

STATUTES FOR TAXATION OF BUSINESS ORGANIZATIONS

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§ 267. Losses, expenses, and interest with respect to transactions between related taxpayers.

(a) In general.

(1) **Deduction for losses disallowed.** No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

(2) Matching of deduction and payee income item in the case of expenses and interest. If--

(A) by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not (unless paid) includible in the gross income of such person [*translation: recipient is on cash method*], and

(B) at the close of the taxable year of the taxpayer for which (but for this paragraph) the amount would be deductible under this chapter, both the taxpayer and the person to whom the payment is to be made are persons specified in any of the paragraphs of subsection (b) [*translation: payor and recipient are "related parties"*]

then **any deduction** allowable under this chapter in respect of such amount shall be allowable **as of the day as of which such amount is includible in the gross income of the person to whom the payment is made** (or, if later, as of the day on which it would be so allowable but for this paragraph). For purposes of this paragraph, in the case of a personal service corporation (within the meaning of section 441(i)(2)), such corporation and any employee-owner (within the meaning of section 269A(b)(2), as modified by section 441(i)(2)) shall be treated as persons specified in subsection (b).

(3) Payments to foreign persons. The Secretary shall by regulations apply the matching principle of paragraph (2) in cases in which the person to whom the payment is to be made is not a United States person.

(b) **Relationships.** The persons referred to in subsection (a) are:

(1) **Members of a family, as defined in subsection (c)(4);**

(2) **An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;**

(3) Two corporations which are members of the same controlled group (as defined in subsection (f));

- (4) A grantor and a fiduciary of any trust;
- (5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
- (6) A fiduciary of a trust and a beneficiary of such trust;
- (7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
- (8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
- (9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
- (10) A corporation and a partnership if the same persons own--
 - (A) more than 50 percent in value of the outstanding stock of the corporation, and
 - (B) more than 50 percent of the capital interest, or the profits interest, in the partnership;
- (11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;
- (12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or
- (13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an **executor of an estate and a beneficiary of such estate.**

(c) Constructive ownership of stock. For purposes of determining, in applying subsection (b), the ownership of stock--

(1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1), (2), or (3), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

(d) Amount of gain where loss previously disallowed. If--

(1) in the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a)(1) (or by reason of section 24(b) of the Internal Revenue Code of 1939); and

(2) after December 31, 1953, the taxpayer sells or otherwise disposes of such property (or of other property the basis of which in his hands is determined directly or indirectly by reference to such property) at a gain,

then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer. This subsection applies with respect to taxable years ending after December 31, 1953. This subsection shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091 (relating to wash sales) or by reason of section 118 of the Internal Revenue Code of 1939.

§ 291. Special rules relating to corporate preference items.

(a) Reduction in certain preference items, etc. For purposes of this subtitle, in the case of a corporation--

(1) Section 1250 capital gain treatment. in the case of section *1250 property [usually buildings]* which is disposed of during the taxable year, **20 percent of the excess (if any) of--**

(A) the amount which would be treated as ordinary income if such property was section 1245 property, over

(B) the amount treated as ordinary income under section 1250 (determined without regard to this paragraph), **shall be treated as gain which is ordinary income** under section 1250 and shall be recognized notwithstanding any other provision of this title.

Under regulations prescribed by the Secretary, the provisions of this paragraph shall not apply to the disposition of any property to the extent section 1250(a) does not apply to such disposition by reason of section 1250(d).

§ 301. Distributions of property.

(a) In general. Except as otherwise provided in this chapter, a distribution of property (as defined in section 317(a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(b) Amount distributed.

(1) General rule. For purposes of this section, the amount of any distribution shall be the amount of money received, plus the fair market value of the other property received.

(2) Reduction for liabilities. The amount of any distribution determined under paragraph (1) shall be reduced (but not below zero) by--

(A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution, and

(B) the amount of any liability to which the property received by the shareholder is subject immediately before, and immediately after, the distribution.

(3) Determination of fair market value. For purposes of this section, fair market value shall be determined as of the date of the distribution.

(c) **Amount taxable.** In the case of a distribution to which subsection (a) applies--

(1) **Amount constituting dividend.** That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

(2) **Amount applied against basis.** That portion of the distribution which is not a dividend shall be applied against and reduce the adjusted basis of the stock.

(3) **Amount in excess of basis.**

(A) In general. Except as provided in subparagraph (B), that portion of the distribution which is not a dividend, to the extent that it exceeds the adjusted basis of the stock, shall be treated as *gain from the sale or exchange of property*.

(d) **Basis.** The basis of *property received in a distribution* to which subsection (a) applies shall be the *fair market value* of such property.

§ 302. Distributions in redemption of stock.

(a) **General rule.** If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) **Redemptions treated as exchanges.**

(1) **Redemptions not equivalent to dividends.** Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) **Substantially disproportionate redemption of stock.**

(A) **In general.** Subsection (a) shall apply if the distribution is *substantially disproportionate* with respect to the shareholder.

(B) **Limitation.** This paragraph shall not apply unless immediately after the redemption the shareholder *owns less than 50 percent of the total combined voting power* of all classes of stock entitled to vote.

(C) **Definitions.** For purposes of this paragraph, the distribution is substantially disproportionate if--

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of--

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) Series of redemptions. This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) Termination of shareholder's interest. Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder.

(4) Redemption from noncorporate shareholder in partial liquidation. Subsection (a) shall apply to a distribution if such distribution is--

(A) in redemption of stock held by a shareholder who is not a corporation, and

(B) in partial liquidation of the distributing corporation.

(5) Application of paragraphs. In determining whether a redemption meets the requirements of paragraph (1), the fact that such redemption fails to meet the requirements of paragraph (2), (3), or (4) shall not be taken into account. If a redemption meets the requirements of paragraph (3) and also the requirements of paragraph (1), (2), or (4), then so much of subsection (c)(2) as would (but for this sentence) apply in respect of the acquisition of an interest in the corporation within the 10-year period beginning on the date of the distribution shall not apply.

(c) Constructive ownership of stock.

(1) In general. Except as provided in paragraph (2) of this subsection, **section 318(a)** [*the family and entity attribution rules*] shall apply in determining the ownership of stock for purposes of this section.

(2) For determining termination of interest.

(A) In the case of a distribution described in subsection (b)(3), [a "*complete termination of interest*"], sec **318(a)(1)** [*the family attribution rules only*] shall not apply if--

(i) immediately after the distribution the distributee has **no interest in the corporation (including an interest as officer, director, or employee), other than an interest as a creditor,**

(ii) the distributee does not acquire any such interest (other than stock acquired by bequest or inheritance) within 10 years from the date of such distribution, and

(iii) the distributee, at such time and in such manner as the Secretary by regulations prescribes, files an agreement to notify the Secretary of any acquisition described in clause (ii) and to retain such records as may be necessary for the application of this paragraph.

If the distributee acquires such an interest in the corporation (other than by bequest or inheritance) within 10 years from the date of the distribution, then the periods of limitation provided in sections 6501 and 6502 on the making of an assessment and the

collection by levy or a proceeding in court shall, with respect to any deficiency (including interest and additions to the tax) resulting from such acquisition, include one year immediately following the date on which the distributee (in accordance with regulations prescribed by the Secretary) notifies the Secretary of such acquisition; and such assessment and collection may be made notwithstanding any provision of law or rule of law which otherwise would prevent such assessment and collection.

§ 303. Distributions in redemption of stock to pay death taxes.

(a) In general. A distribution of property to a shareholder by a corporation in redemption of part or all of the stock of such corporation which (for Federal estate tax purposes) is included in determining the gross estate of a decedent, to the extent that the amount of such distribution *does not exceed the sum of--*

(1) the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of such decedent's death, and

(2) the amount of funeral and administration expenses allowable as deductions to the estate under section 2053 (or under section 2106 in the case of the estate of a decedent nonresident, not a citizen of the United States),

shall be treated as a distribution in full payment in *exchange for the stock* so redeemed.

(b) Limitations on application of subsection (a).

(1) Period for distribution. Subsection (a) shall apply only to amounts distributed after the death of the decedent and--

(A) within the period of limitations provided in section 6501 (a) for the assessment of the Federal estate tax (determined without the application of any provision other than section 6501 (a)), or within 90 days after the expiration of such period,

(B) if a petition for redetermination of a deficiency in such estate tax has been filed with the Tax Court within the time prescribed in section 6213, at any time before the expiration of 60 days after the decision of the Tax Court becomes final, or

(C) If an election has been made under section 6166 and if the time prescribed by this subparagraph expires at a later date than the time prescribed by subparagraph (B) of this paragraph, within the time determined under section 6166 for the payment of the installments.

§ 305. Distributions of stock and stock rights.

(a) General rule. Except as otherwise provided in this section, gross income does not include the amount of any distribution of the stock of a corporation made by such corporation to its shareholders with respect to its stock.

(b) Exceptions. Subsection (a) shall not apply to a distribution by a corporation of its stock, and the distribution shall be treated as a distribution of property to which section 301 applies--

(1) Distributions in lieu of money [e.g., dividend-reinvestment programs]. If the distribution is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either--

- (A) in its stock, or
- (B) in property.

(2) Disproportionate distributions. If the distribution (or a series of distributions of which such distribution is one) has the result of--

- (A) the receipt of property by some shareholders, and
- (B) an increase in the proportionate interests of other shareholders in the assets or earnings and profits of the corporation.

(3) Distributions of common and preferred stock. If the distribution (or a series of distributions of which such distribution is one) has the result of--

- (A) the receipt of preferred stock by some common shareholders, and
- (B) the receipt of common stock by other common shareholders.

(4) Distributions on preferred stock. If the distribution is with respect to preferred stock, other than an increase in the conversion ratio of convertible preferred stock made solely to take account of a stock dividend or stock split with respect to the stock into which such convertible stock is convertible.

(5) Distributions of convertible preferred stock. If the distribution is of convertible preferred stock, unless it is established to the satisfaction of the Secretary that such distribution will not have the result described in paragraph (2).

§ 311. Taxability of corporation on distribution.

(a) General rule. Except as provided in subsection (b), **no gain or loss** shall be recognized to a corporation on the distribution (not in complete liquidation) with respect to its stock, of--

- (1) its stock (or rights to acquire its stock), or
- (2) property.

