

shall be available for reduction under section 108(b)(2).

(d) *Examples.* The following examples illustrate the application of this section:

Example 1. (i) *Facts.* In Year 4, X, a corporation in a title 11 case, is entitled under section 108(a)(1)(A) to exclude from gross income \$100,000 of COD income. For Year 4, X has gross income in the amount of \$50,000. In each of Years 1 and 2, X had no taxable income or loss. In Year 3, X had a net operating loss of \$100,000, the use of which when carried over to Year 4 is not subject to any restrictions other than those of section 172.

(ii) *Analysis.* Pursuant to paragraph (b) of this section, X takes into account the net operating loss carryover from Year 3 in computing its taxable income for Year 4 before any portion of the COD income excluded under section 108(a)(1)(A) is applied to reduce tax attributes. Thus, the amount of the net operating loss carryover that is reduced under section 108(b)(2) and paragraph (a) of this section is \$50,000.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that in Year 4 X sustains a net operating loss in the amount of \$100,000. In addition, in each of Years 2 and 3, X reported taxable income in the amount of \$25,000.

(ii) *Analysis.* Pursuant to paragraph (b) of this section and section 172, the net operating loss sustained in Year 4 is carried back to Years 2 and 3 before any portion of the COD income excluded under section 108(a)(1)(A) is applied to reduce tax attributes. Thus, the amount of the net operating loss that is reduced under section 108(b)(2) and paragraph (a) of this section is \$50,000.

Example 3. (i) *Facts.* In Year 2, X, a corporation in a title 11 case, has outstanding trade debts of \$200,000 and a depreciable asset that has an adjusted basis of \$75,000 and a fair market value of \$100,000. X has no other assets or liabilities. X has a net operating loss of \$80,000 that is carried over to Year 2 but has no general business credit, minimum tax credit, or capital loss carryovers. Under a plan of reorganization, X transfers its asset to Corporation Y in exchange for Y stock with a value of \$100,000. X distributes the Y stock to its trade creditors in exchange for release of their claims against X. X's shareholders receive nothing in the transaction. The transaction qualifies as a reorganization under section 368(a)(1)(G) that satisfies the requirements of section 354(a)(1)(A) and (B). For Year 2, X has gross income of \$10,000 (without regard to any income from the discharge of indebtedness) and is allowed a depreciation deduction of \$10,000 in respect of the asset. In addition, it generates no general business credits.

(ii) *Analysis.* On the distribution of Y stock to X's trade creditors, under section 108(a)(1)(A), X is entitled to exclude from gross income the debt discharge amount of \$100,000. (Under section 108(e)(8), X is treated as satisfying \$100,000 of the debt owed the trade creditors for \$100,000, the fair market value of the Y stock transferred to those creditors.) In Year 2, X has no taxable

income or loss because its gross income is exactly offset by the depreciation deduction. As a result of the depreciation deduction, X's basis in the asset is reduced by \$10,000 to \$65,000. Pursuant to paragraph (c) of this section, the amount of X's net operating loss to which Y succeeds pursuant to section 381 and the basis of X's property transferred to Y must take into account the reductions required by section 108(b). Pursuant to paragraph (a) of this section, X's net operating loss carryover in the amount of \$80,000 is reduced by \$80,000 of the COD income excluded under section 108(a)(1). In addition, X's basis in the asset is reduced by \$20,000, the extent to which the COD income excluded under section 108(a)(1) did not reduce the net operating loss. Accordingly, as a result of the reorganization, there is no net operating loss to which Y succeeds under section 381. Pursuant to section 361, X recognizes no gain or loss on the transfer of its property to Y. Pursuant to section 362(b), Y's basis in the asset acquired from X is \$45,000.

Example 4. (i) *Facts.* The facts are the same as in *Example 3*, except that X elects under section 108(b)(5) to reduce first the basis of its depreciable asset.

