

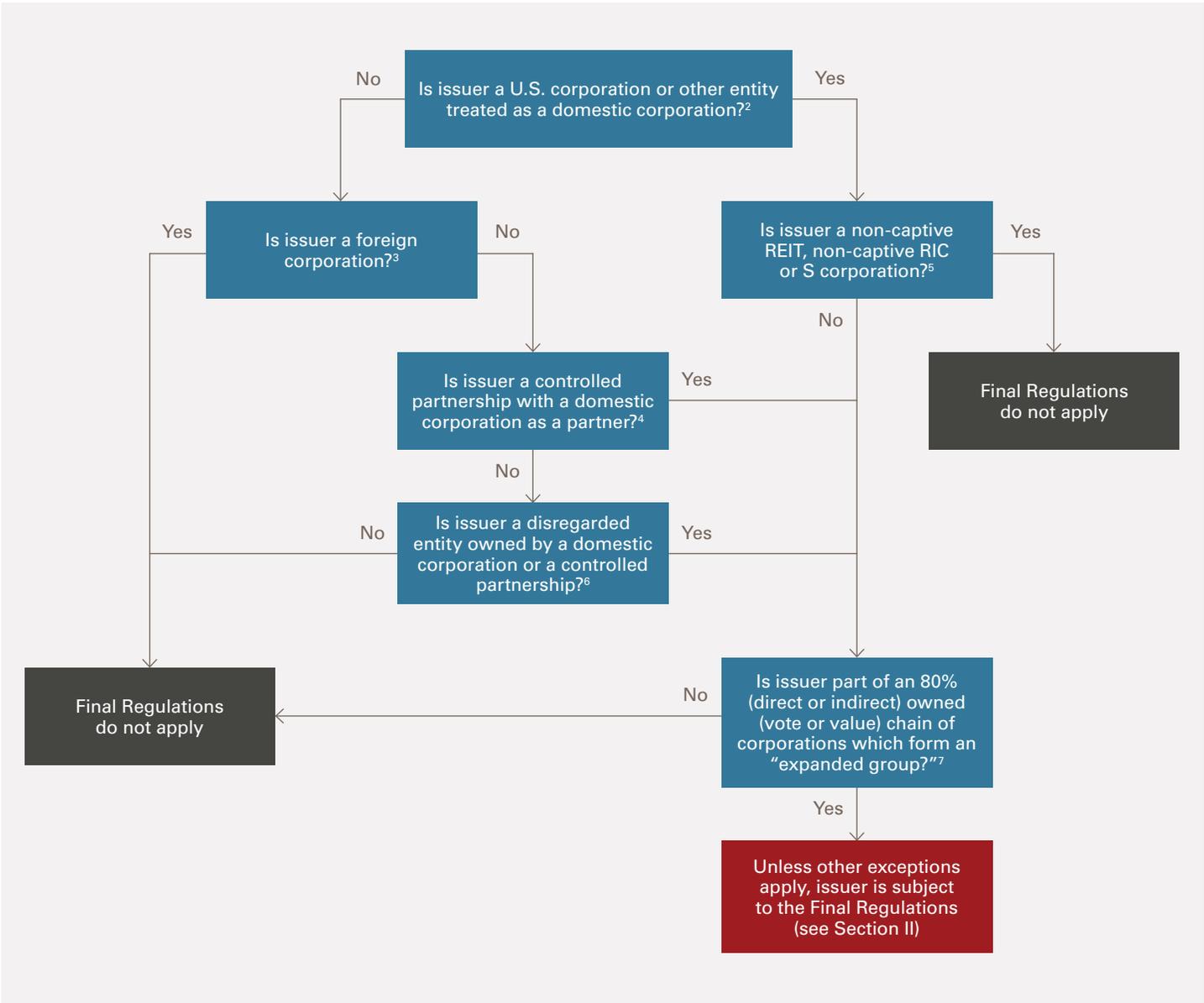
10/25/16

# The Skadden Guide to the Final and Temporary Section 385 Regulations

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As of October 13, 2016

# I. Issuers Subject to the Final Regulations<sup>1</sup>



<sup>1</sup> These regulations were issued on October 13, 2016, and supplant proposed regulations issued on April 4, 2016. This flowchart is only intended to provide an overview of the Final Regulations and does not address all taxpayers and all situations. Please consult with your Skadden tax advisor for a more detailed discussion of these provisions.