(b) Distributions of appreciated property.

(1) In general. If--

- (A) a corporation distributes property (other than an obligation of such corporation) to a shareholder in a distribution to which subpart A applies, and
- (B) the fair market value of such property exceeds its adjusted basis (in the hands of the distributing corporation),

then gain shall be recognized to the distributing corporation as if such property were sold to the distributee at its fair market value.

(2) Treatment of liabilities. Rules similar to the rules of section 336(b) shall apply for purposes of this subsection.

(3) Special rule for certain distributions of partnership or trust interests. If the property distributed consists of an interest in a partnership or trust, the Secretary may by

regulations provide that the amount of the gain recognized under paragraph (1) shall be computed without regard to any loss attributable to property contributed to the partnership or trust for the principal purpose of recognizing such loss on the distribution.

§ 318. Constructive ownership of stock.

(a) General rule. For purposes of those provisions of this subchapter to which the rules contained in this section are expressly made applicable--

(1) Members of family. [318(a)(1) is only *family* attribution]

(A) In general. An individual shall be considered as owning the stock owned, directly or indirectly, by or for--

(i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and

(ii) his children, grandchildren, and parents.

(B) Effect of adoption. For purposes of subparagraph (A)(ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

(2) Attribution from partnerships, estates, trusts, and corporations. <<[ENTITY attribution]

(A) From partnerships and estates. Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

(B) From trusts.

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) From corporations. If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

(3) Attribution to partnerships, estates, trusts, and corporations.

(A) To partnerships and estates. Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate.

(B) To trusts.

(i) Stock owned directly or indirectly, by or for a beneficiary of a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property.

(ii) Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by the trust.

(C) To corporations. If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.

(4) Options. If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(5) Operating rules.

(A) **In general.** Except as provided in subparagraphs (B) and (C), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), or (4), shall, for purposes of applying paragraphs (1), (2), (3), and (4), be considered as actually owned by such person.

(B) Members of family. Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be considered as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) Partnerships, estates, trusts, and corporations. Stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of paragraph (3) shall not be considered as owned by it for purposes of applying paragraph (2) in order to make another the constructive owner of such stock.

(D) Option rule in lieu of family rule. For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (4), it shall be considered as owned by him under paragraph (4).

(E) S Corporation treated as partnership. For purposes of this subsection--

(i) an S corporation shall be treated as a partnership, and

(ii) any shareholder of the S corporation shall be treated as a partner of such partnership.

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person.

return to sec. 302:

(B) Subparagraph (A) of this paragraph shall not apply if--

(i) any portion of the stock redeemed was acquired, directly or indirectly, within the 10-year period ending on the date of the distribution by the distributee from a person the ownership of whose stock would (at the time of distribution) be attributable to the distributee under section 318(a), or

(ii) any person owns (at the time of the distribution) stock the ownership of which is attributable to the distributee under section 318(a) and such person acquired any stock in the corporation, directly or indirectly, from the distributee within the 10-year period ending on the date of the distribution, unless such stock so acquired from the distributee is redeemed in the same transaction.

The preceding sentence shall not apply if the acquisition (or, in the case of clause (ii), the disposition) by the distributee did not have as one of its principal purposes the avoidance of Federal income tax.

(C) Special rule for waivers by entities.

(i) In general. Subparagraph (A) shall not apply to a distribution to any entity unless--
(I) such entity and each related person meet the requirements of clauses (i), (ii), and (iii) of subparagraph (A), and

(II) Each related person agrees to be jointly and severally liable for any deficiency (including interest and additions to tax) resulting from an acquisition described in clause (ii) of subparagraph (A).

In any case to which the preceding sentence applies, the second sentence of subparagraph (A) and subparagraph (B)(ii) shall be applied by substituting "distributee or any related person" for "distributee" each place it appears.

(ii) Definitions. For purposes of this subparagraph--

(I) the term "entity" means a partnership, estate, trust, or corporation; and

(II) the term "related person" means any person to whom ownership of stock in the corporation is (at the time of the distribution) attributable under section 318(a)(1) if such stock is further attributable to the entity under section 318(a)(3).

(d) Redemptions treated as distributions of property. Except as otherwise provided in this subchapter, if a corporation redeems its stock (within the meaning of section 317(b)), and *if subsection (a) of this section does not apply*, such redemption shall be treated as a distribution of property to which **section 301 applies**.

(2) Relationship of stock to decedent's estate.

(A) In general. Subsection (a) shall apply to a distribution by a corporation only if the value (for Federal estate tax purposes) of all of the *stock of such corporation which is included in determining the value of the decedent's gross estate exceeds 35 percent of the excess of--*

(i) the value of the gross estate of such decedent, over

(ii) the sum of the amounts allowable as a deduction under section 2053 or 2054.

(B) Special rule for stock in 2 or more corporations. For purposes of subparagraph (A), *stock of 2 or more corporations, with respect to each of which there is included in determining the value of the decedent's gross estate 20 percent or more in value of the outstanding stock, shall be treated as the stock of a single corporation.* For purposes of the 20-percent requirement of the preceding sentence, stock which, at the decedent's death, represents the surviving spouse's interest in property held by the decedent and the surviving spouse as community property or as joint tenants, tenants by the entirety, or tenants in common shall be treated as having been included in determining the value of the decedent's gross estate.

§ 331. Gain or loss to shareholders in corporate liquidations.

(a) Distributions in complete liquidation treated as exchanges. Amounts received by a shareholder in a distribution in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(b) Nonapplication of section 301. Section 301 (relating to effects on shareholder of

distributions of property) shall not apply to any distribution of property (other than a distribution referred to in paragraph (2)(B) of section 316(b)) in complete liquidation.

§ 332. Complete liquidations of subsidiaries.

(a) General rule. No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

(b) Liquidations to which section applies. For purposes of this section, a distribution shall be considered to be in complete liquidation only if--

- (1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) meeting the requirements of section 1504(a)(2); and either
- (2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or
- (3) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within 3 years from the close of the taxable year during which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year, the Secretary may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such 3-year period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, the assessment and collection of all income taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this subsection shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for purposes of this subsection a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, on an exchange described in section 361, and (B) the complete cancellation or

redemption under the plan, as a result of exchanges described in section 354, of the shares not owned by the taxpayer.

§ 334. Basis of property received in liquidations.

(a) General rule. If property is received in a distribution in complete liquidation, and if gain or loss is recognized on receipt of such property, *then the basis of the property in the hands of the distributee shall be the fair market value of such property* at the time of the distribution.

(b) Liquidation of subsidiary.

(1) In general. If property is received by a corporate distributee in a distribution in a complete liquidation to which section 332 applies (or in a transfer described in section 337(b)(1)), the basis of such property in the hands of such distributee shall be *the same as it would be in the hands of the transferor*; except that, in any case in which gain or loss is recognized by the liquidating corporation with respect to such property, the basis of such property in the hands of such distributee shall be the fair market value of the property at the time of the distribution.

(2) Corporate distributee. For purposes of this subsection, the term "corporate distributee" means only the corporation which meets the stock ownership requirements specified in section 332

§ 336. Gain or loss recognized [to the corporation] on property distributed in complete liquidation.

(a) General rule. Except as otherwise provided in this section or section 337, *gain or loss* shall be recognized to a liquidating corporation on the distribution of property in complete liquidation as if such property were sold to the distributee at its fair market value.

(b) Treatment of liabilities. If any property distributed in the liquidation is subject to a liability or the shareholder assumes a liability of the liquidating corporation in connection with the distribution, for purposes of subsection (a) and section 337, the fair market value of such property shall be treated as not less than the amount of such liability.

(c) Exception for liquidations which are part of a reorganization. For provision providing that this subpart does not apply to distributions in pursuance of a plan of reorganization, see section 361(c)(4).

(d) Limitations on recognition of loss.

(1) No loss recognized in certain distributions to related persons.

(A) In general. No loss shall be recognized to a liquidating corporation on the distribution of any property to a related person (within the meaning of section 267) if--

- (i) such distribution is not pro rata, or
- (ii) such property is disqualified property.

(B) Disqualified property. For purposes of subparagraph (A), the term "disqualified property" means any property which is acquired by the liquidating corporation in a transaction to which section 351 applied, or as a contribution to capital, during the 5-year period ending on the date of the distribution. Such term includes any property if the adjusted basis of such property is determined (in whole or in part) by reference to the adjusted basis of property described in the preceding sentence.

(2) Special rule for certain property acquired in certain carryover basis transactions.

(A) In general. For purposes of determining the amount of loss recognized by any liquidating corporation on any sale, exchange, or distribution of property described in subparagraph (B), the adjusted basis of such property shall be reduced (but not below zero) by the excess (if any) of--

(i) the adjusted basis of such property immediately after its acquisition by such corporation, over

(ii) the fair market value of such property as of such time.

(B) Description of property.

(i) In general. For purposes of subparagraph (A), property is described in this subparagraph if--

(I) such property is acquired by the liquidating corporation in a transaction to which **section 351** applied or as a contribution to capital, **and**

(II) the acquisition of such property by the liquidating corporation was ***part of a plan a principal purpose of which was to recognize loss by the liquidating corporation*** with respect to such property in connection with the liquidation.

Other property shall be treated as so described if the adjusted basis of such other property is determined (in whole or in part) by reference to the adjusted basis of property described in the preceding sentence.

(ii) Certain acquisitions treated as part of plan. For purposes of clause (i), any property described in clause (i)(I) acquired by the liquidated corporation ***after the date 2 years before the date of the adoption of the plan of complete liquidation shall, except as provided in regulations, be treated as acquired as part of a plan described in clause (i)(II)***.

(C) Recapture in lieu of disallowance. The Secretary may prescribe regulations under which, in lieu of disallowing a loss under subparagraph (A) for a prior taxable year, the gross income of the liquidating corporation for the taxable year in which the plan of complete liquidation is adopted shall be increased by the amount of the disallowed loss.

(3) Special rule in case of liquidation to which section 332 applies. In the case of any liquidation to which section 332 applies, no loss shall be recognized to the liquidating corporation on any distribution in such liquidation. The preceding sentence shall apply to any distribution to the 80-percent distributee only if subsection (a) or (b)(1) of section 337 applies to such distribution.

