MAYER | BROWN

September 11, 2019

Legal Update

Creative Accounting: The IRS Proposes Regulations Addressing Advance Payments and Book-Tax Conformity

By Mark Leeds, Juan Lopez Valek, Brennan Young and Stephanie Wood[1]

Charlie Munger, Warren Buffett's legendary co-manager, wisely noted that "[c]reative accounting is an absolute curse to a civilization." Mr. Munger was lamenting the use of accounting fictions to create false revenues. When taxpayers determine their revenue for US federal income tax purposes, however, false revenue seems to vanish, and Congress was concerned that actual receipts might vanish as well. In order to curtail such creative accounting, as part of the 2017 Tax Cuts and Jobs Act (the "TCJA"),[2] Congress inserted Section 451(b) into the Internal Revenue Code of 1986, as amended (the "Code") to require taxpayers, beginning in 2018, to report income no later than when such revenue is shown on an applicable financial statement (an "AFS"). On the other hand, the TCJA, building on Revenue Procedure 2004-34, added Code § 451(c). This provision permits taxpayers to elect to defer certain advance payments received for goods and services for one year, provided that such payments are not taken into account in the year of payment for financial accounting purposes. On September 5, 2019, the Internal Revenue Service (the "IRS") proposed regulations (together, the "Proposed Regulations") and Revenue Procedure 2019-37 to implement and coordinate these two sets of rules.[3]

The Rules for Advance Payments

The Proposed Regulations affecting the timing for the recognition of advance payments will not be effective until final regulations are published, but the IRS will allow taxpayers to rely on these rules for taxable years beginning after 2017.[4] The IRS has already issued a Revenue Procedure that allows taxpayers to adopt changes to their federal income tax income recognition to conform to the AFS conformity rules, and Revenue Procedure 2019-37 further streamlines this process.[5]

PAYMENTS TREATED AS ADVANCE PAYMENTS

An "advance payment" includes any payment (i) the full inclusion of which in gross income for the year in which the payment is received is a permissible method of accounting, (ii) any portion of which is included in revenue by the taxpayer in an AFS for a year after the year of receipt, and (iii) which is for goods or services.[6] The preamble to the Proposed Regulations states that the definition of

“advance payment” in the regulations is meant to be consistent with the definition of advance payment in Revenue Procedure 2004-34. The Proposed Regulations expand the categories of items for which an advance payment can be made to include:

1) Services;
2) The sale of goods;
3) The use, including by license or lease, of intellectual property, including copyrights, patents, trademarks, service marks, trade names, and similar intangible property rights, such as franchise rights and arena naming rights;
4) The occupancy or use of property if the occupancy or use is ancillary to the provision of services (e.g., advance payments for the use of rooms or other quarters in a hotel);
5) The sale, lease, or license of computer software;
6) Guaranty or warranty contracts ancillary to (1)-(5) above;
7) Subscriptions in tangible or intangible format (other than subscriptions for which an election under Code § 455 is in effect);
8) Memberships in an organization (other than subscriptions for which an election under Code § 456 is in effect);
9) An eligible gift card sale; or
10) Any combination of items described in (1)-(10) above.[7]

Concomitantly, the Proposed Regulations exclude a number of income items from the definition of “advance payment,” specifically:

1) Rent (except for amounts paid with respect to an item or items described in (3)-(5) above);
2) Insurance premiums, to the extent the inclusion of those premiums is governed by Subchapter L;
3) Payments with respect to financial instruments, financial derivatives, or similar items, including purported prepayments of interest;
4) Payments with respect to service warranty contracts for which the taxpayer uses the accounting method provided in Revenue Procedure 97-38;
5) Payments with respect to warranty and guaranty contracts under which a third party is the primary obligor;
6) Payments made to non-US persons that are subject to US federal income tax withholding;
7) Compensatory transfers of property to which Code § 83 applies; and
8) Payments received in a taxable year earlier than the taxable year immediately preceding the taxable year of the contractual delivery date for a “specified good.”[8]