<sup>2</sup> Treas. Reg. § 1.385-1(c)(2)(i).

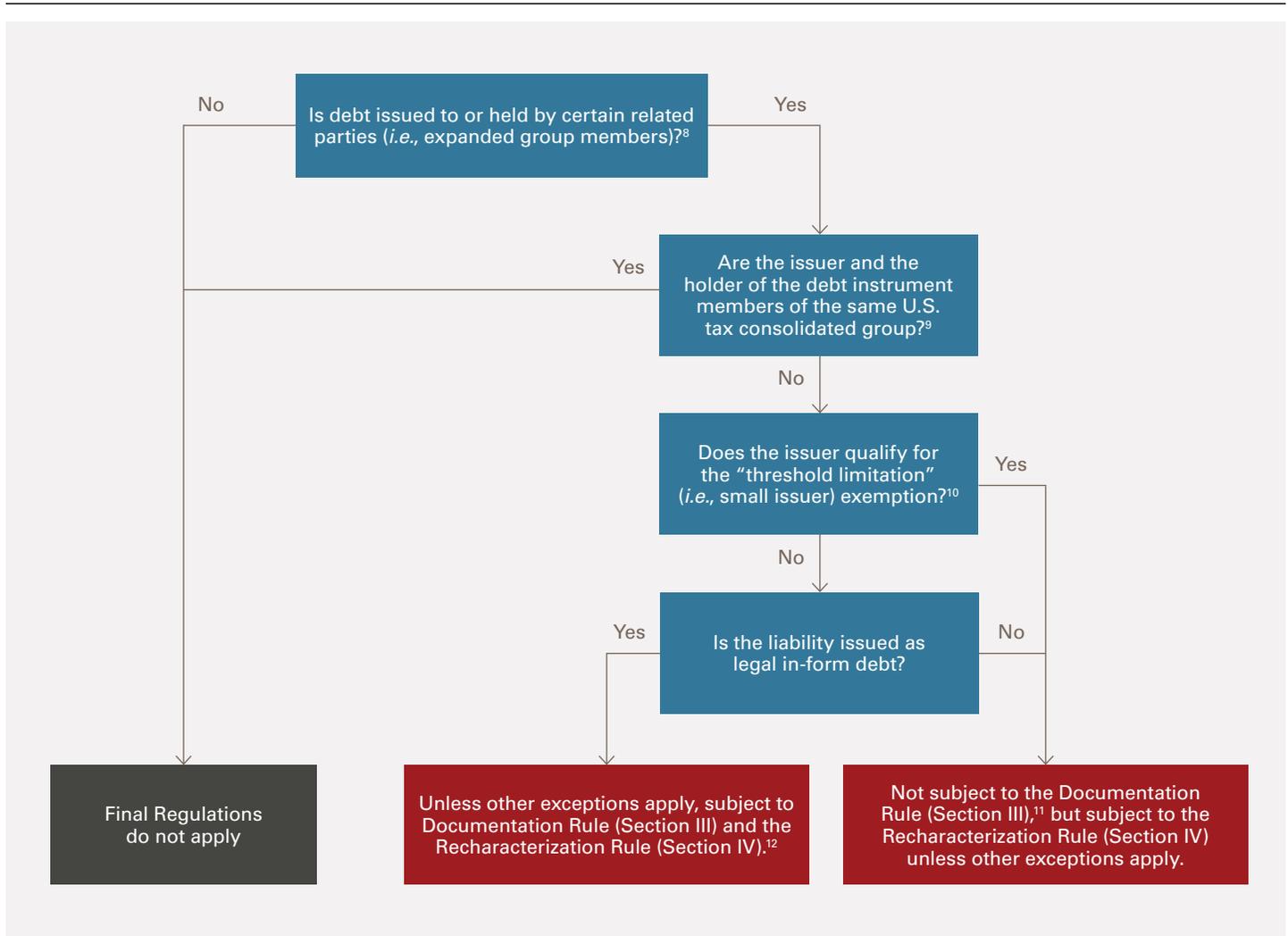
<sup>3</sup> Treas. Reg. § 1.385-1(c)(2)(ii) (reserved).

<sup>4</sup> Treas. Reg. § 1.385-1(c)(1). A controlled partnership means a partnership where at least 80 percent of the interest in the partnership capital or profits is owned, directly or indirectly, by members of the expanded group. See note 7 for the definition of expanded group. Debt issued by a controlled partnership is generally treated as issued by its partners. Treas. Reg. § 1.385-3T(f)(3)(i).

