

**Selected Sections**

**Corporate and Partnership**

**Income Tax Code and Regulations**

**Steven A. Bank  
Kirk J. Stark**

**2015–2016 Edition**

 **FOUNDATION  
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# CORPORATE AND PARTNERSHIP INCOME TAX CODE AND REGULATIONS SELECTED SECTIONS

2015–2016

by

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## SUBTITLE A—INCOME TAXES

Current through April 1, 2015

### Chapter 1—Normal Taxes or Surtaxes

#### Subchapter A—Determination of Tax Liability

#### Part I—Tax on Individuals

##### § 1. Tax imposed

(a) **Married individuals filing joint returns and surviving spouses.**—There is hereby imposed on the taxable income of—

(1) every married individual (as defined in section 7703) who makes a single return jointly with his spouse under section 6013, and

(2) every surviving spouse (as defined in section 2(a)),

a tax determined in accordance with the following table:

<i>If taxable income is:</i>	<i>The tax is:</i>
Not over \$36,900 .....	15% of taxable income.
Over \$36,900 but not over \$89,150 .....	\$5,535, plus 28% of the excess over \$36,900.
Over \$89,150 but not over \$140,000 .....	\$20,165, plus 31% of the excess over \$89,150.
Over \$140,000 but not over \$250,000 .....	\$35,928.50, plus 36% of the excess over \$140,000.
Over \$250,000 .....	\$75,528.50, plus 39.6% of the excess over \$250,000.

\* \* \*

(c) **Unmarried individuals (other than surviving spouses and heads of households).**—There is hereby imposed on the taxable income of every individual (other than a surviving spouse as defined in section 2(a) or the head of a household as defined in section 2(b)) who is not a married individual (as defined in section 7703) a tax determined in accordance with the following table:

<i>If taxable income is:</i>	<i>The tax is:</i>
Not over \$22,100 .....	15% of taxable income.
Over \$22,100 but not over \$53,500 .....	\$3,315, plus 28% of the excess over \$22,100.
Over \$53,500 but not over \$115,000 .....	\$12,107, plus 31% of the excess over \$53,500.
Over \$115,000 but not over \$250,000 .....	\$31,172, plus 36% of the excess over \$115,000.
Over \$250,000 .....	\$79,772, plus 39.6% of the excess over \$250,000.

\* \* \*

(e) **Estates and trusts.**—There is hereby imposed on the taxable income of—

(1) every estate, and

(2) every trust,

taxable under this subsection a tax determined in accordance with the following table:

*If taxable income is: .....The tax is:*

<i>Not over \$1,500</i>	<i>15% of taxable income.</i>
Over \$1,500 but not over \$3,500 .....	\$225, plus 28% of the excess over \$1,500.
Over \$3,500 but not over \$5,500 .....	\$785, plus 31% of the excess over \$3,500.
Over \$5,500 but not over \$7,500 .....	\$1,405, plus 36% of the excess over \$5,500.
Over \$7,500 .....	\$2,125, plus 39.6% of the excess over \$7,500.

\* \* \*

**(h) Maximum capital gains rate.—**

**(1) In general.**—If a taxpayer has a net capital gain for any taxable year, the tax imposed by this section for such taxable year shall not exceed the sum of—

**(A)** a tax computed at the rates and in the same manner as if this subsection had not been enacted on the greater of—

**(i)** taxable income reduced by the net capital gain; or

**(ii)** the lesser of—

**(I)** the amount of taxable income taxed at a rate below 25 percent; or

**(II)** taxable income reduced by the adjusted net capital gain,

**(B)** 0 percent of so much of the adjusted net capital gain (or, if less, taxable income) as does not exceed the excess (if any) of—

**(i)** the amount of taxable income which would (without regard to this paragraph) be taxed at a rate below 25 percent, over

**(ii)** the taxable income reduced by the adjusted net capital gain;

**(C)** 15 percent of the lesser of—

**(i)** so much of the adjusted net capital gain (or, if less, taxable income) as exceeds the amount on which a tax is determined under subparagraph (B), or

**(ii)** the excess of—

**(I)** the amount of taxable income which would (without regard to this paragraph) be taxed at a rate below 39.6 percent, over

**(II)** the sum of the amounts on which a tax is determined under subparagraphs (A) and (B),

**(D)** 20 percent of the adjusted net capital gain (or, if less, taxable income) in excess of the sum of the amounts on which tax is determined under subparagraphs (B) and (C),

**(E)** 25 percent of the excess (if any) of—

**(i)** the unrecaptured section 1250 gain (or, if less, the net capital gain (determined without regard to paragraph (11))), over

**(ii)** the excess (if any) of—

**(I)** the sum of the amount on which tax is determined under subparagraph (A) plus the net capital gain, over

**(II)** taxable income; and

(F) 28 percent of the amount of taxable income in excess of the sum of the amounts on which tax is determined under the preceding subparagraphs of this paragraph.

