

IRC & Regulation Sections for Reading 7

§267 Losses, expenses, and interest with respect to transactions between related taxpayers [excerpt]

(a) In general.

(1) Deduction for losses disallowed. No deduction shall be allowed in respect of any loss from the sale or exchange of property, directly or indirectly, between persons specified in any of the paragraphs of subsection (b). The preceding sentence shall not apply to any loss of the distributing corporation (or the distributee) in the case of a distribution in complete liquidation.

(b) Relationships. The persons referred to in subsection (a) are:

- (1) Members of a family, as defined in subsection (c)(4);
- (2) An individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;
- (3) Two corporations which are members of the same controlled group (as defined in subsection (f));
- (4) A grantor and a fiduciary of any trust;
- (5) A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
- (6) A fiduciary of a trust and a beneficiary of such trust;
- (7) A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;
- (8) A fiduciary of a trust and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust;
- (9) A person and an organization to which section 501 (relating to certain educational and charitable organizations which are exempt from tax) applies and which is controlled directly or indirectly by such person or (if such person is an individual) by members of the family of such individual;
- (10) A corporation and a partnership if the same persons own—
 - (A) more than 50 percent in value of the outstanding stock of the corporation, and
 - (B) more than 50 percent of the capital interest, or the profits interest, in the partnership;
- (11) An S corporation and another S corporation if the same persons own more than 50 percent in value of the outstanding stock of each corporation;
- (12) An S corporation and a C corporation, if the same persons own more than 50 percent in value of the outstanding stock of each corporation; or
- (13) Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.

(c) Constructive ownership of stock. For purposes of determining, in applying subsection (b), the ownership of stock—

- (1) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;
- (2) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;
- (3) An individual owning (otherwise than by the application of paragraph (2)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;
- (4) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and
- (5) Stock constructively owned by a person by reason of the application of paragraph (1) shall, for the purpose of applying paragraph (1) , (2) , or (3) , be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of paragraph (2) or (3) shall not be treated as owned by him for the purpose of again applying either of such paragraphs in order to make another the constructive owner of such stock.

(d) Amount of gain where loss previously disallowed. If—

- (1) in the case of a sale or exchange of property to the taxpayer a loss sustained by the transferor is not allowable to the transferor as a deduction by reason of subsection (a)(1) (or by reason of section 24(b) of the Internal Revenue Code of 1939); and
- (2) after December 31, 1953, the taxpayer sells or otherwise disposes of such property (or of other property the basis of which in his hands is determined directly or indirectly by reference to such property) at a gain,

then such gain shall be recognized only to the extent that it exceeds so much of such loss as is properly allocable to the property sold or otherwise disposed of by the taxpayer. This subsection applies with respect to taxable years ending after December 31, 1953. This subsection shall not apply if the loss sustained by the transferor is not allowable to the transferor as a deduction by reason of section 1091 (relating to wash sales) or by reason of section 118 of the Internal Revenue Code of 1939.

(g) Coordination with section 1041. Subsection (a)(1) shall not apply to any transfer described in section 1041(a) (relating to transfers of property between spouses or incident to divorce).

§707(b) Certain sales or exchanges of property with respect to controlled partnerships

(1) Losses disallowed. No deduction shall be allowed in respect of losses from sales or exchanges of property (other than an interest in the partnership), directly or indirectly, between—

(A) a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or the profits interest, in such partnership, or

(B) two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interests or profits interests.

In the case of a subsequent sale or exchange by a transferee described in this paragraph, section 267(d) shall be applicable as if the loss were disallowed under section 267(a)(1). For purposes of section 267(a)(2), partnerships described in subparagraph (B) of this paragraph shall be treated as persons specified in section 267(b).

(2) Gains treated as ordinary income. In the case of a sale or exchange, directly or indirectly, of property, which in the hands of the transferee, is property other than a capital asset as defined in section 1221 —

(A) between a partnership and a person owning, directly or indirectly, more than 50 percent of the capital interest, or profits interest, in such partnership, or

(B) between two partnerships in which the same persons own, directly or indirectly, more than 50 percent of the capital interest or profits interests,

any gain recognized shall be considered as ordinary income.

(3) Ownership of a capital or profits interest. For purposes of paragraphs (1) and (2) of this subsection, the ownership of a capital or profits interest in a partnership shall be determined in accordance with the rules for constructive ownership of stock provided in section 267(c) other than paragraph (3) of such section.

§453 Installment method

- (a) General rule. Except as otherwise provided in this section , income from an installment sale shall be taken into account for purposes of this title under the installment method.
- (b) Installment sale defined. For purposes of this section —
- (1) In general. The term “installment sale” means a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs.
 - (2) Exceptions. The term “installment sale” does not include—
 - (A) Dealer dispositions. Any dealer disposition (as defined in subsection (l)).
 - (B) Inventories of personal property. A disposition of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year.
- (c) Installment method defined. For purposes of this section , the term “installment method” means a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.
- (d) Election out.
- (1) In general. Subsection (a) shall not apply to any disposition if the taxpayer elects to have subsection (a) not apply to such disposition.
 - (2) Time and manner for making election. Except as otherwise provided by regulations, an election under paragraph (1) with respect to a disposition may be made only on or before the due date prescribed by law (including extensions) for filing the taxpayer's return of the tax imposed by this chapter for the taxable year in which the disposition occurs. Such an election shall be made in the manner prescribed by regulations.
 - (3) Election revocable only with consent. An election under paragraph (1) with respect to any disposition may be revoked only with the consent of the Secretary.
- (e) Second dispositions by related persons.
- (1) In general. If—
 - (A) any person disposes of property to a related person (hereinafter in this subsection referred to as the “first disposition”), and
 - (B) before the person making the first disposition receives all payments with respect to such disposition, the related person disposes of the property (hereinafter in this subsection referred to as the “second disposition”),then, for purposes of this section , the amount realized with respect to such second disposition shall be treated as received at the time of the second disposition by the person making the first disposition.
 - (2) 2-year cutoff for property other than marketable securities.
 - (A) In general. Except in the case of marketable securities, paragraph (1) shall apply only if the date of the second disposition is not more than 2 years after the date of the first disposition.
 - (B) Substantial diminishing of risk of ownership. The running of the 2-year period set forth in subparagraph (A) shall be suspended with respect to any property for any period during which the related person's risk of loss with respect to the property is substantially diminished by—

- (i) the holding of a put with respect to such property (or similar property),
 - (ii) the holding by another person of a right to acquire the property, or
 - (iii) a short sale or any other transaction.
- (3) Limitation on amount treated as received. The amount treated for any taxable year as received by the person making the first disposition by reason of paragraph (1) shall not exceed the excess of—
 - (A) the lesser of—
 - (i) the total amount realized with respect to any second disposition of the property occurring before the close of the taxable year, or
 - (ii) the total contract price for the first disposition, over
 - (B) the sum of—
 - (i) the aggregate amount of payments received with respect to the first disposition before the close of such year, plus
 - (ii) the aggregate amount treated as received with respect to the first disposition for prior taxable years by reason of this subsection .
- (4) Fair market value where disposition is not sale or exchange. For purposes of this subsection , if the second disposition is not a sale or exchange, an amount equal to the fair market value of the property disposed of shall be substituted for the amount realized.
- (5) Later payments treated as receipt of tax paid amounts. If paragraph (1) applies for any taxable year, payments received in subsequent taxable years by the person making the first disposition shall not be treated as the receipt of payments with respect to the first disposition to the extent that the aggregate of such payments does not exceed the amount treated as received by reason of paragraph (1) .
- (6) Exception for certain dispositions. For purposes of this subsection —
 - (A) Reacquisitions of stock by issuing corporation not treated as first dispositions. Any sale or exchange of stock to the issuing corporation shall not be treated as a first disposition.
 - (B) Involuntary conversions not treated as second dispositions. A compulsory or involuntary conversion (within the meaning of section 1033) and any transfer thereafter shall not be treated as a second disposition if the first disposition occurred before the threat or imminence of the conversion.
 - (C) Dispositions after death. Any transfer after the earlier of—
 - (i) the death of the person making the first disposition, or
 - (ii) the death of the person acquiring the property in the first disposition,and any transfer thereafter shall not be treated as a second disposition.
- (7) Exception where tax avoidance not a principal purpose. This subsection shall not apply to a second disposition (and any transfer thereafter) if it is established to the satisfaction of the Secretary that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of Federal income tax.
- (8) Extension of statute of limitations. The period for assessing a deficiency with respect to a first disposition (to the extent such deficiency is attributable to the application of this subsection) shall not expire before the day which is 2 years after the date on which the person making the first disposition furnishes (in such manner as the Secretary may by regulations prescribe) a notice that there was a second disposition of the property to

which this subsection may have applied. Such deficiency may be assessed notwithstanding the provisions of any law or rule of law which would otherwise prevent such assessment.

