

circumstances (e.g., telephone call, personal interview, etc.) under which it was made;

(D) A brief statement of the substance of the matters discussed; and

(E) Whether the person making the communication persisted in doing so after being advised that the communication was prohibited.

(3) *Filing.* All communications and statements forwarded to the Secretariat or Presiding Officer under this section shall be placed in a public file which shall be associated with, but not made a part of, the record of the proceedings to which the communication or statement pertains.

(4) *Service on parties.* The Secretariat or the Presiding Officer, as appropriate, shall serve a copy of each communication and statement forwarded under this section on all parties to the proceedings. However, if the parties are numerous, or if the Secretary or Presiding Officer, as appropriate, determine that service of the communication or statement would be unduly burdensome, he/she, in lieu of service, may notify all parties in writing that the communication or statement has been made and filed and that it is available for inspection and copying.

(5) *Service on maker.* The Secretariat or the Presiding Officer, as appropriate, shall forward to the person who made the prohibited *ex parte* communication a copy of each communication or statement filed under this section.

(f) *Effect of ex parte communications.* No prohibited *ex parte* communication shall be considered as part of the record for decision unless introduced into evidence by a party to the proceedings.

(g) *Sanctions.* A person or party who makes a prohibited *ex parte* communication, or who encourages or solicits another to make any such communication, may be subject to sanctions including but not limited to exclusion from the proceedings and an adverse ruling on the issue which is the subject of the prohibited communication. A person, not a party to the proceeding, who makes or causes to be made an *ex parte* communication prohibited by paragraph (b) of this section shall be subject to all sanctions provided in this section if such person subsequently becomes a party to the proceeding.

#### Subpart H—Implementation of the Equal Access to Justice Act in Adjudicative Proceedings With the Commission

■ 49. The authority citation for part 1025, subpart H, is revised to read as follows:

**Authority:** 5 U.S.C. 504, 551 *et seq.*

■ 50. Add § 1025.69 to subpart H to read as follows:

#### § 1025.69 Separation of functions.

An employee or agent engaged in the performance of investigative or prosecuting functions for the Commission in a case, other than a Commissioner, may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency review of the recommended decision, except as witness or counsel in public proceedings.

■ 51. Revise § 1025.70 to read as follows:

#### § 1025.70 General provisions.

The Equal Access to Justice Act, 5 U.S.C. 504 (called “the EAJA” in this subpart), provides for the award of attorney fees and other expenses to eligible persons who are parties to certain adversary adjudicative proceedings before the Commission. Applications for such fees and expenses may be made according to the EAJA, as interpreted by the federal courts and guidance provided by the U.S. Department of Justice.

#### 1025.71 and 1025.72 and Appendix I to Part 1025 [Removed]

■ 52. Remove §§ 1025.71 and 1025.72 and appendix I to part 1025.

Dated: April 5, 2016.

**Todd A. Stevenson,**  
*Secretary, Consumer Product Safety Commission.*

[FR Doc. 2016–08125 Filed 4–12–16; 8:45 am]

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## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG–133673–15]

RIN 1545–BN07

#### Deemed Distributions Under Section 305(c) of Stock and Rights to Acquire Stock

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed regulations regarding deemed distributions of stock and rights to acquire stock. The proposed regulations would resolve ambiguities concerning the amount and timing of deemed distributions that are or result from

adjustments to rights to acquire stock. The proposed regulations also would provide additional guidance to withholding agents regarding their current withholding and information reporting obligations under chapters 3 and 4 with respect to these deemed distributions. The proposed regulations would affect corporations issuing rights to acquire stock, their shareholders and holders of these rights, and withholding agents with respect to these deemed distributions.

**DATES:** Written or electronic comments and requests for a public hearing must be received by July 12, 2016.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG–133673–15), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC, 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–133673–15), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC, 20224 or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (indicate IRS and REG–133673–15).

#### FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations under section 305, Maurice M. LaBrie, (202) 317–5322; concerning the proposed regulations under sections 860G, 861, 1441, 1461, 1471, and 1473, Subin Seth, (202) 317–6942; concerning the proposed regulations under section 6045B, Pamela Lew, (202) 317–7053; concerning submission of comments, contact Regina Johnson, (202) 317–6901 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

#### Background and Explanation of Provisions

##### 1. Overview

This document contains proposed regulations that amend 26 CFR part 1 under sections 305, 860G, 861, 1441, 1461, 1471, 1473, and 6045B of the Internal Revenue Code of 1986 (Code) concerning deemed distributions that are or result from adjustments to rights to acquire stock.

Final regulations under section 305 were published in the **Federal Register** on July 12, 1973 (TD 7281, 38 FR 18531), and amendments to those final regulations were published in the **Federal Register** on October 15, 1974 (TD 7329, 39 FR 36860), and in the **Federal Register** on December 21, 1995 (TD 8643, 60 FR 66134).

Final regulations under sections 1441 and 1461 were published in the **Federal**

**Register** on October 14, 1997 (TD 8734, 62 FR 53387), and the following amendments to those final regulations were published in the **Federal Register** on: December 31, 1998 (TD 8804, 63 FR 72187); December 30, 1999 (TD 8856, 64 FR 73412); May 22, 2000 (TD 8881, 65 FR 32186); August 1, 2006 (TD 9272, 71 FR 43366); July 14, 2008 (TD 9415, 73 FR 40172) (corrected on August 6, 2008 (73 FR 45612)); January 23, 2012 (TD 9572, 77 FR 3109); December 5, 2013 (TD 9648, 78 FR 73081); March 6, 2014 (TD 9658, 79 FR 12726) (corrected on July 1, 2014 (79 FR 37175)); and, September 18, 2015 (TD 9734, 80 FR 56866). Final regulations under sections 1471 and 1473 were published in the **Federal Register** on January 28, 2013 (TD 9610, 78 FR 5874) (corrected on September 10, 2013 (78 FR 55202)), and the amendments to those final regulations were published as temporary regulations in the **Federal Register** on March 6, 2014 (TD 9657, 79 FR 12812) (corrected on July 1, 2014 (79 FR 37175)).

Final regulations under section 6045B were published in the **Federal Register** on October 18, 2010 (TD 9504, 75 FR 64072), and amendments to those final regulations were published in the **Federal Register** on April 18, 2013 (TD 9616, 78 FR 23116).

## 2. Amount and Timing of Deemed Distributions Under Section 305(c)

### A. Application of Section 305(b) and (c) Generally

Section 305 and the regulations thereunder apply to actual and deemed distributions by a corporation of its own stock and rights to acquire its own stock. Section 305(a) provides the general rule that the receipt of these distributions is not included in the gross income of the recipient; however, under section 305(b)(1) through (b)(5) certain actual and deemed distributions of stock and stock rights are treated as distributions of property to which section 301 applies. For example, under section 305(b)(2), if a distribution (or series of distributions) by a corporation has the result of a receipt of property by some shareholders and an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the corporation, all the distributions are treated as distributions of property to which section 301 applies.

Section 305(c) authorizes the Secretary to prescribe regulations to treat changes in the conversion ratio of instruments convertible into stock and other events having similar effects as distributions to shareholders whose

proportionate interests in the assets or earnings and profits of the corporation are increased by such events.

Under section 305(d)(1) and current § 1.305-1(d), for purposes of section 305 and the regulations thereunder, the term *stock* includes rights to acquire stock, and under section 305(d)(2), for purposes of section 305(b) and (c) and the regulations thereunder, the term *shareholder* includes a holder of rights to acquire stock. For purposes of this preamble:

The term *actual shareholder* means a holder of stock (not including rights to acquire stock).

The term *deemed shareholder* means a holder of a right to acquire stock.

The term *deemed distribution* means a transaction or event, other than an actual distribution of stock, money, or other property, that is a distribution under section 305(b) and (c).

The term *applicable adjustment* means an adjustment to a right to acquire stock, including an increase or reduction in conversion ratio, conversion price, option price, or number of shares the holder would receive upon conversion or exercise.

The term *right to acquire stock* means any right to acquire stock, whether pursuant to a convertible instrument (such as a debt instrument that is convertible into shares of stock), a warrant, subscription right, or stock right issued by the corporation that issued or will issue the underlying stock, or any other right to acquire stock of the corporation issuing such right (whether settled in stock or in cash).

Under current § 1.305-1(b)(1), when a distribution of stock (including a right to acquire stock) is a distribution of property to which sections 305(b) and 301 apply, the amount of the distribution is the fair market value, on the date of the distribution, of the stock or right to acquire stock that is distributed.

### B. Application of Section 305(b) and (c) to Adjustments to Rights To Acquire Stock

A corporation may issue rights to acquire its stock in a number of forms, including warrants, subscription rights, options, convertible instruments that give the holder a right to convert the instruments into shares of stock in the issuing corporation, and similar instruments. In any of these forms, rights to acquire stock may provide for applicable adjustments that grant deemed shareholders economic benefits that correspond to distributions of stock, cash, or other property made to actual shareholders. Similarly, rights to acquire stock may provide for

adjustments to prevent actual shareholders' interests from being diluted as a result of distributions of stock, cash, or other property to deemed shareholders (that is, holders of rights to acquire stock).

An applicable adjustment to a convertible instrument may consist of an increase in the number of shares of stock a holder would receive upon conversion. Similarly, an applicable adjustment to a warrant, subscription right, stock right, option, or similar right to acquire stock may consist of an increase in the number of shares the holder would receive upon exercise. In either situation, the applicable adjustment may have the effect of increasing the deemed shareholders' proportionate interests in the assets or earnings and profits of the corporation. If this increase has a result described in section 305(b), then under section 305(c) the applicable adjustment is a deemed distribution to the deemed shareholder, and section 301 applies to the deemed distribution.

Under current § 1.305-7(b)(1), an applicable adjustment made pursuant to a bona fide, reasonable adjustment formula that has the effect of preventing dilution of a shareholder's interest is not a deemed distribution of stock to which sections 305(b) and 301 apply. However, also under current § 1.305-7(b)(1), an applicable adjustment to compensate for a distribution of cash or property to actual shareholders that is taxable under section 301, 356(a)(2), 871(a)(1)(A), 881(a)(1), 852(b), or 857(b) is not considered as made pursuant to such a bona fide, reasonable adjustment formula, and therefore may be a distribution to which sections 305(b) and 301 apply.

