

Final Regs on Installment Obligations in Liquidation

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Final regulations have been published (T.D. 8762) on the treatment a shareholder may receive on the liquidation of a corporation. Specifically, the regulations cover the ability of a shareholder to use the installment method of reporting gain on installment obligations that are distributed in complete liquidation of the corporation. Proposed regulations on this topic were issued in January 1997 (REG-209332-80). The final regulations make various modifications in the proposed regulations, although holding to their general tenets.

Installment Treatment

As enacted by the Installment Sales Revision Act of 1980 and amended by the Tax Reform Act of 1986, Section 453(h) provides a different treatment for certain installment obligations that are distributed in a complete liquidation to which Section 331 applies. Under Section 453(h), a shareholder that does not elect out of the installment method treats the payments under the obligation, rather than the obligation itself, as consideration received in exchange for the stock.

The shareholder then takes into account the income from the payments under the obligation using the installment method. In this manner, the shareholder generally is treated as if the shareholder sold the shareholder's stock to an unrelated purchaser on the installment method.

This treatment under Section 453(h) applies

generally to installment obligations received by a shareholder (in exchange for the shareholder's stock) in a complete liquidation to which Section 331 applies if: (a) the installment obligations are qualifying installment obligations, *i.e.*, the installment obligations are acquired in respect of a sale or exchange of property by the corporation during the 12-month period beginning on the date a plan of complete liquidation is adopted; and (b) the liquidation is completed within that 12-month period.

However, an installment obligation acquired in a sale or exchange of inventory, stock in trade, or property held for sale in the ordinary course of business qualifies for this treatment only if the obligation arises from a single bulk sale of substantially all of such property attributable to a trade or business of the corporation. If an installment obligation arises from both a sale or exchange of inventory, etc., that does not comply with the requirements of the preceding sentence and a sale or exchange of other assets, the portion of the installment obligation that is attributable to the sale or exchange of other assets is a qualifying installment obligation.

Final Regulations

Under the final regulations, where a shareholder receives an installment obligation from a corporation in a liquidating distribution, it will not be a "qualifying obligation" if the corporation's stock is traded on an established securities market. Likewise, the same installment obligation would not qualify for installment reporting if the corporation's stock is traded on an established securities market.

Thus, either the installment obligation itself or the company's stock is being traded on an established securities market, it will accelerate any gain inherent in the installment obligation to the shareholder.

On the more positive side, however, there are circumstances where installment treatment will be available. If a shareholder receives an installment obligation from a liquidating corporation whose stock is not publicly traded, and the obligation arose from a sale by the corporation of stock or securities that are traded on an established market, the obligation generally will qualify as an installment obligation in

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January 28, 1998. The rules apply to distributions of qualifying installment obligations made on or after that date. ■

the hands of the transferor.

The final regulations provide, though, that this treatment will not apply if the liquidating corporation is formed or availed of for a principal purpose of avoiding limitations on the availability of installment sales treatment through the use of a related party.

Multiple Tax Year Distributions

The final regulations also cover what happens where shareholders receive liquidating distributions in multiple tax years. Under the current year recognition rule, shareholders must recognize in the current year the additional amount of gain that would have been recognized in the earlier year had the total amount of liquidating distributions been known in the earlier year. When allocating basis to calculate gain to be reported in the first year in which a liquidating distribution is received, shareholders must reasonably estimate the aggregate distribution. The regulations require shareholders to take into account distributions and other events occurring up to the time at which the return is filed for the first tax year.

Suggestions Sloughed Off

In releasing the final regulations, the IRS noted in its preamble that it failed to include a number of suggestions made by commentators to the proposed regulations. For example, it had been suggested that the anti-abuse rule should be eliminated (no chance!). Commentators also suggested that there be an ordering rule adopted for shareholders who receive liquidating distributions in multiple tax years.

It had also been recommended that the regulations should be modified to provide relief from a bunching of income that occurs for shareholders receiving liquidating distributions from S corporations. Finally, one suggestion was to expand the regulations to address the use of the installment method to the sale of corporate stock for which a Section 338(h)(10) election has been made.

Effective Date

The new regulations on installment obligations received from liquidating corporations are effective