

Reg. Section 1.385-4T

Treatment of consolidated groups

(a) Scope. This section provides rules for applying §§1.385-3 and 1.385-3T to members of consolidated groups. Paragraph (b) of this section sets forth rules concerning the extent to which, solely for purposes of applying §§1.385-3 and 1.385-3T, members of a consolidated group that file (or that are required to file) a consolidated U.S. federal income tax return are treated as one corporation. Paragraph (c) of this section sets forth rules concerning the treatment of a debt instrument that ceases to be, or becomes, a consolidated group debt instrument. Paragraph (d) of this section provides rules for applying the funding rule of §1.385-3(b)(3) to members that depart a consolidated group. For definitions applicable to this section, see paragraph (e) of this section and §§1.385-1(c) and 1.385-3(g). For examples illustrating the application of this section, see paragraph (f) of this section.

(b) Treatment of consolidated groups.

(1) Members treated as one corporation. For purposes of this section and §§1.385-3 and 1.385-3T, and except as otherwise provided in this section and §1.385-3T, all members of a consolidated group (as defined in §1.1502-1(h)) that file (or that are required to file) a consolidated U.S. federal income tax return are treated as one corporation. Thus, for example, when a member of a consolidated group issues a covered debt instrument that is not a consolidated group debt instrument, the consolidated group generally is treated as the issuer of the covered debt instrument for purposes of this section and §§1.385-3 and 1.385-3T. Also, for example, when one member of a consolidated group issues a covered debt instrument that is not a consolidated group debt instrument and therefore is treated as issued by the consolidated group, and another member of the consolidated group makes a distribution or acquisition described in §1.385-3(b)(3)(i)(A) through (C) with an expanded group member that is not a member of the consolidated group, §1.385-3(b)(3)(i) may treat the covered debt instrument as funding the distribution or acquisition made by the consolidated group. In addition, except as otherwise provided in this section, acquisitions and distributions described in §1.385-3(b)(2) and (b)(3)(i) in which all parties to the transaction are members of the same consolidated group both before and after the transaction are disregarded for purposes of this section and §§1.385-3 and 1.385-3T.

(2) One-corporation rule inapplicable to expanded group member determination. The one-corporation rule described in paragraph (b)(1) of this section does not apply in determining the members of an expanded group. Notwithstanding the previous sentence, an expanded group does not exist for purposes of this section and §§1.385-3 and 1.385-3T if it consists only of members of a single consolidated group.

(3) Application of §1.385-3 to debt instruments issued by members of a consolidated group.

(i) Debt instrument treated as stock of the issuing member of a consolidated group. If a covered debt instrument treated as issued by a consolidated group under the one-corporation rule described in paragraph (b)(1) of this section is treated as stock under §§ 1.385-3 or 1.385-3T, the covered debt instrument is treated as stock in the member of the consolidated group that would be the issuer of such debt instrument without regard to this section. But see §1.385-3(d)(7) (providing that a covered debt instrument that is treated as stock under §1.385-3(b)(2), (3), or (4) 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) Application of the covered debt instrument exclusions. For purposes of determining whether a debt instrument issued by a member of a consolidated group is a covered debt instrument, each test described in §1.385-3(g)(3) is applied on a separate member basis without regard to the one-corporation rule described in paragraph (b)(1) of this section.

(iii) Qualified short-term debt instrument. The determination of whether a member of a consolidated group has issued a qualified short-term debt instrument for purposes of §1.385-3(b)(3)(vii) is made on a separate member basis without regard to the one-corporation rule described in paragraph (b)(1) of this section.

(4) Application of the reductions of §1.385-3(c)(3) to members of a consolidated group.

(i) Application of the reduction for expanded group earnings-

(A) In general. A consolidated group maintains one expanded group earnings account with respect to an expanded group period, and only the earnings and profits, determined in accordance with §1.1502-33 (without regard to the application of §1.1502-33(b)(2), (e), and (f)), of the common parent (within the meaning of section 1504) of the consolidated group are considered in calculating the expanded group earnings for the expanded group period of the consolidated group. Accordingly, a regarded distribution or acquisition made by a member of a consolidated group is reduced to the extent of the expanded group earnings account of the consolidated group.