(e) Certain stock sales and distributions may be treated as asset transfers. Under regulations prescribed by the Secretary, if--

- (1) a corporation owns stock in another corporation meeting the requirements of section 1504(a)(2), and
- (2) such corporation sells, exchanges, or distributes all of such stock,

an election may be made to treat such sale, exchange, or distribution as a disposition of all of the assets of such other corporation, and no gain or loss shall be recognized on the sale, exchange, or distribution of such stock.

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§ 337. Nonrecognition for property distributed to parent in complete liquidation of subsidiary.

(a) In general. *No gain or loss* shall be recognized to the liquidating corporation on the distribution to the 80-percent distributee of any property in a complete liquidation to which section 332 applies.

(b) Treatment of indebtedness of subsidiary, etc.

(1) Indebtedness of subsidiary to parent. If--

(A) a corporation is liquidated in a liquidation to which section 332 applies, and

(B) on the date of the adoption of the plan of liquidation, such corporation was indebted to the 80-percent distributee,

for purposes of this section and section 336, any transfer of property to the 80-percent distributee in satisfaction of such indebtedness shall be treated as a distribution to such distributee in such liquidation.

(2) Treatment of tax-exempt distributee.

(A) In general. Except as provided in subparagraph (B), paragraph (1) and subsection (a) shall not apply where the 80-percent distributee is an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter.

(B) Exception where property will be used in unrelated business.

(i) In general. Subparagraph (A) shall not apply to any distribution of property to an organization described in section 511(a)(2) if, immediately after such distribution, such organization uses such property in an activity the income from which is subject to tax under section 511(a).

(ii) Later disposition or change in use. If any property to which clause (i) applied is disposed of by the organization acquiring such property, notwithstanding any other provision of law, any gain (not in excess of the amount not recognized by reason of clause (i)) shall be included in such organization's unrelated business taxable income. For purposes of the preceding sentence, if such property ceases to be used in an activity referred to in clause (i), such organization shall be treated as having disposed of such property on the date of such cessation.

(c) 80-Percent Distributee. For purposes of this section, the term "80-percent distributee" means only the corporation which meets the 80-percent stock ownership

requirements specified in section 332(b). For purposes of this section, the determination of whether any corporation is an 80-percent distributee shall be made without regard to any consolidated return regulation.

(d) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments made by subtitle D of title VI of the Tax Reform Act of 1986, including--

(1) regulations to ensure that such purposes may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations and part III of this subchapter) or through the use of a regulated investment company, real estate investment trust, or tax-exempt entity, and

(2) regulations providing for appropriate coordination of the provisions of this section with the provisions of this title relating to taxation of foreign corporations and their shareholders.

§ 338. Certain stock purchases treated as asset acquisitions.

(a) **General rule.** For purposes of this subtitle, if a purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such an election), then, in the case of any qualified stock purchase, the target corporation--

(1) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction, and

(2) shall be treated as a new corporation which purchased all of the assets referred to in paragraph (1) as of the beginning of the day after the acquisition date.

(b) Basis of assets after deemed purchase.

(1) In general. For purposes of subsection (a), the assets of the target corporation shall be treated as purchased for an amount equal to the sum of --

(A) the grossed-up basis of the purchasing corporation's recently purchased stock, and

(B) the basis of the purchasing corporation's nonrecently purchased stock.

(2) Adjustment for liabilities and other relevant items. The amount described in paragraph (1) shall be adjusted under regulations prescribed by the Secretary for liabilities of the target corporation and other relevant items.

(3) Election to step-up the basis of certain target stock.

(A) In general. Under regulations prescribed by the Secretary, the basis of the purchasing corporation's nonrecently purchased stock shall be the basis amount determined under subparagraph (B) of this paragraph if the purchasing corporation makes an election to recognize gain as if such stock were sold on the acquisition date for an amount equal to the basis amount determined under subparagraph (B).

(B) Determination of basis amount. For purposes of subparagraph (A), the basis amount determined under this subparagraph shall be an amount equal to the grossed-up basis determined under subparagraph (A) of paragraph (1) multiplied by a fraction--

(i) the numerator of which is the percentage of stock (by value) in the target corporation attributable to the purchasing corporation's nonrecently purchased stock, and

(ii) the denominator of which is 100 percent minus the percentage referred to in clause

(i).

(4) Grossed-up basis. For purposes of paragraph (1), the grossed-up basis shall be an amount equal to the basis of the corporation's recently purchased stock, multiplied by a fraction--

(A) the numerator of which is 100 percent, minus the percentage of stock (by value) in the target corporation attributable to the purchasing corporation's nonrecently purchased stock, and

(B) the denominator of which is the percentage of stock (by value) in the target corporation attributable to the purchasing corporation's recently purchased stock.

(5) Allocation among assets. The amount determined under paragraphs (1) and (2) shall be allocated among the assets of the target corporation under regulations prescribed by the Secretary.

(6) Definitions of recently purchased stock and nonrecently purchased stock. For purposes of this subsection--

(A) Recently purchased stock. The term "recently purchased stock" means any stock in the target corporation which is held by the purchasing corporation on the acquisition date and which was purchased by such corporation during the 12-month acquisition period.

(B) Nonrecently purchased stock. The term "nonrecently purchased stock" means any stock in the target corporation which is held by the purchasing corporation on the acquisition date and which is not recently purchased stock.

(c) Repealed.

(d) Purchasing corporation; target corporation; qualified stock purchase. For purposes of this section--

(1) Purchasing corporation. The term "purchasing corporation" means any corporation which makes a qualified stock purchase of stock of another corporation.

(2) Target corporation. The term "target corporation" means any corporation the stock of which is acquired by another corporation in a qualified stock purchase.

(3) Qualified stock purchase. The term "qualified stock purchase" means any transaction or series of transactions in which stock (meeting the requirements of section 1504(a)(2)) of 1 corporation is acquired by another corporation by purchase during the 12-month acquisition period.

(e) Deemed election where purchasing corporation acquires asset of target corporation.

(1) In general. A purchasing corporation shall be treated as having made an election under this section with respect to any target corporation if, at any time during the consistency period, it acquires any asset of the target corporation (or a target affiliate).

(2) Exceptions. Paragraph (1) shall not apply with respect to any acquisition by the purchasing corporation if--

(A) such acquisition is pursuant to a sale by the target corporation (or the target affiliate) in the ordinary course of its trade or business,

(B) the basis of the property acquired is determined wholly by reference to the adjusted basis of such property in the hands of the person from whom acquired,

(C) such acquisition was before September 1, 1982, or

(D) such acquisition is described in regulations prescribed by the Secretary and meets

such conditions as such regulations may provide.

(3) Anti-avoidance rule. Whenever necessary to carry out the purpose of this subsection and subsection (f), the Secretary may treat stock acquisitions which are pursuant to a plan and which meet the requirements of section 1504(a)(2) as qualified stock purchases.

(f) Consistency required for all stock acquisitions from same affiliated group. If a purchasing corporation makes qualified stock purchases with respect to the target corporation and 1 or more target affiliates during any consistency period, then (except as otherwise provided in subsection (e))--

(1) any election under this section with respect to the first such purchase shall apply to each other such purchase, and

(2) no election may be made under this section with respect to the second or subsequent such purchase if such an election was not made with respect to the first such purchase.

(g) Election.

(1) When made. Except as otherwise provided in regulations, an election under this section shall be made not later than the 15th day of the 9th month beginning after the month in which the acquisition date occurs.

(2) Manner. An election by the purchasing corporation under this section shall be made in such manner as the Secretary shall by regulations prescribe.

(3) Election irrevocable. An election by a purchasing corporation under this section, once made, shall be irrevocable.

(h) Definitions and special rules. For purposes of this section

(1) 12-month acquisition period. The term "12-month acquisition period" means the 12-month period beginning with the date of the first acquisition by purchase of stock included in a qualified stock purchase (or, if any of such stock was acquired in an acquisition which is a purchase by reason of subparagraph (C) of paragraph (3), the date on which the acquiring corporation is first considered under section 318(a) (other than paragraph (4) thereof) as owning stock owned by the corporation from which such acquisition was made).

(2) Acquisition date. The term "acquisition date" means, with respect to any corporation, the first day on which there is a qualified stock purchase with respect to the stock of such corporation.

(3) Purchase.

(A) In general. The term "purchase" means any acquisition of stock, but only if--

(i) the basis of the stock in the hands of the purchasing corporation is not determined (I) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (II) under section 1014(a) (relating to property acquired from a decedent),

(ii) the stock is not acquired in an exchange to which section 351, 354, 355, or 356 applies and is not acquired in any other transaction described in regulations in which the transferor does not recognize the entire amount of the gain or loss realized on the transaction, and

(iii) the stock is not acquired from a person the ownership of whose stock would, under section 318(a) (other than paragraph (4) thereof), be attributed to the person acquiring

such stock.

(B) Deemed purchase under subsection (a). The term "purchase" includes any deemed purchase under subsection (a)(2). The acquisition date for a corporation which is deemed purchased under subsection (a)(2) shall be determined under regulations prescribed by the Secretary.

(C) Certain stock acquisitions from related corporations.

(i) In general. Clause (iii) of subparagraph (A) shall not apply to an acquisition of stock from a related corporation if at least 50 percent in value of the stock of such related corporation was acquired by purchase (within the meaning of subparagraphs (A) and (B)).

(ii) Certain distributions. Clause (i) of subparagraph (A) shall not apply to an acquisition of stock described in clause (i) of this subparagraph if the corporation acquiring such stock--

(I) made a qualified stock purchase of stock of the related corporation, and

(II) made an election under this section (or is treated under subsection (e) as having made such an election) with respect to such qualified stock purchase.

(iii) Related corporation defined. For purposes of this subparagraph, a corporation is a related corporation if stock owned by such corporation is treated (under section 318(a) other than paragraph (4) thereof) as owned by the corporation acquiring the stock.

(4) Consistency period.

(A) In general. Except as provided in subparagraph (B), the term "consistency period" means the period consisting of--

(i) the 1-year period before the beginning of the 12-month acquisition period for the target corporation,

(ii) such acquisition period (up to and including the acquisition date), and

(iii) the 1-year period beginning on the day after the acquisition date.

