

provide services or property in the future, to provide for the satisfaction of the liability prior to the resolution of the contest. The regulations also affect taxpayers that transfer money or other property to a trust, an escrow account, or a court to provide for the satisfaction of a liability for which payment is economic performance. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective November 19, 2003.

Applicability Dates: For dates of applicability, see § 1.461–2T(g).

FOR FURTHER INFORMATION CONTACT: Norma Rotunno, (202) 622–7900 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under section 461(f) of the Internal Revenue Code (Code) relating to the transfer of money or other property to provide for the satisfaction of an asserted liability that a taxpayer is contesting. Section 461(f) provides an exception to the general rules of tax accounting by allowing a taxpayer to deduct a contested liability in a year prior to the resolution of the contest if the following conditions are met: (1) The taxpayer contests an asserted liability, (2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability, (3) the contest with respect to the asserted liability exists after the time of transfer, and (4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year) determined after the application of the economic performance rules. If these requirements are satisfied, a taxpayer may deduct the liability in the taxable year of the transfer.

Section 461(f)(2) requires the taxpayer to transfer money or other property to provide for the satisfaction of the asserted liability. Neither the statute nor the regulations specifically define *money or other property*. The examples in the regulations and the legislative history involve only transfers of cash.

Under § 1.461–2(c)(1) of the Income Tax Regulations, a transfer for the satisfaction of an asserted liability is a transfer of money or other property beyond the taxpayer's control to: (1) The person asserting the liability, (2) an

escrowee or trustee pursuant to a written agreement (among the escrowee or trustee, the taxpayer, and the person who is asserting the liability) providing that the money or other property be delivered in accordance with the settlement of the contest, (3) an escrowee or trustee pursuant to an order of a court or government entity providing that the money or other property be delivered in accordance with the settlement of the contest, or (4) a court with jurisdiction over the contest. The taxpayer must relinquish all authority over the money or other property transferred.

To qualify for a deduction, section 461(f)(4) provides that a deduction is allowed in the taxable year of the transfer only if, but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year) A determined after application of subsection (h).” Congress added the quoted language to section 461(f)(4) when Congress enacted section 461(h), which provides, for amounts with respect to which a deduction would be allowable after July 18, 1984, that the all events test is not met any earlier than when economic performance has occurred with respect to the liability. Section 461(h)(2)(C) provides that payment to another person is required to satisfy economic performance for liabilities arising out of any workers compensation act or any tort. The Conference Report accompanying enactment of section 461(h) explains the impact of the economic performance requirement on trusts established under section 461(f):

In the case of workers' compensation or tort liabilities of the taxpayer requiring payments to another person, economic performance occurs as payments are made to that person. Since payment to a section 461(f) trust is not a payment to the claimant and does not discharge the taxpayer's liability to the claimant, such payment does not satisfy the economic performance test.

H. R. Rep. No. 861, 98th Cong., 2d Sess. 871, 876 (1984).

For transfers in taxable years beginning after December 31, 1991, § 1.461–4(g)(2)–(7) expands the list of liabilities for which payment to the person “to which the liability is owed” constitutes economic performance (payment liabilities). The additional payment liabilities listed in § 1.461–4(g)(2)–(6) include liabilities for breach of contract (to the extent of incidental, consequential, and liquidated damages) or violation of law, rebates and refunds, awards, prizes, jackpots, insurance, warranty and service contracts, and taxes. In addition, § 1.461–4(g)(7)

characterizes as payment liabilities other liabilities for which other specific rules are not provided.

Section 1.461–4(g)(1)(ii)(A) provides that payment does not include the furnishing of a note or other evidence of indebtedness of the taxpayer.

Section 1.461–4(g)(1)(i) provides that, for liabilities for which payment is economic performance, economic performance does not occur as a taxpayer makes payments in connection with a liability to any other person, including a trust, escrow account, court-administered fund, or any similar arrangement, unless the payments constitute payment to the person to which the liability is owed under paragraph (g)(1)(ii)(B). Section 1.461–4(g)(1)(ii)(B) states that payment is accomplished if a cash basis taxpayer in the position of the person to which the liability is owed would be treated as having actually or constructively received the amount of the payment as gross income under section 451.

Explanation of Provisions

Transfers of Property To Provide for the Satisfaction of an Asserted Liability

The regulations remove § 1.461–2(c)(1) and add § 1.461–2T(c)(1). The temporary regulations restructure the provisions of current § 1.461–2(c)(1) for greater clarity but retain all of the rules in § 1.461–2(c)(1), including the requirement that the taxpayer must transfer money or other property beyond the taxpayer's control and relinquish all authority over the money or other property transferred. The temporary regulations clarify that the transfer of the indebtedness of a taxpayer or of any promise by the taxpayer to provide services or property in the future is not a transfer to provide for the satisfaction of an asserted liability. See *Eckert v. Burnet*, 283 U.S. 140 (1931); *Willamette Industries, Inc., v. Commissioner*, 92 T.C. 1116 (1989), aff'd, 149 F. 3d 1057 (9th Cir. 1998). In addition, the temporary regulations provide the express rule that a transfer (other than to the person asserting the liability) of a taxpayer's stock, or the indebtedness or stock of a person related to the taxpayer (as defined in section 267(b)), is not a transfer to provide for the satisfaction of an asserted liability. These rules are consistent with section 468B(d)(1)(B), which excludes as a qualified payment to a designated settlement fund the transfer of any stock or indebtedness of the taxpayer (or any related person). See § 1.461–4(g)(1)(ii)(A), which provides that payment does not include the furnishing of a note or other evidence of