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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9140

RIN 1545-BA90

Transfers to Provide for Satisfaction of Contested Liabilities

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to transfers of money or other property to provide for the satisfaction of contested liabilities. The regulations affect taxpayers that are contesting an asserted liability and that transfer their own stock or indebtedness, the stock or indebtedness of a related party, or a promise to provide services or property in the future, to provide for the satisfaction of the liability prior to the resolution of the contest. The regulations also affect taxpayers that transfer money or other property to a trust, an escrow account, or a court to provide for the satisfaction of a liability for which payment is economic performance.

DATES: Effective Date: These regulations are effective July 20, 2004.

Applicability Dates: For dates of applicability, see ' 1.461-2(g).

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

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR Part 1 under section 461(f) of the Internal Revenue Code (Code). On November 21, 2003, temporary regulations (TD 9095) were published in the **Federal Register** (68 FR 65634) relating to the transfer of money or other property to provide for the satisfaction of an asserted liability that a taxpayer is contesting. A notice of proposed rulemaking (REG-136890-02) cross-referencing the temporary regulations also was published in the **Federal Register** (68 FR 65645) on November 21, 2003. No public hearing was requested or held. One comment was received responding to the notice of proposed rulemaking. After consideration of the comment, the proposed regulations are adopted by this Treasury decision.

Summary of Comment

The temporary regulations clarify that, in general, economic performance does not occur in the taxable year in which a taxpayer transfers money or other property to a trust, escrow account, or court to provide for the satisfaction of an asserted liability under section 461(f) for which payment constitutes economic performance. Rather, economic performance occurs in the taxable year in which a taxpayer transfers money or other property to the person asserting the liability that the taxpayer is contesting, or in the taxable year in which payment from the trust, escrow account, or court registry is made to the person to which the liability is owed. The temporary regulations also indicate that economic performance may be satisfied under section 468B and the regulations thereunder (relating to designated settlement funds and qualified settlement funds).

A commentator suggested that the regulations provide an example of a transfer to a contested liability fund that qualifies for a deduction in the taxable year of transfer because

it also satisfies the requirements for a qualified settlement fund under §1.468B-1. The final regulations do not adopt this comment because the requirements for establishing a qualified settlement fund under §1.468B-1 are complex and are beyond the scope of these regulations.

Effective Date

In general, these final regulations apply to transfers made in taxable years beginning after December 31, 1953, and ending after August 16, 1954. However, these regulations apply to transfers of any stock of the taxpayer or any stock or indebtedness of a related person on or after November 19, 2003. Additionally, §1.461-2(e)(2)(i), relating to economic performance, applies to transfers of money or other property after July 18, 1984, the effective date of section 461(h). Section 1.461-2(e)(2)(ii) applies to (1) transfers of money or other property after July 18, 1984, to satisfy workers compensation or tort liabilities, and (2) transfers of money or other property in taxable years beginning after December 31, 1991, the effective date of ' 1.461-4(g), to satisfy payment liabilities designated under ' 1.461-4(g) (other than liabilities for workers compensation or tort).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the

proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Norma Rotunno of the Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1-- INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

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

Par. 2. In §1.461-2, paragraphs (c)(1), (e)(2), (e)(3) Example 2, and (g) are revised to read as follows:

§1.461-2 Contested liabilities.

* * * * *

(c) Transfer to provide for the satisfaction of an asserted liability--(1) In general. (i)

A taxpayer may provide for the satisfaction of an asserted liability by transferring money or other property beyond his control to--

(A) The person who is asserting the liability;

(B) An escrowee or trustee pursuant to a written agreement (among the escrowee or trustee, the taxpayer, and the person who is asserting the liability) that the money or other property be delivered in accordance with the settlement of the contest;

(C) An escrowee or trustee pursuant to an order of the United States or of any State or political subdivision thereof or any agency or instrumentality of the foregoing, or of a court, that the money or other property be delivered in accordance with the settlement of the contest; or

(D) A court with jurisdiction over the contest.

(ii) In order for money or other property to be beyond the control of a taxpayer, the taxpayer must relinquish all authority over the money or other property.

(iii) The following are not transfers to provide for the satisfaction of an asserted liability--

(A) Purchasing a bond to guarantee payment of the asserted liability;

(B) An entry on the taxpayer's books of account;

(C) A transfer to an account that is within the control of the taxpayer;

(D) A transfer of any indebtedness of the taxpayer or of any promise by the taxpayer to provide services or property in the future; and

(E) A transfer to a person (other than the person asserting the liability) of any stock of the taxpayer or of any stock or indebtedness of a person related to the taxpayer (as defined in section 267(b)).

* * * * *

(e) * * *

(2) Application of economic performance rules to transfers under section 461(f). (i)

A taxpayer using an accrual method of accounting is not allowed a deduction under section 461(f) in the taxable year of the transfer unless economic performance has occurred.

(ii) Economic performance occurs for liabilities requiring payment to another person arising out of any workers compensation act or any tort, or any other liability designated in ' 1.461-4(g), as payments are made to the person to which the liability is owed. Except as provided in section 468B or the regulations thereunder, economic performance does not occur when a taxpayer transfers money or other property to a trust, an escrow account, or a court to provide for the satisfaction of an asserted workers compensation, tort, or other liability designated under ' 1.461-4(g) that the taxpayer is contesting unless the trust, escrow account, or court is the person to which the liability is owed or the taxpayer's payment to the trust, escrow account, or court discharges the taxpayer's liability to the claimant. Rather, economic performance occurs in the taxable year the taxpayer transfers money or other property to the person that is asserting the workers compensation, tort, or other liability designated under ' 1.461-4(g) that the taxpayer is contesting or in the taxable year that payment is made from a trust, an escrow account, or a court registry funded by the taxpayer to the person to which the liability is owed.

(3) * * *

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Example 2. Corporation X is a defendant in a class action suit for tort liabilities. In 2002, X establishes a trust for the purpose of satisfying the asserted liability and transfers \$10,000,000 to the trust. The trust does not satisfy the requirements of section 468B or the regulations thereunder. In 2004, the trustee pays \$10,000,000 to the plaintiffs in settlement of the litigation. Under paragraph (e)(2) of this section, economic performance with

respect to X's liability to the plaintiffs occurs in 2004. X may deduct the \$10,000,000 payment to the plaintiffs in 2004.

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(g) Effective dates. (1) Except as otherwise provided, this section applies to transfers of money or other property in taxable years beginning after December 31, 1953, and ending after August 16, 1954.

(2) Paragraph (c)(1)(iii)(E) of this section applies to transfers of any stock of the taxpayer or any stock or indebtedness of a person related to the taxpayer on or after November 19, 2003.

(3) Paragraph (e)(2)(i) of this section applies to transfers of money or other property after July 18, 1984.

(4) Paragraph (e)(2)(ii) and paragraph (e)(3) Example 2 of this section apply to--

(i) Transfers after July 18, 1984, of money or other property to provide for the satisfaction of an asserted workers compensation or tort liability; and

(ii) Transfers in taxable years beginning after December 31, 1991, of money or other property to provide for the satisfaction of asserted liabilities designated in ' 1.461-

4(g) (other than liabilities for workers compensation or tort).

Mark E. Matthews

Deputy Commissioner for Services and Enforcement.

Approved: July 7, 2004

Gregory F. Jenner

Acting Assistant Secretary of the Treasury.