Notice 89-35, 1989-1 CB 675

Allocation of Interest Expense in Connection with Passthrough Entities and Modification of 15-day Rules in Section 1.163-8T (Extension of Guidance in Notice 88-20)

I. PURPOSE

This notice provides guidance with respect to the allocation of interest expense in connection with certain transactions involving partnerships and S corporations (“passthrough entities”) and the allocation of interest expense on debt proceeds received in cash or deposited in an account.

II. BACKGROUND

Section 1.163-8T of the Income Tax Regulations (T.D. 8145, 52 FR 24,996) provides rules for allocating interest expense for purposes of applying the passive activity loss limitation in section 469 of the Code, the investment interest limitation in section 163(d), and the personal interest limitation in section 163(h). The regulation provides that debt generally is allocated by tracing disbursements of the debt proceeds to specific expenditures and that interest expense on such debt is allocated in the same manner as the debt to which such interest expense relates. Section 1.163-8T does not address the treatment of debt allocated to expenditures for interests in passthrough entities and debt of passthrough entities allocated to distributions by such entities. For purposes of this notice, the term “expenditure” has the same meaning as when used in section 1.163-8T.

Notice 88-20, 1988-1 C.B. 487, provides guidance on the allocation of interest expense in connection with (a) debt-financed contributions to the capital of, and purchases of interests in, passthrough entities (“debt-financed acquisitions”) and (b) debt-financed distributions by passthrough entities to owners of such entities (“debt-financed distributions”), for taxable years ending on or before December 31, 1987. Notice 88-20 also modifies certain rules for tracing debt proceeds received in cash or deposited in an account on or before December 31, 1987. Notice 88-37, 1988-1 C.B. 522, provides guidance on the reporting of interest expense with respect to debt-financed acquisitions and debt-financed distributions for taxable years beginning after December 31, 1986.

This notice expands the guidance provided in Notice 88- 20 and Notice 88-37.

III. EFFECTIVE DATES

In the case of debt-financed acqudanr7(i)5.74033(c)-2.3(i)-5.15Td .957164( )]TJ 224.83 0 Td .957164(p)-0.Ipi8-0.r7(i)5.74

In the case of expenditures made from debt proceeds

Notice 88-37 provides additional guidance on the reporting of interest expense in connection with debt-financed distributions.

VI. EXTENSION OF MODIFICATION OF SINGLE ACCOUNT AND 15-DAY RULES

Paragraph (c)(4)(iii)(B) of section 1.163-8T provides, among other things, that a taxpayer may treat any expenditure made from an account within 15 days after debt proceeds are deposited in such account as made from such proceeds to the extent thereof. Paragraph (c)(5)(i) of section 1.163-8T provides a similar rule with respect to debt proceeds received in cash. In the case of debt proceeds deposited in an account, taxpayers may treat any expenditure made from any account of the taxpayer, or from cash, within 30 days before or 30 days after debt proceeds are deposited in any account of the taxpayer as made from such proceeds to the extent thereof. Similarly, in the case of debt proceeds received in cash, taxpayers may treat any expenditure made from any account of the taxpayer, or from cash, within 30 days before or 30 days after debt proceeds are received in cash as made from such proceeds to the extent thereof.

VII. ADMINISTRATIVE PRONOUNCEMENT

This document serves as an “administrative pronouncement” as that term is described in section 1.6661-3(b)(2) of the regulations and may be relied upon to the same extent as a revenue ruling or revenue procedure.

FSA 200011025 (excerpt) – Is Notice 89-35 still in effect?

ISSUES

1. Was Section VI of Notice 89-35, 1989-1 C.B. 675, which modified the “single account” and “15-day rules” of Temp. Treas. Reg. section 1.163-8T(c)(4)(iii)(B) still in effect during 1994?

2. Under the “any account of the taxpayer” rule set out in Notice 89-35, can the taxpayer's loan be allocated to the subsidiary's expenditure, and must that subsidiary be members of taxpayer's consolidated group?

3. Do the “any account” and “30-day rules” of Notice 89-35 apply to debt refinancing as defined at Treas. Reg. section 1.163-8T(e)?

4. Is an intercompany loan an “investment expenditure . . . properly chargeable to capital account” for purposes of the debt allocation rules of Treas. Reg. section 1.163-8T?

CONCLUSIONS

1. Yes

2. Under Section VI of Notice 89-35 it would not be appropriate to treat the account of a subsidiary (even if the member of the same consolidated group) as an account of the taxpayer for purposes of the “same account” rule.

3. The “any account” and “30 day” rule would apply to debt refinancing proceeds only to the extent that the proceeds are not allocable to the repayment of the preexisting debt.

4. Treas. Reg. section 1.163-8T(j)(1)(iii) applies in a very narrow context and does not provide any authority for a broad treatment of intercompany loans.

FACTS

A is a limited liability company taxable as a partnership and subject to TEFRA procedures. A was formed on or

It appears that C and F subsequently contributed their respective interests in A to B. B was then owned in the following percentages: #2 percent K, #3 percent C, #4 percent F, and #5 percent D. A assumed $1 of B's liabilities. It is our understanding that the Intermediate Subsidiaries assumed the liabilities in connection with either their acquisition or their development of the lower-tier subsidiaries. These liabilities originally were assumed by F, C and B from K.

The assumption agreements provide as follows: The assumption agreement dated Date1, between K, A, and B provides that whereas K assigned to B, and B in turn, assigned to A #6 shares of E, and K issued $2 of commercial paper allocated to those shares, that B assumed the liability in connection with the transfer of shares to A, and A then assumed the liability for the indebtedness.

The assumption agreement dated Date 4 between F and A provides that whereas F assumed $3 in indebtedness of

It does not appear to be appropriate to allocate a liability of a taxpayer to a subsidiary's expenditure under the “any account of the taxpayer” rule. Specifically, the debt of the corporate parent should not be allocated to expenditures paid out of a subsidiary's bank account. Section VI of Notice 89-35 provides considerable freedom to taxpayers in

Advice has been requested on the proper interpretation of Treas. Reg. section 1.163-8T(j)(1)(iii). That section indicates, in part, that:

> [A]n expenditure to make a loan is treated as an expenditure properly chargeable to capital account with respect to an asset, and for purposes of paragraph