(f) Definitions and special rules. For purposes of this section —

- (1) Related person. Except for purposes of subsections (g) and (h) , the term “related person” means—
 - (A) a person whose stock would be attributed under section 318(a) (other than paragraph (4) thereof) to the person first disposing of the property, or
 - (B) a person who bears a relationship described in section 267(b) to the person first disposing of the property.
- (2) Marketable securities. The term “marketable securities” means any security for which, as of the date of the disposition, there was a market on an established securities market or otherwise.
- (3) Payment. Except as provided in paragraph (4) , the term “payment” does not include the receipt of evidences of indebtedness of the person acquiring the property (whether or not payment of such indebtedness is guaranteed by another person).
- (4) Purchaser evidences of indebtedness payable on demand or readily tradable. Receipt of a bond or other evidence of indebtedness which—
 - (A) is payable on demand, or
 - (B) is readily tradable,shall be treated as receipt of payment.
- (5) Readily tradable defined. For purposes of paragraph (4) , the term “readily tradable” means a bond or other evidence of indebtedness which is issued—
 - (A) with interest coupons attached or in registered form (other than one in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or
 - (B) in any other form designed to render such bond or other evidence of indebtedness readily tradable in an established securities market.
- (6) Like-kind exchanges. In the case of any exchange described in section 1031(b) —
 - (A) the total contract price shall be reduced to take into account the amount of any property permitted to be received in such exchange without recognition of gain,
 - (B) the gross profit from such exchange shall be reduced to take into account any amount not recognized by reason of section 1031(b) , and
 - (C) the term “payment”, when used in any provision of this section other than subsection (b)(1) , shall not include any property permitted to be received in such exchange without recognition of gain.Similar rules shall apply in the case of an exchange which is described in section 356(a) and is not treated as a dividend.
- (7) Depreciable property. The term “depreciable property” means property of a character which (in the hands of the transferee) is subject to the allowance for depreciation provided in section 167 .
- (8) Payments to be received defined. The term “payments to be received” includes—

(A) the aggregate amount of all payments which are not contingent as to amount,
and

(B) the fair market value of any payments which are contingent as to amount.

(g) Sale of depreciable property to controlled entity.

(1) In general. In the case of an installment sale of depreciable property between related persons—

(A) subsection (a) shall not apply,

(B) for purposes of this title—

(i) except as provided in clause (ii) , all payments to be received shall be treated as received in the year of the disposition, and

(ii) in the case of any payments which are contingent as to the amount but with respect to which the fair market value may not be reasonably ascertained, the basis shall be recovered ratably, and

(C) the purchaser may not increase the basis of any property acquired in such sale by any amount before the time such amount is includible in the gross income of the seller.

(2) Exception where tax avoidance not a principal purpose. Paragraph (1) shall not apply if it is established to the satisfaction of the Secretary that the disposition did not have as one of its principal purposes the avoidance of Federal income tax.

(3) Related persons. For purposes of this subsection , the term “related persons” has the meaning given to such term by section 1239(b) , except that such term shall include 2 or more partnerships having a relationship to each other described in section 707(b)(1)(B) .

(h) Use of installment method by shareholders in certain liquidations.

(1) Receipt of obligations not treated as receipt of payment.

(A) In general. If, in a liquidation to which section 331 applies, the shareholder receives (in exchange for the shareholder's stock) an installment obligation acquired in respect of a sale or exchange by the corporation during the 12-month period beginning on the date a plan of complete liquidation is adopted and the liquidation is completed during such 12-month period, then, for purposes of this section, the receipt of payments under such obligation (but not the receipt of such obligation) by the shareholder shall be treated as the receipt of payment for the stock.

(B) Obligations attributable to sale of inventory must result from bulk sale.

Subparagraph (A) shall not apply to an installment obligation acquired in respect of a sale or exchange of—

(i) stock in trade of the corporation,

(ii) other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year,
and

(iii) property held by the corporation primarily for sale to customers in the ordinary course of its trade or business,

unless such sale or exchange is to 1 person in 1 transaction and involves substantially all of such property attributable to a trade or business of the corporation.

(C) Special rule where obligor and shareholder are related persons. If the obligor of any installment obligation and the shareholder are married to each other or are related persons (within the meaning of section 1239(b)), to the extent such installment obligation is attributable to the disposition by the corporation of depreciable property—

(i) subparagraph (A) shall not apply to such obligation, and

(ii) for purposes of this title, all payments to be received by the shareholder shall be deemed received in the year the shareholder receives the obligation.

(D) Coordination with subsection (e)(1)(A) . For purposes of subsection (e)(1)(A) , disposition of property by the corporation shall be treated also as disposition of such property by the shareholder.

(E) Sales by liquidating subsidiaries. For purposes of subparagraph (A) , in the case of a controlling corporate shareholder (within the meaning of section 368(c)) of a selling corporation, an obligation acquired in respect of a sale or exchange by the selling corporation shall be treated as so acquired by such controlling corporate shareholder. The preceding sentence shall be applied successively to each controlling corporate shareholder above such controlling corporate shareholder.

(2) Distributions received in more than 1 taxable year of shareholder. If—

(A) paragraph (1) applies with respect to any installment obligation received by a shareholder from a corporation, and

(B) by reason of the liquidation such shareholder receives property in more than 1 taxable year,

then, on completion of the liquidation, basis previously allocated to property so received shall be reallocated for all such taxable years so that the shareholder's basis in the stock of the corporation is properly allocated among all property received by such shareholder in such liquidation.

(i) Recognition of recapture income in year of disposition.

(1) In general. In the case of any installment sale of property to which subsection (a) applies—

(A) notwithstanding subsection (a) , any recapture income shall be recognized in the year of the disposition, and

(B) any gain in excess of the recapture income shall be taken into account under the installment method.

(2) Recapture income. For purposes of paragraph (1) , the term “recapture income” means, with respect to any installment sale, the aggregate amount which would be treated as ordinary income under section 1245 or 1250 (or so much of section 751 as relates to section 1245 or 1250) for the taxable year of the disposition if all payments to be received were received in the taxable year of disposition.

(j) Regulations.

(1) In general. The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provisions of this section.

(2) Selling price not readily ascertainable. The regulations prescribed under paragraph (1) shall include regulations providing for ratable basis recovery in transactions where the gross profit or the total contract price (or both) cannot be readily ascertained.

(k) Current inclusion in case of revolving credit plans, etc. In the case of—

(1) any disposition of personal property under a revolving credit plan, or

(2) any installment obligation arising out of a sale of—

(A) stock or securities which are traded on an established securities market, or

(B) to the extent provided in regulations, property (other than stock or securities) of a kind regularly traded on an established market,

subsection (a) shall not apply, and, for purposes of this title, all payments to be received shall be treated as received in the year of disposition. The Secretary may provide for the application of this subsection in whole or in part for transactions in which the rules of this subsection otherwise would be avoided through the use of related parties, pass-thru entities, or intermediaries.

(l) Dealer dispositions. For purposes of subsection (b)(2)(A) —

(1) In general. The term “dealer disposition” means any of the following dispositions:

(A) Personal property. Any disposition of personal property by a person who regularly sells or otherwise disposes of personal property of the same type on the installment plan.

(B) Real property. Any disposition of real property which is held by the taxpayer for sale to customers in the ordinary course of the taxpayer's trade or business.

(2) Exceptions. The term “dealer disposition” does not include—

(A) Farm property. The disposition on the installment plan of any property used or produced in the trade or business of farming (within the meaning of section 2032A(e)(4) or (5)).

(B) Timeshares and residential lots.

(i) In general. Any dispositions described in clause (ii) on the installment plan if the taxpayer elects to have paragraph (3) apply to any installment obligations which arise from such dispositions. An election under this paragraph shall not apply with respect to an installment obligation which is guaranteed by any person other than an individual.

(ii) Dispositions to which subparagraph applies. A disposition is described in this clause if it is a disposition in the ordinary course of the taxpayer's trade or business to an individual of—

(I) a timeshare right to use or a timeshare ownership interest in residential real property for not more than 6 weeks per year, or a right to use specified campgrounds for recreational purposes, or

(II) any residential lot, but only if the taxpayer (or any related person) is not to make any improvements with respect to such lot.

For purposes of subclause (I) , a timeshare right to use (or timeshare ownership interest in) property held by the spouse, children, grandchildren, or parents of an individual shall be treated as held by such individual.

