corporation unless the taxpayer anticipates efficiency savings. Although the prospect of such savings in general may establish a business purpose for the establishment of the subsidiary, it does not prevent the subsidiary from acting as a conduit with respect to any particular financing arrangement. This is demonstrated by the hedging example described above, the rationale for which is that either the financed entity or the financing entity could have entered into the long-term hedge so there is no economic justification for the participation of the intermediate entity in the particular financing arrangement. The IRS and Treasury believe that an affiliate that is not taking a continuing active role in coordinating and managing a financing transaction should not be entitled to the presumption that its participation is not pursuant to a tax avoidance plan.

As to the suggestion of extending the significant financing activities presumption to unrelated parties, the IRS and Treasury believe that this extension would be inconsistent with the purpose of the presumption. The significant financing presumption recognizes that there are legitimate business reasons for conducting financing activities through a centralized financing and hedging subsidiary. The decision to have an unrelated intermediate entity participate in a financing transaction is based on different considerations, including the regulatory effects of such transactions and the interests of the shareholders of the unrelated intermediary. These considerations are addressed by providing that such entities will not be conduit entities unless they satisfy the "but for" test. The final regulations do not extend the significant financing activities presumption to unrelated parties.

Accordingly, the requirements for the significant financing activities presumption in $\S 1.881-3(b)(3)$ of the final regulations are generally the same as those in the proposed regulations. However, the final regulations do add a requirement that the participation of the intermediate entity generate efficiency savings, and change the term business risks to market risks (to differentiate the risks of currency and interest rate movements from other, primarily credit, risks). In addition, one of the examples that illustrates the significant financing activities presumption has been revised to indicate that a finance subsidiary may be managing market risks even in the case of a fully-hedged transaction if the intermediate entity routinely terminates such long term arrangements when it

finds cheaper hedging alternatives. See § 1.881–3(e) *Example 22.*

6. "But for" Test

a. In general. Under the proposed regulations, if the intermediate entity is not related to either the financing entity or the financed entity, the financing arrangement will not be recharacterized unless the intermediate entity would not have participated in the financing arrangement on substantially the same terms "but for" the fact that the financing entity advanced money or property to (or entered into a lease or license with) the intermediate entity.

Commentators asked for clarification regarding what it means for terms to be not substantially the same. One commentator proposed using the standards for material modifications under section 1001.

The IRS and Treasury believe that an attempt to set forth a comprehensive system of bright-line rules like those suggested by commentators would add unnecessary complexity to the regulation, given its anti-abuse purpose. Accordingly, the final regulations make no change to the proposed regulations in this regard.

b. Presumption where financing entity guarantees the liability of the financed entity. Under the proposed regulations, it is presumed that the intermediate entity would not have participated in the financing arrangement on substantially the same terms if, in addition to entering into a financing transaction with the intermediate entity, the financing entity guarantees the financed entity's liabilities under its financing transaction with the intermediate entity. A taxpayer may rebut this presumption by producing clear and convincing evidence that the intermediate entity would have participated in the financing arrangement on substantially the same terms even if the financing entity had not entered into a financing transaction with the intermediate entity.

Several commentators asked for clarification of this presumption. Some commentators suggested that the existence of a guarantee makes the existence of the financing transaction between the financing entity and the intermediate entity irrelevant to the determination of whether the intermediate entity would have participated in the financing arrangement on substantially the same terms. Another commentator proposed eliminating the "clear and convincing evidence" standard on the grounds that it is too difficult an evidentiary burden for the taxpayer to overcome.

The presumption regarding guarantees originated in Rev. Rul. 87–89 (1987–2 C.B. 195), which articulated the "but for" test in substantially the same terms as adopted in the final regulations. Rev. Rul. 87-89 provided that a statutory or contractual right of offset is presumptive evidence that the unrelated intermediary would not have participated in the financing arrangement on substantially the same terms without the financing transaction from the financing entity. The proposed regulations extend the presumption to all guarantees in order to prevent taxpayers from using forms of credit support other than the right of offset to avoid this presumption. The final regulations retain this rule. See § 1.881-3(c)(2)

The final regulations also retain the "clear and convincing evidence" standard. The taxpayer always must overcome the presumption of correctness in favor of the government by a preponderance of the evidence. Therefore, in order for this additional presumption to have any effect, it is necessary to raise the evidentiary standard. In addition, this standard of proof is not unreasonable, because an intermediate entity that is unrelated to the financing entity and the financed entity and that proves, by clear and convincing evidence, that it would have entered into the financing arrangement on substantially the same terms will avoid recharacterization as a conduit entity even though its participation in the financing arrangement is pursuant to a tax avoidance plan.

7. Multiple Intermediate Entities

a. In general. The proposed regulations provide guidance as to how some but not all of the operative provisions and presumptions apply to multiple intermediate entities. Several commentators asked that the final regulations clarify the manner in which the operative rules apply in the case of multiple intermediate entities. The final regulations provide additional guidance in the relevant operative rules and presumptions. In addition, the final regulations modify the example in the proposed regulations relating to multiple intermediate entities to clarify how some of these provisions and presumptions apply. See § 1.881–3(e) Example 8.

b. Special rule for related persons. Section 1.881–3(a)(4)(ii)(B) of the proposed regulations allows the district director to treat related persons as a single intermediate entity if he determines that one of the principal purposes for the structuring of a transaction was the avoidance of the