(B) Effect of certain corporate transactions on the calculation of expanded group earnings.

(1) Consolidation. A consolidated group succeeds to the expanded group earnings account of a joining member under the principles of §1.385-3(c)(3)(i)(F)(2)(ii).

(2) Deconsolidation.

(i) In general. Except as otherwise provided in paragraph (b)(4)(i)(B)(2)(ii) of this section, no amount of the expanded group earnings account of a consolidated group for an expanded group period, if any, is allocated to a departing member. Accordingly, immediately after leaving the consolidated group, the departing member has no expanded group earnings account with respect to its expanded group period.

(ii) Allocation of expanded group earnings to a departing member in a distribution described in section 355. If a departing member leaves the consolidated group by reason of an exchange or distribution to which section 355 (or so much of section 356 that relates to section 355) applies, the expanded group earnings account of the consolidated group is allocated between the consolidated group and the departing member in proportion to the earnings and profits of the consolidated group and the earnings and profits of the departing member immediately after the transaction.

(i) Application of the reduction for qualified contributions-

(A) In general. For purposes of applying §1.385-3(c)(3)(ii)(A) to a consolidated group-

(1) A qualified contribution to any member of a consolidated group that remains a member of the consolidated group immediately after the qualified contribution from a person other than a member of the same consolidated group is treated as made to the one corporation described in paragraph (b)(1) of this section;

(2) A qualified contribution that causes a member of a consolidated group to become a departing member of that consolidated group is treated as made to the departing member and not to the consolidated group of which the departing member was a member immediately prior to the qualified contribution; and

(3) No contribution of property by a member of a consolidated group to any other member of the consolidated group is a qualified contribution.

(B) Effect of certain corporate transactions on the calculation of qualified contributions.

(1) Consolidation. A consolidated group succeeds to the qualified contributions of a joining member under the principles of §1.385-3(c)(3)(ii)(F)(2)(ii).

(2) Deconsolidation.

(i) In general. Except as otherwise provided in paragraph (b)(4)(ii)(B)(2)(ii) of this section, no amount of the qualified contributions of a consolidated group for an expanded group period, if any, is allocated to a departing member. Accordingly, immediately after leaving the consolidated group, the departing member has no qualified contributions with respect to its expanded group period.

(ii) Allocation of qualified contributions to a departing member in a distribution described in section 355. If a departing member leaves the consolidated group by reason of an exchange or distribution to which section 355 (or so much of section 356 that relates to section 355) applies, each qualified contribution of the consolidated group is allocated between the consolidated group and the departing member in proportion to the earnings and profits of the consolidated group and the earnings and profits of the departing member immediately after the transaction.

(5) Order of operations. For purposes of this section and §§1.385-3 and 1.385-3T, the consequences of a transaction involving one or more members of a consolidated group are determined as provided in paragraphs (b)(5)(i) and (ii) of this section.

(i) First, determine the characterization of the transaction under federal tax law without regard to the one-corporation rule described in paragraph (b)(1) of this section.

(ii) Second, apply this section and §§1.385-3 and 1.385-3T to the transaction as characterized to determine whether to treat a debt instrument as stock, treating the consolidated group as one corporation under paragraph (b)(1) of this section, unless otherwise provided.

(6) Partnership owned by a consolidated group. For purposes of this section and §§1.385-3 and 1.385-3T, and notwithstanding the one-corporation rule described in paragraph (b)(1) of this section, a partnership that is wholly owned by members of a consolidated group is treated as a partnership. Thus, for example, if members of a consolidated group own all of the interests in a controlled partnership that issues a debt instrument to a member of the consolidated group, such debt instrument would be treated as a consolidated group debt instrument because, under §1.385-3T(f)(3)(i), for purposes of this section and §1.385-3, a consolidated group member that is an expanded group partner is treated as the issuer with respect to its share of the debt instrument issued by the partnership.

(7) Predecessor and successor.