(C) Carrying charges or interest. Any carrying charges or interest with respect to a disposition described in subparagraph (A) or (B) which are added on the books of account of the seller to the established cash selling price of the property shall be included in the total contract price of the property and, if such charges or interest are not so included, any payments received shall be treated as applying first against such carrying charges or interest.

(3) Payment of interest on timeshares and residential lots.

(A) In general. In the case of any installment obligation to which paragraph (2)(B) applies, the tax imposed by this chapter for any taxable year for which payment is received on such obligation shall be increased by the amount of interest determined in the manner provided under subparagraph (B) .

(B) Computation of interest.

(i) In general. The amount of interest referred to in subparagraph (A) for any taxable year shall be determined—

(I) on the amount of the tax for such taxable year which is attributable to the payments received during such taxable year on installment obligations to which this subsection applies,

(II) for the period beginning on the date of sale, and ending on the date such payment is received, and

(III) by using the applicable Federal rate under section 1274 (without regard to subsection (d)(2) thereof) in effect at the time of the sale compounded semiannually.

(ii) Interest not taken into account. For purposes of clause (i) , the portion of any tax attributable to the receipt of any payment shall be determined without regard to any interest imposed under subparagraph (A) .

(iii) Taxable year of sale. No interest shall be determined for any payment received in the taxable year of the disposition from which the installment obligation arises.

(C) Treatment as interest. Any amount payable under this paragraph shall be taken into account in computing the amount of any deduction allowable to the taxpayer for interest paid or accrued during such taxable year.

Reg §15a.453-1 Installment method reporting for sales of real property and casual sales of personal property [excerpt]

(a) In general. Unless the taxpayer otherwise elects in the manner prescribed in paragraph (d)(3) of this section, income from a sale of real property or a casual sale of personal property, where any payment is to be received in a taxable year after the year of sale, is to be reported on the installment method.

(b) Installment sale defined.

(1) *In general.* The term “installment sale” means a disposition of property (except as provided in paragraph (b)(4) of this section) where at least one payment is to be received after the close of the taxable year in which the disposition occurs. The term “installment sale” includes dispositions from which payment is to be received in a lump sum in a taxable year subsequent to the year of sale. For purposes of this paragraph, the taxable year in which payments are to be received is to be determined without regard to section 453(e) (relating to related party sales), section (f)(3) (relating to the definition of a

“payment”) and section (g) (relating to sales of depreciable property to a spouse or 80-percent-owned entity).

(2) *Installment method defined.*

- (i) In general. Under the installment method, the amount of any payment which is income to the taxpayer is that portion of the installment payment received in that year which the gross profit realized or to be realized bears to the total contract price (the “gross profit ratio”). See paragraph (c) of this section for rules describing installment method reporting of contingent payment sales.
- (ii) Selling price defined. The term “selling price” means the gross selling price without reduction to reflect any existing mortgage or other encumbrance on the property (whether assumed or taken subject to by the buyer) and, for installment sales in taxable years ending after October 19, 1980, without reduction to reflect any selling expenses. Neither interest, whether stated or unstated, nor original issue discount is considered to be a part of the selling price. See paragraph (c) of this section for rules describing installment method reporting of contingent payment sales.
- (iii) Contract price defined. The term “contract price” means the total contract price equal to selling price reduced by that portion of any qualifying indebtedness (as defined in paragraph (b)(2)(iv) of this section, assumed or taken subject to by the buyer, which does not exceed the seller's basis in the property (adjusted, for installment sales in taxable years ending after October 19, 1980, to reflect commissions and other selling expenses as provided in paragraph (b)(2)(v) of this section). See paragraph (c) of this section for rules describing installment method reporting of contingent payment sales.
- (iv) Qualifying indebtedness. The term “qualifying indebtedness” means a mortgage or other indebtedness encumbering the property and indebtedness, not secured by the property but incurred or assumed by the purchaser incident to the purchaser's acquisition, holding, or operation in the ordinary course of business or investment, of the property. The term “qualifying indebtedness” does not include an obligation of the taxpayer incurred incident to the disposition of the property (*e.g.*, legal fees relating to the taxpayer's sale of the property) or an obligation functionally unrelated to the acquisition, holding, or operating of the property (*e.g.*, the taxpayer's medical bill). Any obligation created subsequent to the taxpayer's acquisition of the property and incurred or assumed by the taxpayer or placed as an encumbrance on the property in contemplation of disposition of the property is not qualifying indebtedness if the arrangement results in accelerating recovery of the taxpayer's basis in the installment sale.
- (v) Gross profit defined. The term “gross profit” means the selling price less the adjusted basis as defined in section 1011 and the regulations thereunder. For sales in taxable years ending after October 19, 1980, in the case of sales of real property by a person other than a dealer and casual sales of personal property, commissions and other selling expenses shall be added to basis for purposes of determining the proportion of payments which is gross profit attributable to the disposition. Such additions to basis will not be deemed to affect the taxpayer's holding period in the transferred property.

(3) *Payment.*

- (i) In general. Except as provided in paragraph (e) of this section (relating to purchaser evidences of indebtedness payable on demand or readily tradable), the term “payment” does not include the receipt of evidences of indebtedness of the

person acquiring the property (“installment obligation”), whether or not payment of such indebtedness is guaranteed by a third party (including a government agency). For special rules regarding the receipt of an evidence of indebtedness of a transferee of a qualified intermediary, see §§1.1031(b)-2(b) and 1.1031(k)-1(j)(2)(iii) of this chapter. A standby letter of credit (as defined in paragraph (b)(3)(iii) of this section) shall be treated as a third party guarantee. Payments include amounts actually or constructively received in the taxable year under an installment obligation. For a special rule regarding a transfer of property to a qualified intermediary followed by the sale of such property by the qualified intermediary, see §1.1031(k)-1(j)(2)(ii) of this chapter. Receipt of an evidence of indebtedness which is secured directly or indirectly by cash or a cash equivalent, such as a bank certificate of deposit or a treasury note, will be treated as the receipt of payment. For a special rule regarding a transfer of property in exchange for an obligation that is secured by cash or a cash equivalent held in a qualified escrow account or a qualified trust, see §1.1031(k)-1(j)(2)(i) of this chapter. Payment may be received in cash or other property, including foreign currency, marketable securities, and evidences or indebtedness which are payable on demand or readily tradable. However, for special rules relating to the receipt of certain property with respect to which gain is not recognized, see paragraph (f) of this section (relating to transactions described in sections 351, 356(a) and 1031). Except as provided in §15A.453-2 of these regulations (relating to distributions of installment obligations in corporate liquidations described in section 337), payment includes receipt of an evidence of indebtedness of a person other than the person acquiring the property from the taxpayer. For purposes of determining the amount of payment received in the taxable year, the amount of qualifying indebtedness (as defined in paragraph (b)(2)(iv) of this section) assumed or taken subject to by the person acquiring the property shall be included only to the extent that it exceeds the basis of the property (determined after adjustment to reflect selling expenses). For purposes of the preceding sentence, an arrangement under which the taxpayer's liability on qualifying indebtedness is eliminated incident to the disposition (*e.g.*, a novation) shall be treated as an assumption of the qualifying indebtedness. If the taxpayer sells property to a creditor of the taxpayer and indebtedness of the taxpayer is cancelled in consideration of the sale, such cancellation shall be treated as payment. To the extent that cancellation is not in consideration of the sale, see §§ 1.61-12(b)(1) and 1.1001-2(a)(2) relating to discharges of indebtedness. If the taxpayer sells property which is encumbered by a mortgage or other indebtedness on which the taxpayer is not personally liable, and the person acquiring the property is the obligee, the taxpayer shall be treated as having received payment in the amount of such indebtedness.

- (ii) Wrap-around mortgage. This paragraph (b)(3)(ii) shall apply generally to any installment sale after March 4, 1981 unless the installment sale was completed before June 1, 1981 pursuant to a written obligation binding on the seller that was executed on or before March 4, 1981. A “wrap-around mortgage” means an agreement in which the buyer initially does not assume and purportedly does not take subject to part or all of the mortgage or other indebtedness encumbering the property (“wrapped indebtedness”) and, instead, the buyer issues to the seller an installment obligation the principal amount of which reflects such wrapped indebtedness. Ordinarily, the seller will use payments received on the installment obligation to service the wrapped indebtedness. The wrapped indebtedness shall be deemed to have been taken subject to even though title to the property has not passed in the year of sale and even though the seller remains liable for payments on the wrapped indebtedness. In the hands of the seller, the wrap-around

installment obligation shall have a basis equal to the seller's basis in the property which was the subject of the installment sale, increased by the amount of gain recognized in the year of sale, and decreased by the amount of cash and the fair market value of other nonqualifying property received in the year of sale. For purposes of this paragraph (b)(3)(ii), the amount of any indebtedness assumed or taken subject to by the buyer (other than wrapped indebtedness) is to be treated as cash received by the seller in the year of sale. Therefore, except as otherwise required by section 483 or 1232, the gross profit ratio with respect to the wrap-around installment obligation is a fraction, the numerator of which is the face value of the obligation less the taxpayer's basis in the obligation and the denominator of which is the face value of the obligation.

