

more appropriate that the participation in the corporation which the obligation represents be treated for purposes of the deduction of interest as if it were a stockholder interest rather than a creditors interest. To deal with such cases, section 279 imposes certain limitations on the deductibility of interest paid or incurred on obligations which have certain equity characteristics and are classified as corporate acquisition indebtedness. Generally, section 279 provides that no deduction will be allowed for any interest paid or incurred by a corporation during the taxable year with respect to its corporate acquisition indebtedness to the extent such interest exceeds \$5 million. However, the \$5 million limitation is reduced by the amount of interest paid or incurred on obligations issued under the circumstances described in section 279(a)(2) but which are not corporate acquisition indebtedness. Section 279(b) provides that an obligation will be corporate acquisition indebtedness if it was issued under certain circumstances and meets the four tests enumerated therein. Although an obligation may satisfy the conditions referred to in the preceding sentence, it may still escape classification as corporate acquisition indebtedness if the conditions as described in sections 279(d) (3), (4), and (5), 279(f), or 279(i) are present. However, no inference should be drawn from the rules of section 279 as to whether a particular instrument labeled a bond, debenture, note, or other evidence of indebtedness is in fact a debt. Before the determination as to whether the deduction for payments pursuant to an obligation as described in this section is to be disallowed, the obligation must first qualify as debt in accordance with section 385. If the obligation is not debt under section 385, it will be unnecessary to apply section 279 to any payments pursuant to such obligation.

[T.D. 7262, 38 FR 5844, Mar. 5, 1973]

§ 1.279-2 Amount of disallowance of interest on corporate acquisition indebtedness.

(a) *In general.* Under section 279(a), no deduction is allowed for any interest paid or incurred by a corporation during the taxable year with respect to its

corporate acquisition indebtedness to the extent that such interest exceeds:

- (1) \$5 million, reduced by
- (2) The amount of interest paid or incurred by such corporation during such year on any obligation issued after December 31, 1967, to provide consideration directly or indirectly for an acquisition described in section 279(b)(1) but which is not corporate acquisition indebtedness. Such an obligation is not corporate acquisition indebtedness if it:
 - (i) Was issued prior to October 10, 1969, or
 - (ii) Was issued after October 9, 1969, but does not meet any one or more of the tests of section 279(b) (2), (3), or (4), or
 - (iii) Was originally deemed to be corporate acquisition indebtedness but is no longer so treated by virtue of the application of paragraphs (3) or (4) of section 279(d) or
 - (iv) Is specifically excluded from treatment as corporate acquisition indebtedness by virtue of sections 279(d)(5), (f), or (i).

The computation of the amount by which the \$5 million limitation described in this paragraph is to be reduced with respect to any taxable year is to be made as of the last day of the taxable year in which an acquisition described in section 279(b)(1) occurs. In no case shall the \$5 million limitation be reduced below zero.

(b) *Certain terms defined.* When used in section 279 and the regulations thereunder:

(1) The term *issued* includes the giving of a note or other evidence of indebtedness to a bank or other lender as well as an issuance of a bond or debenture. In the case of obligations which are registered with the Securities and Exchange Commission, the date of issue is the date on which the issue is first offered to the public. In the case of obligations which are not so registered, the date of issue is the date on which the obligation is sold to the first purchaser.

(2) The term *interest* includes both stated interest and unstated interest (such as original issue discount as defined in paragraph (a)(1) of § 1.163-4 and amounts treated as interest under section 483).

(3) The term *money* means cash and its equivalent.

(4) The term *control* shall have the meaning assigned to such term by section 368(c).

(5) The term *affiliated group* shall have the meaning assigned to such term by section 1504(a), except that all corporations other than the acquired corporation shall be treated as includible corporations (without any exclusion under section 1504(b)) and the acquired corporation shall not be treated as an includible corporation. This definition shall apply whether or not some or all of the members of the affiliated group file a consolidated return.

(c) *Examples.* The provisions of paragraph (a) of this section may be illustrated by the following examples:

Example 1. On March 4, 1973, X Corporation, a calendar year taxpayer, issues an obligation which satisfies the test of section 279(b)(1) but fails to satisfy either of the tests of section 279(b)(2) or (3). Since at least one of the tests of section 279(b) is not satisfied the obligation is not corporate acquisition indebtedness. However, since the test of section 279(b)(1) is satisfied, the interest on the obligation will reduce the \$5 million limitation provided by section 279(a)(1).

Example 2. On January 1, 1969, X Corporation, a calendar year taxpayer, issues an obligation, which satisfies all the tests of section 279(b), requiring it to pay \$3.5 million of interest each year. Since the obligation was issued before October 10, 1969, the obligation cannot be corporate acquisition indebtedness, and a deduction for the \$3.5 million of interest attributable to such obligation is not subject to disallowance under section 279(a). However, since the obligation was issued after December 31, 1967, in an acquisition described in section 279(b)(1), under section 279(a)(2) the \$3.5 million of interest attributable to such obligation reduces the \$5 million limitation provided by section 279(a)(1) to \$1.5 million.

Example 3. Assume the same facts as in *Example 2*. Assume further that on January 1, 1970, X Corporation issues more obligations which are classified as corporate acquisition indebtedness and which require X Corporation to pay \$4 million of interest each year. For 1970 the amount of interest paid or accrued on corporate acquisition indebtedness, which may be deducted is \$1.5 million (\$5 million maximum provided by section 279(a)(1) less \$3.5 million, the reduction required under section 279(a)(2)). Thus, \$2.5 million of the \$4 million interest incurred on a corporate acquisition indebtedness is subject to disallowance under section 279(a) for the taxable year 1970.

Example 4. Assume the same facts as in *Example 3*. Assume further that on the last day of each of the taxable years 1971, 1972, and 1973 of X Corporation neither of the conditions described in section 279(b)(4) was present.

Under these circumstances, such obligations for all taxable years after 1973 are not corporate acquisition indebtedness under section 279(d)(4). Therefore, the \$2.5 million of interest previously not deductible is not deductible for all taxable years after 1973. Although such obligations are no longer treated as corporate acquisition indebtedness, the interest attributable thereto must be applied in further reduction of the \$5 million limitation. The \$5 million limitation of section 279(a)(1) is therefore reduced to zero. While the limitation is at the zero level any interest paid or incurred on corporate acquisition indebtedness will be disallowed.

[T.D. 7262, 38 FR 5844, Mar. 5, 1973]

§ 1.279-3 Corporate acquisition indebtedness.

(a) *Corporate acquisition indebtedness.* For purposes of section 279, the term *corporate acquisition indebtedness* means any obligation evidenced by a bond, debenture, note, or certificate or other evidence of indebtedness issued after October 9, 1969, by a corporation (referred to in section 279 and the regulations thereunder as “issuing corporation”) if the obligation is issued to provide consideration directly or indirectly for the acquisition of stock in, or certain assets of, another corporation (as described in paragraph (b) of this § 1.279-3), is “subordinated” (as described in paragraph (c) of this § 1.279-3), is “convertible” (as described in paragraph (d) of this § 1.279-3), and satisfies either the ratio of debt to equity test (as described in paragraph (f) of § 1.279-5) or the projected earnings test (as described in paragraph (d) of § 1.279-5).

(b) *Acquisition of stock or assets.* (1) Section 279(b)(1) describes one of the tests to be satisfied if an obligation is to be classified as corporate acquisition indebtedness. Under section 279(b)(1), the obligation must be issued to provide consideration directly or indirectly for the acquisition of:

(i) Stock (whether voting or non-voting) in another corporation (referred to in section 279 and the regulations thereunder as “acquired corporation”), or