

### Reg. Section 1.385-3

Transactions in which debt proceeds are distributed or that have a similar effect

(a) Scope. This section sets forth factors that control the determination of whether an interest is treated as stock or indebtedness. Specifically, this section addresses the issuance of a covered debt instrument to a related person as part of a transaction or series of transactions that does not result in new investment in the operations of the issuer. Paragraph (b) of this section sets forth rules for determining when these factors are present, such that a covered debt instrument is treated as stock under this section. Paragraph (c) of this section provides exceptions to the application of paragraph (b) of this section. Paragraph (d) of this section provides operating rules. Paragraph (e) of this section reserves on the affirmative use of this section. Paragraph (f) of this section provides rules for the aggregate treatment of controlled partnerships. Paragraph (g) of this section provides definitions. Paragraph (h) of this section provides examples illustrating the application of the rules of this section. Paragraph (j) of this section provides dates of applicability. For rules regarding the application of this section to members of a consolidated group, see generally §1.385-4T.

(b) Covered debt instrument treated as stock.

(1) Effect of characterization as stock. Except as otherwise provided in paragraph (d)(7) of this section, to the extent a covered debt instrument is treated as stock under paragraphs (b)(2), (3), or (4) of this section, it is treated as stock for all federal tax purposes.

(2) General rule. Except as otherwise provided in paragraphs (c) and (e) of this section, a covered debt instrument is treated as stock to the extent the covered debt instrument is issued by a covered member to a member of the covered member's expanded group in one or more of the following transactions:

(i) In a distribution;

(ii) In exchange for expanded group stock, other than in an exempt exchange; or

(iii) In exchange for property in an asset reorganization, but only to the extent that, pursuant to the plan of reorganization, a shareholder in the transferor corporation that is a member of the issuer's expanded group immediately before the reorganization receives the covered debt instrument with respect to its stock in the transferor corporation.

(3) Funding rule.

(i) In general. Except as otherwise provided in paragraphs (c) and (e) of this section, a covered debt instrument that is not a qualified short-term debt instrument (as defined in paragraph (b)(3)(vii) of this section) is treated as stock to the extent that it is both issued by a covered member to a member of the covered member's expanded group in exchange for property and, pursuant to paragraph (b)(3)(iii) or (b)(3)(iv) of this section, treated as funding a distribution or acquisition described in one or more of paragraphs (b)(3)(i)(A) through (C) of this section. A covered member that makes a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) is referred to as a "funded member," regardless of when it issues a covered debt instrument in exchange for property.

(A) A distribution of property by the funded member to a member of the funded member's expanded group, other than in an exempt distribution;

(B) An acquisition of expanded group stock, other than an exempt exchange, by the funded member from a member of the funded member's expanded group in exchange for property other than expanded group stock; or

(C) An acquisition of property by the funded member in an asset reorganization but only to the extent that, pursuant to the plan of reorganization, a shareholder in the transferor corporation that is a member of the funded member's expanded group immediately before the reorganization receives other property or money within the meaning of section 356 with respect to its stock in the transferor corporation.

(ii) Transactions described in more than one paragraph. For purposes of this section, to the extent that a distribution or acquisition by a funded member is described in more than one of paragraphs (b)(3)(i)(A) through (C) of this section, the funded member is treated as making only a single distribution or acquisition described in paragraph (b)(3)(i) of this section. In the case of an asset reorganization, to the extent an acquisition by the transferee corporation is described in paragraph (b)(3)(i)(C) of this section, a distribution or acquisition by the transferor corporation is not also described in paragraph (b)(3)(i)(A) through (C) of this section. For purposes of this paragraph (b)(3)(ii), whether a distribution or acquisition is described in paragraphs (b)(3)(i)(A) through (C) of this section is determined without regard to paragraph (c) of this section.

(iii) Per se funding rule-

(A) In general. A covered debt instrument is treated as funding a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section if the covered debt instrument is issued by a funded member during the period beginning 36 months before the date of the distribution or acquisition, and ending 36 months after the date of the distribution or acquisition (per se period).

(B) Multiple interests. If, pursuant to paragraph (b)(3)(iii)(A) of this section, two or more covered debt instruments may be treated as stock by reason of this paragraph (b)(3), the covered debt instruments are tested under paragraph (b)(3)(iii)(A) of this section based on the order in which they are issued, with the earliest issued covered debt instrument tested first. See paragraph (h)(3) of this section, Example 6, for an illustration of this rule.

(C) Multiple distributions or acquisitions. If, pursuant to paragraph (b)(3)(iii)(A) of this section, a covered debt instrument may be treated as funding more than one distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section, the covered debt instrument is treated as funding one or more distributions or acquisitions based on the order in which the distributions or acquisitions occur, with the earliest distribution or acquisition treated as the first distribution or acquisition that is funded. See paragraph (h)(3) of this section, Example 9, for an illustration of this rule.

(D) Transactions that straddle different expanded groups-

(1) In general. For purposes of paragraph (b)(3)(iii)(A) of this section, a covered debt instrument is not treated as issued by a funded member during the per se period with respect to a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section if all of the conditions described in paragraphs (b)(3)(iii)(D)(1)(i) through (iii) of this section are satisfied.

(i) The distribution or acquisition occurs prior to the issuance of the covered debt instrument by the funded member or, if the funded member is treated as making the distribution or acquisition of a predecessor or a successor, the predecessor or successor is not a member of the expanded group of which the funded member is a member on the date on which the distribution or the acquisition occurs.

(ii) The distribution or acquisition is made by the funded member when the funded member is a member of an expanded group that does not have an expanded group parent that is the funded member's expanded group parent when the covered debt instrument is issued. For purposes of the preceding sentence, a reference to an expanded group parent includes a reference to a predecessor or successor of the expanded group parent.

(iii) On the date of the issuance of the covered debt instrument, the recipient member (as defined in paragraph (b)(3)(iii)(D)(2) of this section) is neither a member nor a controlled partnership of an expanded group of which the funded member is a member.

(2) Recipient member. For purposes of this paragraph (b)(3)(iii)(D), the term recipient member means, with respect to a distribution or acquisition by a funded member described in paragraphs (b)(3)(i)(A) through (C) of this section, the expanded group member that receives a distribution of property, property in exchange for expanded group stock, or other property or money within the meaning of section 356 with respect to its stock in the transferor corporation. For purposes of this paragraph (b)(3)(iii)(D), a reference to the recipient member includes a predecessor or successor of the recipient member or one or more other entities that, in the aggregate, acquire substantially all of the property of the recipient member.

(E) Modifications of a covered debt instrument-

(1) In general. For purposes of paragraph (b)(3)(iii)(A) of this section, if a covered debt instrument is treated as exchanged for a modified covered debt instrument pursuant to §1.1001-3(b), the modified covered debt instrument is treated as issued on the original issue date of the covered debt instrument.

(2) Effect of certain modifications. Notwithstanding paragraph (b)(3)(iii)(E)(1) of this section, if a covered debt instrument is treated as exchanged for a modified covered debt instrument pursuant to §1.1001-3(b) and the modification, or one of the modifications, that results in the deemed exchange includes the substitution of an obligor on the covered debt instrument, the addition or deletion of a co-obligor on the covered debt instrument, or the material deferral of scheduled payments due under the covered debt instrument, then the modified covered debt instrument is treated as issued on the date of the deemed exchange for purposes of paragraph (b)(3)(iii)(A) of this section.

(3) Additional principal amount. For purposes of paragraph (b)(3)(iii)(A) of this section, if the principal amount of a covered debt instrument is increased, the portion of the covered debt instrument attributable to such increase is treated as issued on the date of such increase.

(iv) Principal purpose rule. For purposes of this paragraph (b)(3), a covered debt instrument that is not issued by a funded member during the period with respect to a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section is treated as funding the distribution or acquisition to the extent that it is issued by a funded member with a principal purpose of funding a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section. Whether a covered debt instrument is issued with a principal purpose of funding a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C)

of this section is determined based on all the facts and circumstances. A covered debt instrument may be treated as issued with a principal purpose of funding a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section regardless of whether it is issued before or after the distribution or acquisition.

(v) Predecessors and successors-

(A) In general. Subject to the limitations in paragraph (b)(3)(v)(B) of this section, for purposes of this paragraph (b)(3), references to a funded member include references to any predecessor or successor of such member. See paragraph (h)(3) of this section, Examples 9 and 10, for illustrations of this rule.

(B) Limitations to the application of the per se funding rule. For purposes of paragraph (b)(3)(iii)(A) of this section, a covered debt instrument issued by a funded member that satisfies the condition described in paragraph (b)(3)(iii)(A) with respect to a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section made by a predecessor or successor of the funded member is not treated as issued during the per se period with respect to the distribution or acquisition unless the conditions described in paragraphs (b)(3)(v)(B)(1) and (2) of this section are satisfied:

(1) The covered debt instrument is issued by the funded member during the period beginning 36 months before the date of the transaction in which the predecessor or successor becomes a predecessor or successor and ending 36 months after the date of the transaction.

(2) The distribution or acquisition is made by the predecessor or successor during the period beginning 36 months before the date of the transaction in which the predecessor or successor becomes a predecessor or successor of the funded member and ending 36 months after the date of the transaction.

(vi) Treatment of funded transactions. When a covered debt instrument is treated as stock pursuant to paragraph (b)(3) of this section, the distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section that is treated as funded by such covered debt instrument is not recharacterized as a result of the treatment of the covered debt instrument as stock.

(vii) Qualified short-term debt instrument. [Reserved]. For further guidance, see §1.385-3T(b)(3)(vii).

(viii) Distributions or acquisitions occurring before April 5, 2016. A distribution or acquisition that occurs before April 5, 2016, is not taken into account for purposes of applying this paragraph (b)(3).