The Treasury Department and the IRS have concluded that, under section 305(b) and (c) and the regulations thereunder, it is clear that an applicable adjustment is a deemed distribution to which section 301 applies, if: (i) The applicable adjustment increases the proportionate interest of an actual shareholder or a deemed shareholder in the corporation's assets or earnings and profits; (ii) such increase in proportionate interest has a result described in section 305(b); and (iii) the anti-dilution exception of § 1.305-7(b)(1) does not apply. For example, it has been the position of the Treasury Department and the IRS for over forty years that, under section 305(b) and (c) and the regulations thereunder, an increase in the conversion ratio of a convertible debt instrument may be treated as a deemed distribution to the deemed shareholder that holds the instrument, and, if so treated, section

301 applies to the deemed distribution. *See* Rev. Rul. 75–513 (1975–2 CB 114) (section 301 applied to deemed distribution where conversion ratio of convertible debentures increased due to payment of cash dividend to common shareholders); and Rev. Rul. 76–186 (1976–1 CB 86) (same; basis of the convertible debentures was increased by the value of the deemed distribution); *cf.* Rev. Rul. 77–37 (1977–1 CB 85) (no deemed distribution because anti-dilution exception of § 1.305–7(b) applied where distribution to actual shareholders was tax-free under section 355).

The current regulations are unclear, however, as to the amount of a deemed distribution to a deemed shareholder. The current regulations may reasonably be interpreted as providing either that such a deemed distribution is treated as a distribution of a right to acquire stock (the amount of which is the fair market value of the right), or that such a distribution is treated as a distribution of the actual stock to which the right relates (the amount of which is the fair market value of the stock). Accordingly, for deemed distributions to deemed shareholders occurring before final regulations are published, the IRS will not challenge either position.

The current regulations are also unclear as to the timing of such a distribution. Under the proposed regulations, such a distribution generally would be deemed to occur at the time the applicable adjustment occurs, in accordance with the instrument setting forth the terms of the right to acquire stock, but in no event later than the date of the distribution of cash or property that results in the deemed distribution (taking into account § 1.305–3(b)).

These proposed regulations would amend the current regulations under section 305(b) and (c) only to clarify the amount and timing of such deemed distributions, not the fact of their occurrence, which is clear under current law.

### C. Summary of Proposed Regulations

#### i. Amount of Deemed Distributions

After studying this area, the Treasury Department and the IRS have concluded that a deemed distribution of a right to acquire stock is more accurately viewed as a distribution of additional rights to acquire stock, the amount of which is the fair market value of the right.

Under the terms of a convertible instrument, a distribution of cash or property to actual shareholders may increase the number of shares the holder of the convertible instrument would

receive upon conversion. Similarly, a distribution of cash or property to actual shareholders may increase the number of shares the holder of other rights to acquire stock, such as warrants or options, would receive upon exercise. In either case, the increase is an applicable adjustment and a deemed distribution of additional rights to acquire stock to the holders of the rights to acquire stock. Under the proposed regulations, the amount of the deemed distribution would be the excess of (i) the fair market value of the right to acquire stock immediately after the applicable adjustment over (ii) the fair market value of the right to acquire stock without the applicable adjustment. In determining the fair market value of a right to acquire stock, any particular facts pertaining to the deemed shareholder's rights, including the number of actual shares of stock or rights to acquire stock held by such deemed shareholder, would be disregarded.

Also, under the terms of a convertible debt instrument or other right to acquire stock, a payment of cash or property to the holder may cause a reduction in the number of shares the holder would receive upon conversion or exercise. Such a reduction is an applicable adjustment that increases the actual shareholders' proportionate interests in the assets or earnings and profits of the corporation. Thus, the applicable adjustment results in a deemed distribution of stock to the actual shareholders, and section 301 applies to the deemed distribution. Under the proposed regulations, the amount of this deemed distribution would be the fair market value of the stock deemed distributed, determined in accordance with § 1.305–3(e), *Examples 8 and 9* (relating to deemed distributions to shareholders resulting from certain redemptions of stock from other shareholders). *See also* Tax Revenue Act of 1969: Hearings on H.R. 13270 Before the House Ways and Means Comm., 91st Cong. 1st Sess., pt. 14, 5196–98 (1969).

#### ii. Timing of Deemed Distributions

When an applicable adjustment is or results in a deemed distribution under proposed § 1.305–7(c)(1) or (2), the deemed distribution occurs at the time such applicable adjustment occurs, in accordance with the instrument setting forth the terms of the right to acquire stock, but in no event later than the date of the distribution of cash or property that results in the deemed distribution (taking into account § 1.305–3(b)). For such an applicable adjustment relating to a right to acquire publicly-traded stock, if the instrument setting forth the

terms of such right does not set forth the date and time the applicable adjustment occurs, the deemed distribution would occur immediately prior to the opening of business on the ex-dividend date for the distribution of cash or property that results in the deemed distribution. For such an applicable adjustment relating to a right to acquire non-publicly traded stock, if the instrument setting forth the terms of such right does not set forth the date and time the applicable adjustment occurs, the deemed distribution occurs on the date that a holder is legally entitled to the distribution of cash or property that results in the deemed distribution.

### 3. Withholding Under Chapters 3 and 4 on Deemed Distributions Under Section 305(c)

This section provides a discussion of the proposed rules regarding deemed distributions under section 305(c). Section 4 of the preamble provides a discussion of the proposed rules regarding substitute dividend payments that are deemed payments determined with respect to a deemed distribution under section 305(c). The proposed rules that would apply for deemed payments are analogous to the proposed rules that would apply to deemed distributions.

#### A. Background

Sections 1441 and 1442 (referred to herein as “chapter 3”) require all persons having the control, receipt, custody, disposal, or payment of items of income subject to withholding of any nonresident alien, foreign partnership, or foreign corporation to withhold tax at a 30-percent rate unless a reduced rate of withholding applies. Amounts subject to withholding include amounts from sources within the United States that are fixed or determinable annual or periodical income, which generally includes, among other things, interest, dividends, and similar types of investment income. § 1.1441–2(b)(1)(i). Under § 1.1441–2(e)(1), “a payment” is considered made to a person “if that person realizes income whether or not such income results from an actual transfer of cash or other property.” For this purpose, a payment is considered made when the amount would be includible in the income of the beneficial owner under the U.S. tax principles governing the cash basis method of accounting. § 1.1441–2(e)(1).

On March 18, 2010, the Hiring Incentives to Restore Employment Act of 2010, Public Law 111–147 (H.R. 2847), added chapter 4 to the Code (sections 1471 through 1474, commonly known as “FATCA”). Chapter 4

generally requires a withholding agent to withhold tax at a 30-percent rate on a “withholdable payment” (as defined in § 1.1473–1(a)) made to a foreign financial institution (FFI) unless the FFI has entered into an agreement described in section 1471(b) to obtain status as a participating FFI or the FFI is deemed to have satisfied the requirements of section 1471(b). Chapter 4 also generally requires a withholding agent to withhold tax at a 30-percent rate on a withholdable payment made to a nonfinancial foreign entity (NFFE) unless the NFFE has provided information to the withholding agent with respect to the NFFE’s substantial U.S. owners or has certified that it has no such owners. *See* section 1472.

These proposed regulations would provide guidance to withholding agents regarding their obligations to withhold under chapters 3 and 4 on deemed distributions under section 305(c). Withholding agents have commented that ambiguities in the current law have made it difficult for them to satisfy their withholding obligations. In particular, withholding agents have commented that these deemed distributions often occur when there is no cash payment that corresponds to the deemed distribution, which makes it difficult for them to satisfy their withholding obligation on the date of the deemed distribution. In addition, withholding agents commented that they often lack knowledge of the fact that a deemed distribution on a security has been made and are therefore unable to withhold on the date of the deemed distribution.

#### B. Amendments to Chapter 3

##### i. Withholding on Deemed Distributions, and New Exception for Deemed Distributions on Specified Securities

Proposed § 1.1441–2(d)(4)(i) would clarify that a withholding agent has an obligation to withhold on a deemed distribution (as defined in § 1.305–1(d)(7)) that is made on a security. Proposed § 1.1441–7(a)(4) would clarify that an issuer of a security upon which a deemed distribution is made and any person that holds directly or indirectly (for example, through an account maintained for an intermediary) a security on behalf of the beneficial owner of the security, or a flow-through entity that owns directly or indirectly (through another flow-through entity) a security, is considered to have custody of or control over the deemed distribution made on the security and, therefore, is a withholding agent with respect to the distribution.

Under current § 1.1441–2(d)(1), a withholding agent does not have an obligation to withhold on a payment when it lacks control over, or custody of, money or property of the recipient, or knowledge of the facts giving rise to the payment (the general exception). This general exception does not apply when, in relevant part, the payment is a distribution with respect to stock. The proposed regulations, however, would allow a withholding agent (other than the issuer of the specified security) to benefit from a new exception to withholding in proposed § 1.1441–2(d)(4) for deemed distributions (as defined in § 1.305–1(d)(7)) of stock or a right to acquire stock on a specified security (as defined in § 1.6045–1(a)(14)). Under this new exception, a withholding agent (other than the issuer of the specified security) would have an obligation to withhold on such a deemed distribution only if, before the due date (not including extensions) for filing Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, with respect to the calendar year in which the deemed distribution occurred, either (i) the issuer meets its reporting requirements under § 1.6045B–1 (by furnishing an issuer statement or publicly reporting the information required under that section) or (ii) the withholding agent has actual knowledge that a deemed distribution has occurred, in which case the obligation to withhold would not arise until January 15 of the year following the calendar year of the deemed distribution.

##### ii. When and How To Withhold

Once the requirements of proposed § 1.1441–2(d)(4)(i) have been satisfied, a withholding agent would have an obligation to withhold on a deemed distribution. Except as provided in § 1.1441–5 regarding the time to withhold for partnerships and trusts, under proposed § 1.1441–2(d)(4)(ii), a withholding agent would be required to satisfy its withholding obligation by withholding on the earliest of (i) the date on which a future cash payment is made with respect to the security; (ii) the date on which the security is sold, exchanged, or otherwise disposed of (including a transfer of the security to another account not maintained by the withholding agent or a termination of the account relationship); or (iii) the due date (not including extensions) for filing Form 1042 with respect to the calendar year in which the deemed distribution occurred. Under this approach, a withholding agent that continues to directly or indirectly hold or own the security when the requirements of

proposed § 1.1441–2(d)(4)(i) are satisfied generally would be able to satisfy its withholding obligation by withholding on future cash payments on the security (for example, an interest payment on a convertible bond). If, however, the security is disposed of before sufficient future cash payments have been made on the security, the withholding agent would be required to withhold at the time of disposition and generally would be expected to do so by, for example, withholding on the proceeds from the disposal, liquidating other property held in custody for the beneficial owner, or obtaining other funds directly or indirectly from the beneficial owner to satisfy the withholding.