(iii) Standby letter of credit. The term "standby letter of credit" means a non-negotiable, non-transferable (except together with the evidence of indebtedness which it secures) letter of credit, issued by a bank or other financial institution, which serves as a guarantee of the evidence of indebtedness which is secured by the letter of credit. Whether or not the letter of credit explicitly states it is non-negotiable and nontransferable, it will be treated as non-negotiable and nontransferable if applicable local law so provides. The mere right of the secured party (under applicable local law) to transfer the proceeds of a letter of credit shall be disregarded in determining whether the instrument qualifies as a standby letter of credit. A letter of credit is not a standby letter of credit if it may be drawn upon in the absence of default in payment of the underlying evidence of indebtedness.

(4) *Exceptions.* The term "installment sale" does not include, and the provisions of section 453 do not apply to, dispositions of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan, or to dispositions of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year. See section 453A and the regulations thereunder for rules relating to installment sales by dealers in personal property. A dealer in real property or a farmer who is not required under his method of accounting to maintain inventories may report the gain on the installment method under section 453.

(5) *Examples.* The following examples illustrate installment method reporting under this section:

Example (1). In 1980, A, a calendar year taxpayer, sells Blackacre, an unencumbered capital asset in A's hands, to B for \$100,000: \$10,000 down and the remainder payable in equal annual installments over the next 9 years, together with adequate stated interest. A's basis in Blackacre, exclusive of selling expenses, is \$38,000. Selling expenses paid by A are \$2,000. Therefore, the gross profit is \$60,000 (\$100,000 selling price – \$40,000 basis inclusive of selling expenses). The gross profit ratio is $\frac{3}{5}$ (gross profit of \$60,000 divided by \$100,000 contract price). Accordingly, \$6,000 $\frac{3}{5}$ of \$10,000 of each \$10,000 payment received is gain attributable to the sale and \$4,000 (\$10,000 – \$6,000) is recovery of basis. The interest received in addition to principal is ordinary income to A.

Example (2). C sells Whiteacre to D for a selling price of \$160,000. Whiteacre is encumbered by a longstanding mortgage in the principal amount of \$60,000. D will assume or take subject to the \$60,000 mortgage and pay the remaining \$100,000 in 10 equal annual installments together with adequate stated interest. C's basis in Whiteacre is \$90,000. There are no selling expenses. The contract price is \$100,000, the \$160,000 selling price reduced by the mortgage of \$60,000 assumed or taken subject to. Gross profit is \$70,000 (\$160,000 selling price less C's basis of \$90,000). C's gross profit ratio

is 7/10 (gross profit of \$70,000 divided by \$100,000 contract price). Thus, \$7,000 (7/10 of \$10,000) of each \$10,000 annual payment is gain attributable to the sale, and \$3,000 (\$10,000 – \$7,000) is recovery of basis.

(c) Contingent payment sales.

(1) *In general.* Unless the taxpayer otherwise elects in the manner prescribed in paragraph (d)(3) of this section, contingent payment sales are to be reported on the installment method. As used in this section, the term “contingent payment sale” means a sale or other disposition of property in which the aggregate selling price cannot be determined by the close of the taxable year in which such sale or other disposition occurs. The term “contingent payment sale” does not include transactions with respect to which the installment obligation represents, under applicable principles of tax law, a retained interest in the property which is the subject of the transaction, an interest in a joint venture or a partnership, an equity interest in a corporation or similar transactions, regardless of the existence of a stated maximum selling price or a fixed payment term. See paragraph (c)(8) of this section, describing the extent to which the regulations under section 385 apply to the determination of whether an installment obligation represents an equity interest in a corporation. This paragraph prescribes the rules to be applied in allocating the taxpayer’s basis (including selling expenses except for selling expenses of dealers in real estate) to payments received and to be received in a contingent payment sale. The rules are designed appropriately to distinguish contingent payment sales for which a maximum selling price is determinable, sales for which a maximum selling price is not determinable but the time over which payments will be received is determinable, and sales for which neither a maximum selling price nor a definite payment term is determinable. In addition, rules are prescribed under which, in appropriate circumstances, the taxpayer will be permitted to recover basis under an income forecast computation.

§1038 Certain reacquisitions of real property

(a) General rule. If—

- (1) a sale of real property gives rise to indebtedness to the seller which is secured by the real property sold, and
- (2) the seller of such property reacquires such property in partial or full satisfaction of such indebtedness,

then, except as provided in subsections (b) and (d) , no gain or loss shall result to the seller from such reacquisition, and no debt shall become worthless or partially worthless as a result of such reacquisition.

(b) Amount of gain resulting.

(1) In general. In the case of a reacquisition of real property to which subsection (a) applies, gain shall result from such reacquisition to the extent that—

- (A) the amount of money and the fair market value of other property (other than obligations of the purchaser) received, prior to such reacquisition, with respect to the sale of such property, exceeds
- (B) the amount of the gain on the sale of such property returned as income for periods prior to such reacquisition.

(2) Limitation. The amount of gain determined under paragraph (1) resulting from a reacquisition during any taxable year beginning after the date of the enactment of this section shall not exceed the amount by which the price at which the real property was sold exceeded its adjusted basis, reduced by the sum of—

- (A) the amount of the gain on the sale of such property returned as income for periods prior to the reacquisition of such property, and
- (B) the amount of money and the fair market value of other property (other than obligations of the purchaser received with respect to the sale of such property) paid or transferred by the seller in connection with the reacquisition of such property.

For purposes of this paragraph , the price at which real property is sold is the gross sales price reduced by the selling commissions, legal fees, and other expenses incident to the sale of such property which are properly taken into account in determining gain or loss on such sale.

(3) Gain recognized. Except as provided in this section , the gain determined under this subsection resulting from a reacquisition to which subsection (a) applies shall be recognized, notwithstanding any other provision of this subtitle.

(c) Basis of reacquired real property. If subsection (a) applies to the reacquisition of any real property, the basis of such property upon such reacquisition shall be the adjusted basis of the indebtedness to the seller secured by such property (determined as of the date of reacquisition), increased by the sum of—

- (1) the amount of the gain determined under subsection (b) resulting from such reacquisition, and
- (2) the amount described in subsection (b)(2)(B) .

If any indebtedness to the seller secured by such property is not discharged upon the reacquisition of such property, the basis of such indebtedness shall be zero.

- (d) Indebtedness treated as worthless prior to reacquisition. If, prior to a reacquisition of real property to which subsection (a) applies, the seller has treated indebtedness secured by such property as having become worthless or partially worthless—
- (1) such seller shall be considered as receiving, upon the reacquisition of such property, an amount equal to the amount of such indebtedness treated by him as having become worthless, and
 - (2) the adjusted basis of such indebtedness shall be increased (as of the date of reacquisition) by an amount equal to the amount so considered as received by such seller.

(e) Principal residences. If—

- (1) subsection (a) applies to a reacquisition of real property with respect to the sale of which gain was not recognized under section 121 (relating to gain on sale of principal residence); and
- (2) within 1 year after the date of the reacquisition of such property by the seller, such property is resold by him,

then, under regulations prescribed by the Secretary, subsections (b) , (c) , and (d) of this section shall not apply to the reacquisition of such property and, for purposes of applying section 121 , the resale of such property shall be treated as a part of the transaction constituting the original sale of such property.

(f) Repealed.

(g) Acquisition by estate, etc., of seller. Under regulations prescribed by the Secretary, if an installment obligation is indebtedness to the seller which is described in subsection (a) , and if such obligation is, in the hands of the taxpayer, an obligation with respect to which section 691(a)(4)(B) applies, then—

- (1) for purposes of subsection (a) , acquisition of real property by the taxpayer shall be treated as reacquisition by the seller, and
- (2) the basis of the real property acquired by the taxpayer shall be increased by an amount equal to the deduction under section 691(c) which would (but for this subsection) have been allowable to the taxpayer with respect to the gain on the exchange of the obligation for the real property.