<sup>5</sup> Treas. Reg. § 1.385-1(c)(4).

<sup>6</sup> Treas. Reg. § 1.385-1(c)(3).

<sup>7</sup> Generally, for these purposes, an expanded group is one or more chains of corporations connected through stock ownership where the common parent or other members of the expanded group own, directly or indirectly, 80% or more of the vote or value in the other corporations. Treas. Reg. § 1.385-1(c)(4). For these purposes, a U.S. consolidated group of corporations is generally treated as one corporation.



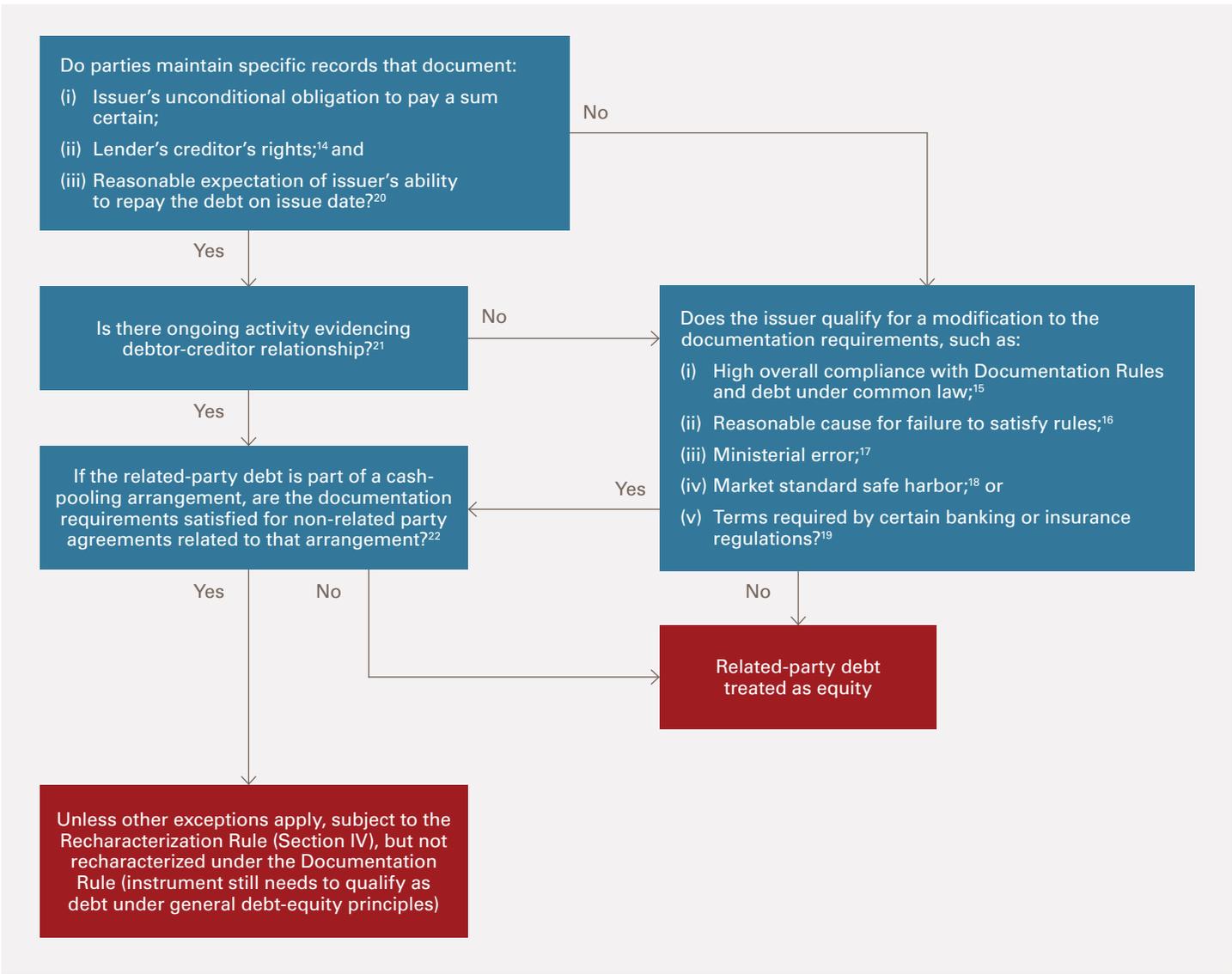
<sup>8</sup> For these purposes and subject to common law principles, certain third party debt guaranteed by a related party is not treated as related-party debt.