If there are not sufficient future cash payments on the security and the security has not been disposed of or transferred before the due date (not including extensions) for filing Form 1042 with respect to the calendar year in which the deemed distribution occurred, then, to avoid having to pay the tax out of the withholding agent’s own funds, the withholding agent may apply current § 1.1461–2(b) in order to collect the underwithheld amount. Under these rules, the withholding agent can satisfy the tax by withholding on other cash payments made to the same beneficial owner or by liquidating other property held in custody for the beneficial owner or over which it has control. The proposed regulations would amend current § 1.1461–2(b) to clarify that a withholding agent may obtain the property from which to withhold under these rules through additional contributions obtained directly or indirectly from the beneficial owner. The proposed regulations also would add a sentence to current § 1.1461–2(b) to clarify that a withholding agent that satisfies its obligation to withhold under § 1.1461–2(b) will not be subject to any penalties for failure to deposit or failure to pay under sections 6656, 6672, and 7202 when it deposits the amounts obtained in this manner by the due date (not including extensions) for filing Form 1042 with respect to the calendar year in which the deemed distribution occurred. These clarifications reflect the IRS interpretation of current § 1.1461–2(b) in applying these penalties, and thus no penalties will be imposed for withholding agents that apply these rules to satisfy their obligations to withhold before the effective date of these regulations.

When the requirements of proposed § 1.1441–2(d)(4)(i) are satisfied after a withholding agent has terminated its relationship with the beneficial owner

of the security, the withholding agent would remain liable for any underwithheld amount with respect to the deemed distribution. In order to avoid having to pay the tax due out of the withholding agent's own funds, before terminating an account relationship, a withholding agent should make arrangements with the beneficial owner to ensure that the withholding agent can satisfy any tax due, such as by retaining funds or other property of the owner.

### iii. Foreign Entities Assuming Withholding Responsibilities

Proposed § 1.1441-2(d)(4)(iii) would provide that a withholding agent may treat certain foreign entities (qualified intermediaries, withholding foreign partnerships, withholding foreign trusts, and U.S. branches treated as U.S. persons) as assuming primary chapter 3 withholding responsibilities for a deemed distribution on a specified security only if (i) the withholding agent provides the foreign entity with a copy of the issuer statement described in § 1.6045B-1(b)(1) within 10 days of the issuer furnishing the statement to the holder of record or its nominee, or (ii) the issuer has met the public reporting requirements under § 1.6045B-1(a)(3). The foreign entity would have an obligation to withhold on the deemed distribution only if it receives a copy of the issuer statement or if the issuer has met the public reporting requirements by the due date (not including extensions) for filing Form 1042 with respect to the calendar year in which the deemed distribution occurred. A withholding agent that fails to provide a copy of the issuer statement to a foreign entity (in the absence of public reporting) would not be permitted to treat the foreign entity as having assumed primary withholding responsibilities for the deemed distribution and would therefore have to withhold and report based on the information that it has regarding the recipient of the deemed distribution. The purpose of this proposed rule is to ensure that foreign entities that assume primary withholding responsibilities for deemed distributions will possess the information described in § 1.6045B-1 to meet their withholding and information reporting obligations, as these entities (or their nominees) may not be holders of record that otherwise would receive the issuer statement described in § 1.6045B-1(b)(1).

### iv. Reliance on Issuer Information Reporting

Under proposed § 1.1441-3(c)(5), a withholding agent (other than the issuer

of the specified security) would be permitted to rely on the information that an issuer provides on an issuer statement described in § 1.6045B-1(b)(1) or on a public Web site described in § 1.6045B-1(a)(3) to determine the proper amount of withholding on a deemed distribution on a specified security unless it knows that the information is incorrect or unreliable. Additionally, a foreign entity that has assumed primary withholding responsibilities would be permitted to rely on the copy of the issuer statement described in § 1.6045B-1(b)(1) that it receives from another withholding agent under the circumstances described in proposed § 1.1441-2(d)(4)(iii) unless it knows that the information is incorrect or unreliable.

### v. Other Changes to Current § 1.1441-2(d)(1)

The proposed regulations would add language to § 1.1441-2(d)(1) to clarify that a withholding agent does not lack control over money or property if it directs another person to make a payment, and that a withholding agent does not lack knowledge of the facts that give rise to a payment merely because the withholding agent does not know the character or source of the payment for U.S. tax purposes. The proposed regulations also would add an example to § 1.1441-2(d)(1) of when a withholding agent lacks knowledge of the facts that give rise to a payment. These clarifications and the example are consistent with similar rules in current § 1.1471-2(a)(4)(i) that apply for chapter 4 purposes.

The proposed regulations also would make nonsubstantive changes to reorganize the structure of current § 1.1441-2(d)(1).

### C. Amendments to Chapter 4

The proposed regulations would modify the regulations under chapter 4 to provide guidance similar to the rules described in proposed §§ 1.1441-2(d)(1), 1.1441-2(d)(4), 1.1441-3(c)(5), and 1.1441-7(a)(4) for withholding on a deemed distribution (as defined in § 1.305-1(d)(7)) that is a withholdable payment under chapter 4. The amendment to proposed § 1.1461-2(b) that clarifies that a withholding agent may obtain additional contributions of property directly or indirectly from a beneficial owner and the new sentence added to proposed § 1.1461-2(b) regarding penalties also would apply to withholding agents adjusting underwithholding under chapter 4 through cross-reference in § 1.1474-2(b). The proposed regulations also would make nonsubstantive changes to

reorganize the structure of current § 1.1471-2(a)(4)(i), which are consistent with the organizational changes proposed for current § 1.1441-2(d)(1).

### 4. A Substitute Dividend May Include Deemed Payments

Section 1.861-3(a)(6) provides that a substitute dividend payment made to a transferor in a securities lending transaction or sale-repurchase transaction is sourced in the same manner as a dividend on the transferred securities. The regulations define a substitute dividend payment as "a payment, made to the transferor of a security in a securities lending transaction or a sale-repurchase transaction, of an amount equivalent to a dividend distribution which the owner of the transferred security is entitled to receive during the term of the transaction." These proposed regulations would modify § 1.861-3(a)(6) to clarify that a substitute dividend payment includes a deemed payment made in the amount (as determined under § 1.305-7(c)(4)) of a deemed distribution (as defined in § 1.305-1(d)(7)).

These proposed regulations would provide that the general exception to withholding in § 1.1441-2(d)(1)(i) does not apply for deemed payments (as defined in § 1.861-3(a)(6)). However, proposed § 1.1441-2(d)(4) would allow a withholding agent to benefit from the same exception to withholding that would apply to deemed distributions (as defined in § 1.305-1(d)(7)) on a specified security for deemed payments (as defined in § 1.861-3(a)(6)) that are determined with respect to a deemed distribution on a specified security. Thus, a withholding agent would have an obligation to withhold on such a deemed payment only if, before the due date (not including extensions) for filing Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, with respect to the calendar year in which the deemed distribution on a specified security occurred, either (i) the issuer meets its reporting requirements under § 1.6045B-1 (by furnishing an issuer statement or publicly reporting the information required under that section) or (ii) the withholding agent has actual knowledge that a deemed distribution has occurred, in which case the obligation to withhold would not arise until January 15 of the year following the calendar year of the deemed distribution or the deemed payment. If a withholding agent has an obligation to withhold on a deemed payment (as defined in § 1.861-3(a)(6)) under § 1.1441-2(d)(4)(i), it would be required

to withhold subject to the rules regarding when and how to withhold in proposed § 1.1441-2(d)(4)(ii) and the rules regarding foreign entities that assume withholding responsibilities in § 1.1441-2(d)(4)(iii). These proposed regulations also would modify the regulations under chapter 4 to provide similar guidance with respect to deemed payments that are withholdable payments.

#### 5. Issuer Reporting Under Section 6045B

To facilitate broker reporting of a security's adjusted basis to the holder of the security under section 6045, section 6045B provides that, according to the forms or regulations prescribed by the Secretary, an issuer of a specified security (for example, stock, a convertible debt instrument, or a warrant) must report certain information relating to an organizational action that affects the basis of the security to both the IRS and the holders of the security. Under section 6045B and current § 1.6045B-1, an issuer must file an issuer return (Form 8937, Report of Organizational Actions Affecting Basis of Securities) with the IRS by the earlier of 45 days after the organizational action or January 15 of the calendar year following the organizational action. In addition, the issuer must send a written statement (for example, a copy of the issuer return) to holders by January 15 of the calendar year following the organizational action. In lieu of filing the issuer return with the IRS and furnishing the written statement to holders, current § 1.6045B-1(a)(3) permits an issuer to post the required information on its public Web site by the due date for reporting the issuer return to the IRS. Under current § 1.6045B-1, however, an issuer is not required to send a statement to exempt recipients, such as C corporations and foreign persons, nor is an issuer required to file an issuer return if the issuer reasonably determines that all of the holders of the security are exempt recipients. An issuer must comply with current § 1.6045B-1 for an organizational action that occurs on or after the applicability date prescribed in current § 1.6045B-1(j). For example, an issuer of a convertible debt instrument must comply with current § 1.6045B-1 for an organizational action that occurs after December 31, 2015.

An applicable adjustment, including a conversion ratio adjustment, is an organizational action that often will affect the holder's basis in a specified security. For example, the instructions to Form 8937 provide that if a conversion ratio adjustment on a convertible debt instrument occurring

after December 31, 2015, results in a distribution under section 305(c) (for example, because it is made in conjunction with a cash distribution to shareholders), the issuer of the debt instrument must file Form 8937.