The importance of the final exception cannot be understated. Large equipment manufacturers frequently receive payments for goods (think airplanes) two years or more prior to delivery of the equipment. Accordingly, providing that the manufacturer does not have goods in inventory that could be used to satisfy an order and the income from the delivery is recognized in the year in which the goods are delivered, the manufacturer can defer income from the sale without being subject to the strictures of the 2-year advance rule.[9]

Taxpayers who are parties to a contract with multiple performance obligations must allocate the transaction price to each performance obligation and therefore defer (or accelerate) income inclusion consistent

with the transaction price allocation.[10] The Proposed Regulations define the term "performance obligation" to mean a promise in a contract with a customer to transfer to the customer either a good or service (or a bundle of goods or services) that is distinct, or a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.[11] For taxpayers with an AFS, the Proposed Regulations define the "transaction price" as the gross amount of consideration a taxpayer expects to be entitled to for AFS purposes in exchange for transferring promised goods, services, or other property but excluding certain items such as amounts collected on behalf of a third party that would not otherwise be income to the taxpayer, increases for consideration to which a taxpayer's entitlement is contingent on the occurrence or nonoccurrence of a future event, and reductions for amounts subject to Code § 461.[12] The Proposed Regulations permit non-AFS taxpayers to allocate the revenue of a contract with multiple performance obligations in a single contract based on how such obligations are separately priced or on any method that may be provided in guidance published in the Internal Revenue Bulletin.[13]

FEDERAL INCOME TAX ACCOUNTING FOR ADVANCE PAYMENTS

The Proposed Regulations provide that an accrual method taxpayer with an AFS includes an advance payment in gross income in the taxable year of receipt unless the taxpayer uses the "AFS deferral method."[14] Under the AFS deferral method, a taxpayer with an AFS that receives an advance payment must include: (i) the advance payment in income in the taxable year of receipt, to the extent that it is included in revenue in its AFS, and (ii) the remaining amount of the advance payment in income in the next taxable year.[15] The AFS deferral method provided in the Proposed Regulations closely follows the deferral method of Revenue Procedure 2004-34, as modified by Revenue Procedure 2011-14, and as modified and clarified by Revenue Procedures 2011-18 and 2013-29 ("Revenue Procedure deferral method").[16]

The Proposed Regulations provide a similar deferral method for non-AFS taxpayers, whereby an accrual method taxpayer without an AFS that receives an advance payment must include: (i) the advance payment in income in the taxable year of receipt, to the extent that it is earned, and (ii) the remaining amount of the advance payment in income in the next taxable year.[17] Essentially, the IRS concluded that Code § 451(c) does not prohibit a deferral method that is otherwise permissible under Revenue Procedure 2004-34.[18] Revenue Procedure 2004-34 permitted non-AFS taxpayers to use the Revenue Procedure deferral method based on when the income is earned.[19] The IRS explained that the Revenue Procedure deferral method based on when income is earned is a permissible method of accounting for non-AFS taxpayers.[20]

ACCELERATION OF INCOME FROM ADVANCE PAYMENTS

The Proposed Regulations include acceleration rules that require taxpayers to include in gross income for the taxable year of receipt the amount of all deferred advance payments if, in the same taxable year, the taxpayer dies or ceases to exist,[21] or the advance payment is satisfied or otherwise ends.[22]

Notwithstanding the general rule, advance payments received by a taxpayer that ceases to exist in the same taxable year of receipt, or an advance payment that is otherwise satisfied in the same taxable year of receipt, may remain eligible for the deferral method if the acceleration event results from a complete liquidation of the taxpayer under Code

Section 332,[23] or from a transaction pursuant to a reorganization under Code § 368(a)(1).[24] In addition, a deferred advance payment that is satisfied in the year of receipt as a result of a transaction to which Code § 351(a) applies will remain eligible for the deferral method provided that: (i) substantially all assets of the trade or business, including the advance payments, are transferred as a result of such transaction; (ii) the recipient of the assets and advance payments uses the deferral method in the year in which the transfer takes place; and (iii) both the transferee and transferor are members of the same consolidated group.[25]

The acceleration rules described in this section apply to both taxpayers that use the AFS deferral method[26] and the non-AFS deferral method[27] described in the Proposed Regulations.