<sup>9</sup> Members of the same consolidated group are generally treated as one corporation. Treas. Reg. § 1.385-4T(b).

<sup>10</sup> Treas. Reg. § 1.385-2(a)(3)(ii).

<sup>11</sup> Anti-abuse rules may apply. Treas. Reg. § 1.385-2(a)(4).

<sup>12</sup> This generally includes loans from CFCs to related U.S. corporations.



<sup>13</sup> Effective for debt instruments issued after January 1, 2018. Documentation must be completed by due date of issuer's tax return for the year of issuance (including extensions).

<sup>14</sup> Treas. Reg. § 1.385-2(c)(2)(i) and (ii).

<sup>15</sup> Treas. Reg. § 1.385-2(b)(2)(i) (with certain exceptions).

<sup>16</sup> Treas. Reg. § 1.385-2(b)(2)(ii).

<sup>17</sup> Treas. Reg. § 1.385-2(b)(2)(iii).

<sup>18</sup> Treas. Reg. § 1.385-2(c)(1)(ii).

<sup>19</sup> Treas. Reg. § 1.385-2(c)(1)(iii).

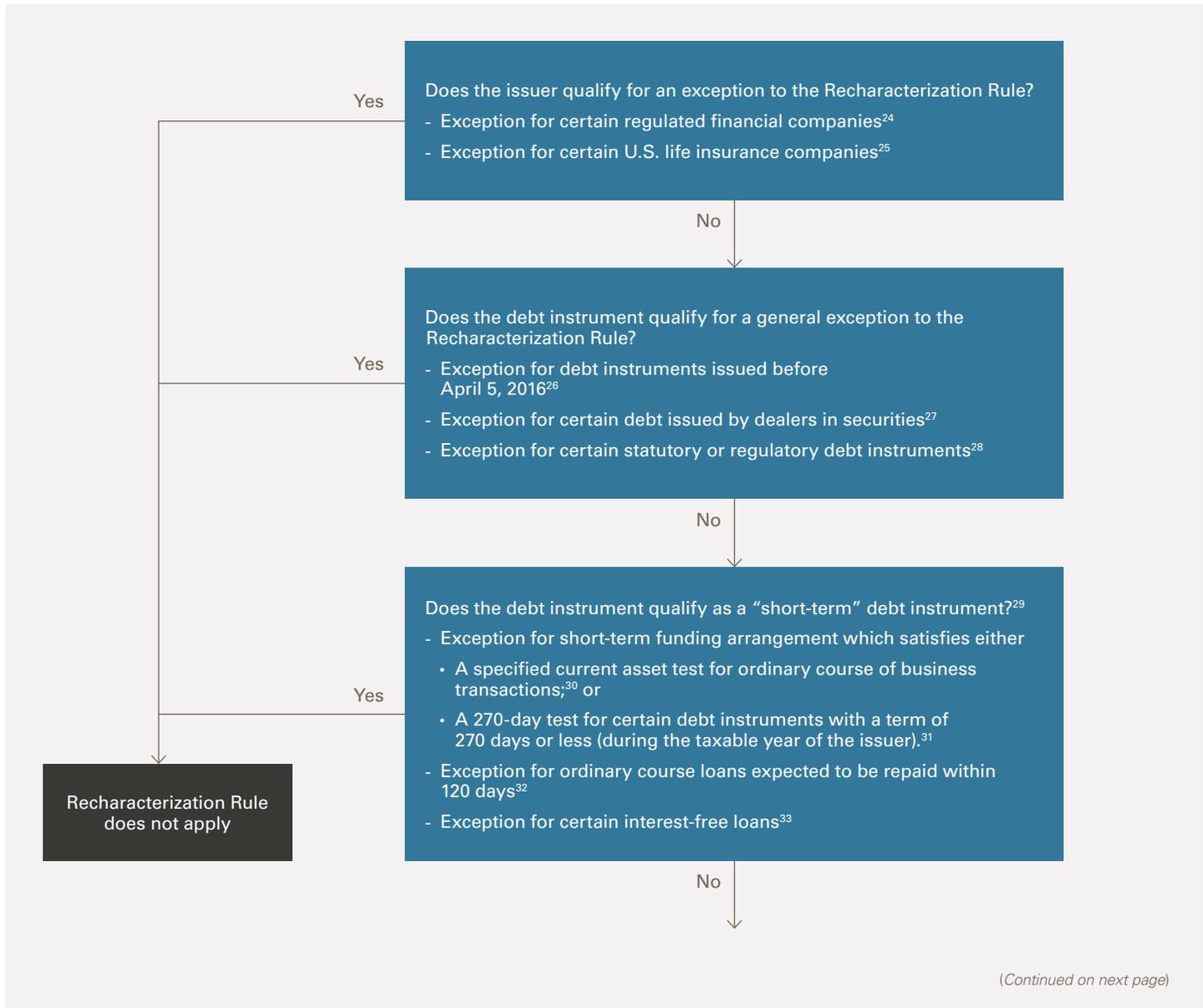
<sup>20</sup> Treas. Reg. § 1.385-2(c)(2)(iii).

