

## Section 337.—Nonrecognition for Property Distributed to Parent in Complete Liquidation of Subsidiary

26 CFR 1.337(d)–5T: Tax on C assets becoming RIC or REIT assets (temporary).

T.D. 8872

### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 602

#### Certain Asset Transfers to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that apply with respect to the net built-in gain of C corporation assets that become assets of a Regulated Investment Company [RIC] or Real Estate Investment Trust [REIT] by the qualification of a C corporation as a RIC or REIT or by the transfer of assets of a C corporation to a RIC or REIT in a carryover basis transaction. The regulations generally require the corporation to recognize gain as if it had sold the assets transferred or converted to RIC or REIT assets at fair market value and immediately liquidated. The regulations permit the transferee RIC or REIT to elect, in lieu of liquidation treatment, to be subject to the rules of section 1374 of the Internal Revenue Code and the regulations thereunder. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking REG–209135–88 on page 681.

DATES: *Effective Date:* These regulations are effective February 4, 2000.

*Applicability Dates:* For dates of applicability, see the Effective Dates portion of the preamble under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CON-

TACT: Christopher W. Schoen, (202) 622-7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. section 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1672. Responses to this collection of information are required to obtain a benefit, i.e., to elect to be subject to section 1374 of the Internal Revenue Code (Code) and the regulations thereunder.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions as to reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking, REG–209135–88, on page 681.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. section 6103.

#### Background

Sections 631 and 633 of the Tax Reform Act of 1986 (the 1986 Act) (Public Law 99-514), as amended by sections 1006(e) and (g) of the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act) (Public Law 100-647), amended the Code to repeal the *General Utilities* doctrine. The 1986 Act amended sections 336 and 337 of the Code, generally requiring corporations to recognize gain when appreciated property is distributed in connection

with a complete liquidation. Section 337(d) directs the Secretary to prescribe regulations as may be necessary to carry out the purposes of *General Utilities* repeal, including rules to “ensure that such purposes shall not be circumvented ... through the use of a regulated investment company [RIC], a real estate investment trust [REIT], or a tax exempt entity....” The transfer of the assets of a C corporation to a RIC or REIT could result in permanently removing the built-in gain inherent in those assets from the reach of the corporate income tax because RIC and REIT income is not subject to a corporate-level income tax if such income is distributed to the RIC or REIT shareholders.

Accordingly, on February 4, 1988, the IRS issued Notice 88–19 (1988–1 C.B. 486). Notice 88–19 announced that the IRS intended to promulgate regulations under the authority of section 337(d) with respect to transactions or events that result in the ownership of C corporation assets by a RIC or REIT with a basis determined by reference to the corporation’s basis (a carryover basis). Notice 88–19 served as an “administrative pronouncement,” and could be relied upon to the same extent as a revenue ruling or revenue procedure. Notice 88–19 also indicated that the regulations would be applicable retroactively to June 10, 1987. See also Notice 88–96 (1988–2 C.B. 420).

As a result of the issuance of Notice 88–19, many taxpayers have become uncertain about the current law applicable to their transactions, as well as the proper method of making a valid election to be subject to the rules of section 1374 and the regulations thereunder. In order to resolve this uncertainty and to provide taxpayers with guidance, the IRS and Treasury are issuing these temporary regulations.

#### Explanation of Provisions

These regulations implement Notice 88–19 by providing that when a C corporation (1) qualifies to be taxed as a RIC or REIT, or (2) transfers assets to a RIC or REIT in a carryover basis transaction, the C corporation is treated as if it sold all of its assets at their respective fair market

values and immediately liquidated, unless the RIC or REIT elects to be subject to tax under section 1374. Any resulting net built-in gain is recognized by the C corporation and the bases of the assets in the hands of the RIC or REIT are generally adjusted to their fair market values to reflect the recognized net built-in gain. The regulations do not permit a C corporation to recognize a net built-in loss, and, in this case, the carryover bases of the assets in the hands of the RIC or REIT are preserved.

If the RIC or REIT elects to be subject to treatment under section 1374, its built-in gain, and the corporate-level tax imposed on that gain, is subject to rules similar to the rules applying to the net income of foreclosure property of REITs.

### Effective Dates

In the case of carryover basis transactions involving the transfer of property of a C corporation to a RIC or REIT, the regulations apply to transactions occurring on or after June 10, 1987. In the case of a C corporation that qualifies to be taxed as a RIC or REIT, the regulations apply to such qualifications that are effective for taxable years beginning on or after June 10, 1987.

### 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 the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel of Advocacy of the Small Business Administration for comment on their impact on small business.

### Drafting Information

The principal author of these regulations is Christopher W. Schoen of the Office of Assistant Chief Counsel (Corpo-

rate). Other personnel from the IRS and Treasury participated in their development.

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### Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

#### PART I—INCOME TAXES

Paragraph 1. The authority citation for 26 CFR part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.337(d)–5T also issued under 26 U.S.C. 337. \* \* \*

Par. 2. Section 1.337(d)–5T is added to read as follows:

*§1.337(d)–5T Tax on C assets becoming RIC or REIT assets (temporary).*

(a) *Treatment of C corporations--(1) Scope.* This section applies to the net built-in gain of C corporation assets that become assets of a RIC or REIT by—

(i) The qualification of a C corporation as a RIC or REIT; or

(ii) The transfer of assets of a C corporation to a RIC or REIT in a transaction in which the basis of such assets are determined by reference to the C corporation's basis (a carryover basis).

