolio stock investments to the extent that other investment assets or cash of equivalent value is substituted.

(7)Regarded owner. For purposes of this section, the term regarded owner means a person (that is that is not a disregarded entity) that is the single owner (within the meaning of §301.7701-2(c)(2) of this chapter) of a disregarded entity.

(e)Operating rules.

(1)Applicable interest that becomes an EGI. If an applicable interest that is not an EGI becomes an EGI, this section applies to the applicable interest immediately after the applicable interest becomes an EGI and at all times thereafter during which the applicable interest remains an EGI.

(2) EGI treated as stock ceases to be an EGI. If an EGI treated as stock due to the application of this section ceases to be an EGI, the character of the applicable interest is determined under general federal tax principles at the time that the applicable interest ceases to be an EGI. If the applicable interest is characterized as indebtedness under general federal tax principles, the issuer is treated for federal tax purposes as issuing a new debt instrument to the holder in exchange for the EGI immediately before the transaction that causes the EGI to cease to be treated as an EGI in a transaction that is disregarded for purposes of §1.385-3(b)(2) and (3). See §1.385-1(d).

(3)Date of characterizations under this section.

(i) In general. If an applicable interest that is an EGI when issued is determined to be stock due to the application of this section, the EGI is treated as stock from the

date it was issued. However, if an applicable interest that is not an EGI when issued subsequently becomes an EGI and is then determined to be stock due to the application of this section, the EGI is treated as stock as of the date it becomes an EGI.

(ii) Recharacterization of EGI based on behavior of issuer or holder after issuance. Notwithstanding paragraph (e)(3)(i) of this section, if an EGI initially treated as indebtedness is recharacterized as stock as a result of failing to satisfy paragraph (c)(2)(iv) of this section (actions evidencing debtor-creditor relationship), the EGI will cease to be treated as indebtedness as of the time the facts and circumstances regarding the behavior of the issuer or the holder with respect to the EGI cease to evidence a debtor-creditor relationship. For purposes of determining whether an EGI originally treated as indebtedness ceases to be treated as indebtedness by reason of this section, the rules of this section apply before the rules of §1.1001-3. Thus, an EGI initially treated as indebtedness may be recharacterized as stock regardless of whether the indebtedness is altered or modified (as defined in §1.1001-3(c)) and, in determining whether indebtedness is recharacterized as stock, §1.1001-3(f)(7)(ii)(A) does not apply.

(4) Disregarded entities of regarded corporate owners. This paragraph (e)(4) applies to an EGI issued by a disregarded entity, the regarded owner of which is a covered member, if such EGI would, absent the application of this paragraph (e)(4), be treated as stock under this section. In this case, rather than the EGI being treated as stock, the covered member that is the regarded owner of the disregarded entity is deemed to issue its stock in the manner described in this paragraph (e)(4). If the EGI would have been recharacterized as stock from the date it was issued under paragraph (e)(3)(i) of this section, then the covered member is deemed to issue its stock to the actual holder to which the EGI was, in form, issued. If the EGI would have been recharacterized as stock at any other time, then the covered member is deemed to issue its stock to the holder of the EGI in exchange for the EGI. In each case, the covered member that is the regarded owner of the disregarded entity is treated as the holder of the EGI issued by the disregarded entity, and the actual holder is treated as the holder of the stock deemed to be issued by the regarded owner. Under federal tax principles, the EGI issued by the disregarded entity generally is disregarded. The stock deemed issued is deemed to have the same terms as the EGI issued by the disregarded entity, other than the identity of the issuer, and payments on the stock are determined by reference to payments made on the EGI issued by the disregarded entity.

(f) Anti-avoidance. If an applicable interest that is not an EGI is issued with a principal purpose of avoiding the application of this section, the applicable interest is treated as an EGI subject to this section.

(g) Affirmative use. [Reserved]

(h) Example. The following example illustrates the rules of this section. Except as otherwise stated, the following facts are assumed for purposes of the example in this paragraph (h):

(1) FP is a foreign corporation that owns 100% of the stock of USS1, a domestic corporation, and 100% of the stock of USS2, a domestic corporation.

(2) USS1 and USS2 file separate federal income tax returns and have a calendar year taxable year.

(3) USS1 and USS2 timely file their federal income tax returns on September 15 of the calendar year following each taxable year.

(4) FP is traded on an established financial market within the meaning of §1.1092(d)-1(b).

Example. Application of paragraphs (c)(2)(iii) and (c)(4) of this section to an EGI.

(i) Facts. USS1 issues an EGI (EGI A) to FP on Date A in Year 1. USS1 issues an EGI (EGI B) to USS2 on Date B in Year 1. Date B is after Date A. USS1 issues another EGI (EGI C) to FP on Date A in Year 2. USS1 prepares documentation sufficient to meet the requirements of paragraphs (c)(2)(i) and (ii) of this section on or before September 15 of Year 2. USS1, FP and USS2 also contemporaneously document the timely payment of interest by USS1 on EGI A and EGI B sufficient to meet the requirements of paragraph (c)(2)(iv) of this section. USS1 prepares documentation on Date C in Year 2, which is prior to September 15, to satisfy the requirements of paragraph (c)(2)(iii)(B) of this section (the credit analysis). The credit analysis concludes that as of Date B in Year 1, USS1 would be able to pay interest and principal on an amount greater than the combined principal amounts of EGI A, EGI B and EGI C.

(ii) Analysis.

(ii) P, USS1, and USS2 are members of an expanded group. Because FP is traded on an established financial market within the meaning of §1.1092(d)-1(b) and USS1 is a covered member, EGI A, EGI B, and EGI C are subject to the rules of this section.

(ii) The documentation evidencing USS1's obligation to pay a sum certain and the creditor's rights of the holders was prepared by September 15, Year 2, which is the time for filing USS1's federal income tax return (taking into account any applicable extensions) for the taxable year that includes the relevant date specified in paragraph (c)(4)(ii)(A) of this section. Thus, USS1 is treated as having timely documented its obligation to pay a sum certain and the creditor's rights of the holders of EGI A and EGI B for purposes of paragraph (c)(4)(i) of this section.

(ii) The credit analysis was prepared with an analysis date of Date B of Year 1.

(ii) Similarly, under paragraph (c)(4)(ii)(B) of this section, the date when USS1 became an issuer of EGI B (Date B of Year 1) is a relevant date for the documentation and information described in paragraph (c)(2)(iii) of this section. The credit analysis was timely prepared under paragraph (c)(4)(i) of this section because it was prepared before the filing of the USS1 federal income tax return for Year 1. As a result, EGI B does

satisfy the indebtedness factor in paragraph (c)(2)(iii) of this section (reasonable expectation of ability to repay EGI).

(ii) Finally, the date when USS1 became an issuer of EGI C (Date A of Year 2) is also a relevant date for the documentation and information described in paragraph (c)(2)(iii) of this section. Under paragraph (c)(2)(iii)(B) of this section, the credit analysis can be used to support the reasonable expectation that USS1 has the ability to repay multiple EGIs issued on any day within the 12-month period following the analysis date. Date A of Year 2 is within the 12-month period following the analysis date. The credit analysis was timely prepared under paragraph (c)(4)(i) of this section because it was prepared before the filing of the USS1 federal income tax return for Year 2. As a result, EGI C does satisfy the indebtedness factor in paragraph (c)(2)(iii) of this section (reasonable expectation of ability to repay EGI).

(i) **Applicability date.** This section applies to taxable years ending on or after January 19, 2017.