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subject: Real Estate Investment Trust ("REIT") Election upon Taxable Transfer of a Failed Bank's Assets and Liabilities

This Chief Counsel Advice responds to your request for assistance dated January 21, 2014. This advice may not be used or cited as precedent.

<u>LEGEND</u>

Taxpayer =
Bank =
Failed Holdco =
Failed Institution =
BankLLC =
Agency =
REIT-1 =
Securitization Trust =
State A =
State B =
Year 1 =
Year 2 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =

Date 5 =
Date 6 =
a =
b =
c =
d =
e =
f =
g =
h =
i =
j =
k =
l =
m =
n =

ISSUES

1. Do I.R.C § 597 and the accompanying regulations preclude a disregarded entity ("BankLLC"), which Taxpayer's subsidiary ("Bank") acquired from Failed Institution in a transaction in which Federal financial assistance ("FFA") was provided, from making a REIT election that would enable BankLLC to claim a carryover basis in its assets?

2. If BankLLC's REIT election were effective as of the date of BankLLC's formation, would § 362(e)(2) require BankLLC to reduce its basis in its assets to their fair market value as of the close of the previous day if such assets had a built-in loss?

CONCLUSIONS

1. Yes. Under Treas. Reg. §§ 1.597-3(g) and 1.597-5, BankLLC cannot claim a carryover basis in its assets. The regulations and legislative history accompanying § 597 provide that, in transactions where an acquiring bank purchases assets from a failed bank and receives "Net Worth Assistance" (i.e., up-front cash payments) from an "Agency" (as defined in § 1.597-1(b)), the failed bank should include such FFA in income, and the income inclusion should be offset by the failed bank's net operating losses and built-in losses triggered by the taxable transfer of its assets. The regulations and legislative history contemplate that the taxable transfer will eliminate the failed bank's tax attributes. The regulations and legislative history further clarify that the tax consequences of an Agency-assisted acquisition should not depend upon its form—i.e., the acquisition should be treated as an asset transfer regardless of whether the form of the transaction is a stock transfer or an asset transfer. We conclude that permitting post-acquisition REIT elections that enable acquiring banks to remove assets from a failed bank's consolidated group and claim a carryover

basis in such assets would run afoul of the anti-abuse provision set forth in § 1.597-3(g). Furthermore, we interpret § 1.597-5 as not permitting an acquiring bank to recast an actual asset acquisition as a stock acquisition through a post-acquisition REIT election for an acquired disregarded entity, particularly when the effect of the election is to carry over a failed institution's tax attributes to the acquiring bank.

2. Yes. If BankLLC's REIT election were effective as of the date of BankLLC's formation, then Failed Institution would be deemed to have contributed BankLLC's assets to BankLLC in a § 351 transaction immediately before the close of the preceding day. Under § 362(e)(2), BankLLC's basis in any built-in loss assets should have been reduced to such assets' fair market value immediately after the deemed § 351 transaction, unless Failed Holdco made an election under § 362(e)(2)(C) on its return for Year 1 and that return was filed by the due date (including extensions).

FACTS

Background

Taxpayer is a bank holding company headquartered in State A. Bank is a member of Taxpayer's consolidated group.

Failed Institution is a State B-chartered bank and a member of Failed Holdco's consolidated group. On Date 1, Year 1, Failed Institution formed BankLLC, a single-member LLC that Failed Institution treated as a disregarded entity for Federal income tax purposes under Treas. Reg. § 301.7701-3(b). Also on Date 1, Failed Institution transferred to BankLLC all of the regular and residual REMIC interests issued by Securitization Trust (such interests, the "REMIC Securities").

On Date 2, Year 1 (the "Acquisition Date"), the State B Banking Department closed Failed Institution, and Agency was named receiver of Failed Institution. Also on the Acquisition Date, Bank acquired the assets and deposit liabilities of Failed Institution under a Purchase and Assumption Agreement with Agency. Specifically, Bank assumed approximately $a of deposit liabilities and purchased $b of loan assets, $c of Other Real Estate Owned (or OREO), and $d of investment securities. We refer to this transaction herein as the "Acquisition."