(2) *Net built-in gain.* Net built-in gain is the excess of aggregate gains (including items of income) over aggregate losses.

(3) *General rule.* Unless an election is made pursuant to paragraph (b) of this section, the C corporation will be treated, for all purposes including recognition of net built-in gain, as if it had sold all of its assets at their respective fair market values on the deemed liquidation date described in paragraph (a)(7) of this section and immediately liquidated.

(4) *Loss.* Paragraph(a)(3) of this section shall not apply if its application would result in the recognition of net built-in loss.

(5) *Basis adjustment.* If a corporation is subject to corporate-level tax under paragraph (a)(3) of this section, the bases of the assets in the hands of the RIC or REIT will be adjusted to reflect the recognized net built-in gain. This adjustment is made by taking the C corporation's basis in each asset, and, as appropriate, increasing it by the amount of any built-in gain

attributable to that asset, or decreasing it by the amount of any built-in loss attributable to that asset.

(6) *Exception—(i) In general.* Paragraph (a)(3) of this section does not apply to any C corporation that—

(A) Immediately prior to qualifying to be taxed as a RIC was subject to tax as a C corporation for a period not exceeding one taxable year; and

(B) Immediately prior to being subject to tax as a C corporation was subject to the RIC tax provisions for a period of at least one taxable year.

(ii) *Additional requirement.* The exception described in paragraph (a)(6)(i) of this section applies only to assets acquired by the corporation during the year when it was subject to tax as a C corporation in a transaction that does not result in its basis in the asset being determined by reference to a corporate transferor's basis.

(7) *Deemed liquidation date—(i) Conversions.* In the case of a C corporation that qualifies to be taxed as a RIC or REIT, the deemed liquidation date is the last day of its last taxable year before the taxable year in which it qualifies to be taxed as a RIC or REIT.

(ii) *Carryover basis transfers.* In the case of a C corporation that transfers property to a RIC or REIT in a carryover basis transaction, the deemed liquidation date is the day before the date of the transfer.

(b) *Section 1374 treatment—(1) In general.* Paragraph (a) of this section will not apply if the transferee RIC or REIT elects (as described in paragraph (b)(3) of this section) to be subject to the rules of section 1374, and the regulations thereunder. The electing RIC or REIT will be subject to corporate-level taxation on the built-in gain recognized during the 10-year period on assets formerly held by the transferor C corporation. The built-in gains of electing RICs and REITs, and the corporate-level tax imposed on such gains, are subject to rules similar to the rules relating to net income from foreclosure property of REITs. See sections 857(a)(1)(A)(ii), and 857(b)(2)(B), (D), and (E). An election made under this paragraph (b) shall be irrevocable.

(2) *Ten-year recognition period.* In the case of a C corporation that qualifies to be taxed as a RIC or REIT, the 10-year recognition period described in section 1374(d)(7) begins on the first day of the

RIC's or REIT's taxable year for which the corporation qualifies to be taxed as a RIC or REIT. In the case of a C corporation that transfers property to a RIC or REIT in a carryover basis transaction, the 10-year recognition period begins on the day the assets are acquired by the RIC or REIT.

(3) *Making the election.* A RIC or REIT validly makes a section 1374 election with the following statement: “[Insert name and employer identification number of electing RIC or REIT] elects under §1.337(d)–5T(b) to be subject to the rules of section 1374 and the regulations thereunder with respect to its assets which formerly were held by a C corporation, [insert name and employer identification number of the C corporation, if different from name and employer identification number of RIC or REIT].” This statement must be signed by an official authorized to sign the income tax return of the RIC or REIT and attached to the RIC's or REIT's Federal income tax return for the first taxable year in which the assets of the C corporation become assets of the RIC or REIT.

(c) *Special rule.* In cases where the first taxable year in which the assets of the C corporation become assets of the RIC or

REIT ends after June 10, 1987 but before March 8, 2000, the section 1374 election may be filed with the first Federal income tax return filed by the RIC or REIT after March 8, 2000.

(d) *Effective date.* In the case of carryover basis transactions involving the transfer of property of a C corporation to a RIC or REIT, the regulations apply to transactions occurring on or after June 10, 1987. In the case of a C corporation that qualifies to be taxed as a RIC or REIT, the regulations apply to such qualifications that are effective for taxable years beginning on or after June 10, 1987.

Par. 3. In §1.852–12, paragraph (d) is added to read as follows:  
*§1.852–12 Non-RIC earnings and profits.*  
 \* \* \* \* \*

(d) For treatment of net built-in gain assets of a C corporation that become assets of a RIC, see §1.337(d)–5T.

Par. 4. In §1.857–11, paragraph (e) is added to read as follows:  
*§1.857–11 Non-REIT earnings and profits.*  
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(e) For treatment of net built-in gain assets of a C corporation that become assets

of a REIT, see §1.337(d)–5T.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:  
*§602.101—OMB Control numbers.*  
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(b) \*\*\*

Robert E. Wenzel,  
*Deputy Commissioner of  
 Internal Revenue.*

Approved January 21, 2000.

Jonathan Talisman,  
*Acting Assistant Secretary  
 for Tax Policy.*

(Filed by the Office of the Federal Register on February 4, 2000, 8:45 a.m., and published in the issue of the Federal Register for February 7, 2000, 65 F.R. 5775)

CFR part or section where identified and described

Current OMB control No.

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1.337(d)–5T .....1545–1672