
Section 385 regulations summary chart

November 2, 2016

In brief

US Treasury and the IRS released final and temporary Section 385 regulations on October 13, 2016. These regulations address whether certain instruments between related parties are treated as debt or equity.

PwC has created a one-page (11 x 17) summary chart to help you think through these very complex regulations. Note that this summary chart should be your first step in analyzing how the regulations might impact your company. For additional guidance on the Section 385 regulations, please reach out to your regular PwC contact, or one of the contacts listed below.

In addition, PwC is hosting a webcast on the Section 385 regulations on Thursday, November 3, at 12:00pm ET. You are welcome to [register](#) for this webcast if you have not already.

Let's talk

Chip Harter
(202) 414-1308
chip.harter@pwc.com

Wade Sutton
(202) 346-5188
william.w.sutton@pwc.com

Krishnan Chandrasekhar
(312) 298-2567
krishnan.chandrasekhar@pwc.com

Pam Olson
(202) 414-1401
pam.olson@pwc.com

David Schenck
(202) 346-5235
david.a.schenck@pwc.com

Jeff Maddrey
(202) 414-4350
jeffrey.maddrey@pwc.com

Trent Johnson
(202) 414-1484
trent.h.johnson@pwc.com

Gabe Gartner
(408) 808-2901
gabe.gartner@pwc.com

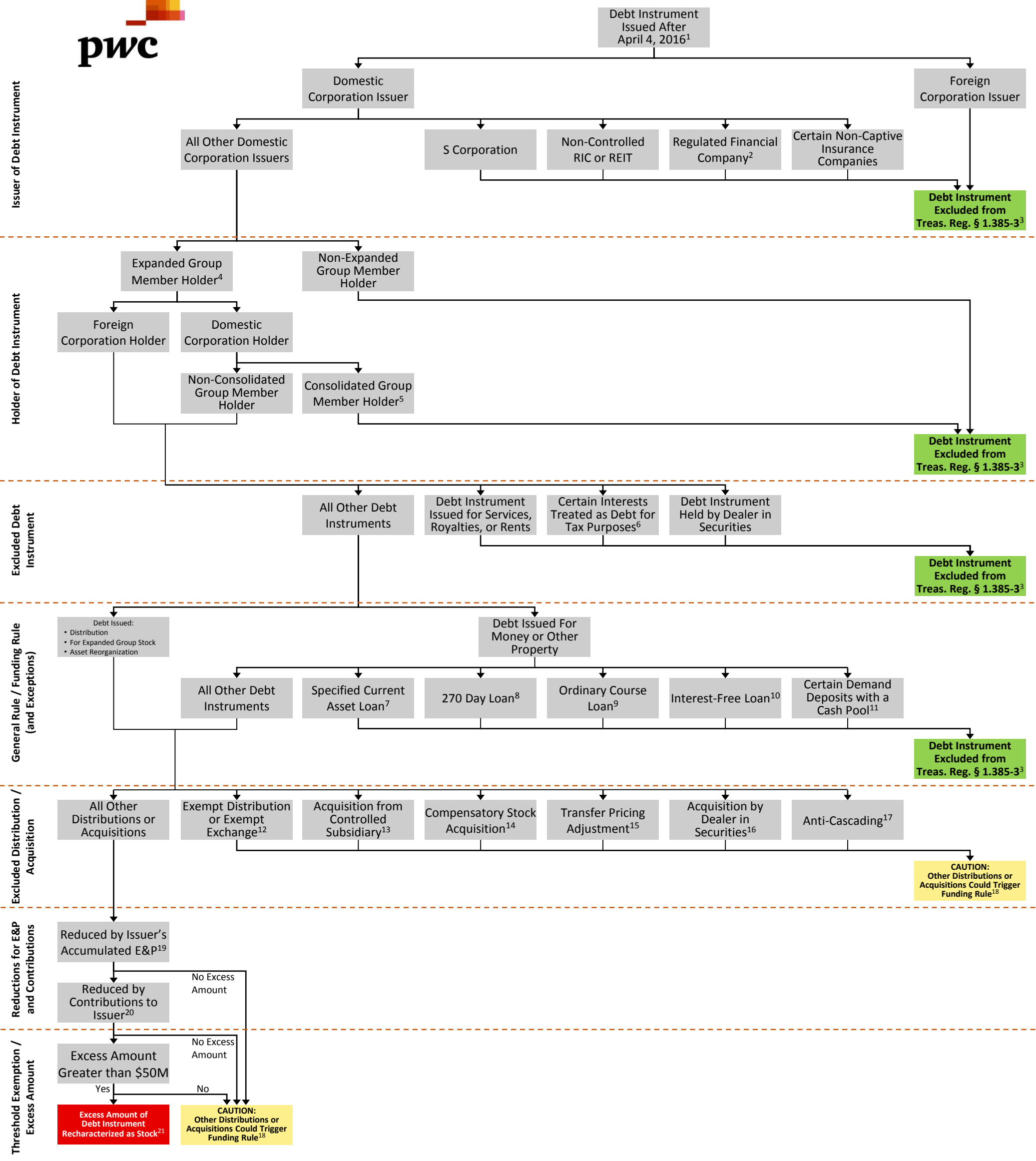
Robert Black
(408) 817-5750
robert.s.black@pwc.com

