[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8924]

RIN 1545-AY63

Liabilities Assumed in Certain Corporate Transactions

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Temporary and final regulations.

SUMMARY: These temporary and final regulations relate to the assumption of liabilities in certain corporate transactions under section 301 of the Internal Revenue Code. The temporary and final regulations affect corporations and their shareholders. Changes to the applicable law were made by the Miscellaneous Trade and Technical Corrections Act of 1999, Public Law 106-36 (113 Stat. 127). The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective January 4, 2001.

Applicability Date: For dates of applicability, see the Effective Dates portion of the preamble under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: Mary Dean, (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION

Background

A. State of the Law Before the Miscellaneous Trade and Technical Corrections Act of 1999

Section 301(b)(2) of the Internal Revenue Code (Code) provides that in a distribution of property made by a corporation to a shareholder with respect to its stock, the amount of the distribution shall be reduced (but not below zero) by (A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution and (B) the amount of any liability to which the property was subject immediately before, and after, the distribution. See also §1.301-1(g) of the regulations.

Section 357 of the Code generally provides rules for the treatment of the assumption of liabilities in connection with transfers of property to which section 351 or 361 of the Code applies. Prior to the Miscellaneous Trade and Technical Corrections Act of 1999 (the Act), section 357(a) provided that, except as otherwise provided, in such transfers the assumption of the transferor's liability or acquisition of property subject to a liability is not treated as money or other property, i.e., is not treated as boot received by the transferor.

Prior to the Act, section 357(c) provided that in an exchange to which section 351 applies or section 361 applies by reason of a section 368(a)(1)(D) reorganization, if the sum of the amount of the liabilities assumed plus the amount of the liabilities to which the property transferred is subject exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess is considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

B. Enactment of Amendments to Section 357

The Act amended the language in section 357(a) and (c) and added new section 357(d). Under the amendment to section 357(a) and (c), the reference to the acquisition of an asset subject to a liability was eliminated. Section 357(c) gain will be realized only on the excess of the amount of liabilities assumed over the adjusted basis of the property transferred in the transaction. New section 357(d) sets forth the rules for determining the amount of both recourse and nonrecourse liabilities assumed. Section 357(d) states that except as provided in regulations, a recourse liability (or portion thereof) is treated as having been assumed if, based on all the facts and circumstances, the transferee has agreed to, and is expected to, satisfy such liability, whether or not the transferor has been relieved of such liability. A nonrecourse liability is treated as having been assumed by the transferee of any asset subject to such liability, except that the amount of nonrecourse liability treated as having been assumed is reduced by the lesser of (A) the amount of such liability which an owner of other assets not transferred to the transferee and also subject to such liability has agreed with the transferee to, and is expected to, satisfy, or (B) the fair market value of such other assets. Congress provided these clarifications because certain interpretations of the existing law failed to adequately reflect the true economics of many transactions, resulting in inappropriate positions claimed by taxpayers. See S. Rep. No. 106-2, at 75 (1999).

Section 357(d)(3) directs the Secretary to prescribe regulations necessary to carry out the purposes of subsection (d). It also authorizes the Secretary to prescribe regulations which provide that the manner in which a liability is treated as assumed under subsection (d) is applied, where appropriate, elsewhere in the Code.

C. Application of Regulatory Authority to Section 301

The Treasury and the IRS have determined that it is appropriate to apply the rules of section 357(d), relating to the manner in which a liability is treated as assumed, to distributions of property under section 301 of the Code. Section 301(b)(2)(A) provides that the amount of the distribution will be reduced if the transferee assumes a liability of the corporation. Section 301(b)(2)(B) provides that the amount of the distribution will be reduced if the transferee receives property subject to a liability. These two sections do not provide specific rules for determining the amount of liabilities assumed, as contained in section 357(d). The lack of specific rules has led to interpretations of existing law that fail to reflect the true economics of certain transactions. For reasons similar to those that motivated the enactment of section 357(d), these interpretations are inappropriate for purposes of section 301. Notice 99-59, 1999-52 I.R.B. 761, illustrates one such case. In the transaction addressed in Notice 99-59, a corporation distributes property subject to a recourse liability, with the expectation that the distributee will take the position that it receives little or no net distribution, even though it is anticipated that the distributor will later satisfy its continuing primary liability on the debt.