(2) **Net capital gain taken into account as investment income.**—For purposes of this subsection, the net capital gain for any taxable year shall be reduced (but not below zero) by the amount which the taxpayer takes into account as investment income under section 163(d)(4)(B)(iii).

(3) **Adjusted net capital gain.**—For purposes of this subsection, the term “adjusted net capital gain” means the sum of—

(A) net capital gain (determined without regard to paragraph (11)) reduced (but not below zero) by the sum of—

- (i) unrecaptured section 1250 gain, and
- (ii) 28-percent rate gain, plus

(B) qualified dividend income (as defined in paragraph (11)).

(4) **28 percent rate gain.**—For purposes of this subsection, the term “28-percent rate gain” means the excess (if any) of—

(A) the sum of—

- (i) collectibles gain; and
- (ii) section 1202 gain, over

(B) the sum of—

- (i) collectibles loss;
- (ii) the net short-term capital loss; and
- (iii) the amount of long-term capital loss carried under section 1212(b)(1)(B) to the taxable year.

(5) **Collectibles gain and loss.**—For purposes of this subsection—

(A) **In general.**—The terms “collectibles gain” and “collectibles loss” mean gain or loss (respectively) from the sale or exchange of a collectible (as defined in section 408(m) without regard to paragraph (3) thereof) which is a capital asset held for more than 1 year but only to the extent such gain is taken into account in computing gross income and such loss is taken into account in computing taxable income.

(B) **Partnerships, etc.**—For purposes of subparagraph (A), any gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles shall be treated as gain from the sale or exchange of a collectible. Rules similar to the rules of section 751 shall apply for purposes of the preceding sentence.

(6) **Unrecaptured section 1250 gain.**—For purposes of this subsection—

(A) **In general.**—The term “unrecaptured section 1250 gain” means the excess (if any) of—

- (i) the amount of long-term capital gain (not otherwise treated as ordinary income) which would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent, over



(ii) the excess (if any) of—

(I) the amount described in paragraph (4)(B); over

(II) the amount described in paragraph (4)(A).

**(B) Limitation with respect to section 1231 property.**—The amount described in subparagraph (A)(i) from sales, exchanges, and conversions described in section 1231(a)(3)(A) for any taxable year shall not exceed the net section 1231 gain (as defined in section 1231(c)(3)) for such year.

**(7) Section 1202 gain**

For purposes of this subsection, the term “section 1202 gain” means the excess of—

(A) the gain which would be excluded from gross income under section 1202 but for the percentage limitation in section 1202(a), over

(B) the gain excluded from gross income under section 1202.

**(8) Coordination with recapture of net ordinary losses under section 1231.**—If any amount is treated as ordinary income under section 1231(c), such amount shall be allocated among the separate categories of net section 1231 gain (as defined in section 1231(c)(3)) in such manner as the Secretary may by forms or regulations prescribe.

**(9) Regulations.**—The Secretary may prescribe such regulations as are appropriate (including regulations requiring reporting) to apply this subsection in the case of sales and exchanges by pass-thru entities and of interests in such entities.

**(10) Pass-thru entity defined.**—For purposes of this subsection, the term “pass-thru entity” means—

(A) a regulated investment company;

(B) a real estate investment trust;

(C) an S corporation;

(D) a partnership;

(E) an estate or trust;

(F) a common trust fund; and

(G) a qualified electing fund (as defined in section 1295).

**(11) Dividends taxed as net capital gain.**—

**(A) In general.**—For purposes of this subsection, the term ‘net capital gain’ means net capital gain (determined without regard to this paragraph) increased by qualified dividend income.

