

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2003-73, page 44.

Deductions of section 277 membership organizations. This ruling illustrates the operation of section 277. Membership organizations subject to section 277 can take allowable deductions attributable to providing goods and services to members only to the extent of member income in computing the organization's taxable income. Excess deductions are not deductible against nonmember income but are allowable as deductions against member income in succeeding years. Other allowable deductions are fully deductible, including deductible against member income, in computing taxable income.

T.D. 9062, page 46.

REG-106736-00, page 60.

Temporary and proposed regulations under section 752 of the Code concern the assumption of a partner's liability, by a partnership, that is not taken into account under section 752(a) and (b) (section 1.752-7 liability). The proposed regulations contained in section 1.752-7 require a partner who has a section 1.752-7 liability assumed by a partnership to reduce the partner's outside basis in the partnership interest by the remaining amount of the section 1.752-7 liability (but not below the adjusted value of that interest) where there is a sale of the partnership interest, a liquidation of the partnership interest, or an assumption of the contingent liability by another partner. The proposed and temporary regulations contained in section 1.752-6T apply section 358(h) to partnerships for the period between October 18, 1999, and June 24, 2003. A public hearing on the proposed regulations is scheduled for October 14, 2003.

Notice 2003-43, page 50.

2003 enhanced oil recovery credit. The enhanced oil recovery credit for taxable years beginning in the 2003 calendar year is determined without regard to the phase-out for crude oil price increases provided in section 43(b) of the Code.

Notice 2003-44, page 52.

2003 marginal production rates. This notice announces the applicable percentage under section 613A of the Code to be used in determining percentage depletion for marginal properties for the 2003 calendar year.

Rev. Proc. 2003-47, page 55.

This procedure provides new procedural rules regarding the election under section 953(d) of the Code, whereby certain foreign insurance companies may elect to be treated as domestic corporations for U.S. tax purposes. These rules reflect changes in the administration of the election and replace the procedural rules contained in Section II of Notice 89-79, 1989-2 C.B. 392. Notice 89-79 modified and superseded.

Announcement 2003-45, page 73.

This announcement advises payers about a reduction in the backup withholding rate authorized by section 3406(a)(1) of the Code. Section 105(a) of the *Jobs and Growth Tax Relief Reconciliation Act of 2003* (Public Law 108-27) reduced the rate for backup withholding on reportable payments. This announcement also addresses when tax forms and publications will be revised to reflect the new rates.

(Continued on the next page)

Finding Lists begin on page ii.



EXEMPT ORGANIZATIONS

Announcement 2003–48, page 73.

Broward County Bowling Association, Inc., of Sunrise, FL, and Del Oro Conservatory for the Classical Arts of Music and Dance, Inc., of Chandler, AZ, no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

ADMINISTRATIVE

Notice 2003–41, page 49.

This notice provides guidance to state authorities responsible for allocating private activity bond state ceiling under section 146(e) of the Code. It clarifies that the deadline for allocating any portion of the state ceiling under section 146(e) is the earlier of (1) February 15 of the calendar year following the year in which the state ceiling arises, or (2) the date of issue of bonds issued pursuant to an allocation of that portion of the state ceiling.

Notice 2003–42, page 49.

This notice provides guidance to issuing authorities on the deadline for assigning private activity bond volume cap under section 146 of the Code to other issuing authorities. It clarifies that the deadline for an issuing authority to assign any portion of its volume cap to another issuing authority in the state is the earlier of (1) February 15 of the calendar year following the year in which the state ceiling represented by that volume cap arises, or (2) the date of issue of bonds issued pursuant to the assignment of that portion of the volume cap.

Notice 2003–46, page 53.

This notice announces the intention of the IRS and Treasury to withdraw the extraordinary transaction rule from the NPRM (REG–110385–99, 1999–2 C.B. 670) and to finalize the remaining portions of the NPRM.

Rev. Proc. 2003–46, page 54.

This procedure provides relief to issuing authorities that failed to file Form 8328, *Carryforward Election of Unused Private Activity Bond Volume Cap*, under section 146(f) of the Code for years prior to 2003 because the authority responsible for allocating state ceiling in their state filed Form 8328 instead. The relief is necessary because the Form 8328 (1) should have been filed by the issuing authority and (2) fails to provide the information required under regulations section 1.103(n)–4T (as amended by the Tax Reform Act of 1986).

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 146.—Volume Cap

Rev. Rul. 2003-73

LAW

26 CFR 1.103(n)-3T: Private Activity Bond Limit (Temporary).

Guidance is provided to state authorities responsible for allocating private activity bond state ceiling under section 146(e) of the Internal Revenue Code regarding the deadline for allocating any portion of the state ceiling among issuing authorities. See Notice 2003-41, page 49.

Guidance is provided to issuing authorities regarding the deadline for assigning the private activity bond volume cap to other issuing authorities under section 146 of the Internal Revenue Code. See Notice 2003-42, page 49.

26 CFR 1.103(n)-4T: Elective carryforward of unused private activity bond limit (Temporary).

Relief is provided to issuing authorities and authorities responsible under state law for allocating private activity bond volume cap that filed Form 8328 (*Carryforward Election of Unused Private Activity Bond Volume Cap*) for volume cap allocated to such issuing authorities. Relief is needed because the Form 8328 should have been filed by the issuing authority that has been allocated the volume cap subject to the carryforward election. See Rev. Proc. 2003-46, page 54.

Section 277.—Membership Organizations

Deductions of section 277 membership organizations. This ruling illustrates the operation of section 277. Membership organizations subject to section 277 can take allowable deductions attributable to providing goods and services to members only to the extent of member income in computing the organization's taxable income. Excess deductions are not deductible against nonmember income but are allowable as deductions against member income in succeeding years. Other allowable deductions are fully deductible, including deductible against member income, in computing taxable income.

ISSUE

(1) Whether a membership organization described in section 277(a) of the Internal Revenue Code may offset losses generated from the provision of goods and services to members during the current year against income earned from the provision of goods and services to nonmembers during the current year?

(2) Whether a membership organization described in section 277(a) of the Internal Revenue Code may offset losses generated from the provision of goods and services to nonmembers during the current year against income earned from the provision of goods and services to members during the current year?

FACTS

Club A is a taxable social club that operates a golf course, tennis courts and a clubhouse (including a restaurant) primarily for the benefit of its members. A has significant nonmember source income from use of the clubhouse by the general public for wedding receptions, anniversary parties and special events. The nonmember use of the clubhouse is a trade or business. A also has investment income. Over a four-year period, after deducting allowable expenses, A has the following amounts of income (or loss) derived from the provision of goods and services to members and nonmembers and from investments:

In Year 1, A has a loss of \$2,000 from member transactions, income of \$3,500 from nonmember transactions, and investment income of \$500.

In Year 2, A has income of \$1,500 from member transactions, income of \$3,000 from nonmember transactions, and investment income of \$500.

In Year 3, A has income of \$2,250 from member transactions, income of \$2,500 from nonmember transactions, and investment income of \$500.

In Year 4, A has income of \$1,000 from member transactions, a loss of \$2,000 from nonmember transactions, and investment income of \$500.

Section 277(a) applies to taxable social clubs or other taxable membership organizations operated primarily to provide goods or services to members.

Section 277(a) generally provides that deductions for the taxable year attributable to furnishing services, insurance, goods, or other items of value to members shall be allowed only to the extent of income derived during that year from members or transactions with members. If for any taxable year such member-transaction deductions exceed member income, the excess shall be treated as a deduction attributable to furnishing services, insurance, goods, or other items of value to members paid or incurred in the succeeding taxable year.

Section 277(a) only applies to transactions with members. As a result, deductions for a taxable year attributable to furnishing services to members in excess of member income earned during such taxable year are not permitted to offset income derived from transactions with nonmembers (nonmember income) during such taxable year. Instead, the excess deductions are permitted to reduce income derived from furnishing services to members in the next succeeding taxable year. Moreover, investment income generally constitutes nonmember income for purposes of section 277, and, therefore, investment income cannot be offset by expenses of providing goods and services to members. See *Concord Consumers Housing Cooperative v. Commissioner*, 89 T.C. 105 (1987).

Section 172 generally provides for a deduction of net operating losses, and the taxable years to which the net operating losses may be carried back or carried forward.

ANALYSIS

Section 277(a) applies to A. Consistent with the analysis in *Concord Consumers Housing Cooperative*, the fact that some or all of the principal generating A's investment income came from members does not cause the investment income to be treated as member income. As A's investment income is not otherwise derived from transactions with members, A's investment income is nonmember income for purposes of section 277.

Section 277(a) applies to A's member and nonmember income and losses as follows:

<i>Year 1</i>	<i>Member Income</i>	<i>Nonmember Income</i>	<i>Taxable Income</i>
Income/(loss) before loss carryforward	(2,000)	4,000	
Minus loss carried forward	N/A	N/A	
Income/(loss)	(2,000)	4,000	4,000
Loss carryforward	(2,000)	- 0 -	
 <i>Year 2</i>			
Income/(loss) before loss carryforward	1,500	3,500	
Minus loss carried forward	(2,000)	- 0 -	
Income/(loss)	(500)	3,500	3,500
Loss carryforward	(500)	- 0 -	
 <i>Year 3</i>			
Income/(loss) before loss carryforward	2,250	3,000	
Minus loss carried forward	(500)	- 0 -	
Income/(loss)	1,750	3,000	4,750
Loss carryforward	- 0 -	- 0 -	
 <i>Year 4</i>			
Income/(loss) before loss carryforward	1,000	(1,500)	
Minus loss carried forward	- 0 -	- 0 -	
Income/(loss)	1,000	(1,500)	(500)
Loss available for carryback or carryforward	- 0 -	(500)	

In Year 1, A has a loss of \$2,000 from providing goods and services to members. A cannot deduct this loss against nonmember income. The loss is carried forward to Year 2 as an expense of providing goods and services to members in the next succeeding taxable year. Thus, A has zero member income in Year 1. A has \$4,000 in nonmember income in Year 1 (\$3,500

+ 500). A's taxable income in Year 1 is \$4,000 (\$0 + \$4,000).

In Year 2, A has income before any loss carryforward of \$1,500 from providing goods and services to members. A deducts the \$2,000 net loss carried forward from Year 1 against its member income of \$1,500, resulting in a member loss of (\$500) in Year 2 (\$1,500 - \$2,000). The \$500 unused net loss carryforward from

Year 1 is carried to Year 3 as an expense of providing goods and services to members in the next succeeding taxable year. A has \$3,500 in nonmember income in Year 2 (\$3,000 + \$500). A's taxable income in Year 2 is \$3,500 (\$0 + \$3,500).

In Year 3, A has income of \$2,250 from providing goods and services to members. A deducts the \$500 net loss carried forward from Year 2 against its member income

of \$2,250, resulting in member income of \$1,750 in Year 3 (\$2,250 - \$500). A has \$3,000 in nonmember income (\$2,500 + \$500). A's taxable income in Year 3 is \$4,750 (\$1,750 + \$3,000).

In Year 4, A has income of \$1,000 from providing goods and services to members and no loss carryforward deduction from Year 3. A's member income in Year 3 is \$1,000. A has a \$1,500 nonmember loss ((\$2,000) + \$500). A offsets its nonmember loss against its member income, resulting in a taxable loss in Year 4 of \$500 (\$1,000 - \$1,500). If the \$500 loss satisfies the requirements of section 172, A has a net operating loss of \$500 that, subject to the net operating loss rules of section 172, may be used in calculating taxable income for other taxable years.

HOLDINGS

(1) A taxable social club's loss from transactions with members does not offset nonmember income, but instead is carried forward to the next succeeding taxable year as expenses incurred in providing goods and services to members.

(2) A taxable social club's loss from transactions with nonmembers is fully deductible against both nonmember income and member income.

DRAFTING INFORMATION

The principal author of this revenue ruling is Ronald B. Weinstock of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Mr. Weinstock at (202) 622-4290 (not a toll-free call).

Section 752.—Treatment of Certain Liabilities

26 CFR 1.752-6T: Partnership assumption of partner's section 358(h)(3) liability after October 18, 1999, and before June 24, 2003.

T.D. 9062

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Assumption of Partner Liabilities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations regarding a partnership's assumption of a partner's liabilities in a transaction occurring after October 18, 1999, and before June 24, 2003. These temporary regulations affect partners and partnerships and clarify the tax treatment of an assumption by a partnership of a partner's liability. The text of these temporary regulations also serves as the text of the proposed regulations set forth in a notice of proposed rulemaking (REG-106736-00) on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective June 24, 2003.

Applicability Date: For date of applicability, see §1.752-6T(d).

FOR FURTHER INFORMATION CONTACT: Horace Howells (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

With certain exceptions, no gain or loss is recognized if property is transferred to a corporation solely in exchange for stock of the corporation, and, immediately after the exchange, the transferors control the corporation. If, however, the transferee corporation assumes a liability of the transferor, then, under section 358(d), the transferor's basis in the stock received in the exchange is reduced by the amount of that liability. If the amount of the liability exceeds the transferor's basis in the property transferred to the corporation, then the transferor recognizes gain under section 357(c)(1). Under section 357(c)(3), a liability the payment of which would give rise to a deduction or that would be described in section 736(a) (regarding payments to a retiring partner) is not taken into account in applying section 357(c)(1), unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of any property.

Under section 752(a) and (b), similar rules apply where a partnership assumes

a liability from a partner or a partner contributes property to a partnership subject to a liability. The difference between the amount of the liability and the partner's share of that liability after the partnership's assumption is treated as a distribution of money, which reduces the partner's basis in the partnership interest and may cause the partner to recognize gain. There is no statutory or regulatory definition of liabilities for purposes of section 752. Case law and revenue rulings, however, have established that, as under section 357(c)(3), the term *liabilities* for this purpose does not include liabilities the payment of which would give rise to a deduction, unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of property. Rev. Rul. 88-77, 1988-2 C.B. 128; *Salina Partnership LP, FPL Group, Inc. v. Commissioner*, T.C. Memo 2000-352.

On December 21, 2000, as part of the Community Renewal Tax Relief Act of 2000 (Appendix G of H.R. 4577, Consolidated Appropriations Act, 2001) Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) (the Act), Congress enacted section 358(h) to address certain situations where property was transferred to a corporation in exchange for both stock and the corporation's assumption of certain obligations of the transferor. In these situations, transferors took the position that the obligations were not liabilities within the meaning of section 357(c) or that they were described in section 357(c)(3), and, therefore, the obligations did not reduce the basis of the transferor's stock. These assumed obligations, however, did reduce the value of the stock. The transferors then sold the stock and claimed a loss. In this way, taxpayers attempted to duplicate a loss in corporate stock and to accelerate deductions that typically are allowed only on the economic performance of these types of obligations.

Section 358(h) addresses these transactions by requiring that, after application of section 358(d), the basis in stock received in an exchange to which section 351, 354, 355, 356, or 361 applies be reduced (but not below the fair market value of the stock) by the amount of any liability assumed in the exchange. Exceptions to section 358(h) are provided where: (1) the trade or business with which the liability is associated is transferred to the person assuming the liability as part of the

exchange; or (2) substantially all of the assets with which the liability is associated are transferred to the person assuming the liability as part of the exchange. The term *liability* for purposes of section 358(h) includes any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code (Code).

Congress recognized that taxpayers were attempting to use partnerships to carry out the same types of abuses that section 358(h) was designed to deter. Therefore, in section 309(c) and (d)(2) of the Act, Congress directed the Secretary to prescribe rules to provide “appropriate adjustments under subchapter K of chapter 1 of the Code to prevent the acceleration or duplication of losses through the assumption of (or transfer of assets subject to) liabilities described in section 358(h)(3) . . . in transactions involving partnerships.” This statutory provision does not specify whether the exceptions in section 358(h)(2) should apply. The only cross-reference to section 358(h) in this statutory provision is to section 358(h)(3), which defines the term *liability*. Under the statute, these rules are to “apply to assumptions of liability after October 18, 1999, or such later date as may be prescribed in such rules.”

In response to this directive, these temporary regulations provide rules to prevent the duplication and acceleration of loss through the assumption by a partnership of a liability of a partner in a nonrecognition transaction. Section 1.752-6T adopts the approach of section 358(h), with some modifications, for transactions involving partnership assumptions of partners’ liabilities occurring after October 18, 1999, and before June 24, 2003. The modifications made to the approach of section 358(h) were to provide rules to conform the application of section 358(h) to partnerships and, as discussed below, to prevent abuse.

Prior to the enactment of Code section 358(h) and section 309(c) and (d)(2) of the Act, the lack of specific rules addressing the treatment of liabilities upon the transfer of property to a corporation or a partnership led to interpretations of then existing law that failed to reflect the true economics of certain transactions. In some

cases, taxpayers continued to assert these interpretations even after the enactment of these statutory provisions. For example, in a transaction addressed in Notice 2000-44, 2000-2 C.B. 255, a taxpayer purchases and writes economically offsetting options and then purports to create substantial positive basis by transferring those option positions to a partnership. On the disposition of the partnership interest, the liquidation of the partner’s interest in the partnership, or the taxpayer’s sale or depreciation of distributed partnership assets, the taxpayer claims a tax loss, even though the taxpayer has incurred no corresponding economic loss.

Treasury and the IRS believe that it is appropriate to prohibit partners and partnerships engaging in transactions described in, or transactions that are substantially similar to the transactions described in, Notice 2000-44 from relying on the exception in section 358(h)(2)(B). The exceptions to section 358(h) were intended to exclude from the application of section 358(h) ordinary business transactions. They were not intended to allow taxpayers to engage in transactions that create noneconomic tax losses.