Aaron Junge
(202) 414-1857
aaron.h.junge@pwc.com

Jared Hermann
(202) 312-7940
jared.a.hermann@pwc.com

Viraj Patel
(408) 817-3969
viraj.d.patel@pwc.com

Treas. Reg. § 1.385-3 Summary Chart



¹ A debt instrument issued by an entity that is disregarded for U.S. federal tax purposes generally is treated as issued by its disregarded owner. A debt instrument issued by a "controlled partnership" (i.e., a partnership at least 80 percent of the capital or profits of which are owned by expanded group members) generally is treated as issued proportionately by its partners. Treas. Reg. § 1.385-3 also applies to a debt instrument issued on or before April 4, 2016 that has undergone certain types of "significant modifications" under Treas. Reg. § 1.1001-3 after April 4, 2016.

² A "regulated financial company" includes a bank holding company, a national bank, a bank that is a member of the Federal Reserve System, certain brokers or dealers registered with the SEC, and certain members of a regulated financial group.

³ Note that a debt instrument may be treated as stock pursuant to the "anti-abuse rule" if the debt instrument is issued, or an expanded group member engages in a transaction, with a principal purpose of avoiding the purposes of Treas. Reg. § 1.385-3.

⁴ An "expanded group" generally is a corporate group with a common parent that owns (directly or indirectly) at least 80 percent of the voting power or value of each subsidiary.

⁵ A "consolidated group" generally is a corporate group (i) with a U.S. common parent that owns (directly or indirectly) at least 80 percent of the voting power and value of each U.S. subsidiary that (ii) files a U.S. consolidated federal income tax return. A debt instrument that ceases to be held within a consolidated group (but remains within the expanded group) as a result of (i) the issuer or the holder ceasing to be a member of the consolidated group, or (ii) the debt instrument being transferred outside the consolidated group, will be subject to the rules of Treas. Reg. § 1.385-4T.

⁶ The following interests are excluded from Treas. Reg. § 1.385-3: (i) a production payment with respect to mineral property; (ii) a "regular interest" in a REMIC; (iii) a debt instrument established in connection with a transfer pricing adjustment under Rev. Proc. 99-32; (iv) a striped bond or a striped coupon; or (v) a lease treated as a loan under IRC § 467.

⁷ The "specified current asset" exception generally requires that (i) the interest rate does not exceed the arm's length rate that would be charged on a loan with a term of 90 days and (ii) the total amount owed by the issuer under the various short-term debt instrument exceptions does not exceed the maximum amount of "specified current assets" (i.e., assets realized in cash or sold) reasonably expected to be reflected on the issuer's balance sheet in the subsequent 90 days. Note that either the "specified current asset" exception or the "270 day loan" exception (but not both) may apply for a particular tax year.