(i) In general. Pursuant to paragraph (b)(5) of this section, the determination as to whether a member of an expanded group is a predecessor or successor of another

member of the consolidated group is made without regard to paragraph (b)(1) of this section. For purposes of §1.385-3(b)(3), if a consolidated group member is a predecessor or successor of a member of the same expanded group that is not a member of the same consolidated group, the consolidated group is treated as a predecessor or successor of the expanded group member (or the consolidated group of which that expanded group member is a member). Thus, for example, a departing member that departs a consolidated group in a distribution or exchange to which section 355 applies is a successor to the consolidated group and the consolidated group is a predecessor of the departing member.

(ii) Joining members. For purposes of §1.385-3(b)(3), the term predecessor also means, with respect to a consolidated group, a joining member and the term successor also means, with respect to a joining member, a consolidated group.

(c) Consolidated group debt instruments.

(1) Debt instrument ceases to be a consolidated group debt instrument but continues to be issued and held by expanded group members.

(i) Consolidated group member leaves the consolidated group. For purposes of this section and §§1.385-3 and 1.385-3T, when a debt instrument ceases to be a consolidated group debt instrument as a result of a transaction in which the member of the consolidated group that issued the instrument (the issuer) or the member of the consolidated group holding the instrument (the holder) ceases to be a member of the same consolidated group but both the issuer and the holder continue to be members of the same expanded group, the issuer is treated as issuing a new debt instrument to the holder in exchange for property immediately after the debt instrument ceases to be a consolidated group debt instrument. To the extent the newly-issued debt instrument is a covered debt instrument that is treated as stock under §1.385-3(b)(3), the covered debt instrument is then immediately deemed to be exchanged for stock of the issuer. For rules regarding the treatment of the deemed exchange, see §1.385-1(d). For examples illustrating this rule, see paragraph (f) of this section, Examples 4 and 5.

(ii) Consolidated group debt instrument that is transferred outside of the consolidated group. For purposes of this section and §§1.385-3 and 1.385-3T, when a member of a consolidated group that holds a consolidated group debt instrument transfers the debt instrument to an expanded group member that is not a member of the same consolidated group (transferee expanded group member), the debt instrument is treated as issued by the consolidated group to the transferee expanded group member immediately after the debt instrument ceases to be a consolidated group debt instrument. Thus, for example, for purposes of this section and §§1.385-3 and 1.385-3T, the sale of a consolidated group debt instrument to a transferee expanded group member is treated as an issuance of the debt instrument by the consolidated group to the transferee expanded group member in exchange for property. To the extent the newly-issued debt instrument is a covered debt instrument that is treated as stock upon being transferred, the covered debt instrument is deemed to be exchanged for stock of the member of

the consolidated group treated as the issuer of the debt instrument (determined under paragraph (b)(3)(i) of this section) immediately after the covered debt instrument is transferred outside of the consolidated group. For rules regarding the treatment of the deemed exchange, see §1.385-1(d). For examples illustrating this rule, see paragraph (f) of this section, Examples 2 and 3.

(iii) Overlap transactions. If a debt instrument ceases to be a consolidated group debt instrument in a transaction to which both paragraphs (c)(1)(i) and (ii) of this section apply, then only the rules of paragraph (c)(1)(ii) of this section apply with respect to such debt instrument.

(iv) Subgroup exception. A debt instrument is not treated as ceasing to be a consolidated group debt instrument for purposes of paragraphs (c)(1)(i) and (ii) of this section if both the issuer and the holder of the debt instrument are members of the same consolidated group immediately after the transaction described in paragraph (c)(1)(i) or (ii) of this section.

(2) Covered debt instrument treated as stock becomes a consolidated group debt instrument. When a covered debt instrument that is treated as stock under §1.385-3 becomes a consolidated group debt instrument, then immediately after the covered debt instrument becomes a consolidated group debt instrument, 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 addition, in a manner consistent with §1.385-3(d)(2)(ii)(A), when the covered debt instrument that previously was treated as stock becomes a consolidated group debt instrument, other covered debt instruments issued by the issuer of that instrument (including a consolidated group that includes the issuer) that are not treated as stock when the instrument becomes a consolidated group debt instrument are re-tested to determine whether those other covered debt instruments are treated as funding the regarded distribution or acquisition that previously was treated as funded by the instrument (unless such distribution or acquisition is disregarded under paragraph (b)(1) of this section). Further, also in a manner consistent with §1.385-3(d)(2)(ii)(A), a covered debt instrument that is issued by the issuer (including a consolidated group that includes the issuer) after the application of this paragraph and within the per se period may also be treated as funding that regarded distribution or acquisition.

