

Supporting Statement
(Treatment of certain interests between members
of an expanded group as indebtedness)
1545-XXXX

1. CIRCUMSTANCES NECESSITATING COLLECTION OF INFORMATION

Section 385(a) authorizes the Secretary to prescribe such regulations as may be necessary or appropriate to determine whether an interest in a corporation is to be treated as stock or indebtedness for federal tax purposes in particular situations. Related party transactions may not be subject to, and frequently do not adhere to, standard commercial practices of third-party transactions. As a result, the documentation and information necessary to determine the treatment of an EGI as stock or indebtedness for federal tax purposes is often incomplete or unavailable.

Section 1.385-2 prescribes the documentation and information that must be prepared, maintained, and provided by persons claiming that an EGI is indebtedness for federal tax purposes. Satisfying the requirements of this section does not establish that an interest is indebtedness; such satisfaction serves as a minimum standard that enables this determination to be made under general federal tax principles.

2. USE OF DATA

This information will be used by IRS to determine the treatment of an EGI as stock or indebtedness for federal tax purposes.

Failure to provide the documentation and information described in this regulation section upon request will result in the EGI being treated as stock for all federal tax purposes.

3. USE OF IMPROVED INFORMATION TECHNOLOGY TO REDUCE BURDEN

We have no plans at this time to offer electronic filing.

Section 1.385-2(b)(2) sets forth the documentation and information that must be prepared, maintained, and provided to satisfy the requirements of this section.

4. EFFORTS TO IDENTIFY DUPLICATION

We have attempted to eliminate duplication within the agency wherever possible. Section 1.385-2(b)(1) provides that while the rule applies to each instrument separately, there are situations in which the same documentation and

information may satisfy the documentation and information requirements for multiple instruments.

5. **METHODS TO MINIMIZE BURDEN ON SMALL BUSINESSES OR OTHER SMALL ENTITIES**

There are no small businesses or entities affected by this collection.

6. **CONSEQUENCES OF LESS FREQUENT COLLECTION ON FEDERAL PROGRAMS OR POLICY ACTIVITIES**

This section prescribes the documentation and information that must be prepared and maintained by persons claiming that an EGI is indebtedness for federal tax purposes. Related party transactions may not be subject to, and frequently do not adhere to, standard commercial practices of third-party transactions. As a result, the documentation and information necessary to determine the treatment of an EGI as stock or indebtedness for federal tax purposes is often incomplete or unavailable.

This will affect proper tax reporting and compromise the Agency's ability to enforce tax compliance. Tax compliance is a vital part of the government's ability to meet its mission and serve the public.

7. **SPECIAL CIRCUMSTANCES REQUIRING DATA COLLECTION TO BE INCONSISTENT WITH GUIDELINES IN 5 CFR 1320.5(d)(2)**

There are no special circumstances requiring data collection to be inconsistent with Guidelines in 5 CFR 1320.5(d)(2).

8. **CONSULTATION WITH INDIVIDUALS OUTSIDE OF THE AGENCY ON AVAILABILITY OF DATA, FREQUENCY OF COLLECTION, CLARITY OF INSTRUCTIONS AND FORMS, AND DATA ELEMENTS**

This notice of proposed rulemaking was published in the Federal Register (81 FR 20912), on April 8, 2016, to provide the public a 90-day period in which to review and provide public comments relating to any aspect of the proposed regulation. A public hearing will be held with respect to this NPRM if any person who has submitted written comments requests one.

9. **EXPLANATION OF DECISION TO PROVIDE ANY PAYMENT OR GIFT TO RESPONDENTS**

No payment or gift has been provided to any respondents.

10. ASSURANCE OF CONFIDENTIALITY OF RESPONSES

Generally, tax returns and tax return information are confidential as required by 26 U.S.C. 6103.

11. JUSTIFICATION OF SENSITIVE QUESTIONS

No personally identifiable information (PII) is collected.