(4) Anti-abuse rule. If a member of an expanded group enters into a transaction with a principal purpose of avoiding the purposes of this section or §1.385-3T, an interest issued or held by that member or another member of the member's expanded group may, depending on the relevant facts and circumstances, be treated as stock. Paragraphs (b)(4)(i) and (ii) of this section include a non-exhaustive list of transactions that could result in an interest being treated as stock under this paragraph (b)(4).

(i) Interests. An interest is treated as stock if it is issued with a principal purpose of avoiding the purposes of this section or §1.385-3T. Interests subject to this paragraph (b)(4)(i) may include:

(A) An interest that is not a covered debt instrument for purposes of this section (for example, a contract to which section 483 applies that is not otherwise a covered debt instrument or a non-periodic swap payment that is not otherwise a covered debt instrument).

(B) A covered debt instrument issued to a person that is not a member of the issuer's expanded group, if the covered debt instrument is later acquired by a member of the issuer's expanded group or such person later becomes a member of the issuer's expanded group.

(C) A covered debt instrument issued to an entity that is not taxable as a corporation for federal tax purposes.

(D) A covered debt instrument issued in connection with a reorganization or similar transaction.

(E) A covered debt instrument issued as part of a plan or a series of transactions to expand the applicability of the transition rules described in §1.385-3(j)(2) or §1.385-3T(k)(2).

(ii) Other transactions. A covered debt instrument is treated as stock if the funded member or any member of the expanded group engages in a transaction (including a distribution or acquisition) with a principal purpose of avoiding the purposes of this section or §1.385-3T.

Transactions subject to this paragraph (b)(4)(ii) may include:

(A) A member of the issuer's expanded group is substituted as a new obligor or added as a co-obligor on an existing covered debt instrument.

(B) A covered debt instrument is transferred in connection with a reorganization or similar transaction.

(C) A covered debt instrument funds a distribution or acquisition where the distribution or acquisition is made by a member other than the funded member and the funded member acquires the assets of the other member in a transaction that does not make the other member a predecessor to the funded member.

(D) Members of a consolidated group engage in transactions as part of a plan or a series of transactions through the use of the consolidated group rules set forth in §1.385-4T, including through the use of the departing member rules.

(5) Coordination between general rule and funding rule. For purposes of this section, a distribution or acquisition described in paragraph (b)(2) of this section is not also described in paragraph (b)(3)(i) of this section. In the case of an asset reorganization, an acquisition described in paragraph (b)(2)(iii) of this section by the transferee corporation is not also a distribution or acquisition described in paragraph (b)(3)(i) of this section by the transferor corporation. For purposes of this paragraph (b)(5), whether a distribution or acquisition is described in paragraphs (b)(2)(i) through (iii) of this section is determined without regard to paragraph (c) of this section.

(6) Non-duplication. Except as otherwise provided in paragraph (d)(2) of this section, to the extent a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section is treated as funded by a covered debt instrument under paragraph (b)(3) of this section, the distribution or acquisition is not treated as funded by another covered debt instrument and the covered debt instrument is not treated as funding another distribution or acquisition for purposes of paragraph (b)(3).

(c) Exceptions-

(1) In general. This paragraph (c) provides exceptions for purposes of applying paragraphs (b)(2) and (b)(3) of this section to a covered member. These exceptions are applied in the following order: first, paragraph (c)(2) of this section; second, paragraph (c)(3) of this section; and, third, paragraph (c)(4) of this section. The exceptions under §1.385-3(c)(2) and (c)(3) apply to distributions and acquisitions that are otherwise described in paragraph (b)(2) or (b)(3)(i) of this section after applying paragraphs (b)(3)(ii) and (b)(5) of this section. Except as otherwise provided, the exceptions are applied by taking into account the aggregate treatment of controlled partnerships described in §1.385-3T(f).

(2) Exclusions for transactions otherwise described in paragraph (b)(2) or (b)(3)(i) of this section-

(i) Exclusion for certain acquisitions of subsidiary stock-

(A) In general. An acquisition of expanded group stock (including by issuance) is not treated as described in paragraph (b)(2)(ii) or (b)(3)(i)(B) of this section if, immediately after the acquisition, the covered member that acquires the expanded group stock (acquirer) controls the member of the expanded group from which the expanded group stock is acquired (seller), and the acquirer does not relinquish control of the seller pursuant to a plan that existed on the date of the acquisition, other than in a transaction in which the seller ceases to be a member of the expanded group of which the acquirer is a member. For purposes of the preceding sentence, an acquirer and seller do not cease to be members of the same expanded group by reason of a complete liquidation described in section 331.

(B) Control. For purposes of this paragraph (c)(2)(i) and paragraph (c)(3)(ii)(E) of this section, control of a corporation means the direct or indirect ownership of more than 50 percent of the total combined voting power of all classes of stock of the corporation entitled to vote and more than 50 percent of the total value of the stock of the corporation. For purposes of the preceding sentence, indirect ownership is determined by applying the principles of section 958(a) without regard to whether an intermediate entity is foreign or domestic.

(C) Rebuttable presumption. For purposes of paragraph (c)(2)(i)(A) of this section, the acquirer is presumed to have a plan to relinquish control of the seller on the date of the acquisition if the acquirer relinquishes control of the seller within the 36-month period following the date of the acquisition. The presumption created by the previous sentence may be rebutted by facts and circumstances clearly establishing that the loss of control was not contemplated on the date of the acquisition and that the avoidance of the purposes of this section or §1.385-3T was not a principal purpose for the subsequent loss of control.

(ii) Exclusion for compensatory stock acquisitions. An acquisition of expanded group stock is not treated as described in paragraph (b)(2)(ii) or (b)(3)(i)(B) of this section if the expanded group stock is delivered to individuals that are employees, directors, or independent contractors in consideration for services rendered by such individuals to a member of the expanded group or a controlled partnership in which a member of the expanded group is an expanded group partner.

(iii) Exclusion for distributions or acquisitions resulting from transfer pricing adjustments. A distribution or acquisition deemed to occur under §1.482-1(g)



(including adjustments made pursuant to Revenue Procedure 99-32, 1999-2 C.B. 296) is not treated as described in paragraph (b)(3)(i)(A) or (B) of this section.

(iv) Exclusion for acquisitions of expanded group stock by a dealer in securities. An acquisition of expanded group stock by a dealer in securities (within the meaning of section 475(c)(1)), or by an expanded group partner treated as acquiring expanded group stock pursuant to §1.385-3T(f)(2) if the relevant controlled partnership is a dealer in securities, is not treated as described in paragraph (b)(2)(ii) or (b)(3)(i)(B) of this section to the extent the expanded group stock is acquired in the ordinary course of the dealer's business of dealing in securities. The preceding sentence applies solely to the extent that-

(A) The dealer accounts for the stock as securities held primarily for sale to customers in the ordinary course of business;

(B) The dealer disposes of the stock within a period of time that is consistent with the holding of the stock for sale to customers in the ordinary course of business, taking into account the terms of the stock and the conditions and practices prevailing in the markets for similar stock during the period in which it is held; and

(C) The dealer does not sell or otherwise transfer the stock to a person in the same expanded group, other than in a sale to a dealer that in turn satisfies the requirements of paragraph (c)(2)(iv) of this section.

(v) Exclusion for certain acquisitions of expanded group stock resulting from application of this section. The following deemed acquisitions are not treated as acquisitions of expanded group stock described in paragraph (b)(3)(i)(B) of this section, provided that they are not part of a plan or arrangement to prevent the application of paragraph (b)(3)(i) to a covered debt instrument:

(A) An acquisition of a covered debt instrument that is treated as stock by means of paragraph (b)(3) of this section.

(B) An acquisition of stock of a regarded owner that is deemed to be issued under §1.385-3T(d)(4).

(C) An acquisition of deemed partner stock pursuant to a deemed transfer or a specified event described in §1.385-3T(f)(4) or (5).

(3) Reductions for transactions described in paragraph (b)(2) or (b)(3)(i) of this section-

(i) Reduction for expanded group earnings-

(A) In general. The aggregate amount of any distributions or acquisitions by a covered member described in paragraph (b)(2) or (b)(3)(i) of this section in a taxable year during the covered member's expanded group period is reduced by the covered member's expanded group earnings account (as defined in paragraph (c)(3)(i)(B) of this section) for the expanded group period as of the close of the taxable year. The reduction described in this paragraph (c)(3)(i)(A) applies to one or more distributions or acquisitions based on the order in which the distributions or acquisitions occur, regardless of whether any distribution or acquisition would be treated as funded by a covered debt instrument without regard to this paragraph (c)(3).

(B) Expanded group earnings account. The term expanded group earnings account means, with respect to a covered member and an expanded group period (as defined in paragraph (c)(3)(i)(E) of this section) of the covered member, the excess, if any, of the covered member's expanded group earnings (as defined in paragraph (c)(3)(i)(C) of this section) for the expanded group period over the covered member's expanded group reductions (as defined in paragraph (c)(3)(i)(D) of this section) for the expanded group period.

(C) Expanded group earnings-

(1) In general. The term expanded group earnings means, with respect to a covered member and an expanded group period of the covered member, the earnings and profits accumulated by the covered member during the expanded group period, computed as of the close of the taxable year of the covered member, without diminution by reason of any distributions or acquisitions by the covered member described in paragraphs (b)(2) and (b)(3)(i) of this section. Notwithstanding the preceding sentence, the expanded group earnings of a covered member do not include earnings and profits accumulated by the covered member in any taxable year ending before April 5, 2016.