Agency provided two types of FFA (as defined in § 597(c) and § 1.597-1(b)) to Bank in connection with the Acquisition. First, Agency provided cash "Net Worth Assistance" to Bank of approximately $e (including the "Reimbursement" payment discussed below). Second, Agency provided "Loss Guarantees"[1] on certain loans and securities that Bank

[1] The parties agree that, in connection with the Acquisition, Agency provided "Federal financial assistance" consisting of "Net Worth Assistance" and "Loss Guarantees" (as each of these terms is defined in § 1.597-1(b)).

acquired from Failed Institution. Such Loss Guarantees included a Loss Sharing Agreement ("LSA") with respect to the BankLLC portfolio of REMIC Securities that Bank acquired in the Acquisition.

As disclosed in the LSA, Agency and Bank initially agreed to an "aggregate Book Value" of $f for the REMIC Securities. Six weeks later, in an agreement dated Date 3, Year 1 (the "Letter Agreement"), Agency and Bank agreed that: (i) Bank would be deemed to have acquired the REMIC Securities at an aggregate purchase price of $g (the "REMIC Securities Purchase Price"); (ii) this revised amount reflects the fair market value of the REMIC Securities; (iii) the REMIC Securities would be subject to loss sharing under the LSA; and (iv) Agency would reimburse Bank in the amount of $h (the difference between $f and $g) (the "Reimbursement"), plus interest. Agency reimbursed Bank within a week after entering into the Letter Agreement.

Among the other assets that Bank acquired from Failed Institution in the Acquisition was the stock of REIT-1, an entity that had made a REIT election prior to the Acquisition. On Date 4, Year 2, Taxpayer submitted a Private Letter Ruling ("PLR") request to the Service seeking permission to treat Bank's acquisition of REIT-1 from Failed Institution as a stock purchase rather than a purchase of REIT-1's assets, thus allowing REIT-1 to retain a carryover basis in its assets. The Service did not issue a PLR in response to Taxpayer's request, but rather entered into a Form 906, "Closing Agreement on Final Determination Covering Specific Matters" (referred to herein as the "REIT-1 Form 906"), with Taxpayer on Date 5, Year 2. In the REIT-1 Form 906, Taxpayer made specific representations to the Service, and the parties agreed that (i) for purposes of Bank's purchase price allocation under § 1.597-5(d)(2), the stock of REIT-1 would be treated as a Class V asset, and (ii) REIT-1's basis in its assets immediately prior to the Acquisition would carry over. In effect, the Service and Taxpayer agreed that REIT-1's status as a REIT would not be jeopardized by the application of §§ 1.597-3(a) and 1.597-5, and that Bank could account for the acquisition of REIT-1 as a purchase of REIT-1's shares rather than a purchase of REIT-1's assets.

Taxpayer's Reporting of the Acquisition for Tax Purposes

On Date 6, Year 2, BankLLC (now controlled by Taxpayer) filed a Form 1120-REIT, "U.S. Income Tax Return for Real Estate Investment Trusts," for the period from Date 1, Year 1 through the end of Year 1. Taxpayer took the position that BankLLC should be treated as a REIT from its date of formation by Failed Institution (Date 1, Year 1), even though (i) Taxpayer held no interest in either this disregarded entity or its assets until Date 2, Year 1, and (ii) the REIT election, if respected, would remove BankLLC from Failed Institution's consolidated Federal income tax return for Year 1 without Failed Institution's knowledge or consent. See § 1504(b)(6).

BankLLC's Form 1120-REIT was signed by BankLLC's President, who also was an executive in Taxpayer's tax department. The Form 1120-REIT contained the following statement:

Statement Pursuant to § 1.351-3(b) By [BankLLC], A Transferee Corporation

> [Failed Institution] . . . transferred assets with an aggregate fair market value of [$i] and basis of [$j] on [Date 1, Year 1]. No private letter ruling was issued by the IRS in connection with the exchange.