Reg. 1.1038-1(h) Illustrations. The application of this section may be illustrated by the following examples in which it is assumed that the reacquisition is in satisfaction of secured indebtedness arising out of the sale of the real property:

Example (1). (a) S purchases real property for \$20 and sells it to P for \$100, the property not being mortgaged at the time of sale. Under the contract P pays \$10 down and executes a note for \$90, with stated interest at 6 percent, to be paid in nine annual installments. S properly elects to report the gain on the installment method. After the second \$10 annual payment P defaults and S accepts a voluntary reconveyance of the property in complete satisfaction of the indebtedness. S pays \$5 in connection with the reacquisition of the property. The fair market value of the property at the time of the reacquisition is \$110.

(b) The gain derived by S on the reacquisition of the property is \$6, determined as follows:

Gain before application of limitation:	
Money with respect to the sale received by S prior to the reacquisition.....	\$ 30
Less: Gain returned by S as income for periods prior to the reacquisition (\$30 X [(\$100 - \$20)/\$100]).....	<u>24</u>
Gain before application of limitation..... 6
	=====

Limitation on amount of gain:	
Sales price of real property...	100
Less:	
Adjusted basis of the property at the time of sale.....	\$ 20
Gain returned by S as income for periods prior the reacquisition...	24
Amount of money paid by S in connection with the reacquisition...	<u>5</u>
	<u>49</u>
Limitation on amount of gain.....	51
	=====
Gain resulting from the reacquisition of the property	6

(c) The basis of the reacquired real property at the date of the reacquisition is \$25, determined as follows:

Adjusted basis of P's indebtedness to S ($\$70 - [\$70 \times \$80/\$100]$).....	\$ 14
Gain resulting from the reacquisition of the property...	6
Amount of money paid by S in connection with the reacquisition.....	<u>5</u>
Basis of reacquired property	25

Example (2). (a) The facts are the same as in example (1) except that S purchased the property for \$80.

(b) The gain derived by S on the reacquisition of the property is \$9, determined as follows:

Gain before application of limitation:.....	
Money with respect to the sale received by S prior to the reacquisition	\$30
Less: Gain returned by S as income for periods prior to the reacquisition ($\$30 \times [(\$100 - \$80)/\$100]$)	<u>6</u>
Gain before application of limitation	24
	=====

Limitation on amount of gain:	
Sales price of real property...	100
Less:	
Adjusted basis of the property at the time of sale	\$80
Gain returned by S as income for periods prior to the reacquisition	6
Amount of money paid by S in connection with the reacquisition	<u>5</u>
Limitation on amount of gain...	9
	=====
Gain resulting from the reacquisition of the property.....	9

(c) The basis of the reacquired real property at the date of the acquisition is \$70, determined as follows:

Adjusted basis of P's indebtedness to S ($\$70 \times \$20/\$200$)	\$56
Gain resulting from the reacquisition of the property	9
Amount of money paid by S in connection with the reacquisition	<u>5</u>
Basis of reacquired property	70
	=====

§1060 Special allocation rules for certain asset acquisitions

(a) General rule. In the case of any applicable asset acquisition, for purposes of determining both—

- (1) the transferee's basis in such assets, and
- (2) the gain or loss of the transferor with respect to such acquisition,

the consideration received for such assets shall be allocated among such assets acquired in such acquisition in the same manner as amounts are allocated to assets under section 338(b)(5) . If in connection with an applicable asset acquisition, the transferee and transferor agree in writing as to the allocation of any consideration, or as to the fair market value of any of the assets, such agreement shall be binding on both the transferee and transferor unless the Secretary determines that such allocation (or fair market value) is not appropriate.

(b) Information required to be furnished to Secretary. Under regulations, the transferor and transferee in an applicable asset acquisition shall, at such times and in such manner as may be provided in such regulations, furnish to the Secretary the following information:

- (1) The amount of the consideration received for the assets which is allocated to section 197 intangibles.
- (2) Any modification of the amount described in paragraph (1) .
- (3) Any other information with respect to other assets transferred in such acquisition as the Secretary deems necessary to carry out the provisions of this section .

(c) Applicable asset acquisition. For purposes of this section, the term “applicable asset acquisition” means any transfer (whether directly or indirectly)—

- (1) of assets which constitute a trade or business, and
- (2) with respect to which the transferee's basis in such assets is determined wholly by reference to the consideration paid for such assets.

A transfer shall not be treated as failing to be an applicable asset acquisition merely because section 1031 applies to a portion of the assets transferred.

(d) Treatment of certain partnership transactions. In the case of a distribution of partnership property or a transfer of an interest in a partnership—

- (1) the rules of subsection (a) shall apply but only for purposes of determining the value of section 197 intangibles for purposes of applying section 755, and
- (2) if section 755 applies, such distribution or transfer (as the case may be) shall be treated as an applicable asset acquisition for purposes of subsection (b).

(e) Information required in case of certain transfers of interests in entities.

(1) In general. If—

- (A) a person who is a 10-percent owner with respect to any entity transfers an interest in such entity, and
- (B) in connection with such transfer, such owner (or a related person) enters into an employment contract, covenant not to compete, royalty or lease agreement, or other agreement with the transferee,

such owner and the transferee shall, at such time and in such manner as the Secretary may prescribe, furnish such information as the Secretary may require.

(2) 10-percent owner. For purposes of this subsection —

- (A) In general. The term “10-percent owner” means, with respect to any entity, any person who holds 10 percent or more (by value) of the interests in such entity immediately before the transfer.
- (B) Constructive ownership. Section 318 shall apply in determining ownership of stock in a corporation. Similar principles shall apply in determining the ownership of interests in any other entity.
- (3) Related person. For purposes of this subsection, the term “related person” means any person who is related (within the meaning of section 267(b) or 707(b)(1)) to the 10-percent owner.
- (f) Cross reference. For provisions relating to penalties for failure to file a return required by this section, see section 6721.

Reg §1.1060-1. Special allocation rules for certain asset acquisitions

(a) Scope

(1) *In general.* This section prescribes rules relating to the requirements of section 1060, which, in the case of an applicable asset acquisition, requires the transferor (the seller) and the transferee (the purchaser) each to allocate the consideration paid or received in the transaction among the assets transferred in the same manner as amounts are allocated under section 338(b)(5) (relating to the allocation of adjusted grossed-up basis among the assets of the target corporation when a section 338 election is made). In the case of an applicable asset acquisition described in paragraph (b)(1) of this section, sellers and purchasers must allocate the consideration under the residual method as described in §§1.338-6 and 1.338-7 in order to determine, respectively, the amount realized from, and the basis in, each of the transferred assets. For rules relating to distributions of partnership property or transfers of partnership interests which are subject to section 1060(d), see §1.755-2T.

(2) Effective dates.

(i) In general. The provisions of this section apply to any asset acquisition occurring after March 15, 2001. However, paragraphs (b)(9) and (c)(5) of this section apply only to applicable asset acquisitions occurring on or after April 10, 2006. A purchaser or a seller may make an irrevocable election to apply the rules in §1.338-11 (including the applicable provisions in §§1.197-2(g)(5), 1.381(c)(22)-1, 846 and 1060) to an applicable asset acquisition occurring before April 10, 2006. Paragraph (a)(2)(ii) of this section describes the time and manner of the election for the purchaser and paragraph (a)(2)(iii) of this section prescribes the time and manner of the election for the seller. The seller may make the election to apply the regulations retroactively without regard to whether the purchaser also makes the election. For rules applicable to asset acquisitions on or before March 15, 2001, see §1.1060-1T in effect before March 16, 2001 (see 26 CFR part 1 revised April 1, 2000).

(ii) Time and manner of making the election for the purchaser. The purchaser may make an election described in this paragraph (a)(2) by attaching a statement to its original or amended income tax return for the taxable year that includes the applicable asset sale. The statement must be entitled “Election to Retroactively Apply the Rules in §1.338-11 (Including the Applicable Provisions in §§1.197-2(g)(5), 1.381(c)(22)-1, 846 and 1060) to an Applicable Asset Acquisition Completed Before April 10, 2006” and must include the following information—

(A) The name and E.I.N. for the purchaser; and

(B) The following declaration (or a substantially similar declaration): The purchaser has amended its income tax returns for the taxable year that includes the applicable asset acquisition and for all affected subsequent years to reflect the rules in §1.338-11 (Including the Applicable Provisions in §§ 1.197-2(g)(5), 1.381(c)(22)-1,846 and 1060).

(iii) Time and manner of making the election for the seller. The seller may make an election described in this paragraph (a)(2) by attaching a statement to its original or amended income tax return for the taxable year that includes the applicable asset sale. The statement must be entitled “Election to retroactively apply the rules in §1.338-11(d) (including the applicable provisions in §§1.197-2(g)(5), 1.381(c)(22)-1, 846 and 1060) to an applicable asset acquisition completed before April 10, 2006” and must include the following information—

(A) The name and E.I.N. for the seller; and

(B) The following declaration (or a substantially similar declaration): The seller has amended its income tax returns for the taxable year that includes the applicable asset acquisition and for all affected subsequent years to reflect the rules in §§1.338-11 (including the applicable provisions in §§ 1.197-2(g)(5), 1.381(c)(22)-1, 846 and 1060).