(2) Special rule for change in expanded group within a taxable year. For purposes of calculating a covered member's expanded group earnings for a taxable year that is not wholly included in an expanded group period, the covered member's expanded group earnings are ratably allocated among the portion of the taxable year included in the expanded group period and the portion of the taxable year not included in the expanded group period. For purposes of the preceding sentence, the expanded group period is determined by excluding the day on which the covered member becomes a member of an expanded group with the same expanded group parent and including the day on which the covered member ceases to be a member of an expanded group with the same expanded group parent.

(3) Look-through rule for dividends-

(i) In general. For purposes of paragraph (c)(3)(i)(C)(1) of this section, a dividend from a member of the same expanded group (distributing member) is not taken into account for purposes of calculating a covered member's expanded group earnings, except to the extent the dividend is attributable to earnings and profits accumulated by the distributing member in a taxable year ending after April 4, 2016, during its expanded group period (qualified earnings and profits). For purposes of the preceding sentence, a dividend received from a member (intermediate distributing member) is not taken into account for purposes of calculating the qualified earnings and profits of a distributing member (or another intermediate distributing member), except to the extent the dividend is attributable to qualified earnings and profits of the intermediate distributing member. A dividend from a distributing member or an intermediate distributing member is considered to be attributable to qualified earnings and profits to the extent thereof. If the distributing member or the intermediate distributing member is not a covered member, the expanded group period of the member is determined under the principles of paragraph (c)(3)(i)(E) of this section. If a controlled partnership receives a dividend from a distributing member and a portion of the dividend is allocated (including through one or more partnerships) to a covered member, then, for purposes of this paragraph (c)(3)(i)(C)(3), the covered member is treated as receiving the dividend from the distributing member.

(ii) Dividend. For purposes of paragraph (c)(3)(i)(C)(3)(i) of this section, the term dividend has the meaning specified in section 316, including the portion of gain recognized under section 1248 that is treated as a dividend and deemed dividends under section 367(b) and the regulations thereunder. In addition, the term dividend includes inclusions with respect to stock (for example, inclusions under sections 951(a) and 1293).

(4) Effect of interest deductions. For purposes of calculating the expanded group earnings of a covered member for a taxable year, expanded group earnings are calculated without regard to the application of this section during the taxable year to a covered debt instrument issued by the covered member that was not treated as stock under paragraph (b) of this section as of the close of the preceding taxable year, or, if the covered member is an expanded group partner in a controlled partnership that is the issuer of a debt instrument, without regard to the application of §1.385-3T(f)(4)(i) during the taxable year with respect to the covered member's share of the debt instrument. To the extent that the application of this paragraph (c)(3)(i)(C)(4) reduces the expanded group earnings of the covered member for the taxable year, the expanded group earnings of the covered member are increased as of the beginning of the succeeding taxable year during the expanded group period.

(D) Expanded group reductions. The term expanded group reductions means, with respect to a covered member and an expanded group period of the covered member, the amounts by which acquisitions or distributions described in paragraph (b)(2) or (b)(3)(i) of this section were reduced by reason of paragraph (c)(3)(i)(A) of this section during the portion of the expanded group period preceding the taxable year.

(E) Expanded group period-

(1) In general. For purposes of this paragraph (c)(3)(i) and paragraph (c)(3)(ii) of this section, the term expanded group period means, with respect to a covered member, the period during which a covered member is a member of an expanded group with the same expanded group parent.

(2) Mere change. For purposes of paragraph (c)(3)(i)(E)(1) of this section, an expanded group parent that is a resulting corporation (within the meaning of §1.368-2(m)(1)) in a reorganization described in section 368(a)(1)(F) is treated as the same expanded group parent as an expanded group parent that is a transferor corporation (within the meaning of §1.368-2(m)(1)) in the same reorganization, provided that either-

(i) The transferor corporation is not a covered member; or

(ii) Both the transferor corporation and the resulting corporation are covered members.

(F) Special rules for certain corporate transactions-

(1) Reduction for expanded group earnings in an asset reorganization. For purposes of applying paragraph (c)(3)(i) of this section, a distribution or acquisition described in paragraph (b)(2) or (b)(3)(i) of this section that occurs pursuant to a reorganization described in section 381(a)(2) is reduced solely by the expanded group earnings account of the acquiring member after taking into account the adjustment to its expanded group earnings account provided in paragraph (c)(3)(i)(F)(2)(ii) of this section.

(2) Effect of certain corporate transactions on the calculation of expanded group earnings account-

(i) In general. Section 381 and §1.312-10 are not taken into account for purposes of calculating a covered member's expanded group earnings account for an expanded group period. The expanded group earnings account that a covered member succeeds to under paragraphs (c)(3)(i)(F)(2)(ii) through (iv) of this section is attributed to the covered member's expanded group period as of the close of the date of the distribution or transfer.

(ii) Section 381 transactions. If a covered member (acquiring member) acquires the assets of another covered member (acquired member) in a transaction described in section 381(a), and, immediately before the transaction, both corporations are members of the same expanded group, then the acquiring member succeeds to the expanded group earnings account of the acquired member, if any, determined after application of paragraph (c)(3)(i) of this section with respect to the final taxable year of the acquired member.

(iii) Section 1.312-10(a) transactions. If a covered member (transferor member) transfers property to another covered member (transferee member) in a transaction described in §1.312-10(a), the expanded group earnings account of the transferor member is allocated between the transferor member and the transferee member in the same proportion as the earnings and profits of the transferor member are allocated between the transferor member and the transferee member under §1.312-10(a).

(iv) Section 1.312-10(b) transactions. If a covered member (distributing member) distributes the stock of another covered member (controlled member) in a transaction described in §1.312-10(b), the expanded group earnings account of the distributing member is decreased by the amount that the expanded group earnings account of the distributing member would have been decreased under paragraph (c)(3)(i)(F)(2)(iii) of this section if the distributing member had transferred the stock of the controlled member to a newly formed corporation in a transaction described in §1.312-10(a). If the amount of the decrease described in the preceding sentence exceeds the expanded group earnings account of the controlled member immediately before the transaction described in §1.312-10(b), then the expanded group earnings account of the controlled member after the transaction is equal to the amount of the decrease.

(G) Overlapping expanded groups. A covered member that is a member of two expanded groups at the same time has a single expanded group earnings account with respect to a single expanded group period. In this case, the expanded group period is determined by reference to the shorter of the two periods during which the covered member is a member of an expanded group with the same expanded group parent.

(ii) Reduction for qualified contributions-

(A) In general. The amount of a distribution or acquisition by a covered member described in paragraph (b)(2) or (b)(3)(i) of this section is reduced by the aggregate fair market value of the stock issued by the covered member in one or more qualified contributions (as defined in paragraph (c)(3)(ii)(B) of this section) during the qualified period (as

defined in paragraph (c)(3)(ii)(C) of this section), but only to the extent the qualified contribution or qualified contributions have not reduced another distribution or acquisition. The reduction described in this paragraph (c)(3)(ii)(A) applies to one or more distributions or acquisitions based on the order in which the distributions or acquisitions occur, regardless of whether any distribution or acquisition would be treated as funded by a covered debt instrument without regard to this paragraph (c)(3).

(B) Qualified contribution. The term qualified contribution means, with respect to a covered member, except as provided in paragraph (c)(3)(ii)(E) of this section, a contribution of property, other than excluded property (defined in paragraph (c)(3)(ii)(D) of this section), to the covered member by a member of the covered member's expanded group (or by a controlled partnership of the expanded group) in exchange for stock.

(C) Qualified period. The term qualified period means, with respect to a covered member, a qualified contribution, and a distribution or acquisition described in paragraph (b)(2) or (b)(3)(i) of this section, the period beginning on the later of the beginning of the periods described in paragraphs (c)(3)(ii)(C)(1) and (2) of this section, and ending on the earlier of the ending of the periods described in paragraphs (c)(3)(ii)(C)(1) and (2) of this section or the date described in paragraph (c)(3)(ii)(C)(3) of this section.

(1) The period beginning 36 months before the date of the distribution or acquisition, and ending 36 months after the date of the distribution or acquisition.

(2) The covered member's expanded group period (as defined in paragraph (c)(3)(i)(E) of this section) that includes the distribution or acquisition.

(3) The last day of the first taxable year that a covered debt instrument issued by the covered member would, absent the application of this paragraph (c)(3)(ii) with respect to the distribution or acquisition, be treated, in whole or in part, as stock under paragraph (b) of this section or, in the case of a covered debt instrument issued by a controlled partnership in which the covered member is an expanded group partner, the covered debt instrument would be treated, in whole or in part, as a specified portion.

(D) Excluded property. The term excluded property means-

(1) Expanded group stock;

(2) Property acquired by the covered member in an asset reorganization from a member of the expanded group of which the covered member is a member;

(3) A covered debt instrument of any member of the same expanded group, including a covered debt instrument issued by the covered member;

(4) Property acquired by the covered member in exchange for a covered debt instrument issued by the covered member that is recharacterized under paragraph (b)(3) of this section;

(5) A debt instrument issued by a controlled partnership of the expanded group of which the covered member is a member, including the portion of such a debt instrument that is a deemed transferred receivable or a retained receivable; and

(6) Any other property acquired by the covered member with a principal purpose to avoid the purposes of this section or §1.385-3T, including a transaction involving an indirect transfer of property described in paragraphs (c)(3)(ii)(D)(1) through (5) of this section.

(E) Excluded contributions-

(1) Upstream contributions from certain subsidiaries. For purposes of paragraph (c)(3)(ii)(B) of this section, a contribution of property from a corporation (controlled member) that the covered member controls, within the meaning of paragraph (c)(2)(i)(B) of this section, is not a qualified contribution.