The text of the temporary regulations also serves as the text of the proposed regulations (REG-106736-00) set forth in this issue of the Bulletin (§1.752-6 of the proposed Income Tax Regulations). As part of that notice of proposed rulemaking, §1.752-7 of the proposed Income Tax Regulations is being issued to carry out the directive of section 309(c) of the Act with respect to assumptions of liabilities occurring on or after June 24, 2003. The proposed regulations conform the application of section 358(h) to partnerships by providing a basis reduction upon an event that separates the partner from the liability rather than on assumption of the liability by the partnership and by adopting certain exceptions. Section 1.752-7(j) of the proposed Income Tax Regulations allows a partnership to elect to apply §1.752-7 of the proposed Income Tax Regulations and related proposed provisions to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003, in lieu of applying §1.752-6T of the temporary Income Tax Regulations to this period.

Explanation of Provisions

Under these temporary regulations, if a partnership assumes a liability of a partner (other than a liability to which section 752(a) and (b) apply) in a transaction described in section 721(a), then, after application of section 752(a) and (b), the partner’s basis in the partnership is reduced (but not below the adjusted value of such interest) by the amount (determined as of the date of the exchange) of the liability. For this purpose, the term *liability* includes any fixed or contingent obligation to make payment, without regard to whether the obligation is otherwise taken into account for federal tax purposes. The adjusted value of a partner’s interest in a partnership is the fair market value of that interest increased by the partner’s share of partnership liabilities under §§1.752-1 through 1.752-5.

The exceptions under section 358(h) applicable to corporate assumptions of shareholder liabilities generally apply for purposes of these temporary regulations. Therefore, a reduction in a partner’s basis generally is not required, under these regulations, after an assumption of a liability by a partnership from that partner if: (1) the trade or business with which the liability is associated is transferred to the partnership assuming the liability as part of the transaction, or (2) substantially all of the assets with which the liability is associated are contributed to the partnership assuming the liability.

However, in the case of a partnership transaction described in, or a partnership transaction that is substantially similar to the transactions described in, Notice 2000-44, the exception for contributions of “substantially all of the assets with which the liability is associated” does not apply.

Effective Date

In accordance with the directive in section 309(c) and (d)(2) of the Act, these temporary regulations apply to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003. Under section 7805(b)(6), the Secretary may provide that any regulation may take effect in accordance with a legislative grant from

Congress authorizing the Secretary to prescribe the effective date for such regulation. In addition, under section 7805(b)(3), the Secretary may provide that any regulation may take effect or apply retroactively to prevent abuse. The Secretary has determined that a later effective date is inappropriate. Therefore, these regulations are being applied retroactively in accordance with the directive from Congress in section 309(d)(2) of the Act and to prevent abuse.

Special Analysis

These temporary regulations are necessary to prevent abusive transactions of the type described in the Notice 2000-44. Accordingly, good cause is found for dispensing with notice and public procedure pursuant to 5 U.S.C. 553(b)(B) and for dispensing with a delayed effective date pursuant to 5 U.S.C. 553(d)(1) and (3).

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. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analyses section of the preamble to the notice of proposed rulemaking on this subject published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these temporary regulations is Horace Howells, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of 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 continues to read in part as follows:

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

*Section 1.752-6T also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * **

Par. 2. Section 1.752-6T is added to read as follows:

§1.752-6T Partnership assumption of partner's section 358(h)(3) liability after October 18, 1999, and before June 24, 2003.

(a) *In general.* If, in a transaction described in section 721(a), a partnership assumes a liability (defined in section 358(h)(3)) of a partner (other than a liability to which section 752(a) and (b) apply), then, after application of section 752(a) and (b), the partner's basis in the partnership is reduced (but not below the adjusted value of such interest) by the amount (determined as of the date of the exchange) of the liability. For purposes of this section, the adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under §§1.752-1 through 1.752-5.

(b) *Exceptions—(1) In general.* Except as provided in paragraph (b)(2) of this section, the exceptions contained in section 358(h)(2)(A) and (B) apply to this section.

(2) *Transactions described in Notice 2000-44.* The exception contained in section 358(h)(2)(B) does not apply to an assumption of a liability (defined in section 358(h)(3)) by a partnership as part of a transaction described in, or a transaction that is substantially similar to the transactions described in, Notice 2000-44, 2000-2 C.B. 255. See §601.601(d)(2) of this chapter.

(c) *Example.* The following example illustrates the principles of paragraph (a) of this section:

Example. In 1999, A and B form partnership PRS. A contributes property with a value and basis of \$200, subject to a nonrecourse debt obligation of \$50 and a fixed or contingent obligation of \$100 that is

not a liability to which section 752(a) and (b) applies, in exchange for a 50% interest in PRS. Assume that, after the contribution, A's share of partnership liabilities under §§1.752-1 through 1.752-5 is \$25. Also assume that the \$100 liability is not associated with a trade or business contributed by A to PRS or with assets contributed by A to PRS. After the contribution, A's basis in PRS is \$175 (A's basis in the contributed land (\$200) reduced by the nonrecourse debt assumed by PRS (\$50), increased by A's share of partnership liabilities under §§1.752-1 through 1.752-5 (\$25)). Because A's basis in the PRS interest is greater than the adjusted value of A's interest, \$75 (the fair market value of A's interest (\$50) increased by A's share of partnership liabilities (\$25)), paragraph (a) of this section operates to reduce A's basis in the PRS interest (but not below the adjusted value of that interest) by the amount of liabilities described in section 358(h)(3) (other than liabilities to which section 752(a) and (b) apply) assumed by PRS. Therefore, A's basis in PRS is reduced to \$75.

(d) *Effective dates—(1) In general.* This section applies to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003.

(2) *Election to apply §1.752-7.* The partnership may elect, under the provisions of REG-106736-00, 2003-28 I.R.B. 60, (see §601.601(d)(2) of this chapter) to apply those provisions and related proposed Income Tax Regulations to all assumptions of liabilities by the partnership occurring after October 18, 1999, and before June 24, 2003. The provisions of REG-106736-00, 2003-28 I.R.B. 60, (see §601.601(d)(2) of this chapter) describes the manner in which the election is made.

David A. Mader,
Assistant Deputy Commissioner
of Internal Revenue.

Approved May 7, 2003.

Gregory Jenner,
Deputy Assistant Secretary of
the Treasury.

(Filed by the Office of the Federal Register on June 23, 2003, 8:45 a.m., and published in the issue of the Federal Register for June 24, 2003, 68 F.R. 37414)

Part III. Administrative, Procedural, and Miscellaneous

Deadline for Allocating Private Activity Bond State Ceiling Among Issuing Authorities Under Section 146(e)

Notice 2003-41

PURPOSE

This notice provides guidance to state authorities responsible for allocating private activity bond state ceiling under § 146(e) of the Internal Revenue Code (the “Code”). It clarifies that the deadline for allocating any portion of the state ceiling under § 146(e) is the earlier of (1) February 15 of the calendar year following the year in which the state ceiling arises, or (2) the date of issue of bonds issued pursuant to an allocation of that portion of the state ceiling. Notice 2003-42 clarifies the deadline under § 146 for an issuing authority that has been allocated state ceiling, referred to as the issuing authority’s volume cap, to assign all or any portion of that volume cap to another issuing authority in the state.

BACKGROUND

Under § 103(a), except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(e) provides, in part, that a qualified bond must meet the applicable requirements of § 146.

Section 146(a) provides that a private activity bond issued as part of an issue meets the requirements of § 146 if the aggregate face amount of the private activity bonds issued pursuant to such issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed such authority’s volume cap for such calendar year.

In general, an issuing authority’s volume cap for a calendar year is the portion of the state ceiling allocated to the issuing authority for that year. Under § 146(d)(1), the state ceiling applicable to any state for any calendar year is the greater of (1) an

amount equal to \$75 multiplied by the state population, or (2) \$225 million. Beginning in 2003, these amounts are adjusted for inflation in accordance with § 146(d)(2).

Generally, §§ 146(b) and (c) provide formulae for allocating state ceiling among issuing authorities in the state authorized to issue tax-exempt private activity bonds. However, § 146(e)(1) provides that, except as provided in § 146(e)(3) (relating to volume cap of constitutional home rule cities), a state may, by law, provide a different allocation formula for allocating the state ceiling among the governmental units (or other authorities) in such state having authority to issue tax-exempt private activity bonds.

Section 146(f)(1) provides that if an issuing authority’s volume cap for any calendar year after 1985 exceeds the aggregate amount of tax-exempt private activity bonds issued by the authority during such calendar year, such issuing authority may elect to treat all (or any portion) of such excess as a carryforward for one or more carryforward purposes described in § 146(f)(5). Section 146(f)(4) provides that any carryforward election (and any identification or specification contained therein), once made, shall be irrevocable.

Temporary Income Tax Regulations § 1.103(n)-4T, A-2, generally provides that an election to carry forward volume cap must be filed prior to the end of the calendar year with respect to which the issuing authority has the unused volume cap. These regulations, which were issued under the predecessor to § 146, generally continue to apply to the extent they are not inconsistent with the Tax Reform Act of 1986. *See* H.R. Conf. Rep. 99-841 at II-686 (1986), 1986-3 (Vol. 4) C.B. 686. However, Notice 89-12, 1989-1 C.B. 633, which may be relied upon, provides that regulations to be issued under § 146 will require that the issuing authority file the carryforward election by the earlier of (1) February 15 of the calendar year following the year in which the excess amount arises, or (2) the date of issue of bonds issued pursuant to the carryforward election.

DISCUSSION

Neither the Code nor the regulations specifically provide a due date for making allocations of state ceiling under § 146(e). In Notice 89-12, the Internal Revenue Service extended the time to file a carryforward election to accommodate difficulties issuers may experience in determining the amount of unused volume cap and filing the election by the end of the calendar year. To coordinate the deadline for allocating state ceiling and the deadline for making a carryforward election, the deadline for allocating any portion of the state ceiling under § 146(e) is the earlier of (1) February 15 of the calendar year following the year in which the state ceiling arises, or (2) the date of issue of bonds issued pursuant to an allocation of that portion of the state ceiling.

EFFECTIVE DATE

This notice applies to allocations of state ceiling arising after 2002.

DRAFTING INFORMATION

The principal authors of this notice are Rebecca L. Harrigal and Zoran Stojanovic of the Office of the Division Counsel/Associate Chief Counsel (TEGE). For further information regarding this notice, contact Mr. Stojanovic at (202) 622-3980 (not a toll-free call).

Deadline for an Issuing Authority to Assign Private Activity Bond Volume Cap to Another Issuing Authority Under Section 146

Notice 2003-42

PURPOSE

This notice provides guidance to issuing authorities on the deadline for assigning private activity bond volume cap under § 146 of the Internal Revenue Code (the “Code”) to other issuing authorities. It clarifies that the deadline for an issuing authority to assign any portion of its volume cap to another issuing authority in the state is the earlier of (1) February 15 of the calendar year following the year in which the state ceiling represented by that volume

cap arises, or (2) the date of issue of bonds issued pursuant to the assignment of that portion of the volume cap. Notice 2003-41 clarifies the deadline under § 146(e) for a state to allocate its state ceiling among issuing authorities in the state.

BACKGROUND

Under § 103(a), except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(e) provides, in part, that a qualified bond must meet the applicable requirements of § 146.

Section 146(a) provides that a private activity bond issued as part of an issue meets the requirements of § 146 if the aggregate face amount of the private activity bonds issued pursuant to such issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed such authority's volume cap for such calendar year.

In general, an issuing authority's volume cap for a calendar year is the portion of the state ceiling allocated to the issuing authority for that year. Under § 146(d)(1), the state ceiling applicable to any state for any calendar year is the greater of (1) an amount equal to \$75 multiplied by the state population, or (2) \$225 million. Beginning in 2003, these amounts are adjusted for inflation in accordance with § 146(d)(2).

Generally, §§ 146(b) and (c) provide formulae for allocating state ceiling among issuing authorities in the state authorized to issue tax-exempt private activity bonds. However, § 146(e)(1) provides that, except as provided in § 146(e)(3) (relating to volume cap of constitutional home rule cities), a state may, by law, provide a different allocation formula for allocating the state ceiling among the governmental units (or other authorities) in such state having authority to issue tax-exempt private activity bonds.

Section 1.103(n)-3T, A-14, of the temporary Income Tax Regulations provides that in certain circumstances an issuing authority may assign all or any portion of its volume cap to other issuing authorities within the state. These regulations, which

were issued under the predecessor to § 146, generally continue to apply to the extent they are not inconsistent with the Tax Reform Act of 1986. *See* H.R. Conf. Rep. 99-841 at II-686 (1986), 1986-3 (Vol. 4) C.B. 686.

Section 146(f)(1) provides that if an issuing authority's volume cap for any calendar year after 1985 exceeds the aggregate amount of tax-exempt private activity bonds issued by the authority during such calendar year, such issuing authority may elect to treat all (or any portion) of such excess as a carryforward for one or more carryforward purposes described in § 146(f)(5).

Section 146(f)(3) provides that if any issuing authority elects a carryforward with respect to any carryforward purpose, any private activity bonds issued by such authority with respect to such purpose during the three calendar years following the calendar year in which the carryforward arose shall not be taken into account under § 146(a) to the extent the amount of such bonds does not exceed the amount of the carryforward elected for that purpose.

Section 146(f)(4) provides that any carryforward election (and any identification or specification contained therein), once made, shall be irrevocable.

Section 1.103(n)-4T, A-2, generally provides that an election to carry forward volume cap must be filed prior to the end of the calendar year with respect to which the issuing authority has the unused volume cap. However, Notice 89-12, 1989-1 C.B. 633, which may be relied upon, provides that regulations to be issued under § 146 will require that the issuing authority file the carryforward election by the earlier of (1) February 15 of the calendar year following the year in which the excess amount arises, or (2) the date of issue of bonds issued pursuant to the carryforward election.

DISCUSSION

Neither the Code nor the regulations specifically provide a due date for making assignments of volume cap under § 146. In Notice 89-12, the Internal Revenue Service extended the time to file a carryforward election to accommodate difficulties issuers may experience in determining the amount of unused volume cap and filing the election by the end of the calendar year.

To coordinate the deadline for assigning volume cap and the deadline for making a carryforward election, the deadline for an issuing authority to assign any portion of its volume cap to another issuing authority in the state is the earlier of (1) February 15 of the calendar year following the year in which the state ceiling represented by that volume cap arises, or (2) the date of issue of bonds issued pursuant to the assignment of that portion of the volume cap.

EFFECTIVE DATE

This notice applies to assignments of volume cap with respect to state ceiling arising after 2002.

DRAFTING INFORMATION

The principal authors of this notice are Rebecca L. Harrigal and Zoran Stojanovic of the Office of the Division Counsel/Associate Chief Counsel (TEGE). For further information regarding this notice, contact Mr. Stojanovic at (202) 622-3980 (not a toll-free call).

2003 Section 43 Inflation Adjustment

Notice 2003-43

Section 43(b)(3)(B) of the Internal Revenue Code requires the Secretary to publish an inflation adjustment factor. The enhanced oil recovery credit under § 43 for any taxable year is reduced if the "reference price," determined under § 29(d)(2)(C), for the calendar year preceding the calendar year in which the taxable year begins is greater than \$28 multiplied by the inflation adjustment factor for that year.

The term "inflation adjustment factor" means, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990.

Because the reference price for the 2002 calendar year (\$22.51) does not exceed \$28 multiplied by the inflation adjustment factor for the 2003 calendar year, the enhanced oil recovery credit for qualified costs paid or incurred in 2003 is determined without regard to the phase-out for crude oil price increases.

Table 1 contains the GNP implicit price deflator used for the 2003 calendar year, as well as the previously published GNP

implicit price deflators used for the 1991 through 2002 calendar years.

Notice 2003-43 TABLE 1	
GNP IMPLICIT PRICE DEFLATORS	
<i>Calendar Year</i>	<i>GNP Implicit Price Deflator</i>
1990	112.9 (used for 1991)
1991	117.0 (used for 1992)
1992	120.9 (used for 1993)
1993	124.1 (used for 1994)
1994	126.0 (used for 1995)
1995	107.5 (used for 1996)*
1996	109.7 (used for 1997)
1997	112.35 (used for 1998)**
1998	112.64 (used for 1999)
1999	104.59 (used for 2000)***
2000	106.89 (used for 2001)
2001	109.31 (used for 2002)
2002	110.63 (used for 2003)

* Beginning in 1995, the GNP implicit price deflator was rebased relative to 1992. The 1990 GNP implicit price deflator used to compute the 1996 § 43 inflation adjustment factor is 93.6.

** Beginning in 1997, two digits follow the decimal point in the GNP implicit price deflator. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

*** Beginning in 1999, the GNP implicit price deflator was rebased relative to 1996. The 1990 GNP implicit price deflator used to compute the 2000 § 43 inflation adjustment factor is 86.53.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 2003 calendar year as well as the previously published

inflation adjustment factors and phase-out amounts for taxable years beginning in the 1991 through 2002 calendar years.

Notice 2003-43 TABLE 2		
INFLATION ADJUSTMENT FACTORS AND PHASE-OUT AMOUNTS		
<i>Calendar Year</i>	<i>Inflation Adjustment Factor</i>	<i>Phase-out Amount</i>
1991	1.0000	0
1992	1.0363	0
1993	1.0708	0
1994	1.0992	0
1995	1.1160	0

Notice 2003-43 TABLE 2 Continued

INFLATION ADJUSTMENT FACTORS AND PHASE-OUT AMOUNTS

<i>Calendar Year</i>	<i>Inflation Adjustment Factor</i>	<i>Phase-out Amount</i>
1996	1.1485	0
1997	1.1720	0
1998	1.1999	0
1999	1.2030	0
2000	1.2087	0
2001	1.2353	0
2002	1.2633	0
2003	1.2785	0

DRAFTING INFORMATION

The principal author of this notice is Jaime Park of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622-3120 (not a toll-free call).