(3) *Outline of topics.* In order to facilitate the use of this section, this paragraph (a)(3) lists the major paragraphs in this section as follows: (a) Scope. (1) In general. (2) Effective date. (3) Outline of topics. (b) Applicable asset acquisition. (1) In general. (2) Assets constituting a trade or business. (i) In general. (ii) Goodwill or going concern value. (iii) Factors indicating goodwill or going concern value. (3) Examples. (4) Asymmetrical transfers of assets. (5) Related transactions. (6) More than a single trade or business. (7) Covenant entered into by the seller. (8) Partial non-recognition exchanges. (9) Insurance Business. (c) Allocation of consideration among assets under the residual method. (1) Consideration. (2) Allocation of consideration among assets. (3) Certain costs. (4) Effect of agreement between parties. (5) Insurance Business. (d) Examples. (e) Reporting requirements. (1) Applicable asset acquisitions. (i) In general. (ii) Time and manner of reporting. (A) In general. (B) Additional reporting requirement. (C) Election described in §1.338-6(c)(5). (2) Transfers of interests in partnerships.

(b) Applicable asset acquisition.

(1) *In general.* An applicable asset acquisition is any transfer, whether direct or indirect, of a group of assets if the assets transferred constitute a trade or business in the hands of either the seller or the purchaser and, except as provided in paragraph (b)(8) of this section, the purchaser's basis in the transferred assets is determined wholly by reference to the purchaser's consideration.

(2) *Assets constituting a trade or business.*

(i) In general. For purposes of this section, a group of assets constitutes a trade or business if—

(A) The use of such assets would constitute an active trade or business under section 355; or

(B) Its character is such that goodwill or going concern value could under any circumstances attach to such group.

(ii) Goodwill or going concern value. Goodwill is the value of a trade or business attributable to the expectancy of continued customer patronage. This expectancy may be due to the name or reputation of a trade or business or any other factor. Going concern value is the additional value that attaches to property because of

its existence as an integral part of an ongoing business activity. Going concern value includes the value attributable to the ability of a trade or business (or a part of a trade or business) to continue functioning or generating income without interruption notwithstanding a change in ownership. It also includes the value that is attributable to the immediate use or availability of an acquired trade or business, such as, for example, the use of the revenues or net earnings that otherwise would not be received during any period if the acquired trade or business were not available or operational.

(iii) Factors indicating goodwill or going concern value. In making the determination in this paragraph (b)(2), all the facts and circumstances surrounding the transaction are taken into account. Whether sufficient consideration is available to allocate to goodwill or going concern value after the residual method is applied is not relevant in determining whether goodwill or going concern value could attach to a group of assets. Factors to be considered include—

- (A) The presence of any intangible assets (whether or not those assets are section 197 intangibles), provided, however, that the transfer of such an asset in the absence of other assets will not be a trade or business for purposes of section 1060;
- (B) The existence of an excess of the total consideration over the aggregate book value of the tangible and intangible assets purchased (other than goodwill and going concern value) as shown in the financial accounting books and records of the purchaser; and
- (C) Related transactions, including lease agreements, licenses, or other similar agreements between the purchaser and seller (or managers, directors, owners, or employees of the seller) in connection with the transfer.

(3) *Examples.* The following examples illustrate paragraphs (b)(1) and (2) of this section:

Example (1). S is a high grade machine shop that manufactures microwave connectors in limited quantities. It is a successful company with a reputation within the industry and among its customers for manufacturing unique, high quality products. Its tangible assets consist primarily of ordinary machinery for working metal and plating. It has no secret formulas or patented drawings of value. P is a company that designs, manufactures, and markets electronic components. It wants to establish an immediate presence in the microwave industry, an area in which it previously has not been engaged. P is acquiring assets of a number of smaller companies and hopes that these assets will collectively allow it to offer a broad product mix. P acquires the assets of S in order to augment its product mix and to promote its presence in the microwave industry. P will not use the assets acquired from S to manufacture microwave connectors. The assets transferred are assets that constitute a trade or business in the hands of the seller. Thus, P's purchase of S's assets is an applicable asset acquisition. The fact that P will not use the assets acquired from S to continue the business of S does not affect this conclusion.

Example (2). S, a sole proprietor who operates a car wash, both leases the building housing the car wash and sells all of the car wash equipment to P. S's use of the building and the car wash equipment constitute a trade or business. P begins operating a car wash in the building it leases from S. Because the assets transferred together with the asset leased are assets which constitute a trade or business, P's purchase of S's assets is an applicable asset acquisition.

Example (3). S, a corporation, owns a retail store business in State X and conducts activities in connection with that business enterprise that meet the active trade or business requirement of section 355. P is a minority shareholder of S. S distributes to P all the assets of S used in S's retail business in State X in complete redemption of P's stock in S held by P. The distribution of S's assets in redemption of P's stock is treated as a sale or exchange under sections 302(a) and 302(b)(3), and P's basis in the assets distributed to it is determined wholly by reference to the consideration paid, the S stock. Thus, S's distribution of assets constituting a trade or business to P is an applicable asset acquisition.

Example (4). S is a manufacturing company with an internal financial bookkeeping department. P is in the business of providing a financial bookkeeping service on a contract basis. As part of an agreement for P to begin providing financial bookkeeping services to S, P agrees to buy all of the assets associated with S's internal bookkeeping operations and provide employment to any of S's bookkeeping department employees who choose to accept a position with P. In addition to selling P the assets associated with its bookkeeping operation, S will enter into a long term contract with P for bookkeeping services. Because assets transferred from S to P, along with the related contract for bookkeeping services, are a trade or business in the hands of P, the sale of the bookkeeping assets from S to P is an applicable asset acquisition.

- (4) *Asymmetrical transfers of assets.* A purchaser is subject to section 1060 if—
- (i) Under general principles of tax law, the seller is not treated as transferring the same assets as the purchaser is treated as acquiring;
 - (ii) The assets acquired by the purchaser constitute a trade or business; and
 - (iii) Except as provided in paragraph (b)(8) of this section, the purchaser's basis in the transferred assets is determined wholly by reference to the purchaser's consideration.
- (5) *Related transactions.* Whether the assets transferred constitute a trade or business is determined by aggregating all transfers from the seller to the purchaser in a series of related transactions. Except as provided in paragraph (b)(8) of this section, all assets transferred from the seller to the purchaser in a series of related transactions are included in the group of assets among which the consideration paid or received in such series is allocated under the residual method. The principles of §1.338-1(c) are also applied in determining which assets are included in the group of assets among which the consideration paid or received is allocated under the residual method.
- (6) *More than a single trade or business.* If the assets transferred from a seller to a purchaser include more than one trade or business, then, in applying this section, all of the assets transferred (whether or not transferred in one transaction or a series of related transactions and whether or not part of a trade or business) are treated as a single trade or business.
- (7) *Covenant entered into by the seller.* If, in connection with an applicable asset acquisition, the seller enters into a covenant (e.g., a covenant not to compete) with the purchaser, that covenant is treated as an asset transferred as part of a trade or business.
- (8) *Partial non-recognition exchanges.* A transfer may constitute an applicable asset acquisition notwithstanding the fact that no gain or loss is recognized with respect to a portion of the group of assets transferred. All of the assets transferred, including the non-recognition assets, are taken into account in determining whether the group of assets constitutes a trade or business. The allocation of consideration under paragraph (c) of this section is done without taking into account either the non-recognition assets or the amount of money or other property that is treated as transferred in exchange for the non-

recognition assets (together, the non-recognition exchange property). The basis in and gain or loss recognized with respect to the non-recognition exchange property are determined under such rules as would otherwise apply to an exchange of such property. The amount of the money and other property treated as exchanged for non-recognition assets is the amount by which the fair market value of the non-recognition assets transferred by one party exceeds the fair market value of the non-recognition assets transferred by the other (to the extent of the money and the fair market value of property transferred in the exchange). The money and other property that are treated as transferred in exchange for the non-recognition assets (and which are not included among the assets to which section 1060 applies) are considered to come from the following assets in the following order: first from Class I assets, then from Class II assets, then from Class III assets, then from Class IV assets, then from Class V assets, then from Class VI assets, and then from Class VII assets. For this purpose, liabilities assumed (or to which a non-recognition exchange property is subject) are treated as Class I assets. See Example 1 in paragraph (d) of this section for an example of the application of section 1060 to a single transaction which is, in part, a non-recognition exchange.