(2) Contributions to a predecessor or successor. For purposes of paragraph (c)(3)(ii)(B) of this section, a contribution of property to a covered member from a corporation of which the covered member is a predecessor or successor, or from a corporation controlled by that corporation within the meaning of paragraph (c)(2)(i)(B) of this section, is not a qualified contribution.

(3) Contributions that do not increase fair market value. A contribution of property to a covered member that is not described in paragraph (c)(3)(ii)(E)(1) or (2) of this section is not a qualified contribution to the extent that the contribution does not increase the aggregate fair market value of the outstanding stock of the covered member immediately after the transaction and taking into account all related transactions, other than distributions and acquisitions described in paragraphs (b)(2) and (b)(3)(i) of this section.

(4) Contributions that become excluded contributions after the date of the contribution. If a contribution of property described in paragraph (c)(3)(ii)(E)(1) or (2) of this section occurs before the covered member acquires control of the controlled member described in paragraph (c)(3)(ii)(E)(1) or before the transaction in which the corporation described in paragraph (c)(3)(ii)(E)(2) becomes a predecessor or successor to the covered member, the contribution of property ceases to be a qualified contribution on the date that the covered member acquires control of the controlled member or on the date of the transaction in which the corporation becomes a predecessor or successor to the covered member (transaction date). If the contribution of property occurs within 36 months before the transaction date, the covered member is treated as making a distribution described in paragraph (b)(3)(i)(A) of this section on the transaction date equal to the amount by which any distribution or acquisition described in paragraph (b)(2) or (b)(3)(i) of this section was reduced under paragraph (c)(3)(ii)(A) of this section because the contribution of property was treated as a qualified contribution.

(F) Special rules for certain corporate transactions-

(1) Reduction for qualified contributions in an asset reorganization. For purposes of applying paragraph (c)(3)(ii)(A) of this section, a distribution or acquisition described in paragraph (b)(2) or (b)(3)(i) of this section that occurs pursuant to a reorganization described in section 381(a)(2) is reduced solely by the qualified contributions of the acquiring member after taking into account the adjustment to its qualified contributions provided in paragraph (c)(3)(ii)(F)(2) of this section.

(2) Effect of certain corporate transactions on the calculation of qualified contributions-

(i) In general. This paragraph (c)(3)(ii)(F)(2) provides rules for allocating or reducing the qualified contributions of a covered member as a result of certain corporation transactions. For purposes of paragraph (c)(3)(ii)(C)(1) of this section, a qualified contribution that a covered member succeeds to under paragraphs (c)(3)(ii)(F)(2)(ii) and (iii) of this section is treated as made to the covered member on the date on which the qualified contribution was made to the covered member that received the qualified contribution. For purposes of paragraph (c)(3)(ii)(C)(2) of this section, a qualified contribution that a covered member succeeds to under paragraphs (c)(3)(ii)(F)(2)(ii) and (iii) of this section is attributed to the covered member's expanded group period as of the close of the date of the distribution or transfer. For purposes of paragraph (c)(3)(ii)(C)(3) of this section, a qualified contribution a covered member succeeds to under paragraphs (c)(3)(ii)(F)(2)(ii) and (iii) of this section is treated as made to the covered member as of the close of the date of the distribution or transfer.



(ii) Section 381 transactions. If a covered member (acquiring member) acquires the assets of another covered member (acquired member) in a transaction described in section 381(a), and, immediately before the transaction, both corporations are members of the same expanded group, the acquiring member succeeds to the qualified contributions of the acquired member, if any, adjusted for the application of paragraph (c)(3)(ii)(E)(4) of this section.

(iii) Section 1.312-10(a) transactions. If a covered member (transferor member) transfers property to another covered member (transferee member) in a transaction described in §1.312-10(a), each qualified contribution of the transferor member is allocated between the transferor member and the transferee member in the same proportion as the earnings and profits of the transferor member are allocated between the transferor member and the transferee member under §1.312-10(a).

(iv) Section 1.312-10(b) transactions. If a covered member (distributing member) distributes the stock of another covered member (controlled member) in a transaction described in §1.312-10(b), each qualified contribution of the distributing member is decreased by the amount that each qualified contribution of the distributing member would have been decreased under paragraph (c)(3)(ii)(F)(2)(iii) of this section if the distributing member had transferred the stock of the controlled member to a newly formed corporation in a transaction described in §1.312-10(a). No amount of the qualified contributions of the distributing member is allocated to the controlled member.

(iii) Predecessors and successors. For purposes of this paragraph (c)(3), references to a covered member do not include references to any corporation of which the covered member is a predecessor or successor. Accordingly, a distribution or acquisition by a covered member described in paragraphs (b)(3)(i)(A) through (C) is reduced solely by the expanded group earnings account of the covered member (taking into account the application of paragraph (c)(3)(i)(F)(2) of this section) and the qualified contributions of the covered member (taking into account the application of paragraph (c)(3)(ii)(F)(2) of this section), notwithstanding that the distribution or acquisition is treated as made by a funded member of which the covered member is a predecessor or successor.

(iv) Ordering rule. The exceptions described in this paragraph (c)(3) are applied in the following order: first, paragraph (c)(3)(i) of this section; and, second, paragraph (c)(3)(ii) of this section.

(4)Threshold exception. A covered debt instrument is not treated as stock under this section if, immediately after the covered debt instrument would be treated as stock under this section but for the application of this paragraph (c)(4), the aggregate adjusted issue price of covered debt instruments held by members of the issuer's expanded group that would be treated as stock under this section but for the application of this paragraph (c)(4) does not exceed \$50 million. To the extent a debt instrument issued by a controlled partnership would be treated as a specified portion (as defined in paragraph (g)(23) of this section) but for the application of this paragraph (c)(4), the debt instrument is treated as a covered debt instrument described in the preceding sentence for purposes of this paragraph (c)(4). To the extent that, immediately after a covered debt instrument would be treated as stock under this section but for the application of this paragraph (c)(4), the aggregate adjusted issue price of covered debt instruments held by members of the issuer's expanded group that would be treated as stock under this section but for the application of this paragraph (c)(4) exceeds \$50 million, only the amount of the covered debt instrument in excess of \$50 million is treated as stock under this section. For purposes of this rule, any covered debt instrument that is not denominated in U.S. dollars is translated into U.S. dollars at the spot rate (as defined in §1.988-1(d)) on the date that the covered debt instrument is issued.

(d)Operating rules.

(1)Timing. This paragraph (d)(1) provides rules for determining when a covered debt instrument is treated as stock under paragraph (b) of this section. For special rules regarding the treatment of a deemed exchange of a covered debt instrument that occurs pursuant to paragraphs (d)(1)(ii), (d)(1)(iii), or (d)(1)(iv) of this section, see §1.385-1(d).

(i) General timing rule. Except as otherwise provided in this paragraph (d)(1), when paragraph (b) of this section applies to treat a covered debt instrument as stock, the covered debt instrument is treated as stock when the covered debt instrument is issued. When paragraph (b)(3) of this section applies to treat a covered debt instrument as stock when the covered debt instrument is issued, see also paragraph (b)(3)(vi) of this section.

(ii) Exception when a covered debt instrument is treated as funding a distribution or acquisition that occurs after the issuance of the covered debt instrument. When paragraph (b)(3)(iii) of this section applies to treat a covered debt instrument as funding a distribution or acquisition described in paragraph (b)(3)(i)(A) through (C) of this section that occurs after the covered debt instrument is issued, the covered debt instrument is deemed to be exchanged for stock on the date that the distribution or acquisition occurs. See paragraph (h)(3) of this section, Examples 4 and 9, for an illustration of this rule.

(iii) Exception for certain predecessor and successor transactions. To the extent that a covered debt instrument would not be treated as stock but for the fact that a funded member is treated as the predecessor or successor of another expanded group member under paragraph (b)(3)(v) of this section, the covered debt instrument is deemed to be exchanged for stock on the later of the date that the funded member completes the transaction causing it to become a predecessor or

successor of the other expanded group member or the date that the covered debt instrument would be treated as stock under paragraph (d)(1)(i) or (ii) of this section.

(iv) Exception when a covered debt instrument is re-tested under paragraph (d)(2) of this section. When paragraph (b)(3)(iii) of this section applies to treat a covered debt instrument as funding a distribution or acquisition described in paragraphs (b)(3)(i)(A) through (C) of this section as a result of a re-testing described in paragraph (d)(2)(ii) of this section that occurs in a taxable year subsequent to the taxable year in which the covered debt instrument is issued, the covered debt instrument is deemed to be exchanged for stock on the later of the date of the re-testing or the date that the covered debt instrument would be treated as stock under paragraph (d)(1)(i) or (ii) of this section. See paragraph (h)(3) of this section, Example 7, for an illustration of this rule.

(2) Covered debt instrument treated as stock that leaves the expanded group.

(i) Events that cause a covered debt instrument to cease to be treated as stock. Subject to paragraph (b)(4) of this section, this paragraph (d)(2)(i) applies with respect to a covered debt instrument that is treated as stock under this section when the holder and issuer of a covered debt instrument cease to be members of the same expanded group, either because the covered debt instrument is transferred to a person that is not a member of the expanded group that includes the issuer or because the holder or the issuer ceases to be a member of the same expanded group, or in the case of a holder that is a controlled partnership, when the holder ceases to be a controlled partnership with respect to the expanded group of which the issuer is a member, either because the partnership ceases to be a controlled partnership or because the issuer ceases to be a member of the same expanded group with respect to which the holder is a controlled partnership. In such a case, the covered debt instrument ceases to be treated as stock under this section. For this purpose, immediately before the transaction that causes the holder and issuer of the covered debt instrument to cease to be members of the same expanded group, or, if the holder is a controlled partnership, that causes the holder to cease to be a controlled partnership with respect to the expanded group of which the issuer is a member, the issuer is deemed to issue a new covered debt instrument to the holder in exchange for the covered debt instrument that was treated as stock in a transaction that is disregarded for purposes of paragraphs (b)(2) and (b)(3) of this section.