2003 Marginal Production Rates

Notice 2003-44

Section 613A(c)(6)(C) of the Internal Revenue Code defines the term “applicable percentage” for purposes of determining percentage depletion for oil and gas produced from marginal properties. The applicable percentage is the percentage (not greater than 25 percent) equal to the sum of 15 percent, plus one percentage

point for each whole dollar by which \$20 exceeds the reference price (determined under § 29(d)(2)(C)) for crude oil for the calendar year preceding the calendar year in which the taxable year begins. The reference price determined under § 29(d)(2)(C) for the 2002 calendar year is \$22.51.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 2003.

Notice 2003-44 Table 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION

<i>Calendar Year</i>	<i>Applicable Percentage</i>
1991	15 percent
1992	18 percent
1993	19 percent
1994	20 percent
1995	21 percent
1996	20 percent
1997	16 percent
1998	17 percent
1999	24 percent
2000	19 percent
2001	15 percent
2002	15 percent
2003	15 percent

The principal author of this notice is Jaime Park of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Park at (202) 622-3120 (not a toll-free call).

Entity Classification for Certain Foreign Eligible Entities

Notice 2003-46

On November 29, 1999, the IRS and Treasury issued proposed regulations (REG-110385-99, 1999-2 C.B. 670 [64 FR 66591]) addressing certain transactions that occur within a specified period of time before or after a change in entity classification. The proposed regulations generally would provide that if an “extraordinary transaction,” as defined in the proposed regulations, occurred either one day before or within 12 months after the date a foreign entity changed its classification to disregarded-entity status, then the entity would not be treated as a disregarded entity but instead would be classified as an association taxable as a corporation for all purposes. In addition to this extraordinary transaction rule, the proposed regulations also address “grandfathered” pass-through entities and the determination of relevance of the classification of a foreign entity for U.S. federal income tax purposes.

A public hearing on the proposed regulations was held on January 31, 2000. In addition, written comments were received. Most commentators criticized the approach adopted in the proposed regulations as overly broad and expressed concern that it would mitigate the increased certainty promoted by the entity classification regulations issued in 1996.

After considering the comments received, the IRS and Treasury have decided to withdraw the extraordinary transaction rule of the proposed regulations. Therefore, the IRS and Treasury will withdraw proposed section 301.7701-3(h). The IRS and Treasury received minimal comments on the portions of the proposed regulations addressing grandfathered entities and the relevancy of classification status, and intend to finalize those portions of the proposed regulations.

The IRS and Treasury remain concerned about cases in which a taxpayer,

seeking to dispose of an entity, makes an election to disregard it merely to alter the tax consequences of the disposition. The IRS will continue to pursue the application of other principles of existing law (such as the substance over form doctrine) to determine the proper tax consequences in such cases. As the Supreme Court has noted: “To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.” *Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945).

In addition, the IRS and Treasury are continuing to examine the potential use of the entity classification regulations to achieve results inconsistent with the policies and rules of particular Code provisions or of U.S. tax treaties. In contrast to the approach of the extraordinary transaction rule, which would operate to change the classification of an entity if certain conditions are met, this examination will focus on ensuring that the substantive rules of particular Code provisions and U.S. tax treaties reach appropriate results notwithstanding changes in entity classification.

One category of transactions that the IRS and Treasury are considering is the acquisition of the assets of one controlled foreign corporation (the acquired CFC) by a second controlled foreign corporation (the acquiring CFC) that involves the acquisition of the stock in the acquired CFC followed by its liquidation into the acquiring CFC (through an actual liquidation or by electing to treat the acquired CFC as a disregarded entity). Such a transaction typically would be treated as an asset reorganization under section 368(a)(1)(C) or (D), provided that the transaction meets the other requirements generally applicable to reorganizations, including the requirements that the transaction have a valid business purpose and continuity of business enterprise. See §1.368-1. Although the regulations under section 367(a) would require certain U.S. shareholders of the acquired corporation to enter into a gain recognition agreement if the acquiring CFC had acquired the stock of the acquired CFC, the regulations do not require a gain recognition agreement in an asset reorganization. §1.367(a)-3(a) and (b)(1)(ii). A gain recognition agreement

generally requires former U.S. shareholders of the acquired corporation to recognize gain on their original transfers if the acquiring corporation disposes of the stock or substantially all of the assets of the acquired corporation (including a disposition of substantially all of the assets following a liquidation of the acquired corporation) during the five-year period following the initial transaction. The IRS and Treasury are considering whether to extend the gain recognition agreement requirement for nonrecognition treatment under the section 367 regulations to asset reorganizations.

Another category of transactions that the IRS and Treasury are considering is the disposition of a controlled foreign corporation by liquidating the corporation (through an actual liquidation or by electing to treat the corporation as a disregarded entity) and selling its assets rather than by selling the stock of the controlled foreign corporation. For purposes of subpart F, section 954(c)(1) generally characterizes gain on the sale of assets based on the type of income produced by such assets. Thus, section 954(c)(1) distinguishes between gain from the sale of stock, which generally is characterized as subpart F income because stock gives rise to dividend income, and gain from the sale of the underlying assets of the corporation, which is characterized as subpart F income or other income based on the types of income produced by such assets. The IRS and Treasury are continuing to consider the proper treatment of these transactions under the substantive rules of subpart F.

Written comments concerning this notice may be submitted to CC:PA:RU (Notice 2003-46), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 am and 4 pm to: CC:PA:RU (Notice 2003-46), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically to: notice.comments@irs.counsel.treas.gov.

FOR FURTHER INFORMATION CONTACT: Concerning the notice, Aaron A. Farmer or Ronald M. Gootzeit at (202) 622-3860; concerning submissions of comments, Lanita Van Dyke, (202) 622-7180 (not toll-free numbers).

26 CFR 601.601: Rules and regulations.
(Also Part 1, §§ 146; 1.103(n)-4T; 301.9100-1; 301.9100-3.)

Rev. Proc. 2003-46

SECTION 1. PURPOSE

This revenue procedure sets forth procedures under § 146(f) of the Internal Revenue Code of 1986 (the “1986 Code”) for correcting certain Forms 8328 (*Carryforward Election of Unused Private Activity Bond Volume Cap*) that were improperly filed by an authority (other than the issuing authority) authorized under state law to allocate state private activity bond volume cap to issuing authorities (the “allocating authority”). The correction is needed because the Form 8328 should have been filed by the issuing authority.

SECTION 2. BACKGROUND

.01 Under § 103(a), except as provided in § 103(b), gross income does not include interest on any state or local bond. Section 103(b) provides, in part, that § 103(a) shall not apply to any private activity bond that is not a qualified bond (within the meaning of § 141). Section 141(e) provides, in part, that a qualified bond must meet the applicable requirements of § 146.

.02 Section 146(a) provides that a private activity bond issued as part of an issue meets the requirements of § 146 if the aggregate face amount of the private activity bonds issued pursuant to such issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed the authority’s volume cap for such calendar year.

.03 Section 146(f)(1) provides that if an issuing authority’s volume cap for any calendar year after 1985 exceeds the aggregate amount of tax-exempt private activity bonds the authority issued during such calendar year, such issuing authority may

elect to treat all (or any portion) of such excess as a carryforward.

.04 Section 146(f)(2) provides that, in making an election under § 146(f)(1), an issuing authority must identify one or more carryforward purposes described in § 146(f)(5) and specify the portion of the excess that is to be carried forward for each such purpose.

.05 Section 146(f)(4) provides that any carryforward election (and any identification or specification contained therein), once made, shall be irrevocable.

.06 Section 1.103(n)-4T, A-2(i), of the temporary Income Tax Regulations (together with § 1301(b) of the Tax Reform Act of 1986 (the “1986 Act”) 1986-3 (Vol. 1) C.B. 1, 520, *see* H.R. Conf. Rep. 99-841, at II-740 (1986), 1986-3 (Vol. 4) C.B. 740) provides that the carryforward election shall be made by means of a statement, signed by an authorized public official responsible for making allocations of the issuing authority’s volume cap, that the issuing authority elects to carry forward its unused volume cap.

.07 Section 1.103(n)-4T, A-2(ii) (together with § 1301(b) of the 1986 Act), requires that the carryforward election provide the following information:

(A) The name, address, and TIN of the issuing authority;

(B) The issuing authority’s volume cap for the calendar year;

(C) The aggregate amount of volume cap used by the issuing authority during the calendar year for which the election is being made;

(D) The unused volume cap of the issuing authority; and

(E) The purposes for the carryforward and the amount to be carried forward for each such carryforward purpose.

.08 Announcement 87-43, 1987-19 I.R.B. 15, provides that Form 8328 should be used by issuers of tax-exempt bonds who wish to make the carryforward election under § 146(f). *See also* Announcement 85-2, 1985-1 I.R.B. 42 (announcing the development of Form 8328 for carryforward elections under § 103(n) of the Internal Revenue Code of 1954).

.09 Notice 89-12, 1989-1 C.B. 633, provides that the issuing authority must file the carryforward election by the earlier of (1) February 15 of the calendar year following the year in which the excess amount arises or (2) the date of issue

of bonds issued pursuant to the carryforward election.

.10 The Internal Revenue Service has learned that certain allocating authorities have filed a Form 8328 to carry forward unused private activity bond volume cap that was properly allocated to an issuing authority (other than the allocating authority). A Form 8328 filed by an allocating authority that is not the issuing authority does not comply with the 1986 Code and regulations because the Form 8328 does not constitute an election by the issuing authority and because the form may fail to provide other information required under § 1.103(n)-4T, A-2.

SECTION 3. SCOPE

.01 This revenue procedure provides relief if a Form 8328 was filed by an allocating authority to carry forward unused private activity bond volume cap arising in any calendar year prior to 2003 that was properly allocated to an issuing authority (other than the allocating authority). This revenue procedure only applies when all requirements of § 146 (other than the requirement that the issuing authority file the carryforward election containing the information required under § 146(f)) have been met.

.02 This revenue procedure does not limit an issuing authority’s ability to request relief under § 301.9100-3 of the Procedure and Administration Regulations. For example, if no carryforward election has been made for an issuing authority, that issuing authority may apply for relief under § 301.9100-3, Rev. Proc. 2003-1, 2003-1 I.R.B. 1 (or its successor), and Rev. Proc. 96-16, 1996-1 C.B. 630.

SECTION 4. PROCEDURE

If an allocating authority improperly filed a Form 8328 to carry forward unused private activity bond volume cap for an issuing authority for a calendar year prior to 2003, the Form 8328 will be deemed effective to carry forward such unused volume cap for that issuing authority if either the allocating authority or the issuing authority has on file the following information with respect to the issuing authority:

(1) The name, address, and TIN of the issuing authority;

(2) The issuing authority's volume cap for the calendar year;

(3) The aggregate amount of volume cap for the calendar year used by the issuing authority during the calendar year;

(4) The unused volume cap of the issuing authority for the calendar year (determined by subtracting (3) of this § 4 from (2) of this § 4); and

(5) The purpose(s) for the issuing authority's carryforward and the amount to be carried forward for each such carryforward purpose.

SECTION 5. INQUIRIES

.01 The Service invites comments with respect to carryforward election procedures under § 146(f), including whether the procedures should be changed to permit the filing of a single Form 8328 to carry forward unused volume cap for all of the issuing authorities within the state.

.02 Comments should be sent to Internal Revenue Service, Associate Chief Counsel, Attention: CC:TEGE:EOEG:TEB, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. The words "Comments Submitted Pursuant to Rev. Proc. 2003-46" should be typed or printed across the top of the document. Comments should be submitted on or before October 14, 2003.

SECTION 6. EFFECT ON OTHER DOCUMENTS

Except as expressly provided in this revenue procedure, this revenue procedure has no effect on the application of any other document.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective as of July 14, 2003.

SECTION 8. PAPERWORK REDUCTION ACT

The collection of information referenced in this revenue procedure has been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-0874.

An agency may not conduct or sponsor, and a person is not required to respond

to, a collection of information unless the collection of information displays a valid OMB control number.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Rebecca L. Harrigal and Zoran Stojanovic of the Office of Assistant Chief Counsel (Exempt Organizations/Employment Tax/Government Entities). For further information regarding this revenue procedure, contact Mr. Stojanovic at (202) 622-3980 (not a toll-free call).

Guidance Regarding Election Under Section 953d

Rev. Proc. 2003-47

SECTION 1. PURPOSE AND SCOPE

This revenue procedure provides new procedural rules regarding the election under section 953(d) of the Internal Revenue Code of 1986 (the "Code"), under which certain foreign insurance companies may elect to be treated as domestic corporations for U.S. tax purposes. These new procedural rules reflect changes in the administration of the election. This revenue procedure replaces the procedural rules for making an election under section 953(d) contained in Section II of Notice 89-79, 1989-2 C.B. 392.

SECTION 2. BACKGROUND

In 1989, the Internal Revenue Service published Notice 89-79, which provides substantive and procedural rules regarding the election under section 953(d). Section 953(d) allows a controlled foreign corporation engaged in the insurance business to elect to be treated as a U.S. corporation for U.S. tax purposes. A controlled foreign corporation that makes this election will be subject to tax in the United States on its worldwide income but will not be subject to the branch profits tax or the branch-level interest tax imposed by section 884. Further, the excise tax imposed under section 4371 on policies issued by foreign insurers will not apply.

SECTION 3. SUMMARY OF CHANGES

Changes in the administration of the election under section 953(d) have made it necessary to issue new procedural rules. Specifically, this revenue procedure provides a new mailing address for section 953(d) elections and takes into account the replacement of Form 2848-D by Form 8821 ("*Tax Information Authorization*") to designate an authorized representative to receive confidential tax information on behalf of the corporation that makes a section 953(d) election ("electing corporation"). Additionally, this revenue procedure sets forth specific procedures regarding the satisfaction of the Office and Asset Tests (discussed below), including procedures for taking into account the office and assets of a U.S. affiliate. Finally, this revenue procedure requires that the electing corporation, or its U.S. affiliate, provide a calculation demonstrating that the requirements of the Asset Test are met.

SECTION 4. PROCEDURAL RULES

.01 *Electing Corporation Is Subject to U.S. Tax Rules.*

Determination of Tax Due and Timely Filing of Returns. An electing corporation must determine the tax due on its income as if it were a domestic corporation subject to part I or part II of subchapter L. The electing corporation must timely file the U.S. tax return that is due when the election becomes effective and must timely pay any U.S. taxes due (including estimated payments).

.02 *Termination or Revocation of Section 953(d) Election.*

(1) Once approved, the election generally remains effective for each subsequent taxable year in which the requirements of this revenue procedure and section 953(d) are satisfied unless revoked by the electing corporation with the consent of the Commissioner. However, if the electing corporation fails to timely file a return, pay the tax due as stated on the return, or comply with any other requirement for making the election contained in this revenue procedure and section 953(d), the Commissioner, in his discretion, may terminate the election as of the beginning of the taxable year after the taxable year with respect to which the failure occurs. If an

election is terminated or revoked, the foreign corporation and its successors will be barred from making another election under section 953(d) without the consent of the Commissioner.

(2) Termination or revocation of the election may cause the U.S. shareholders of the foreign corporation to be liable for subpart F inclusions for taxable years in which the election no longer is in effect. It will also cause the corporation to be considered a foreign person for purposes of the excise tax under section 4371 on premiums for insurance or reinsurance issued by the foreign corporation. Funds obtained by the Internal Revenue Service under the letter of credit (described later in this revenue procedure) may be applied to the taxes due from the foreign corporation. If a corporation's section 953(d) election ceases to apply for any subsequent taxable year, for purposes of section 367 the corporation will be treated as a domestic corporation transferring (as of the first day of the subsequent taxable year) all of its property to a foreign corporation in connection with an exchange to which section 354 applies.

.03 *Prior Elections under Section 953(c)(3)(C)*

A corporation that has an election in effect under section 953(c)(3)(C) to treat related person insurance income as income effectively connected with a U.S. trade or business may revoke that election and make the election under section 953(d) without requesting the consent of the Commissioner. Any such corporation must state in its section 953(d) election statement that it revokes its election under section 953(c)(3)(C), effective as of the date its election under section 953(d) commences.

.04 *Procedures for Making an Election.*

(1) *Election statement.* The process of making a section 953(d) election must be initiated by filing an original election statement, an example of which is provided in Appendix A. The electing corporation must attach to its election statement a complete list of all U.S. shareholders (within the meaning of section 953(c)(1)(A)) of the electing corporation as of a date no more than 90 days prior to the date the election statement is mailed. The list must

include the name, address, and tax identification number of, and ownership percentage for, each U.S. shareholder. The electing corporation must agree to file an updated list containing the information prescribed as of the last day of each taxable year. The updated list will be filed with the U.S. tax return reporting the income earned by the electing corporation for each taxable year the election is in effect. The electing corporation must also attach to its election statement a Form 2848 ("*Power of Attorney and Declaration of Representative*") or Form 8821 ("*Tax Information Authorization*") designating a U.S. representative authorized to receive confidential tax information, including any notice of deficiency, on behalf of the electing corporation. In the election statement, the electing corporation must agree to produce its books and records, or a true and accurate copy thereof, in the United States upon request of the Internal Revenue Service.

