

## Treasury Gives Taxpayers Extra Year to Meet Related-Party Debt Documentation Requirements; Per Se Equity Rule Unchanged

***The one-year postponement assists taxpayers that are developing compliance systems, amidst broader government review of the related-party debt regulations.***

On July 28, 2017, the US Department of the Treasury (Treasury) and the Internal Revenue Service (the IRS) issued [Notice 2017-36](#), delaying for one year the documentation requirements applicable to certain related-party debt instruments under regulations issued pursuant to Internal Revenue Code Section 385 (the Regulations). As reasons for the delay, Treasury and the IRS cited (1) continued taxpayer concern about the time needed to develop systems and processes to comply with the documentation requirements and (2) Treasury's broader review of the Regulations under President Trump's recent executive order instructing the Treasury Secretary to identify and reduce tax regulatory burdens.<sup>1</sup> The announcement does not affect the Regulations' per se equity rule, under which certain debt instruments will be treated as stock for tax purposes.

Under Notice 2017-36, the documentation requirements will apply to instruments issued or deemed issued on or after January 1, 2019. Treasury and the IRS also requested comments from taxpayers as to whether the proposed delay will give taxpayers adequate time to develop their compliance systems and processes. Comments are due by September 1, 2017.

### Documentation Requirements

As described in greater detail in a previous Latham & Watkins [Client Alert](#), the documentation requirements generally require US corporations and their disregarded entities to prepare, maintain, and provide the IRS with information about certain related-party obligations held by members of the issuer's "expanded group" or a "controlled partnership" of the expanded group (as such terms are defined under the Regulations), other than members of the issuer's consolidated group. The documentation requirements identify several factors that must be considered in determining whether an obligation subject to the requirements is properly classified as debt or stock for federal income tax purposes. Subject to limited exceptions, related-party obligations that are not compliant with the documentation requirements will be treated as stock for all federal income tax purposes.

The April 2016 proposed regulations on related-party debt would have applied the documentation requirements to instruments issued or deemed issued on or after the date of final regulations. In response to taxpayer comments that the proposed regulations gave taxpayers insufficient time to be able to comply with the documentation requirements, the Regulations as issued in October 2016 made the documentation requirements applicable only to instruments issued or deemed issued on or after January

1, 2018. Notice 2017-36 announces Treasury's and the IRS' intention to amend the documentation requirements to apply only to instruments issued or deemed issued on or after January 1, 2019. Until Treasury and the IRS adopt amended regulations, taxpayers may rely on the delay set forth in Notice 2017-36.

## Further Governmental Action on the Regulations Is Possible

Notably, Notice 2017-36 does not address the Regulations' per se rule, under which certain related-party debt instruments will be reclassified as stock for tax purposes. However, Treasury is separately conducting a more wide-ranging review of the Regulations pursuant to [Notice 2017-38](#), issued on July 7, 2017. Notice 2017-38 identified the Regulations as falling within President Trump's directive to Treasury to review all "significant tax regulations" issued since January 1, 2016 and to identify those that: (1) impose an undue financial burden on US taxpayers, (2) add undue complexity to the US federal tax laws, or (3) exceed the IRS' statutory authority.<sup>2</sup> Treasury concluded that the Regulations satisfy at least one of the first two of these criteria and announced its intention to propose reforms that could range from "streamlining problematic rule provisions to full repeal." Treasury's report to the President recommending specific actions to mitigate the burden imposed by the identified regulations is due by September 18, 2017.

The inclusion of the Regulations in Treasury's broader regulatory review suggests the delay in the application of the documentation requirements may be followed by further modifications to the Regulations in the near future.

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#### Endnotes

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<sup>1</sup> Executive Order 13789 of April 21, 2017, published in 82 Fed. Reg. 19317 (Apr. 26, 2017) available at <https://www.gpo.gov/fdsys/pkg/FR-2017-04-26/pdf/2017-08586.pdf>.

<sup>2</sup> See *id.*