(ii) Re-testing of covered debt instruments and certain distributions and acquisitions-

(A) General rule. For purposes of paragraph (b)(3)(iii) of this section, when paragraph (d)(2)(i) of this section or §1.385-4T(c)(2) causes a covered debt instrument that previously was treated as stock pursuant to paragraph (b)(3) of this section to cease to be treated as stock, all other covered debt instruments of the issuer that are not treated as stock on the date that the transaction occurs that causes paragraph (d)(2)(i) of this

section to apply are re-tested to determine whether those other covered debt instruments are treated as funding the distribution or acquisition that previously was treated as funded by the covered debt instrument that ceases to be treated as stock pursuant to paragraph (d)(2)(i) of this section. In addition, a covered debt instrument that is issued after an application of paragraph (d)(2)(i) of this section and within the per se period may also be treated as funding that distribution or acquisition. See paragraph (h)(3) of this section, Example 7, for an illustration of this rule.

(B) Re-testing upon a specified event with respect to a debt instrument issued by a controlled partnership. If, with respect to a covered member that is an expanded group partner and a debt instrument issued by the controlled partnership, there is reduction in the covered member's specified portion under §1.385-3T(f)(5)(i) by reason of a specified event, the covered member must re-test its debt instruments as described in paragraph (d)(2)(ii)(A) of this section.

(3) Inapplicability of section 385(c)(1). Section 385(c)(1) does not apply with respect to a covered debt instrument to the extent that it is treated as stock under this section.

(4) Treatment of disregarded entities. [Reserved]. For further guidance, see §1.385-3T(d)(4).

(5) Payments with respect to partially recharacterized covered debt instruments.

(i) General rule. Except as otherwise provided in paragraph (d)(5)(ii) of this section, a payment with respect to an instrument that is partially recharacterized as stock is treated as made pro rata to the portion treated as stock and to the portion treated as indebtedness.

(ii) Special rule for payments not required pursuant to the terms of the instrument. A payment with respect to an instrument that is partially recharacterized as stock and that is a payment that is not required to be made pursuant to the terms of the instrument (for example, a prepayment of principal) may be designated by the issuer and the holder as with respect to the portion treated as stock or to the portion treated as indebtedness, in whole or in part. In the absence of such designation, see paragraph (d)(5)(i) of this section.

(6) Treatment of a general rule transaction to which an exception applies. To the extent a covered member would, absent the application of paragraph (c)(2) or (c)(3) of this section, be treated as making a distribution or acquisition described in paragraph (b)(2) of this section, then, solely for purposes of applying paragraph (b)(3) of this section, the covered member is treated as issuing the covered debt instrument issued in the

distribution or acquisition to a member of the covered member's expanded group in exchange for property.

(7) Treatment for purposes of section 1504(a).

(i) Debt instruments treated as stock. A covered debt instrument that is treated as stock under paragraph (b)(2), (3), or (4) of this section and that is not described in section 1504(a)(4) is not treated as stock for purposes of determining whether the issuer is a member of an affiliated group (within the meaning of section 1504(a)).

(ii) Deemed partner stock and stock deemed issued by a regarded owner. If deemed partner stock or stock that is deemed issued by a regarded owner under §1.385-3T(d)(4) is not described in section 1504(a)(4), then that stock is not treated as stock for purposes of determining whether the issuer of the stock is a member of an affiliated group (within the meaning of section 1504(a)).

(e) No affirmative use. [Reserved]

(f) Treatment of controlled partnerships. [Reserved]. For further guidance, see §1.385-3T(f).

(g) Definitions. The definitions in this paragraph (g) apply for purposes of this section and §§1.385-3T and 1.385-4T.

(1) Asset reorganization. The term asset reorganization means a reorganization described in section 368(a)(1)(A), (C), (D), (F), or (G).

(2) Consolidated group. The term consolidated group has the meaning specified in §1.1502-1(h).

(3) Covered debt instrument.

(i) In general. The term covered debt instrument means a debt instrument issued after April 4, 2016, that is not a qualified dealer debt instrument (as defined in paragraph (g)(3)(ii) of this section) or an excluded statutory or regulatory debt instrument (as defined in paragraph (g)(3)(iii) of this section), and that is issued by a covered member that is not an excepted regulated financial company (as defined in paragraph (g)(3)(iv) of this section) or a regulated insurance company (as defined in paragraph (g)(3)(v) of this section).

(ii) Qualified dealer debt instrument. For purposes of this paragraph (g)(3), the term qualified dealer debt instrument means a debt instrument that is issued to or acquired by an expanded group member that is a dealer in securities (within the meaning of section 475(c)(1)) in the ordinary course of the dealer's business of dealing in securities. The preceding sentence applies solely to the extent that-

(A) The dealer accounts for the debt instruments as securities held primarily for sale to customers in the ordinary course of business;

(B) The dealer disposes of the debt instruments (or the debt instruments mature) within a period of time that is consistent with the holding of the debt instruments for sale to customers in the ordinary course of business, taking into account the terms of the debt instruments and the conditions and practices prevailing in the markets for similar debt instruments during the period in which it is held; and

(C) The dealer does not sell or otherwise transfer the debt instrument to a member of the dealer's expanded group unless that sale or transfer is to a dealer that satisfies the requirements of this paragraph (g)(3)(ii).

(iii) Excluded statutory or regulatory debt instrument. For purposes of this paragraph (g)(3), the term excluded statutory or regulatory debt instrument means a debt instrument that is described in any of the following paragraphs:

(A) Production payments treated as a loan under section 636(a) or (b).

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

(C) 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).

(D) A stripped bond or coupon described in section 1286, unless such instrument was issued with a principal purpose of avoiding the purposes of this section or §1.385-3T.

(E) A lease treated as a loan under section 467.

(iv) Excepted regulated financial company. For purposes of this paragraph (g)(3), the term excepted regulated financial company means a covered member that is a regulated financial company (as defined in paragraph (g)(3)(iv)(A) of this section) or a member of a regulated financial group (as defined in paragraph (g)(3)(iv)(B) of this section).

(A) Regulated financial company. For purposes of paragraph (g)(3)(iv), the term regulated financial company means-

(1) A bank holding company, as defined in 12 U.S.C. 1841;

- (2) A covered savings and loan holding company, as defined in 12 CFR 217.2;
- (3) A national bank;
- (4) A bank that is a member of the Federal Reserve System and is incorporated by special law of any State, or organized under the general laws of any State, or of the United States, including a Morris Plan bank, or other incorporated banking institution engaged in a similar business;
- (5) An insured depository institution, as defined in 12 U.S.C. 1813(c)(2);
- (6) A nonbank financial company subject to a determination under 12 U.S.C. 5323(a)(1) or (b)(1);
- (7) A U.S. intermediate holding company formed by a foreign banking organization in compliance with 12 C.F.R. 252.153;
- (8) An Edge Act corporation organized under section 25A of the Federal Reserve Act (12 U.S.C. 611-631);
- (9) Corporations having an agreement or undertaking with the Board of Governors of the Federal Reserve System under section 25 of the Federal Reserve Act (12 U.S.C. 601-604a);
- (10) A supervised securities holding company, as defined in 12 U.S.C. 1850a(a)(5);
- (11) A broker or dealer that is registered with the Securities and Exchange Commission under 15 U.S.C. 78o(b);
- (12) A futures commission merchant, as defined in 7 U.S.C. 1a(28);
- (13) A swap dealer, as defined in 7 U.S.C. 1a(49);
- (14) A security-based swap dealer, as defined in 15 U.S.C. 78c(a)(71);

(15) A Federal Home Loan Bank, as defined in 12 U.S.C. 1422(1)(A);

(16) A Farm Credit System Institution chartered and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.); or

(17) A small business investment company, as defined in 15 U.S.C. 662(3).

(B) Regulated financial group-

(1) General rule. For purposes of paragraph (g)(3)(iv) of this section, except as otherwise provided in paragraph (g)(3)(iv)(B)(2) of this section, the term regulated financial group means any expanded group of which a covered member that is a regulated financial company within the meaning of paragraphs (g)(3)(iv)(A)(1) through (10) of this section would be the expanded group parent if no person owned, directly or indirectly (as defined in §1.385-1(c)(4)(iii)), the regulated financial company. A domestic eligible entity (within the meaning of §301.7701-5(a) of this chapter) treated as a partnership or disregarded as an entity separate from its owner is, for purposes of this paragraph (g)(3)(iv)(B), also treated as a covered member.

(2) Exception for certain non-financial entities. A corporation is not a member of a regulated financial group if it is held by a regulated financial company pursuant to 12 U.S.C. 1843(k)(1)(B), 12 U.S.C. 1843(k)(4)(H), or 12 U.S.C. 1843(o).

(v) Regulated insurance company. For purposes of this paragraph (g)(3), the term regulated insurance company means a covered member that is-

(A) Subject to tax under subchapter L of chapter 1 of the Internal Revenue Code;

(B) Domiciled or organized under the laws of one of the 50 states or the District of Columbia (for purposes of paragraph (g)(3)(v) of this section, each being a "state");

(C) Licensed, authorized, or regulated by one or more states to sell insurance, reinsurance, or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such states, but in no case will a corporation satisfy the requirements of this paragraph (g)(3)(v)(C) if a principal purpose for obtaining such license, authorization, or regulation was to qualify the issuer as a regulated insurance company; and



(D) Engaged in regular issuances of (or subject to ongoing liability with respect to) insurance, reinsurance, or annuity contracts with persons that are not related persons (within the meaning of section 954(d)(3)).