(ii) *Analysis.* As in *Example 3*, on the distribution of Y stock to X's trade creditors, under section 108(a)(1)(A), X is entitled to exclude from gross income the debt discharge amount of \$100,000. In addition, in Year 2, X has no taxable income or loss because its gross income is exactly offset by the depreciation deduction. As a result of the depreciation deduction, X's basis in the asset is reduced by \$10,000 to \$65,000. Pursuant to paragraph (c) of this section, the amount of X's net operating loss to which Y succeeds pursuant to section 381 and the basis of X's property transferred to Y must take into account the reductions required by section 108(b). As a result of the election under section 108(b)(5), X's basis in the asset is reduced by \$65,000 to \$0. In addition, X's net operating loss is reduced by \$35,000, the extent to which the amount excluded from income under section 108(a)(1)(A) does not reduce X's asset basis. Accordingly, as a result of the reorganization, Y succeeds to X's net operating loss in the amount of \$45,000 under section 381. Pursuant to section 361, X recognizes no gain or loss on the transfer of its property to Y. Pursuant to section 362(b), Y's basis in the asset acquired from X is \$0.

(e) *Effective date.* This section applies to discharges of indebtedness occurring after July 17, 2003.

■ **Par. 3.** Section 1.1017-1 is amended by adding paragraph (b)(4) to read as follows:

§ 1.1017-1 Basis reductions following a discharge of indebtedness.

* * * * *

(b) * * *

(4) For further guidance, *see* § 1.1017-1T(b)(4).

* * * * *

■ **Par. 4.** Section 1.1017-1T is added to read as follows:

§ 1.1017-1T Basis reductions following a discharge of indebtedness (temporary).

(a) Through (b)(3) [Reserved]. For further guidance, *see* § 1.1017-1(a) through (b)(3).

(4) *Transactions to which section 381 applies.* In the case of a transaction described in section 381(a) that ends a taxable year in which the distributor or transferor corporation excludes COD income from gross income under section 108(a), the basis of property acquired by the acquiring corporation in the transaction shall reflect the reductions required by section 1017 and this section. For this purpose, the basis of property of the distributor or transferor corporation immediately prior to the transaction described in section 381(a), but after the determination of tax for the year of the discharge, shall be available for reduction under section 108(b)(2). *See* § 1.108-7T. This paragraph (b)(4) applies to discharges of indebtedness occurring after July 17, 2003.

(c) Through (i) [Reserved]. For further guidance, *see* § 1.1017-1(c) through (i).

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

Approved: July 9, 2003.

Pamela F. Olson,

Assistant Secretary of the Treasury.

[FR Doc. 03-18145 Filed 7-17-03; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 20 and 25

[TD 9077]

RIN 1545-AY91

Net Gift Treatment Under Section 2519

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating both to the amount treated as a transfer under section 2519 of the Internal Revenue Code when there is a right to recover gift tax under section 2207A(b) and to the related gift and estate tax consequences if the right to recover the gift tax is not exercised. The final regulations will affect donee spouses who make lifetime dispositions of all or part of a qualifying income interest in qualified terminable interest property.

EFFECTIVE DATE: These regulations are effective July 18, 2003.

FOR FURTHER INFORMATION CONTACT:
DeAnn K. Malone, (202) 622-7830 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On July 22, 2002, the IRS and the Treasury Department published in the **Federal Register** (67 FR 47755) a notice of proposed rulemaking (REG-123345-01) relating to the amount treated as a transfer under section 2519 of the Internal Revenue Code when there is a right to recover gift tax under section 2207A(b) and the related gift tax consequences if the right to recover the gift tax is not exercised. Written comments responding to the notice were received. No public hearing was requested or held. This document adopts final regulations with respect to the notice of proposed rulemaking. The principal comments received and revisions in response to those comments are discussed below.

Explanation of Provisions

Under the proposed regulations, any delay in the exercise of the right of recovery was treated as an interest-free loan with the resulting Federal tax consequences. One commentator suggested that the regulations be revised to provide a thirty-day safe harbor to ease the administrative burden to taxpayers and to avoid complex loan calculations. Accordingly, the commentator suggested that section 7872 would not apply if the transferor received reimbursement of the amount of gift tax within thirty days after paying the tax.