A completed election statement, together with attachments, should be filed with: Internal Revenue Service, 7850 SW 6th Court, Stop 5780, Plantation, FL 33324. The election statement must be signed by a duly authorized officer of the electing corporation, within the meaning of section 6062. When the electing corporation files its annual income tax return for the first year for which the election is made, Form 1120PC ("*U.S. Property and Casualty Insurance Company Income Tax Return*") or Form 1120L ("*U.S. Life Insurance Company Income Tax Return*"), it must attach a copy of this election statement (without attachments). The return is filed with the Internal Revenue Service, Philadelphia Submission Processing Center, Philadelphia, Pennsylvania 19255-0012, unless the electing corporation is part of a consolidated group that files elsewhere.

(2) *Election Due Date and Election Effective Date.* For an election to be effective for a taxable year, the original election statement must be filed by the due date prescribed in section 6072(b) (including extensions) for the U.S. income tax return that is due if the election becomes effective. When approved, the election is effective as of the first day of the first taxable year (including a short taxable year) for which it is made.

(3) *Closing Agreement and Letter of Credit.*

(a) To complete the election, an electing corporation that does not satisfy the Office and Asset Tests set forth below, either directly or through a U.S. affiliate, must enter into a closing agreement and provide a letter of credit to secure payment of taxes due, if any, from the electing corporation. Such an electing corporation first must file an election statement indicating that it does not satisfy the Office and Asset Tests by completing the third alternative paragraph six in the election statement in Appendix A. After filing the election statement, the electing corporation (or its designated representative) will be provided with instructions for completing the election process and will be notified when it must submit a letter of credit. The corporation's election will not be approved until a sufficient letter of credit has been provided. The letter of credit must be in an amount equal to 10% of the electing corporation's gross income (as this term is defined below), but not less than \$75,000 and not greater than \$10,000,000. The electing corporation may be required to provide evidence to support the computation of the amount of security.

(b) For purposes of this revenue procedure, the term "gross income" means "life insurance gross income" as defined in section 803, or "gross income" as defined in section 832(b)(1) (with the phrase "gross premiums written less return premiums and premiums paid for reinsurance" substituted for the term "underwriting income" where that term appears in section 832(b)(1)(A)).

(4) *Office and Asset Tests for Electing Corporation or U.S. Affiliate.*

(a) A closing agreement and letter of credit will not be required if the electing corporation: (1) maintains an office or other fixed place of business in the United States ("Office Test"); and (2) owns assets that are physically located in the United States with an adjusted basis equal to 10% of its gross income for the base year, as defined below ("Asset Test"). An Asset Calculation Sheet is provided in Appendix B.

(b) In addition, if as a result of the section 953(d) election, the electing corporation is a member of a consolidated group within the meaning of Treas. Reg. § 1.1502-1(h), the electing corporation may satisfy the Office and Asset Tests

based on the office and assets of a U.S. corporation that is a member of the consolidated group (“U.S. Affiliate”). An electing corporation will satisfy the Asset Test based on the assets of the U.S. Affiliate if the U.S. Affiliate owns assets that are physically located in the United States with an adjusted basis equal to 10% of the electing corporation's gross income for the base year, as defined below.

(c) The “base year” is the taxable year immediately before the taxable year for which the election is first made. However, if the electing corporation did not receive gross income in such prior taxable year, the base year is the first year of the election. If the first year is not a full taxable year, gross income is determined on an annualized basis. If, in any taxable year subsequent to the base year, the electing corporation's gross income is more than 120% of the gross income for the base year, such subsequent taxable year is treated as the new base year and the electing corporation must satisfy the Asset Test with respect to the new base year based on its assets, or based on the assets of the U.S. Affiliate pursuant to section 4.04(4)(b) and (e) of this revenue procedure. If the electing corporation does not satisfy the Asset Test with respect to the new base year, the electing corporation must provide an amended election statement indicating that it no longer satisfies the Asset Test and must enter into a closing agreement and provide a letter of credit to maintain its election.

(d) To satisfy the Asset Test, a corporation may include an asset only to the extent

that any claim of the U.S. government with respect to the asset, which may arise from the failure of the corporation to pay any tax imposed by the Internal Revenue Code, is not subordinated to the claims of any other creditor. Intangible personal property will qualify as an asset physically located in the United States only if the income from that property is income from sources within the United States, within the meaning of section 861, and the evidence of ownership of such property is physically present in the United States.

(e) If the electing corporation chooses to satisfy the Office and Asset Tests based on the office and assets of a U.S. Affiliate, the U.S. Affiliate must enter into a closing agreement with the Internal Revenue Service to agree that, in the event of termination or revocation of the electing corporation's section 953(d) election, the U.S. Affiliate will be liable for excise tax imposed under section 4371 (up to a stated amount) that remains unpaid after the electing corporation has been issued a statement of notice and demand for such tax. Information regarding the preparation of this closing agreement will be sent to the electing corporation after it has filed an election statement.

(5) Approval of Election.

When the section 953(d) election is approved, a stamped copy of the election statement and, if applicable, the executed closing agreement will be returned to the electing corporation. If an insured or broker receives a copy of the stamped election statement, he will no longer be liable under section 4374 with respect to

the excise tax imposed under section 4371. The exemption from the excise tax is effective as of the first day of the first taxable year for which the election is made. Any excise taxes that have been paid for periods for which the election is effective may be refunded to the person who remitted the taxes. A refund of excise tax (including statutory interest) may be obtained by filing a claim on Form 720 (“*Quarterly Federal Excise Tax Return*”) or Form 843 (“*Claim for Refund and Request for Abatement*”).

SECTION 5. EFFECT ON OTHER DOCUMENTS

Notice 89-79, 1989-2 C.B. 392, Section II, Procedural Rules, is modified and superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Alexandra K. Helou of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Ms. Helou at (202) 622-3840 (not a toll-free number). For further information concerning the processing of an election under section 953(d), contact Technical Services Group Manager in Plantation, FL, at (954) 423-7344 (not a toll-free number).

APPENDIX A

The election statement must set forth the following information, which may be provided in the following format:

FOREIGN INSURANCE COMPANY ELECTION UNDER SECTION 953(d)

(1) _____

(Name, address, principal place of business, if different, tax identification number, and place of incorporation of the electing corporation) hereby elects to be treated as a domestic corporation for U.S. tax purposes. [The electing corporation may obtain a tax identification number by filing a Form SS-4 (“*Application for Employer Identification Number*”) with the Philadelphia Submission Processing Center.]

- (2) *(Name of electing corporation)* waives all benefits to *(Name of electing corporation)* granted by the United States under any treaty.
- (3) *(Name of electing corporation)* agrees, (for all years in which this election is in effect), to timely file a U.S. income tax return and timely remit the income tax due on its income, determined as if *(Name of electing corporation)* were a domestic corporation subject to part I or part II of subchapter L, and the additional tax imposed under section 953(d)(6).
- (4) Attached to this election statement is a complete list of all U.S. shareholders (within the meaning of section 953(c)(1)(A)) of *(Name of electing corporation)* as of a date no more than 90 days prior to the date this election statement is mailed. The list includes the name, address, and tax identification number of, and ownership percentage for, each U.S. shareholder. *(Name of electing corporation)* agrees to file an updated list containing the information prescribed in this paragraph determined as of the last day of each taxable year. This updated list will be filed with the U.S. tax return reporting the income earned by the electing corporation for each taxable year the election is in effect.
- (5) Attached to this election statement is the Form 2848 (“*Power of Attorney and Declaration of Representative*”) or Form 8821 (“*Tax Information Authorization*”) designating a U.S. resident authorized to receive confidential tax information, including any notice of deficiency, on behalf of *(Name of electing corporation)*. *(Name of electing corporation)* agrees to produce its books and records, or a true and accurate copy thereof, in the United States upon request of the Internal Revenue Service.
- (6) *(Name of electing corporation)* maintains an office or other fixed place of business in the United States located at _____ and owns assets which are physically located in the United States with an adjusted basis equal to 10% of the base year's gross income of *(Name of electing corporation)* (“Office and Asset Tests”). Attached is the Asset Calculation Sheet [see Appendix B].

or

- (6) *(Name of electing corporation)* is a member of a consolidated group within the meaning of Treas. Reg. § 1.1502-1(h). *(Name of electing corporation)* satisfies the Office and Asset Tests based on the office and assets of *(Name of U.S. Affiliate)* (a member of the consolidated group). *(Name of U.S. Affiliate)* maintains an office or fixed place of business in the United States located at _____ and owns assets that are physically located in the United States with an adjusted basis equal to 10% of *(Name of electing corporation)*'s gross income for the base year. Attached are: 1) a copy of the Form 1122 (“*Authorization and Consent of Subsidiary Corporation To Be Included in a Consolidated Income Tax Return*”) in which the electing corporation consented to be included in the consolidated return, if such form was filed for the electing corporation; 2) a copy of the most recent Form 851 (“*Affiliations Schedule*”) filed by the consolidated group; 3) copies of the supporting statements attached to the most recent consolidated return, showing gross and taxable income and beginning and ending balance sheets with respect to the U.S. Affiliate upon whose office and assets the electing corporation will rely to satisfy the Office and Asset Tests; and 4) the Asset Calculation Sheet [see Appendix B].

or

- (6) *(Name of electing corporation)* agrees to provide security for the payment of any amounts due under the Code. The security will be in an amount and upon such terms as stated in a closing agreement to be executed between the Internal Revenue Service and *(Name of electing corporation)*. Attached is the power of attorney, Form 2848, for the person authorized to execute a closing agreement on behalf of *(Name of electing corporation)*.
- (7) This election shall be effective as of the first day of the electing corporation's taxable year (including a short taxable year) commencing _____. The undersigned declares under penalty of perjury that the statements contained in this election and accompanying documents are true and complete to the best of his/her knowledge and belief.

Date

(Title)

(Name of corporation)

APPENDIX B

Asset Calculation Sheet

Taxable year upon which this calculation is based:	_____
Is this calculation based upon full year actual or annualized figures? (See Section 4.04(4)(c) of this revenue procedure)	_____
Gross Premiums	_____
Less return premiums and premiums paid for reinsurance	(_____)
Investment income	_____
Total gross income of electing corporation	_____
10% of gross income of electing corporation	_____
Total assets of (electing corporation or U.S. Affiliate) held in the United States	_____

Part IV. Items of General Interest

Notice of Proposed Rulemaking; Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations; and Notice of Public Hearing

Assumption of Partner Liabilities

REG-106736-00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; notice of proposed rulemaking by cross-reference to temporary regulations; and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the definition of liabilities under section 752 of the Internal Revenue Code. These regulations provide rules regarding a partnership's assumption of certain fixed and contingent obligations in exchange for a partnership interest and provide conforming changes to certain regulations. These regulations also provide rules under section 358(h) for assumptions of liabilities by corporations from partners and partnerships. In addition, this document provides notice that the IRS and Treasury intend to issue supplemental guidance that may apply certain of the rules outlined in these proposed regulations to transactions involving corporations. This document also provides notice of public hearing on the proposed regulations.

DATES: Written or electronic comments and requests to speak at the public hearing scheduled for Tuesday, October 14, 2003, must be received by September 22, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG-106736-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:RU (REG-106736-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically, via the IRS

Internet site at: www.irs.gov/regs. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Horace Howells at (202) 622-3050; concerning submissions, the hearing, and/or placement on the building access list to attend the hearing, Sonya Cruse, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by August 25, 2003. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and

purchase of services to provide information.

The collection of information in this proposed regulation is in §1.752-7(e), (f), (g), and (h). This information is required for a former or current partner of a partnership to take deductions attributable to the economic performance of certain fixed or contingent obligations assumed from the partner by a partnership. This information will be used by the partner to permit the partner to take a deduction. An additional collection of information in this proposed regulation is in §1.752-7(j)(2). This information is required to inform the IRS of partnerships making the designated election and to report income appropriately. The collection of information is required to obtain a benefit, *i.e.*, to elect to apply the provisions of §1.752-7 of the proposed regulations in lieu of §1.752-6T of the temporary regulations. The likely respondents are individuals, business or other for-profit institutions, and small businesses or organizations.

Estimated total annual reporting burden: 125 hours.

The estimated annual burden per respondent varies from 20 to 40 minutes, depending on individual circumstances, with an estimated average of 30 minutes.

Estimated number of respondents: 250

Estimated annual frequency of responses: On occasion

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

With certain exceptions, no gain or loss is recognized if property is transferred to a corporation solely in exchange for stock of the corporation, and, immediately after the

exchange, the transferors control the corporation. If, however, the transferee corporation assumes a liability of the transferor, then, under section 358(d), the transferor's basis in the stock received in the exchange is reduced by the amount of that liability. If the amount of the liability exceeds the transferor's basis in the property transferred to the corporation, then the transferor recognizes gain under section 357(c)(1). Under section 357(c)(3), a liability the payment of which would give rise to a deduction or that would be described in section 736(a) (regarding payments to a retiring partner) is not taken into account in applying section 357(c)(1), unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of any property.

Under section 752(a) and (b), similar rules apply where a partnership assumes a liability from a partner or a partner contributes property to a partnership subject to a liability. The difference between the amount of the liability and the partner's share of that liability after the partnership's assumption is treated as a distribution of money, which reduces the partner's basis in the partnership interest and may cause the partner to recognize gain. There is no statutory or regulatory definition of liabilities for purposes of section 752. Case law and revenue rulings, however, have established that, as under section 357(c)(3), the term *liabilities* for this purpose does not include liabilities the payment of which would give rise to a deduction, unless the incurrence of the liability resulted in the creation of, or an increase in, the basis of property. Rev. Rul. 88-77, 1988-2 C.B. 128; *Salina Partnership LP, FPL Group, Inc. v. Commissioner*, T.C. Memo 2000-352.

On December 21, 2000, as part of the Community Renewal Tax Relief Act of 2000 (Appendix G of H.R. 4577, Consolidated Appropriations Act, 2001) Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) (the Act), Congress enacted section 358(h) to address certain situations where property was transferred to a corporation in exchange for both stock and the corporation's assumption of certain obligations of the transferor. In these situations, transferors took the position that the obligations were not liabilities within the meaning of section 357(c) or that they were described in section 357(c)(3), and, therefore, the

obligations did not reduce the basis of the transferor's stock. These assumed obligations, however, did reduce the value of the stock. The transferors then sold the stock and claimed a loss. In this way, taxpayers attempted to duplicate a loss in corporate stock and to accelerate deductions that typically are allowed only on the economic performance of these types of obligations.

Section 358(h) addresses these transactions by requiring that, after application of section 358(d), the basis in stock received in an exchange to which section 351, 354, 355, 356, or 361 applies be reduced (but not below the fair market value of the stock) by the amount of any liability assumed in the exchange. Exceptions to section 358(h) are provided where: (1) the trade or business with which the liability is associated is transferred to the person assuming the liability as part of the exchange; or (2) substantially all of the assets with which the liability is associated are transferred to the person assuming the liability as part of the exchange. The term *liability* for purposes of section 358(h) includes any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code (Code).

Congress recognized that taxpayers were attempting to use partnerships and S corporations to carry out the same types of abuses that section 358(h) was designed to deter. Therefore, in section 309(c) and (d)(2) of the Act, Congress directed the Secretary to prescribe rules to provide "appropriate adjustments under subchapter K of chapter 1 of the Code to prevent the acceleration or duplication of losses through the assumption of (or transfer of assets subject to) liabilities described in section 358(h)(3) . . . in transactions involving partnerships" and to prescribe similar rules for S corporations. Under the statute, these rules are to "apply to assumptions of liability after October 18, 1999, or such later date as may be prescribed in such rules."

In response to this directive, these proposed regulations provide rules to prevent the duplication and acceleration of loss through the assumption by a partnership of a §1.752-7 liability from a partner. For this purpose, a partnership that takes property subject to a liability is generally treated as assuming the liability. A

§1.752-7 liability is any fixed or contingent obligation to make payment that is not described in §1.752-1(a)(1), without regard to whether the obligation is otherwise taken into account for purposes of the Code.

The proposed regulations also provide that section 704(c) principles shall apply to a §1.752-7 liability assumed by a partnership from a partner. Accordingly, the §1.752-7 liability is treated under section 704(c) principles as having a built-in loss equal to the amount of such liability at the time of its assumption by the partnership. The amount of the §1.752-7 liability is the amount that a willing assignor would pay to a willing assignee to assume the §1.752-7 liability in an arm's-length transaction.

In addition, the proposed regulations make conforming amendments to §§1.704-1(b)(2)(iv)(b) (by providing that a partner's capital account be reduced by the §1.752-7 liabilities that the partnership assumes from the partner), 1.704-2(b)(3) (by treating a §1.752-7 liability as a nonrecourse liability for purposes of the partnership allocation rules), and 1.705-1 (by directing taxpayers to §1.358-7(b) and §1.752-7 for basis adjustments necessary to coordinate section 705 with section 358(h) and §1.752-7).

Moreover, the proposed regulations provide rules under section 358(h) for assumptions of liabilities by corporations from partners and partnerships. In addition, in the Explanation of Provisions section of this preamble, the IRS and Treasury are alerting taxpayers that they are considering adopting the definition of liability proposed in these regulations as an appropriate interpretation of the term *liability* for purposes of subchapter C of chapter 1 of the Code. The IRS and Treasury are also considering issuing regulations to conform the exceptions to section 358(h) to the exceptions described in these regulations. These regulations will be retroactive to the extent necessary to prevent abuse.