(3) No interaction with the intercompany obligation rules of §1.1502-13(g). The rules of this section do not affect the application of the rules of §1.1502-13(g). Thus, any deemed satisfaction and reissuance of a debt instrument under §1.1502-13(g) and any deemed issuance and deemed exchange of a debt instrument under this paragraph (c) that arise as part of the same transaction or series of transactions are not integrated. Rather, each deemed satisfaction and reissuance under the rules of §1.1502-13(g), and each deemed issuance and exchange under the rules of this section, are respected as separate steps and treated as separate transactions.

(d)Application of the funding rule of §1.385-3(b)(3) to members departing a consolidated group. This paragraph (d) provides rules for applying the funding rule of §1.385-3(b)(3) when a departing member ceases to be a member of a consolidated group, but only if the departing member and the consolidated group are members of the same expanded group immediately after the deconsolidation.

(1)Continued application of the one-corporation rule. A disregarded distribution or acquisition by any member of the consolidated group continues to be disregarded when the departing member ceases to be a member of the consolidated group.

(2)Continued recharacterization of a departing member's covered debt instrument as stock. A covered debt instrument of a departing member that is treated as stock of the departing member under §1.385-3(b) continues to be treated as stock when the departing member ceases to be a member of the consolidated group.

(3)Effect of issuances of covered debt instruments that are not consolidated group debt instruments on the departing member and the consolidated group. If a departing member has issued a covered debt instrument (determined without regard to the one-corporation rule described in paragraph (b)(1) of this section) that is not a consolidated group debt instrument and that is not treated as stock immediately before the departing member ceases to be a consolidated group member, then the departing member (and not the consolidated group) is treated as issuing the covered debt instrument on the date and in the manner the covered debt instrument was issued. If the departing member is not treated as the issuer of a covered debt instrument pursuant to the preceding sentence, then the consolidated group continues to be treated as issuing the covered debt instrument on the date and in the manner the covered debt instrument was issued.

(4)Treatment of prior regarded distributions or acquisitions. This paragraph (d)(4) applies when a departing member ceases to be a consolidated group member in a transaction other than a distribution to which section 355 (or so much of section 356 as relates to section 355) applies, and the consolidated group has made a regarded distribution or acquisition.

(i) If the departing member made the regarded distribution or acquisition (determined without regard to the one-corporation rule described in paragraph (b)(1) of this section), the departing member (and not the consolidated group) is treated as having made the regarded distribution or acquisition.

(ii) If the departing member did not make the regarded distribution or acquisition (determined without regard to the one-corporation rule described in paragraph (b)(1) of this section), then the consolidated group (and not the departing member) continues to be treated as having made the regarded distribution or acquisition.

(e)Definitions. The definitions in this paragraph (e) apply for purposes of this section.

(1) Consolidated group debt instrument. The term consolidated group debt instrument means a covered debt instrument issued by a member of a consolidated group and held by a member of the same consolidated group.

(2) Departing member. The term departing member means a member of an expanded group that ceases to be a member of a consolidated group but continues to be a member of the same expanded group. In the case of multiple members leaving a consolidated group as a result of a single transaction that continue to be members of the same expanded group, if such members are treated as one corporation under paragraph (b)(1) of this section immediately after the transaction, that one corporation is a departing member with respect to the consolidated group.

(3) Disregarded distribution or acquisition. The term disregarded distribution or acquisition means a distribution or acquisition described in §1.385-3(b)(2) or (b)(3)(i) between members of a consolidated group that is disregarded under the one-corporation rule described in paragraph (b)(1) of this section.