Brokers and withholding agents have expressed concerns about the difficulty of complying with their reporting and withholding obligations in the absence of information about the fact and amount of a deemed distribution under section 305(c), including a deemed distribution under section 305(c) resulting from an applicable adjustment. Even after December 31, 2015, when issuers are generally required to report an applicable adjustment on a convertible debt instrument, brokers and withholding agents may not have the necessary information to comply with their reporting and withholding obligations because of the exempt recipient exception for providing a written statement (and assuming that the issuer does not choose the public reporting alternative). In response to these concerns, § 1.6045B-1(i)(2) of the proposed regulations would require that an issuer provide an issuer return to the IRS and a written statement to each holder of record of a specified security (or to the holder's nominee) relating to a deemed distribution under section 305(c) on the security, without regard to any of the general exceptions in the current regulations under section 6045B or in the instructions to Form 8937. The proposed regulations, like the current regulations, permit an issuer to not provide an issuer return to the IRS or a written statement to the holders regarding the deemed distribution if the issuer satisfies the public reporting requirements in current § 1.6045B-1(a)(3).

#### 6. Reporting for U.S. Persons

Section 1.6045B-1 generally applies when a deemed distribution affects the basis of a specified security. It is expected that similar principles would apply under section 6042 with respect to reporting of deemed distributions made to U.S. persons on Form 1099-DIV. Comments are requested on the implementation of Form 1099-DIV reporting on these amounts.

#### Proposed Effective/Applicability Date

The proposed regulations under section 305 would apply to deemed distributions occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A taxpayer, however, may rely on these proposed regulations for deemed distributions under section 305(c) that

occur prior to such date. For purposes of determining the amount of a deemed distribution to a deemed shareholder occurring prior to the date of publication, a taxpayer may determine the amount of the deemed distribution by treating such distribution either as a distribution of a right to acquire stock or as a distribution of the actual stock to which the right relates.

The proposed regulations under sections 860G, 861, 1441, 1461, 1471, and 1473 would apply to payments made on or after the date of publication. A withholding agent, however, may rely on the proposed regulations under sections 861, 1441, 1471, and 1473 for all deemed distributions under section 305(c) or, to the extent applicable, deemed payments (as defined in § 1.861-3(a)(6)) occurring on or after January 1, 2016 until the date of publication. No inference as to the application of these provisions under current law is intended by permitting reliance on these proposed regulations. A withholding agent also may rely on the proposed regulations under section 1461 for any payments occurring on or after January 1, 2016 until the date of publication, including for any deemed distribution under section 305(c) or deemed payment (as defined in § 1.861-3(a)(6)) for which the withholding agent failed to withhold.

Section 1.6045B-1(i)(2) would apply to a deemed distribution under section 305(c) occurring on or after the date of publication. In addition, an issuer would report the amount and timing of a deemed distribution in accordance with the proposed regulations under section 305 for a deemed distribution occurring on or after the date of publication. For purposes of reporting the amount of a deemed distribution occurring prior to the date of publication, an issuer may determine the amount of the deemed distribution by treating such distribution either as a distribution of a right to acquire stock, or as a distribution of the shares of stock that would be received upon exercise of the right. In addition, an issuer may rely on § 1.305-7(c)(5) of the proposed regulations to determine the date of a deemed distribution occurring prior to the date of publication.

#### Statement of Availability of IRS Documents

IRS Revenue Rulings cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402, or by visiting the IRS Web site at <http://www.irs.gov>.

### Effect on Other Documents

The IRS will modify, clarify, or obsolete publications as necessary to conform to these proposed regulations as of the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. See, e.g., Rev. Rul. 75-513 (1975-2 CB 114) and Rev. Rul. 76-186 (1976-1 CB 186). The IRS solicits comments as to whether other publications should be modified, clarified, or obsoleted.

### Special Analyses

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the proposed regulations under section 6045B in this document will not have a significant economic impact on a substantial number of small entities. Any effect on small entities by the rules in the proposed regulations flows directly from section 403 of the Energy Improvement and Extension Act of 2008, Division B of Public Law 110-343 (122 Stat. 3765, 3854 (2008)) (the Act).

Section 403(d) of the Act added section 6045B, which requires an issuer, including an issuer that is a small entity, to report certain information relating to any organizational action by the issuer that affects the basis of a specified security. In general, an issuer reports the information required under section 6045B to the IRS and to holders or nominees on Form 8937. The proposed regulations limit reporting to the information necessary to meet the Act's requirements. In addition, the proposed regulations retain the rule in the current regulations under section 6045B that permits an issuer to report each action publicly on its Web site instead of filing a return and furnishing each holder or nominee a statement about the action. The proposed regulations therefore do not add to the statutory impact on small entities but instead eases this impact to the extent the statute permits. Moreover, any economic impact on small entities is expected to be minimal.

Therefore, because the proposed regulations in this document will not have a significant economic impact on a substantial number of small entities, a

regulatory flexibility analysis is not required.

Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Requests for Public Hearing

Before the proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the "Addresses" heading. The Treasury Department and the IRS request comments on all aspects of the proposed regulations. All comments will be available for public inspection and copying upon request, or at [www.regulations.gov](http://www.regulations.gov). A public hearing will 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 for the public hearing will be published in the **Federal Register**.

### Drafting Information

The principal authors of these regulations are: With respect to the regulations under section 305, Maurice M. LaBrie of the Office of Associate Chief Counsel (Corporate); with respect to the regulations under sections 860G, 861, 1441, 1461, 1471, and 1473, Subin Seth of the Office of Associate Chief Counsel (International); and with respect to the regulations under section 6045B, Pamela Lew of the Office of Associate Chief Counsel (Financial Institutions and Products), all within the Office of Chief Counsel, IRS. Other personnel from the Treasury Department and the IRS participated in developing the regulations.

### 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 TAX REGULATIONS

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

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

■ **Par. 2.** Section 1.305-1 is amended by:

- 1. Revising paragraphs (b)(3) and (d).
- 2. Adding paragraph (e).

The revisions and addition read as follows:

### § 1.305-1 Stock dividends.

\* \* \* \* \*

(b) \* \* \*

(3) For rules determining the amount of the distribution for certain transactions, such as periodic redemptions or applicable adjustments (as defined in § 1.305-7(a)) of rights to acquire stock that are treated as distributions under section 305(b) and (c), see § 1.305-7 and *Examples 6, 7, 8, 9, and 15* of § 1.305-3(e).

\* \* \* \* \*

(d) *Definitions.* For purposes of section 305, this section, and §§ 1.305-2 through 1.305-7:

(1) *Stock.* The term *stock* means actual stock or a right to acquire stock.

(2) *Actual stock.* The term *actual stock* means stock issued by a corporation, excluding rights to acquire stock as defined in paragraph (d)(3) of this section.

(3) *Right to acquire stock.* The term *right to acquire stock* means—

(i) A right of a holder of a convertible instrument (including a debt instrument that is convertible into shares of stock and stock that is convertible into shares of another class of stock) to convert the instrument into one or more shares of stock of the corporation issuing the instrument;

(ii) A warrant, subscription right, stock right, or other option to acquire shares of stock of the corporation issuing the instrument;

(iii) A right to acquire stock of the corporation issuing such right similar to the rights described in paragraphs (d)(3)(i) and (ii) of this section; and

(iv) A right to receive an amount of cash or other property determined in whole or in part by reference to the value of a specified number of shares of stock (whether or not in lieu of such stock) of the corporation issuing the right.

(4) *Shareholder.* The term *shareholder* means a holder of actual stock or a holder of a right to acquire stock.

(5) *Actual shareholder.* The term *actual shareholder* means a holder of actual stock.

(6) *Deemed shareholder.* The term *deemed shareholder* means a holder of a right to acquire stock.

(7) *Deemed distribution.* The term *deemed distribution* means a transaction or event, other than an actual distribution of cash or property, that constitutes a distribution under section 305(b) and (c). An applicable adjustment to a right to acquire stock is not and does not result in a deemed distribution if either—



(i) The right to acquire stock is a nonqualified stock option without a readily ascertainable fair market value (see section 83(e) and § 1.83-7), or

(ii) Section 83(a) applies to the right to acquire stock or the stock to which the right relates or the stock is subject to a substantial risk of forfeiture, and the holder of the right has not made an election under section 83(b).

(e) *Effective/applicability date.*

Paragraphs (b)(3) and (d) of this section apply to deemed distributions under section 305(b) and (c) occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A taxpayer, however, may rely on these proposed regulations for deemed distributions under section 305(c) that occur prior to such date. For purposes of determining the amount of a deemed distribution to a deemed shareholder occurring prior to such date, a taxpayer may determine the amount of the deemed distribution by treating such distribution either as a distribution of a right to acquire stock or as a distribution of the actual stock to which the right relates.

■ **Par. 3.** Section 1.305-3 is amended by:

■ 1. Revising paragraph (e) introductory text,

■ *Example (6)(ii)*,

■ *Example (7)(ii)* and (iii).

■ 2. Adding paragraph (f).

The revisions and addition read as follows:

**§ 1.305-3 Disproportionate distributions.**

\* \* \* \* \*

(e) *Examples.* The following examples illustrate the application of section 305(b)(2) to distributions of stock and rights to acquire stock and the application of section 305(c) to deemed distributions of stock and rights to acquire stock. \* \* \*

*Example 6.* \* \* \*

(ii) M pays an annual cash dividend on the class A stock. At the beginning of the second year, when the conversion ratio is increased to 1.05 shares of class A stock for each share of class B stock, an applicable adjustment occurs, as defined in § 1.305-7(a), and a distribution of rights to acquire 0.05 shares of class A stock is deemed made under section 305(c) and § 1.305-7(c)(1) with respect to each share of class B stock. The proportionate interests of the class B shareholders in the assets or earnings and profits of M are increased, and the transaction has the effect described in section 305(b)(2). Accordingly, sections 305(b)(2) and 301 apply to the transaction. The amount of the deemed distribution is determined in accordance with § 1.305-7(c)(4)(ii), and the date and time of the deemed distribution are determined in accordance with § 1.305-7(c)(5).

*Example 7.* \* \* \*

(ii) In 2017, a \$1 cash dividend per share is declared and paid on the class B stock. Pursuant to the terms of the class B stock, on the date of payment, the conversion ratio of the class B stock is reduced. The reduction in conversion ratio is an applicable adjustment, as defined in § 1.305-7(a). Under section 305(c) and § 1.305-7(c)(2), the reduction is a deemed distribution of stock to the class A shareholders, since their proportionate interest in the assets or earnings and profits of the corporation is increased, and the transaction has the effect described in section 305(b)(2). Accordingly, sections 305(b)(2) and 301 apply to the transaction. The amount of the distribution is determined in accordance with § 1.305-7(c)(4)(ii), and the date and time of the deemed distribution are determined in accordance with § 1.305-7(c)(5).

