

satisfaction of the nonrecourse liability to which Asset A is subject.

The IRS and Treasury are considering two alternatives for determining the amount of liability S2 is treated as assuming upon the subsequent transfer of Asset A following S1's agreement with P regarding the satisfaction of the liability. Under the first alternative, the \$20 of the nonrecourse liability assumed by S1 would be treated as though it were a recourse liability of S1, and thus S2 would be treated as assuming no portion of the liability in accordance with section 357(d)(1)(A). Under the second alternative, the \$20 of the nonrecourse liability assumed by S1 would be treated as a nonrecourse liability of S1, and thus S2 would be treated as assuming \$20 of the liability in accordance with section 357(d)(1)(B). The IRS and Treasury request comments regarding whether the amount of liability (if any) assumed by S2 should be determined with reference to the rules pertaining to assumptions of nonrecourse liabilities or, given S1's agreement with P regarding the satisfaction of the liability, with reference to the rules pertaining to assumptions of recourse liabilities.

The IRS and Treasury also request comments regarding the subsequent treatment of nonrecourse liabilities that are treated as assumed by a transferee where the transferee has not agreed to assume any portion of the nonrecourse liability but rather is treated as assuming all or a portion of the nonrecourse liability pursuant to section 357(d)(1)(B) or a substitute rule that is adopted by regulation.

C. Identifying the Amount of the Agreement

1. Transferee at Risk in Excess of Amount It Agreed To Satisfy

The IRS and Treasury are concerned that, where the transferee has agreed to satisfy an amount of a nonrecourse liability that is less than the lesser of (i) the total amount of the nonrecourse liability that is a liability of the transferor, or (ii) the fair market value of the assets that are subject to the nonrecourse liability that are owned by such transferee immediately after the transfer, that agreement may not reflect the amount that the transferee is expected to satisfy, particularly where neither the transferor nor another person has agreed to protect the transferee from liability for any amount of the liability in excess of the amount it has agreed to satisfy. 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 transfers Asset A to S, a newly formed corporation, in exchange for 100 percent of the stock of S in a transfer to which section 351 applies. S agrees with P to satisfy \$80 of the nonrecourse liability but S's agreement with P does not give S the right to seek indemnification from P in the event that S is required to satisfy more than \$80 of the liability. Accordingly, if the lender of the nonrecourse liability forecloses on Asset A immediately after the transfer, S will satisfy \$100 rather than \$80 of the nonrecourse liability.

The IRS and Treasury request comments as to the proper approach to address this situation. One possible approach might be to respect the transferee's agreement to the extent of \$80 and to treat the transferee as assuming the additional amount of the liability, if any, that it is expected to satisfy based on the facts and circumstances. Another possible approach is to treat the transferor and the transferee as having no agreement regarding the extent to which the transferee will satisfy the liability.

2. Agreement To Satisfy in Excess of Satisfaction Expectations

The IRS and Treasury recognize that, in certain cases, a transferee may agree to satisfy an amount of a nonrecourse liability that is greater than the amount of such liability that it, in fact, is expected to satisfy. For example, a transferor of assets subject to a nonrecourse liability may require more than one transferee to agree to satisfy the same liability so as to ensure that the transferor ultimately will not incur any loss resulting from the liability. Nonetheless, as described above, the legislative history of section 357 reflects that Congress intended that where more than one person agrees to satisfy a liability or portion thereof, only one would be treated as expected to satisfy the liability or portion thereof. The IRS and Treasury are considering proposing a rule that would provide that, if the transferee has agreed to satisfy an amount of a liability that is greater than the amount that it is expected to satisfy, the transferee will be treated as having agreed to satisfy the amount of such liability that it is expected to satisfy, provided that the transferor, the transferee, and each person related to the transferor and transferee within the meaning of sections 267(b) and 707(b) treat the transferee as having agreed to satisfy the amount of the liability that it is expected to satisfy. If this condition were not satisfied, the transferor and the transferee might be treated as having no

agreement regarding the extent to which the transferee will satisfy the liability.

D. Accounting for Liabilities

In furtherance of the legislative intent that all or a portion of a liability be treated as a liability of only one person, the IRS and Treasury are considering proposing two rules. The first rule would provide that the amount of a liability treated as assumed by a transferee from a transferor will not thereafter be treated as a liability of the transferor. The second rule would provide that a transferee may not be treated as assuming from a transferor an amount of liabilities greater than the amount of the liabilities of the transferor. The following example illustrates the operation of these two rules.

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 \$400. P also has \$600 in cash. 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. P agrees, and is expected, to satisfy \$350 of the nonrecourse liability and agrees to indemnify S1 to the extent that it has losses in excess of \$50 that are attributable to the nonrecourse liability. In Year 2, P transfers Asset B to S2, a newly formed corporation, in exchange for 100 percent of the stock of S2 in a transfer to which section 351 applies. At that time, Asset A and Asset B are subject to the nonrecourse liability and the amount of the nonrecourse liability remains \$400. P and S2 have no agreement regarding the satisfaction of the nonrecourse liability. Assume that the presumption of section 357(d)(1)(B) that the transferee assumes the entire nonrecourse liability to which the property received is subject is not modified by regulation.

Pursuant to section 357(d)(1)(B), S1 would be treated as assuming the entire \$400 of the nonrecourse liability. That amount, however, would be reduced by \$350 to \$50 pursuant to section 357(d)(2). Pursuant to the first rule described above, immediately after the Year 1 transfer to S1, \$50 of the nonrecourse liability would no longer be treated as a liability of P as a result of S1's assumption of that amount. Pursuant to the second rule described above, even though Asset B may be subject to the \$400 nonrecourse liability for purposes of state law, S2 cannot be treated as assuming more than \$350 of the nonrecourse liability, the amount of the nonrecourse liability that is treated