

Section 108.—Income From Discharge of Indebtedness

26 CFR 1.108-7: Reduction of attributes.

T.D. 9127

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Reduction of Tax Attributes Due to Discharge of Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations regarding the reduction of tax attributes under sections 108 and 1017 of the Internal Revenue Code. These final regulations affect taxpayers that realize income from the discharge of indebtedness that is excluded from gross income pursuant to section 108.

DATES: *Effective Date:* These final regulations are effective May 10, 2004.

Applicability Date: These final regulations apply to discharges of indebtedness occurring on or after May 10, 2004.

FOR FURTHER INFORMATION CONTACT: Theresa M. Kolish, (202) 622-7530, of the Office of Associate Chief Counsel (Corporate) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On July 18, 2003, the IRS and Treasury Department promulgated temporary regulations providing guidance regarding the application of the attribute reduction rules of sections 108 and 1017. Those

temporary regulations clarified that, in the case of a transaction described in section 381(a) that ends a year in which the distributor or transferor corporation excludes income from the discharge of indebtedness from gross income under section 108(a) (excluded COD income), any tax attributes to which the acquiring corporation succeeds, including the basis of property acquired by the acquiring corporation in the transaction, must 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 termination of tax for the year of the discharge, are available for reduction under section 108(b)(2).

The temporary regulations (T.D. 9080, 2003-40 I.R.B. 696) were published in the **Federal Register** (68 FR 42590) for July 18, 2003, and a notice of proposed rulemaking (REG-113112-03, 2003-40 I.R.B. 761) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (68 FR 42652). No public hearing was requested or held. One written comment was received. The following paragraphs describe the written comment received and the changes made to the temporary regulations in these final regulations.

The comment received argued that the rules of the temporary regulations are contrary to the relevant provisions of the Internal Revenue Code. The IRS and Treasury Department continue to believe that the rules of sections 108(b)(4)(A) and 1017 merely prescribe an ordering of calculations and that the rules of the temporary regulations are 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).

The IRS and Treasury Department, however, have become aware that taxpayers are taking the position that the rules

of the temporary regulations do not apply in certain cases to reduce the attributes to which the acquiring corporation succeeded as a result of certain transactions described in section 381(a). Therefore, these final regulations make certain modifications to the rules of the temporary regulations to ensure that, to the extent possible, the transferor corporation’s excluded COD income is applied to reduce attributes in a manner that will effect a deferral, rather than a permanent elimination, of income. In that regard, the final regulations apply in cases in which the taxpayer realizes excluded COD income either during or after the taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a). In addition, it provides that the basis of stock or securities of the acquiring corporation received by the taxpayer in exchange for the transferred assets in the transaction described in section 381(a) is not available for reduction under section 108(b)(2).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was 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 regulations is Theresa M. Kolish, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Final 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 removing the entry for “1.108–7T” and continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.108–7T is redesignated as §1.108–7 and amended as follows:

1. The language “(temporary)” is removed from the section heading.
2. Paragraphs (c) and (e) are revised. The revisions read as follows:

§1.108–7 Reduction of attributes.

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(c) *Transactions to which section 381 applies.* If a taxpayer realizes COD income that is excluded from gross income under section 108(a) either during or after a taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a), any tax attributes to which the acquiring corporation succeeds, including the basis of property acquired by the acquiring corporation in the transaction, must reflect the reductions required by section 108(b). For this purpose, all attributes listed in section 108(b)(2) immediately prior to the transaction described in section 381(a), but after the determination of tax for the year of the distribution or transfer of assets, including basis of property, will be available for reduction under section 108(b)(2). However, the basis of stock or securities of the acquiring corporation, if any, received by the taxpayer in exchange for the transferred assets shall not be available for reduction under section 108(b)(2).

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(e) *Effective date.* This section applies to discharges of indebtedness occurring on or after May 10, 2004.

Par. 3. Section 1.1017–1 is amended by revising paragraph (b)(4) to read as follows:

§1.1017–1 Basis reductions following a discharge of indebtedness.

* * * * *

(b) * * *

(4) *Transactions to which section 381 applies.* If a taxpayer realizes COD income that is excluded from gross income under section 108(a) either during or after a taxable year in which the taxpayer is the distributor or transferor of assets in a transaction described in section 381(a), the basis of property acquired by the acquiring corporation in the transaction must reflect the reductions required by section 1017 and this section. For this purpose, the basis of property 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 distribution or transfer of assets, will be available for reduction under section 108(b)(2). However, the basis of stock or securities of the acquiring corporation, if any, received by the taxpayer in exchange for the transferred assets shall not be available for reduction under section 108(b)(2). See §1.108–7. This paragraph (b)(4) applies to discharges of indebtedness occurring on or after May 10, 2004.

Par. 4. In section §1.1017–1T, paragraph (b)(4) is removed.

§1.1017–1T Basis reductions following a discharge of indebtedness (temporary).

Paragraphs (a) through (b)(4) [Reserved]. For further guidance, see §1.1017–(a) through (b)(4).

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Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*

Approved May 4, 2004.

Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 10, 2004, 8:45 a.m., and published in the issue of the Federal Register for May 11, 2004, 69 F.R. 26038)