(iii) In the following year a cash dividend is paid on the class A stock but not on the class B stock, and the conversion ratio of the class B stock increases. The increase in the conversion ratio of the class B shares is an applicable adjustment. Under section 305(c) and § 1.305-7(c)(1), the adjustment is a deemed distribution of rights to acquire stock to the class B shareholders since their proportionate interest in the assets or earnings and profits of the corporation is increased, and the transaction has the effect described in section 305(b)(2). Accordingly, sections 305(b)(2) and 301 apply to the transaction. The amount of the distribution is determined in accordance with § 1.305-7(c)(4)(i), and the date and time of the deemed distribution are determined in accordance with § 1.305-7(c)(5).

\* \* \* \* \*

(f) *Effective/applicability date.* The first sentence of paragraph (e) of this section and *Examples 6* and *7* of paragraph (e) of this section apply to deemed distributions under section 305(c) occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A taxpayer, however, may rely on these proposed regulations for deemed distributions under section 305(c) that occur prior to such date. For purposes of determining the amount of a deemed distribution to a deemed shareholder occurring prior to the date of publication, a taxpayer may determine the amount of the deemed distribution by treating such distribution either as a distribution of a right to acquire stock or as a distribution of the actual stock to which the right relates.

■ **Par. 4.** Section 1.305-7 is revised to read as follows:

**§ 1.305-7 Certain transactions treated as distributions.**

(a) *Applicable adjustment.* For purposes of section 305, §§ 1.305-1 through 1.305-6, and this section, the term *applicable adjustment* means an

adjustment to a right to acquire stock (as defined in § 1.305-1(d)(3)), including—

(1) With respect to a convertible instrument and a holder thereof, an increase in the conversion ratio or a reduction in the conversion price of such instrument;

(2) With respect to a warrant, subscription right, stock right, option, or other similar right and a holder thereof, an increase in the number of shares to be received by the holder upon exercise or a reduction in exercise price;

(3) With respect to a convertible instrument and a holder of actual stock into which such instrument may be converted, an increase in the conversion price or a reduction in the conversion ratio of such instrument;

(4) With respect to a warrant, subscription right, stock right, option, or similar right and a holder of actual stock into which such instrument is exercisable, an increase in the exercise price or a reduction in the number of shares to be received by the holder upon exercise; and

(5) An adjustment in the terms of a right to acquire stock having an effect similar to the effects of the adjustments described in paragraphs (a)(1) through (a)(4) of this section, including, for example, an extension or reduction of the term during which a right to acquire stock may be exercised.

(b) *Transactions treated as distributions—(1) In general.* Under section 305(c), an applicable adjustment, a change in redemption price, a difference between redemption price and issue price, a redemption that is treated as a distribution to which section 301 applies, or any transaction (including a recapitalization) having a similar effect on the interest of any shareholder is treated as a distribution of stock to which sections 305(b) and 301 apply if such transaction increases a shareholder's proportionate interest in the assets or earnings and profits of the corporation deemed to make such distribution, and the distribution has the result described in section 305(b)(2), (3), (4), or (5). Depending upon the facts presented, the distribution may be deemed to be made in shares of actual stock or in additional rights to acquire stock (which, in either case, may be common or preferred stock).

(c) *Applicable adjustment to right to acquire stock—(1) Increase in deemed shareholder's proportionate interest.*

Under section 305(c), if an applicable adjustment has the effect of increasing a deemed shareholder's proportionate interest in the assets or earnings and profits of the corporation, and if such increase has the effect described in section 305(b)(2), (3), (4) or (5), the



applicable adjustment is a deemed distribution to the deemed shareholder of a right to acquire stock, and section 301 applies to the deemed distribution. Applicable adjustments that can have this effect include, with respect to a convertible instrument, an increase in the conversion ratio or the number of shares of stock to be received upon conversion or a reduction in the conversion price.

(2) *Increase in actual shareholder's proportionate interest.* If an applicable adjustment has the effect of reducing a deemed shareholder's proportionate interest in the assets or earnings and profits of the corporation and thereby increasing an actual shareholder's proportionate interest, and if such increase has the effect described in section 305(b)(2), (3), (4), or (5), then the applicable adjustment is a deemed distribution of stock to the actual shareholder, and section 301 applies to the deemed distribution. Applicable adjustments that can have this effect include, with respect to a convertible instrument, a reduction in the conversion ratio or in the number of shares to be received upon conversion, or an increase in the conversion price.

(3) *Exception.* For purposes of applying section 305(c) in conjunction with section 305(b), an applicable adjustment that is made pursuant to a bona fide, reasonable adjustment formula (including but not limited to an applicable adjustment made to compensate for a distribution of stock to another shareholder) and that has the effect of preventing dilution of the proportionate interest of the holders of actual stock or rights to acquire stock does not result in a deemed distribution of stock. An applicable adjustment that is made to compensate for a cash or property distribution to another shareholder and that is taxable under section 301, 356(a)(2), 871(a)(1)(A), 881(a)(1), 852(b), or 857(b) is not made pursuant to a bona fide adjustment formula described in the preceding sentence.

(4) *Amount of deemed distribution—*  
(i) *Deemed distribution to deemed shareholder.* For a deemed distribution under section 305(b) and (c) that is made to a deemed shareholder and is an applicable adjustment, the amount of the deemed distribution is the excess of—

(A) The fair market value of the right to acquire stock held by the deemed shareholder immediately after the applicable adjustment, over

(B) The fair market value, determined immediately after the applicable adjustment, of such right to acquire

stock as if no applicable adjustment had occurred.

(ii) *Deemed distribution to actual shareholder.* For a deemed distribution under section 305(b) and (c) that is made to an actual shareholder and results from an applicable adjustment, the amount of the deemed distribution is the fair market value of the stock deemed distributed, determined in accordance with the methodology set forth in § 1.305–3(e), *Examples 8* and *9*.

(iii) *Fair market value standard.* In determining the fair market value of a right to acquire stock for purposes of this paragraph (c)(4),

(A) Any particular facts pertaining to the deemed shareholder, including the number of rights or shares such deemed shareholder owns, will be disregarded, and

(B) Any value or reduction in value attributable to the possibility of future applicable adjustments that may result from actual or deemed distributions will not be taken into account.

(5) *Date and time of deemed distribution.* When an applicable adjustment is a deemed distribution under paragraphs (c)(1) or (2) of this section, the deemed distribution occurs at the time such applicable adjustment occurs, in accordance with the instrument setting forth the terms of the right to acquire stock, but in no event later than the date of the distribution of cash or property that results in the deemed distribution (taking into account § 1.305–3(b)). For such applicable adjustment relating to a right to acquire publicly-traded stock, if the instrument setting forth the terms of such right does not set forth the time the applicable adjustment occurs, the deemed distribution occurs immediately prior to the opening of business on the ex-dividend date for the distribution of the cash or property that results in the deemed distribution. For such an applicable adjustment relating to a right to acquire non-publicly traded stock, if the instrument setting forth the terms of such right does not set forth the time the applicable adjustment occurs, the deemed distribution occurs on the date that a holder is legally entitled to the distribution of cash or property that results in the deemed distribution.

(6) *Examples.* The following examples and the examples in §§ 1.305–3(e) and 1.305–5(d) illustrate the application of section 305(c) and paragraphs (a), (b) and (c) of this section.

*Example 1.* (i) *Facts.* Corporation U has two classes of actual stock outstanding, class A and class B. Each class B share is convertible into class A stock. In accordance with a bona fide, reasonable antidilution provision, the conversion price is adjusted

downward if the corporation transfers class A stock to anyone for consideration below the conversion price. The corporation sells class A stock to the public at the current market price, which is below the conversion price. Pursuant to the antidilution provision, the conversion price is adjusted downward.

(ii) *Analysis.* Although such a reduction in conversion price is an applicable adjustment, under paragraph (c)(3) of this section the reduction is not a distribution under section 305(c) for the purposes of section 305(b).

*Example 2.* (i) *Facts.* Corporation X has outstanding one class of actual common stock and convertible debt securities. The convertible securities have a bona fide, reasonable antidilution provision that provides for an increase in conversion ratio in the event stock dividends or rights to acquire stock are distributed to the common shareholders. Corporation X distributes to the common shareholders an actual stock dividend that results in an increase in the conversion ratio of the convertible securities. Pursuant to the antidilution provision, the conversion ratio is increased.

(ii) *Analysis.* Under section 305(d) and § 1.305–1(d)(4), the holders of convertible securities are shareholders for purposes of section 305(b) and (c). The convertible securities are rights to acquire stock and are stock for purposes of section 305. The increase in conversion ratio caused by the distribution of the stock dividend to the common shareholders is an applicable adjustment. Because the applicable adjustment is made pursuant to a bona fide, reasonable adjustment formula within the meaning of paragraph (c)(3) of this section, the applicable adjustment is not a deemed distribution under section 305(c) of rights to acquire stock.

*Example 3.* (i) *Facts.* Corporation X has outstanding one class of publicly-traded common stock and convertible debt securities. The terms of the convertible securities provide for an increase in the conversion ratio in the event stock, cash, or property is distributed to the holders of the common stock. Corporation X distributes cash to the holders of the common stock, and the distribution results in an increase in the conversion ratio of the convertible securities.

(ii) *Analysis.* Under section 305(d) and § 1.305–1(d)(5), the holders of the convertible securities are shareholders for purposes of section 305(b) and (c). The conversion rights in the convertible securities are rights to acquire stock (as defined in § 1.305–1(d)(3)) and is stock for purposes of section 305. The increase in conversion ratio resulting from the cash distribution to the holders of common stock is an applicable adjustment. Because the applicable adjustment is not made pursuant to a bona fide, reasonable adjustment formula within the meaning of paragraph (c)(3) of this section, it is a deemed distribution to the holders of the convertible securities of rights to acquire stock under section 305(c) and paragraph (c)(1) of this section. Because the proportionate interests of these deemed shareholders in the assets or earnings and profits of Corporation X are increased by the change in conversion ratio, the distribution has the result described in section 305(b)(2) and is treated as a

distribution to which section 301 applies. The amount of the deemed distribution is determined in accordance with paragraph (c)(4)(i) of this section, and the date and time of the deemed distribution are determined in accordance with paragraph (c)(5) of this section.