On the Form 1120-REIT, BankLLC claimed a bad debt deduction of $k.[2] This amount reflects the difference between the "REMIC Securities Book Value" ($n)[3] and the REMIC Securities Purchase Price ($g) as determined by Agency and Bank after the Acquisition.

Upon examination, the Service Operating Division disallowed the bad debt deduction because it determined that BankLLC's tax basis in the REMIC Securities immediately after the Acquisition was $g rather than $f. The Operating Division reasoned that BankLLC is attempting to claim a tax loss with respect to the REMIC Securities even though Agency already had provided Bank with a Net Worth Assistance payment that compensated Bank for the amount of the claimed tax loss.

LAW AND ANALYSIS

1. Whether § 597 and the accompanying regulations preclude BankLLC from claiming a carryover basis in the REMIC Securities

Overview of § 597, its Legislative History, and the Regulations Promulgated Thereunder

As noted above, the parties agree that the Acquisition is a transaction in which FFA was provided, and that § 597 will govern the taxation of any FFA. Congress enacted the current version of § 597 as part of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. 101-73 ("FIRREA"). FIRREA repealed former section 597, which treated certain FFA as tax-free.[4]

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[2] Taxpayer applied section 382 to Bank's purported acquisition of BankLLC's stock. BankLLC thus limited its recognition of the $k deduction to $l in Year 1 and $m in Year 2. Under Taxpayer's position, BankLLC will recognize the remaining amount of the bad debt deduction at a pro-rata annual amount of $m.

[3] The $n amount is the book value of the REMIC Securities when BankLLC acquired the securities on Date 1, Year 1. The $f amount is the book value of the REMIC Securities agreed upon by Agency and BankLLC on the Acquisition Date.

[4] Tax treatises that address bank taxation will have a more detailed explanation of the background to the current version of § 597. See, e.g., Stanley I. Langbein, Federal Income Taxation of Banks & Financial Institutions, at ¶ 8.04[1][a]-[g] (2014).

Section 597(a) provides that the “treatment for purposes of this chapter of any transaction in which Federal financial assistance is provided with respect to a bank . . . shall be determined under regulations prescribed by the Secretary.” Section 597(b)(1) provides that in the case of taxable asset acquisitions, the regulations prescribed under § 597(a) shall “(A) provide that Federal financial assistance shall be properly taken into account by the institution from which the assets were acquired; and (B) provide the proper method of allocating basis among the assets so acquired . . . .” Section 597(b)(3) provides that “[n]o regulations prescribed under this section shall permit the utilization of any deduction (or other tax benefit) if such amount was in effect reimbursed by nontaxable Federal financial assistance.”

The legislative history of FIRREA explains the intended operation of § 597. The House Report issued in May 1989 provides the following explanation for its changes to § 597:

> The committee believes that the tax subsidy provided to financially troubled financial institutions through more favorable tax rules than those applicable to other taxpayers is an inefficient way to provide assistance to such institutions. In addition, indirect assistance provided through the tax system will no longer be necessary because other provisions of [FIRREA] will provide adequate assistance directly to financially troubled financial institutions.

H.R. Rep. 101-54(II) (May 22, 1989) at p. 25. The House Report further provides:

> The committee bill directs the Treasury Department to issue regulations providing rules for the Federal income tax treatment of transactions involving financially troubled financial institutions. The committee bill also provides principles to be used by the Treasury Department in providing such rules. As to all types of transactions, the Treasury Department is not authorized to issue regulations that would permit the utilization of any deduction (or other tax benefit) which is, in effect, reimbursed by Federal financial assistance that is not includible in income.

Id. (footnotes omitted). With respect to transactions in the form of asset acquisitions, the House Report then directs the Treasury Department to issue regulations that set forth the following rules concerning the taxation of FFA and the allocation of acquisition basis:

> In the case of taxable asset acquisitions . . . any such regulations are to provide that Federal financial assistance shall be properly taken into account by the institution from which the assets were acquired. In addition, the regulations are to provide for the proper method of allocating basis among assets acquired in the acquisition (including any rights to receive Federal financial assistance at the time of the acquisition or in the future).

