DESCRIPTION OF REVENUE PROVISION TO BE CONSIDERED IN CONNECTION WITH THE MARKUP OF THE MISCELLANEOUS TRADE AND TECHNICAL CORRECTIONS ACT OF 1999

Scheduled for Markup

by the

SENATE COMMITTEE ON FINANCE

on

January 22, 1999

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

January 21, 1999

JCX-2-99

CONTENTS

INTRODUCTION

This document[1], prepared by the staff of the Joint Committee on Taxation, contains a description of the revenue proposal to be considered by the Senate Committee on Finance in connection with the markup of the Miscellaneous Trade and Technical Corrections Act of 1999, scheduled for January 22, 1999.

This document contains a description of the following revenue proposal: to clarify the definition of "subject to" liabilities under Code section 357(c).

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of Revenue Provision to be Considered in Connection with the Markup of the Miscellaneous Trade and Technical Corrections Act of 1999* (JCX-2-99), January 21, 1999.

DESCRIPTION OF REVENUE PROVISION

1. Clarify Definition of "Subject to" Liabilities Under Code Section 357(c)

Present Law

Present law provides that the transferor of property recognizes no gain or loss if the property is exchanged solely for qualified stock in a controlled corporation (sec. 351). The assumption by the controlled corporation of a liability of the transferor (or the acquisition of property "subject to" a liability) generally will not cause the transferor to recognize gain. However, under section 357(c), the transferor does recognize gain to the extent that the sum of the assumed liabilities, together with the liabilities to which the transferred property is subject, exceeds the transferor's basis in the transferred property. If the transferred property is "subject to" a liability, Treasury regulations indicate that the amount of the liability is included in the calculation regardless of whether the underlying liability is assumed by the controlled corporation. Treas. Reg. sec. 1.357-2(a). Similar rules apply to reorganizations described in section 368(a)(1)(D).

The gain recognition rule of section 357(c) is applied separately to each transferor in a section 351 exchange.

The basis of the property in the hands of the controlled corporation equals the transferor's basis in such property, increased by the amount of gain recognized by the transferor, including section 357(c) gain.

Description of Proposal

Under the proposal, the distinction between the assumption of a liability and the acquisition of an asset subject to a liability is generally eliminated. First, except as provided in regulations, a recourse liability or any portion thereof is treated as having been assumed if, as determined on the basis of all facts and circumstances, the transferee has agreed to, and is expected to, satisfy the liability or portion thereof (whether or not the transferor has been relieved of the liability). Thus, where more than one person agrees to satisfy a liability or portion thereof, only one would be expected to satisfy such liability or portion thereof. Second, except as provided in regulations, a nonrecourse liability is treated as having been assumed by the transferee of any asset subject to such liability; except that the amount treated as assumed shall be reduced by 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, up to the fair market value of such other assets (determined without regard to section 7701(g)).

In determining whether any person has agreed to and is expected to satisfy a liability, all facts and circumstances are to be considered. In any case where the transferee does agree to satisfy a liability, the transferee will also be expected to satisfy the liability in the absence of facts indicating the contrary.

In determining any increase to the basis of property transferred to the transferee as a result of gain recognized because of the assumption of liabilities under section 357, such increase shall not cause the basis to exceed the fair market value of the property (determined without regard to sec. 7701(g)). In addition, if gain is recognized to the transferor as the result of an assumption by a corporation of a nonrecourse liability that is also secured by any assets not transferred to the corporation, and if no person is subject to tax under the Internal Revenue Code on such gain, then for purposes of determining the basis of assets transferred, the amount of gain treated as recognized as the result of such assumption of liability shall be determined as if the liability assumed by the transferee equaled such transferee's ratable portion of the liability, based on the relative fair market values (determined without regard to sec. 7701(g)) of all assets subject to such nonrecourse liability.

The Treasury Department has authority to prescribe such regulations as may be necessary to carry out the purposes of the provision. Where appropriate, the Treasury Department may also prescribe regulations which provide that the manner in which a liability is treated as assumed under the provision is applied elsewhere in the Code.

The Miscellaneous Trade and Technical Corrections Act of 1998 (H.R. 4856), as passed by the House of Representatives on October 20, 1998, contained a substantially identical provision.

Effective Date

The proposal would be effective for transfers on or after October 19, 1998. No inference regarding the tax treatment under present law is intended.