Section 358(h) applies to S corporations. The Act states that the Secretary may prescribe comparable rules which provide appropriate adjustments under subchapter S. These proposed regulations do not address the assumption of liabilities by S corporations; however, any rules applicable to assumptions of liabilities

by corporations would, in the absence of provisions to the contrary, apply equally to S corporations. Comments regarding the assumption of liabilities by S corporations are requested.

Explanation of Provisions

1. Addition of §1.752-1(a)(1)—Definition of Liability

The question of what constitutes a liability for purposes of section 752 was addressed in Rev. Rul. 88-77, 1988-2 C.B. 128. Rev. Rul. 88-77 holds that partnership liabilities include an obligation only if, and to the extent that, incurring the obligation creates or increases the basis to the partnership of any of the partnership's assets (including cash attributable to borrowings), gives rise to an immediate deduction to the partnership, or, under section 705(a)(2)(B) (relating to noncapital, nondeductible expenditures of a partnership) currently decreases a partner's basis in the partner's partnership interest. Section 1.752-1T(g) (T.D. 8237, 1989-1 C.B. 180, 192 [53 F.R. 53140]), included a definition of a liability for purposes of section 752 that reaffirmed the position of the IRS in Rev. Rul. 88-77. This definition was removed from the final version of those regulations in response to comments that the definition was redundant and therefore unnecessary. The Service continues to follow the definition of liability set forth in Rev. Rul. 88-77. See Rev. Rul. 95-26, 1995-1 C.B. 131.

Because these proposed regulations define a §1.752-7 liability as a fixed or contingent obligation to make payment to which section 752 does not apply, Treasury and the IRS believe that it is appropriate to describe in these regulations the liabilities to which section 752 does apply. Therefore, following the principles set forth in §1.752-1T(g) and Rev. Rul. 88-77, the proposed regulations provide that an obligation is a liability if and to the extent that incurring the obligation: (A) creates or increases the basis of any of the obligor's assets (including cash); (B) gives rise to an immediate deduction to the obligor; or (C) gives rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital. An obligation for this purpose is any fixed or contingent

obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Code. Obligations include, but are not limited to, debt obligations, environmental obligations, tort obligations, contract obligations, pension obligations, obligations under a short sale, and obligations under derivative financial instruments such as options, forward contracts, and futures contracts. The definition of a liability contained in these proposed regulations does not follow *Helmer v. Commissioner*, T.C. Memo 1975-160. (The Tax Court, in *Helmer*, held that a partnership's issuance of an option to acquire property did not create a partnership liability for purposes of section 752.)

Treasury and the IRS are considering adopting the definition of liability proposed in these regulations as an appropriate interpretation of the term *liability* for purposes of subchapter C of chapter 1 of the Code. Treasury and the IRS request comments on the scope and substance of such regulations, which will be retroactive to the extent necessary to prevent abuse.

2. §1.752-7—Partnership Assumption of Partner's §1.752-7 Liability

In the corporate context, section 358(h) prevents the duplication and acceleration of loss with respect to obligations not encompassed by section 358(d) by reducing the transferor shareholder's basis in corporate stock received in the exchange. Treasury and the IRS do not believe that this is the best approach for partnerships given their passthrough nature. Ultimately, the partners' shares of a partnership's deductions are limited by the partners' bases in their partnership interests (their outside bases). If, at the time of an assumption of a §1.752-7 liability by a partnership from a partner (the §1.752-7 liability partner), the partner's outside basis were reduced by the amount of the §1.752-7 liability, then the partner would not have sufficient outside basis to absorb any deduction with respect to the §1.752-7 liability that passed through the partnership.

For this reason, these proposed regulations do not reduce the outside basis of the §1.752-7 liability partner upon the partnership's assumption of the §1.752-7 liability. If the partnership satisfies the §1.752-7 liability while the §1.752-7

liability partner is a partner in the partnership, then the deduction with respect to the portion of the §1.752-7 liability assumed by the partnership from the §1.752-7 liability partner (the built-in loss associated with the §1.752-7 liability) is allocated to the §1.752-7 liability partner, reducing that partner's outside basis. If, instead, one of three events occur that separate the §1.752-7 liability partner from the §1.752-7 liability, then the §1.752-7 liability partner's outside basis is reduced at that time. These events are: (1) a disposition (or partial disposition) of the partnership interest by the §1.752-7 liability partner, (2) a liquidation of the §1.752-7 liability partner's partnership interest, and (3) the assumption (or partial assumption) of the §1.752-7 liability by a partner other than the §1.752-7 liability partner. Immediately before the occurrence of one of these events, the §1.752-7 liability partner's basis in the partnership interest generally is reduced by the lesser of: (1) the excess of the §1.752-7 liability partner's basis in the partnership interest over the adjusted value of that interest, or (2) the remaining built-in loss associated with the §1.752-7 liability (the §1.752-7 liability reduction). For this purpose, the adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under §§1.752-1 through 1.752-5. In the case of a partial disposition of the §1.752-7 liability partner's partnership interest or a partial assumption of the §1.752-7 liability by another partner, the §1.752-7 liability reduction is pro rated based on the portion of the interest sold or the portion of the §1.752-7 liability assumed.

After the occurrence of such an event, the partnership (or the assuming partner) is not entitled to any deduction or capital expense on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability. If, however, the partnership (or the assuming partner) notifies the §1.752-7 liability partner of the partial or complete economic performance of the §1.752-7 liability, then the §1.752-7 liability partner is entitled to a deduction or loss. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7

liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the §1.752-7 liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

The proposed regulations further provide that, solely for purposes of section 705 (adjustments to the basis of a partnership interest) and §1.704-1(b)(2)(iv)(b) (partnership capital accounting rules), the remaining built-in loss associated with the §1.752-7 liability is not treated as a nondeductible, noncapital expense to the partnership. Therefore, the remaining partners' bases in their partnership interests and capital accounts are not reduced by the remaining built-in loss associated with the §1.752-7 liability.

If the §1.752-7 liability is assumed by a partner other than the §1.752-7 liability partner, then, on economic performance of the §1.752-7 liability, the assuming partner is treated as contributing cash to the partnership in the amount of the lesser of: (1) the amount paid to satisfy the §1.752-7 liability; or (2) the remaining built-in loss associated with the §1.752-7 liability as of the time of the assumption. Adjustments as a result of this deemed cash contribution may include adjusting the basis of the partnership interest, any assets (other than cash, accounts receivable, or inventory) distributed by the partnership to the partner, or gain or loss on the disposition of the partnership interest or of property distributed by the partnership, as the case may be. However, the assuming partner cannot take into account any adjustments to depreciable basis, reduction in gain, or increase in loss until economic performance of the §1.752-7 liability. Any adjustment to the basis of an asset under this provision is taken into account over the recovery period of that asset.

3. Exceptions

Certain exceptions apply to these rules. In the corporate context, section

358(h) does not apply in the following two situations: (1) where the trade or business with which the liability is associated is transferred to the corporation assuming the liability; and (2) where substantially all of the assets with which the liability is associated are transferred to the corporation assuming the liability. Section 358(h)(2) authorizes the Secretary to limit the application of these exceptions.

The statutory provision relating to partnerships does not specify whether the exceptions in section 358(h)(2) should apply. The only cross-reference to section 358(h) in this statutory provision is to section 358(h)(3), which defines the term *liability*. Treasury and IRS believe it is appropriate to provide for a variation on one of the two exceptions to section 358(h), as well as an additional exception that is not included in section 358(h), in these proposed regulations. Treasury and the IRS request comments on these exceptions and on whether additional exceptions should be included in the final regulations.

The first exception applies where the partnership assumes the §1.752-7 liability as part of the contribution of the trade or business with which the liability is associated and the partnership continues to conduct that trade or business after the contribution. For this purpose, a trade or business is a specific group of activities carried on by a person for the purpose of earning income or profit if the activities included in that group include every operation that forms a part of, or a step in, the process of earning income or profit.

The proposed regulations provide that the activity of acquiring, holding, or disposing of financial instruments constitutes a trade or business for this purpose if and only if the activity is conducted by an entity registered with the Securities and Exchange Commission as a management company under the Investment Company Act of 1940, as amended. Treasury and the IRS are concerned that certain activities involving acquiring, holding, or disposing of financial instruments could be structured to accomplish the types of transactions that section 309(c) of the Act was designed to prevent. Nonetheless, Treasury and the IRS recognize that many persons contribute such activities to partnerships for substantial business purposes. For example, mutual funds often contribute sub-

stantially all of their assets to a master partnership to save administrative costs. Under some circumstances, such a mutual fund may transfer portfolio positions (including hedge positions that could be considered §1.752-7 liabilities under the proposed regulations) to the master partnership. Because a contribution by a mutual fund to a master partnership is not the type of abusive loss duplication transaction that section 309(c) of the Act was designed to address, the proposed regulations treat this type of contribution as a contribution of a trade or business. Treasury and the IRS request comments on additional types of activities that should be treated as trades or businesses for purposes of these regulations.

The proposed regulations do not include the section 358(h) exception for situations in which substantially all of the assets with which the liability is associated are transferred to the partnership assuming the liability. Treasury and the IRS are concerned that taxpayers would rely on that exception to facilitate transactions of the type that section 309(c) of the Act was designed to prevent.

An additional *de minimis* exception, not present in section 358(h), is included in the proposed regulations. Under this exception, the proposed regulations do not apply where, immediately before the disposition of the partnership interest by the §1.752-7 liability partner, the liquidation of the §1.752-7 liability partner's partnership interest, or the assumption of the §1.752-7 liability by another partner, the amount of the remaining built-in loss with respect to all §1.752-7 liabilities assumed by the partnership (other than §1.752-7 liabilities that are assumed by the partnership with an associated trade or business) is less than the lesser of 10% of the gross value of the partnership's assets or \$1,000,000. This exception was added in recognition of the fact that loss acceleration and duplication strategies typically are engaged in only if the accelerated or duplicated loss is substantial.

4. Advanced Notice of Proposed Rulemaking Under Section 358(h)(2)

Treasury and the IRS are considering exercising their regulatory authority under section 358(h)(2) to limit the exceptions

to section 358(h)(1) to follow the exceptions set forth in these proposed regulations (other than the *de minimis* exception). Treasury and the IRS request comments on the scope and substance of such regulations, which will be retroactive to the extent necessary to prevent abuse.

5. Rules Applicable to Tiered Structures

Proposed §1.752-7(e) and (i) provide rules to address a contribution of a partnership interest to another partnership. First, under §1.752-7(e)(3), a transfer by a partner of an interest in a partnership (lower-tier partnership) to another partnership (upper-tier partnership) is not treated as a transfer of a partnership interest for purposes of applying these rules. Therefore, the partner does not have to reduce the basis of the partnership interest before such a transfer. However, look-through rules in §1.752-7(i) apply to treat the transfer of the partnership interest as a transfer of the partner's share of the assets and §1.752-7 liabilities of the partnership. Therefore, a transfer of a partnership interest to another partnership may be treated as an assumption of a §1.752-7 liability by a partnership under these proposed regulations. Under proposed §1.358-7(a), similar rules apply to a contribution of a partnership interest to a corporation.

Also, §1.752-7(i)(2) provides a limitation on the trade or business exception where a partnership (upper-tier partnership) assumes a §1.752-7 liability from a partner, and then another partnership (lower-tier partnership) assumes the §1.752-7 liability from the upper-tier partnership. In such a case, the trade or business exception does not apply on the assumption of the §1.752-7 liability by the lower-tier partnership from the upper-tier partnership unless it applied on the assumption of the §1.752-7 liability by the upper-tier partnership from the §1.752-7 liability partner. Section 1.358-7(c) of these proposed regulations provide for similar rules where a corporation assumes an obligation described in section 358(h)(3) from a partnership that the partnership had previously assumed from a partner. In addition, §1.358-7(b) of these proposed regulations provide special rules for adjusting the partners' bases in a partnership when a corporation assumes a §1.752-7 liability from the partnership.

Additional rules are provided for look-through treatment where a partnership is a §1.752-7 liability partner in another partnership. The proposed regulations also provide special rules for situations in which the §1.752-7 liability partner disposes of the partner's interest in the partnership and then another partnership (or a corporation) assumes the §1.752-7 liability from the partnership.

Effective Date

The regulations described above are proposed to apply to assumptions of §1.752-7 liabilities occurring on or after June 24, 2003. On page 46 of this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9062) (§1.752-6T) that apply to liabilities assumed by a partnership after October 18, 1999, and before June 24, 2003. The text of those temporary regulations published in this issue of the Bulletin serves as the text of §1.752-6 of these regulations. In lieu of applying §1.752-6T of the temporary Income Tax Regulations, partnerships may elect to be subject to the proposed rules of §§1.358-7 and 1.752-7 and the proposed revisions of §§1.704-1(b)(2)(iv)(b), 1.704-2(b)(3), 1.705-1(a)(7), and 1.752-1, published as part of this Notice of Proposed Rulemaking, with respect to all liabilities (including §1.752-7 liabilities) assumed by the partnership after October 18, 1999, and before June 24, 2003. The election must be filed with the first federal income tax return filed by the partnership on or after September 22, 2003. The election will be valid only if the partnership and its partners promptly amend any returns for open taxable years that would be affected by the election.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that few partnerships engage in the type of transactions that are subject to these regulations (assumptions of liabilities not described in section 752(a) and (b) from a partner).

In addition, available data indicates that most partnerships that engage in the type of transactions that are subject to these regulations are large partnerships. Certain broad exceptions to the application of these regulations (including a *de minimis* exception) further limit the economic impact of these regulations on small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. Comments are sought as to the number of legitimate business transactions that will be affected by the proposed regulations.

Drafting Information

The principal author of these regulations is Horace Howells, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 continues to read in part as follows:

PART 1—INCOME TAXES

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

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

Section 1.752-1(a) also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Section 1.752-6 also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Section 1.752-7 also issued under Public Law 106-554, 114 Stat. 2763, 2763A-638 (2001) * * *

Par. 2. Section 1.358-7 is added to read as follows:

§1.358-7 Transfers by partners and partnerships to corporations.

(a) *Contributions of partnership interests.* For purposes of section 358(h), a

transfer of a partnership interest to a corporation is treated as a transfer of the partner's share of each of the partnership's assets and an assumption by the corporation of the partner's share of partnership liabilities (including section 358(h) liabilities, as defined in paragraph (d) of this section). See paragraph (e), *Example 1* of this section.

(b) *Contributions by partnerships.* If a corporation assumes a section 358(h) liability from a partnership in an exchange to which section 358(a) applies, then, for purposes of applying section 705 (determination of basis of partner's interest) and §1.704-1(b), any reduction, under section 358(h)(1), in the partnership's basis in corporate stock received in the transaction is treated as an expenditure of the partnership described in section 705(a)(2)(B). See paragraph (e), *Example 2* of this section. This expenditure must be allocated among the partners in accordance with section 704(b) and (c) and §1.752-7(c). If a partner's share of the reduction, under section 358(h)(1), in the partnership's basis in corporate stock exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess, which is treated as gain from the sale or exchange of a partnership interest. This paragraph does not apply to the extent that §1.752-7(i)(4) applies to the assumption of the §1.752-7 liability by the corporation.

(c) *Assumption of section 358(h) liability by partnership followed by transfer of partnership interest or partnership property to a corporation—trade or business exception.* Where a partnership assumes a section 358(h) liability from a partner and, subsequently, the partner transfers all or part of the partner's partnership interest to a corporation in an exchange to which section 358(a) applies, the section 358(h) liability is treated as associated only with the contribution made to the partnership by that partner. Similar rules apply where a partnership assumes a section 358(h) liability of a partner and a corporation subsequently assumes that section 358(h) liability from the partnership in an exchange to which section 358(a) applies. See paragraph (e), *Example 1* of this section.

(d) *Section 358(h) liabilities defined.* For purposes of this section, section 358(h) liabilities are liabilities described in section 358(h)(3).

(e) *Examples.* The following examples illustrate the provisions of this section. Assume, for purposes of these examples, that the obligation assumed by the corporation does not reduce the shareholder's basis in the corporate stock under section 358(d). The examples are as follows:

Example 1. Contribution of partnership interest to corporation. In 2004, A contributes undeveloped land with a value and basis of \$4,000,000 in exchange for a 50% interest in PRS and an assumption by PRS of \$2,000,000 of pension liabilities from a separate business that A conducts. A's basis in the PRS interest immediately after the contribution is A's basis in the land, \$4,000,000, unreduced by the amount of the pension liabilities. PRS develops the land as a landfill. Before PRS has economically performed with respect to the pension liabilities, A contributes A's interest in PRS to Corporation X, in an exchange to which section 351 applies. At the time of the exchange, the value of A's PRS interest is \$2,000,000, A's basis in PRS is \$4,000,000, and A has no share of partnership liabilities other than the pension liabilities. For purposes of applying section 358(h), the contribution of the PRS interest to Corporation X is treated as a contribution to Corporation X of A's share of PRS assets and of A's share of the pension liabilities of PRS (\$2,000,000). Because the pension liabilities were not assumed by PRS from A in an exchange in which either the trade or business associated with the liability or substantially all of the assets associated with the liability were transferred to PRS, the contribution of the PRS interest to Corporation X is not excepted from section 358(h) under section 358(h)(2). Under section 358(h), A's basis in the Corporation X stock is reduced by the \$2,000,000 of pension liabilities.

