

(1) Liabilities assumed are not to be treated as “other property or money” for the purpose of determining the amount of realized gain which is to be recognized under section 351, 361, 371, or 374, if the transactions would, but for the receipt of “other property or money” have been exchanges of the type described in any one of such sections; and

(2) If the only type of consideration received by the transferor in addition to that permitted to be received by section 351, 361, 371, or 374, consists of an assumption of liabilities, the transaction, if otherwise qualified, will be deemed to be within the provisions of section 351, 361, 371, or 374.

(b) *Application of general rule.* The application of paragraph (a) of this section may be illustrated by the following example:

Example. A, an individual, transfers to a controlled corporation property with an adjusted basis of \$10,000 in exchange for stock of the corporation with a fair market value of \$8,000, \$3,000 cash, and the assumption by the corporation of indebtedness of A amounting to \$4,000. A’s gain is \$5,000, computed as follows:

Stock received, fair market value	\$8,000
Cash received	3,000
Liability assumed by transferee	4,000
	15,000
Total consideration received	15,000
Less: Adjusted basis of property transferred	10,000
	5,000
Gain realized	5,000

Assuming that the exchange falls within section 351 as a transaction in which the gain to be recognized is limited to “other property or money” received, the gain recognized to A will be limited to the \$3,000 cash received, since, under the general rule of section 357(a), the assumption of the \$4,000 liability does not constitute “other property.”

(c) *Tax avoidance purpose.* The benefits of section 357(a) do not extend to any exchange involving an assumption of liabilities where it appears that the principal purpose of the taxpayer with respect to such assumption was to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose. In such cases, the total amount of liabilities assumed or acquired pursuant to such exchange (and not merely a particular liability with respect to which the tax avoidance purpose existed) shall, for the purpose of determining the amount

of gain to be recognized upon the exchange in which the liabilities are assumed or acquired, be treated as money received by the taxpayer upon the exchange. Thus, if in the example set forth in paragraph (b) of this section, the principal purpose of the assumption of the \$4,000 liability was to avoid tax on the exchange, or was not a bona fide business purpose, then the amount of gain recognized would be \$5,000. In any suit or proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as “other property or money” under section 357, which is the case if the Commissioner determines that the taxpayer’s purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose, and the taxpayer contests such determination by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove his case by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6528, 26 FR 399, Jan. 19, 1961]

§ 1.357-2 Liabilities in excess of basis.

(a) Section 357(c) provides in general that in an exchange to which section 351 (relating to a transfer to a corporation controlled by the transferor) is applicable, or to which section 361 (relating to the nonrecognition of gain or loss to corporations) is applicable by reason of a section 368(a)(1)(D) reorganization, if the sum of the amount of liabilities assumed plus the amount of liabilities to which the property is subject exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset as the case may be. Thus, if an individual transfers, under section 351, properties having a total basis in his hands of \$20,000, one of which has a basis of \$10,000 but is subject to a mortgage of \$30,000, to a corporation controlled by him, such individual will be subject to

tax with respect to \$10,000, the excess of the amount of the liability over the total adjusted basis of all the properties in his hands. The same result will follow whether or not the liability is assumed by the transferee. The determination of whether a gain resulting from the transfer of capital assets is long-term or short-term capital gain shall be made by reference to the holding period to the transferor of the assets transferred. An exception to the general rule of section 357(c) is made (1) for any exchange as to which under section 357(b) (relating to assumption of liabilities for tax-avoidance purposes) the entire amount of the liabilities is treated as money received and (2) for an exchange to which section 371 (relating to reorganizations in certain receivership and bankruptcy proceedings) or section 374 (relating to gain or loss not recognized in certain railroad reorganizations) is applicable.

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

Example 1. If all such assets transferred are capital assets and if half the assets (ascertained by reference to their fair market value at the time of the transfer) have been held for less than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), and the remaining half for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), half the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as short-term capital gain, and the remaining half shall be treated as long-term capital gain.

Example 2. If half of the assets (ascertained by reference to their fair market value at the time of the transfer) transferred are capital assets and half are assets other than capital assets, then half of the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as capital gain, and the remaining half shall be treated as gain from the sale or exchange of assets other than capital assets.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6528, 26 FR 399, Jan. 19, 1961; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

§ 1.358-1 Basis to distributees.

(a) In the case of an exchange to which section 354 or 355 applies in

which, under the law applicable to the year in which the exchange is made, only nonrecognition property is received, immediately after the transaction, the sum of the basis of all of the stock and securities received in the transaction shall be the same as the basis of all the stock and securities in such corporation surrendered in the transaction, allocated in the manner described in § 1.358-2. In the case of a distribution to which section 355 applies in which, under the law applicable to the year in which the distribution is made, only nonrecognition property is received, immediately after the transaction, the sum of the basis of all of the stock and securities with respect to which the distribution is made plus the basis of all stock and securities received in the distribution with respect to such stock and securities shall be the same as the basis of the stock and securities with respect to which the distribution is made immediately before the transaction, allocated in the manner described in § 1.358-2. In the case of an exchange to which section 351 or 361 applies in which, under the law applicable to the year in which the exchange was made, only nonrecognition property is received, the basis of all the stock and securities received in the exchange shall be the same as the basis of all property exchanged therefor. If in an exchange or distribution to which section 351, 356, or 361 applies both nonrecognition property and "other property" are received, the basis of all the property except "other property" held after the transaction shall be determined as described in the preceding three sentences decreased by the sum of the money and the fair market value of the "other property" (as of the date of the transaction) and increased by the sum of the amount treated as a dividend (if any) and the amount of the gain recognized on the exchange, but the term gain as here used does not include any portion of the recognized gain that was treated as a dividend. In any case in which a taxpayer transfers property with respect to which loss is recognized, such loss shall be reflected in determining the basis of the property received in the exchange. The basis of the "other property" is its fair market value as of the