Whether a transaction involves a below-market loan subject to section 7872 depends on all the facts and circumstances of the particular case. Section 1.7872-5T(b)(14) of the Temporary Income Tax Regulations exempts from the application of section 7872 loans the interest arrangements of which the taxpayer is able to show have no significant effect on any Federal tax liability of the lender or the borrower, as described in § 1.7872-5T(c)(3). Section 1.7872-5T(c)(3) provides that whether a loan is without significant effect is determined according to all of the facts and circumstances. Among the factors to be considered are: (1) Whether items of income and deduction generated by the loan offset each other; (2) the amount of such items; (3) the cost to the taxpayer of complying with the provisions of section 7872 if the section were applied; and (4) any non-tax reasons for deciding to structure the transaction as a below-market loan rather than a loan with interest at a rate equal to or greater than the applicable

Federal rate and a payment by the lender to the borrower. The Treasury Department and the IRS believe that, in most cases, a reasonable delay in the exercise of the right of recovery will result in a loan without significant tax effect under the facts and circumstances test in § 1.7872-5T(c)(3). Accordingly, these final regulations do not create an additional safe harbor for a payment received within thirty days of payment of the tax.

The final regulations have been revised to more completely describe the interrelation of section 2207A and section 7872. Specifically, the final regulations provide that a delay in the exercise of the right of recovery (that is, the request for and receipt of the amount of the tax) will be treated as a below-market loan if the loan does not provide for the payment of sufficient interest. Depending on the facts and circumstances as described in § 1.7872-5T(c)(3), a loan arising from the delay may be a loan exempt from the application of section 7872 because it is a loan the interest arrangements of which do not have a significant effect on any Federal tax liability of the lender or the borrower. The estate tax regulations under section 2207A are revised to be consistent with the gift tax regulations.

In response to a comment, the final regulations clarify that the enforceability of the right of recovery is determined under applicable law.

Commentators requested simplification of the method of determining when a right to recovery is no longer enforceable. One commentator suggested adopting a three-year period for determining whether or not the right of recovery is enforceable, and thus whether the gift is complete for gift tax purposes if the right of recovery is not exercised. The final regulations instead provide that the transferor may waive the right of recovery thus causing the gift from the transferor to the donee to be complete upon the later of the date of the waiver or the date of the payment of the Federal gift tax. The Treasury Department and the IRS believe that the waiver allows for the certainty requested by the commentators, and is more efficient for a taxpayer who will not exercise the right of recovery because the gift of the unrecovered tax can be completed simultaneously with the lifetime disposition of the qualifying income interest.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It

also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the proposed regulations preceding this final rule were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is DeAnn K. Malone, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 20

Estate taxes, Reporting and recordkeeping requirements.

26 CFR Part 25

Gift taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 20 and 25 are amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

■ **Paragraph 1.** The authority citation for part 20 continues to read in part as follows:

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

■ **Par. 2.** Section 20.2207A-1 is amended by removing the last two sentences of paragraph (a)(2) and adding three new sentences in their place to read as follows:

§ 20.2207A-1 Right of recovery of estate taxes in the case of certain marital deduction property.

(a) * * *

(2) * * * The transfer is considered made when the right of recovery is no longer enforceable under applicable law. A delay in the exercise of the right of recovery without payment of sufficient interest is a below-market loan. Section 1.7872-5T of the Temporary Income Tax regulations describes factors that are used to determine, based on the facts and circumstances of a particular case, whether a loan otherwise subject to

imputation under section 7872 (relating to the treatment of below-market loans) is exempted from its provisions.

* * * * *

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

■ **Par. 3.** The authority citation for part 25 continues to read in part as follows:

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

■ **Par. 4.** Section 25.2207A-1 is amended by adding the text of paragraph (b) to read as follows:

§ 25.2207A-1 Right of recovery of gift taxes in the case of certain marital deduction property.

* * * * *

(b) *Failure of a person to exercise the right of recovery.* (1) The failure of a person to exercise a right of recovery provided by section 2207A(b) upon a lifetime transfer subject to section 2519 is treated as a transfer for Federal gift tax purposes of the unrecovered amounts to the person(s) from whom the recovery could have been obtained. *See* § 25.2511-1. The transfer is considered to be made when the right to recovery is no longer enforceable under applicable law and is treated as a gift even if recovery is impossible. A delay in the exercise of the right of recovery without payment of sufficient interest is a below-market loan. Section 1.7872-5T of this chapter describes factors that are used to determine, based on the facts and circumstances of a particular case, whether a loan otherwise subject to imputation under section 7872 (relating to the treatment of below-market loans) is exempted from its provisions.