**(B) Qualified dividend income.**—For purposes of this paragraph—

**(i) In general.**—The term ‘qualified dividend income’ means dividends received during the taxable year from—

(I) domestic corporations, and

(II) qualified foreign corporations.

**(ii) Certain dividends excluded.**—Such term shall not include—

(I) any dividend from a corporation which for the taxable year of the corporation in which the distribution is made, or the preceding taxable year, is a corporation exempt from tax under section 501 or 521,

(II) any amount allowed as a deduction under section 591 (relating to deduction for dividends paid by mutual savings banks, etc.), and

(III) any dividend described in section 404(k).

**(iii) Coordination with section 246(c).**— Such term shall not include any dividend on any share of stock—

(I) with respect to which the holding period requirements of section 246(c) are not met (determined by substituting in section 246(c) “60 days” for “45 days” each place it appears and by substituting “121-day period” for “91-day period”), or

(II) to the extent that the taxpayer is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property.

**(C) Qualified foreign corporations.**—

**(i) In general.**— Except as otherwise provided in this paragraph, the term ‘qualified foreign corporation’ means any foreign corporation if—

(I) such corporation is incorporated in a possession of the United States, or

(II) such corporation is eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this paragraph and which includes an exchange of information program.

**(ii) Dividends on stock readily tradable on United States securities market.**— A foreign corporation not otherwise treated as a qualified foreign corporation under clause (i) shall be so treated with respect to any dividend paid by such corporation if the stock with respect to which such dividend is paid is readily tradable on an established securities market in the United States.

**(iii) Exclusion of dividends of certain foreign corporations.**— Such term shall not include any foreign corporation which for the taxable year of the corporation in which the dividend was paid, or the preceding taxable year, is a passive foreign investment company (as defined in section 1297).

**(iv) Coordination with foreign tax credit limitation.**— Rules similar to the rules of section 904(b)(2)(B) shall apply with respect to the dividend rate differential under this paragraph.

**(D) Special rules.**—

**(i) Amounts taken into account as investment income.**— Qualified dividend income shall not include any amount which the taxpayer takes into account as investment income under section 163(d)(4)(B).

**(ii) Extraordinary dividends.**— If an individual receives, with respect to any share of stock, qualified dividend income from 1 or more dividends which are extraordinary dividends (within the meaning of section 1059(c)), any loss on the sale or exchange of such share shall, to the extent of such dividends, be treated as long-term capital loss.

**(iii) Treatment of dividends from regulated investment companies and real estate investment trusts.**—A dividend received from a regulated investment company or a real estate investment trust shall be subject to the limitations prescribed in sections 854 and 857.

**(i) Rate reductions after 2000.—**

**(1) 10-percent rate bracket.—**

**(A) In general.**—In the case of taxable years beginning after December 31, 2000—

(i) the rate of tax under subsections (a), (b), (c), and (d) on taxable income not over the initial bracket amount shall be 10 percent, and

(ii) the 15 percent rate of tax shall apply only to taxable income over the initial bracket amount but not over the maximum dollar amount for the 15-percent rate bracket.

**(B) Initial bracket amount.**—For purposes of this paragraph, the initial bracket amount is—

(i) \$14,000 in the case of subsection (a),

(ii) \$10,000 in the case of subsection (b), and

(iii) 1/2 the amount applicable under clause (i) (after adjustment, if any, under subparagraph (C)) in the case of subsections (c) and (d).

**(C) Inflation adjustment.**—In prescribing the tables under subsection (f) which apply with respect to taxable years beginning in calendar years after 2003—

(i) the cost-of-living adjustment shall be determined under subsection (f)(3) by substituting “2002” for “1992” in subparagraph (B) thereof, and

(ii) the adjustments under clause (i) shall not apply to the amount referred to in subparagraph (B)(iii).

If any amount after adjustment under the preceding sentence is not a multiple of \$50, such amount shall be rounded to the next lowest multiple of \$50.