(4)Debt instrument. The term debt instrument means an interest that would, but for the application of this section, be treated as a debt instrument as defined in section 1275(a) and §1.1275-1(d), provided that the interest is not recharacterized as stock under §1.385-2.

(5)Deemed holder. [Reserved]. For further guidance, see §1.385-3T(g)(5).

(6)Deemed partner stock. [Reserved]. For further guidance, see §1.385-3T(g)(6).

(7)Deemed transfer. [Reserved]. For further guidance, see §1.385-3T(g)(7).

(8)Deemed transferred receivable. [Reserved]. For further guidance, see §1.385-3T(g)(8).

(9)Distribution. The term distribution means any distribution made by a corporation with respect to its stock.

(10)Exempt distribution. The term exempt distribution means either-

(i) A distribution of stock that is permitted to be received without the recognition of gain or income under section 354(a)(1) or 355(a)(1), or, if section 356 applies, that is not treated as other property or money described in section 356; or

(ii) A distribution of property in a complete liquidation under section 336(a) or 337(a).

(11) Exempt exchange. The term exempt exchange means an acquisition of expanded group stock in which either-

(i) In a case in which the transferor and transferee of the expanded group stock are parties to an asset reorganization, either-

(A) Section 361(a) or (b) applies to the transferor of the expanded group stock and the stock is not transferred by issuance; or

(B) Section 1032 or §1.1032-2 applies to the transferor of the expanded group stock and the stock is distributed by the transferee pursuant to the plan of reorganization;

(ii) The transferor of the expanded group stock is a shareholder that receives property in a complete liquidation to which section 331 or 332 applies; or

(iii) The transferor of the expanded group stock is an acquiring entity that is deemed to issue the stock in exchange for cash from an issuing corporation in a transaction described in §1.1032-3(b).

(12)Expanded group partner. The term expanded group partner means, with respect to a controlled partnership of an expanded group, a member of the expanded group that is a partner (directly or indirectly through one or more partnerships).

(13)Expanded group stock. The term expanded group stock means, with respect to a member of an expanded group, stock of a member of the same expanded group.

(14)Funded member. The term funded member has the meaning provided in paragraph (b)(3)(i) of this section.

(15)Holder-in-form. [Reserved]. For further guidance, see §1.385-3T(g)(15).

(16)Issuance percentage. [Reserved]. For further guidance, see §1.385-3T(g)(16).

(17) Liquidation value percentage. [Reserved]. For further guidance, see §1.385-3T(g)(17).

(18)Member of a consolidated group. The term member of a consolidated group means a corporation described in §1.1502-1(b).

(19)Per se period. The term per se period has the meaning provided in paragraph (b)(3)(iii)(A) of this section.

(20)Predecessor.

(i) In general. Except as otherwise provided in paragraph (g)(20)(ii) of this section, the term predecessor means, with respect to a corporation-

(A) The distributor or transferor corporation in a transaction described in section 381(a) in which the corporation is the acquiring corporation; or

(B) The distributing corporation in a distribution or exchange to which section 355 (or so much of section 356 that relates to section 355) applies in which the corporation is a controlled corporation.

(ii) Predecessor ceasing to be a member of the same expanded group as corporation. The term predecessor does not include the distributing corporation described in paragraph (g)(20)(i)(B) of this section from the date that the distributing corporation ceases to be a member of the expanded group of which the controlled corporation is a member.

(iii) Multiple predecessors. A corporation may have more than one predecessor, including by reason of a predecessor of the corporation having a predecessor or successor. Accordingly, references to a corporation also include references to a predecessor or successor of a predecessor of the corporation.

(21)Property. The term property has the meaning specified in section 317(a).

(22)Retained receivable. [Reserved]. For further guidance, see §1.385-3T(g)(22).

(23)Specified portion. [Reserved]. For further guidance, see §1.385-3T(g)(23).

(24)Successor.

(i) In general. Except as otherwise provided in paragraph (g)(24)(iii) of this section, the term successor means, with respect to a corporation-

(A) The acquiring corporation in a transaction described in section 381(a) in which the corporation is the distributor or transferor corporation;

(B) A controlled corporation in a distribution or exchange to which section 355 (or so much of section 356 that relates to section 355) applies in which the corporation is the distributing corporation; or

(C) Subject to the rules in paragraph (g)(24)(ii) of this section, a seller in an acquisition described in paragraph (c)(2)(i)(A) of this section in which the corporation is the acquirer.

(ii) Special rules for certain acquisitions of subsidiary stock. The following rules apply with respect to a successor described in paragraph (g)(24)(i)(C) of this section:

(A) The seller is a successor to the acquirer only to the extent of the value (adjusted as described in paragraph (g)(24)(ii)(C) of this section) of the

expanded group stock acquired from the seller in exchange for property (other than expanded group stock) in the acquisition described in paragraph (c)(2)(i)(A) of this section.

(B) A distribution or acquisition by either the seller or a successor seller to or from either the acquirer, the seller, or a successor seller is not treated as described in paragraph (b)(3) of this section for purposes of applying paragraph (b)(3) of this section to a covered debt instrument of the acquirer. For purposes of the preceding sentence, the term successor seller means a member of the expanded group that receives property (other than expanded group stock) in a distribution or acquisition from the seller or another successor seller and is controlled by the acquirer as determined under the principles of paragraph (c)(2)(i) of this section. A successor seller is treated as a successor to the acquirer to the extent of the value of the property received in a distribution or acquisition described in the preceding sentence and, for purposes of applying this paragraph (g)(24)(ii)(B).

(C) To the extent that a covered debt instrument of the acquirer is treated as funding a distribution or acquisition by the seller or successor seller described in paragraphs (b)(3)(i)(A) through (C) of this section, or would be treated but for the exceptions described in paragraphs (c)(3)(i) and (ii) of this section, the value of the expanded group stock described in paragraph (g)(24)(ii)(A) of this section is reduced by an amount equal to the distribution or acquisition for purposes of any further application of paragraph (g)(24)(ii)(A) of this section with respect to the acquirer and seller.

(iii) Successor ceasing to be a member of the same expanded group as corporation. The term successor does not include a controlled corporation described in paragraph (g)(24)(i)(B) of this section with respect to a distributing corporation or a seller described in paragraph (g)(24)(i)(C) of this section with respect to an acquirer from the date that the controlled corporation or the seller ceases to be a member of the expanded group of which the controlled corporation or acquirer, respectively, is a member.

(iv) Multiple successors. A corporation may have more than one successor, including by reason of a successor of the corporation having a predecessor or successor. Accordingly, references to a corporation also include references to a predecessor or successor of a successor of the corporation.

(25) Taxable year. The term taxable year refers to the taxable year of the issuer of the covered debt instrument.

(h) Examples.

(1) Assumed facts. Except as otherwise stated, the following facts are assumed for purposes of the examples in paragraph (h)(3) of this section:

(i) FP is a foreign corporation that owns 100% of the stock of USS1, a covered member, 100% of the stock of USS2, a covered member, and 100% of the stock of FS, a foreign corporation;

(ii) USS1 owns 100% of the stock of DS, a covered member, and CFC, which is a controlled foreign corporation within the meaning of section 957;

(iii) At the beginning of Year 1, FP is the common parent of an expanded group comprised solely of FP, USS1, USS2, FS, DS, and CFC (the FP expanded group);

(iv) The FP expanded group has more than \$50 million of covered debt instruments described in paragraph (c)(4) of this section at all times;

(v) No issuer of a covered debt instrument has a positive expanded group earnings account within the meaning of paragraph (c)(3)(i)(B) of this section or has received qualified contributions within the meaning of paragraph (c)(3)(ii) of this section;

(vi) All notes are covered debt instruments (as defined in paragraph (g)(3) of this section) and are not qualified short-term debt instruments (as defined in paragraph (b)(3)(vii) of this section);

(vii) Each entity has as its taxable year the calendar year;

(viii) PRS is a partnership for federal income tax purposes;

(ix) No corporation is a member of a consolidated group;

(x) No domestic corporation is a United States real property holding corporation within the meaning of section 897(c)(2);

(xi) Each note is issued with adequate stated interest (as defined in section 1274(c)(2)); and

(xii) Each transaction occurs after January 19, 2017.

(2)No inference. Except as otherwise provided in this section, it is assumed for purposes of the examples in paragraph (h)(3) of this section that the form of each transaction is respected for federal tax purposes. No inference is intended, however, as to whether any particular note would be respected as indebtedness or as to whether the form of any particular transaction described in an example in paragraph (h)(3) of this section would be respected for federal tax purposes.

(3)Examples. The following examples illustrate the rules of this section.

Example (1). Distribution of a covered debt instrument.

(i) Facts. On Date A in Year 1, FS lends \$100x to USS1 in exchange for USS1 Note A. On Date B in Year 2, USS1 issues USS1 Note B, which is has a value of \$100x, to FP in a distribution.

(ii) Analysis. USS1 Note B is a covered debt instrument that is issued by USS1 to FP, a member of the expanded group of which USS1 is a member, in a distribution. Accordingly, USS1 Note B is treated as stock under paragraph (b)(2)(i) of this section. Under paragraph (d)(1)(i) of this section, USS1 Note B is treated as stock when it is issued by USS1 to FP on Date B in Year 2. Accordingly, USS1 is treated as distributing USS1 stock to its shareholder FP in a distribution that is subject to section 305. Under paragraph (b)(5) of this section, because the distribution of USS1 Note B is described in paragraph (b)(2)(i) of this section, the distribution of USS1 Note B is not treated as a distribution of property described in paragraph (b)(3)(i)(A) of this section. Accordingly, USS1 Note A is not treated as funding the distribution of USS1 Note B for purposes of paragraph (b)(3)(i)(A) of this section.