(d) *Recapitalizations*—(1) *In general.* A recapitalization (whether or not an isolated transaction) will be deemed to result in a distribution to which section 305(c) and this section apply if—

(i) It is pursuant to a plan to periodically increase a shareholder's proportionate interest in the assets or earnings and profits of the corporation, or

(ii) A shareholder owning preferred stock with dividends in arrears exchanges his stock for other stock and, as a result, increases his proportionate interest in the assets or earnings and profits of the corporation. An increase in a preferred shareholder's proportionate interest occurs in any case where the fair market value or the liquidation preference, whichever is greater, of the stock received in the exchange (determined immediately following the recapitalization), exceeds the issue price of the preferred stock surrendered.

(2) *Amount of distribution.* In a case to which paragraph (d)(1)(ii) of this section applies, the amount of the distribution deemed under section 305(c) to result from the recapitalization is the lesser of—

(i) The amount by which the fair market value or the liquidation preference, whichever is greater, of the stock received in the exchange (determined immediately following the recapitalization) exceeds the issue price of the preferred stock surrendered, or

(ii) The amount of the dividends in arrears.

(3) *Definition.* For purposes of applying paragraphs (d)(1) and (2) of this section with respect to stock issued before July 12, 1973, the term *issue price of the preferred stock surrendered* shall mean the greater of the issue price or the liquidation preference (not including dividends in arrears) of the stock surrendered.

(4) *Examples.* For an illustration of the application of this paragraph (d), see *Example 12* of § 1.305-3(e) and *Examples 1, 2, 3, and 6* of § 1.305-5(d).

(e) *Redemption premiums with respect to preferred stock.* Under section 305(c), if a redemption premium exists with respect to a class of preferred stock under the circumstances described in § 1.305-5(b) and the other requirements of this section are met, the distribution will be deemed made with respect to such preferred stock, in stock of the

same class. Accordingly, the preferred shareholders are considered under section 305(b)(4) and (c) to have received a deemed distribution of preferred stock to which section 301 applies.

(f) *Coordination with section 871(m).* For coordination of sections 305 and 871(m), see § 1.871-15(c)(2)(ii).

(g) *Effective date.* This section applies to deemed distributions under section 305(c) occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A taxpayer, however, may rely on these proposed regulations for deemed distributions under section 305(c) that occur prior to such date. For purposes of determining the amount of a deemed distribution to a deemed shareholder occurring prior to the date of publication, a taxpayer may determine the amount of the deemed distribution by treating such distribution either as a distribution of a right to acquire stock or as a distribution of the actual stock to which the right relates.

#### § 1.860G-3 [Amended]

■ **Par. 5.** Section 1.860G-3(b)(1) is amended by removing the language “1.1441-2(d)(4)” in the last sentence, and adding the language “1.1441-2(d)(1)(ii)(C)” in its place, and by removing the language “1.1441-5(b)(2)(i)(A), and” and adding the language “1.1441-5(b)(2)(i)(A), 1.1471-2(a)(4)(i)(B)(4), and” in its place.

■ **Par. 6.** Section 1.861-3 is amended by:

■ 1. In paragraph (a)(6), removing “A substitute dividend payment is a payment” in the first sentence and adding “A substitute dividend payment is a payment or a deemed payment” in its place, and adding a new second sentence.

■ 2. In paragraph (d), replacing the third sentence with a new sentence.

The additions read as follows:

#### § 1.861-3. Dividends.

(a) \* \* \* \* \*

(6) *Substitute dividend payments.*

\* \* \* A deemed payment is a payment deemed to have been made in the amount (as determined under § 1.305-7(c)(4)) of a deemed distribution (as defined in § 1.305-1(d)(7)) that the owner of the transferred security is entitled to during the term of the transaction. \* \* \*

\* \* \* \* \*

(d) *Effective/applicability date.* \* \* \* Paragraph (a)(6) of this section applies to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations

in the **Federal Register**; however, a taxpayer may rely on the rule in the second sentence of paragraph (a)(6) of this section for all deemed distributions (as defined in § 1.305-1(d)(7)) occurring on or after January 1, 2016, until the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

\* \* \*

■ **Par. 7.** Section 1.1441-2 is amended by:

■ 1. Revising paragraphs (d)(1) and (4).

■ 2. Amending paragraph (f) by removing the language “(d)(4)” in the second sentence and adding in its place “(d)(1)(ii)(C),” and adding a fourth and fifth sentence.

The revisions and addition read as follows:

#### § 1.1441-2 Amounts subject to withholding.

\* \* \* \* \*

(d) \* \* \*

(1) *General rule*—(i) *Control or custody and knowledge.* Except as provided in paragraph (d)(1)(ii) of this section, a withholding agent has an obligation to withhold under section 1441 only to the extent that, at any time between the date that the obligation to withhold would arise (but for the provisions of this paragraph (d)) and the due date (including extensions) for filing Form 1042 with respect to the calendar year in which the payment occurs, it has—

(A) Control over, or custody of, money or property owned by the recipient or beneficial owner from which to withhold an amount; and

(B) Knowledge of the facts that give rise to the payment.

(ii) *Exception not available.* The exception from the obligation to withhold under paragraph (d)(1)(i) of this section does not apply if—

(A) The withholding agent is related (within the meaning of section 482) to the recipient or the beneficial owner of the payment;

(B) The payment is a distribution with respect to stock (including a deemed distribution (as defined in § 1.305-1(d)(7)) of stock or a right to acquire stock); see, however, paragraph (d)(4) of this section, which provides a limited exception from the obligation to withhold on a deemed distribution;

(C) The amounts are described in § 1.860G-3(b)(1) (regarding certain partnership allocations of REMIC net income with respect to a REMIC residual interest);

(D) The lack of control over or custody of money or property from which to withhold is part of a pre-arranged plan known to the withholding

agent to avoid withholding under section 1441, 1442, or 1443; or

(E) The payment is a deemed payment (as defined in § 1.861-3(a)(6)); *see*, however, paragraph (d)(4) of this section, which provides a limited exception from the obligation to withhold on a deemed payment.

(iii) *Documentation.* Any exception from withholding pursuant to paragraph (d)(1)(i) of this section applies without a requirement that documentation be furnished to the withholding agent. However, documentation may have to be furnished for purposes of the information reporting provisions under chapter 61 of the Code and backup withholding under section 3406.

(iv) *Scope of exception.* The exception from withholding under this paragraph (d) is not a determination that the amounts are not fixed or determinable annual or periodical income, nor is it an exception from reporting the amount under § 1.1461-1(b) and (c).

(v) *Lack of money or property or lack of knowledge.* A withholding agent does not lack control over money or property for purposes of this paragraph (d)(1) if the withholding agent directs another party to make the payment. Thus, for example, a principal does not cease to have control over a payment when it contracts with a paying agent to make the payments to its account holders in lieu of paying the account holders directly. Further, a withholding agent does not lack knowledge of the facts that give rise to a payment merely because the withholding agent does not know the character or source of the payment for U.S. tax purposes. *See* § 1.1441-3(d)(1) for rules addressing a withholding agent's obligations when the withholding agent has knowledge of the facts that give rise to the payment, but the character or source of the payment is not known.

(vi) *Example.* A, an individual, owns stock in DC, a domestic corporation, through a custodian, Bank 1. A also has a money market account at Bank 2. DC pays a dividend of \$1,000 that is deposited in A's custodial account at Bank 1. A then directs Bank 1 to transfer \$1,000 to A's money market account at Bank 2. With respect to the payment of the dividend into A's custodial account with Bank 1, both DC and Bank 1 are withholding agents making a payment of an amount subject to withholding for which they have custody, control, and knowledge. *See* §§ 1.1441-2(b)(1) and 1.1441-7(a)(1). Therefore, both DC and Bank 1 have an obligation to withhold on the payment unless they can reliably associate the payment with documentation sufficient to treat the respective payees as not subject to withholding under chapter 3. With respect to the wire transfer of \$1,000 from A's account at Bank 1 to A's account at Bank 2, neither

Bank 1 nor Bank 2 is required to withhold on the transfer because neither bank has knowledge of the facts that gave rise to the payment. Even though Bank 1 is a custodian for A's stock in DC and has knowledge regarding the \$1,000 dividend paid to A, once Bank 1 credits the \$1,000 dividend to A's account, the \$1,000 becomes A's property. When A transfers the \$1,000 to its account at Bank 2, this is a separate transfer about which Bank 1 has no knowledge regarding the type of payment made. Further, Bank 2 only has knowledge that it receives \$1,000 to be credited to A's account but has no knowledge regarding the type of payment made. Accordingly, Bank 1 and Bank 2 have no withholding obligation with respect to the transfer from A's custodial account at Bank 1 to A's money market account at Bank 2.

\* \* \* \* \*

(4) *Deemed distributions under section 305(c) and deemed payments—*

(i) *General rule.* Subject to the rules in this paragraph (d)(4)(i) and paragraph (d)(4)(iii) of this section, and any other exception to withholding (for example, under § 1.1441-4), a withholding agent has an obligation to withhold on a deemed distribution (as defined in § 1.305-1(d)(7)) or a deemed payment (as defined in § 1.861-3(a)(6)) on a security. However, a withholding agent other than the issuer of a specified security (as defined in § 1.6045-1(a)(14)) has an obligation to withhold on a deemed distribution (as defined in § 1.305-1(d)(7)) on a specified security or a deemed payment (as defined in § 1.861-3(a)(6)) that is determined with respect to a deemed distribution on a specified security only if:

(A) The issuer of the specified security reports the information required under § 1.6045B-1 regarding the deemed distribution before the due date (not including extensions) for the withholding agent to file Form 1042 for the calendar year in which the deemed distribution or the deemed payment occurred; or

(B) The withholding agent has actual knowledge of the deemed distribution before the due date (not including extensions) for it to file Form 1042 for the calendar year in which the deemed distribution or the deemed payment occurred, but in such case the requirements of this paragraph (d)(4)(i) will not be considered to be met until January 15 of the year following the calendar year in which the deemed distribution or the deemed payment occurred.