**(2) 25-, 28-, and 33-percent rate brackets** – The tables under subsections (a), (b), (c), (d), and (e) shall be applied—

**(A)** by substituting “25%” for “28%” each place it appears (before the application of subparagraph (B)),

**(B)** by substituting “28%” for “31%” each place it appears, and

**(C)** by substituting “33%” for “36%” each place it appears.

**(3) Modifications to income tax brackets for high-income taxpayers**

**(A) 35-percent rate bracket**—In the case of taxable years beginning after December 31, 2012—

(i) the rate of tax under subsections (a), (b), (c), and (d) on a taxpayer’s taxable income in the highest rate bracket shall be 35 percent to the extent such income does not exceed an amount equal to the excess of—

(I) the applicable threshold, over

(II) the dollar amount at which such bracket begins, and

(ii) the 39.6 percent rate of tax under such subsections shall apply only to the taxpayer's taxable income in such bracket in excess of the amount to which clause (i) applies.

**(B) Applicable threshold**—For purposes of this paragraph, the term “applicable threshold” means—

(i) \$450,000 in the case of subsection (a),

(ii) \$425,000 in the case of subsection (b),

(iii) \$400,000 in the case of subsection (c), and

(iv) 1/2 the amount applicable under clause (i) (after adjustment, if any, under subparagraph (C)) in the case of subsection (d).

**(C) Inflation adjustment**—For purposes of this paragraph, with respect to taxable years beginning in calendar years after 2013, each of the dollar amounts under clauses (i), (ii), and (iii) of subparagraph (B) shall be adjusted in the same manner as under paragraph (1)(C)(i), except that subsection (f)(3)(B) shall be applied by substituting “2012” for “1992”.

**(4) Adjustment of tables**—The Secretary shall adjust the tables prescribed under subsection (f) to carry out this subsection.

## Part II—Tax on Corporations

### § 11. Tax imposed.

**(a) Corporations in general.** A tax is hereby imposed for each taxable year on the taxable income of every corporation.

#### **(b) Amount of tax.**

**(1) In general.** The amount of the tax imposed by subsection (a) shall be the sum of—

(A) 15 percent of so much of the taxable income as does not exceed \$50,000,

(B) 25 percent of so much of the taxable income as exceeds \$50,000 but does not exceed \$75,000,

(C) 34 percent of so much of the taxable income as exceeds \$75,000 but does not exceed \$10,000,000, and

(D) 35 percent of so much of the taxable income as exceeds \$10,000,000.

In the case of a corporation which has taxable income in excess of \$100,000 for any taxable year, the amount of tax determined under the preceding sentence for such taxable year shall be increased by the lesser of (i) 5 percent of such excess, or (ii) \$11,750. In the case of a corporation which has taxable income in excess of \$15,000,000, the amount of the tax determined under the foregoing provisions of this paragraph shall be increased by an additional amount equal to the lesser of (i) 3 percent of such excess, or (ii) \$100,000.

**(2) Certain personal service corporations not eligible for graduated rates.** Notwithstanding paragraph (1), the amount of the tax imposed by subsection (a) on the taxable in-

come of a qualified personal service corporation (as defined in section 448(d)(2)) shall be equal to 35 percent of the taxable income.

(c) **Exceptions.** Subsection (a) shall not apply to a corporation subject to a tax imposed by—

- (1) section 594 (relating to mutual savings banks conducting life insurance business),
- (2) subchapter L (sec. 801 and following, relating to insurance companies), or
- (3) subchapter M (sec. 851 and following, relating to regulated investment companies and real estate investment trusts).

(d) **Foreign corporations.** In the case of a foreign corporation, the taxes imposed by subsection (a) and section 55 shall apply only as provided by section 882.

\* \* \*

## Subchapter B—Computation of Taxable Income

### Part I—Definition of Gross Income

#### § 83. Property transferred in connection with performance of services.

(a) **General rule.**—If, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of—

- (1) the fair market value of such property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over
- (2) the amount (if any) paid for such property,

shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable. The preceding sentence shall not apply if such person sells or otherwise disposes of such property in an arm's length transaction before his rights in such property become transferable or not subject to a substantial risk of forfeiture.

(b) **Election to include in gross income in year of transfer.**—

(1) **In general.**—Any person who performs services in connection with which property is transferred to any person may elect to include in his gross income, for the taxable year in which such property is transferred, the excess of—

- (A) the fair market value of such property at the time of transfer (determined without regard to any restriction other than a restriction which by its terms will never lapse), over
- (B) the amount (if any) paid for such property.

If such election is made, subsection (a) shall not apply with respect to the transfer of such property, and if such property is subsequently forfeited, no deduction shall be allowed in respect of such forfeiture.