Id. at p. 26. With respect to the "[t]reatment of acquiring financial institutions in taxable asset acquisitions", the House Report further explains:

> In the case of a taxable asset acquisition, the tax attributes of the corporation whose assets were purchased (including net operating losses, built-in losses, etc.) will be eliminated and the purchase price . . . will be allocated among the various assets acquired in the transaction. In general, such basis allocation shall reflect the fair market values of all assets acquired in the transaction.

Id. at pp. 27-28. With respect to acquisitions in which FFA is provided in the form of "negative net worth contributions,"[5] the House Report further explains:

> Negative net worth contributions refer to the amounts contributed by the insurer at the time of the acquisition to bring the acquired institution's net worth to zero. The committee intends that basis will first be allocated to negative net worth contributions and that the amount of basis allocated to such payments will be equal to the amount of the contributions.

Id. at p. 28.

The Conference Report issued in August 1989 (just prior to the enactment of FIRREA) summarizes Congressional intent regarding taxable asset acquisitions as follows:

> Under the interim rules for taxable asset acquisitions set forth in the legislative history of this provision, financial assistance received by, or paid with respect to, financially troubled financial institutions is generally treated as taxable. Such assistance is deemed to be received by the financially troubled financial institution at the time the assets of such institution are sold or transferred. As a result, the financial assistance generally will be offset by the net operating losses and built-in losses of the financially troubled financial institution. Thus, an acquired financially troubled financial institution will generally have no net tax liability resulting from the receipt of (or deemed receipt) of financial assistance.

H.R. Conf. Rep. 101-222 (Aug. 4, 1989), at pp. 463-64.

The legislative history thus reflects Congress's expectation that, in instances where an agency contributes cash or property to encourage an acquiring bank to accept a failed institution's deposit liabilities, the cash or property represents the amount required to bring the failed institution's net worth to zero, and the consideration paid by the

[5] The regulations refer to this type of assistance as "Net Worth Assistance." See § 1.597-1(b).

acquiring bank (in the form of deposit liabilities assumed) equals the value of the assets obtained by the acquiring bank. By requiring the acquiring bank to allocate acquisition basis first to any net worth assistance received, Congress sought to ensure that the acquiring bank's acquisition basis in the acquired assets would equal the value of all assets received. Likewise, Congress expected that the failed institution's net operating losses and its built-in losses on the transferred assets would be eliminated by requiring the failed institution to treat the cash or other property as income that would be offset by losses triggered by treating the transaction as a taxable asset transfer.

Under Congress's grant of authority set forth in § 597(a), the Service in 1995 issued final regulations under § 597. See T.D. 8641, 1996-1 C.B. 103. The regulations reflect the principles set forth in the legislative history by providing detailed rules for the proper treatment of FFA and the allocation of basis to assets transferred through "Taxable Transfers."

Section 1.597-1(b) defines "FFA" as "any money or property provided by Agency[6] to an Institution [i.e., a bank or domestic building and loan association] or to a direct or indirect owner of stock in an Institution" under certain provisions of law. The definition of FFA includes "Net Worth Assistance" and "Loss Guarantee payments," among other types of assistance. "Net Worth Assistance" is defined as money or property that Agency provides as an integral part of the transfer of a failed Institution's liabilities and/or assets to an acquiring Institution, other than FFA that accrues after the date of the transfer (such as Loss Guarantee payments). In turn, a "Loss Guarantee" is defined as an agreement pursuant to which Agency guarantees or agrees to pay an Institution a specified amount upon the disposition or charge-off (in whole or in part) of specific assets, an agreement pursuant to which an Institution has a right to put assets to Agency at a specified price, or a similar arrangement.