(9) *Insurance business.* The mere reinsurance of insurance contracts by an insurance company is not an applicable asset acquisition, even if it enables the reinsurer to establish a customer relationship with the owners of the reinsured contracts. However, a transfer of an insurance business is an applicable asset acquisition if the purchaser acquires significant business assets, in addition to insurance contracts, to which goodwill and going concern value could attach. For rules regarding the treatment of an applicable asset acquisition of an insurance business, see paragraph (c)(5) of this section.

(c) Allocation of consideration among assets under the residual method.

(1) *Consideration.* The seller's consideration is the amount, in the aggregate, realized from selling the assets in the applicable asset acquisition under section 1001(b). The purchaser's consideration is the amount, in the aggregate, of its cost of purchasing the assets in the applicable asset acquisition that is properly taken into account in basis.

(2) *Allocation of consideration among assets.* For purposes of determining the seller's amount realized for each of the assets sold in an applicable asset acquisition, the seller allocates consideration to all the assets sold by using the residual method under §§1.338-6 and 1.338-7, substituting consideration for ADSP. For purposes of determining the purchaser's basis in each of the assets purchased in an applicable asset acquisition, the purchaser allocates consideration to all the assets purchased by using the residual method under §§1.338-6 and 1.338-7, substituting consideration for AGUB. In allocating consideration, the rules set forth in paragraphs (c)(3) and (4) of this section apply in addition to the rules in §§1.338-6 and 1.338-7.

(3) *Certain costs.* The seller and purchaser each adjusts the amount allocated to an individual asset to take into account the specific identifiable costs incurred in transferring that asset in connection with the applicable asset acquisition (e.g., real estate transfer costs or security interest perfection costs). Costs so allocated increase, or decrease, as appropriate, the total consideration that is allocated under the residual method. No adjustment is made to the amount allocated to an individual asset for general costs associated with the applicable asset acquisition as a whole or with groups of assets included therein (e.g., non-specific appraisal fees or accounting fees). These latter amounts are taken into account only indirectly through their effect on the total consideration to be allocated. If an election described in §1.338-6(c)(5) is made with respect to an applicable asset acquisition, any allocation of costs pursuant to this paragraph (c)(3) shall be made as if such election had not been made. The preceding sentence applies to applicable asset acquisitions occurring on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007, and on or

after September 15, 2004, see §1.1060-1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§1.338-6 and 1.1060-1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

(4) *Effect of agreement between parties.* If, in connection with an applicable asset acquisition, the seller and purchaser agree in writing as to the allocation of any amount of consideration to, or as to the fair market value of, any of the assets, such agreement is binding on them to the extent provided in this paragraph (c)(4). Nothing in this paragraph (c)(4) restricts the Commissioner's authority to challenge the allocations or values arrived at in an allocation agreement. This paragraph (c)(4) does not apply if the parties are able to refute the allocation or valuation under the standards set forth in *Commissioner v. Danielson*, 378 F.2d 771 (3d Cir.), cert. denied, 389 U.S. 858 (1967) (a party wishing to challenge the tax consequences of an agreement as construed by the Commissioner must offer proof that, in an action between the parties to the agreement, would be admissible to alter that construction or show its unenforceability because of mistake, undue influence, fraud, duress, etc.).

(5) *Insurance business.* If the trade or business transferred is an insurance business, the rules of this paragraph (c) are modified by the principles of §1.338-11(a) through (d). However, in transactions governed by section 1060, such principles apply even if the transfer of the trade or business is effected in whole or in part through indemnity reinsurance rather than assumption reinsurance, and, for the insurer or reinsurer, an insurance contract (including an annuity or reinsurance contract) is a Class VI asset regardless of whether it is a section 197 intangible. In addition, the principles of §1.338-11(f) through (h) apply if the transfer occurs in connection with the complete liquidation of the transferor.

(d) Examples. The following examples illustrate this section:

Example (1). (i) On January 1, 2001, A transfers assets X, Y, and Z to B in exchange for assets D, E, and F plus \$1,000 cash.

(ii) Assume the exchange of assets constitutes an exchange of like-kind property to which section 1031 applies. Assume also that goodwill or going concern value could under any circumstances attach to each of the DEF and XYZ groups of assets and, therefore, each group constitutes a trade or business under section 1060.

(iii) Assume the fair market values of the assets and the amount of money transferred are as follows:

Asset	Fair market value

By A:	
X	\$ 400
Y	400
Z	<u>200</u>
Total	1,000
	=====
By B:	
D	40
E	30
F	30
Cash (amount)	<u>1,000</u>
Total	1,100

(iv) Under paragraph (b)(8) of this section, for purposes of allocating consideration under paragraph (c) of this section, the like-kind assets exchanged and any money or other property that are treated as transferred in exchange for the like-kind property are excluded from the application of section 1060.

(v) Since assets X, Y, and Z are like-kind property, they are excluded from the application of the section 1060 allocation rules.

(vi) Since assets D, E, and F are like-kind property, they are excluded from the application of the section 1060 allocation rules. Thus, the allocation rules of section 1060 do not apply in determining B's gain or loss with respect to the disposition of assets D, E, and F, and the allocation rules of section 1060 and paragraph (c) of this section are not applied to determine A's bases of assets D, E, and F. In addition, \$900 of the \$1,000 cash B gave to A for A's like-kind assets (X, Y, and Z) is treated as transferred in exchange for the like-kind property in order to equalize the fair market values of the like-kind assets. Therefore, \$900 of the cash is excluded from the application of the section 1060 allocation rules.

(vii) \$100 of the cash is allocated under section 1060 and paragraph (c) of this section.

(viii) A received \$100 that must be allocated under section 1060 and paragraph (c) of this section. Since A transferred no Class I, II, III, IV, V, or VI assets to which section 1060 applies, in determining its amount realized for the part of the exchange to which section 1031 does not apply, the \$100 is allocated to Class VII assets (goodwill and going concern value).

(ix) B gave A \$100 that must be allocated under section 1060 and paragraph (c) of this section. Since B received from A no Class I, II, III, IV, V, or VI assets to which section 1060 applies, the \$100 consideration is allocated by B to Class VII assets (goodwill and going concern value).

Example (2). (i) On January 1, 2001, S, a sole proprietor, sells to P, a corporation, a group of assets that constitutes a trade or business under paragraph (b)(2) of this section. S, who plans to retire immediately, also executes in P's favor a covenant not to compete. P pays S \$3,000 in cash and assumes \$1,000 in liabilities. Thus, the total consideration is \$4,000.

(ii) On the purchase date, P and S also execute a separate agreement that states that the fair market values of the Class II, Class III, Class V, and Class VI assets S sold to P are as follows:

Asset class	Asset	Fair market value
II.....	Actively traded securities	<u>\$500</u>
	Total Class II.....	500
=====		
III.....	Accounts receivable.....	<u>200</u>
	Total Class III.....	200
=====		
V.....	Furniture and fixtures.....	800
	Building.....	800
	Land.....	200
	Equipment.....	<u>400</u>
	Total Class V.....	2,200
=====		
VI.....	Covenant not to compete.....	<u>900</u>
	Total Class VI.....	900

(iii) P and S each allocate the consideration in the transaction among the assets transferred under paragraph (c) of this section in accordance with the agreed upon fair market values of the assets, so that \$500 is allocated to Class II assets, \$200 is allocated to the Class III asset, \$2,200 is

allocated to Class V assets, \$900 is allocated to Class VI assets, and \$200 (\$4,000 total consideration less \$3,800 allocated to assets in Classes II, III, V, and VI) is allocated to the Class VII assets (goodwill and going concern value).

(iv) In connection with the examination of P's return, the Commissioner, in determining the fair market values of the assets transferred, may disregard the parties' agreement. Assume that the Commissioner correctly determines that the fair market value of the covenant not to compete was \$500. Since the allocation of consideration among Class II, III, V, and VI assets results in allocation up to the fair market value limitation, the \$600 of unallocated consideration resulting from the Commissioner's redetermination of the value of the covenant not to compete is allocated to Class VII assets (goodwill and going concern value).

(e) Reporting requirements.

(1) Applicable asset acquisitions.

(i) In general. Unless otherwise excluded from this requirement by the Commissioner, the seller and the purchaser in an applicable asset acquisition each must report information concerning the amount of consideration in the transaction and its allocation among the assets transferred. They also must report information concerning subsequent adjustments to consideration.

(ii) Time and manner of reporting.

