

assets that secure a nonrecourse liability are transferred to a transferee, then the transferee would be treated as assuming a *pro rata* amount of such nonrecourse liability that is a liability of the transferor, determined on the basis of the fair market value of those assets that secure the liability that are transferred to the transferee as compared to the total fair market value of all of the assets that secure the liability that are owned by the transferor immediately before the transfer. The IRS and Treasury invite comments regarding whether the rule of section 357(d)(1)(B) should be modified by regulation and whether the rule described above should be proposed.

## 2. Agreements to Satisfy Nonrecourse Liabilities

### a. Agreement by the Transferee Regarding Satisfaction of a Nonrecourse Liability in the Absence of a Transfer of Assets Subject to That Liability

Section 357(d) contemplates that a transferee may be treated as assuming all or a portion of a nonrecourse liability only if assets that are subject to such nonrecourse liability are transferred to it. 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. Asset A is subject to a nonrecourse liability in the amount of \$50. P transfers Asset B to S, a newly formed corporation, in exchange for 100 percent of the stock of S and S's agreement with P to satisfy the nonrecourse liability to which Asset A is subject. For purposes of section 357(d), it appears that S is not treated as assuming the \$50 nonrecourse liability.

The IRS and Treasury are concerned that there may not be a sufficient distinction between recourse and nonrecourse liabilities to warrant treating a transferee as assuming a nonrecourse liability for purposes of section 357(d) only if assets subject to that liability are transferred to it. Accordingly, the IRS and Treasury are considering whether a transferee that agrees, and is expected, to satisfy all or a portion of a nonrecourse liability should be treated as assuming the nonrecourse liability to the extent of such agreement, even if no assets that are subject to such liability are transferred to the transferee. The IRS and Treasury request comments on this matter.

### b. Effect of Agreement by Owner of Nontransferred Property

As described above, pursuant to section 357(d)(2), the amount of the nonrecourse liability that is treated as

assumed pursuant to section 357(d)(1)(B) by a transferee of assets subject to the nonrecourse liability is reduced by the lesser of (i) the amount of such liability that the owner of other assets that are subject to such liability but not transferred to the transferee has agreed, and is expected, to satisfy or (ii) the fair market value of such other assets (determined without regard to section 7701(g)). In certain circumstances, the limitation of section 357(d)(2) effectively permits the amount of the nonrecourse liability treated as assumed by the transferee to be reduced only to the extent of the value of other assets subject to the nonrecourse liability, even where the owner of such assets agrees, and is expected, to satisfy an amount of the liability in excess of such value.

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 \$250. P also has \$600 in cash. P transfers Asset B 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 agrees with S, and is expected, to satisfy the entire \$250 nonrecourse liability. Pursuant to section 357(d)(1)(B), S is treated as assuming the entire \$250 of the nonrecourse liability. Pursuant to section 357(d)(2), however, this amount is reduced by \$100, the lesser of the amount of the liability that P has agreed, and is expected, to satisfy (\$250) and the fair market value of Asset A (\$100). Accordingly, S is treated as assuming \$150 of the nonrecourse liability and P recognizes gain in the amount of \$150 pursuant to section 357(c). In this case, given that P is expected to satisfy the entire \$250 of the nonrecourse liability, the IRS and Treasury are considering whether it is appropriate to treat S as assuming no amount of the nonrecourse liability. In particular, the IRS and Treasury are considering proposing a rule that modifies the rule in section 357(d)(2) such that the amount of the nonrecourse liability a transferee is treated as assuming is reduced to reflect the amount another person has agreed, and is expected, to satisfy, even if such amount is in excess of the fair market value of the assets subject to such liability that such person owns immediately after the transfer. The IRS and Treasury, however, are concerned regarding whether such a rule is appropriate where the nonrecourse liability exceeds the value of the assets securing it.

## B. Subsequent Transfers of Property Subject to Nonrecourse Liabilities

A transferee of property is treated as assuming all or a portion of a recourse liability if it has agreed, and is expected, to satisfy that liability (or portion). That treatment is not conditioned on any arrangement between the transferee and the original lender; it can be based entirely on an arrangement between the transferor and transferee of the property. The implicit premise underlying this treatment is that the transferee's agreement to be personally liable to the transferor is equivalent to the transferor's agreement to be personally liable to the original lender. This recourse justifies treating the transferee as having assumed the recourse liability. (Conversely, the transferee of property securing a recourse liability will not be treated as assuming the liability without an agreement.)

As described above, the IRS and Treasury are considering applying standards similar to those that apply for purposes of determining whether a transferee of property has assumed a recourse liability to determine whether a transferee of property has assumed a nonrecourse liability where the transferee agrees to satisfy all or a portion of the liability. Such an agreement might create the same level of recourse against the transferee as would an agreement to assume an actual recourse liability. In that case, if property securing the debt is transferred again, the IRS and Treasury are considering whether the amount treated as assumed by the subsequent transferee should be determined with reference to the rules for nonrecourse liabilities (because the original lender's rights continue to be nonrecourse) or for recourse liabilities (because the first transferee agreed, and was expected, to satisfy the liability).

For example, suppose P owns Asset A, with a value of \$50, and Asset B, with a value of \$100, both of which secure a nonrecourse liability in the amount of \$100. In Year 1, P transfers Asset A to S1, a newly formed corporation, in exchange for 100 percent of the stock of S1 in a transfer to which section 351 applies. S1 agrees with P, and is expected, to satisfy \$20 of the nonrecourse liability. In addition, P agrees to indemnify S1 to the extent that it has losses in excess of \$20 that are attributable to the nonrecourse liability. In Year 2, S1 transfers Asset A to S2, a newly formed corporation, in exchange for 100 percent of the stock of S2 in a transfer to which section 351 applies. S1 and S2 have no agreement regarding the