(B) Extension where there is plan. The period referred to in subparagraph (A) shall also include any period during which the Secretary determines that there was in effect a plan to make a qualified stock purchase plus 1 or more other qualified stock purchases (or asset acquisitions described in subsection (e)) with respect to the target corporation or any target affiliate.

(5) Affiliated group. The term "affiliated group" has the meaning given to such term by section 1504(a) (determined without regard to the exceptions contained in section 1504(b)).

(6) Target affiliate.

(A) In general. A corporation shall be treated as a target affiliate of the target corporation if each of such corporations was, at any time during so much of the consistency period as ends on the acquisition date of the target corporation, a member of an affiliated group which had the same common parent.

(B) Certain foreign corporations, etc. Except as otherwise provided in regulations (and subject to such conditions as may be provided in regulations)--

(i) the term "target affiliate" does not include a foreign corporation, a DISC, or a corporation to which an election under section 936 applies, and

(ii) stock held by a target affiliate in a foreign corporation or a domestic corporation which is a DISC or described in section 1248(e) shall be excluded from the operation of this section.

(7) Repealed.

(8) Acquisitions by affiliated group treated as made by 1 corporation. Except as provided in regulations prescribed by the Secretary, stock and asset acquisitions made by members of the same affiliated group shall be treated as made by 1 corporation.

(9) Target not treated as member of affiliated group. Except as otherwise provided in paragraph (10) or in regulations prescribed under this paragraph, the target corporation shall not be treated as a member of an affiliated group with respect to the sale described in subsection (a)(1).

(10) Elective recognition of gain or loss by target corporation, together with nonrecognition of gain or loss on stock sold by selling consolidated group.

(A) In general. Under regulations prescribed by the Secretary, an election may be made under which if--

(i) the target corporation was, before the transaction, a member of the selling consolidated group, and

(ii) the target corporation recognizes gain or loss with respect to the transaction as if it sold all of its assets in a single transaction,

then the target corporation shall be treated as a member of the selling consolidated group with respect to such sale, and (to the extent provided in regulations) no gain or loss will be recognized on stock sold or exchanged in the transaction by members of the selling consolidated group.

(B) Selling consolidated group. For purposes of subparagraph (A), the term "selling consolidated group" means any group of corporations which (for the taxable period which includes the transaction)--

(i) includes the target corporation, and

(ii) files a consolidated return.

To the extent provided in regulations, such term also includes any affiliated group of corporations which includes the target corporation (whether or not such group files a consolidated return).

(C) Information required to be furnished to the secretary. Under regulations, where an election is made under subparagraph (A), the purchasing corporation and the common parent of the selling consolidated group shall, at such times and in such manner as may be provided in regulations, furnish to the Secretary the following information:

(i) The amount allocated under subsection (b)(5) to goodwill or going concern value.

(ii) Any modification of the amount described in clause (i).

(iii) Any other information as the Secretary deems necessary to carry out the provisions of this paragraph.

(11) Elective formula for determining fair market value. For purposes of subsection (a)(1), fair market value may be determined on the basis of a formula provided in regulations prescribed by the Secretary which takes into account liabilities and other relevant items.

(12) Repealed.

(13) Tax on deemed sale not taken into account for estimated tax purposes. For purposes of section 6655, tax attributable to the sale described in subsection (a)(1) shall not be taken into account.

(14) Deleted.

(15) Combined deemed sale return. Under regulations prescribed by the Secretary, a

combined deemed sale return may be filed by all target corporations acquired by a purchasing corporation on the same acquisition date if such target corporations were members of the same selling consolidated group (as defined in subparagraph (B) of paragraph (10)).

(16) Coordination with foreign tax credit provisions. Except as provided in regulations, this section shall not apply for purposes of determining the source or character of any item for purposes of subpart A of part III of subchapter N of this chapter (relating to foreign tax credit). The preceding sentence shall not apply to any gain to the extent such gain is includible in gross income as a dividend under section 1248 (determined without regard to any deemed sale under this section by a foreign corporation).

(i) Regulations. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section, including--

- (1) regulations to ensure that the purpose of this section to require consistency of treatment of stock and asset sales and purchases may not be circumvented through the use of any provision of law or regulations (including the consolidated return regulations) and
- (2) regulations providing for the coordination of the provisions of this section with the provision of this title relating to foreign corporations and their shareholders.

§ 351. Transfer to corporation controlled by transferor.

(a) General rule. No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.

(b) Receipt of property. If subsection (a) would apply to an exchange but for the fact that there is received, in addition to the stock permitted to be received under subsection (a), other property or money, then--

- (1) gain (if any) to such recipient shall be recognized, but not in excess of--
 - (A) the amount of money received, plus
 - (B) the fair market value of such other property received; and
- (2) no loss to such recipient shall be recognized.

(c) Special rules where distribution to shareholders.

(1) In general. In determining control for purposes of this section, the fact that any corporate transferor distributes part or all of the stock in the corporation which it receives in the exchange to its shareholders shall not be taken into account.

(2) Special rule for section 355. If the requirements of section 355 (or so much of section 356 as relates to section 355) are met with respect to a distribution described in paragraph (1), then, solely for purposes of determining the tax treatment of the transfers of property to the controlled corporation by the distributing corporation, the fact that the shareholders

of the distributing corporation dispose of part or all of the distributed stock, or the fact that the corporation whose stock was distributed issues additional stock, shall not be taken into account in determining control for purposes of this section.

(d) Services, certain indebtedness, and accrued interest not treated as property. For purposes of this section, stock issued for--

(1) services,

(2) indebtedness of the transferee corporation which is not evidenced by a security, or

(3) interest on indebtedness of the transferee corporation which accrued on or after the beginning of the transferor's holding period for the debt,

shall not be considered as issued in return for property.

(e) Exceptions. This section shall not apply to--

(1) Transfer of property to an investment company. A transfer of property to an investment company. For purposes of the preceding sentence, the determination of whether a company is an investment company shall be made--

§ 357. Assumption of liability.

(a) General rule. Except as provided in subsections (b) and (c), if--

(1) the taxpayer receives property which would be permitted to be received under section 351 or 361 without the recognition of gain if it were the sole consideration, and

(2) as part of the consideration, another party to the exchange assumes a liability of the taxpayer,

then such assumption shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351 or 361, as the case may be.

(b) Tax avoidance purpose.

(1) In general. If, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption was made, it appears that the principal purpose of the taxpayer with respect to the assumption described in subsection (a)--

(A) was a purpose to avoid Federal income tax on the exchange, or

(B) if not such purpose, was not a bona fide business purpose,

then such assumption (in the total amount of the liability assumed pursuant to such exchange) shall, for purposes of section 351 or 361 (as the case may be), be considered as money received by the taxpayer on the exchange.

(2) Burden of proof. In any suit or proceeding where the burden is on the taxpayer to prove such assumption is not to be treated as money received by the taxpayer, such burden shall not be considered as sustained unless the taxpayer sustains such burden by the clear preponderance of the evidence.

(c) Liabilities in excess of basis.

(1) In general. In the case of an exchange--

(A) to which section 351 applies, or

(B) to which section 361 applies by reason of a plan of reorganization within the meaning of section 368(a)(1)(D),

if the sum of the amount of the liabilities assumed exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

(2) Exceptions. Paragraph (1) shall not apply to any exchange--

(A) to which subsection (b)(1) of this section applies, or

(B) which is pursuant to a plan of reorganization within the meaning of section 368(a)(1)(G) where no former shareholder of the transferor corporation receives any consideration for his stock.

(3) Certain liabilities excluded.

(A) In general. If a taxpayer transfers, in an exchange to which section 351 applies, a liability the payment of which either--

(i) would give rise to a deduction, or

(ii) would be described in section 736(a),

then, for purposes of paragraph (1), the amount of such liability shall be excluded in determining the amount of liabilities assumed.

(B) Exception. Subparagraph (A) shall not apply to any liability to the extent that the incurrence of the liability resulted in the creation of, or an increase in, the basis of any property.

(d) Determination of amount of liability assumed.

(1) In general. For purposes of this section, section 358(d), section 358(h), section 362(d), section 368(a)(1)(C), and section 368(a)(2)(B), except as provided in regulations--

(A) a recourse liability (or portion thereof) shall be treated as having been assumed if, as determined on the basis of all facts and circumstances, the transferee has agreed to, and is expected to, satisfy such liability (or portion), whether or not the transferor has been relieved of such liability; and

(B) except to the extent provided in paragraph (2), a nonrecourse liability shall be treated as having been assumed by the transferee of any asset subject to such liability.

(2) Exception for nonrecourse liability. The amount of the nonrecourse liability treated as described in paragraph (1)(B) shall be reduced by the lesser of--

(A) the amount of such liability which an owner of other assets not transferred to the transferee and also subject to such liability has agreed with the transferee to, and is expected to, satisfy; or

(B) the fair market value of such other assets (determined without regard to section 7701(g)).

(3) Regulations. The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and section 362(d). The Secretary may also prescribe regulations which provide that the manner in which a liability is treated as assumed under this subsection is applied, where appropriate, elsewhere in this title.

§ 358. Basis to distributees.

(a) General rule. In the case of an exchange to which section 351, 354, 355, 356, or 361 applies--

(1) Nonrecognition property (the "stock"). The basis of the property permitted to be received under such section without the recognition of gain or loss shall be the same as that of the property exchanged--

(A) decreased by--

- (i) the fair market value of any other property (except money) received by the taxpayer,
- (ii) the amount of any money received by the taxpayer, and
- (iii) the amount of loss to the taxpayer which was recognized on such exchange, and

(B) increased by--

- (i) the amount which was treated as a dividend, and
- (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

(2) Other property (the "boot"). The basis of any other property (except money) received by the taxpayer shall be its fair market value.

(b) Allocation of basis.

(1) In general. Under regulations prescribed by the Secretary, the basis determined under subsection (a)(1) shall be allocated among the properties permitted to be received without the recognition of gain or loss.

(2) Special rule for section 355. In the case of an exchange to which section 355 (or so much of section 356 as relates to section 355) applies, then in making the allocation under paragraph (1) of this subsection, there shall be taken into account not only the property so permitted to be received without the recognition of gain or loss, but also the stock or securities (if any) of the distributing corporation which are retained, and the allocation of basis shall be made among all such properties.