Explanation of Provisions

Liabilities Assumed in Connection with Distributions to Shareholders

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 301 relating to liabilities assumed in connection with distributions made by a corporation to shareholders with respect to their stock. The regulations provide that the amount of a distribution under section 301 will be reduced by the amount of any liability that is treated as assumed by the distributee within the meaning of section 357(d)(1) and (2).

The Treasury and the IRS intend to propose regulations under sections 357(d) and 301 clarifying the treatment of the subsequent payment of assumed liabilities. Prior to the issuance of such regulations, the Treasury and the IRS believe that such payments generally should be treated in a manner consistent with the treatment of the liabilities assumed. Thus, in a situation where a liability is treated as assumed by the transferee under the rules of section 357(d), a later payment by the party whose liability was treated as assumed should be treated in accordance with the relationship of the parties (e.g., a distribution or capital contribution). See, e.g., Enoch v. Commissioner, 57 T.C. 781 (1972), acq. in part, 1974-2 C.B. 2, 4, nonacq., 1984-2 C.B. 5.

Effective Date

The regulations apply generally to distributions occurring after January 4, 2001. The regulations also apply to distributions occurring on or prior to January 4, 2001, if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 99-59, including transactions designed to reduce gain. Under section 7805(b)(3), the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse. These regulations are being applied retroactively to prevent the abuse described in Notice 99-59. No inference should be drawn regarding the tax treatment of distributions not covered by these regulations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Because no preceding notice of proposed rulemaking is required for this temporary regulation, the provisions of the Regulatory Flexibility Analysis do not apply.

This Treasury decision is issued pursuant to the grants of authority in sections 357(d)(3) and 7805 of the Internal Revenue Code. This Treasury decision provides specific rules for determining the amount by which a distribution under section 301(b) will be reduced, by applying the rules of section 357(d). Section 357(d) was intended to clarify the law because certain interpretations of existing law did not reflect the economics of certain transactions. Issuing the regulation in proposed form would continue the difficulty in ascertaining the appropriate reduction in distributions under section 301(b). Based on these considerations, it is determined that this temporary regulation will provide taxpayers with the necessary guidance and authority to ensure equitable administration of the tax laws. Therefore, it would be contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) or subject to the effective date limitation of section 553(d) of title 5 of the United States Code.

Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.301-1 also issued under 26 U.S.C. 357(d)(3).
Section 1.301-1T also issued under 26 U.S.C. 357(d)(3). * * *

Par. 2. Section 1.301-1 is amended by adding two new sentences at the end of paragraph (g) to read as follows:

<u>§1.301-1 Rules applicable with respect to distributions of money and other property</u>.

* * * * *

(g) * * * This paragraph (g) applies to distributions occurring on or before January 4, 2001. See §1.301-1T for rules for distributions occurring after January 4, 2001, and for distributions made on or before January 4, 2001 if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 1999-59, 1999-52 I.R.B. 761, including transactions designed to reduce gain (see §601.601(d)(2) of this chapter).

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Par. 3. Section 1.301-1T is added to read as follows:

<u>§1.301-1T Rules applicable with respect to distributions of money and other property (temporary)</u>.

(a) through (f). [Reserved] For further guidance, see §1.301-1(a) through (f).

(g) Reduction for liabilities - - (1) General rule. For the purpose of section 301, no reduction shall be made for the amount of any liability, unless the liability is assumed by the shareholder within the meaning of section 357(d)(1) and (2).

(2) No reduction below zero. Any reduction pursuant to paragraph (g)(1) of this section shall not cause the amount of the distribution to be reduced below zero.

(3) <u>Effective dates</u> - - (i) <u>In general</u>. This paragraph (g) applies to distributions occurring after January 4, 2001**.**

(ii) <u>Retroactive application</u>. This paragraph also applies to distributions made on or before January 4, 2001 if the distribution is made as part of a transaction described in, or substantially similar to, the transaction in Notice 1999-59 (1999-52 I.R.B. 761), including transactions designed to reduce gain (see §601.601(d)(2) of this chapter).

Deputy Commissioner of Internal Revenue
Robert E. Wenzel

Approved:

12/20/00

Acting Assistant Secretary for Tax Policy
Jonathan Talisman