

are to be reduced, shall be determined under regulations.

The Reorganization Rules

Section 368(a)(1) defines a reorganization to include certain types of asset acquisitions. Under section 361, a corporation that is a party to a reorganization recognizes neither gain nor loss when it exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation that is a party to the reorganization. If the corporation receives in the exchange not only stock or securities permitted to be received without the recognition of gain, but also other property or money, then the corporation may be required to recognize gain. Under section 362(b), if property is acquired by a corporation in connection with a reorganization, then the basis is the same as it would be in the hands of the transferor, increased by the amount of gain recognized to the transferor on such transfer.

Section 332(a) provides that a corporation recognizes no gain or loss on the receipt of property distributed in complete liquidation of another corporation. Section 337(a) provides that a liquidating corporation recognizes no gain or loss on the distribution to the 80-percent distributee of any property in a complete liquidation to which section 332 applies. Under section 334(b)(1), if property is received by a corporate distributee in a distribution in a complete liquidation to which section 332 applies, the basis of such property in the hands of such distributee is the same as it would be in the hands of the transferor. However, in any case in which gain or loss is recognized by the liquidating corporation with respect to such property, the basis of such property in the hands of such distributee is the fair market value of the property at the time of the distribution.

Section 381 provides that a corporation that acquires the assets of another corporation in a distribution to which section 332 applies or in a transfer to which section 361 applies (but only if the transfer is in connection with certain reorganizations described in sections 368(a)(1)(A), (C), (D), (F), or (G)) shall succeed to, and take into account, as of the close of the day of distribution or transfer, the items described in section 381(c) of the distributor or transferor corporation, subject to certain conditions and limitations. Among those items described in section 381(c) are net operating loss carryovers, capital loss carryovers, general business credits, and minimum tax credits. With respect to net operating loss carryovers and capital

loss carryovers, the regulations under section 381 reflect that the acquiring corporation succeeds to only those carryovers that remain after the application of sections 172 and 1212 and their carryforward and carryback provisions. See §§ 1.381(c)(1)–1; 1.381(c)(3)–1. Furthermore, those regulations provide that the acquiring corporation succeeds to only those general business credits that remain unused by the transferor corporation after computing its taxable income for the year of the transfer. See § 1.381(c)(23)–1. Section 381(b)(1) provides that, except in the case of an acquisition in connection with a reorganization described in section 368(a)(1)(F), the taxable year of the distributor or transferor corporation ends on the date of distribution or transfer.

Interaction Between Debt Discharge and Reorganization Rules

Questions have arisen regarding the application of the attribute reduction rules of sections 108 and 1017 when a transaction described in section 381(a) ends a taxable year in which the transferor excludes COD income from gross income. If section 108(b)(4)(A) and section 1017 were interpreted to require attribute reduction to occur after the close of the taxable year of discharge and after the transfer of assets and carryover of items described in section 381(c), then arguably no attributes described in section 108(b)(2) would be available for reduction.

Explanation of Provisions

The IRS and Treasury Department believe that the rule of section 108(b)(4)(A) prescribes an ordering of calculations. First, section 108(b)(4)(A) requires a determination of the taxpayer's tax for the taxable year of discharge in order to identify the amounts, if any, of the tax attributes described in section 108(b)(2) that remain available for reduction. Second, section 108(b)(4)(A) requires the reduction of those attributes. This ordering rule affords the taxpayer the use of certain of its tax attributes described in section 108(b)(2), including any losses carried forward to the taxable year of discharge, for purposes of determining its tax for the taxable year of discharge, before subjecting those attributes to reduction.

Similarly, the IRS and Treasury believe that the rule of section 1017 prescribes an ordering of calculations. The Bankruptcy Tax Act of 1980 reflects that Congress enacted the rule of section 1017 “to avoid interaction between basis reduction and reduction of other

attributes.” S. Rep. No. 96–1035, at 14 (1980); H. Rep. No. 96–833, at 11 (1980). Without this rule, a circular calculation could be required. The taxpayer's net operating loss for the year of the discharge of indebtedness might be based in part on the amount of cost recovery deductions allowed to the taxpayer. The amount of cost recovery deductions, however, would depend on the taxpayer's basis in its depreciable or amortizable property at the end of the year. Because net operating losses are reduced by excluded COD income prior to the reduction of asset basis absent an election under section 108(b)(5), the amount of basis required to be reduced would depend on the amount of net operating losses. Reducing the basis of property held by the taxpayer at the beginning of the taxable year following the taxable year in which the discharge occurs avoids this circularity.

The position that sections 108 and 1017 require the reduction of attributes, including the basis of transferred assets, in cases where the debtor's taxable year ends with a transfer of assets in a transaction described in section 381 is consistent with the policies underlying sections 108 and 1017 and the corporate reorganization provisions, including “deferring, but eventually collecting within a reasonable period, tax on ordinary income realized from debt discharge.” S. Rep. No. 96–1035, at 10 (1980). For example, assume that a debt of corporation X is discharged in a title 11 case. X's attributes described in section 108(b)(2) consist solely of basis in property. As part of a plan of reorganization, X transfers all of its assets to a newly formed corporation, Y. Under section 368(a)(3)(C), even though the transaction also qualifies as a reorganization under section 368(a)(1)(F), the transaction is treated as qualifying as a reorganization only under section 368(a)(1)(G). If sections 108 and 1017 were interpreted to not require a reduction of the bases of the property transferred, X would permanently exclude from gross income the COD income, notwithstanding that X underwent nothing more than a mere change in identity, form, or place of organization. Accordingly, consistent with the legislative history of the Bankruptcy Tax Act of 1980, the IRS and Treasury Department believe that the basis reduction rules of sections 108 and 1017 apply to property of a debtor transferred in a transaction described in section 381(a).

The legislative history of the Bankruptcy Tax Act of 1980 reflects that Congress specifically anticipated that amounts that carry over in a transaction described in section 381, including the