Section 1.597-5 addresses the treatment of "Taxable Transfers" in a manner consistent with Congress's discussion of "taxable asset acquisitions" in the legislative history. The regulations set forth a broad definition of "Taxable Transfers" in order to treat transactions consistently for Federal income tax purposes, regardless of whether the form of the transaction is a stock purchase or an asset purchase.[7] Section 1.597-5(a)(1)(i) defines the term "Taxable Transfer" as a transaction in which an entity transfers to a transferee (other than a "Bridge Bank") either (A) any deposit liability, if FFA is provided in connection with the transaction, or (B) any asset for which Agency has any financial obligation (e.g., pursuant to a Loss Guarantee). Section 1.597-

[6] In the present case, Agency qualifies as an "Agency," as that term is defined in the regulations.

[7] The preamble to the proposed regulations under § 597 explains that "[t]he purpose of these rules is to treat acquisitions of Institutions under Agency Control as taxable asset acquisitions *whether the acquisition is in the form of an asset purchase, a stock purchase or a carryover basis transaction*." 57 Fed. Reg. 14795, FI-46-89, 1992-1 C.B. 1037, 1040 (emphasis added). Rules deeming stock transfers as asset transfers remained in place in the final regulations.

5(a)(1)(ii) and (b) provide that certain stock transfers will be “deemed” Taxable Transfers of assets; thus, even transactions structured as stock acquisitions will trigger recognition of the financially troubled Institution’s built-in gains or losses.[8] For example, under § 1.597-5(b)(1)(i) and -5(b)(2)(i), deemed Taxable Transfers include transactions in which a consolidated subsidiary of the failed Institution becomes a non-member (under Treas. Reg. § 1.1502-32(d)(4)) of its consolidated group in connection with a transaction in which FFA is provided.[9]

Section 1.597-2(a)(1) provides that, except as otherwise set forth in the regulations, “all FFA is includible as ordinary income to the recipient at the time the FFA is received or accrued in accordance with the recipient's method of accounting.” Section 1.597-5(c)(1), which contains an exception to this general rule, provides that the failed Institution in a Taxable Transfer is treated as having directly received, immediately before the transfer of its assets and/or liabilities to the acquiring Institution, any Net Worth Assistance that the Agency provides to the acquiring Institution in connection with the transfer. The Net Worth Assistance generally is includible as ordinary income to the failed Institution at the time it is deemed to have been received under § 1.597-2(a) and, under the rules governing “Taxable Transfers,” it typically will be offset by the failed Institution’s NOLs and built-in losses. The Net Worth Assistance is then treated as an asset of the failed Institution that is sold to the acquiring Institution in the Agency-assisted transaction.

Section 1.597-5(d)(1) provides that the purchase price for assets acquired in certain Taxable Transfers, including transactions in which a failed Institution transfers assets covered by an Agency-provided Loss Guarantee to the acquiring Institution, is the cost of the assets acquired. Section 1.597-5(d)(2) provides that the purchase price shall be allocated among the transferred assets under the provisions of Treas. Reg. § 1.338-6(b), (c)(1) and (2), subject to certain modifications. For example, as described in § 1.597-5(c)(3)(ii), an asset covered by a Loss Guarantee in the hands of the acquiring Institution is treated as a Class II asset, and the fair market value of such an asset is deemed to be not less than the greater of the asset's highest guaranteed value or the highest price at which the asset can be put to the Agency.

Finally, § 1.597-3(g) sets forth the following general “anti-abuse” rule:

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[8] The preamble to the proposed regulations explains: “In addition to conforming the federal income tax consequences of various forms of acquisitions, the deemed transfer rule in proposed § 1.597-5(b) fosters the matching of FFA income with an Institution's losses by triggering an Institution's built-in losses. The deemed transfer rules also implement the policies reflected in the legislative history by preventing another taxpayer from purchasing the tax attributes of an Institution.” 1992-1 C.B. 1037, 1040.

[9] Section 1.597-5(e)(2) provides that the consolidated subsidiary is treated as completely liquidating in a § 332 transaction immediately after the deemed sale of its assets. The tax attributes of the consolidated subsidiary do not carry over to the acquiring Institution.

> The regulations under section 597 must be applied in a manner consistent with the purposes of section 597. Accordingly, if, in structuring or engaging in any transaction, a principal purpose is to achieve a tax result that is inconsistent with the purposes of section 597 and the regulations thereunder, the Commissioner can make appropriate adjustments to income, deductions and other items that would be consistent with those purposes.