PURCHASE ACCOUNTING ADJUSTMENTS

Financial accounting adjustments (which generally occur when a company that has received, but not been fully taxed on, an advance payment is acquired by another company) could result in income that is deferred under Code § 451(c) from ever being taxed. Accordingly, the Proposed Regulations provide that financial statement adjustments and write-downs of deferred income items are acceleration events that trigger the deferred income.[28] In one example illustrating this rule, a taxpayer using the deferral method receives an advance payment that will recognize, for financial accounting purposes, (i) 25% in 2018, (ii) 50% in 2019 and (iii) 25% in 2020. The taxpayer is acquired in 2018 and its tax year ends on the date of the acquisition. The acquirer writes down the taxpayer's deferred revenue liability to $10. The example holds the taxpayer must recognize 25% of the payment in its short 2018 year and the remainder is taxable in the following year notwithstanding the write-down. Other examples apply similar rules even when the acquisition does not result in a short tax year[29]or the deferred revenue is charged to retained earnings.[30]

COSTS TO-BE-INCURRED

The IRS considered, and rejected, the idea that if income is accelerated to the first two years of a multi-year contract that it would appropriate to provide taxpayers with an allowance for the future cost of goods sold ("COGS") or future estimated costs.[31] Existing Treasury Regulation § 1.451-5(c)(1)(ii) provides an extremely limited rule allowing taxpayers who receive substantial advance payments for goods to deduct the estimated cost of supplying such goods in the year following the receipt of the advance payment. The IRS cited this rule as the only relief available to this adverse timing mismatch. The IRS did, however, invite comments on this rule.

PROCEDURES FOR ADOPTING THE DEFERRAL METHOD

The Code itself specifies that the election to use the deferral method is treated as a method of accounting.[32] The proposed regulations do not contain applicable procedures for a taxpayer to use to adopt the deferral method. In the preamble, however, the IRS specified that the rules in Revenue Procedure 2004-34 will continue to apply for taxpayers to adopt the deferral method. In general, the adoption of the deferral method is an "automatic change." This means that while a taxpayer must file an IRS Form 3115 to adopt the deferral method, it need not wait for IRS approval to begin using the method.[33]

Taxable Income Acceleration to Match Financial Statement Income Recognition

At the outset, it is worth keeping in mind that the rules for recognizing income in accordance with an AFS can never cause income to be recognized later than when it would be recognized under the accrual

method of accounting.[34] The rule operates solely to result in accelerated income recognition for federal income tax purposes. Thus, if a taxpayer is using an AFS over-time income recognition method for a particular item of income, the taxpayer is not entitled to follow its book treatment for federal income tax purposes. Similar to the proposed regulations for advanced payments, the Proposed Regulations affecting the timing for the recognition of payments included on an AFS will not generally be effective until final regulations are published, but the IRS will allow taxpayers to rely on these rules for taxable years beginning after 2017.[35]

TAXPAYERS SUBJECT TO THE AFS RULE

The AFS income inclusion rules apply to taxpayers that use an accrual method of accounting and have an AFS. The Proposed Regulations provide that the AFS income inclusion rule generally applies to accrual method taxpayers with an AFS when the timing of income inclusion for one or more items of income is determined using the all events test.[36]

The Proposed Regulations do not include special rules regarding the applicability of the AFS income inclusion rule to foreign persons. The Treasury and the IRS noted that the application of the AFS income inclusion rule to a controlled foreign corporation ("CFC") may create mismatches between the CFC's taxable income for US federal and foreign tax purposes, causing certain taxpayers to lose the ability to credit foreign taxes imposed on a CFC's income.[37] Therefore, the IRS has requested comments on whether special rules are needed in order to address the applicability of the AFS income inclusion rule to foreign persons, including whether and how the rules for determining the taxable income of a CFC can be adjusted to better align the US federal and foreign income tax bases.[38]