(ii) *Time to withhold on a deemed distribution or deemed payment.* After the requirements of paragraph (d)(4)(i) of this section have been met, except as provided in § 1.1441-5 regarding the time to withhold for partnerships and trusts, a withholding agent must

withhold on a deemed distribution (as defined in § 1.305-1(d)(7)) or a deemed payment (as defined in § 1.861-3(a)(6)) on the earliest of:

(A) The date on which a payment of cash is made with respect to the security or the securities lending or sales-repurchase transaction;

(B) The date on which the security is sold, exchanged, or otherwise disposed of (including a transfer of the security to a separate account not maintained by the withholding agent or a termination of the account relationship); or

(C) The due date (not including extensions) for the withholding agent to file Form 1042 for the calendar year in which the deemed distribution or the deemed payment occurred.

(iii) *Treatment of foreign entities assuming withholding responsibilities.* Notwithstanding § 1.1441-1(b)(1), a withholding agent may not treat a foreign entity as having assumed primary withholding responsibility under § 1.1441-1(e)(5), § 1.1441-1(b)(2)(iv), § 1.1441-5(c)(2)(i), or § 1.1441-5(e)(5)(v) for a deemed distribution (as defined in § 1.305-1(d)(7)) on a specified security (as defined in § 1.6045-1(a)(14)) or a deemed payment (as defined in § 1.861-3(a)(6)) that is determined with respect to a deemed distribution on a specified security unless the withholding agent has provided the foreign entity a copy of the issuer statement described in § 1.6045B-1(b)(1) within 10 days of the issuer furnishing the statement to the holder of record (or its nominee), or the issuer has met the public reporting requirements described in § 1.6045B-1(a)(3). A foreign entity described in the preceding sentence has an obligation to withhold on the deemed distribution or the deemed payment (unless an exception to withholding under section 1441 applies) if it receives a copy of the statement described in § 1.6045B-1(b)(1) or the issuer has met the public reporting requirements described in § 1.6045B-1(a)(3) by the due date (not including extensions) for filing Form 1042 with respect to the calendar year in which the deemed distribution or the deemed payment occurred. *See* § 1.1441-3(c)(5)(i) for when the foreign entity may rely on the copy of the issuer statement that it receives to determine the amount to withhold.

(iv) *Examples.* The following examples illustrate when a withholding agent must satisfy its obligation to withhold under paragraph (d)(4) of this section on a deemed distribution.

*Example 1 (i) Facts.* WA is a U.S. custodian that holds a convertible debt instrument (CDI) of Corporation X that is a specified security (as defined in § 1.6045-

1(a)(14)) on behalf of A, a foreign person. On March 1 of Year 1, there is a change in the conversion ratio of the CDI that is treated as a deemed distribution under § 1.305–7(b) and (c). On March 15 of Year 1, Corporation X makes an interest payment on the CDI to WA as custodian for A. On April 1 of Year 1, Corporation X reports the information required under § 1.6045B–1 regarding the deemed distribution on its public Web site. On April 15 of Year 1, Corporation X makes another interest payment on the CDI to WA as custodian for A.

(ii) *Analysis.* Under paragraph (d)(4)(i) of this section, WA does not have an obligation to withhold on the deemed distribution on the CDI that it holds on behalf of A until April 1 of Year 1, the date on which Corporation X satisfied its reporting requirements under § 1.6045B–1 regarding the deemed distribution. WA must withhold on the April 15 cash payment, which is the earliest of the dates specified in paragraph (d)(4)(ii) of this section for withholding on the deemed distribution.

*Example 2 (i) Facts.* The facts are the same as in Example 1, except that an interest payment is not made on the Corporation X CDI on April 15 of Year 1, and the CDI is transferred to a separate account of A that is not maintained by WA on April 15 of Year 1.

(ii) *Analysis.* Because WA is a withholding agent under § 1.1441–7(a)(4) with respect to the deemed distribution on March 1 of Year 1 and Corporation X reports the information required under § 1.6045B–1, WA is required to satisfy the withholding obligation even though the CDI was transferred before a cash payment is made with respect to the CDI. WA does not have an obligation to withhold on the deemed distribution until April 1 of Year 1, the date on which Corporation X reported the conversion ratio adjustment as required by § 1.6045B–1 regarding the deemed distribution. WA must withhold upon the transfer of the CDI to an account not maintained by WA on April 15 of Year 1, which is the earliest of the dates specified in paragraph (d)(4)(ii) of this section for withholding.

*Example 3 (i) Facts.* The facts are the same as in Example 2, except that the CDI is transferred to a separate account of A that is not maintained by WA on March 30 of Year 1.

(ii) *Analysis.* Because WA is a withholding agent under § 1.1441–7(a)(4) with respect to the deemed distribution on March 1 of Year 1 and Corporation X has satisfied its reporting requirements with respect to the deemed distribution, WA is required to satisfy the withholding obligation even though the CDI was transferred before WA received the issuer reporting from Corporation X under § 1.6045B–1 regarding the deemed distribution. WA does not have an obligation to withhold on the deemed distribution until April 1 of Year 1, the date on which Corporation X satisfied its reporting requirements under § 1.6045B–1 regarding the deemed distribution. Because neither of the events specified in paragraphs (d)(4)(ii)(A) and (B) of this section occurred after April 1 of Year 1, WA must satisfy its withholding obligation by the due date (not

including extensions) for filing Form 1042 (that is, by March 15 of Year 2), as provided in paragraph (d)(4)(ii)(C) of this section. WA may apply § 1.1461–2(b) in order to collect the underwithheld amount.

\* \* \* \* \*

(f) *Effective/applicability date.* \* \* \* Paragraphs (d)(1) and (d)(4) of this section apply to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A withholding agent may, however, rely on the rules in paragraphs (d)(1) and (d)(4) of this section for all deemed distributions (as defined in § 1.305–1(d)(7)) or deemed payments (as defined in § 1.861–3(a)(6)) occurring on or after January 1, 2016, until the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

■ **Par. 8.** Section 1.1441–3 is amended by:

- 1. Adding paragraph (c)(5).
- 2. Amending paragraph (i) by removing the language “paragraphs (g) and (h)” and adding in its place “paragraphs (c)(5), (g), and (h)”.

The addition reads as follows:

**§ 1.1441–3 Determination of amounts to be withheld.**

\* \* \* \* \*

(c) \* \* \* \* \*

(5) *Reliance rule for applicable adjustments—(i) In general.* For purposes of determining the amount of a deemed distribution (as defined in § 1.305–1(d)(7)) on a specified security (as defined in § 1.6045–1(a)(14)) or a deemed payment (as defined in § 1.861–3(a)(6)) that is determined with respect to a deemed distribution on a specified security, a withholding agent other than the issuer of the specified security (as defined in § 1.6045–1(a)(14)) may rely on the information provided by the issuer under § 1.6045B–1 (or a copy of the issuer statement in the circumstances described in § 1.1441–2(d)(4)(iii)) unless it knows that such information is incorrect or unreliable. See § 1.1441–2(d)(4) for a withholding agent’s obligation to withhold on a deemed distribution or a deemed payment.

(ii) *Effective/applicability date.* Paragraph (c)(5)(i) of this section applies to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A withholding agent may, however, rely on the rules in paragraph (c)(5)(i) of this section for all deemed distributions (as defined in § 1.305–1(d)(7)) or deemed payments (as defined in § 1.861–3(a)(6)) occurring on or after January 1, 2016, until the date

of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

\* \* \* \* \*

■ **Par. 9.** Section 1.1441–7 is amended by:

- 1. Redesignating paragraph (a)(4) as (a)(5) and adding a second and third sentence to newly redesignated (a)(5).
- 2. Adding a new paragraph (a)(4).
- 3. Amending paragraph (g) by removing the language “paragraphs (a)(4)” and adding in its place “paragraphs (a)(5).”

The addition reads as follows:

**§ 1.1441–7 General provisions relating to withholding agents.**

(a) \* \* \*

(4) *Withholding agent with respect to deemed distributions under section 305(c).* Any person that issues or holds directly or indirectly (for example, through an account maintained for another intermediary) on behalf of a beneficial owner, or a flow through entity that owns directly or indirectly (through another flow-through entity), a security upon which a deemed distribution (as defined in § 1.305–1(d)(7)) is made has custody of or control over the deemed distribution. See § 1.1441–2(d)(4) for a withholding agent’s obligation to withhold on the deemed distribution and § 1.1441–3(c)(5)(i) for when a withholding agent may rely on the information reported by the issuer under § 1.6045B–1 to determine the amount to withhold.

(5) \* \* \* Paragraph (a)(4) of this section applies to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A withholding agent may, however, rely on the rules in paragraph (a)(4) of this section for all deemed distributions (as defined in § 1.305–1(d)(7)) occurring on or after January 1, 2016, until the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

■ **Par. 10.** Section 1.1461–2 is amended by revising the second sentence to paragraph (b), adding a fourth sentence to paragraph (b), and adding a second and third sentence to paragraph (d) to read as follows:

**§ 1.1461–2 Adjustments for overwithholding or underwithholding of tax.**

\* \* \* \* \*

(b) *Withholding of additional tax when underwithholding occurs.* \* \* \* In the alternative, the withholding agent may satisfy the tax from property that it holds in custody for the beneficial owner, property over which it has

control, or additional contributions of property obtained directly or indirectly from the beneficial owner. \* \* \* A withholding agent that adjusts its underwithholding under the procedure described in this paragraph (b) will not be subject to any penalties or additions to tax described in § 1.1461-1(a)(2) if it timely deposits the amounts that it withholds from future payments, proceeds from the liquidation of property, or additional contributions of property obtained directly or indirectly from the beneficial owner. \* \* \*

(d) \* \* \* Paragraph (b) of this section applies to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A withholding agent may, however, rely on the rules in paragraph (b) of this section for payments occurring on or after January 1, 2016, until the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

■ **Par. 11.** Section 1.1471-2 is amended by:

■ 1. Revising paragraph (a)(4)(i)(A), redesignating paragraph (B) as new paragraph (E), and adding new paragraphs (B) through (D).

■ 2. Amending paragraph (c) by adding a third and fourth sentence.