(2) The transferor subject to section 2519 may execute a written waiver of the right of recovery arising under section 2207A before that right of recovery becomes unenforceable. If a waiver is executed, the transfer of the unrecovered amounts by the transferor is considered to be made on the later of—

(i) The date of the valid and irrevocable waiver rendering the right of recovery no longer enforceable; or

(ii) The date of the payment of the tax by the transferor.

* * * * *

■ **Par. 5.** Section 25.2519-1 is amended as follows:

■ 1. Paragraph (c)(1) is amended by adding a sentence to the end of the paragraph.

■ 2. The paragraph heading for paragraph (c)(4) is revised and the text of paragraph (c)(4) is added.

■ 3. Paragraph (g) introductory text is revised.

The additions and revisions read as follows:

§ 25.2519-1 Dispositions of certain life estates.

* * * * *

(c) * * * (1) * * * See paragraph (c)(4) of this section for the effect of gift tax that the donee spouse is entitled to recover under section 2207A.

* * * * *

(4) *Effect of gift tax entitled to be recovered under section 2207A on the amount of the transfer.* The amount treated as a transfer under paragraph (c)(1) of this section is further reduced by the amount the donee spouse is entitled to recover under section 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). If the donee spouse is entitled to recover gift tax under section 2207A(b), the amount of gift tax recoverable and the value of the remainder interest treated as transferred under section 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

* * * * *

(g) *Examples.* The following examples illustrate the application of paragraphs (a) through (f) of this section. Except as provided otherwise in the examples, assume that the decedent, D, was survived by spouse, S, that in each example the section 2503(b) exclusion has already been fully utilized for each year with respect to the donee in question, that section 2503(e) is not applicable to the amount deemed transferred, and that the gift taxes on the amount treated as transferred under paragraph (c) are offset by S's unified credit. The examples are as follows:

* * * * *

Robert E. Wenzel,

Deputy Commissioner for Services and Enforcement.

Approved: July 9, 2003.

Pamela F. Olson,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 03-18018 Filed 7-17-03; 8:45 am]

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Parts 2, 26, 62, 64, 95, 100, 120, and 165

46 CFR Parts 7 and 28

[USCG-2001-9044]

RIN 1625-AA30

Territorial Seas, Navigable Waters, and Jurisdiction

AGENCY: Coast Guard, DHS.

ACTION: Final rule.

SUMMARY: This rule conforms the Coast Guard's definitions of jurisdictional terms to existing law. We have made these changes so that our regulatory definitions will reflect statutory changes and Presidential proclamations affecting our jurisdiction. These changes are intended to clarify how the Coast Guard interprets its jurisdiction to enforce treaties, laws, and regulations of the United States.

DATES: This final rule is effective August 18, 2003.

ADDRESSES: Comments and material received from the public, as well as documents mentioned in this preamble as being available in the docket, are part of docket USCG-2001-9044 and are available for inspection or copying at the Docket Management Facility, U.S. Department of Transportation, room PL-401, 400 Seventh Street, SW., Washington, DC, between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. You may also find this docket on the Internet at <http://dms.dot.gov>.

FOR FURTHER INFORMATION CONTACT: If you have questions on this rule, call Alex Weller, Office of Maritime and International Law, U.S. Coast Guard, telephone 202-267-0097. If you have questions on viewing the docket, call Dorothy Beard, Chief, Dockets, Department of Transportation, telephone 202-366-5149.

SUPPLEMENTARY INFORMATION:

Regulatory History

On October 22, 1975, we published a rule in the **Federal Register** entitled "Jurisdiction and Navigable Waters" that established general duties and jurisdiction regulations in part 2 of Title 33 of the Code of Federal Regulations (33 CFR part 2) (40 FR 49326). Most of those regulations have not changed since 1975.

In an effort to conform the Coast Guard's definitions of jurisdictional