Consistent with the exception in Code § 451(b)(1)(B)(i), the Proposed Regulations clarify that the AFS income inclusion rule only applies to taxpayers that have one or more AFS covering the entire taxable year.[39] To address situations in which accrual method taxpayers have an AFS in one taxable year and no AFS in another, the Proposed Regulations provide that the AFS income inclusion rule applies on a year-by-year basis and, therefore, an accrual method taxpayer with an AFS in one taxable year and not in another must apply the AFS income inclusion rule in the taxable year that it has an AFS, and does not apply the rule in the taxable year in which it does not have an AFS.[40]

The AFS income inclusion rule does not apply to items of income in connection with a mortgage servicing contract.[41] In a letter addressed to the Treasury, one commenter indicated that it is unclear whether this exclusion can be applied to income relating to interest rate lock commitments ("IRLCs") entered into by mortgage lenders.[42] The Proposed Regulations do not address this issue because Code § 451 generally would require mortgage lenders to include income relating to IRLCs in taxable income in accordance with the mark-to-market method of accounting.[43] Thus, the book-tax conformity rule is not applicable to a mortgage lender to determine when income relating to IRLCs is includible in income.[44]

APPLICABLE FINANCIAL STATEMENTS

The Proposed Regulations describe and clarify the definition of an AFS. In general, AFS include financial statements prepared according to generally accepted accounting principles, certain financial statements prepared according to international financial reporting standards ("IFRS financial statements") and financial statements with certain regulatory or government bodies.[45]

The list of financial statements that qualify as an AFS under the Code is similar, although not identical, to the list of financial statements in Revenue Procedure 2004-34.[46]
Specifically, Revenue Procedure 2004-34 includes the following list of applicable financial statements: (i) a financial statement required to be filed with the Securities and Exchange Commission ("SEC") (the 10-K or the Annual Statement to Shareholders); (ii) a certified audited financial statement that is accompanied by the report of an independent CPA (or in the case of a foreign corporation, by the report of a similarly qualified independent professional), that is used for credit purposes, reporting to shareholders or any other substantial non-tax purpose; or (iii) a financial statement (other than a tax return) required to be provided to the federal or a state government or any federal or state agencies (other than the SEC or the IRS).[47] Certain financial statements that have traditionally been treated as AFS under Revenue Procedure 2004-34, such as IFRS financial statements used for credit purposes, reporting to shareholders, partners, other proprietors or beneficiaries, and any other substantial non-tax purposes, are not expressly included in Code § 451(b)(3).[48] However, the legislative history indicates that Congress intended for Revenue Procedure 2004-34 to be followed.[49] Accordingly, the Proposed Regulations are generally consistent with the list of AFS in Revenue Procedure 2004-34.[50] Financial statements that are filed with a state government or state agency, or a self-regulatory organization, also qualify as an AFS.[51] The IRS provided the Financial Industry Regulatory Authority and state agencies that regulate insurance companies or public utilities as examples of agencies requiring reports that qualify as an AFS.[52]

If the financial results of a taxpayer are reported on the AFS for a group of entities, such statements will be treated as the AFS of the taxpayer.[53] When a consolidated or combined AFS or other financial statement lists items separately for each member taxpayer, the amount of revenue attributable to a particular taxpayer is determined based on its respective separately stated item.[54] However, if the amounts are aggregated, the taxpayer must rely on the source documents that were used to create the group's AFS to determine its percentage of each aggregated item reported on the consolidated or combined AFS.[55] To properly reflect the correct amount of gross income, the source documents should be used to determine the taxpayer's respective share of revenue on the AFS.[56]

The Proposed Regulations also provide guidance for a restatement of a taxpayer's financial statements. In general, the rules provide that a taxpayer must determine the reason for the restatement of the AFS.[57] As an example, the Proposed Regulations provide that if a taxpayer restates revenue on an AFS and such restatement changes the time at which an item of income or a portion thereof is taken into account as revenue on the AFS, the change constitutes a change in method of accounting under Code § 446.[58] This rule is consistent with current practice regarding the determination of a change in method of accounting.[59]

