

ISSUE

[REDACTED]

CONCLUSION

[REDACTED]

FACTS

[REDACTED]

Under the ANCSA, the purpose of a Settlement Trust is to promote the health, education and welfare of its beneficiaries and preserve the heritage and culture of the Alaska Natives. [REDACTED]

[REDACTED]

LAW AND ANALYSIS

Section 301 provides rules governing the income tax treatment of the shareholders who receive distributions of property by corporations. Section 301(a) provides that a distribution of property by a corporation to shareholders with respect to its stock is governed by § 301(c). Section 301(c) treats distributions: (1) as a dividend and included in gross income if the distribution is from corporate earnings and profits as defined in § 316(a); (2) as a reduction in the shareholder's basis in its stock to the extent the distribution is not a dividend; and (3) any amount which exceeds the shareholder's basis is treated as capital gain. Under § 301(d), the basis of any property received in a § 301(a) distribution is the property's fair market value.

Section 311 addresses the income tax effect on a corporation of a distribution of property. Under § 311(a), no gain or loss is recognized by a corporation on a non-liquidating distribution of property to shareholders made with respect to its stock. This rule is modified by § 311(b), whereby a corporation recognizes gain on distributions of property to a shareholder when the fair market value of such property exceeds the adjusted basis of the property in the hands of the distributing corporation (“Built-in Gain Property”).

Section 646 provides special rules governing the income tax treatment of ANCs, Alaska Native Settlement Trusts (“ANS Trusts”) and ANS Trust beneficiaries. Section 646(d)(1) provides that, when a proper election is made, no amount is includible in the gross income of a beneficiary of an ANS Trust by reason of a contribution to such trust.

The legislative history accompanying the enactment of § 646 also provides that Congress intended that, even though the ANS Trust beneficiaries do not recognize income on the contribution of Built-in Gain Property from the ANC to the ANS Trust of which the shareholders are beneficiaries, and the ANC does not reduce its earnings and profits by the amount of the distribution, the ANC recognizes gain on Built-in Gain Property under § 311(b). See H. Rpt. 107-84, p. 302, n. 141 (“[i]f the ANC transfers appreciated property to the Trust, section 311(b) of the Code will apply to the ANC, as under present law, so that the ANC will recognize gain as if it had sold the property for fair market value. *The Trust takes the property with a fair market value basis, pursuant to section 301(d) of the Code.*”) (emphasis added).

Section 1015(b) provides the rule for determining the basis of property transferred in trust (other than by gift, bequest or devise). It generally provides that such property has the same basis as it would be in the hands of the grantor/transferor, adjusted by the amount of gain or loss recognized by the transferor (“Transferred Basis”).

Section 646 does not change the normal application of § 301 to transactions involving transfers of property from ANCs to ANS Trusts; instead, § 646 (to the extent relevant to this issue) merely excludes any resulting dividends or gains from the income of the ANS Trust beneficiaries. Consequently, an ANS Trust takes a fair market value basis pursuant to § 301(d) for all property contributed by an ANC. This conclusion is a change from the position taken in several prior private letter rulings issued after the enactment of § 646. Those prior rulings held that the basis for Built-in Gain Property contributed to the ANS Trust is determined pursuant to § 301(d), while the basis for Built-in Loss Property contributed to the ANS Trust is determined pursuant to § 1015(b), thereby preserving the loss in the property. See PLR 128030-02, PLR 134446-02, PLR 158316-06, PLR 142599-08, and PLR 143287-06.

Although the prior rulings did not explain their analysis, the conclusion that ANS Trusts took a transferred basis under § 1015 with respect to Built-in Loss Property apparently rested on the premise that the exclusion of ANC distributions from potential dividend/gain treatment of §301 by § 646 meant that those distributions were not distributions with respect to stock for purposes of § 301(a) at all. Because the fair market value basis rule of § 301(d) applies only if the property is first subject to § 301(a), the prior rulings apparently concluded that the basis rules in § 1015(b) that govern the basis of property transferred in trust applied instead.

The prior rulings reached a different conclusion regarding Built-in Gain Property, however, because the legislative history that accompanied the enactment of § 646 in 2001 specifically noted that § 311(b) applied to distributions of Built-in Gain Property from an ANC to an ANS Trust. Furthermore, that legislative history stated that the ANS Trust would take a fair market value basis under § 301(d). The fact that the legislative history specifically provided that Built-in Gain Property distributions were subject to § 301 without mentioning the treatment for Built-in Loss Property might be interpreted that the enactment of § 646 had generally removed ANC distributions from the rules of § 301, and the specific mention of the treatment of Built-in Gain Property in the legislative history was an exception to that general rule. Otherwise, if the application of § 301 was the norm, the specific mention of the treatment of Built-in Gain Property distributions in the legislative history would be unnecessary.

However, we now conclude this prior understanding was incorrect. There is no logic to differentiate application of § 301(d) based on whether the contributed property is Built-in Gain Property or Built-in Loss Property. Rather, § 646(d) merely suspends the normative tax effects of the constructive distribution to both the shareholder/beneficiary (no income to the shareholders/beneficiaries) and the distributing corporation (no reduction in earnings and profits). Congress suspended these effects to accomplish its goals: specifically, to avoid ANC earnings and profits reductions, and phantom income to ANS Trust beneficiaries. Because the deemed distribution of property remains a § 301 distribution “to a shareholder with respect to its stock,” § 301(d) applies to determine the basis of the property regardless of who holds legal title to the property distributed.

While the legislative history discussed only the basis of the ANS Trust in Built-in Gain Property contributed by an ANC and did not discuss the basis of Built-in Loss Property, this does not result in the conclusion that the normal rules of § 301(d) do not apply. Rather, the Committee only discussed Built-in Gain Property because the Committee wanted to make sure the ANC continued to recognize gain on Built-in Gain Property, which was the law prior to enactment of § 646, and to clarify that § 646 would not alter this outcome. [REDACTED]

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Please call Charles Wien at 202-317-5279 if you have any further questions.

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