Example 2. Contribution of partnership property to corporation. In 2004, in an exchange to which section 351(a) applies, PRS, a cash basis taxpayer, contributes \$2,000,000 cash to Corporation X, also a cash basis taxpayer, in exchange for Corporation X shares and the assumption by Corporation X of \$1,000,000 of accounts payable incurred by PRS. At the time of the exchange, PRS has two partners, A, a 90% partner, who has a \$2,000,000 basis in the PRS interest, and B, a 10% partner, who has a \$50,000 basis in the PRS interest. Assume that, under section 358(h)(1), PRS's basis in the Corporation X stock is reduced by the accounts payable assumed by Corporation X (\$1,000,000). Under paragraph (b) of this section, A's and B's bases in PRS must be reduced, but not below zero, by their respective shares of the section 358(h)(1) basis reduction. If either partner's share of the section 358(h)(1) basis reduction exceeds the partner's basis in the partnership interest, then the partner recognizes gain equal to the excess. A's share of the section 358(h) basis reduction is \$900,000 (90% of \$1,000,000). Therefore, A's basis in the PRS interest is reduced to \$1,100,000 (\$2,000,000 - \$900,000). B's share of the section 358(h) basis reduction is \$100,000 (10% of \$1,000,000). Because B's share of the section 358(h) basis reduction (\$100,000) exceeds B's basis in the PRS interest (\$50,000), B's basis in the PRS interest is reduced to \$0 and B recognizes \$50,000 of gain. This gain is treated as gain from the sale of the PRS interest.

(f) *Effective date.* This section applies to assumptions of liabilities by a corporation occurring on or after June 24, 2003.

§1.704-1 [Amended]

Par. 3. Section 1.704-1 is amended as follows:

1. Paragraph (b)(1)(ii) is amended by removing the language "The" at the beginning of the first sentence and adding "Except as otherwise provided in this section, the" in its place.

2. Paragraph (b)(2)(iv)(b)(2) is amended by removing the language "secured by such contributed property" in the parenthetical.

3. Paragraph (b)(2)(iv)(b)(2) is further amended by removing the language "under section 752" in the parenthetical.

4. Paragraph (b)(2)(iv)(b)(5) is amended by removing the language "secured by such distributed property" in the parenthetical.

5. Paragraph (b)(2)(iv)(b)(5) is further amended by removing the language "under section 752" in the parenthetical.

6. Paragraph (b)(2)(iv)(b) is further amended by adding a sentence at the end of the paragraph.

The addition reads as follows:

§1.704-1 Partner's distributive share.

* * * * *

(b) * * *

(2) * * *

(iv) * * *

(b) * * * For liabilities assumed before June 24, 2003, references to liabilities in this paragraph (b)(2)(iv)(b) shall include only liabilities secured by the contributed or distributed property that are taken into account under section 752(a) and (b).

* * * * *

§1.704-2 [Amended]

Par. 4. In §1.704-2, paragraph (b)(3) is amended by adding the language "or a §1.752-7 liability (as defined in §1.752-7(b)(2)(i)) assumed by the partnership from a partner on or after June 24, 2003" at the end of the sentence.

Par. 5. Section 1.705-1 is amended by adding paragraph (a)(8) to read as follows:

§1.705-1 Determination of basis of partner's interest.

(a) * * *

(8) For basis adjustments necessary to coordinate sections 705 and 358(h), see §1.358-7(b). For certain basis adjustments with respect to a §1.752-7 liability assumed by a partnership from a partner, see §1.752-7.

* * * * *

§1.752-0 [Amended]

Par. 6. Section 1.752-0 is amended as follows:

1. The section heading and introductory text of §1.752-0 are revised.

2. The entries for §1.752-1(a)(1) through (a)(3) are redesignated as §1.752-1(a)(2) through (a)(4).

3. A new entry for §1.752-1(a)(1) is added.

4. The entries for §1.752-1(a)(1)(i), (ii), (iii), and (iv) are added.

5. The entries for §§1.752-6 and 1.752-7 are added.

The revision and additions read as follows:

§1.752-0 Table of contents.

This section lists the major captions that appear in §§1.752-1 through 1.752-7.

§1.752-1 Treatment of partnership liabilities.

- (a) Definitions.
 - (1) Liability defined.
- (i) In general.
- (ii) Obligation.
- (iii) Other liabilities.
- (iv) Effective date.

* * * * *

§1.752-6 Partnership assumption of partner's §358(h)(3) liability after October 18, 1999, and before June 24, 2003.

- (a) In general.
- (b) Exceptions.
 - (1) In general.
 - (2) Transactions described in Notice 2000-44.
- (c) Example.
- (d) Effective date.
 - (1) In general.
 - (2) Election to apply §1.752-7.

§1.752-7 Partnership assumption of partner's §1.752-7 liability on or after June 24, 2003.

- (a) General rules.
 - (1) Purpose and structure.
 - (2) Exception from disguised sale rules.
- (b) Definitions.
 - (1) Assumption.
 - (2) §1.752-7 liability.
 - (i) In general.
 - (ii) Amount and share of §1.752-7 liability.
 - (3) §1.752-7 liability partner.
 - (4) Remaining built-in loss associated with a §1.752-7 liability.
 - (5) §1.752-7 liability reduction.
 - (i) In general.
 - (ii) Partial dispositions and assumptions.
 - (6) §1.752-7 liability transfer.
 - (7) Testing date.
 - (8) Trade or business.
 - (i) In general.
 - (ii) Trading and investment partnerships.
 - (A) In general.
 - (B) Financial instruments.
 - (iii) Examples.
 - (9) Adjusted value.
 - (c) Application of section 704(c) to assumed §1.752-7 liabilities.
 - (1) In general.
 - (2) Example.
 - (d) Special rules for sales of partnership interests, distributions of partnership assets, and assumptions of the §1.752-7 liability after a §1.752-7 liability transfer.
 - (1) In general.
 - (2) Exceptions.
 - (i) In general.
 - (ii) Examples.
 - (e) Transfer of §1.752-7 liability partner's partnership interest.
 - (1) In general.
 - (2) Examples.
 - (3) Exception for nonrecognition transactions.
 - (i) In general.
 - (ii) Examples.
 - (f) Distribution in liquidation of §1.752-7 liability partner's partnership interest.
 - (1) In general.
 - (2) Example.
 - (g) Assumption of §1.752-7 liability by a partner other than §1.752-7 liability partner.
 - (1) In general.
 - (2) Consequences to §1.752-7 liability partner.

- (3) Consequences to partnership.
- (4) Consequences to assuming partner.
- (5) Example.
- (h) Notification by the partnership (or successor) of the economic performance of the §1.752-7 liability.
 - (i) Tiered partnerships.
 - (1) Look-through treatment.
 - (2) Trade or business exception.
 - (3) Partnership as a §1.752-7 liability partner.
 - (4) Transfer of §1.752-7 liability by partnership to another partnership or corporation after a transaction described in paragraphs (e), (f), or (g).
 - (i) In general.
 - (ii) Subsequent transfers.
 - (5) Example.
 - (j) Effective date.
 - (1) In general.
 - (2) Election to apply this section to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003.
 - (i) In general.
 - (ii) Manner of making election.
 - (iii) Filing of amended returns.
 - (iv) Time for making election.

Par. 7. In §1.752-1, paragraphs (a)(1) through (a)(3) are redesignated as paragraphs (a)(2) through (a)(4) and a new paragraph (a)(1) is added to read as follows:

§1.752-1 Treatment of Partnership Liabilities.

(a) *Definitions*—(1) *Liability defined*—(i) *In general*. An obligation is a liability for purposes of section 752 and the regulations thereunder, only if and to the extent that incurring the obligation—

(A) Creates or increases the basis of any of the obligor's assets (including cash);

(B) Gives rise to an immediate deduction to the obligor; or

(C) Gives rise to an expense that is not deductible in computing the obligor's taxable income and is not properly chargeable to capital.

(ii) *Obligation*. For purposes of this paragraph and §1.752-7, an obligation is any fixed or contingent obligation to make payment without regard to whether the obligation is otherwise taken into account for purposes of the Internal Revenue Code. Obligations include, but are not limited to, debt obligations, environmental

obligations, tort obligations, contract obligations, pension obligations, obligations under a short sale, and obligations under derivative financial instruments such as options, forward contracts, and futures contracts.

(iii) *Other liabilities.* For obligations that are not liabilities as defined in paragraph (a)(1)(i) of this section, see §§1.752-6 and 1.752-7.

(iv) *Effective date.* This paragraph (a)(1) applies to liabilities that are incurred or assumed by a partnership on or after June 24, 2003.

* * * * *

§1.752-5(a) [Amended]

Par. 8. Section 1.752-5 is amended as follows:

1. Paragraph 1.752-5(a) is amended by removing the language “Unless” at the beginning of the first sentence and adding “Except as otherwise provided in §§1.752-1 through 1.752-4, unless” in its place.

Par. 9. Section 1.752-6 is added to read as follows:

§1.752-6 Partnership assumption of partner’s section 358(h)(3) liability after October 18, 1999, and before June 24, 2003.

The text of proposed §1.752-6 is the same as the text of §1.752-6T published elsewhere in this issue of the Bulletin.

Par. 10. Section 1.752-7 is added to read as follows:

§1.752-7 Partnership assumption of partner’s §1.752-7 liability on or after June 24, 2003.

(a) *General rules—(1) Purpose and structure.* The purpose of this section is to prevent the acceleration or duplication of loss through the assumption of obligations not described in §1.752-1(a)(1) in transactions involving partnerships. Under paragraph (c) of this section, any such obligation that is assumed by a partnership from a partner in a transaction governed by section 721(a) must be taken into account by applying principles under section 704(c). Paragraphs (e), (f), and (g) of this section provide rules for situations where a partnership assumes such an obligation from a partner and, subsequently,

that partner sells or exchanges all or part of the partnership interest, that partner receives a distribution in liquidation of the partnership interest, or another partner assumes part or all of that obligation from the partnership. These rules prevent the duplication of loss by prohibiting the partnership and any person other than the partner from whom the obligation was assumed from claiming a deduction or capital expense to the extent of the built-in loss associated with the obligation. These rules also prevent the acceleration of loss by deferring the partner’s deduction or loss attributable to the obligation (if any) until economic performance occurs. Paragraph (d) of this section provides a number of exceptions to paragraphs (e), (f), and (g) of this section, including a *de minimis* exception. Paragraph (i) of this section provides special rules for tiered partnership transactions.

(2) *Exception from disguised sale rules.* The assumption of a §1.752-7 liability is not treated as an assumption of a liability or as a transfer of cash for purposes of section 707(a)(2)(B).

(b) *Definitions.* For purposes of this section, the following definitions apply—

(1) *Assumption.* A person that takes property subject to a §1.752-7 liability of another person is treated as assuming the §1.752-7 liability, but only to the extent of the fair market value of the property taken subject to the §1.752-7 liability.

(2) *§1.752-7 liability—(i) In general.* A §1.752-7 liability is an obligation (as defined in §1.752-1(a)(1)(ii)) that is not described in §1.752-1(a)(1)(i).

(ii) *Amount and share of §1.752-7 liability.* The amount of a §1.752-7 liability is the amount of cash that a willing assignor would pay to a willing assignee to assume the §1.752-7 liability in an arm’s-length transaction. A partner’s share of a partnership’s §1.752-7 liability is the amount of deduction that would be allocated to the partner with respect to the §1.752-7 liability if the partnership disposed of all of its assets, satisfied all of its liabilities (other than §1.752-7 liabilities), and paid an unrelated person to assume all of its §1.752-7 liabilities in a fully taxable arm’s-length transaction (assuming such payment would give rise to an immediate deduction to the partnership).

(3) *§1.752-7 liability partner.* A §1.752-7 liability partner is a partner from

whom a partnership assumes a §1.752-7 liability as part of a §1.752-7 liability transfer or any person who acquires a partnership interest from the §1.752-7 liability partner in a transaction described in paragraph (e)(3) of this section. If a partnership (lower-tier partnership) assumes a §1.752-7 liability from another partnership (upper-tier partnership), then both the upper-tier partnership and the partners of the upper-tier partnership are §1.752-7 liability partners. Therefore, paragraphs (e) and (f) of this section apply on a sale or liquidation of any partner’s interest in the upper-tier partnership and on a sale or liquidation of the upper-tier partnership’s interest in the lower-tier partnership. See paragraph (i)(3) of this section.

(4) *Remaining built-in loss associated with a §1.752-7 liability.* The remaining built-in loss associated with a §1.752-7 liability equals the amount of the §1.752-7 liability as of the time of the assumption of the §1.752-7 liability by the partnership, reduced by the portion of the §1.752-7 liability previously taken into account by the §1.752-7 liability partner under paragraph (i)(4) of this section and adjusted as provided in paragraph (c) of this section and §1.704-3 for—

(i) Partnership allocations of loss or deduction with respect to the §1.752-7 liability on or prior to the testing date; and

(ii) Any assumption of all or part of the §1.752-7 liability by the §1.752-7 liability partner (including any assumption that occurs on the testing date).

(5) *§1.752-7 liability reduction—(i) In general.* The §1.752-7 liability reduction is the amount by which the §1.752-7 liability partner is required to reduce the basis in the partner’s partnership interest by operation of paragraphs (e), (f), and (g) of this section. The §1.752-7 liability reduction is the lesser of—

(A) The excess of the §1.752-7 liability partner’s basis in the partner’s partnership interest over the adjusted value of that interest (as defined in paragraph (b)(9) of this section); or

(B) The remaining built-in loss associated with the §1.752-7 liability.

(ii) *Partial dispositions and assumptions.* In the case of a partial disposition of the §1.752-7 liability partner’s partnership interest or a partial assumption of the §1.752-7 liability by another partner, the §1.752-7 liability reduction is pro rated

based on the portion of the interest sold or the portion of the §1.752-7 liability assumed.

(6) *§1.752-7 liability transfer.* A §1.752-7 liability transfer is any assumption of a §1.752-7 liability by a partnership from a partner in a transaction governed by section 721(a).

(7) *Testing date.* The testing date is—

(i) For purposes of paragraph (e) of this section, the date of the sale, exchange, or other disposition of part or all of the §1.752-7 liability partner's partnership interest;

(ii) For purposes of paragraph (f) of this section, the date of the partnership's distribution in liquidation of the §1.752-7 liability partner's partnership interest; and

(iii) For purposes of paragraph (g) of this section, the date of the assumption (or partial assumption) of the §1.752-7 liability by a partner other than the §1.752-7 liability partner.

(8) *Trade or business—(i) In general.* A trade or business is a specific group of activities carried on by a person for the purpose of earning income or profit if the activities included in that group include every operation that forms a part of, or a step in, the process of earning income or profit. Such group of activities ordinarily includes the collection of income and the payment of expenses. Subject to paragraph (b)(8)(ii) of this section, the group of activities must constitute the carrying on of a trade or business under section 162(a) (determined as though the activities were conducted by an individual).

(ii) *Trading and investment partnerships—(A) In general.* The activity of acquiring, holding, or disposing of financial instruments constitutes a trade or business for purposes of this paragraph (b)(8) if and only if the activity is conducted by an entity registered with the Securities and Exchange Commission as a management company under the Investment Company Act of 1940, as amended (15 U.S.C. 80a).

(B) *Financial instruments.* For purposes of paragraph (b)(8)(ii) of this section, financial instruments include stock in corporations; notes, bonds, debentures, or other evidences of indebtedness; interest rate, currency, or equity notional principal contracts; evidences of an interest in, or derivative financial instruments in, stock,

securities, currencies, or commodities, including options, forward or futures contracts, or short positions; or any similar financial instrument.

(iii) *Examples.* The following examples illustrate the provisions of paragraph (b)(8) of this section:

Example 1. Corporation Y owns, manages, and derives rental income from an office building and also owns vacant land that may be subject to environmental liabilities. Corporation Y contributes the land subject to the environmental liabilities to PRS in a transaction governed by section 721(a). PRS plans to develop the land as a landfill. The contribution of the vacant land does not constitute the contribution of a trade or business because Corporation Y did not conduct any significant business or development activities with respect to the land prior to the contribution.

Example 2. For the past 5 years, Corporation X has owned and operated gas stations in City A, City B, and City C. Corporation X transfers all of the assets associated with the operation of the gas station in City A to PRS for interests in PRS and the assumption by PRS of the §1.752-7 liabilities associated with that gas station. PRS continues to operate the gas station in City A after the contribution. The contribution of the gas station to PRS constitutes the contribution of a trade or business.

Example 3. For the past 7 years, Corporation Z has engaged in the manufacture and sale of household products. Throughout this period, Corporation Z has maintained a research department for use in connection with its manufacturing activities. The research department has 10 employees actively engaged in the development of new products. Corporation Z contributes the research department to PRS in exchange for a PRS interest and the assumption by PRS of pension liabilities with respect to the employees of the research department. PRS continues the research operations on a contractual basis with several businesses, including Corporation Z. The contribution of the research operations to PRS constitutes a contribution of a trade or business.

(9) *Adjusted value.* The adjusted value of a partner's interest in a partnership is the fair market value of that interest increased by the partner's share of partnership liabilities under §§1.752-1 through 1.752-5.

(c) *Application of section 704(c) to assumed §1.752-7 liabilities—(1) In general.* Any §1.752-7 liability assumed by a partnership in a §1.752-7 liability transfer is treated under section 704(c) principles as having a built-in loss equal to the amount of the §1.752-7 liability as of the date of the partnership's assumption of the §1.752-7 liability. Thus, items of deduction or loss with respect to the §1.752-7 liability, if any, must be allocated, first, to the §1.752-7 liability partner to the extent of the built-in loss. Deductions or losses with respect to the §1.752-7 liability that exceed the built-in loss are shared

among the partners in accordance with section 704(b) and the regulations thereunder.