REVENUE RECOGNITION IN AN AFS

If a taxpayer has an AFS, the item is recognized in income no later than when that item is taken into account as revenue in the taxpayer's AFS.[60] In order to ensure compliance with the AFS income inclusion rule, the Proposed Regulations define "revenue" broadly to include all transaction price amounts, such as gains, profits and income, that are includible in gross income under Code § 61.[61] In other words, the inclusion of an item of income in an AFS overrides the normal accrual method of accounting rules. In addition, if a taxpayer is

subject to multiple performance obligations pursuant to a single contract, such as distinct obligations to provide goods and services, it must separately account for each performance obligation.[62]

RULES FOR TRANSACTIONS TREATED DIFFERENTLY FOR BOOK AND TAX PURPOSES

The Conference Report states that the AFS income inclusion rules do not revise the rules associated with realization of income for federal income tax purposes and do not require recognition of income in situations where such an event has not yet occurred for tax.[63] Accordingly, the Proposed Regulations include two provisions that provide rules relating to the interaction between the AFS income inclusion rules with certain transactions and items of income that may be treated differently or excluded from income for federal income tax purposes.

Transactions Treated Differently for Federal Income Tax Purposes

The AFS income inclusion rules do not generally require a taxpayer to recharacterize a transaction so that its treatment for federal income tax purposes is consistent with its treatment under an AFS.[64] Examples provided by the Proposed Regulations of transactions that can be treated differently under each set of rules include (i) transactions treated for tax as a lease, license or a similar transaction that qualify as a sale or financing for AFS, (ii) transactions that are not required to be marked-to-market for tax but that are so required for AFS, (iii) certain transactions treated as asset transfers or liquidations for tax purposes,[65] (iv) a distribution by a corporation or allocable partnership income that is accounted for under the equity method for AFS, (v) a distribution of previously taxed E&P of a foreign corporation, and (vi) a deposit or conduit payment for tax that is treated as revenue for AFS.[66]

The IRS has requested comments on the interaction between the AFS income inclusion rules and the federal income tax treatment of certain future contingent income and liabilities that may be included in revenue for AFS purposes.[67] We expect that these items may be addressed in the final regulations.

Exclusion Provisions and Non-Recognition Transactions for Federal Income Tax Purposes

The AFS income inclusion rule does not change the applicability of any exclusion provision or the treatment of non-recognition transactions in the Code, regulations or guidance published by the IRS.[68] Examples of provisions that are not affected by the Proposed Regulations include (i) liquidations described in Code §§ 332 and 337; (ii) exchanges described in Code § 351(a); (iii) distributions described in Code § 355; (iv) reorganizations pursuant to Code § 368(a)(1); (v) contributions to a partnership described in Code § 721; (vi) transactions described in Code §§ 1031 through 1045; and, (vii) items excluded from income under Code §§ 101 through 140.[69]

SPECIAL RULES FOR DEBT INSTRUMENTS

The AFS conformity rules will have a major impact on lenders and credit card issuers. A significant number of costs paid by borrowers in lending transactions are not treated as fees for federal income tax purposes,[70] but are treated as fees for financial accounting purposes. Instead, for federal income tax purposes, such fees are treated as reducing the issue price of the loan. Various authorities apply this rule, even when the loan is provided through a loan facility and not through a term loan, the proceeds of which are immediately advanced to the borrower.[71] These rules allow credit card issuers to defer a significant number of fees paid by credit card users.[72]

In C.C.A. 200019041 (Mar. 3, 2000), the IRS considered the tax treatment of prepaid interest on loans made by insurance companies on policyholder loans. Prior to the promulgation of Treasury Regulation § 1.1273-2(g)(2), the IRS had ruled that insurance companies were required to include prepaid interest in income. Following the promulgation of the regulation, however, the IRS held that, "prepaid interest reduces a loan's issue price." Accordingly, in the CCA, the IRS held that the prepaid interest was not taxable to the insurance company, but only created a discount on the loan.