Application of § 597 and the Regulations Promulgated Thereunder to the Present Case

On the Acquisition Date, Bank acquired Failed Institution's deposit liabilities and assets (including the REMIC Securities) in a transaction that constituted a "Taxable Transfer" under § 1.597-5(a)(1)(i). The following month, Bank negotiated with Agency for additional Net Worth Assistance based on Bank's assessment of the fair market value of the REMIC Securities. Approximately one year later, Taxpayer caused BankLLC to make a REIT election with the intended effect of recasting Bank's acquisition of the REMIC Securities as an acquisition of REIT stock.

As noted above, BankLLC has attempted to make a REIT election that is effective as of Date 1, Year 1 (about 6 months prior to the Acquisition Date). Taxpayer cites the provisions governing REIT elections and deemed check-the-box elections in support of BankLLC's position. Taxpayer further maintains that Bank should be treated for Federal income tax purposes as having acquired stock in a REIT (BankLLC) rather than BankLLC's assets (the REMIC Securities) on the Acquisition Date, and that BankLLC thus should retain a carryover basis in the REMIC Securities after the Acquisition Date.

Taxpayer acknowledges that the provisions of § 597 and the accompanying regulations govern the tax treatment of the Acquisition, but Taxpayer contends that § 597 does not preclude BankLLC's REIT election. In this vein, Taxpayer argues that Bank has properly complied with § 597 by allocating its purchase price under § 1.597-5(d) first to the Net Worth Assistance provided by Agency (including the Reimbursement), and then to the remaining purchased assets (including the stock of BankLLC). Taxpayer also notes that Bank's allocation of purchase price to Net Worth Assistance (in accordance with the § 597 regulations) means that Bank had less acquisition basis to apply to the remainder of the acquired assets.

We disagree with Taxpayer's conclusion that Bank and BankLLC have fully complied with § 597 and the regulations promulgated thereunder. In so doing, we repeat the language from the House Report that "[i]n the case of a taxable asset acquisition, the tax attributes of the corporation whose assets were purchased (including net operating losses, built-in losses, etc.) *will be eliminated* . . . ." [emphasis added]. To this end, the

regulations implement the principle that the tax consequences of an acquisition involving FFA should not depend upon its form.[10]

We conclude that BankLLC's REIT election runs afoul of the anti-abuse provision set forth in § 1.597-3(g). The Service is authorized under this regulation to "make appropriate adjustments to income, deductions and other items" where a taxpayer structures or engages in "any transaction, [if] a principal purpose is to achieve a tax result that is inconsistent with the purposes of section 597 and the regulations thereunder." In the present case, Taxpayer caused BankLLC to make a REIT election with a principal purpose of obtaining a carryover basis in the REMIC Securities rather than triggering the assets' built-in losses in the hands of Failed Institution on the Acquisition Date. Thus, Taxpayer (through BankLLC) is attempting to avail itself of $k of built-in losses that are the type of carryover losses that Congress sought to eliminate when it enacted § 597. The legislative history is clear that those built-in losses should have remained with Failed Institution; that Failed Institution's tax attributes should have been eliminated in the Taxable Transfer; and that this tax treatment should not be affected by the form of the transaction. The regulations establish a detailed regime to implement this intended result. We thus interpret § 1.597-3(g) as permitting the Service to deem BankLLC's REIT election ineffective prior to the Acquisition Date.

As noted above, the Acquisition constituted a "Taxable Transfer" within the meaning of § 1.597-5(a)(1)(i). Thus, we further conclude that Bank should be treated as having acquired BankLLC's assets (rather than BankLLC stock) in the Acquisition, and that Bank should have an acquisition basis of $g in the REMIC Securities (their fair market value as stated in the Letter Agreement).[11] This treatment reflects the requirement in § 1.597-5(c) that a financially troubled Institution treat an Agency-assisted acquisition as a Taxable Transfer that eliminates the financially troubled Institution's tax attributes, as contemplated by the legislative history and the regulations. To conclude otherwise would allow the form of a transaction in which a failed Institution is acquired to dictate the tax treatment thereof.

