DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–105964–98]

RIN 1545–AW30

Intercompany Obligations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed regulation that clarifies the treatment of the transfer or extinguishment of rights under an intercompany obligation. The existing regulation has caused uncertainty concerning the tax treatment of such transactions. The proposed regulation affects corporations that are members of consolidated groups, their subsidiaries, and their shareholders.

DATES: Comments and requests for a public hearing must be received by March 22, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–105964–98), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (REG–105964–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax—__regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulation, Theresa A. Abell, (202) 622–7790; concerning submissions of comments, LaNita Van Dyke, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to § 1.1502–13(g) of the Income Tax Regulations. Section 1.1502–13(g) prescribes rules relating to the treatment of the transfer or extinguishment of rights under an intercompany obligation. An intercompany obligation is generally defined as an obligation between members of a consolidated group, but only for the period during which both parties are members of the group. The current regulation provides that if a member of a consolidated group realizes an amount (other than zero) of income, gain, deduction, or loss upon the transfer or extinguishment of all or part of its remaining rights or obligations under an intercompany obligation, the obligation is treated as satisfied (and the transferor's basis in the property received is adjusted to reflect the satisfaction amount) and, if the obligation remains outstanding, it is treated as reissued as a new obligation.

The current regulation is, however, ambiguous regarding the form of the recast transaction, i.e., the deemed transaction that encompasses the satisfaction, reissuance, and actual transaction. Under one interpretation of the regulation, there is a potential that the form of the recast jeopardizes the tax-free treatment of common corporate restructuring transactions. While it is not clear the regulation produces such consequences, the IRS and Treasury believe that any such consequences would be inappropriate and unnecessary to achieve the objectives of the regulation. Accordingly, the IRS and Treasury propose to amend the regulation as described below.

Explanation of Provisions

The existing regulation does not apply to transactions in which the amount of income, gain, deduction, or loss realized is zero. This rule was intended to avoid application of the regulation to transactions in which preservation of gain or loss location, an objective of § 1.1502–13(g), would not be at issue. However, the determination of whether the amount of income, gain, deduction, or loss realized is zero might depend on the fair market value of property received in an exchange. The difficulty and manipulability of that valuation is a reason for the enactment of certain provisions of the original issue discount (OID) rules, particularly section 1274. To the extent that taxpayers were able to avoid the deemed satisfaction and reissuance rule by inaccurately maintaining that the amount of income, gain, deduction, or loss realized is zero, taxpayers could avoid those OID rules and could inappropriately shift gain or loss among members. The IRS and Treasury have concluded that the better and more administrable approach is not to condition the application of the regulation on a realization of some amount of income, gain, deduction, or loss other than zero. Accordingly, the regulation as proposed will apply to all transactions in which any amount is realized due to the transfer or extinguishment of rights in an intercompany obligation.

The IRS and Treasury believe the exception from the operation of this provision for transactions that will not have a significant effect on any person's Federal income tax liability for any year is unclear in its application and scope. Further, the exception offers little, if any, relief from the requirements of the provision. Accordingly, the exception is eliminated from the regulation.

The proposed regulation clarifies the form and timing of the recast applied to transactions subject to the regulation. In particular, it clarifies that the deemed satisfaction proceeds (rather than the obligation) are treated as transferred by the initial creditor in the actual transaction and then advanced by the transferee to the debtor in the deemed reissuance of the obligation. The proposed regulation includes an example to illustrate clearly the mechanics of the proposed regulation. It also includes certain conforming adjustments.

The proposed regulation retains the rule that the deemed satisfaction and reissuance amounts are determined under the principles of the OID provisions if the debt is transferred for property. The IRS and Treasury recognize that an alternate rule providing for a fair market value determination of the deemed satisfaction and reissuance amounts might (in theory) more accurately preserve location of economic gain or loss. In such an alternate regime, however, the inherent difficulty of valuing intercompany obligations would prove burdensome to both taxpayers and the IRS and may provide significant potential for abuse when member obligations are transferred. Certain provisions of the OID rules are intended to address the difficulty and manipulability of this valuation. Other developments in the tax law have recognized that issue price, as determined under the OID rules, is the surrogate for fair market value in the case of a debt obligation. For example, § 1.1001–1(g) provides that issue price is used in determining the amount realized from the receipt of a debt instrument.

For these reasons, and consistent with the objective of promoting single entity treatment of the group, the IRS and Treasury continue to believe that the use of the OID provisions is appropriate and desirable in determining the deemed satisfaction amount and the amount for which the obligation is deemed reissued. Accordingly, the regulation as proposed continues to use the OID provisions to determine both the amount repaid in the deemed satisfaction and the issue price of the

reissued obligation in cases involving the exchange of an intercompany obligation for cash or property.

In addition, the proposed regulation clarifies that the term ''conversion'' includes only conversions pursuant to the terms of the instrument.