The IRS has consistently treated unused facility fees as premiums paid for the option to borrow money, granting the borrower the right to sell debt securities containing pre-specified terms to the lender for a fixed price.[73] When a loan commitment fee was determined based upon the amount of unissued bonds, the IRS held that the loan commitment fees were in the nature of a standby charge that resulted in the acquisition of a valuable property right, that is, the right to borrow money:

> Such a loan commitment fee is similar to the cost of an option, which becomes part of the cost of the property acquired upon exercise of the option. Therefore, if the right is exercised, the commitment fee becomes a cost of acquiring the loan and is to be deducted ratably over the term of the loan. If the right is not exercised, the taxpayer may be entitled to a loss deduction.[74]

The Proposed Regulations provide that any amounts received by a lender in connection with a lending transaction that are treated as fees on an AFS must be included in the income of the lender in the year of receipt.[75] This rule voids out the rules discussed in the authorities discussed above for US taxpayers and non-US taxpayers receiving such amounts in connection with a US trade or business. In addition, the preamble to the Proposed Regulations concludes that the enactment of the AFC conformity rule evidences that "Congress [intended] to overturn the tax treatment of those credit card fees as OID [original issue discount], including the use of the OID timing rules, and subject them to the all events test."[76] Accordingly, the Proposed Regulations are explicit that credit card fees and charges must be recognized when recognized under an AFS and may not be deferred under the OID rules.[77] Under Revenue Procedure 2019-37, this change will be made on a cut-off method.

Apart from the changes to amounts paid in connection with lending transactions as described above, the AFS conformity rule does not affect the accrual of OID[78] or market discount.[79]

INTERACTION WITH SPECIAL ACCOUNTING AND NON-RECOGNITION RULES

The AFS conformity rule, without an explicit exception, would require recognition of gains or losses on book-ups and book-downs that occur in connection with tax-free reorganizations. The Proposed Regulations contain a blanket rule providing the AFS conformity rule does not apply to any non-recognition transaction.[80] An example in the Proposed Regulations illustrates this rule in connection with a divisive spin-off transaction in which the assets of the controlled corporation are booked-up in connection with the spin-off.[81] The Proposed Regulations also provide that book-tax conformity is not required when the taxpayer uses a special method of income inclusion for federal income tax purposes, such as installment sales accounting, hedging transactions, the mark-to-market method of accounting and REMIC inducement fees.[82]

MULTI-YEAR CONTRACTS

Special rules are provided for multi-year contracts. Specifically, instead of comparing the amount of income reported each year, the Proposed Regulations take a cumulative approach. Specifically, a taxpayer with a multi-year contract will compare the cumulative amount of income recognized for both book and tax purposes over the life of the contract, and if, in a given year, the cumulative amount of book income exceeds the cumulative amount of income recognized for federal income tax purposes, the taxpayer will be required to include such excess in income.[83]

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

Mark H. Leeds
+1 212 506 2499
mleeds@mayerbrown.com

Juan F. Lopez Valek
+1 212 506 2471
jlopezvalek@mayerbrown.com

Brennan W. Young
+1 212 506 2691
byoung@mayerbrown.com

Stephanie Wood
+1 212 506 2504
swood@mayerbrown.com

Endnotes

[1] The authors are all tax lawyers with the New York office of Mayer Brown LLP.

[2] P.L. 115-97, 131 Stat. 2054 (2017). For an overview of the TCJA and related IRS guidance implementing the same, see the Mayer Brown Tax Reform Roadmap, available at https://www.mayerbrown.com/en/capabilities/key-issues/us-tax-reform-roadmap?tab=overview.

[3] REG-104554-18 (Sep. 5, 2019) and REG-104870-18 (Sep. 5, 2019).

[4] Prop. Treas. Reg. § 1.451-8(f).

[5] *See* Rev. Proc. 2018-31 as amended by Rev. Proc. 2019-60.

[6] Code § 451(c)(4)(A); Prop. Treas. Reg. § 1.451-8(b)(1).

[7] Prop. Treas. Reg. § 1.451-8(b)(1)(i).

[8] Prop. Treas. Reg. § 1.451-8(b)(ii). This list of exclusions generally tracks the exclusions set forth in Code § 451(c)(4)(B).