<sup>21</sup> Treas. Reg. § 1.385-2(c)(2)(iv).

<sup>22</sup> Treas. Reg. § 1.385-2(c)(3)(i)(B). Based on the Preamble to the regulations, this provision also applies to notional cash pool arrangements.

# IV. Application of the Recharacterization Rule<sup>23</sup>

The Recharacterization Rule, which includes the General Rule and the Funding Rule, recharacterizes as stock certain debt instruments issued to expanded group members in certain prohibited transactions, such as a distribution (the General Rule), or, if not issued in such a transaction, that are otherwise issued close in time with or with a principal purpose of funding such prohibited transactions (the Funding Rule).

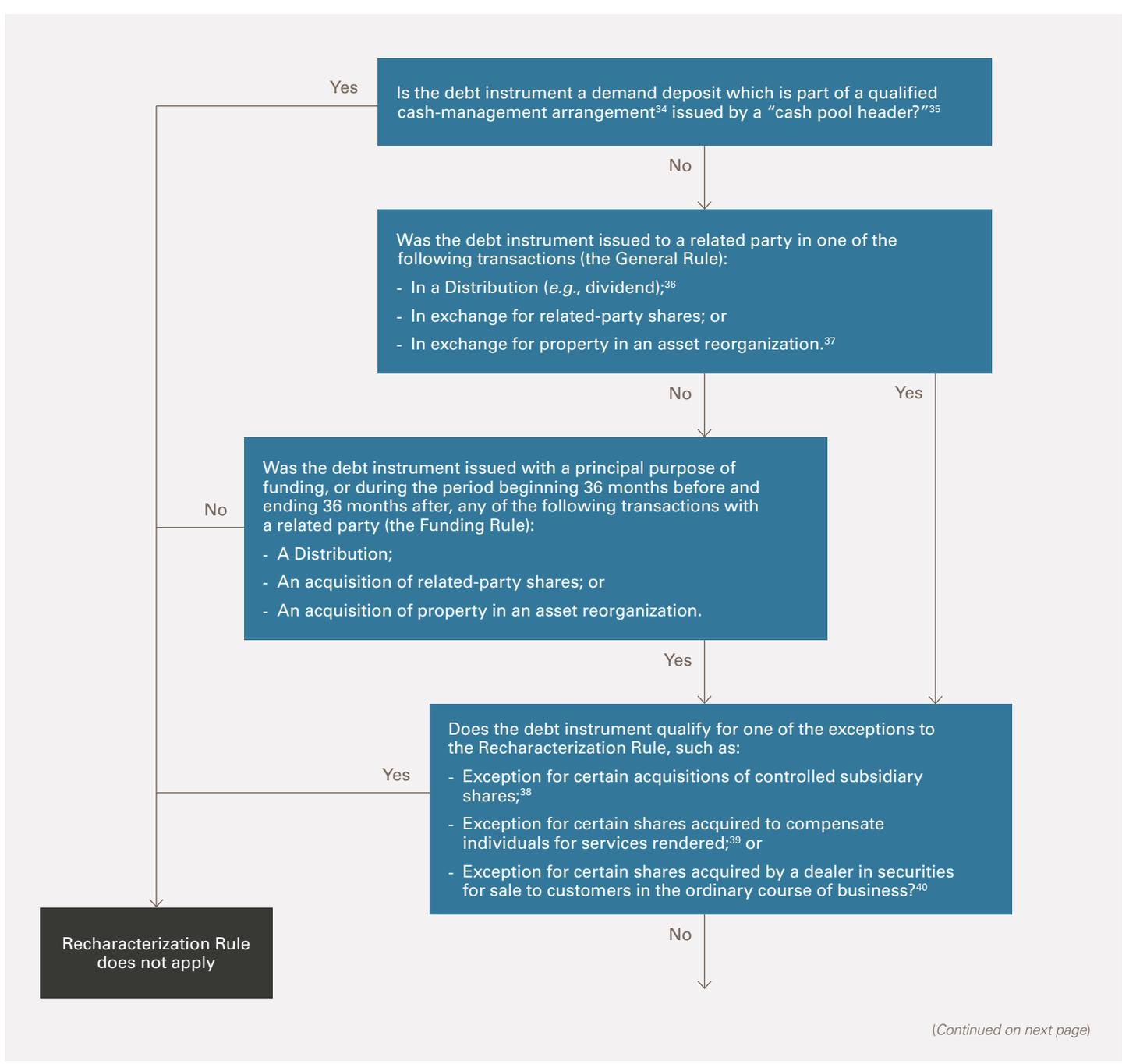


<sup>23</sup>Under Treasury Regulation section 1.385-3, if the General Rule or the Funding Rule applies, certain related-party debt may be treated as equity at the time of issuance or in a subsequent taxable year.  
<sup>24</sup>Treas. Reg. § 1.385-3(g)(3)(iv). This exception includes certain banks and broker dealers. However, the Funding Rule does apply to certain non-bank subsidiaries of financial holding companies, certain merchant bank and related companies and certain grandfathered financial holding companies.  
<sup>25</sup>Treas. Reg. § 1.385-3(g)(3)(v). However, this exception does not apply to, for example, U.S. holding companies of property and casualty insurance companies.  
<sup>26</sup>Treas. Reg. § 1.385-3(g)(3)(i).

<sup>27</sup>Treas. Reg. § 1.385-5(g)(3)(iii).  
<sup>28</sup>Treas. Reg. § 1.385-3(g)(3)(iii). These debt instruments include certain production payments, REMIC regular interests and certain leases treated as loans.  
<sup>29</sup>Treas. Reg. § 1.385-3T(b)(3)(viii).  
<sup>30</sup>Treas. Reg. § 1.385-3T(b)(3)(viii)(A)(1).  