(2) *Example.* The following example illustrates the provisions of this paragraph (c):

Example—(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value and basis of \$400X, subject to a §1.752-7 liability of \$100X, for a 25% interest in PRS. B contributes \$300X cash for a 25% interest in PRS, and C contributes \$600X cash for a 50% interest in PRS. Assume that the partnership complies with the substantial economic effect safe harbor of §1.704-1(b)(2). Under §1.704-1(b)(2)(iv)(b), A's capital account is credited with \$300X (the fair market value of Property 1, \$400X, less the §1.752-7 liability assumed by PRS, \$100X). In 2005, PRS earns \$200X of income and uses it to satisfy the §1.752-7 liability. Assume that the cost to PRS of satisfying the §1.752-7 liability is deductible by PRS. The \$200X of partnership income is allocated according to the partnership agreement, \$50X to A, \$50X to B, and \$100X to C.

(ii) *Analysis.* Pursuant to paragraph (c) of this section, \$100X of the deduction attributable to the economic performance of the §1.752-7 liability is specially allocated to A, the §1.752-7 liability partner, under section 704(c)(1)(A) and the regulations thereunder. No book item corresponds to this tax allocation. The remaining \$100X of deduction attributable to economic performance of the §1.752-7 liability is allocated, for both book and tax purposes, according to the partnership agreement, \$25X to A, \$25X to B, and \$50X to C. If the partnership, instead, satisfied the §1.752-7 liability over a number of years, the first \$100X of deduction with respect to the §1.752-7 liability would be allocated to A, the §1.752-7 liability partner, before any deduction with respect to the §1.752-7 liability would be allocated to the other partners. For example, if PRS were to satisfy \$50X of the §1.752-7 liability at a time when PRS reasonably believed that it would cost \$200X to satisfy the §1.752-7 liability in full, the \$50X deduction with respect to the §1.752-7 liability would be allocated to A for tax purposes only. No deduction would arise for book purposes. If PRS later paid a further \$100X in satisfaction of the §1.752-7 liability, \$50X of the deduction with respect to the §1.752-7 liability would be allocated, solely for tax purposes, to A and the remaining \$50X would be allocated, for both book and tax purposes, according to the partnership agreement.

(d) *Special rules for sales of partnership interests, distributions of partnership assets, and assumptions of the §1.752-7 liability after a §1.752-7 liability transfer—(1) In general.* Except as provided in paragraph (d)(2) of this section, paragraphs (e), (f), and (g) of this section apply to certain partnership transactions occurring after a §1.752-7 liability transfer.

(2) *Exceptions—(i) In general.* Paragraphs (e), (f), and (g) of this section do not apply—

(A) If the partnership assumes the §1.752-7 liability as part of a contribution to the partnership of the trade or business with which the liability is associated, and the partnership continues to carry on that trade or business after the contribution (for the definition of a trade or business see paragraph (b)(8) of this section); or

(B) If, immediately before the testing date, the amount of the remaining built-in loss with respect to all §1.752-7 liabilities assumed by the partnership (other than §1.752-7 liabilities assumed by the partnership with an associated trade or business) in one or more §1.752-7 liability transfers is less than the lesser of 10% of the gross value of partnership assets or \$1,000,000.

(ii) *Examples.* The following examples illustrate the principles of this paragraph (d)(2):

Example 1. For the past 5 years, Corporation X, a C corporation, has been engaged in Business A and Business B. In 2004, Corporation X contributes Business A, in a transaction governed by section 721(a), to PRS in exchange for a PRS interest and the assumption by PRS of pension liabilities with respect to the employees engaged in Business A. PRS plans to carry on Business A after the contribution. Because PRS has assumed the pension liabilities as part of a contribution to PRS of the trade or business with which the liabilities are associated, paragraphs (e), (f), and (g) of this section do not apply to any transaction occurring after the §1.752-7 liability transfer.

Example 2—(i) Facts. The facts are the same as in *Example 1*, except that PRS also assumes from Corporation X certain pension liabilities with respect to the employees of Business B. At the time of the assumption, the amount of the pension liabilities with respect to the employees of Business A is \$3,000,000 (the A liabilities) and the amount of the pension liabilities associated with the employees of Business B (the B liabilities) is \$2,000,000. Two years later, Corporation X sells its interest in PRS to Y for \$9,000,000. At the time of the sale, the remaining built-in loss associated with the A liabilities is \$2,100,000, the remaining built-in loss associated with the B liabilities is \$900,000, and the gross value of PRS's assets (excluding §1.752-7 liabilities) is \$20,000,000. Assume that PRS has no §1.752-7 liabilities other than those assumed from Corporation X.

(ii) *Analysis.* The only liabilities assumed by PRS from Corporation X that were not assumed as part of Corporation X's contribution of Business A were the B liabilities. Immediately before the testing date, the remaining built-in loss associated with the B liabilities (\$900,000) was less than the lesser of 10% of the gross value of PRS's assets (\$2,000,000) or \$1,000,000. Therefore, paragraph (d)(2)(i)(B) of this section applies to exclude Corporation X's sale of the PRS interest to Y from the application of paragraph (e) of this section.

(e) *Transfer of §1.752-7 liability partner's partnership interest—(1) In general.* Except as provided in paragraphs (d)(2)

and (e)(3) of this section, immediately before the sale, exchange, or other disposition of all or a part of a §1.752-7 liability partner's partnership interest, the §1.752-7 liability partner's basis in the partnership interest is reduced by the §1.752-7 liability reduction. No deduction or capital expense is allowed to the partnership on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability. For purposes of section 705(a)(2)(B) and §1.704-1(b)(2)(ii)(b) only, the remaining built-in loss associated with the §1.752-7 liability is not treated as a nondeductible, noncapital expenditure of the partnership. Therefore, the remaining partners' capital accounts and bases in their partnership interests are not reduced by the remaining built-in loss associated with the §1.752-7 liability. If the partnership (or any successor) notifies the §1.752-7 liability partner of the economic performance of the §1.752-7 liability (as described in paragraph (h) of this section), then the §1.752-7 liability partner is entitled to a loss or deduction. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

(2) *Examples.* The following examples illustrate the principles of paragraph (e)(1) of this section:

Example 1—(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value of \$5,000,000 and basis of \$4,000,000 subject to a §1.752-7 liability of \$2,000,000 in exchange for a 25% interest in PRS. B contributes \$3,000,000 cash in exchange for a 25% interest in PRS, and C contributes \$6,000,000 cash in exchange for a 50% interest in PRS. In 2006, when PRS has a section 754 election in effect, A sells A's interest in PRS to D for \$3,000,000. At the time of the sale, the basis of A's PRS interest is \$4,000,000, the remaining built-in loss associated with the §1.752-7 liability is \$2,000,000, and PRS has no liabilities (as

defined in §1.752-1(a)(1)). Assume that none of the exceptions of paragraph (d)(2) of this section apply and that economic performance of the §1.752-7 liability would have given rise to a deductible expense to A. In 2007, PRS pays \$3,000,000 to satisfy the liability.

(ii) *Sale of A's PRS interest.* Immediately before the sale of the PRS interest to D, A's basis in the PRS interest is reduced (to \$3,000,000) by the §1.752-7 liability reduction, i.e., the lesser of the excess of A's basis in the PRS interest (\$4,000,000) over the adjusted value of that interest (\$3,000,000), \$1,000,000, or the remaining built-in loss associated with the §1.752-7 liability, \$2,000,000. Therefore, A recognizes no gain or loss on the sale of the PRS interest to D. D's basis in the PRS interest is \$3,000,000. D's share of the adjusted basis of partnership property equals D's interest in the partnership's previously taxed capital of \$2,000,000 (the amount of cash that D would receive on a liquidation of the partnership, \$3,000,000, increased by the amount of tax loss that would be allocated to D in the hypothetical transaction, \$0, and reduced by the amount of tax gain that would be allocated to D in the hypothetical transaction, \$1,000,000). Therefore, the basis adjustment under section 743(b) is \$1,000,000.

(iii) *Satisfaction of §1.752-7 liability.* Neither PRS nor any of its partners is entitled to a deduction for the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability (\$2,000,000). PRS is entitled to a deduction, however, for the amount by which the cost of satisfying the §1.752-7 liability exceeds the remaining built-in loss associated with the §1.752-7 liability. Therefore, in 2007, PRS may deduct \$1,000,000 (cost to satisfy the §1.752-7 liability, \$3,000,000, less the remaining built-in loss associated with the §1.752-7 liability, \$2,000,000). If PRS notifies A of the economic performance of the §1.752-7 liability, then A is entitled to an ordinary deduction in 2007 of \$1,000,000 (the §1.752-7 liability reduction).

*Example 2—*The facts are the same as in *Example 1* except that, at the time of A's sale of the PRS interest to D, PRS has a nonrecourse liability of \$4,000,000, of which A's share is \$1,000,000. A's basis in PRS is \$5,000,000. At the time of the sale of the PRS interest to D, the adjusted value of A's interest is \$4,000,000 (the fair market value of the interest (\$3,000,000), increased by A's share of partnership liabilities (\$1,000,000)). The difference between the basis of A's interest (\$5,000,000) and the adjusted value of that interest (\$4,000,000) is \$1,000,000. Therefore, the §1.752-7 liability reduction is \$1,000,000 (the lesser of this difference or the remaining built-in loss associated with the §1.752-7 liability, \$2,000,000). Immediately before the sale of the PRS interest to D, A's basis is reduced from \$5,000,000 to \$4,000,000. A's amount realized on the sale of the PRS interest to D is \$4,000,000 (\$3,000,000 paid by D, increased under section 752(d) by A's share of partnership liabilities, or \$1,000,000). Therefore, A recognizes no gain or loss on the sale. D's basis in the PRS interest is \$4,000,000. Because D's share of the adjusted basis of partnership property is \$3,000,000 (D's share of the partnership's previously taxed capital, \$2,000,000, plus D's share of partnership liabilities,

\$1,000,000), the basis adjustment under section 743(b) is \$1,000,000.

(3) *Exception for nonrecognition transactions*—(i) *In general.* Paragraph (e)(1) of this section does not apply where a §1.752-7 liability partner transfers all or part of the partner's partnership interest in a transaction in which the transferee's basis in the partnership interest is determined in whole or in part by reference to the transferor's basis in the partnership interest. In addition, paragraph (e)(1) of this section does not apply to a distribution of an interest in the partnership that has assumed the §1.752-7 liability by a partnership that is the §1.752-7 liability partner.

(ii) *Examples.* The following examples illustrate the provisions of this paragraph (e)(3):

Example 1—(i) *Facts.* In 2004, X contributes undeveloped land with a value and basis of \$2,000,000 and subject to environmental liabilities of \$1,500,000 to partnership LTP in exchange for a 50% interest in LTP. LTP develops the land as a landfill. In 2005, in a transaction governed by section 721(a), X contributes the LTP interest to UTP in exchange for a 50% interest in UTP. In 2008, X sells the UTP interest to A for \$500,000. At the time of the sale, X's basis in UTP is \$2,000,000, the remaining built-in loss associated with the environmental liability is \$1,500,000, and the gross value of UTP's assets is \$2,500,000. The environmental liabilities were not assumed by LTP as part of a contribution by X to LTP of a trade or business with which the liabilities were associated. (See paragraph (b)(8)(iii), *Example 1* of this section.)

(ii) *Analysis.* Because UTP's basis in the LTP interest is determined by reference to X's basis in the LTP interest, X's contribution of the LTP interest to UTP is exempted from the rules of paragraph (e)(1) of this section. Under paragraph (i)(1) of this section, X's contribution of the LTP interest to UTP is treated as a contribution of X's share of the assets of LTP and UTP's assumption of X's share of the LTP liabilities (including §1.752-7 liabilities). Therefore, X's transfer of the LTP interest to UTP is a §1.752-7 liability transfer. The §1.752-7 liabilities deemed transferred by X to UTP are not associated with a trade or business transferred to UTP for purposes of paragraph (d)(2)(i)(A) of this section, because they were not associated with a trade or business transferred by X to LTP as part of the original §1.752-7 liability transfer. See paragraph (i)(2) of this section. Because none of the exceptions described in paragraph (d)(2) of this section apply to X's taxable sale of the UTP interest to A in 2008, paragraph (e)(1) of this section applies to that sale.

Example 2. The facts are the same as in *Example 1*, except that, rather than transferring the LTP interest to UTP in 2005, X contributes the LTP interest to Corporation Y in an exchange to which section 351 applies. Because Corporation Y's basis in the LTP interest is determined by reference to X's basis in that interest, X's contribution of the LTP interest is exempted from the rules of paragraph (e)(1) of this section. But see section 358(h) and §1.358-7.

(f) *Distribution in liquidation of §1.752-7 liability partner's partnership interest*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, immediately before a distribution in liquidation of a §1.752-7 liability partner's partnership interest, the §1.752-7 liability partner's basis in the partnership interest is reduced by the §1.752-7 liability reduction. This rule applies before section 737. No deduction or capital expense is allowed to the partnership on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability. For purposes of section 705(a)(2)(B) and §1.704-1(b)(2)(ii)(b) only, the remaining built-in loss associated with the §1.752-7 liability is not treated as a nondeductible, noncapital expenditure of the partnership. Therefore, the remaining partners' capital accounts and bases in their partnership interests are not reduced by the remaining built-in loss associated with the §1.752-7 liability. If the partnership (or any successor) notifies the §1.752-7 liability partner of the economic performance of the §1.752-7 liability (as described in paragraph (h) of this section), then the §1.752-7 liability partner is entitled to a loss or deduction. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

(2) *Example.* The following example illustrates the provision of this paragraph (f):

Example—(i) *Facts.* In 2004, A, B, and C form partnership PRS. A contributes Property 1 with a fair market value and basis of \$5,000,000 subject to a §1.752-7 liability of \$2,000,000 for a 25% interest in PRS. B contributes \$3,000,000 cash for a 25% interest in PRS, and C contributes \$6,000,000 cash for a 50% interest in PRS. In 2012, when PRS has a section 754 election in effect, PRS distributes Property 2,

which has a basis and fair market value of \$3,000,000, to A in liquidation of A's PRS interest. At the time of the distribution, the fair market value of A's PRS interest is \$3,000,000, the basis of that interest is \$5,000,000, and the remaining built-in loss associated with the §1.752-7 liability is \$2,000,000. Assume that none of the exceptions of paragraph (d)(2) of this section apply to the distribution and that the economic performance of the §1.752-7 liability would have given rise to a deductible expense to A. In 2013, PRS pays \$1,000,000 to satisfy the entire §1.752-7 liability.

(ii) *Redemption of A's PRS interest.* Immediately before the distribution of Property 2 to A, A's basis in the PRS interest is reduced (to \$3,000,000) by the §1.752-7 liability reduction, *i.e.*, the lesser of the excess of A's basis in the PRS interest over the adjusted value of that interest (\$2,000,000) or the remaining built-in loss associated with the §1.752-7 liability (\$2,000,000). Therefore, A's basis in Property 2 under section 732(b) is \$3,000,000. Because this is the same as the partnership's basis in Property 2 immediately before the distribution, the partnership's basis adjustment under section 734(b) is \$0.

(iii) *Satisfaction of §1.752-7 liability.* PRS is not entitled to a deduction for the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability (\$2,000,000). Because this amount exceeds the amount paid by PRS to satisfy the §1.752-7 liability (\$1,000,000), PRS is not entitled to any deduction for the §1.752-7 liability in 2013. If, however, PRS notifies A of the economic performance of the §1.752-7 liability, then A is entitled to an ordinary deduction in 2013 of \$1,000,000 (the amount paid in satisfaction of the §1.752-7 liability) and a capital loss of \$1,000,000 (the remaining §1.752-7 liability reduction).

(g) *Assumption of §1.752-7 liability by a partner other than §1.752-7 liability partner*—(1) *In general.* Except as provided in paragraph (d)(2) of this section, section 704(c)(1)(B) does not apply to an assumption of a §1.752-7 liability from a partnership by a partner other than the §1.752-7 liability partner. Instead, this paragraph (g) applies. The rules of paragraph (g)(2) of this section apply only if the §1.752-7 liability partner is a partner in the partnership at the time of the assumption of the §1.752-7 liability. The rules of paragraphs (g)(3) and (4) of this section apply to any assumption of the §1.752-7 liability by a partner other than the §1.752-7 liability partner, whether or not the §1.752-7 liability partner is a partner in the partnership at the time of the assumption.

(2) *Consequences to §1.752-7 liability partner.* If, at the time of an assumption of a §1.752-7 liability from a partnership by a partner other than the §1.752-7 liability partner, the §1.752-7 liability partner remains a partner in the partnership,

then the §1.752-7 liability partner's basis in the partnership interest is reduced by the §1.752-7 liability reduction. If the assuming partner (or any successor) notifies the §1.752-7 liability partner of the economic performance of the §1.752-7 liability (as described in paragraph (h) of this section), then the §1.752-7 liability partner is entitled to a deduction or loss. The amount of that deduction or loss is, in the case of a partial satisfaction of the §1.752-7 liability, the amount paid by the partnership in satisfaction of the §1.752-7 liability (but not more than the §1.752-7 liability reduction) or, in the case of a complete satisfaction of the §1.752-7 liability, the remaining §1.752-7 liability reduction. To the extent of the amount paid in satisfaction of the §1.752-7 liability, the character of that deduction or loss is determined as if the §1.752-7 liability partner had satisfied the liability. To the extent that the §1.752-7 liability reduction exceeds the amount paid in satisfaction of the §1.752-7 liability, the character of the §1.752-7 liability partner's loss is capital.