[9] *See* Prop. Treas. Reg. § 1.451-8(b)(1)(ii)(9).

[10] Code §§ 451(b)(4) and 451(c)(4)(D).

[11] Prop. Treas. Reg. § 1.451-3(c)(3).

[12] Prop. Treas. Reg. § 1.451-3(c)(6).

[13] Prop. Treas. Reg. § 1.451-8(d)(5).

[14] Prop. Treas. Reg. § 1.451-8(c).

[15] REG-104554-18, § 1(A).

[16] Prop. Treas. Reg. § 1.451-8(c); see e.g. Rev. Proc. 2004-34, Rev. Pro. 2011-14, Rev. Pro. 2011-18, and Rev. Pro. 2013-29.

[17] Prop. Treas. Reg. § 1.451-8(d).

[18] *See* H.R. Rep. No. 115-466, at 429 (2017) (Conf. Rep.); *see also* Joint Committee on Taxation, General Explanation of Public Law 115-97 (JCS-1-18) at 170-171 (Dec. 20, 2018).

[19] *See* Rev. Proc. 2004-34.

[20] REG-104554-18, § 1(B).

[21] Prop. Treas. Reg. § 1.451-8(c)(2)(i)(A)

[22] Prop. Treas. Reg. § 1.451-8(c)(2)(i)(B)

[23] Prop. Treas. Reg. § 1.451-8(c)(2)(i)(A); (B)(1), and Code Section § 381(a)(1)

[24] Prop. Treas. Reg. § 1.451-8(c)(2)(i)(A); (B)(1), and Code Section § 381(a)(2)

[25] Prop. Treas. Reg. § 1.451-8(c)(2)(i)(B)(2)(i)-(iii)

[26] Prop. Treas. Reg. § 1.451-8(c)(2)

[27] Prop. Treas. Reg. § 1.451-8(d)(6)

[28] Prop. Treas. Reg. § 1.451-8(c)(3).

[29] Prop. Treas. Reg. § 1.451-8(c)(3)(Ex. 2).

[30] Prop. Treas. Reg. §1.451-3(j)(Ex. 2).

[31] In the preamble to the proposed regulations, the IRS invited comments on this issue.

[32] Code § 451(c)(2)(B).

[33] Rev. Proc. 2004-34, sections 8.02 and 8.04(1).

[34] REG-104870-18, § 1(E)(6).

[35] Prop. Treas. Reg. § 1.451-3(n). The Proposed Regulations delay the effectiveness of the regulations to certain specified fees until one year after the date final regulations are published.

[36] Prop. Treas. Reg. § 1.451-3(b).

[37] REG-104870-18, § 1(A).

[38] REG-104870-18, § 1(A).

[39] Prop. Treas. Reg. § 1.451-3(d)(1).

[40] Prop. Treas. Reg. § 1.451-3(d).

[41] Prop. Treas. Reg. § 1.451-3(d)(2); see Code § 451(b)(1)(B)(ii).

[42] REG-104870-18, § 1(B).

[43] REG-104870-18, § 1(B).

[44] REG-104870-18, § 1(B).

[45] Code § 451(b)(3).

[46] REG-104870-18, § 3; see also Rev. Pro. 2004-34.

[47] Rev. Pro. 2004-34, § 4.06.

[48] Code § 451(b)(3).

[49] See H.R. Rep. No. 115-466, at 429 (2017) (Conf. Rep.).

[50] Prop. Treas. Reg. § 1.451-3(c)(1).

[51] Prop. Treas. Reg. § 1.451-3(c)(1).

[52] REG-104870-18, § 3.

[53] Prop. Treas. Reg. § 1.451-3(h)(1), (2), and (3); Code § 451(b)(5).

[54] Prop. Treas. Reg. § 1.451-3(h)(1), (2), and (3).

[55] Prop. Treas. Reg. § 1.451-3(h)(1), (2), and (3).

[56] Prop. Treas. Reg. § 1.451-3(h)(1), (2), and (3).

[57] Prop. Treas. Reg. § 1.451-3(h)(5).