<sup>31</sup>Treas. Reg. § 1.385-3T(b)(3)(viii)(A)(2).  
<sup>32</sup>Treas. Reg. § 1.385-3T(b)(3)(viii)(B).  
<sup>33</sup>Treas. Reg. § 1.385-3T(b)(3)(viii)(C).

# IV. Application of the Recharacterization Rule

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<sup>34</sup>Treas. Reg. § 1.385-3T(b)(3)(viii)(D). For these purposes, a “cash-management arrangement” means an arrangement the principal purpose of which is the borrowing and lending of excess cash between related parties (including foreign exchange management and investing excess cash with an unrelated person).  
Treas. Reg. § 1.385-3T(b)(3)(viii)(D)(3).

<sup>35</sup>A “cash pool header” is a group member, controlled partnership or QBU whose principal purpose is managing a “cash-management arrangement” for related parties. Treas. Reg. § 1.385-3T(b)(3)(viii)(D)(2).

<sup>36</sup>Distributions received in complete liquidation, certain stock reorganizations and section 355 transactions are exempt as are distributions to persons that are

not members of the expanded group. Treas. Reg. § 1.385-3(g)(10). However, payments on debt instruments, including refinancing, that have not been converted to equity solely as a result of the transition rules are considered distributions under Treasury Regulation section 1.385-3(b)(3).  
Treas. Reg. § 1.385-3(j)(2)(iii).

<sup>37</sup>Treas. Reg. § 1.385-3(a)(2).

<sup>38</sup>Treas. Reg. § 1.385-3(c)(2)(i).

<sup>39</sup>Treas. Reg. § 1.385-3(c)(2)(ii).

<sup>40</sup>Treas. Reg. § 1.385-3(c)(2)(iv).

# IV. Application of the Recharacterization Rule

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<sup>41</sup>Treas. Reg. § 1.385-3(c)(2)(ii).  
<sup>42</sup>Treas. Reg. § 1.385-3(c)(2)(i).  
<sup>43</sup>Treas. Reg. § 1.385-3(c)(4).