⁸ The "270 day loan" exception generally requires that (i) the debt instrument has a term of no more than 270 days or is an advance under a revolving credit agreement, (ii) the interest rate does not exceed the arm's length rate that would be charged on a loan with a term of 270 days, and (iii) the issuer is a net borrower from (x) the lender for no more than 270 days during the tax year (or 270 consecutive days over two tax years) and (y) all expanded group members for no more than 270 days during the tax year. Note that either the "specified current asset" exception or the "270 day loan" exception (but not both) may apply for a particular tax year.

⁹ An "ordinary course loan" generally is a debt instrument issued for property (other than money) in the ordinary course of business that is reasonably expected to be repaid within 120 days.

¹⁰ An "interest free loan" generally is a debt instrument that does not provide for interest and does not have OID (or other imputed interest).

¹¹ A demand deposit generally must be received (i) by a "qualified cash pool header" (which has as its principal purpose managing a "cash management arrangement" for participating expanded group members) (ii) pursuant to a "cash management arrangement" (e.g., borrowing excess funds, lending funds, managing FX exposure, settling intercompany accounts, and investing excess cash).

¹² An "exempt distribution" generally is (i) a distribution of stock to a shareholder in a tax-free reorganization or (ii) a distribution of property in a liquidation. An "exempt exchange" generally is an acquisition of stock (i) by the acquiring corporation or target corporation pursuant to an asset reorganization, (ii) from a shareholder in a liquidation, or (iii) deemed to arise pursuant to a deemed capital contribution under Treas. Reg. § 1.1032-3(b).

¹³ The "controlled subsidiary" exception generally applies to an acquisition of stock by a parent from a subsidiary where the parent (i) owns (directly or indirectly) more than 50 percent of the voting power and value of such subsidiary and (ii) does not relinquish such ownership pursuant to a plan (which is presumed to exist if such ownership is relinquished within the following 36 months).

¹⁴ The "compensatory stock acquisition" exception generally applies to an acquisition of stock that is delivered to an employee, director, or independent contractor as consideration for services.

¹⁵ The "transfer pricing adjustment" exception generally applies to a deemed distribution or deemed acquisition of stock arising as a result of a transfer pricing adjustment under Treas. Reg. § 1.482-1(g).

¹⁶ The "dealer in securities" exception generally applies to an acquisition of stock by a dealer in securities in the ordinary course of its business.

¹⁷ The "anti-cascading" exception generally applies to the acquisition of a debt instrument that is recharacterized as stock under Treas. Reg. § 1.385-3.

¹⁸ The "funding rule" generally provides that a debt instrument issued for money (or other property) will be recharacterized as stock to the extent that, within 36 months before or after the issuance of the debt instrument, the issuer (i) makes a distribution of money (or other property), (ii) acquires stock of an expanded group member for money (or other property), or (iii) acquires a target corporation pursuant to an asset reorganization for money (or other property). Note that acquisitions or distributions arising before April 5, 2016 are not taken into account for purposes of the "funding rule."

¹⁹ The amount of distributions or acquisitions otherwise subject to Treas. Reg. § 1.385-3 for a tax year generally is reduced by the total "earnings and profits" of the issuer accumulated in tax years ending after April 4, 2016.

²⁰ The amount of distributions or acquisitions otherwise subject to Treas. Reg. § 1.385-3 generally is reduced by the total value of property (other than certain "excluded property") contributed to the issuer during the 36 months before or after the date of the distribution or acquisition (but no later than the close of the first tax year in which the debt instrument would otherwise be treated as stock under Treas. Reg. § 1.385-3).

²¹ A debt instrument issued after April 4, 2016 but before January 19, 2017 is subject to certain transition rules.