(c) Section 355 transactions which are not exchanges. For purposes of this section, a distribution to which section 355 (or so much of section 356 as relates to section 355) applies shall be treated as an exchange, and for such purposes the stock and securities of the distributing corporation which are retained shall be treated as surrendered, and received back, in the exchange.

(d) Assumption of liability.

(1) In general. Where, as part of the consideration to the taxpayer, another party to the exchange assumed a liability of the taxpayer, such assumption shall, *for purposes of this section*, be treated as **money received** by the taxpayer on the exchange.

(2) Exception. Paragraph (1) shall not apply to the amount of any liability excluded under section 357(c)(3).

(e) Exception. This section shall not apply to property acquired by a corporation by the

exchange of its stock or securities (or the stock or securities of a corporation which is in control of the acquiring corporation) as consideration in whole or in part for the transfer of the property to it.

(f) Definition of nonrecognition property in case of section 361 exchange. For purposes of this section, the property permitted to be received under section 361 without the recognition of gain or loss shall be treated as consisting only of stock or securities in another corporation a party to the reorganization.

(g) Adjustments in intragroup transactions involving section 355. In the case of a distribution to which section 355 (or so much of section 356 as relates to section 355) applies and which involves the distribution of stock from 1 member of an affiliated group (as defined in section 1504(a) without regard to subsection (b) thereof) to another member of such group, the Secretary may, notwithstanding any other provision of this section, provide adjustments to the adjusted basis of any stock which--

(1) is in a corporation which is a member of such group, and
(2) is held by another member of such group, to appropriately reflect the proper treatment of such distribution.

(h) Special rules for assumption of liabilities to which subsection (d) does not apply.

(1) In general. If, after application of the other provisions of this section to an exchange or series of exchanges, the basis of property to which subsection (a)(1) applies exceeds the fair market value of such property, then such basis shall be reduced (but not below such fair market value) by the amount (determined as of the date of the exchange) of any liability--

(A) which is assumed by another person as part of the exchange, and

(B) with respect to which subsection (d)(1) does not apply to the assumption.

(2) Exceptions. Except as provided by the Secretary, paragraph (1) shall not apply to any liability if--

(A) the trade or business with which the liability is associated is transferred to the person assuming the liability as part of the exchange, or

(B) substantially all of the assets with which the liability is associated are transferred to the person assuming the liability as part of the exchange.

(3) Liability. For purposes of this subsection, the term "liability" shall include any fixed or contingent obligation to make payment, without regard to whether the obligation is otherwise taken into account for purposes of this title.

§ 368. Definitions relating to corporate reorganizations.

(a) Reorganization.

(1) **In general.** For purposes of parts I and II and this part, the term "reorganization" means--

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization;

(F) a mere change in identity, form, or place of organization of one corporation, however effected; or

(G) a transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

PARTNERSHIPS – SUBCHAPTER K

Sec. 701. Partners, not partnership, subject to tax.

A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.

Sec. 702. Income and credits of partner

(a) General rule. In determining his income tax, each partner shall take into account separately his *distributive share* of the partnership's--

- (1) *gains and losses* from sales or exchanges of capital assets held for *not more than 1 year*,
- (2) gains and losses from sales or exchanges of capital assets held for *more than 1 year*,
- (3) gains and losses from sales or exchanges of property described in section 1231 (relating to certain property used in a trade or business and involuntary conversions),
- (4) *charitable contributions* (as defined in section 170(c),
- (5) dividends with respect to which section 1(h)(11) or part VIII of subchapter B applies,
- (6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,
- (7) other items of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary, and
- (8) taxable income or loss, exclusive of items requiring separate computation under other paragraphs of this subsection.

(b) Character of items constituting distributive share. The character of any item of income, gain, loss, deduction, or credit included in a partner's distributive share under paragraphs (1) through (7) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(c) Gross income of a partner. In any case where it is necessary to determine the gross income of a partner for purposes of this title, such amount shall include his distributive share of the gross income of the partnership.

Sec. 703. Partnership computations.

(a) Income and deductions. The taxable income of a partnership shall be computed in the same manner as in the case of an individual *except that--*

- (1) *the items described in section 702(a) shall be separately stated*, and
- (2) the following deductions shall not be allowed to the partnership:
 - (A) the deductions for personal exemptions provided in section 151,
 - (B) the deduction for taxes provided in section 164(a) with respect to taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,
 - (C) the deduction for charitable contributions provided in section 170,
 - (D) the net operating loss deduction provided in section 172,
 - (E) the additional itemized deductions for individuals provided in part VII of subchapter B (sec. 211 and following), and
 - (F) the deduction for depletion under section 611 with respect to oil and gas wells.

(b) Elections of the partnership. Any election affecting the computation of taxable income derived from a partnership shall be made by the partnership, except that any election under--

- (1) subsection (b)(5) or (c)(3) of section 108 (relating to income from discharge of indebtedness),

- (2) section 617 (relating to deduction and recapture of certain mining exploration expenditures), or
- (3) section 901 (relating to taxes of foreign countries and possessions of the United States),

shall be made by each partner separately.

Sec. 704. Partner's distributive share.

(a) Effect of partnership agreement. A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this chapter, be determined by the partnership agreement.

(b) Determination of distributive share. A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), *if--*

(1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or

(2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have *substantial economic effect*.

(c) Contributed property.

(1) In general. Under regulations prescribed by the Secretary--

(A) *income, gain, loss, and deduction* with respect to property contributed to the partnership by a partner shall be shared among the partners so as to *take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution*,

(B) if any property so contributed is distributed (directly or indirectly) by the partnership (other than to the contributing partner) within 7 years of being contributed--

(i) the contributing partner shall be treated as recognizing gain or loss (as the case may be) from the sale of such property in an amount equal to the gain or loss which would have been allocated to such partner under subparagraph (A) by reason of the variation described in subparagraph (A) if the property had been sold at its fair market value at the time of the distribution,

(ii) the character of such gain or loss shall be determined by reference to the character of the gain or loss which would have resulted if such property had been sold by the partnership to the distributee, and

(iii) appropriate adjustments shall be made to the adjusted basis of the contributing partner's interest in the partnership and to the adjusted basis of the property distributed to reflect any gain or loss recognized under this subparagraph, and

(C) if any property so contributed has a built-in loss--

(i) such built-in loss shall be taken into account only in determining the amount of items allocated to the contributing partner, and

(ii) except as provided in regulations, in determining the amount of items allocated to other partners, the basis of the contributed property in the hands of the partnership shall be treated as being equal to its fair market value at the time of contribution.

For purposes of subparagraph (C), the term "built-in loss" means the excess of the adjusted basis of the property (determined without regard to subparagraph (C)(ii)) over its fair market value at the time of contribution.

(2) Special rule for distributions where gain or loss would not be recognized outside partnerships. Under regulations prescribed by the Secretary, if--

(A) property contributed by a partner (hereinafter referred to as the "contributing partner") is distributed by the partnership to another partner, and

(B) other property of a like kind (within the meaning of section 1031) is distributed by the partnership to the contributing partner not later than the earlier of--

(i) the 180th day after the date of the distribution described in subparagraph (A), or

(ii) the due date (determined with regard to extensions) for the contributing partner's return of the tax imposed by this chapter for the taxable year in which the distribution described in subparagraph (A) occurs,

then to the extent of the value of the property described in subparagraph (B), paragraph (1)(B) shall be applied as if the contributing partner had contributed to the partnership the property described in subparagraph (B).

(3) Other rules. Under regulations prescribed by the Secretary, rules similar to the rules of paragraph (1) shall apply to contributions by a partner (using the cash receipts and disbursements method of accounting) of accounts payable and other accrued but unpaid items. Any reference in paragraph (1) or (2) to the contributing partner shall be treated as including a reference to any successor of such partner.

(d) Limitation on allowance of losses. A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership.

(e) Family partnerships.

(1) Recognition of interest created by purchase or gift. A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) Distributive share of donee includible in gross income. In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income, except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) Purchase of interest by member of family. For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

Sec. 705. Determination of basis of partner's interest.

(a) General rule. The adjusted basis of a partner's interest in a partnership shall, except as provided in subsection (b), be the basis of such interest determined under section 722 (relating to contributions to a partnership) or section 742 (relating to transfers of partnership interests)--

(1) increased by the sum of his *distributive share* for the taxable year and prior taxable years of--

(A) taxable income of the partnership as determined under section 703(a),

(B) income of the partnership *exempt* from tax under this title, and

(C) the excess of the deductions for depletion over the basis of the property subject to depletion;

(2) decreased (but not below zero) by distributions by the partnership as provided in section 733 and by the sum of his distributive share for the taxable year and prior taxable years of--

(A) losses of the partnership, and

(B) expenditures of the partnership not deductible in computing its taxable income and not properly chargeable to capital account; and

(3) decreased (but not below zero) by the amount of the partner's deduction for depletion for any partnership oil and gas property to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such partner under section 613A(c)(7)(D).

(b) Alternative rule. The Secretary shall prescribe by regulations the circumstances under which the adjusted basis of a partner's interest in a partnership may be determined by reference to his proportionate share of the adjusted basis of partnership property upon a termination of the partnership.

Sec. 706. Taxable years of partner and partnership.

(a) Year in which partnership income is includible. In computing the taxable income of a partner for a taxable year, the inclusions required by section 702 and section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

(b) Taxable year.

(1) Partnership's taxable year.

(A) Partnership treated as taxpayer. The taxable year of a partnership shall be

determined as though the partnership were a taxpayer.

(B) Taxable year determined by reference to partners. Except as provided in subparagraph (C), a partnership shall not have a taxable year other than--
(i) the majority interest taxable year (as defined in paragraph (4)),
(ii) if there is no taxable year described in clause (i), the taxable year of all the principal partners of the partnership, or
(iii) if there is no taxable year described in clause (i) or (ii), the calendar year unless the Secretary by regulations prescribes another period.

(C) Business purpose. A partnership may have a taxable year not described in subparagraph (B) if it establishes, to the satisfaction of the Secretary, a business purpose therefor. For purposes of this subparagraph, any deferral of income to partners shall not be treated as a business purpose.