(2) **Election.**—An election under paragraph (1) with respect to any transfer of property shall be made in such manner as the Secretary prescribes and shall be made not later than 30

days after the date of such transfer. Such election may not be revoked except with the consent of the Secretary.

**(c) Special rules.**—For purposes of this section—

**(1) Substantial risk of forfeiture.**—The rights of a person in property are subject to a substantial risk of forfeiture if such person's rights to full enjoyment of such property are conditioned upon the future performance of substantial services by any individual.

**(2) Transferability of property.**—The rights of a person in property are transferable only if the rights in such property of any transferee are not subject to a substantial risk of forfeiture.

**(3) Sales which may give rise to suit under Section 16(b) of the Securities Exchange Act of 1934.**—So long as the sale of property at a profit could subject a person to suit under section 16(b) of the Securities Exchange Act of 1934, such person's rights in such property are—

**(A)** subject to a substantial risk of forfeiture, and

**(B)** not transferable.

**(4)** For purposes of determining an individual's basis in property transferred in connection with the performance of services, rules similar to the rules of section 72(w) shall apply.

**(d) Certain restrictions which will never lapse.**—

**(1) Valuation.**—In the case of property subject to a restriction which by its terms will never lapse, and which allows the transferee to sell such property only at a price determined under a formula, the price so determined shall be deemed to be the fair market value of the property unless established to the contrary by the Secretary, and the burden of proof shall be on the Secretary with respect to such value.

**(2) Cancellation.**—If, in the case of property subject to a restriction which by its terms will never lapse, the restriction is canceled, then, unless the taxpayer establishes—

**(A)** that such cancellation was not compensatory, and

**(B)** that the person, if any, who would be allowed a deduction if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as evidenced in such manner as the Secretary shall prescribe by regulations,

the excess of the fair market value of the property (computed without regard to the restrictions) at the time of cancellation over the sum of—

**(C)** the fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

**(D)** the amount, if any, paid for the cancellation,

shall be treated as compensation for the taxable year in which such cancellation occurs.

**(e) Applicability of section.**—This section shall not apply to—

**(1)** a transaction to which section 421 applies,

**(2)** a transfer to or from a trust described in section 401(a) or a transfer under an annuity plan which meets the requirements of section 404(a)(2),

**(3)** the transfer of an option without a readily ascertainable fair market value,

(4) the transfer of property pursuant to the exercise of an option with a readily ascertainable fair market value at the date of grant, or

(5) group-term life insurance to which section 79 applies.

**(f) Holding period.**—In determining the period for which the taxpayer has held property to which subsection (a) applies, there shall be included only the period beginning at the first time his rights in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier.

**(g) Certain exchanges.**—If property to which subsection (a) applies is exchanged for property subject to restrictions and conditions substantially similar to those to which the property given in such exchange was subject, and if section 354, 355, 356, or 1036 (or so much of section 1031 as relates to section 1036) applied to such exchange, or if such exchange was pursuant to the exercise of a conversion privilege—

(1) such exchange shall be disregarded for purposes of subsection (a), and

(2) the property received shall be treated as property to which subsection (a) applies.

**(h) Deduction by employer.**—In the case of a transfer of property to which this section applies or a cancellation of a restriction described in subsection (d), there shall be allowed as a deduction under section 162, to the person for whom were performed the services in connection with which such property was transferred, an amount equal to the amount included under subsection (a), (b), or (d)(2) in the gross income of the person who performed such services. Such deduction shall be allowed for the taxable year of such person in which or with which ends the taxable year in which such amount is included in the gross income of the person who performed such services.

\* \* \*

## § 108. Income from discharge of indebtedness.

### (a) Exclusion from gross income.—

**(1) In general.**—Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if—

(A) the discharge occurs in a title 11 case,

(B) the discharge occurs when the taxpayer is insolvent,

(C) the indebtedness discharged is qualified farm indebtedness, or

(D) in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness.

\* \* \*

### (2) Coordination of exclusions.—

**(A) Title 11 exclusion takes precedence.**—Subparagraphs (B), (C), and (D) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.

**(B) Insolvency exclusion takes precedence over qualified farm exclusion and qualified real property business exclusion.**—Subparagraphs (C) and (D) of paragraph (1) shall not apply to a discharge to the extent the taxpayer is insolvent.