(4) Joining member. The term joining member means a member of an expanded group that becomes a member of a consolidated group and continues to be a member of the same expanded group. In the case of multiple members joining a consolidated group as a result of a single transaction that continue to be members of the same expanded group, if such members were treated as one corporation under paragraph (b)(1) of this section immediately before the transaction, that one corporation is a joining member with respect to the consolidated group.

(5) Regarded distribution or acquisition. The term regarded distribution or acquisition means a distribution or acquisition described in §1.385-3(b)(2) or (b)(3)(i) that is not disregarded under the one-corporation rule described in paragraph (b)(1) of this section.

(f) Examples.

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

- (i) FP is a foreign corporation that owns 100% of the stock of USS1, a covered member, and 100% of the stock of FS, a foreign corporation;
- (ii) USS1 owns 100% of the stock of DS1 and DS3, both covered members;
- (iii) DS1 owns 100% of the stock of DS2, a covered member;
- (iv) FS owns 100% of the stock of UST, a covered member;

(v) At the beginning of Year 1, FP is the common parent of an expanded group comprised solely of FP, USS1, FS, DS1, DS2, DS3, and UST (the FP expanded group);

(vi) USS1, DS1, DS2, and DS3 are members of a consolidated group of which USS1 is the common parent (the USS1 consolidated group);

(vii) The FP expanded group has outstanding more than \$50 million of debt instruments described in §1.385-3(c)(4) at all times;

(viii) No issuer of a covered debt instrument has a positive expanded group earnings account, within the meaning of §1.385-3(c)(3)(i)(B), or has received a qualified contribution, within the meaning of §1.385-3(c)(3)(ii)(B);

(ix) All notes are covered debt instruments, within the meaning of §1.385-3(g)(3), and are not qualified short-term debt instruments, within the meaning of §1.385-3(b)(3)(vii);

(x) All notes between members of a consolidated group are intercompany obligations within the meaning of §1.1502-13(g)(2)(ii);

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

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

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

(xiv) 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 (f)(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 (f)(3) of this section would be respected for federal tax purposes.

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

Example (1). Order of operations. (i) Facts. On Date A in Year 1, UST issues UST Note to USS1 in exchange for DS3 stock representing less than 20% of the value and voting power of DS3.

(ii) Analysis. UST is acquiring the stock of DS3, the non-common parent member of a consolidated group. Pursuant to paragraph (b)(5)(i) of this section, the transaction is first analyzed without regard to the one-corporation rule described in paragraph (b)(1) of this section, and therefore UST is treated as issuing a covered debt instrument in exchange for expanded group stock. The exchange of UST Note for DS3 stock is not an exempt exchange within the meaning of §1.385-3(g)(11) because UST and USS1 are not parties to an asset reorganization. Pursuant to paragraph (b)(5)(ii), §1.385-3 (including §1.385-3(b)(2)(ii)) is then applied to the transaction, thereby treating UST Note as stock for federal tax purposes when it is issued by UST to USS1. The UST 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, UST's acquisition of DS3 stock from USS1 in exchange for UST Note is not an acquisition described in section 304(a)(1).

Example (2). Distribution of consolidated group debt instrument. (i) Facts. On Date A in Year 1, DS1 issues DS1 Note to USS1 in a distribution. On Date B in Year 2, USS1 distributes DS1 Note to FP.

(ii) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to another member of DS1's expanded group in a distribution for purposes of §1.385-3(b)(2), and DS1 Note is not treated as stock under §1.385-3. When USS1 distributes DS1 Note to FP, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(ii) of this section, when USS1 distributes DS1 Note to FP, the USS1 consolidated group is treated as issuing DS1 Note to FP in a distribution on Date B in Year 2. Accordingly, DS1 Note is treated as stock under §1.385-3(b)(2)(i). Under paragraph (c)(1)(ii) of this section, DS1 Note is deemed to be exchanged for stock of the issuing member, DS1, immediately after DS1 Note is transferred outside of the USS1 consolidated group. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-13(g)(3)(ii) and the deemed issuance and exchange under paragraph (c)(1)(ii) of this section, are respected as separate steps and treated as separate transactions.