(2) Partner's taxable year. A partner may not change to a taxable year other than that of a partnership in which he is a principal partner unless he establishes, to the satisfaction of the Secretary, a business purpose therefor.

(3) Principal partner. For the purpose of this subsection, a principal partner is a partner having an interest of 5 percent or more in partnership profits or capital.

(4) Majority interest taxable year; limitation on required changes....

(c) Closing of partnership year.

(1) General rule. Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

(2) Treatment of dispositions.

(A) Disposition of entire interest. The taxable year of a partnership shall close with respect to a partner whose entire interest in the partnership terminates (whether by reason of death, liquidation, or otherwise).

(B) Disposition of less than entire interest. The taxable year of a partnership shall not close (other than at the end of a partnership's taxable year as determined under subsection (b)(1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced (whether by entry of a new partner, partial liquidation of a partner's interest, gift, or otherwise).

(d) Determination of distributive share when partner's interest changes....

Sec. 707. Transactions between partner and partnership.

(a) Partner not acting in capacity as partner.

(1) In general. If a partner engages in a transaction with a partnership other than in his capacity as a member of such partnership, the transaction shall, except as otherwise

provided in this section, be considered as occurring between the partnership and one who is not a partner.

(2) Treatment of payments to partners for property or services. Under regulations prescribed by the Secretary--

(A) Treatment of certain services and transfers of property. If--

(i) a partner performs services for a partnership or transfers property to a partnership,
(ii) there is a related direct or indirect allocation and distribution to such partner, and
(iii) the performance of such services (or such transfer) and the allocation and distribution, when viewed together, are properly characterized as a transaction occurring between the partnership and a partner acting other than in his capacity as a member of the partnership,

such allocation and distribution shall be treated as a transaction described in paragraph (1).

(B) Treatment of certain property transfers. If--

(i) there is a direct or indirect transfer of money or other property by a partner to a partnership,
(ii) there is a related direct or indirect transfer of money or other property by the partnership to such partner (or another partner), and
(iii) the transfers described in clauses (i) and (ii), when viewed together, are properly characterized as a sale or exchange of property,
such transfers shall be treated either as a transaction described in paragraph (1) or as a transaction between 2 or more partners acting other than in their capacity as members of the partnership.

(b) Certain sales or exchanges of property with respect to controlled partnerships.

(1) Losses disallowed. No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between--

(A) a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or

(B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267(d) shall be applicable as if the loss were disallowed under section 267(a)(1). For purposes of section 267(a)(2), partnerships described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b).

(2) Gains treated as ordinary income. In the case of a sale or exchange, directly or indirectly, of property, which in the hands of the transferee, is property other than a capital asset as defined in section 1221--

(A) between a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or profits interest, in such partnership, or

(B) between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interest or profits interests,
any gain recognized shall be considered as ordinary income.

(3) Ownership of a capital or profits interest. For purposes of paragraphs (1) and (2) of this subsection, the ownership of a capital or profits interest in a partnership shall be

determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section.

(c) Guaranteed payments. To the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and, subject to section 263, for purposes of section 162(a) (relating to trade or business expenses).

Sec. 721. Nonrecognition of gain or loss on contribution.

(a) General rule. No gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

(b) Special rule. Subsection (a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of section 351 if the partnership were incorporated).

(c) Regulations relating to certain transfers to partnerships. The Secretary may provide by regulations that subsection (a) shall not apply to gain realized on the transfer of property to a partnership if such gain, when recognized, will be includible in the gross income of a person other than a United States person.

(d) Transfers of intangibles. For regulatory authority to treat intangibles transferred to a partnership as sold, see section 367(d)(3)

Sec. 722. Basis of contributing partner's interest.

The basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Sec. 723. Basis of property contributed to partnership.

The basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under section 721(b) to the contributing partner at such time.

Sec. 724. Character of gain or loss on contributed unrealized receivables, inventory items, and capital loss property.

(a) Contributions of unrealized receivables. In the case of any property which--
(1) was contributed to the partnership by a partner, and
(2) was an unrealized receivable in the hands of such partner immediately before such contribution,

any gain or loss recognized by the partnership on the disposition of such property shall be treated as ordinary income or ordinary loss, as the case may be.

(b) Contributions of inventory items. In the case of any property which--
(1) was contributed to the partnership by a partner, and
(2) was an inventory item in the hands of such partner immediately before such contribution,

any gain or loss recognized by the partnership on the disposition of such property during the 5-year period beginning on the date of such contribution shall be treated as ordinary income or ordinary loss, as the case may be.

(c) Contributions of capital loss property. In the case of any property which--
(1) was contributed by a partner to the partnership, and
(2) was a capital asset in the hands of such partner immediately before such contribution,

any loss recognized by the partnership on the disposition of such property during the 5-year period beginning on the date of such contribution shall be treated as a loss from the sale of a capital asset to the extent that, immediately before such contribution, the adjusted basis of such property in the hands of the partner exceeded the fair market value of such property.

(d) Definitions. For purposes of this section--

(1) Unrealized receivable. The term "unrealized receivable" has the meaning given such term by section 751(c) (determined by treating any reference to the partnership as referring to the partner).

(2) Inventory item. The term "inventory item" has the meaning given such term by section 751(d) (determined by treating any reference to the partnership as referring to the partner and by applying section 1231 without regard to any holding period therein provided).

(3) Substituted basis property.

(A) In general. If any property described in subsection (a), (b), or (c) is disposed of in a nonrecognition transaction, the tax treatment which applies to such property under such subsection shall also apply to any substituted basis property resulting from such transaction. A similar rule shall also apply in the case of a series of non-recognition transactions.

(B) Exception for stock in C corporation. Subparagraph (A) shall not apply to any stock in a C corporation received in an exchange described in section 351

Sec. 731. Extent of recognition of gain or loss on distribution.

- (a) Partners.** In the case of a distribution by a partnership to a partner--
- (1) gain shall not be recognized to such partner, except to the extent that any money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution, and
 - (2) loss shall not be recognized to such partner, except that upon a distribution in liquidation of a partner's interest in a partnership where no property other than that described in subparagraph (A) or (B) is distributed to such partner, loss shall be recognized to the extent of the excess of the adjusted basis of such partner's interest in the partnership over the sum of--
 - (A) any money distributed, and
 - (B) the basis to the distributee, as determined under section 732, of any unrealized receivables (as defined in section 751(c) and inventory (as defined in section 751(d)).

Any gain or loss recognized under this subsection shall be considered as gain or loss from the sale or exchange of the partnership interest of the distributee partner.

(b) Partnerships. No gain or loss shall be recognized to a partnership on a distribution to a partner of property, including money.

(c) Treatment of marketable securities.

(1) In general. *For purposes of subsection (a)(1) and section 737--*

(A) the term "money" includes marketable securities, and

(B) such securities shall be taken into account at their fair market value as of the date of the distribution.

(2) Marketable securities. [defined] ...

(3) Exceptions.

(A) In general. Paragraph (1) shall not apply to the distribution from a partnership of a marketable security to a partner if--

- (i) the security was contributed to the partnership by such partner, except to the extent that the value of the distributed security is attributable to marketable securities or money contributed (directly or indirectly) to the entity to which the distributed security relates,
- (ii) to the extent provided in regulations prescribed by the Secretary, the property was not a marketable security when acquired by such partnership, or
- (iii) such partnership is *an investment partnership* and such partner is an eligible partner thereof.

(B) Limitation on gain recognized. In the case of a distribution of marketable securities to a partner, the amount taken into account under paragraph (1) shall be reduced (but not below zero) by the excess (if any) of--

- (i) such partner's distributive share of the net gain which would be recognized if all of the marketable securities of the same class and issuer as the distributed securities held by the partnership were sold (immediately before the transaction to which the distribution relates) by the partnership for fair market value, over
- (ii) such partner's distributive share of the net gain which is attributable to the marketable securities of the same class and issuer as the distributed securities held by the partnership immediately after the transaction, determined by using the same fair market value as used

under clause (i).

Under regulations prescribed by the Secretary, all marketable securities held by the partnership may be treated as marketable securities of the same class and issuer as the distributed securities.

(C) Definitions relating to investment partnerships. For purposes of subparagraph (A)(iii):

(i) Investment partnership. The term "investment partnership" means any partnership which has never been engaged in a trade or business and substantially all of the assets (by value) of which have always consisted of--

(I) money,

(II) stock in a corporation,

(III) notes, bonds, debentures, or other evidences of indebtedness,

(IV) interest rate, currency, or equity notional principal contracts,

(V) foreign currencies,

(VI) interests in or derivative financial instruments (including options, forward or futures contracts, short positions, and similar financial instruments) in any asset described in any other subclause of this clause or in any commodity traded on or subject to the rules of a board of trade or commodity exchange,

(VII) other assets specified in regulations prescribed by the Secretary, or

(VIII) any combination of the foregoing.

(ii) Exception for certain activities. ...

(d) Exceptions. This section shall not apply to the extent otherwise provided by section 736 (relating to payments to a retiring partner or a deceased partner's successor in interest), section 751 (relating to unrealized receivables and inventory items), and section 737 (relating to recognition of precontribution gain in case of certain distributions).

Sec. 732. Basis of distributed property other than money.

(a) Distributions other than in liquidation of a partner's interest.

(1) General rule. The basis of property (other than money) distributed by a partnership to a partner other than in liquidation of the partner's interest shall, except as provided in paragraph (2), be its adjusted basis to the partnership immediately before such distribution.

(2) Limitation. The basis to the distributee partner of property to which paragraph (1) is applicable shall not exceed the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction.

(b) Distributions in liquidation. The basis of property (other than money) distributed by a partnership to a partner in liquidation of the partner's interest shall be an amount equal to the adjusted basis of such partner's interest in the partnership reduced by any money distributed in the same transaction.

(c) Allocation of basis.