Proposed Effective Date

The regulation is proposed to be effective on the date that the final regulation is published in the **Federal Register**. For purposes of determining the tax treatment of transactions undertaken prior to such effective date, taxpayers may rely on the form and timing of the recast transaction, as clarified by these proposed regulations. No inference is intended, however, as to the correct interpretation of the existing regulation.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant impact on a substantial number of small entities. This certification is based on the fact that these regulations principally affect corporations filing consolidated Federal income tax returns. Available data indicates that many consolidated return filers are large companies (not small businesses). Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before this proposed regulation is adopted as a final regulation, consideration will be given to any written comments (preferably a signed original and eight copies) that are timely submitted to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place of the hearing will be published in the **Federal Register**.

Drafting information. The principal author of this regulation is Theresa A. Abell of the Office of Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in its development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502–13 also issued under 26 U.S.C. 1502.

Par. 2. Section 1.1502–13 is amended by:

1. Revising paragraphs (g)(3)(i)(A), (g)(3)(i)(B)(*3*), (g)(3)(ii)(A), and (g)(3)(iii), and removing paragraph (g)(3)(i)(B)(*4*).

2. Revising paragraph (g)(4)(i)(B).

3. Amending paragraph (g)(5) by:

a. Removing the language ''Example 2'' in each place it appears in paragraphs (d), (e) and (f) of Example 2 and adding ''Example 3'' in its place.

b. Removing the language ''Example 3'' in each place it appears in paragraphs (c) and (d) of Example 3 and adding ''Example 4'' in its place.

c. Removing the language ''Example 5'' in each place it appears in paragraph (c) of Example 5 and adding ''Example 6'' in its place.

d. Redesignating Examples 2, 3, 4 and 5 as Examples 3, 4, 5 and 6 and adding a new Example 2.

The revisions and additions read as follows:

§ 1.1502–13 Intercompany transactions.

* * * * *

(g) * * *

(3) *Deemed satisfaction and reissuance of intercompany obligations*

(i) *Application*—(A) *In general.* If a member realizes an amount from the assignment or extinguishment of all or part of its remaining rights or obligations under an intercompany obligation, the intercompany obligation is treated for all Federal income tax purposes as satisfied under paragraph (g)(3)(ii) of this section and, if it remains outstanding (either as an intercompany obligation or a nonintercompany obligation), reissued under paragraph (g)(3)(iii) of this section. Similar principles apply under this paragraph (g)(3) if a member realizes an amount, directly or indirectly, from a comparable transaction (for example, a marking-to-market of an obligation or a bad debt deduction), or if an intercompany obligation becomes an obligation that is not an intercompany obligation.

(B) * * *

(*3*) The amount realized is from the conversion of an obligation (under the terms of the instrument) into stock of the obligor.

(ii) *Satisfaction*—(A) *General rule.* If a creditor member sells an intercompany debt for cash, the debt is treated as satisfied by the debtor immediately before the sale for an amount equal to the amount of the cash. If the debt is transferred for property, the debt is treated as satisfied immediately before the transaction for an amount equal to the issue price (determined under section 1273 or section 1274) of a new debt issued on the date of the transaction, with identical terms, for such property. If this paragraph (g)(3) applies because the debtor or creditor becomes a nonmember, the debt is treated as satisfied for cash in an amount equal to its fair market value immediately before the debtor or creditor becomes a nonmember. If the debt is transferred for cash or property, the proceeds of the deemed satisfaction are treated as transferred by the creditor to the transferee of the debt in exchange for the cash or property. Similar principles apply to other transactions and to transactions involving intercompany obligations other than debt. For example, if a corporation assumes the debtor's liability in exchange for property of the debtor, the debt is treated as satisfied for an amount equal to the issue price (determined under section 1273 or section 1274) of a new debt issued on the date of the transaction, with identical terms, for such property. If, in a transaction to which this paragraph (g)(3) applies, the obligation is extinguished, including in a transaction in which the creditor and debtor become the same entity, the obligation is treated as satisfied for an amount equal to the issue price (determined under section 1273 or section 1274) of a new debt issued on the date of the transaction, with identical terms, to a third party, for property that is not publicly traded.

* * * * *

(iii) *Reissuance.* If an intercompany debt is transferred for cash or property, it is treated as a new debt (with a new holding period but otherwise identical terms) issued to the transferee in exchange for the proceeds of the deemed satisfaction as determined under paragraph (g)(3)(ii) of this section. If this paragraph (g)(3) applies because the debtor or creditor becomes a nonmember, the debt is treated as a new debt (with a new holding period but

otherwise identical terms) issued to the creditor for the deemed satisfaction proceeds. Similar principles apply to other transactions and to transactions involving intercompany obligations other than debt.

* * * * *

(4) * * *

(i) * * *

(B) *Exception.* This paragraph (g)(4) does not apply to an obligation if the obligation becomes an intercompany obligation by reason of an event described in § 1.108–2(e) (exceptions to the application of section 108(e)(4)).