Example (2). Covered debt instrument issued for expanded group stock that is exchanged for stock in a corporation that is not a member of the same expanded group.

(i) Facts. UST is a publicly traded domestic corporation. On Date A in Year 1, USS1 issues USS1 Note to FP in exchange for FP stock. Subsequently, on Date B of Year 1, USS1 transfers the FP stock to UST's shareholders, which are not members of the FP expanded group, in exchange for all of the stock of UST.

(ii) Analysis.

(A) Because USS1 and FP are both members of the FP expanded group, USS1 Note is treated as stock when it is issued by USS1 to FP in exchange for FP stock on Date A in Year 1 under paragraphs (b)(2)(ii) and (d)(1)(i) of this section. This result applies even though, pursuant to the same plan, USS1 transfers the FP stock to persons that are not members of the FP expanded group. The exchange of USS1 Note for FP stock is not an exempt exchange within the meaning of paragraph (g)(11) of this section.

(B) Because USS1 Note is treated as stock for federal tax purposes when it is issued by USS1, pursuant to section §1.367(b)-10(a)(3)(ii) (defining property for purposes of §1.367(b)-10) there is no potential application of §1.367(b)-10(a) to USS1's acquisition of the FP stock.

Example (3). Issuance of a note in exchange for expanded group stock.

(i) Facts. On Date A in Year 1, USS1 issues USS1 Note to FP in exchange for 40% of the FS stock owned by FP.

(ii) Analysis.

(A) Because USS1 and FP are both members of the FP expanded group, USS1 Note is treated as stock when it is issued by USS1 to FP in exchange for FS stock on Date A in Year 1 under paragraphs (b)(2)(ii) and (d)(1)(i) of this section. The exchange of USS1 Note for FS stock is not an exempt exchange within the meaning of paragraph (g)(11) of this section.

(B) Because USS1 Note is treated as stock for federal tax purposes when it is issued by USS1, USS1 Note is not treated as property for purposes of section 304(a) because it is not property within the meaning specified in section 317(a). Therefore, USS1's acquisition of FS stock from FP in exchange for USS1 Note is not an acquisition described in section 304(a)(1).

Example (4). Funding occurs in same taxable year as distribution.

(i) Facts. On Date A in Year 1, FP lends \$200x to DS in exchange for DS Note A. On Date B in Year 1, DS distributes \$400x of cash to USS1 in a distribution.

(ii) Analysis. Under paragraph (b)(3)(iii)(A) of this section, DS Note A is treated as funding the distribution by DS to USS1 because DS Note A is issued to a member of the FP expanded group during the per se period with respect to DS's distribution to USS1. Accordingly, under paragraphs (b)(3)(i)(A) and (d)(1)(ii) of this section, DS Note A is treated as stock on Date B in Year 1.

Example (5). Additional funding.

(i) Facts. The facts are the same as in Example 4 of this paragraph (h)(3), except that, in addition, on Date C in Year 2, FP lends an additional \$300x to DS in exchange for DS Note B.

(ii) Analysis. The analysis is the same as in Example 4 of this paragraph (h)(3) with respect to DS Note A. DS Note B is also issued to a member of the FP expanded group during the per se period with respect to DS's distribution to USS1. Under paragraphs (b)(3)(iii)(A) and (b)(6) of this section, DS Note B is treated as funding only the remaining portion of DS's distribution to USS1, which is \$200x. Accordingly, \$200x of DS Note B is treated as stock under paragraph (b)(3)(i)(A) of this section. Under paragraph (d)(1)(i) of this section, \$200x of DS Note B is treated as stock when it is issued by DS to FP on Date C in Year 2. The remaining \$100x of DS Note B continues to be treated as indebtedness.

Example (6). Funding involving multiple interests.

(i) Facts. On Date A in Year 1, FP lends \$300x to USS1 in exchange for USS1 Note A. On Date B in Year 2, USS1 distributes \$300x of cash to FP. On Date C in Year 3, FP lends another \$300x to USS1 in exchange for USS1 Note B.

(ii) Analysis.

(A) Under paragraph (b)(3)(iii)(B) of this section, USS1 Note A is tested under paragraph (b)(3) of this section before USS1 Note B is tested. USS1 Note A is issued during the per se period with respect to USS1's \$300x distribution to FP

and, therefore, is treated as funding the distribution under paragraph (b)(3)(iii)(A) of this section. Beginning on Date B in Year 2, USS1 Note A is treated as stock under paragraphs (b)(3)(i)(A) and (d)(1)(ii) of this section.

(B) Under paragraph (b)(3)(iii)(B) of this section, USS1 Note B is tested under paragraph (b)(3) of this section after USS1 Note A is tested. Because USS1 Note A is treated as funding the entire \$300x distribution by USS1 to FP, USS1 Note B will continue to be treated as indebtedness. See paragraph (b)(6) of this section.

Example (7). Re-testing.

(i) Facts. The facts are the same as in Example 6 of this paragraph (h)(3), except that on Date D in Year 4, FP sells USS1 Note A to Bank.

(ii) Analysis.

(A) Under paragraph (d)(2)(i) of this section, USS1 Note A ceases to be treated as stock when FP sells USS1 Note A to Bank on Date D in Year 4. Immediately before FP sells USS1 Note A to Bank, USS1 is deemed to issue a debt instrument to FP in exchange for USS1 Note A in a transaction that is disregarded for purposes of paragraphs (b)(2) and (b)(3) of this section.

(B) Under paragraph (d)(2)(ii) of this section, after USS1 Note A is deemed exchanged for a new debt instrument, USS1's other covered debt instruments that are not treated as stock as of Date D in Year 4 (USS1 Note B) are re-tested for purposes of paragraph (b)(3)(iii) of this section to determine whether the instruments are treated as funding the \$300x distribution by USS1 to FP on Date B in Year 2. USS1 Note B was issued by USS1 to FP during the per se period. Accordingly, USS1 Note B is re-tested under paragraph (b)(3)(iii) of this section. Under paragraph (b)(3)(iii) of this section, USS1 Note B is treated as funding the distribution on Date C in Year 3 and, accordingly, is treated as stock under paragraph (b)(3)(i)(A) of this section. USS1 Note B is deemed to be exchanged for stock on Date D in Year 4, the re-testing date, under paragraph (d)(1)(iv) of this section. See §1.385-1(d) for rules regarding the treatment of this deemed exchange.

Example (8). Distribution of expanded group stock and covered debt instrument in a reorganization that qualifies under section 355.

(i) Facts. On Date A in Year 1, FP lends \$200x to USS2 in exchange for USS2 Note. In a transaction that is treated as independent from the transaction on Date A in Year 1, on Date B in Year 2, USS2 transfers a portion of its assets to DS2, a newly formed domestic corporation, in exchange for all of the stock of DS2 and DS2 Note. Immediately afterwards, USS2 distributes all of the DS2 stock and the DS2 Note to FP with respect to FP's USS2 stock in a transaction that qualifies under section 355. USS2's transfer of a portion of its assets to DS2 qualifies as a reorganization described in section 368(a)(1)(D). The DS2 stock has a value of \$150x and DS2 Note has a value of \$50x. The DS2 stock is not non-qualified preferred stock as defined in section 351(g)(2). Absent the application of this section, DS2 Note would be treated by FP as other property within the meaning of section 356.

(ii) Analysis.



(A) The contribution and distribution transaction is a reorganization described in section 368(a)(1)(D) involving a transfer of property by USS2 to DS2 in exchange for DS2 stock and DS2 Note. The transfer of property by USS2 to DS2 is a contribution of excluded property described in paragraph (c)(3)(ii)(D)(2) of this section and an excluded contribution described in paragraph (c)(3)(ii)(E)(2) of this section. Accordingly, USS2's contribution of property to DS2 is not a qualified contribution described in paragraph (c)(3)(ii)(B) of this section.

(B) DS2 Note is a covered debt instrument that is issued by DS2 to USS2, both members of the FP expanded group, in exchange for property of USS2 in an asset reorganization (as defined in paragraph (g)(1) of this section), and received by FP, another FP expanded group member immediately before the reorganization, as other property with respect to FP's USS2 stock. Accordingly, the transaction is described in paragraph (b)(2)(iii) of this section, and DS2 Note is treated as stock when it is issued by DS2 to USS2 on Date B in Year 2 pursuant to paragraphs (b)(2)(iii) and (d)(1)(i) of this section.

(C) Because the issuance of DS2 Note by DS2 in exchange for the property of USS2 in an asset reorganization is described in paragraph (b)(2)(iii) of this section, the distribution and acquisition of DS2 Note by USS2 is not treated as a distribution or acquisition described in paragraph (b)(3)(i) of this section. Accordingly, USS2 Note is not treated as funding the distribution of DS2 Note for purposes of paragraph (b)(3)(i) of this section.

(D) USS2's acquisition of DS2 stock is not an acquisition described in paragraph (b)(3)(i)(B) of this section because it is an exempt exchange (as defined in paragraph (g)(11) of this section). USS2's acquisition of DS2 stock is an exempt exchange because USS2 and DS2 are both parties to a reorganization that is an asset reorganization, section 1032 applies to DS2, the transferor of the expanded group stock, and the DS2 stock is distributed by USS2, the transferee of the expanded group stock, pursuant to the plan of reorganization.

(E) USS2's distribution of \$150x of the DS2 stock is a distribution of stock that is permitted to be received by FP without recognition of gain under section 355(a)(1). Accordingly, USS2's distribution of the DS2 stock (other than the DS2 Note) to FP is an exempt distribution, and is not described in paragraph (b)(3)(i)(A) of this section.