(1) In general. The basis of distributed properties to which subsection (a)(2) or (b) is applicable shall be allocated--

(A) (i) first to any unrealized receivables (as defined in section 751(c)) and inventory items (as defined in section 751(d)) in an amount equal to the adjusted basis of each such property to the partnership, and

(ii) if the basis to be allocated is less than the sum of the adjusted bases of such properties to the partnership, then, to the extent any decrease is required in order to have the adjusted bases of such properties equal the basis to be allocated, in the manner provided in paragraph (3), and

(B) to the extent of any basis remaining after the allocation under subparagraph (A), to other distributed properties--

(i) first by assigning to each such other property such other property's adjusted basis to the partnership, and

(ii) then, to the extent any increase or decrease in basis is required in order to have the adjusted bases of such other distributed properties equal such remaining basis, in the manner provided in paragraph (2) or (3), whichever is appropriate.

(2) Method of allocating increase. Any increase required under paragraph (1)(B) shall be allocated among the properties--

(A) first to properties with unrealized appreciation in proportion to their respective amounts of unrealized appreciation before such increase (but only to the extent of each property's unrealized appreciation), and

(B) then, to the extent such increase is not allocated under subparagraph (A), in proportion to their respective fair market values.

(3) Method of allocating decrease. Any decrease required under paragraph (1)(A) or (1)(B) shall be allocated--

(A) first to properties with unrealized depreciation in proportion to their respective amounts of unrealized depreciation before such decrease (but only to the extent of each property's unrealized depreciation), and

(B) then, to the extent such decrease is not allocated under subparagraph (A), in proportion to their respective adjusted bases (as adjusted under subparagraph (A)).

(d) Special partnership basis to transferee. For purposes of subsections (a), (b), and (c), a partner who acquired all or a part of his interest by a transfer with respect to which the election provided in section 754 is not in effect, and to whom a distribution of property (other than money) is made with respect to the transferred interest within 2 years after such transfer, may elect, under regulations prescribed by the Secretary, to treat as the adjusted partnership basis of such property the adjusted basis such property would have if the adjustment provided in section 743(b) were in effect with respect to the partnership property. The Secretary may by regulations require the application of this subsection in the case of a distribution to a transferee partner, whether or not made within 2 years after the transfer, if at the time of the transfer the fair market value of the partnership property (other than money) exceeded 110 percent of its adjusted basis to the partnership.

(e) Exception. This section shall not apply to the extent that a distribution is treated as a sale or exchange of property under section 751(b) (relating to unrealized receivables and inventory items).

Sec. 733. Basis of distributee partner's interest.

In the case of a distribution by a partnership to a partner other than in liquidation of a partner's interest, the adjusted basis to such partner of his interest in the partnership shall be reduced (but not below zero) by--

- (1) the amount of any money distributed to such partner, and
- (2) the amount of the basis to such partner of distributed property other than money, as determined under section 732.

Sec. 743. Special rules where section 754 election or substantial built-in loss.

(a) General rule. The *basis of partnership property shall not be adjusted* as the result of a transfer of an interest in a partnership by sale or exchange or on the death of a partner ***unless the election provided by section 754 (relating to optional adjustment to basis of partnership property) is in effect with respect to such partnership*** or unless the partnership has a substantial built-in loss immediately after such transfer.

(b) Adjustment to basis of partnership property. In the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which the election provided in section 754 is in effect or which has a substantial built-in loss immediately after such transfer shall--

- (1) increase the adjusted basis of the partnership property by the excess of the basis to the transferee partner of his interest in the partnership over his proportionate share of the adjusted basis of the partnership property, or
- (2) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of his interest in the partnership.

Under regulations prescribed by the Secretary, such increase or decrease shall constitute ***an adjustment to the basis of partnership property with respect to the transferee partner only***. A partner's proportionate share of the adjusted basis of partnership property shall be determined in accordance with his interest in partnership capital and, in the case of property contributed to the partnership by a partner, section 704(c) (relating to contributed property) shall apply in determining such share. In the case of an adjustment under this subsection to the basis of partnership property subject to depletion, any depletion allowable shall be determined separately for the transferee partner with respect to his interest in such property.

Sec. 754. Manner of electing optional adjustment to basis of partnership property.

If a *partnership* files an election, in accordance with regulations prescribed by the

Secretary, *the basis of partnership property shall be adjusted*, in the case of a distribution of property, in the manner provided in section 734 and, *in the case of a transfer of a partnership interest, in the manner provided in section 743*. Such an election shall apply with respect to all distributions of property by the partnership and to all transfers of interests in the partnership during the taxable year with respect to which such election was filed and all subsequent taxable years. Such election may be revoked by the partnership, subject to such limitations as may be provided by regulations prescribed by the Secretary.

Sec. 761. Terms defined.

(a) Partnership. For purposes of this subtitle, the term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is *not*, within the meaning of this title, a corporation or a trust or estate. Under regulations the Secretary may, at the election of all the members of an unincorporated organization, exclude such organization from the application of all or part of this subchapter, if it is availed of--

- (1) for investment purposes only and not for the active conduct of a business,
- (2) for the *joint* production, extraction, or *use of property*, but not for the purpose of selling services or property produced or extracted, or
- (3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities,

if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

(b) Partner. For purposes of this subtitle, the term "partner" means a member of a partnership.

S CORPORATIONS – SUBCHAPTER S

§ 1361. S Corporation defined.

(a) S Corporation defined.

(1) In general. For purposes of this title, the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

(2) C corporation. For purposes of this title, the term "C corporation" means, with respect to any taxable year, a corporation which is not an S corporation for such year.

(b) Small business corporation.

(1) In general. For purposes of this subchapter, the term "small business corporation" means a domestic corporation which is *not an ineligible corporation* and *which does not--*

(A) have *more than 75 shareholders*,

(B) *have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual*,

(C) *have a nonresident alien as a shareholder*, and

(D) *have more than 1 class of stock*.

(2) Ineligible corporation defined. For purposes of paragraph (1), the term "ineligible corporation" means any corporation which is--

(A) a financial institution which uses the reserve method of accounting for bad debts described in section 585,

(B) an insurance company subject to tax under subchapter L,

(C) a corporation to which an election under section 936 applies, or

(D) a DISC or former DISC.

(3) Treatment of certain wholly owned subsidiaries.

(A) In general. Except as provided in regulations prescribed by the Secretary, for purposes of this title--

(i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and

(ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

(B) Qualified subchapter S subsidiary. For purposes of this paragraph, the term "qualified subchapter S subsidiary" means any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if--

(i) 100 percent of the stock of such corporation is held by the S corporation, and

(ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

(C) Treatment of terminations of qualified subchapter S subsidiary status. For purposes of this title, if any corporation which was a qualified subchapter S subsidiary ceases to meet the requirements of subparagraph (B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

(D) Election after termination. If a corporation's status as a qualified subchapter S subsidiary terminates, such corporation (and any successor corporation) shall not be eligible to make--

(i) an election under subparagraph (B)(ii) to be treated as a qualified subchapter S subsidiary, or

(ii) an election under section 1362(a) to be treated as an S corporation, before its 5th taxable year which begins after the 1st taxable year for which such termination was effective, unless the Secretary consents to such election.

(c) Special rules for applying subsection (b).

(1) Husband and wife treated as 1 shareholder. For purposes of subsection (b)(1)(A), a husband and wife (and their estates) shall be treated as 1 shareholder.

(2) Certain trusts permitted as shareholders.

(A) In general. For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

(i) **A trust all of which is treated ... as owned by an individual who is a citizen or resident of the United States [a "grantor trust"].**

(ii) A trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence **after such death, but only for the 2-year period** beginning on the day of the deemed owner's death.

(iii) A trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it.

(iv) A trust created primarily to exercise the voting power of stock transferred to it.

(v) An **electing small business trust.**

This subparagraph shall not apply to any foreign trust.

(B) Treatment as shareholders. For purposes of subsection (b)(1)--

(i) In the case of a trust described in clause (i) of subparagraph (A), the deemed owner shall be treated as the shareholder.

(ii) In the case of a trust described in clause (ii) of subparagraph (A), the estate of the deemed owner shall be treated as the shareholder.

(iii) In the case of a trust described in clause (iii) of subparagraph (A), the estate of the testator shall be treated as the shareholder.

(iv) In the case of a trust described in clause (iv) of subparagraph (A), each beneficiary of the trust shall be treated as a shareholder.

(v) In the case of a trust described in clause (v) of subparagraph (A), each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period.

(3) Estate of individual in bankruptcy may be shareholder. For purposes of subsection (b)(1)(B), the term "estate" includes the estate of an individual in a case under title 11 of the United States Code.

(4) Differences in common stock voting rights disregarded. For purposes of subsection (b)(1)(D), a corporation shall not be treated as having more than 1 class of stock solely because there are differences in voting rights among the shares of common stock.

(5) Straight debt safe harbor.

(A) In general. For purposes of subsection (b)(1)(D), straight debt shall not be treated as a second class of stock.

(B) Straight debt defined. For purposes of this paragraph, the term "straight debt" means any written unconditional promise to pay on demand or on a specified date a sum certain in money if--

(i) the interest rate (and interest payment dates) are not contingent on profits, the borrower's discretion, or similar factors,

(ii) there is no convertibility (directly or indirectly) into stock, and

(iii) the creditor is an individual (other than a nonresident alien), an estate, a trust described in paragraph (2), or a person which is actively and regularly engaged in the business of lending money.

(C) Regulations.

(6) Certain exempt organizations permitted as shareholders. For purposes of subsection (b)(1)(B), an organization which is--

(A) described in section 401(a) [*qualified retirement plans, such as a profit sharing plan*] or 501(c)(3) [*a charity*], and

(B) exempt from taxation under section 501(a),
may be a shareholder in an S corporation.

(d) Special rule for qualified subchapter S trust [a QSST].

(1) In general. In the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2)--

(A) such trust shall be treated as a trust described in subsection (c)(2)(A)(i), and

(B) for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under paragraph (2) is made.

(2) Election.

(e) Electing small business trust defined [an ESBT].

(1) Electing small business trust. For purposes of this section--

(A) In general. Except as provided in subparagraph (B), the term "electing small business trust" means any trust if--

(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,

(ii) no interest in such trust was acquired by purchase, and

(iii) an election under this subsection applies to such trust....

§ 1362. Election; revocation; termination.

(a) Election.

(1) In general. Except as provided in subsection (g), a small business corporation may elect, in accordance with the provisions of this section, to be an S corporation.