(A) In general. The seller and the purchaser each must file asset acquisition statements on Form 8594, "Asset Allocation Statement," with their income tax returns or returns of income for the taxable year that includes the first date assets are sold pursuant to an applicable asset acquisition. This reporting requirement applies to all asset acquisitions described in this section. For reporting requirements relating to asset acquisitions occurring before March 16, 2001, as described in paragraph (a)(2) of this section, see the temporary regulations under section 1060 in effect prior to March 16, 2001 (see 26 CFR part 1 revised April 1, 2000).

(B) Additional reporting requirement. When an increase or decrease in consideration is taken into account after the close of the first taxable year that includes the first date assets are sold in an applicable asset acquisition, the seller and the purchaser each must file a supplemental asset acquisition statement on Form 8594 with the income tax return or return of income for the taxable year in which the increase (or decrease) is properly taken into account.

(C) Election described in §1.338-6(c)(5).

(1) Availability. The election described in §1.338-6(c)(5) is available in respect of an applicable asset acquisition provided that the requirements of that section are satisfied. Such election may be made by the seller, regardless of whether the purchaser also makes the election, and may be made by the purchaser, regardless of whether the seller also makes the election.

(2) Time and manner of making election. The election described in §1.338-6(c)(5) is made by taking a position on a timely filed original tax return for the taxable year of the applicable asset acquisition that is consistent with having made the election.

(3) Irrevocability of election. The election described in § 1.338-6(c)(5) is irrevocable.

(4) Effective/applicability date. This paragraph (e)(1)(ii)(C) applies to applicable asset acquisitions occurring on or after September 11, 2007. For applicable asset acquisitions occurring before September 11, 2007 and on or after September 15, 2004, see § 1.1060-1T as contained in 26 CFR Part 1 in effect on April 1, 2007. For applicable asset acquisitions occurring before September 15, 2004, see §§1.338-6 and 1.1060-1 as contained in 26 CFR Part 1 in effect on April 1, 2004.

(2) *Transfers of interests in partnerships.* For reporting requirements relating to the transfer of a partnership interest, see §1.755-1(d).

1.338-6(b) General rule for allocating ADSP and AGUB

(1) *Reduction in the amount of consideration for Class I assets.* Both ADSP and AGUB, in the respective allocation of each, are first reduced by the amount of Class I assets. Class I assets are cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions. If the amount of Class I assets exceeds AGUB, new target will immediately realize ordinary income in an amount equal to such excess. The amount of ADSP or AGUB remaining after the reduction is to be allocated to the remaining acquisition date assets.

(2) *Other assets.*

(i) In general. Subject to the limitations and other rules of paragraph (c) of this section, ADSP and AGUB (as reduced by the amount of Class I assets) are allocated among Class II acquisition date assets of target in proportion to the fair market values of such Class II assets at such time, then among Class III assets so held in such proportion, then among Class IV assets so held in such proportion, then among Class V assets so held in such proportion, then among Class VI assets so held in such proportion, and finally to Class VII assets. If an asset is described below as includible in more than one class, then it is included in such class with the lower or lowest class number (for instance, Class III has a lower class number than Class IV).

(ii) Class II assets. Class II assets are actively traded personal property within the meaning of section 1092(d)(1) and §1.1092(d)-1 (determined without regard to section 1092(d)(3)). In addition, Class II assets include certificates of deposit and foreign currency even if they are not actively traded personal property. Class II assets do not include stock of target affiliates, whether or not of a class that is actively traded, other than actively traded stock described in section 1504(a)(4). Examples of Class II assets include U.S. government securities and publicly traded stock.

(iii) Class III assets. Class III assets are assets that the taxpayer marks to market at least annually for Federal income tax purposes and debt instruments (including accounts receivable). However, Class III assets do not include—

(A) Debt instruments issued by persons related at the beginning of the day following the acquisition date to the target under section 267(b) or 707;

(B) Contingent debt instruments subject to §1.1275-4, §1.483-4, or section 988, unless the instrument is subject to the non-contingent bond method of §1.1275-4(b) or is described in §1.988-2(b)(2)(i)(B)(2); and

(C) Debt instruments convertible into the stock of the issuer or other property.

(iv) Class IV assets. Class IV assets are stock in trade of the taxpayer or other property of a kind that would properly be included in the inventory of taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

(v) Class V assets. Class V assets are all assets other than Class I, II, III, IV, VI, and VII assets.

(vi) Class VI assets. Class VI assets are all section 197 intangibles, as defined in section 197, except goodwill and going concern value.

(vii) Class VII assets. Class VII assets are goodwill and going concern value (whether or not the goodwill or going concern value qualifies as a section 197 intangible).

§1091 Loss from wash sales of stock or securities

- (a) Disallowance of loss deduction. In the case of any loss claimed to have been sustained from any sale or other disposition of shares of stock or securities where it appears that, within a period beginning 30 days before the date of such sale or disposition and ending 30 days after such date, the taxpayer has acquired (by purchase or by an exchange on which the entire amount of gain or loss was recognized by law), or has entered into a contract or option so to acquire, substantially identical stock or securities, then no deduction shall be allowed under section 165 unless the taxpayer is a dealer in stock or securities and the loss is sustained in a transaction made in the ordinary course of such business. For purposes of this section, the term “stock or securities” shall, except as provided in regulations, include contracts or options to acquire or sell stock or securities.
- (b) Stock acquired less than stock sold. If the amount of stock or securities acquired (or covered by the contract or option to acquire) is less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the loss from the sale or other disposition of which is not deductible shall be determined under regulations prescribed by the Secretary.
- (c) Stock acquired not less than stock sold. If the amount of stock or securities acquired (or covered by the contract or option to acquire) is not less than the amount of stock or securities sold or otherwise disposed of, then the particular shares of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility of the loss shall be determined under regulations prescribed by the Secretary.
- (d) Unadjusted basis in case of wash sale of stock. If the property consists of stock or securities the acquisition of which (or the contract or option to acquire which) resulted in the nondeductibility (under this section or corresponding provisions of prior internal revenue laws) of the loss from the sale or other disposition of substantially identical stock or securities, then the basis shall be the basis of the stock or securities so sold or disposed of, increased or decreased, as the case may be, by the difference, if any, between the price at which the property was acquired and the price at which such substantially identical stock or securities were sold or otherwise disposed of.
- (e) Certain short sales of stock or securities and securities futures contracts to sell. Rules similar to the rules of subsection (a) shall apply to any loss realized on the closing of a short sale of (or the sale, exchange, or termination of a securities futures contract to sell) stock or securities if, within a period beginning 30 days before the date of such closing and ending 30 days after such date—
- (1) substantially identical stock or securities were sold, or
 - (2) another short sale of (or securities futures contracts to sell) substantially identical stock or securities was entered into.
- For purposes of this subsection, the term “securities futures contract” has the meaning provided by section 1234B(c).
- (f) Cash settlement. This section shall not fail to apply to a contract or option to acquire or sell stock or securities solely by reason of the fact that the contract or option settles in (or could be settled in) cash or property other than such stock or securities.

§1239 Gain from sale of depreciable property between certain related taxpayers

- (a) Treatment of gain as ordinary income. In the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, of a character which is subject to the allowance for depreciation provided in section 167.
- (b) Related persons. For purposes of subsection (a), the term “related persons” means—
- (1) a person and all entities which are controlled entities with respect to such person,
 - (2) a taxpayer and any trust in which such taxpayer (or his spouse) is a beneficiary, unless such beneficiary's interest in the trust is a remote contingent interest (within the meaning of section 318(a)(3)(B)(i)), and
 - (3) except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate.
- (c) Controlled entity defined.
- (1) General rule. For purposes of this section, the term “controlled entity” means, with respect to any person—
 - (A) a corporation more than 50 percent of the value of the outstanding stock of which is owned (directly or indirectly) by or for such person,
 - (B) a partnership more than 50 percent of the capital interest or profits interest in which is owned (directly or indirectly) by or for such person, and
 - (C) any entity which is a related person to such person under paragraph (3), (10), (11), or (12) of section 267(b).
 - (2) Constructive ownership. For purposes of this section, ownership shall be determined in accordance with rules similar to the rules under section 267(c) (other than paragraph (3) thereof).
- (d) Employer and related employee association. For purposes of subsection (a), the term “related person” also includes—
- (1) an employer and any person related to the employer (within the meaning of subsection (b)), and
 - (2) a welfare benefit fund (within the meaning of section 419(e)) which is controlled directly or indirectly by persons referred to in paragraph (1).
- (e) Patent applications treated as depreciable property. For purposes of this section, a patent application shall be treated as property which, in the hands of the transferee, is of a character which is subject to the allowance for depreciation provided in section 167.