Lastly, we reject Taxpayer's argument that the Service's entry into the REIT-1 Form 906 somehow confers validity on BankLLC's REIT election. Section 7121(a) authorizes the Secretary of the Treasury or his delegate to enter into written closing agreements with respect to the tax liability of any person for any taxable period. A Form 906, however, is

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[10] This is one of four principles, derived from the legislative history, described in the preamble to the proposed regulations. 1992-1 C.B. 1037, 1038.

[11] We reiterate that, as of the Acquisition Date, BankLLC was a disregarded entity rather than a REIT. Accordingly, the parties to the Acquisition negotiated for the purchase of BankLLC's assets, not REIT stock. The general rule under § 1.597-5(a) thus applies to treat the Acquisition as a Taxable Transfer, and the deemed Taxable Transfer rules for consolidated subsidiaries in § 1.597-5(b)(2) and (e)(2) do not apply. If BankLLC's REIT election were respected with an effective date of Date 1, Year 1, BankLLC would not be a consolidated subsidiary on the Acquisition Date, and Bank would be able to avoid the rules generally applicable to transfers of a failed Institution's consolidated subsidiary.

a final and conclusive agreement that is binding only as to matters agreed upon for the taxable period stated in the closing agreement. Estate of Magarian v. Commissioner, 97 T.C. 1 (1991); Zaentz v. Commissioner, 90 T.C. 753, 761-762 (1988). Accordingly, the REIT-1 Form 906 is not binding upon the Service with respect to Bank's acquisition of BankLLC.

Even if the REIT-1 Form 906 had precedential value with respect to Bank's acquisition of BankLLC, we note that the facts surrounding REIT-1 and BankLLC on the Acquisition Date were distinguishable in three important respects. First, REIT-1 had elected REIT status prior to the Acquisition, and Taxpayer clearly acquired REIT stock when it purchased REIT-1. Second, the question before the Service with respect to BankLLC differs from the question that was before the Service with respect to REIT-1. The question before the Service with regard to REIT-1 was whether § 1.597-3(a) would require the Service to treat Taxpayer as the owner of REIT-1's assets covered by Agency's Loss Guarantees; if so, REIT-1's REIT status could have been jeopardized. In contrast, the question before the Service with respect to BankLLC is whether and when a REIT election filed after an Agency-assisted acquisition is effective. Lastly, in the case of REIT-1, Agency provided FFA solely in the form of Loss Guarantees. The Service concluded that there was little chance for abuse by allowing a carryover basis for REIT-1's assets (as long as the parties accounted for subsequent guarantee payments as distributions from REIT-1 to Taxpayer) because § 1.597-5(d)(2)(ii) provides (by reference to § 1.597-5(c)(3)(ii)) that the acquisition basis of assets covered by a Loss Guarantee is the greater of the asset's highest guaranteed value or the highest price at which the asset can be put, and the highest guaranteed value of Agency-guaranteed assets is typically based upon a percentage close to the asset's book value. In contrast, in the case of BankLLC, Agency provided Net Worth Assistance with respect to the REMIC Securities, and (as described above), the regulations under § 597 contemplate that Net Worth Assistance will offset the failed institution's tax attributes, including built-in losses. Consequently, allowing a carryover basis for built-in loss assets would lead to an outcome that is inconsistent with those regulations.

For the foregoing reasons, Taxpayer must account for Bank's acquisition of the REMIC Securities as an asset purchase, and BankLLC cannot take a carryover basis in the REMIC Securities. Thus, neither Taxpayer nor BankLLC may claim a bad debt deduction with respect to any built-in loss in these assets as of the Acquisition Date. Finally, the Year 1 Form 1120-REIT filed by BankLLC cannot include income and expense items for the period before Date 2, Year 1, including items of gain or loss triggered by Acquisition, because § 597 and the accompanying regulations contemplate that such items are properly includible in Failed Institution's Year 1 income tax return.