(2) All shareholders must consent to election. An election under this subsection shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

(b) When made.

(1) In general. An election under subsection (a) may be made by a small business corporation for any taxable year--

(A) at any time during the preceding taxable year, or

(B) at any time during the taxable year and on or before the 15th day of the 3d month of the taxable year.

(2) Certain elections made during 1st 2 1/2 months treated as made for next taxable year. If--

(A) an election under subsection (a) is made for any taxable year during such year and on

or before the 15th day of the 3d month of such year, but

(B) either--

(i) on 1 or more days in such taxable year before the day on which the election was made the corporation did not meet the requirements of subsection (b) of section 1361, or

(ii) 1 or more of the persons who held stock in the corporation during such taxable year and before the election was made did not consent to the election,

then such election shall be treated as made for the following taxable year.

(3) Election made after 1st 2 1/2 months treated as made for following taxable year.

If--

(A) a small business corporation makes an election under subsection (a) for any taxable year, and

(B) such election is made after the 15th day of the 3d month of the taxable year and on or before the 15th day of the 3rd month of the following taxable year,

then such election shall be treated as made for the following taxable year.

(4) Taxable years of 2 1/2 months or less. For purposes of this subsection, an election for a taxable year made not later than 2 months and 15 days after the first day of the taxable year shall be treated as timely made during such year.

(5) Authority to treat late elections, etc., as timely. If--

(A) an election under subsection (a) is made for any taxable year (determined without regard to paragraph (3)) after the date prescribed by this subsection for making such election for such taxable year or no such election is made for any taxable year, and

(B) the Secretary determines that there was reasonable cause for the failure to timely make such election,

the Secretary may treat such an election as timely made for such taxable year (and paragraph (3) shall not apply).

(c) Years for which effective. An election under subsection (a) shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, until such election is terminated under subsection (d).

(d) Termination.

(1) By revocation [i.e., voluntarily by shareholders].

(A) In general. An election under subsection (a) may be terminated by revocation.

(B) More than one-half of shares must consent to revocation. An election may be revoked only if shareholders holding more than one-half of the shares of stock of the corporation on the day on which the revocation is made consent to the revocation.

(C) When effective. Except as provided in subparagraph (D)--

(i) a revocation made during the taxable year and on or before the 15th day of the 3d month thereof shall be effective on the 1st day of such taxable year, and

(ii) a revocation made during the taxable year but after such 15th day shall be effective on the 1st day of the following taxable year.

(D) Revocation may specify prospective date. If the revocation specifies a date for revocation which is on or after the day on which the revocation is made, the revocation shall be effective on and after the date so specified.

(2) By corporation ceasing to be small business corporation [could be involuntary].

(A) In general. An election under subsection (a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) *such corporation ceases to be a small business corporation.*

(B) When effective. Any termination under this paragraph shall be effective on and after the date of cessation.

(3) Where passive investment income exceeds 25 percent of gross receipts for 3 consecutive taxable years and corporation has accumulated earnings and profits.

(A) Termination.

(i) In general. An election under subsection (a) shall be terminated whenever the corporation--

(I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and

(II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

(ii) When effective. Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in clause (i)....

(e) Treatment of S termination year....

(f) Inadvertent invalid elections or terminations. If--

(1) an election under subsection (a) by any corporation--

(A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or

(B) was terminated under paragraph (2) or (3) of subsection (d),

(2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent,

(3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken--

(A) so that the corporation is a small business corporation, or

(B) to acquire the required shareholder consents, and

(4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

(g) Election after termination. If a small business corporation has made an election under subsection (a) and if such election has been terminated under subsection (d), such corporation (and any successor corporation) shall not be eligible to make an election under subsection (a) for any taxable year before its *5th taxable year* which begins after

the 1st taxable year for which such termination is effective, unless the Secretary consents to such election.

§ 1368. Distributions.

(a) **General rule.** A distribution of property made by an S corporation with respect to its stock to which (but for this subsection) section 301(c) would apply shall be treated in the manner provided in subsection (b) or (c), whichever applies.

(b) **S corporation having no earnings and profits.** In the case of a distribution described in subsection (a) by

an S corporation which has no accumulated earnings and profits--

(1) **Amount applied against basis.** The distribution shall not be included in gross income to the extent that it

does not exceed the adjusted basis of the stock.

(2) **Amount in excess of basis.** If the amount of the distribution exceeds the adjusted basis of the

stock, such excess shall be treated as gain from the sale or exchange of property.

(c) **S corporation having earnings and profits [an S Corp that converted after having been a C Corp**

and still has profits from C Corp years]. In the case of a distribution described in subsection (a) by an S

corporation which has accumulated earnings and profits--

(1) **Accumulated adjustments account.** That portion of the distribution which does not exceed the

accumulated adjustments account shall be treated in the manner provided by subsection (b).

(2) **Dividend.** That portion of the distribution which remains after the application of paragraph (1) shall be

treated as a dividend to the extent it does not exceed the *accumulated earnings and profits* of the S

corporation.

(3) **Treatment of remainder.** Any portion of the distribution remaining after the application of paragraph (2) of this subsection shall be treated in the manner provided by subsection (b)....

§ 1371. Coordination with subchapter C.

(a) Application of subchapter C rules. *Except as otherwise provided in this title*, and except to the extent

inconsistent with this subchapter, *subchapter C shall apply to an S corporation and its shareholders.*

(c) Earnings and profits.

(e) Cash distributions during post-termination transition period.

§ 1372. Partnership rules to apply for fringe benefit purposes.

(a) General rule. For purposes of applying the provisions of this subtitle which relate to employee fringe benefits--

- (1) the S corporation shall be treated as a partnership, and
- (2) any 2-percent shareholder of the S corporation shall be treated as a partner of such partnership.

(b) 2-percent shareholder defined. For purposes of this section, the term "2-percent shareholder" means any person who owns (or is considered as owning within the meaning of section 318) on any day during the taxable year of the S corporation more than 2 percent of the outstanding stock of such corporation or stock possessing more than 2 percent of the total combined voting power of all stock of such corporation.

§ 1374. Tax imposed on certain built-in gains.

(a) General rule. If for any taxable year beginning in the recognition period an S corporation has a net recognized built-in gain there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation for such taxable year.

(b) Amount of tax.

(1) In general. The amount of the tax imposed by subsection (a) shall be computed by applying the *highest rate of tax specified in section 11(b) [the highest C corp tax rate is applied to the entire gain]* to the net recognized built-in gain of the S corporation for the taxable year.

(2) Net operating loss carryforwards from C years allowed.

(c) Limitations.

(1) Corporations which were always S corporations. Subsection (a) shall *not apply* to any corporation if an election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years. Except as provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of the preceding sentence.

(2) Limitation on amount of net recognized built-in gain. The amount of the net recognized built-in gain taken into account under this section for any taxable year shall

not exceed the excess (if any) of--

(A) the net unrealized built-in gain, over

(B) the net recognized built-in gain for prior taxable years beginning in the recognition period.

(d) Definitions and special rules. For purposes of this section--

(1) Net unrealized built-in gain. The term "net unrealized built-in gain" means the amount (if any) by which--

(A) the fair market value of the assets of the S corporation as of the beginning of its 1st taxable year for which an election under section 1362(a) is in effect, exceeds

(B) the aggregate adjusted bases of such assets at such time.

(2) Net recognized built-in gain.

(A) In general. The term "net recognized built-in gain" means, with respect to any taxable year in the recognition period, the lesser of

(i) the amount which would be the taxable income of the S corporation for such taxable year if only recognized built-in gains and recognized built-in losses were taken into account, or

(ii) such corporation's taxable income for such taxable year (determined as provided in section 1375(b)(1)(B)).

(B) Carryover. If, for any taxable year, the amount referred to in clause (i) of subparagraph (A) exceeds the amount referred to in clause (ii) of subparagraph (A), such excess shall be treated as a recognized built-in gain in the succeeding taxable year. The preceding sentence shall apply only in the case of a corporation treated as an S corporation by reason of an election made on or after March 31, 1988.

(3) Recognized built-in gain. The term "recognized built-in gain" means any gain recognized during the recognition period on the disposition of any asset except to the extent that the S corporation establishes that--

(A) such asset was not held by the S corporation as of the beginning of the 1st taxable year for which it was an S corporation, or

(B) such gain exceeds the excess (if any) of--

(i) the fair market value of such asset as of the beginning of such 1st taxable year, over

(ii) the adjusted basis of the asset as of such time.

(4) Recognized built-in losses. The term "recognized built-in loss" means any loss recognized during the recognition period on the disposition of any asset to the extent that the S corporation establishes that--

(A) such asset was held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3), and

(B) such loss does not exceed the excess of

(i) the adjusted basis of such asset as of the beginning of such 1st taxable year, over

(ii) the fair market value of such asset as of such time.

§ 1375. Tax imposed when passive investment income of corporation having accumulated earnings and profits exceeds 25 percent of gross receipts.

(a) General rule. If for the taxable year an S corporation has--

(1) *accumulated earnings and profits* [from C Corp years] *at the close of such taxable*

year, and

(2) gross receipts more than 25 percent of which are passive investment income,

then there is hereby imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in section 11(b).

(b) Definitions. For purposes of this section--

(1) Excess net passive income.

(A) In general. Except as provided in subparagraph (B), the term "excess net passive income" means an amount which bears the same ratio to the net passive income for the taxable year as

(i) the amount by which the passive investment income for the taxable year exceeds 25 percent of the gross receipts for the taxable year, bears to

(ii) the passive investment income for the taxable year.

(B) Limitation. The amount of the excess net passive income for any taxable year shall not exceed the amount of the corporation's taxable income for such taxable year as determined under section 63(a)--

(i) without regard to the deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures), and

(ii) without regard to the deduction under section 172.

§ 1378. Taxable year of S corporation.

(a) **General rule.** For purposes of this subtitle, the taxable year of an S corporation shall be a permitted year.

(b) **Permitted year defined.** For purposes of this section, the term "permitted year" means a taxable year which--

(1) is a year ending December 31, or

(2) is any other accounting period for which the corporation establishes a business purpose to the satisfaction of the Secretary.

For purposes of paragraph (2), any deferral of income to shareholders shall not be treated as a business purpose.