November 9, 2016

The Honorable Richard Shelby
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Jeb Hensarling
Chairman
The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

Subject: Department of the Treasury, Internal Revenue Service: Treatment of Certain Interests in Corporations as Stock or Indebtedness

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Department of the Treasury, Internal Revenue Service (IRS) entitled “Treatment of Certain Interests in Corporations as Stock or Indebtedness” (RIN: 1545-BN40). We received the rule on October 26, 2016. It was published in the Federal Register as final regulations and temporary regulations on October 21, 2016, with an effective date of October 21, 2016. 81 Fed. Reg. 72,858.

The final rule establishes threshold documentation requirements that must be satisfied in order for certain related-party interests in a corporation to be treated as indebtedness for federal tax purposes and treat as stock certain related-party interests that otherwise would be treated as indebtedness for federal tax purposes. IRS states that these requirements will affect corporations, including those that are partners of certain partnerships, when those corporations or partnerships issue purported indebtedness to related corporations or partnerships.

The Congressional Review Act (CRA) requires a 60-day delay in the effective date of a major rule from the date of publication in the Federal Register or receipt of the rule by Congress, whichever is later. 5 U.S.C. § 801(a)(3)(A). This final rule was published in the Federal Register on October 21, 2016, and has a stated effective date of October 21, 2016. It was received on October 26, 2016. 81 Fed. Reg. 72, 858. Therefore, the final rule does not have the required 60-day delay in its effective date. However, IRS stated that the final rule will become applicable more than 60 days after publication. 81 Fed. Reg. 72,950. For example, section 1.385-3T is applicable to taxable years ending on or after January 19, 2017. 81 Fed. Reg. 72,979.
Enclosed is our assessment of IRS’s compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. With the exception of the 60-day delay in effective date requirement, our review of the procedural steps taken indicates that IRS complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Martin V. Franks
    Chief, Publications and Regulations Branch
    Internal Revenue Service
    Department of the Treasury
(i) Cost-benefit analysis

The Department of Treasury, Internal Revenue Service (IRS) summarized the costs and benefits of this final rule. IRS determined that the primary cost of this rule is the change in compliance costs of businesses, particularly from the section 1.385–2 documentation rules. IRS estimates a compliance cost increase of approximately $56 million or an average of $8,900 per firm in 2016 dollars. IRS states that the $56 million estimate only reflects ongoing compliance costs. IRS notes the estimate does not reflect the initial startup costs and infrastructure investment which are expected to result in additional costs in the first years that the section 385 regulations are in effect.

IRS found that the primary benefit of this rule is an improvement in tax compliance, which the IRS expects will increase tax revenue. Additionally, IRS determined that there are likely to be modest efficiency benefits because differences in the tax treatment of competing corporations will be reduced. IRS states that because the primary effect of the regulations is to limit the extent to which the transactions subject to the regulations can be used for interest stripping, the revenue estimate is calculated primarily as a percentage reduction in the estimated growth in interest stripping relative to the baseline of current law absent the regulations. IRS states that the preliminary estimates of the regulatory revenue effect are $7.4 billion over 10 years (or $600 million per year on an annualized 3 percent discount basis.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

IRS determined that this rule will not have a significant economic impact on a substantial number of small entities.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

Section 202 of the Act requires that an agency prepare a budgetary impact statement before promulgating a rule that may result in expenditure by state, local, and tribal governments, in the aggregate, or by the private sector, of $100 million (adjusted for inflation) or more in any one year. In the final rule, IRS estimated that the cost of compliance would be $56 million in 2016 dollars. IRS included a discussion of the budgetary impact in the final rule.
(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

On April 8, 2016, IRS published a proposed rule. 81 Fed. Reg. 20,912. IRS received 29,780 comments. IRS responded to comments in the final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

The collection of information contained in this rule was reviewed and approved by the Office of Management and Budget under control number 1545-2267.

Statutory authorization for the rule

IRS promulgated this final rule under the authority of 26 U.S.C. §§ 7805, 385, 6001, 6011, 701, 1502, 1504(a)(5)(A), and 7701(l).

Executive Order No. 12,866 (Regulatory Planning and Review)

IRS determined that this rule is economically significant. This rule was reviewed by the Office of Management and Budget.

Executive Order No. 13,132 (Federalism)

IRS did not address Executive Order 13,132.