[58] Prop. Treas. Reg. § 1.451-3(h)(5).

[59] REG-104870-18, § 3.

[60] Prop. Treas. Reg. § 1.451-3(b).

[61] Prop. Treas. Reg. § 1.451-3(c)(4)

[62] Prop. Treas. Reg. § 1.451-3(c)(3).

[63] H.R. Rep. No. 115-466, at 428 fn. 872 (2017) (Conf. Rep.).

[64] Prop. Treas. Reg. § 1.451-3(e)

[65] *See* IRC § 336(e) and § 338(h)(10)

[66] Prop. Treas. Reg. § 1.451-3(e)(1)-(6)

[67] Consider interaction between Code §§ 61, 461 and 451(b)

[68] Prop. Treas. Reg. § 1.451-3(f)

[69] Prop. Treas. Reg. § 1.451-3(f)(1)-(2).

[70] Treas. Reg. § 1.1273-2(g)(2).

[71] *See e.g.* Rev. Rul. 73-559, 1973-2 C.B. 299 (fees paid by seller of loan with below-market interest to compensate purchaser for accepting such below-market interest treated as reduction to loan purchase price and not a fee).

[72] Rev. Proc. 2005-47; Rev. Proc. 2013-26.

[73] Revenue Ruling 81-160, 1981-1 C.B. 312.

[74] *See also* C.C.A. 201136022 (Sep. 9, 2011).

[75] Prop. Treas. Reg. § 1.451-3(i)(1).

[76] REG-104870-18, § 1(E)(7).

[77] Prop. Treas. Reg. § 1.451-3(i)(2).

[78] Prop. Treas. Reg. § 1.451-3(c)(5)(ix), (x).

[79] Prop. Treas. Reg. §1.451-3(c)(5)(xi). The exclusion from Code § 451(b) was previewed by the IRS in Notice 2018-80.

[80] Prop. Treas. Reg. § 1.451-3(f).

[81] Prop. Treas. Reg. § 1.451-3(m)(Ex. 9).

[82] Prop. Treas. Reg. § 1.451-3(c)(5).

[83] Prop. Treas. Reg. § 1.351-3(k).

Mayer Brown is a distinctively global law firm, uniquely positioned to advise the world's leading companies and financial institutions on their most complex deals and disputes. With extensive reach across four continents, we are the only integrated law firm in the world with approximately 200 lawyers in each of the world's three largest financial centers—New York, London and Hong Kong—the backbone of the global economy. We have deep experience in high-stakes litigation and complex transactions across industry sectors, including our signature strength, the global financial services industry. Our diverse teams of lawyers are recognized by our clients as strategic partners with deep commercial instincts and a commitment to creatively anticipating their needs and delivering excellence in everything we do. Our "one-firm" culture—seamless and integrated across all practices and regions—ensures that our clients receive the best of our knowledge and experience.

Please visit mayerbrown.com for comprehensive contact information for all Mayer Brown offices.

Any tax advice expressed above by Mayer Brown LLP was not intended or written to be used, and cannot be used, by any taxpayer to avoid U.S. federal tax penalties. If such advice was written or used to support the promotion or marketing of the matter addressed above, then each offeree should seek advice from an independent tax advisor.

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek legal advice before taking any action with respect to the matters discussed herein.

Mayer Brown is a global services provider comprising associated legal practices that are separate entities, including Mayer Brown LLP (Illinois, USA), Mayer Brown International LLP (England), Mayer Brown (a Hong Kong partnership) and Tauil & Chequer Advogados (a Brazilian law partnership) (collectively the "Mayer Brown Practices") and non-legal service providers, which provide consultancy services (the "Mayer Brown Consultancies"). The Mayer Brown Practices and Mayer Brown Consultancies are established in various jurisdictions and may be a legal person or a partnership. Details of the individual Mayer Brown Practices and Mayer Brown Consultancies can be found in the Legal Notices section of our website.

"Mayer Brown" and the Mayer Brown logo are the trademarks of Mayer Brown.

© 2019 Mayer Brown. All rights reserved.