

exchange for interests in partnership DE; and, immediately thereafter, partnership ABCDE will be treated as distributing interests in partnership DE to D and E in liquidation of their interests in partnership ABCDE. Partnership ABCDE then terminates.

(6) *Prescribed form not followed in certain circumstances.* If any transactions described in paragraph (d)(3) of this section are part of a larger series of transactions, and the substance of the larger series of transactions is inconsistent with following the form prescribed in such paragraph, the Commissioner may disregard such form, and may recast the larger series of transactions in accordance with their substance.

(7) *Effective date.* This paragraph (d) is applicable to partnership divisions occurring on or after January 4, 2001. However, a partnership may apply paragraph (d) of this section to partnership divisions occurring on or after January 11, 2000.

**Par. 3.** Section 1.752-1 is amended as follows:

1. A sentence is added to the end of paragraph (f).

2. The current *Example* in paragraph (g) is redesignated as *Example 1*.

3. *Example 2* is added in paragraph (g).

The additions read as follows:

**§ 1.752-1 Treatment of partnership liabilities.**

\* \* \* \* \*

(f) \* \* \* When two or more partnerships merge or consolidate under section 708(b)(2)(A), as described in § 1.708-1(c)(3)(i), increases and decreases in partnership liabilities associated with the merger or consolidation are netted by the partners in the terminating partnership and the resulting partnership to determine the effect of the merger under section 752.

(g) \* \* \*

*Example 1.* \* \* \*

*Example 2. Merger or consolidation of partnerships holding property encumbered by liabilities.* (i) B owns a 70 percent interest in partnership T. Partnership T's sole asset is property X, which is encumbered by a \$900 liability. Partnership T's adjusted basis in property X is \$600, and the value of property X is \$1,000. B's adjusted basis in its partnership T interest is \$420. B also owns a 20 percent interest in partnership S. Partnership S's sole asset is property Y, which is encumbered by a \$100 liability. Partnership S's adjusted basis in property Y is \$200, the value of property Y is \$1,000, and B's adjusted basis in its partnership S interest is \$40.

(ii) Partnership T and partnership S merge under section 708(b)(2)(A). Under section 708(b)(2)(A) and § 1.708-1(c)(1), partnership T is considered terminated and the resulting partnership is considered a continuation of

partnership S. Partnerships T and S undertake the form described in § 1.708-1(c)(3)(i) for the partnership merger. Under § 1.708-1(c)(3)(i), partnership T contributes property X and its \$900 liability to partnership S in exchange for an interest in partnership S. Immediately thereafter, partnership T distributes the interests in partnership S to its partners in liquidation of their interests in partnership T. B owns a 25 percent interest in partnership S after partnership T distributes the interests in partnership S to B.

(iii) Under paragraph (f) of this section, B nets the increases and decreases in its share of partnership liabilities associated with the merger of partnership T and partnership S. Before the merger, B's share of partnership liabilities was \$650 (B had a \$630 share of partnership liabilities in partnership T and a \$20 share of partnership liabilities in partnership S immediately before the merger). B's share of S's partnership liabilities after the merger is \$250 (25 percent of S's total partnership liabilities of \$1,000). Accordingly, B has a \$400 net decrease in its share of S's partnership liabilities. Thus, B is treated as receiving a \$400 distribution from partnership S under section 752(b). Because B's adjusted basis in its partnership S interest before the deemed distribution under section 752(b) is \$460 (\$420 + \$40), B will not recognize gain under section 731. After the merger, B's adjusted basis in its partnership S interest is \$60.

\* \* \* \* \*

**Par. 4.** In § 1.752-5, paragraph (a) is amended by adding two sentences after the third sentence.

**§ 1.752-5 Effective dates and transition rules.**

(a) *In general.* \* \* \* In addition, § 1.752-1(f) last sentence and (g) *Example 2*, do not apply to any liability incurred or assumed by a partnership prior to January 4, 2001. Nevertheless, § 1.752-1(f) last sentence and (g) *Example 2*, may be relied on for any liability incurred or assumed by a partnership prior to January 4, 2001 and, unless the partnership makes an election under paragraph (b)(1) of this section, on or after December 28, 1991, other than a liability incurred or assumed by the partnership pursuant to a written binding contract in effect prior to December 28, 1991 and at all times thereafter. \* \* \*

\* \* \* \* \*

**David A. Mader,**

*Acting Deputy Commissioner of Internal Revenue.*

Approved: December 20, 2000.

**Jonathan Talisman,**

*Acting Assistant Secretary of the Treasury.*

[FR Doc. 01-202 Filed 1-3-01; 8:45 am]

**BILLING CODE 4830-01-P**

**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[TD 8924]

RIN 1545-AY63

**Liabilities Assumed in Certain Corporate Transactions**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Temporary and final regulations.