2. Whether an adjustment to BankLLC's basis in the REMIC Securities is required under § 362(e)(2)

Taxpayer contends that BankLLC elected to be treated as a REIT for Federal income tax purposes effective Date 1, Year 1. If BankLLC's REIT election were effective as of that date, then immediately before the close of the preceding day, Failed Institution would be treated as having contributed all of BankLLC's assets and liabilities to BankLLC in exchange for the stock thereof in a § 351 exchange. See § 301.7701-3(g).

The basis of property received by the transferee corporation in a § 351 exchange generally equals the basis of such property in the hands of the transferor (adjusted to include gain recognized by the transferor in connection with the transfer). See § 362(a). However, § 362(e)(2) limits the transferee's ability to obtain a carryover basis in property with a built-in loss.[12] More specifically, § 362(e)(2)(A) provides as follows:

> If--(i) property is transferred by a transferor in any transaction which is described in subsection (a) [including § 351 transactions] and which is not described in [§ 362(e)(1), which concerns the importation of built-in losses], and (ii) the transferee's aggregate adjusted bases of such property so transferred would (but for this paragraph) exceed the fair market value of such property immediately after such transaction, then, notwithstanding [§ 362(a)], the transferee's aggregate adjusted bases of the property so transferred shall not exceed the fair market value of such property immediately after such transaction.[13]

The aggregate basis reduction under § 362(e)(2)(A) must be allocated among the transferred built-in loss properties in proportion to their respective built-in losses immediately before the transaction. Section 362(e)(2)(B).

In the present situation, if BankLLC's REIT election were effective as of Date 1, Year 1, then BankLLC would be required to (i) determine whether its aggregate basis in the REMIC Securities exceeded the fair market value thereof immediately after the deemed § 351 transaction on the day preceding Date 1, Year 1 and, if so, (ii) reduce its aggregate basis in the REMIC Securities to the fair market value thereof immediately after the deemed § 351 transaction. In accordance with § 362(e)(2)(B), the aggregate basis reduction must be allocated among the REMIC Securities in proportion to their respective built-in losses immediately before the deemed § 351 transaction.

In other words, even if BankLLC's REIT election were effective as of Date 1, Year 1, BankLLC would be unable to claim a bad debt deduction under § 166 with respect to

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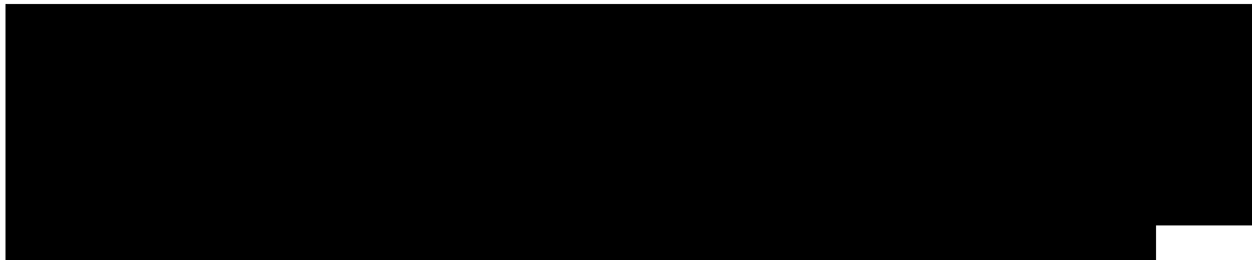
[12] Section 362(e)(2) does not apply to § 351 exchanges between consolidated group members. See Treas. Reg. § 1.1502-80(h). As mentioned above, however, a REIT cannot be included in a consolidated group.

[13] Under § 362(e)(2)(C), the transferor and transferee may elect to reduce the transferor's basis in the transferee's stock rather than reduce the transferee's basis in the transferred built-in loss assets. So far as we are aware, Failed Institution and BankLLC made no such election in the case at hand.

the REMIC Securities until it is determined whether adjustments to BankLLC's basis in the REMIC Securities were required under § 362(e)(2).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



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Please call (202) 317-6842 if you have any further questions.

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