Example (3). Sale of consolidated group debt instrument. (i) Facts. On Date A in Year 1, DS1 lends \$200x of cash to USS1 in exchange for USS1 Note. On Date B in Year 2, USS1 distributes \$200x of cash to FP. Subsequently, on Date C in Year 2, DS1 sells USS1 Note to FS for \$200x.

(ii) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when USS1 issues USS1 Note to DS1 for property on Date A in Year 1, the USS1 consolidated group is not treated as a funded member, and when USS1 distributes \$200x to FP on Date B in Year 2, that distribution is a transaction described in §1.385-3(b)(3)(i)(A), but does not cause USS1 Note to be recharacterized under §1.385-3(b)(3). When DS1 sells USS1 Note to FS, USS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before USS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(ii) of this section, when the USS1 Note is transferred to FS for \$200x on Date C in Year 2, the

USS1 consolidated group is treated as issuing USS1 Note to FS in exchange for \$200x on that date. Because USS1 Note is issued by the USS1 consolidated group to FS within the per se period as defined in §1.385-3(g)(19) with respect to the distribution by the USS1 consolidated group to FP, USS1 Note is treated as funding the distribution under §1.385-3(b)(3)(iii)(A) and, accordingly, is treated as stock under §1.385-3(b)(3). Under §1.385-3(d)(1)(i) and paragraph (c)(1)(ii) of this section, USS1 Note is deemed to be exchanged for stock of the issuing member, USS1, immediately after USS1 Note is transferred outside of the USS1 consolidated group. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-13(g)(3)(ii) and the deemed issuance and exchange under paragraph (c)(1)(ii) of this section, are respected as separate steps and treated as separate transactions.

Example (4). Treatment of consolidated group debt instrument and departing member's disregarded distribution or acquisition when the issuer of the instrument leaves the consolidated group. (i) Facts. The facts are the same as provided in paragraph (f)(1) of this section, except that USS1 and FS own 90% and 10% of the stock of DS1, respectively. On Date A in Year 1, DS1 distributes \$80x of cash and newly-issued DS1 Note, which has a value of \$10x, to USS1. Also on Date A in Year 1, DS1 distributes \$10x of cash to FS. On Date B in Year 2, FS purchases all of USS1's stock in DS1 (90% of the stock of DS1), resulting in DS1 ceasing to be a member of the USS1 consolidated group.

(ii) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, DS1's distribution of \$80x of cash to USS1 on Date A in Year 1 is a disregarded distribution or acquisition, and under paragraph (d)(1) of this section, continues to be a disregarded distribution or acquisition when DS1 ceases to be a member of the USS1 consolidated group. In addition, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to a member of DS1's expanded group in a distribution for purposes of §1.385-3(b)(2)(i), and DS1 Note is not treated as stock under §1.385-3(b)(2)(i). DS1's issuance of DS1 Note to USS1 is also a disregarded distribution or acquisition, and under paragraph (d)(1) of this section, continues to be a disregarded distribution or acquisition when DS1 ceases to be a member of the USS1 consolidated group. The distribution of \$10x cash by DS1 to FS on Date A in Year 1 is a regarded distribution or acquisition. When FS purchases 90% of the stock of DS1's from USS1 on Date B in Year 2 and DS1 ceases to be a member of the USS1 consolidated group, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, for purposes of §1.385-3, DS1 is treated as issuing a new debt instrument to USS1 in exchange for property immediately after DS1 Note ceases to be a consolidated group debt instrument. Under paragraph (d)(4)(i) of this section, the departing member, DS1 (and not the USS1 consolidated group) is treated as having distributed \$10x to FS on Date A in Year 1 (a regarded distribution or acquisition) for purposes of applying §1.385-3(b)(3) after DS1 ceases to be a member of the USS1 consolidated group. Because DS1 Note is reissued by DS1 to USS1 within the per se period (as defined in §1.385-3(g)(19)) with respect to DS1's regarded distribution to FS, DS1 Note is treated as funding the distribution under §1.385-3(b)(3)(iii)(A) and, accordingly, is treated as stock under §1.385-3(b)(3). Under §1.385-3(d)(1)(i) and paragraph (c)(1)(i) of this section, DS1 Note is immediately deemed to be exchanged for stock of DS1 on Date B in Year 2. Under paragraph (c)(3) of this section, the deemed satisfaction and reissuance under §1.1502-

13(g)(3)(ii) and the deemed issuance and exchange under paragraph (c)(1)(i) of this section are respected as separate steps and treated as separate transactions. Under §1.385-3(d)(7)(i), after DS1 Note is treated as stock held by USS1, DS1 Note is not treated as stock for purposes of determining whether DS1 is a member of the USS1 consolidated group.

