

transferee of any asset subject to such liability. Section 357(d)(2), however, reduces the amount of nonrecourse liability treated as assumed pursuant to section 357(d)(1)(B) by the lesser of (1) the amount of such liability that the owner of assets not transferred to the transferee and also subject to such liability has agreed, and is expected, to satisfy or (2) the fair market value of such other assets (determined without regard to section 7701(g)). Section 357(d)(3) directs the Secretary to prescribe such regulations as may be necessary to carry out the purposes of sections 357(d) and 362(d), and to prescribe regulations providing that the manner in which a liability is treated as assumed under section 357(d) is applied, where appropriate, elsewhere in the Code. The rules of section 357(d) apply to determine the amount of liability treated as assumed for purposes of not only those Code provisions listed in section 357(d), but also certain other Code provisions, including sections 584 and 1031.

Section 362(d)(1) provides that in no event will the basis of any property be increased under section 362(a) or (b) above the fair market value of such property (determined without regard to section 7701(g)) by reason of any gain recognized to the transferor as a result of the assumption of a liability. Section 362(d)(2) provides that, except as provided in regulations, if gain is recognized to the transferor as a result of an assumption of a nonrecourse liability by a transferee which is also secured by assets not transferred to such transferee and no person is subject to tax under the Code on such gain, then, for purposes of determining basis under section 362(a) and (b), the amount of gain recognized by the transferor as a result of the assumption of the liability will be determined as if the liability assumed by the transferee equaled such transferee's ratable portion of such liability determined on the basis of the relative fair market values (determined without regard to section 7701(g)) of all of the assets subject to such liability.

Special Analyses

It has been determined that this advance notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

Request for Comments

The IRS and Treasury have been studying these and other rules governing the amount of a liability a transferee of property is treated as assuming in connection with a transfer

of property. The IRS and Treasury are concerned that some of these rules do not always produce appropriate results and that it might be desirable to modify certain rules by regulation. The following sections describe and explain the issues the IRS and Treasury are studying in this regard. In addition, they describe and explain the rules the IRS and Treasury are considering proposing in a notice of proposed rulemaking.

A. Assumptions of Nonrecourse Liabilities Generally

Section 357(d) sets forth one set of criteria that is applied to determine whether a transferee is treated as assuming a recourse liability and a different set of criteria that is applied to determine whether a transferee is treated as assuming a nonrecourse liability. The statute's distinction between the assumption of recourse and nonrecourse liabilities appears to be based on the premise that in the case of recourse liabilities, the parties' agreement and expectation regarding the satisfaction of the liability is a reliable predictor of which party will bear the burden of the liability. In the case of nonrecourse liabilities, the statute presumes that the transferee of assets subject to the liability assumes the entire liability. That amount, however, is reduced by the amount that an owner of other assets subject to that liability has agreed, and is expected, to satisfy, but only up to the amount of the fair market value of the assets that are subject to such liability that are owned by such other owner.

Section 357(d)(1)(B) is consistent with the principles of *Crane v. Commissioner*, 331 U.S. 1 (1947), and *Tufts v. Commissioner*, 461 U.S. 300 (1983). Section 357(d)(2) is consistent with the principle that a party other than the transferee will be responsible for the satisfaction of a nonrecourse liability only to the extent of the fair market value of the property that it owns that is subject to that liability.

The rules that apply to nonrecourse liabilities raise a number of issues that the IRS and Treasury are considering. First, the IRS and Treasury are considering whether the presumption that a transferee of assets subject to a nonrecourse liability is treated as assuming the entire nonrecourse liability absent an agreement is appropriate. Second, the IRS and Treasury are considering whether agreements between the transferor and the transferee regarding the satisfaction of nonrecourse liabilities, other than the agreements described in section 357(d)(2), should be respected. Finally, the IRS and Treasury are considering

whether the rules regarding the amount of a nonrecourse liability treated as assumed by a transferee should be based solely on the agreement of the parties and their expectations as to which party will satisfy the nonrecourse liability. Central to these last two issues is the question of whether the rules that apply to assumptions of nonrecourse liabilities should more closely conform to those that apply to assumptions of recourse liabilities. The following sections describe these issues more fully.

1. Amount of Nonrecourse Liability Assumed Absent an Agreement

As described above, pursuant to section 357(d)(1)(B), where some (but not all) of the assets that secure a nonrecourse liability are transferred to a transferee, and the owner of other assets that are subject to such liability does not agree, or agrees but is not expected, to satisfy any of the liability, the transferee is treated as assuming the entire amount of the liability. For example, suppose P owns Asset A, with a basis of \$0 and a value of \$100, and Asset B, with a basis of \$0 and a value of \$400, both of which secure a nonrecourse liability in the amount of \$500. P also owns Asset C with a basis of \$0 and a value of \$500. P transfers Asset A and Asset C to S, a newly formed corporation, in exchange for 100 percent of the stock of S in a transfer to which section 351 applies. P and S have no agreement regarding the satisfaction of the nonrecourse liability to which Asset A and Asset B are subject. Pursuant to section 357(d)(1)(B), S is treated as assuming the entire nonrecourse liability. As a result, P recognizes gain in the amount of \$500 pursuant to section 357(c).

The IRS and Treasury are concerned that treating S as assuming the entire \$500 of the nonrecourse liability in this case does not reflect the underlying economics of the transfer of property. That is, suppose P defaults on the nonrecourse liability and the lender moves to foreclose on Asset A. Absent compensation from P, S may have no incentive to satisfy more than \$100 of the nonrecourse liability (either by surrendering Asset A to the lender or by paying the lender \$100 in exchange for the release of Asset A from the liability). To address these cases, the IRS and Treasury are considering adopting a rule that would modify the rule of section 357(d)(1)(B) such that, in certain cases where the transferor and the transferee have no agreement regarding the satisfaction of a nonrecourse liability, the transferee will not be treated as assuming the entire amount of the nonrecourse liability. A proposed rule might provide that if one or more of the