

basis of transferred property, are to be adjusted under the rules of sections 108 and 1017 to account for excluded COD income. *See* H.R. Rep. No. 96-833, at 32-34 (1980). The legislative history states:

Assume that Corporation A is in a bankruptcy case commenced after October 1, 1979. Immediately prior to a transfer under a plan of reorganization, A's assets have an adjusted basis of \$75,000 and a fair market value of \$100,000. A has a net operating loss carryover of \$200,000. A has outstanding bonds of \$100,000 (on which there is no accrued but unpaid interest) and trade debts of \$100,000.

Under the plan of reorganization, A is to transfer all its assets to Corporation B in exchange for \$100,000 of B stock. Corporation A will distribute the stock, in exchange for their claims against A, one-half to the security holders and one-half to the trade creditors. A's shareholders will receive nothing.

The transaction would qualify as a reorganization under new section 368(a)(1)(G) of the Code, since all the creditors are here treated as proprietors for continuity of interest purposes. Thus, A would recognize no gain or loss on the transfer of its assets to B (sec. 361). B's basis in the assets would be \$75,000 (sec. 362), and B would succeed to A's net operating loss carryover (sec. 381).

Under the bill, * * * [o]n the distribution of B stock to A's trade creditors, A excludes from gross income the debt discharge amount of \$50,000—i.e., the difference between the \$100,000 debt held by non-security creditors and the \$50,000 worth of stock given for such debt. A may elect to reduce the basis of its depreciable assets transferred to B by all or part of the \$50,000 debt discharge amount; to the extent the election is not made, the debt discharge amount reduces A's net operating loss carryover by the remainder of the debt discharge amount.

H.R. Rep. No. 96-833, at 34 (1980). The treatment of the net operating loss and basis in the legislative history demonstrates that, in a transaction described in section 381, the transferor's attributes, including the basis of transferred property, that carry over to the transferee are reduced.

Accordingly, these temporary regulations clarify that, in the case of a transaction described in section 381(a) that ends a year in which the distributor or transferor corporation excludes COD income from gross income under section 108(a), any tax attributes to which the acquiring corporation succeeds and the basis of property acquired by the acquiring corporation in the transaction shall reflect the reductions required by sections 108 and 1017. For this purpose, all attributes listed in section 108(b)(2) of the distributor or transferor corporation immediately prior to the transaction described in section 381(a), including the basis of property, but after

the determination of tax for the year of the discharge, are available for reduction under section 108(b)(2).

These temporary regulations also clarify that the tax attributes subject to reduction under section 108(b)(2) that are carryovers to the taxable year of the discharge, or that may be carried back to taxable years preceding the year of the discharge, are first taken into account by the taxpayer for the taxable year of the discharge or the preceding years, as the case may be, before such attributes are reduced pursuant to section 108(b)(2).

These temporary regulations apply to discharges of indebtedness occurring after July 17, 2003.

Special Analyses

It has been determined that these temporary regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these temporary regulations, and, because no preceding notice of proposed rulemaking is required for these temporary regulations, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these temporary regulations is Theresa M. Kolish, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding the following entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.108-7T also issued under 26 U.S.C. 108. * * *

■ **Par. 2.** Section 1.108-7T is added to read as follows:

§ 1.108-7T Reduction of attributes (temporary).

(a) *In general.* (1) If a taxpayer excludes discharge of indebtedness income (COD income) from gross income under section 108(a)(1)(A), (B), or (C), then the amount excluded shall be applied to reduce the following tax attributes of the taxpayer in the following order:

- (i) Net operating losses.
 - (ii) General business credits.
 - (iii) Minimum tax credits.
 - (iv) Capital loss carryovers.
 - (v) Basis of property.
 - (vi) Passive activity loss and credit carryovers.
 - (vii) Foreign tax credit carryovers.
- (2) The taxpayer may elect under section 108(b)(5), however, to reduce first the basis of depreciable property to the extent of the excluded COD income. If the basis of depreciable property is insufficient to offset the entire amount of the excluded COD income, the taxpayer must then reduce any remaining tax attributes in the order specified in section 108(b)(2). If the excluded COD income exceeds the sum of the taxpayer's tax attributes, the excess is permanently excluded from the taxpayer's gross income. For rules relating to basis reductions required by sections 108(b)(2)(E) and 108(b)(5), *see* sections 1017 and 1.1017-1. For rules relating to the time and manner for making an election under section 108(b)(5), *see* § 1.108-4.

(b) *Carryovers and carrybacks.* The tax attributes subject to reduction under section 108(b)(2) and paragraph (a)(1) of this section that are carryovers to the taxable year of the discharge, or that may be carried back to taxable years preceding the year of the discharge, are taken into account by the taxpayer for the taxable year of the discharge or the preceding years, as the case may be, before such attributes are reduced pursuant to section 108(b)(2) and paragraph (a)(1) of this section.

(c) *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 under section 108(a), any tax attributes to which the acquiring corporation succeeds and the basis of property acquired by the acquiring corporation in the transaction shall reflect the reductions required by section 108(b). For this purpose, all attributes listed in section 108(b)(2) 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, including basis of property,