\* \* \*

**(3) Insolvency exclusion limited to amount of insolvency.**—In the case of a discharge to which paragraph (1)(B) applies, the amount excluded under paragraph (1)(B) shall not exceed the amount by which the taxpayer is insolvent.

**(b) Reduction of tax attributes.—**

**(1) In general.**—The amount excluded from gross income under subparagraph (A), (B), or (C) of subsection (a)(1) shall be applied to reduce the tax attributes of the taxpayer as provided in paragraph (2).

**(2) Tax attributes affected; order of reduction.**—Except as provided in paragraph (5), the reduction referred to in paragraph (1) shall be made in the following tax attributes in the following order:

**(A) NOL.**—Any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year.

**(B) General business credit.**—Any carryover to or from the taxable year of a discharge of an amount for purposes for determining the amount allowable as a credit under section 38 (relating to general business credit).

**(C) Minimum tax credit.**—The amount of the minimum tax credit available under section 53(b) as of the beginning of the taxable year immediately following the taxable year of the discharge.

**(D) Capital loss carryovers.**—Any net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212.

**(E) Basis reduction.—**

**(i) In general.**—The basis of the property of the taxpayer.

**(ii) Cross reference.**—For provisions for making the reduction described in clause (i), see section 1017.

**(F) Passive activity loss and credit carryovers.**—Any passive activity loss or credit carryover of the taxpayer under section 469(b) from the taxable year of the discharge.

**(G) Foreign tax credit carryovers.**—Any carryover to or from the taxable year of the discharge for purposes of determining the amount of the credit allowable under section 27.

**(3) Amount of reduction.—**

**(A) In general.**—Except as provided in subparagraph (B), the reductions described in paragraph (2) shall be one dollar for each dollar excluded by subsection (a).

**(B) Credit carryover reduction.**—The reductions described in subparagraphs (B), (C), and (G) shall be 33 1/3 cents for each dollar excluded by subsection (a). The reduction described in subparagraph (F) in any passive activity credit carryover shall be 33 1/3 cents for each dollar excluded by subsection (a).



**(4) Ordering rules.—**

**(A) Reductions made after determination of tax for year.**—The reductions described in paragraph (2) shall be made after the determination of the tax imposed by this chapter for the taxable year of the discharge.

**(B) Reductions under subparagraph (A) or (D) of paragraph (2).**—The reductions described in subparagraph (A) or (D) of paragraph (2) (as the case may be) shall be made first in the loss for the taxable year of the discharge and then in the carryovers to such taxable year in the order of the taxable years from which each such carryover arose.

**(C) Reductions under subparagraphs (B) and (G) of paragraph (2).**—The reductions described in subparagraphs (B) and (G) of paragraph (2) shall be made in the order in which carryovers are taken into account under this chapter for the taxable year of the discharge.

**(5) Election to apply reduction first against depreciable property.—**

**(A) In general.**—The taxpayer may elect to apply any portion of the reduction referred to in paragraph (1) to the reduction under section 1017 of the basis of the depreciable property of the taxpayer.

**(B) Limitation.**—The amount to which an election under subparagraph (A) applies shall not exceed the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

**(C) Other tax attributes not reduced.**—Paragraph (2) shall not apply to any amount to which an election under this paragraph applies.

**(c) Treatment of discharge of qualified real property business indebtedness.—****(1) Basis reduction.—**

**(A) In general.**—The amount excluded from gross income under subparagraph (D) of subsection (a)(1) shall be applied to reduce the basis of the depreciable real property of the taxpayer.

**(B) Cross reference.**—For provisions making the reduction described in subparagraph (A), see section 1017.

**(2) Limitations.—**

**(A) Indebtedness in excess of value.**—The amount excluded under subparagraph (D) of subsection (a)(1) with respect to any qualified real property business indebtedness shall not exceed the excess (if any) of—

(i) the outstanding principal amount of such indebtedness (immediately before the discharge), over

(ii) the fair market value of the real property described in paragraph (3)(A) (as of such time), reduced by the outstanding principal amount of any other qualified real property business indebtedness secured by such property (as of such time).

**(B) Overall limitation.**—The amount excluded under subparagraph (D) of subsection (a)(1) shall not exceed the aggregate adjusted bases of depreciable real property (determined after any reductions under subsections (b) and (g)) held by the taxpayer immedi-