Example (5). Treatment of consolidated group debt instrument and consolidated group's regarded distribution or acquisition. (i) Facts. On Date A in Year 1, DS1 issues DS1 Note to USS1. On Date B in Year 2, USS1 distributes \$100x of cash to FP. On Date C in Year 3, USS1 sells all of its interest in DS1 to FS, resulting in DS1 ceasing to be a member of the USS1 consolidated group.

(ii) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, when DS1 issues DS1 Note to USS1 in a distribution on Date A in Year 1, DS1 is not treated as issuing a debt instrument to a member of DS1's expanded group in a distribution for purposes of §1.385-3(b)(2)(i), and DS1 Note is not treated as stock under §1.385-3(b)(2)(i). DS1's issuance of DS1 Note to USS1 is also a disregarded distribution or acquisition, and under paragraph (d)(1) of this section, continues to be a disregarded distribution or acquisition when DS1 ceases to be a member of the USS1 consolidated group. The distribution of \$100x cash by DS1 to USS1 on Date B in Year 2 is a regarded distribution or acquisition. When FS purchases all of the stock of DS1 from USS1 on Date C in Year 3 and DS1 ceases to be a member of the USS1 consolidated group, DS1 Note is deemed satisfied and reissued under §1.1502-13(g)(3)(ii), immediately before DS1 Note ceases to be an intercompany obligation. Under paragraph (c)(1)(i) of this section, for purposes of §1.385-3, DS1 is treated as issuing a new debt instrument to USS1 in exchange for property immediately after DS1 Note ceases to be a consolidated group debt instrument. Under paragraph (d)(4)(ii) of this section, the USS1 consolidated group (and not DS1) is treated as having distributed \$100x to FP on Date B in Year 2 (a regarded distribution or acquisition) for purposes of applying §1.385-3(b)(3) after DS1 ceases to be a member of the USS1 consolidated group. Because DS1 has not engaged in a regarded distribution or acquisition that would have been treated as funded by the reissued DS1 Note, the reissued DS1 Note is not treated as stock.

Example (6). Treatment of departing member's issuance of a covered debt instrument. (i) Facts. On Date A in Year 1, FS lends \$100x of cash to DS1 in exchange for DS1 Note. On Date B in Year 2, USS1 distributes \$30x of cash to FP. On Date C in Year 2, USS1 sells all of its DS1 stock to FP, resulting in DS1 ceasing to be a member of the USS1 consolidated group.

(ii) Analysis. Under paragraph (b)(1) of this section, the USS1 consolidated group is treated as one corporation for purposes of §1.385-3. Accordingly, on Date A in Year 1, the USS1 consolidated group is treated as issuing DS1 Note to FS, and on Date B in Year 2, the USS1 consolidated group is treated as distributing \$30x of cash to FP. Because DS1 Note is issued by the USS1 consolidated group to FS within the per se period as defined in §1.385-3(g)(19) with respect to the distribution by the USS1 consolidated group of \$30x cash to FP, \$30x of DS1 Note is treated as funding the distribution under §1.385-3(b)(3)(iii)(A), and, accordingly, is treated as stock on Date B in Year 2 under §1.385-3(b)(3) and §1.385-3(d)(1)(ii). Under paragraph (d)(3) of this section, DS1 (and not the USS1 consolidated group) is treated as the issuer of the remaining portion of DS1

Note for purposes of applying §1.385-3(b)(3) after DS1 ceases to be a member of the USS1 consolidated group.

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

(h)Expiration date. This section expires on October 13, 2019.