12. ESTIMATED BURDEN OF INFORMATION COLLECTION

The proposed regulation prescribes threshold requirements that must be satisfied regarding the preparation, maintenance, and provision of documentation and information with respect to an expanded group instrument (an EGI, as defined in the regulation) to enable an analysis to be made whether the EGI is appropriately treated as stock or indebtedness for federal tax purposes

The documentation and information must satisfy the following requirements:

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

(ii) **Creditor's rights.** The written documentation must establish that the holder has the rights of a creditor to enforce the obligation. The rights of a creditor typically include, but are not limited to, the right to cause or trigger an event of default or acceleration of the EGI (when the event of default or acceleration is not automatic) for non-payment of interest or principal when required under the terms of the EGI, the right to liquidate assets or force the liquidation of assets of the issuer, and the right to block other distributions by the issuer.

(iii) **Reasonable expectation of ability to repay EGI.** There must be written documentation containing information sufficient to determine the extent to which, as of the date of issuance of the applicable instrument and taking into account all relevant circumstances (including all other obligations incurred by the issuer as of the date of issuance of the applicable instrument or reasonably anticipated to be incurred after the date of issuance of the applicable instrument), the issuer's financial position supported a reasonable expectation that the issuer would be able to meet its obligations pursuant to the terms of the applicable instrument. The documentation may include cash flow projections, financial statements, business forecasts, asset appraisals, determination of debt-to-equity and other relevant financial ratios of the issuer in relation to industry averages, and other information regarding the sources of funds enabling the issuer to meet its obligations pursuant to the terms of the applicable instrument.

If any member of an expanded group relied on any report or analysis prepared by a third party in analyzing whether the issuer would be able to meet its obligations pursuant to the terms of the EGI, the documentation must include the report or analysis. If the report or analysis is protected or privileged under law governing an inquiry or proceeding with respect to the EGI and the protection or privilege is asserted, neither the existence nor the contents of the report or analysis is taken into account in determining whether the requirements of this section are satisfied.

(iv) **Actions evidencing debtor-creditor relationship.** If an obligor made any payment of interest or principal with respect to the EGI (whether in accordance with the terms and conditions of the EGI or otherwise, including prepayments), and such payment is claimed to support the treatment of the EGI as indebtedness, documentation must include written evidence of such payment. Such evidence could include, for example, a wire transfer record or a bank statement reflecting the payment. If the issuer did not make a payment of interest or principal that was due and payable under the terms and conditions of the EGI, or if any other event of default or similar event has occurred, the documentation must include evidence of the holder's reasonable exercise of the diligence and judgment of a creditor. Such documentation may include evidence of the holder's efforts to assert its rights under the terms of the EGI, including the parties' efforts to renegotiate the EGI or to mitigate the breach of an obligation under the EGI, or any change in material terms and conditions of the EGI, such as maturity date, interest rate, or obligation to pay interest or principal, and any documentation detailing the holder's decision to refrain from pursuing any actions to enforce payment.

We estimate that there are 21,000 taxpayers per year that will need to determine whether the EGI is appropriately treated as stock or indebtedness for federal tax purposes as described in the proposed regulation. We estimate that it will take an average of 35 hours (between 30 and 40 hours) per taxpayer each year to comply. The total burden estimated per year is 735,000 hours.

13. ESTIMATED TOTAL ANNUAL COST BURDEN TO RESPONDENTS

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information are not available at this time.

14. ESTIMATED ANNUALIZED COST TO THE FEDERAL GOVERNMENT

There are no annualized costs to the Federal government.

15. REASONS FOR CHANGE IN BURDEN

This is a new regulation.

16. PLANS FOR TABULATION, STATISTICAL ANALYSIS AND PUBLICATION

There are no plans for tabulation, statistical analysis and publication.

17. REASONS WHY DISPLAYING THE OMB EXPIRATION DATE IS INAPPROPRIATE

We believe that displaying the OMB expiration date is inappropriate because it could cause confusion by leading taxpayers to believe that the regulation sunsets as of the expiration date. Taxpayers are not likely to be aware that the Service intends to request renewal of OMB approval and obtain a new expiration date before the old one expires.

18. EXCEPTIONS TO THE CERTIFICATION STATEMENT

There are no exceptions to the certification statement.

Note: The following paragraph applies to all of the collections of information in this submission:

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.