The revisions and addition read as follows:

**§ 1.1471-2 Requirement to deduct and withhold tax on withholdable payments to certain FFIs.**

\* \* \* \* \*

(a) \* \* \*

(4) \* \* \*

(i) \* \* \*

(A) *In general.* Except as provided in paragraph (a)(4)(i)(B) of this section, a withholding agent has an obligation to withhold under chapter 4 only to the extent that, at any time between the date that the obligation to withhold would arise (but for the provisions of this paragraph (a)(4)(i)(A)) and the due date (including extensions) for filing Form 1042 (including extensions) with respect to the calendar year in which the payment occurs, it has—

(1) Control over, or custody of, money or property owned by the recipient or beneficial owner from which to withhold an amount, and

(2) Knowledge of the facts that give rise to the payment.

(B) *Exception not available.* The exception from the obligation to withhold under paragraph (a)(4)(i)(A) of this section does not apply if—

(1) The withholding agent is related (within the meaning of section 482) to the recipient or the beneficial owner of the payment;

(2) The payment is with respect to stock (including a deemed distribution (as defined in § 1.305-1(d)(7)) of stock or a right to acquire stock) or other securities; however, the limited exception from the obligation to withhold on a deemed distribution provided in § 1.1441-2(d)(4) also applies to a deemed distribution that is a withholdable payment under chapter 4;

(3) The lack of control over or custody of money or property from which to withhold is part of a pre-arranged plan known to the withholding agent to avoid withholding under section 1471 or 1472;

(4) The amounts are described in § 1.860G-3(b)(1) (regarding certain partnership allocations of REMIC net income with respect to a REMIC residual interest);

(5) Any of the special rules described in § 1.1441-2(d)(2) or (3), regarding the obligation of a withholding agent with respect to cancellation of debt or the satisfaction of tax liability following underwithholding by a withholding agent, apply with respect to the payment (by applying such rules to payments that are withholdable payments under chapter 4); or

(6) The payment is a deemed payment (as defined in § 1.861-3(a)(6)); however, the limited exception from the obligation to withhold on a deemed payment provided in § 1.1441-2(d)(4) also applies to a deemed payment that is determined with respect to a deemed distribution on a specified security and that is a withholdable payment under chapter 4.

(C) *Documentation.* Any exception from withholding pursuant to paragraph (a)(4)(i)(A) of this section applies without a requirement that documentation be furnished to the withholding agent. However, documentation may have to be furnished for purposes of the information reporting provisions under chapter 61 of the Code and backup withholding under section 3406.

(D) *Lack of money or property or lack of knowledge.* A withholding agent does not lack control over money or property for purposes of this paragraph (a)(4)(i)(A) if the withholding agent directs another party to make the payment. Thus, for example, a principal does not cease to have control over a payment when it contracts with a paying agent to make the payments to its account holders in lieu of paying the account holders directly. Further, a withholding agent does not lack knowledge of the facts that give rise to a payment merely because the withholding agent does not know the

character or source of the payment for U.S. tax purposes. *See* paragraph (a)(5) of this section for rules addressing a withholding agent's obligations when the withholding agent has knowledge of the facts that give rise to the payment, but the character or source of the payment is not known.

\* \* \* \* \*

(c) \* \* \* Paragraph (a)(4)(i) of this section applies to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A withholding agent may, however, rely on the rules in paragraph (a)(4)(i) of this section (together with the rules in § 1.1441-2(d)(4)), for all deemed distributions (as defined in § 1.305-1(d)(7)) or deemed payments (as defined in § 1.861-3(a)(6)) that are withholdable payments occurring on or after January 1, 2016, until the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

■ **Par. 12.** Section 1.1473-1 is amended by:

■ 1. Amending paragraph (a)(2)(vii)(A) by adding a sentence to the end of the paragraph.

■ 2. Adding paragraph (d)(7).

■ 3. Amending paragraph (f) by adding a third and fourth sentence.

The additions read as follows:

**§ 1.1473-1 Section 1473 definitions.**

(a) \* \* \*

(2) \* \* \*

(vii) \* \* \*

(A) \* \* \* For purposes of

determining the amount of a deemed distribution (as defined in § 1.305-1(d)(7)) on a specified security (as defined in § 1.6045-1(a)(14)) or a deemed payment (as defined in § 1.861-3(a)(6)) that is determined with respect to a deemed distribution on a specified security, a withholding agent other than the issuer of the specified security may rely on issuer reporting by applying the rule under § 1.1441-3(c)(5)(i) to deemed distributions or deemed payments that are withholdable payments under chapter 4.

\* \* \* \* \*

(d) \* \* \*

(7) *Withholding agent with respect to deemed distributions under section 305(c).* Any person that issues or holds directly or indirectly (for example, through an account maintained for another intermediary) on behalf of a beneficial owner or a flow through entity that owns directly or indirectly (through another flow-through entity), a security upon which a deemed distribution (as defined in § 1.305-

1(d)(7)) is made has custody of or control over the deemed distribution.

\* \* \* \* \*

(f) \* \* \* Paragraphs (a)(2)(vii) and (d)(7) of this section apply to payments made on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. A withholding agent may, however, rely on the rules in paragraphs (a)(2)(vii) and (d)(7) of this section for all deemed distributions (as defined in § 1.305-1(d)(7)) or deemed payments (as defined in § 1.861-3(a)(6)) that are withholdable payments occurring on or after January 1, 2016, until the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register**.

■ **Par. 13.** Section 1.6045B-1 is amended by adding paragraph (i) to read as follows:

**§ 1.6045B-1 Returns relating to actions affecting basis of securities.**

\* \* \* \* \*

(i) *Deemed distribution under section 305(c)—(1) In general.* This paragraph (i) provides special rules for an organizational action resulting in a deemed distribution under section 305(c) that affects the basis of a specified security, including a deemed distribution resulting from an applicable adjustment (for example, a conversion ratio adjustment). See paragraph (j) of this section to determine when this section applies to an organizational action that affects the basis of a specified security. For example, under paragraph (j)(4) of this section, this section applies to a deemed distribution under section 305(c) resulting from an applicable adjustment to a convertible debt instrument if the deemed distribution occurs on or after January 1, 2016, and the deemed distribution could affect the basis of the convertible debt instrument.

(2) *Mandatory reporting.* Notwithstanding any other provision in this section (including the reporting exceptions for exempt recipients in paragraphs (a)(4) and (b)(5) of this section), for an organizational action described in paragraph (i)(1) of this section the issuer must file an issuer return in accordance with paragraphs (a)(1) and (2) of this section and issuer statements in accordance with paragraphs (b)(1), (2), and (3) of this section. However, the requirement to file an issuer return and issuer statement in accordance with the preceding sentence does not apply if the issuer satisfies the public reporting requirements of paragraph (a)(3) of this section.

(3) *Information required to be reported.* For purposes of paragraph (i)(2) of this section, an issuer must provide the information required under paragraph (a)(1) of this section, including—

(i) The date of the deemed distribution under section 305(c) as determined in accordance with § 1.305-7(c)(5) (pursuant to paragraph (a)(1)(iv) of this section); and

(ii) The amount of the deemed distribution under section 305(c) as determined in accordance with § 1.305-7(c)(4) (pursuant to paragraph (a)(1)(v) of this section).

(4) *Effective/applicability date.* Paragraph (i)(2) of this section applies to a deemed distribution under section 305(c) occurring on or after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**. For purposes of paragraphs (a)(1)(v) and (i)(3)(ii) of this section, an issuer must determine the amount of a deemed distribution under section 305(c) in accordance with § 1.305-7(c)(4) for a deemed distribution occurring on or after the date of publication. For purposes of reporting the amount of a deemed distribution occurring prior to the date of publication, an issuer may determine the amount of the deemed distribution by treating such distribution either as a distribution of a right to acquire stock in accordance with § 1.305-7(c)(4), or as a distribution of the shares of stock that would be received upon exercise of the right. For purposes of paragraphs (a)(1)(iv) and (i)(3)(i) of this section, an issuer must determine the date of a deemed distribution under section 305(c) occurring on or after the date of publication in accordance with § 1.305-7(c)(5). An issuer, however, may rely on § 1.305-7(c)(5) to determine the date of a deemed distribution that occurs prior to the date of publication.

\* \* \* \* \*

**John M. Dalrymple,**

*Deputy Commissioner for Services and Enforcement.*

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**BILLING CODE 4830-01-P**

**DEPARTMENT OF EDUCATION**

**34 CFR Chapter III**

[Docket ID ED-2016-OSERS-0022; CFDA Number: 84.421B.]

**Proposed Priorities, Requirements, and Definitions—Disability Innovation Fund—Transition Work-Based Learning Model Demonstrations**

**AGENCY:** Office of Special Education and Rehabilitative Services, Department of Education.

**ACTION:** Proposed priorities, requirements, and definitions.

**SUMMARY:** The Assistant Secretary for Special Education and Rehabilitative Services proposes priorities, requirements, and definitions under the Disability Innovation Fund (DIF) Program. The Assistant Secretary may use these priorities, requirements, and definitions for competitions in fiscal year (FY) 2016 and later years. The Assistant Secretary takes this action to identify, develop, implement, and evaluate effective work-based learning models that will help students with disabilities prepare for postsecondary education and competitive integrated employment. The models must be delivered through a coordinated system of transition services.

**DATES:** We must receive your comments on or before May 13, 2016.

**ADDRESSES:** Submit your comments through the Federal eRulemaking Portal or by postal mail, commercial delivery, or hand delivery. We will not accept comments submitted by fax or by email or those submitted after the comment period. To ensure that we do not receive duplicate copies, please submit your comments only once. In addition, please include the Docket ID at the top of your comments.

• *Federal eRulemaking Portal:* Go to [www.regulations.gov](http://www.regulations.gov) to submit your comments electronically. Information on using [Regulations.gov](http://Regulations.gov), including instructions for accessing agency documents, submitting comments, and viewing the docket, is available on the site under the “Help” tab.

• *Postal Mail, Commercial Delivery, or Hand Delivery:* If you mail or deliver your comments about these proposed regulations, address them to RoseAnn Ashby, U.S. Department of Education, 400 Maryland Avenue SW., Room 5057, Potomac Center Plaza (PCP), Washington, DC 20202-5076.

**Privacy Note:** The U.S. Department of Education’s (Department) policy is to make all comments received from members of the public available for public viewing in their entirety on the Federal eRulemaking Portal at