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

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

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

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

**SUPPLEMENTARY INFORMATION:**

**Background**

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

Section 301(b)(2) of the Internal Revenue Code (Code) provides that in a distribution of property made by a corporation to a shareholder with respect to its stock, the amount of the distribution shall be reduced (but now below zero) by (A) the amount of any liability of the corporation assumed by the shareholder in connection with the distribution and (B) the amount of any liability to which the property was subject immediately before, and after, the distribution. See also § 1.301-1(g) of the regulations.

Section 357 of the Code generally provides rules for the treatment of the assumption of liabilities in connection with transfers of property to which section 351 or 361 of the Code applies.

Prior to the Miscellaneous Trade and Technical Corrections Act of 1999 (the Act), section 357(a) provided that, except as otherwise provided, in such transfers the assumption of the transferor's liability or acquisition of property subject to a liability is not treated as money or other property, *i.e.*, is not treated as boot received by the transferor.

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

#### *B. Enactment of Amendments to Section 357*

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

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

#### *C. Application of Regulatory Authority to Section 301*

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

#### **Explanation of Provisions**

##### *Liabilities Assumed in Connection With Distributions to Shareholders*

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

The Treasury and the IRS intend to propose regulations under sections 357(d) and 301 clarifying the treatment of the subsequent payment of assumed

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

#### **Effective Date**

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

#### **Special Analyses**

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

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

tax laws. Therefore, it would be contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) or subject to the effective date limitation of section 553(d) of title 5 of the United States Code.

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

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

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

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

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

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

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

#### § 1.301-1 Rules applicable with respect to distributions of money and other property.

\* \* \* \* \*

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

\* \* \* \* \*

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

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

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

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

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

(3) *Effective dates*—(i) *In general.* This paragraph (g) applies to distributions occurring after January 4, 2001.

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

Approved: December 20, 2000.

**Robert E. Wenzel,**

*Deputy Commissioner of Internal Revenue.*

**Jonathan Talisman,**

*Acting Assistant Secretary for Tax Policy.*

[FR Doc. 01-200 Filed 1-3-01; 8:45 am]

**BILLING CODE 4830-01-U**

#### DEPARTMENT OF THE TREASURY

#### Internal Revenue Service

#### 26 CFR Part 301

[TD8922]

**RIN 1545-AX00**

#### Awards of Attorney's Fees and Other Costs Based Upon Qualified Offers

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Temporary regulations.

**SUMMARY:** This document contains temporary regulations relating to the circumstances under which a party, by reason of having made a qualified offer, will be entitled to an award of reasonable administrative and litigation costs in a civil tax proceeding brought in a court of the United States (including the Tax Court). The regulations implement certain changes made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998. They affect taxpayers who make qualified offers. The text of these regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section of this issue of the **Federal Register**.

**DATES:** *Effective Dates.* These regulations are effective January 3, 2001.

*Applicability Date:* These regulations apply to qualified offers made in administrative or court proceedings

described in section 7430 after January 3, 2001.

#### FOR FURTHER INFORMATION CONTACT:

Thomas D. Moffitt (202) 622-7900 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

#### Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301) that reflect changes to section 7430 made by section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998 relating to the circumstances under which taxpayers may recover reasonable administrative and litigation costs in a court proceeding with respect to the determination or refund of any tax, interest or penalty when taxpayers have made a qualified offer.

#### Explanation of Provisions

In general, a prevailing party may recover the reasonable administrative and litigation costs incurred in administrative and court proceedings if the proceedings relate to the determination or refund of any tax, interest or penalty under the Internal Revenue Code. The regulations provide information concerning the circumstances under which the making of a qualified offer will result in the taxpayer being a prevailing party for purposes of a recovery of costs. In general, a taxpayer is a prevailing party by reason of making a qualified offer if the taxpayer's liability under the last qualified offer would equal or exceed the amount of the taxpayer's liability (determined without regard to interest) attributable to the adjustments included in the last qualified offer that were actually determined by the court through litigation, plus the amount of any additional adjustments included in the last qualified offer that were determined by settlements entered into after the making of the last qualified offer. Adjustments raised by any party subsequent to the making of the last qualified offer are disregarded in determining the liability of the taxpayer to be compared with the liability under the last qualified offer. These regulations apply in multiple taxpayer situations, such as joint returns, but do not set forth any special rules regarding the aggregation or segregation of the qualified offer or liability in situations that may present special circumstances, such as claims for innocent spouse relief. After study, further guidance may be issued elaborating on the treatment of such situations under these regulations.

To qualify as a prevailing party under this rule, in addition to the above,