(3) *Consequences to partnership.* Immediately after the assumption of the §1.752-7 liability from the partnership by a partner other than the §1.752-7 liability partner, the partnership must reduce the basis of partnership assets by the remaining built-in loss associated with the §1.752-7 liability. The reduction in the basis of partnership assets must be allocated among partnership assets as if that adjustment were a basis adjustment under section 734(b).

(4) *Consequences to assuming partner.* No deduction or capital expense is allowed to an assuming partner (other than the §1.752-7 liability partner) on the economic performance of a §1.752-7 liability assumed from a partnership to the extent of the remaining built-in loss associated with the §1.752-7 liability. Instead, on economic performance of the §1.752-7 liability, the assuming partner must adjust the basis of the partnership interest, any assets (other than cash, accounts receivable, or inventory) distributed by the partnership to the partner, or gain or loss on the disposition of the partnership interest, as the case may be. These adjustments are determined as if the assuming partner's basis in the partnership interest at the time of the assumption were increased by the lesser of the amount paid to satisfy

the §1.752-7 liability or the remaining built-in loss associated with the §1.752-7 liability. However, the assuming partner cannot take into account any adjustments to depreciable basis, reduction in gain, or increase in loss until economic performance of the §1.752-7 liability. Any adjustment to the basis of an asset under this provision is taken into account over the recovery period of that asset.

(5) *Example.* The following example illustrates the provisions of this paragraph (g):

Example—(i) Facts. In 2004, A, B, and C form partnership PRS. A contributes Property 1, a nondepreciable capital asset with a fair market value and basis of \$5,000,000, in exchange for a 25% interest in PRS and assumption by PRS of a §1.752-7 liability of \$2,000,000. B contributes \$3,000,000 cash for a 25% interest in PRS, and C contributes \$6,000,000 cash for a 50% interest in PRS. PRS uses the cash contributed to purchase Property 2. In 2007, PRS distributes Property 1, subject to the §1.752-7 liability to B in liquidation of B's interest in PRS. At the time of the distribution, A's interest in PRS has a value of \$3,000,000 and a basis of \$5,000,000, and B's interest in PRS has a value and basis of \$3,000,000. Also at that time, Property 1 has a value and basis of \$5,000,000, Property 2 has a value and basis of \$9,000,000, and the remaining built-in loss associated with the §1.752-7 liability is \$2,000,000. Assume that none of the exceptions of paragraph (d)(2)(i) of this section apply to the assumption of the §1.752-7 liability by B and that economic performance of the §1.752-7 liability would have given rise to a deductible expense to A. In 2010, B pays \$1,000,000 to satisfy the entire §1.752-7 liability. At that time, B still owns Property 1, which has a basis of \$3,000,000.

(ii) *Assumption of §1.752-7 liability by B.* Section 704(c)(1)(B) does not apply to the assumption of the §1.752-7 liability by B. Instead, A's basis in the PRS interest is reduced (to \$3,000,000) by the §1.752-7 liability reduction, i.e., the lesser of the excess of A's basis in the PRS interest over the adjusted value of that interest (\$2,000,000), or the remaining built-in loss associated with the §1.752-7 liability as of the time of the assumption (\$2,000,000). PRS's basis in Property 2 is reduced (to \$7,000,000) by the \$2,000,000 remaining built-in loss associated with the §1.752-7 liability. B's basis in Property 1 under section 732(b) is \$3,000,000 (B's basis in the PRS interest). This is \$2,000,000 less than PRS's basis in Property 1 before the distribution of Property 1 to B. If PRS has a section 754 election in effect for 2007, PRS may increase the basis of Property 2 under section 734(b) by \$2,000,000.

(iii) *Satisfaction of §1.752-7 liability.* B is not entitled to a deduction for the economic performance of the §1.752-7 liability in 2010 to the extent of the remaining built-in loss associated with the §1.752-7 liability as of the time of the assumption (\$2,000,000). As this amount exceeds the amount paid by B to satisfy the §1.752-7 liability, B is not entitled to any deduction for the §1.752-7 liability in 2010. B may, however, increase the basis of Property 1 by the lesser of the remaining built-in loss

associated with the §1.752-7 liability (\$2,000,000) or the amount paid to satisfy the §1.752-7 liability (\$1,000,000). Therefore, B's basis in Property 1 is increased to \$4,000,000. If B notifies A of the economic performance of the §1.752-7 liability, then A is entitled to an ordinary deduction in 2010 of \$1,000,000 (the amount paid in satisfaction of the §1.752-7 liability) and a capital loss of \$1,000,000 (the remaining §1.752-7 liability reduction).

(h) *Notification by the partnership (or successor) of the economic performance of the §1.752-7 liability.* For purposes of paragraphs (e), (f), and (g) of this section, notification by the partnership (or successor) of the economic performance of the §1.752-7 liability must be attached to the §1.752-7 liability partner's return for the year in which the loss is being claimed and must include—

(1) The amount paid in satisfaction of the §1.752-7 liability, and whether the amounts paid were in partial or complete satisfaction of the §1.752-7 liability;

(2) The name and address of the person satisfying the §1.752-7 liability;

(3) The date of the payment on the §1.752-7 liability; and

(4) The character of the loss with respect to the §1.752-7 liability.

(i) *Tiered partnerships—(1) Look-through treatment.* For purposes of this section, a contribution by a partner of an interest in a partnership (lower-tier partnership) to another partnership (upper-tier partnership) is treated as a contribution of the partner's share of each of the lower-tier partnership's assets and an assumption by the upper-tier partnership of the partner's share of the lower-tier partnership's liabilities (including §1.752-7 liabilities). See paragraph (e)(3)(ii), *Example 1* of this section. In addition, a partnership is treated as having its share of any §1.752-7 liabilities of the partnerships in which it has an interest.

(2) *Trade or business exception.* If a partnership (upper-tier partnership) assumes a §1.752-7 liability of a partner, and, subsequently, another partnership (lower-tier partnership) assumes that §1.752-7 liability from the upper-tier partnership, then the §1.752-7 liability is treated as associated only with any trade or business contributed to the upper-tier partnership by the §1.752-7 liability partner. The same rule applies where a partnership assumes a §1.752-7 liability of a partner, and, subsequently, the §1.752-7 liability partner transfers that partnership interest

to another partnership. See paragraph (e)(3)(ii), *Example 1* of this section.

(3) *Partnership as a §1.752-7 liability partner.* If a transaction described in paragraph (e), (f), or (g) of this section occurs with respect to a partnership (upper-tier partnership) that is a §1.752-7 liability partner of another partnership (lower-tier partnership), then such transaction will also be treated as a transaction described in paragraph (e), (f), or (g) of this section, as appropriate, with respect to the partners of the upper-tier partnership, regardless of whether the upper-tier partnership assumed the §1.752-7 liability from those partners. (See paragraph (b)(3) of this section for rules relating to the treatment of transactions by the partners of the upper-tier partnership). In such a case, the §1.752-7 liability reduction with respect to each partner in the upper-tier partnership is equal to that partner's share of the §1.752-7 liability. The partners of the upper-tier partnership at the time of the transaction described in paragraph (e), (f), or (g) of this section, and not the upper-tier partnership, are entitled to the loss or deduction on the economic performance of the §1.752-7 liability. Similar principles apply where the upper-tier partnership is itself owned by one or a series of partnerships. This paragraph does not apply to the extent that §1.752-7(i)(4) applies to the assumption of the §1.752-7 liability by the lower-tier partnership.

(4) *Transfer of §1.752-7 liability by partnership to another partnership or corporation after a transaction described in paragraphs (e), (f), or (g)*—(i) *In general.* If, after a transaction described in paragraphs (e), (f), or (g) of this section with respect to a §1.752-7 liability assumed by a partnership (the upper-tier partnership), another partnership or a corporation assumes the §1.752-7 liability from the upper-tier partnership (or the assuming partner) in a transaction in which the basis of property is determined, in whole or in part, by reference to the basis of the property in the hands of the upper-tier partnership (or assuming partner), then—

(A) The upper-tier partnership (or assuming partner) must reduce its basis in any corporate stock or partnership interest received by the remaining built-in loss associated with the §1.752-7 liability (but the partners of the upper-tier partnership

do not reduce their bases or capital accounts in the upper-tier partnership); and

(B) No deduction or capital expense is allowed to the assuming partnership or corporation on the economic performance of the §1.752-7 liability to the extent of the remaining built-in loss associated with the §1.752-7 liability.

(ii) *Subsequent transfers.* Similar rules apply to subsequent assumptions of the §1.752-7 liability in transactions in which the basis of property is determined, in whole or in part, by reference to the basis of the property in the hands of the transferor. If, subsequent to an assumption of the §1.752-7 liability by a partnership in a transaction to which paragraph (i)(4)(i) of this section applies, the §1.752-7 liability is assumed from the partnership by a partner other than the partner from whom the partnership assumed the §1.752-7 liability, then the rules of paragraph (g)(4) of this section apply.

(5) *Example.* The following example illustrates the provisions of paragraphs (i)(3) and (i)(4) of this section.

Example—(i) *Assumption of §1.752-7 liability by UTP and transfer of §1.752-7 liability partner's interest in UTP.* In 2004, A, B, and C form partnership UTP. A contributes Property 1 with a fair market value and basis of \$5,000,000 subject to a §1.752-7 liability of \$2,000,000 in exchange for a 25% interest in UTP. B contributes \$3,000,000 cash in exchange for a 25% interest in UTP, and C contributes \$6,000,000 cash in exchange for a 50% interest in UTP. UTP invests the \$9,000,000 cash in Property 2. In 2006, A sells A's interest in UTP to D for \$3,000,000. At the time of the sale, the basis of A's UTP interest is \$5,000,000, the remaining built-in loss associated with the §1.752-7 liability is \$2,000,000, and UTP has no liabilities other than §1.752-7 liabilities. Assume that none of the exceptions of paragraph (d)(2) of this section apply and that economic performance of the §1.752-7 liability would give rise to a deductible expense to the payor. Under paragraph (e) of this section, immediately before the sale of the UTP interest to D, A's basis in UTP is reduced to \$3,000,000 by the \$2,000,000 §1.752-7 liability reduction. Therefore, A recognizes no gain or loss on the sale of the UTP interest to D. D's basis in the UTP interest is \$3,000,000.

(ii) *Assumption of §1.752-7 liability by LTP from UTP.* In 2008, at a time when the estimated amount of the §1.752-7 liability has increased to \$3,500,000, UTP contributes Property 1 and Property 2, subject to the §1.752-7 liability, to LTP in exchange for a 50% interest in LTP. At the time of the contribution, Property 1 still has a value and basis of \$5,000,000 and Property 2 still has a value and basis of \$9,000,000. UTP's basis in LTP under section 722 is \$14,000,000. Under paragraph (i)(4) of this section, UTP must reduce its basis in LTP by the \$2,000,000 remaining built-in loss associated with the §1.752-7 liability (as

of the time of the sale of the UTP interest by A). The partners in UTP are not required to reduce their bases in UTP by this amount.

(iii) *Sale by UTP of LTP interest.* In 2010, UTP sells its interest in LTP to E for \$10,500,000. At the time of the sale, Property 1 still has a value and basis of \$5,000,000, Property 2 still has a value and basis of \$9,000,000, and the remaining built-in loss associated with the §1.752-7 liability is still \$3,500,000. Under paragraph (e) of this section, immediately before the sale, UTP must reduce its basis in the LTP interest by the §1.752-7 liability reduction. Under paragraph (a)(4) of this section, the remaining built-in loss associated with the §1.752-7 liability is \$1,500,000 (remaining built-in loss associated with the §1.752-7 liability, \$3,500,000, reduced by the amount of the §1.752-7 liability taken into account under paragraph (i)(4) of this section, \$2,000,000). The difference between the basis of the LTP interest held by UTP (\$12,000,000) and the adjusted value of that interest (\$10,500,000) is also \$1,500,000. Therefore, the §1.752-7 liability reduction is \$1,500,000 and UTP's basis in the LTP interest must be reduced to \$10,500,000. In addition, UTP's partners must reduce their bases in their UTP interests by their proportionate shares of the §1.752-7 liability reduction. Thus, the basis of each of B's and D's interest in UTP must be reduced by \$375,000 and the basis of C's interest in UTP must be reduced by \$750,000. In 2011, D sells the UTP interest to F.

(iv) *Economic performance of §1.752-7 liability by LTP.* In 2012, LTP pays \$3,500,000 to satisfy the §1.752-7 liability. Under paragraphs (e) and (i)(4) of this section, LTP is not entitled to any deduction with respect to the §1.752-7 liability. Under paragraph (i)(3) of this section, UTP also is not entitled to any deduction with respect to the §1.752-7 liability. If LTP notifies A, B, C and D of the economic performance of the §1.752-7 liability, then A is entitled to a deduction in 2012 of \$2,000,000, B and D are each entitled to deductions in 2012 of \$375,000, and C is entitled to a deduction in 2012 of \$750,000.

(j) *Effective date*—(1) *In general.* This section applies to §1.752-7 liability transfers occurring on or after June 24, 2003.

(2) *Election to apply this section to assumptions of liabilities occurring after October 18, 1999, and before June 24, 2003*—(i) *In general.* A partnership may elect to apply this section to assumptions of liabilities (including §1.752-7 liabilities) occurring after October 18, 1999, and before June 24, 2003. Such an election is binding on the partnership and all of its partners. A partnership making such an election must apply all of the provisions of these proposed regulations (other than §1.752-6).

(ii) *Manner of making election.* A partnership makes an election under this paragraph (j)(2) by attaching the following statement to its timely filed return: “[Insert name and employer

identification number of electing partnership] elects under §1.752-7 of the Income Tax Regulations to be subject to the rules of §§1.358-7, 1.752-7 and 1.704-1(b)(2)(iv)(b), 1.704-2(b)(3), 1.705-1(a)(7), and 1.752-1, on June 24, 2003, with respect to all liabilities (including §1.752-7 liabilities) assumed by the partnership after October 18, 1999, and before June 24, 2003. In the statement, the partnership must list, with respect to each liability (including each §1.752-7 liability) assumed by the partnership after October 18, 1999, and before June 24, 2003—

(A) The name, address, and taxpayer identification number of the partner from whom the liability was assumed;

(B) The date on which the liability was assumed by the partnership;

(C) The amount of the liability as of the time of its assumption; and

(D) A description of the liability.

(iii) *Filing of amended returns.* An election under this paragraph (j)(2) will be valid only if the partnership and its partners promptly amend any returns for open taxable years that would be affected by the election.

(iv) *Time for making election.* An election under this paragraph (j)(2) must be filed with the first federal income tax return filed by the partnership on or after September 24, 2003.

David A. Mader,
Assistant Deputy Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on June 23, 2003, 8:45 a.m., and published in the issue of the Federal Register for June 24, 2003, 68 F.R. 37434)

New Backup Withholding Rate for Amounts Paid After December 31, 2002

Announcement 2003-45

Purpose

This announcement is to advise payers about a reduction in the backup withholding rate authorized by *section 3406(a)(1) of the Internal Revenue Code*. Section 105(a) of the Jobs and Growth Tax Relief

Reconciliation Act of 2003 (Public Law 108-27) reduced the rate for backup withholding on reportable payments.

New Backup Withholding Rate

For amounts paid after December 31, 2002, the backup withholding rate was reduced to 28%.

New Rate Not Reflected in 2002 Products

The backup withholding rate shown in the latest revision of the following products is incorrect for amounts paid after December 31, 2002

Tax Forms.

- Instructions for the Requester of Form W-9
- Instructions for the Requester of Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY

The Instructions for the Requester of Form W-9 will be revised in December 2003, to reflect the new backup withholding rate for amounts paid after December 31, 2002.

The Instructions for the Requester of Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY will be revised in August 2003 to reflect the new rates.

Technical Publications.

- Publication 17, *Your Federal Income Tax*
- Publication 225, *Farmer's Tax Guide*
- Publication 505, *Tax Withholding and Estimated Tax*
- Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Corporations*
- Publication 525, *Taxable and Nontaxable Income*
- Publication 542, *Corporations*
- Publication 550, *Investment Income and Expenses*
- Publication 583, *Starting a Business and Keeping Records*
- Publication 1212, *List of Original Issue Discount Instruments*

The 2003 version of these publications will show the new backup withholding rate for amounts paid after December 31, 2002.

New Rate Not Reflected in 2003 Products

The backup withholding rate shown in the 2003 version of the following products is incorrect for amounts paid after December 31, 2002.

- Form W-9, *Request for Taxpayer Identification Number and Certification*
- Form W-2G, *Certain Gambling Winnings*
- Form 1099-CAP, *Changes in Corporate Control and Capital Structure*
- Form 1099-G, *Certain Government Payments*
- Form 1099-INT, *Interest Income*
- Form 1099-OID, *Original Issue Discount*
- Form 1099-MISC, *Miscellaneous Income*
- Form 1099-PATR, *Taxable Distributions Received From Cooperatives*
- Instructions for Form 1042-S

The 2004 version of these forms and instructions will show the new backup withholding rate for amounts paid after December 31, 2002.

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2003-48

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was

in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on October 28, 2002,

and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is \$1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or

omissions of the organization that were the basis for revocation.

Broward County Bowling Association,
Inc., Sunrise, FL
Del Oro Conservatory for the Classical
Arts of Music & Dance, Inc.
Chandler, AZ

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.

ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.

PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List¹

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2003-1 through 2003-26 is in Internal Revenue Bulletin 2003-27, dated July 7, 2003.

Findings List of Current Actions on Previously Published Items¹

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¹ A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003-1 through 2003-26 is in Internal Revenue Bulletin 2003-27, dated July 7, 2003.