(F) Because USS2 has not made a distribution or acquisition that is described in paragraph (b)(3)(i)(A), (B), or (C) of this section, USS2 Note is not treated as stock.

Example (9). Funding a distribution by a successor to funded member.

(i) Facts. The facts are the same as in Example 8 of this paragraph (h)(3), except that on Date C in Year 3, DS2 distributes \$200x of cash to FP and, subsequently, on Date D in Year 3, USS2 distributes \$100x of cash to FP.

(ii) Analysis.

(A) USS2 is a predecessor of DS2 under paragraph (g)(20)(i)(B) of this section and DS2 is a successor to USS2 under paragraph (g)(24)(i)(B) of this section because USS2 is the distributing corporation and DS2 is the controlled corporation in a distribution to which section 355 applies. Accordingly, under

paragraph (b)(3)(v) of this section, a distribution by DS2 is treated as a distribution by USS2. Under paragraphs (b)(3)(iii)(A) and (b)(3)(v)(B) of this section, USS2 Note is treated as funding the distribution by DS2 to FP because USS2 Note was issued during the per se period with respect to DS2's \$200x cash distribution, and because both the issuance of USS2 Note and the distribution by DS2 occur during the per se period with respect to the section 355 distribution. Accordingly, under paragraphs (b)(3)(i)(A) and (d)(1)(ii) of this section, USS2 Note is treated as stock beginning on Date C in Year 3. See §1.385-1(d) for rules regarding the treatment of this deemed exchange.

(B) Because the entire amount of USS2 Note is treated as funding DS2's \$200x distribution to FP, under paragraph (b)(3)(iii)(C) of this section, USS2 Note is not treated as funding the subsequent distribution by USS2 on Date D in Year 3.

Example (10). Funding a distribution by a successor to funded member. Asset reorganization; section 354 qualified property.

(i) Facts. On Date A in Year 1, FS lends \$100x to USS2 in exchange for USS2 Note. On Date B in Year 2, in a transaction that qualifies as a reorganization described in section 368(a)(1)(D), USS2 transfers all of its assets to USS1 in exchange for stock of USS1 and the assumption by USS1 of all of the liabilities of USS2, and USS2 distributes to FP, with respect to FP's USS2 stock, all of the USS1 stock that USS2 receives. FP does not recognize gain under section 354(a)(1).

(ii) Analysis.

(A) USS1 is a successor to USS2 under paragraph (g)(24)(i)(A) of this section. For purposes of paragraph (b)(3) of this section, USS2 and, under paragraph (b)(3)(v)(A) of this section, its successor, USS1, are funded members with respect to USS2 Note. Although USS2, a funded member, distributes property (USS1 stock) to its shareholder, FP, pursuant to the reorganization, the distribution of USS1 stock is not described in paragraph (b)(3)(i)(A) of this section because the stock is distributed in an exempt distribution (as defined in paragraph (g)(10) of this section). In addition, neither USS1's acquisition of the assets of USS2 nor USS2's acquisition of USS1 stock is described in paragraph (b)(3)(i)(C) of this section because FP does not receive other property within the meaning of section 356 with respect to its stock in USS2.

(B) USS2's acquisition of USS1 stock is not an acquisition described in paragraph (b)(3)(i)(B) of this section because it is an exempt exchange (as defined in paragraph (g)(11) of this section). USS2's acquisition of USS1 stock is an exempt exchange because USS1 and USS2 are both parties to an asset reorganization, section 1032 applies to USS1, the transferor of the USS1 stock, and the USS1 stock is distributed by USS2, the transferee, pursuant to the plan of reorganization. Furthermore, USS2's acquisition of its own stock from FS is not an acquisition described in paragraph (b)(3)(i)(B) of this section because USS2 acquires its stock in exchange for USS1 stock.

(C) Because neither USS1 nor USS2 has made a distribution or acquisition described in paragraph (b)(3)(i)(A), (B), or (C) of this section, USS2 Note is not treated as stock under paragraph (b)(3)(iii)(A) of this section.

Example (11). Funding a distribution by a successor to funded member.  
Distribution of a covered debt instrument and issuance of a covered debt instrument with a principal purpose of avoiding the purposes of this section.

(i) Facts. On Date A in Year 1, USS1 issues USS1 Note A, which has a value of \$100x, to FP in a distribution. On Date B in Year 1, with a principal purpose of avoiding the purposes of this section, FP sells USS1 Note A to Bank for \$100x of cash and lends \$100x to USS1 in exchange for USS1 Note B.

(ii) Analysis. USS1 Note A is a covered debt instrument that is issued by USS1 to FP, a member of USS1's expanded group, in a distribution. Accordingly, under paragraphs (b)(2)(i) and (d)(1)(i) of this section, USS1 Note A is treated as stock when it is issued by USS1 to FP on Date A in Year 1. Accordingly, USS1 is treated as distributing USS1 stock to FP. Because the distribution of USS1 Note A is described in paragraph (b)(2)(i) of this section, the distribution of USS1 Note A is not described in paragraph (b)(3)(i)(A) of this section under paragraph (b)(5) of this section. Under paragraph (d)(2)(i) of this section, USS1 Note A ceases to be treated as stock when FP sells USS1 Note A to Bank on Date B in Year 1. Immediately before FP sells USS1 Note A to Bank, USS1 is deemed to issue a debt instrument to FP in exchange for USS1 Note A in a transaction that is disregarded for purposes of paragraphs (b)(2) and (b)(3)(i) of this section. USS1 Note B is not treated as stock under paragraph (b)(3)(i)(A) of this section because the funded member, USS1, has not made a distribution of property. However, because the transactions occurring on Date B of Year 1 were undertaken with a principal purpose of avoiding the purposes of this section, USS1 Note B is treated as stock on Date B of Year 1 under paragraph (b)(4) of this section.

Example (12). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 12.

Example (13). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 13.

Example (14). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 14.

Example (15). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 15.

Example (16). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 16.

Example (17). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 17.

Example (18). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 18.

Example (18). [Reserved]. For further guidance, see §1.385-3T(h)(3), Example 19.

(i)[Reserved]

(j)Applicability date and transition rules.

(1)In general. This section applies to taxable years ending on or after January 19, 2017.

(2)Transition rules.

(i) Transition rule for covered debt instruments that would be treated as stock in taxable years ending before January 19, 2017. If paragraphs (b) and (d)(1) of this section, taking into account §§1.385-1, 1.385-3T, and 1.385-4T, would have treated a covered debt instrument as stock in a taxable year ending before January 19, 2017 but for the application of paragraph (j)(1) of this section, to the extent that the covered debt instrument is held by a member of the expanded group of which the issuer is a member immediately after January 19, 2017, then the covered debt instrument is deemed to be exchanged for stock immediately after January 19, 2017.

(ii) Transition rule for certain covered debt instruments treated as stock in taxable years ending on or after January 19, 2017. If paragraphs (b) and (d)(1) of this section, taking into account §§1.385-1, 1.385-3T, and 1.385-4T, would treat a covered debt instrument as stock on or before January 19, 2017 but in a taxable year ending on or after January 19, 2017, that covered debt instrument is not treated as stock during the 90-day period after October 21, 2016. Instead, to the extent that the covered debt instrument is held by a member of the expanded group of which the issuer is a member immediately after January 19, 2017, the covered debt instrument is deemed to be exchanged for stock immediately after January 19, 2017.

(iii) Transition funding rule. When a covered debt instrument would be recharacterized as stock after April 4, 2016, and on or before January 19, 2017 (the transition period), but that covered debt instrument is not recharacterized as stock on such date due to the application of paragraph (j)(1), (j)(2)(i), or (j)(2)(ii) of this section, any payments made with respect to such covered debt instrument (other than stated interest), including pursuant to a refinancing, after the date that the covered debt instrument would have been recharacterized as stock and through the remaining portion of the transition period are treated as distributions for purposes of applying paragraph (b)(3) of this section for taxable years ending on or after January 19, 2017. In addition, to the extent that the holder and the issuer of the covered debt instrument cease to be members of the same expanded group during the transition period, the distribution or acquisition that would have caused the covered debt instrument to be treated as stock is available to be treated as funded by other covered debt instruments of the issuer for purposes of paragraph (b)(3) of this section (to the extent provided in paragraph (b)(3)(iii) of this section). The prior sentence is applied in a manner that is consistent with the rules set forth in paragraph (d)(2) of this section.

(iv) Coordination between the general rule and funding rule. When a covered debt instrument would be recharacterized as stock pursuant to paragraph (b)(2) of this

section after April 4, 2016, and on or before January 19, 2017, but that covered debt instrument is not recharacterized as stock on such date due to the application of paragraph (j)(1), (j)(2)(i), or (j)(2)(ii) of this section, the issuance of such covered debt instrument is not treated as a distribution or acquisition described in §1.385-3(b)(3)(i), but only to the extent that the covered debt instrument is held by a member of the expanded group of which the issuer is a member immediately after January 19, 2017.

(v) Option to apply proposed regulations. In lieu of applying §§1.385-1, 1.385-3, 1.385-3T, and 1.385-4T, taxpayers may apply the provisions matching §§1.385-1, 1.385-3, and 1.385-4 from the Internal Revenue Bulletin (IRB) 2016-17 (<https://www.irs.gov/pub/irs-irbs/irb16-17.pdf>) to all debt instruments issued by a particular issuer (and members of its expanded group that are covered members) after April 4, 2016, and before October 13, 2016, solely for purposes of determining whether a debt instrument is treated as stock, provided that those sections are consistently applied.