

Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware



www.meritas.org

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IRS and Treasury Release Final and Temporary Debt-Equity Regulations

The IRS and the Treasury Department on Oct. 13 issued final and temporary (T.D. 9790, <https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-25105.pdf>) Section 385 debt-equity regulations, removing the bifurcation rule that was in the proposed regulations but largely preserving the remaining rules, with exemptions for cash pools, short-term loans, foreign-to-foreign transactions, regulated financial entities and pass-throughs, and providing documentation relief for debt issued by U.S. corporations. (Section references are to the Internal Revenue Code of 1986, as amended.)

The final and temporary regulations total 518 pages. The proposed regulations (REG-108060-15, <https://www.federalregister.gov/documents/2016/06/21/2016-14734/treatment-of-a-certain-interests-in-corporations-as-stock-or-indebtedness-hearing>) released in April were a mere 136 pages (see our prior coverage at <http://www.stradley.com/insights/publications/2016/tax-insights-2016/tax-insights-april-13-2016>). The temporary regulations also serve as the text of simultaneously released proposed regulations (REG-130314-16, <https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-25104.pdf>). Generally, the portions of the rules that address cash pooling and instruments issued by financial institutions are temporary and will expire in three years if not finalized. The final and temporary regulations apply, in general, to tax years ending after Jan. 18, 2017.

According to the IRS, in response to the comments received, the final and temporary regulations revise the prior proposed regulations to minimize the burdens imposed on taxpayers and narrowly target the transactions of greatest concern while still being administrable. The final and temporary regulations do not include the bifurcation rule of Proposed Regulations Section 1.385-1, which would have allowed the IRS to bifurcate a single financial instrument between related parties into components of debt and equity. The IRS continues to study the potential issues raised by such a rule. Also, the final and temporary regulations do not apply to foreign issuers. The IRS notes that the final regulations “reserve on all aspects of ... [the regulation’s] application to foreign issuers.”

IRS Can Require Pass-Through to File Form 3468 for Rehab Credit

The IRS determined in Chief Counsel Advice 201641022 (https://www.irs.gov/pub/irs-wd/201641022.pdf?_ga=1.266797260.334448623.1476662568) that for purposes of the rehabilitation credit, if a pass-through entity is not an owner of a qualified rehabilitated building and certified historic structure, but is merely a conduit passing through the qualified rehabilitated expenditures of another entity, the IRS may require the pass-through entity to file Form 3468, Investment Credit.

IRS Rules on Status of Entity as an Instrumentality

The IRS rules in Private Letter Ruling 201641021 (https://www.irs.gov/pub/irs-wd/201641021.pdf?_ga=1.266748492.334448623.1476662568) that an organization formed to defend its member cities against state intrusions on their home rule authority and advocate on behalf of those governments before a state’s legislature is a wholly

owned instrumentality of political subdivisions of a state, and contributions to the organization may constitute charitable contributions under Section 170(c)(1) for use of political subdivisions of a state which were deductible under Section 170(a), subject to applicable limitations.

IRS Releases Practice Unit on Income Sourcing for Nonresidents

The IRS made available international practice units on the following topics:

- How the sourcing rules apply to nonresident aliens (https://www.irs.gov/pub/int_practice_units/usb_c_14_02_01_05.pdf)
- Foreign goodwill or going concern (https://www.irs.gov/pub/int_practice_units/iso_p_01_02_02_02.pdf)

NYSBA Tax Section Submits Report on “May Company” Regulations

The New York State Bar Association Tax Section submitted a report (http://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2016/Tax_Section_Report_1355.html) on temporary and proposed regulations (T.D. 9722, REG-149518-03) under Section 337(d) and proposed regulations (REG-138759-14) under Section 732 aimed at preventing a corporate partner from avoiding corporate-level gain on appreciated property through partnership transactions involving the distribution of stock to a corporate partner.



Christopher C. Scarpa



Kristin M. McKenna

For more information, contact Christopher C. Scarpa at 215.564.8106 or cscarpa@stradley.com or Kristin M. McKenna at 215.564.8145 or kmckenna@stradley.com.

AICPA Offers Suggestions on New Partnership Audit Regime

The American Institute of CPAs has submitted a series of recommendations (http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA_%20Comment_Letter_Notice_2016-23_%20BBA_Partnership_Audit_Procedures_10_7_16.pdf) on the new partnership audit regime, focusing on the procedures that will be implemented before the commencement of an examination and on the determination of which individuals and entities are ultimately responsible for paying the appropriate share of an assessment.

Stradley Ronon’s Tax Practice Group

Todd C. Vanett, Chair.....	215.564.8070	tvannett@stradley.com
Zachary P. Alexander	215.564.8043	zalexander@stradley.com
Jacquelyn Gordon	215.564.8176	jgordon@stradley.com
Kristin M. McKenna	215.564.8145	kmckenna@stradley.com
William S. Pilling III.....	215.564.8079	wpilling@stradley.com
William R. Sasso.....	215.564.8045	wsasso@stradley.com
Christopher C. Scarpa	215.564.8106	cscarpa@stradley.com
Roger Wise.....	202.419.8436	rwise@stradley.com