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(5) *Examples.*

* * * * *

Example 2. Nonrecognition transactions. (a) Facts. On January 1 of Year 1, B borrows $100 from S in return for B's note providing for $10 of interest annually at the end of each year, and repayment of $100 at the end of Year 5. B fully performs its obligations with the same tax consequences as described in paragraph (a) of Example 1. At the end of Year 3, S transfers the note to a newly formed subsidiary, Newco, in exchange for Newco stock. Section 351 applies to the exchange. The interest is adequate stated interest within the meaning of section 1274(c)(2) (determined on the date of the transfer). Neither B's note nor Newco's stock is publicly traded.

(b) Deemed satisfaction and reissuance of note. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied for $100 (the issue price of the reissued note, determined under section 1273(b)(4)) immediately before S's transfer of the note to Newco. Zero gain or loss is recognized by S and B on the deemed satisfaction of B's note. S is then treated as transferring the deemed proceeds of the satisfaction of the note ($100) to Newco in exchange for the Newco stock. S's basis in the Newco stock is $100. Under paragraph (g)(3)(iii) of this section, B is treated as reissuing the note to Newco for $100. Newco's basis in B's note is $100.

(c) Intercompany obligation transferred in section 332 transaction. The facts are the same as in paragraph (a) of this Example 2, except that S transfers the note to P in a complete liquidation under section 332. Under paragraph (g)(3)(ii) of this section, B's note is treated as satisfied for $100 (the issue price of the reissued note, determined under section 1273(b)(4)) immediately before S's transfer of the note to P. Zero gain or loss is recognized by S and B on the deemed satisfaction of the note. S is then treated as transferring the deemed proceeds of the satisfaction of the note, with its other assets, to P in complete liquidation. Under paragraph (g)(3)(iii) of this section, B is treated as reissuing the note to P for $100. P's basis in the note is $100.

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Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

[FR Doc. 98–32930 Filed 12–18–98; 8:45 am]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–113694–98]

RIN 1545–AW59

Increase in Cash-Out Limit Under Sections 411(a)(7), 411(a)(11), and 417(e)(1)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of proposed rulemaking.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register,** the IRS is issuing temporary regulations providing guidance relating to the increase from $3,500 to $5,000 of the limit on distributions from qualified retirement plans that can be made without participant consent. This increase is contained in the Taxpayer Relief Act of 1997. The text of those temporary regulations also serves as a portion of the text of these proposed regulations. In addition, these proposed regulations propose the elimination, for all distributions, of the ''lookback rule'' pursuant to which the qualified plan benefits of certain participants are deemed to exceed this limit on mandatory distributions. These proposed regulations affect sponsors and administrators of qualified retirement plans, and participants in those plans. The text of those temporary regulations also serves as a portion of the text of these proposed regulations.

DATES: Written comments and requests for a public hearing must be received by March 22, 1999.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–113694–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–113694–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the ''Tax Regs'' option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs/ustreas.gov/prod/tax__regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael J. Karlan, (202) 622–6030 (not a toll-free call); concerning submissions, Michael Slaughter, (202) 622–7190 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR part 1) relating to the increase from $3,500 to $5,000 of the ''cash-out limit'' described in sections 411(a)(7), 411(a)(11), and 417(e)(1) of the Internal Revenue Code, as amended by section 1071 of the Taxpayer Relief Act of 1997, Public Law 105–34, 111 Stat. 788 (1997).

The text of the temporary regulations also serves as a portion of the text of the proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

As also discussed in the preamble to the temporary regulations, § 1.411(a)–11(c)(3), interpreting the law prior to the enactment of TRA '97, provides that the written consent of a participant is required before the commencement of the distribution of any portion of the participant's accrued benefit if the present value of the nonforfeitable total accrued benefit is greater than $3,500. If the present value does not exceed $3,500, the consent requirements are deemed satisfied, and the plan may distribute that portion to the participant as a single sum. The regulation further provides that, if the present value determined at the time of a distribution to the participant exceeds $3,500, then the present value at any subsequent time shall be deemed to exceed $3,500; this is commonly referred to as the ''lookback rule.'' Section 1.417(e)–1(b)(2)(i) includes a parallel lookback rule.

The temporary regulations remove the lookback rule under section 411(a)(11) for most distributions, but preserve the rule for distributions pursuant to an optional form of benefit under which at least one scheduled periodic distribution is still payable.

These proposed regulations remove the lookback rule under §§ 1.411(a)–11(c)(3) and 1.417(e)–1(b)(2)(i). In accordance with section 417(e)(1), these proposed regulations also provide that, in the case of plans subject to sections 401(a)(11) and 417, consent is required after the annuity starting date for the immediate distribution of the present value of the accrued benefit being distributed in any form, including a qualified joint and survivor annuity or a qualified preretirement survivor annuity, regardless of the amount of that present value. Where only a portion of an accrued benefit is being distributed,