

APPENDIX 5G

Treasury Regulation 1.337(d)-4—Assesses a Tax on Transfer of Assets from a Taxable Corporation to a Tax-exempt Entity

Cross Reference Data

Topical

Exempt organizations
Taxable corporations
Transfer of assets
Transfer tax

Citation

IRC Sections—277—2F, 501(c)—2J
Regulations Sections—1.501(c)(4)-1—5K, 1.501(c)(7)-1—5L
Cases—*Portland Golf Club v. Commissioner*—4A
 —*Commissioner v. Lake Forest, Inc.*—4C
 —*Flat Top Lake Association v. U.S.A.*—4E
 —*United Grocers v. U.S.A.*—4G
 —*Rancho Santa Fe Association v. U.S.A.*—4Q
Revenue Rulings—69-281—6G, 72-102—6I, 74-17—6K, 74-99—6L, 75-286—6O, 75-386—6R,
 75-494—6S, 80-63—6X
GCM—35440—8C, 35570—8D, 38629—8I

Summary

Regulation 1.337(d)-4 assesses a tax on the transfer of assets from a taxable corporation to a tax-exempt organization. It applies to any association seeking exemption under IRC Sec. 501(c)(4) or 501(c)(7), and the tax is assessed on the gain of any assets transferred. The gain is measured as the excess of the fair market value of assets transferred over their tax basis. There are certain exceptions, in that Sec. 501(c)(7) organizations have seven years from the date of incorporation to apply for exemption without having the “transfer tax” rules apply. Sec. 501(c)(4) organizations have three years. (The regulation excludes Sec. 528 homeowners’ associations. Thus, associations that simply elect to switch from filing Form 1120 to Form 1120-H are exempt from the tax.)

Assesses a Tax on Transfer of Assets from a Taxable Corporation to a Tax-exempt Entity

(a) Gain or loss recognition.

- (1) **General rule.** Except as provided in paragraph (b) of this section, if a taxable corporation transfers all or substantially all of its assets to one or more tax-exempt entities, the taxable corporation must recognize gain or loss immediately before the transfer as if the assets transferred were sold at their fair market values. But see section 267 and paragraph (d) of this section concerning limitations on the recognition of loss.
- (2) **Change in corporation’s tax status treated as asset transfer.** Except as provided in paragraphs (a)(3) and (b) of this section, a taxable corporation’s change in status to a tax-exempt entity will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the change in status becomes effective in a transaction to which paragraph (a)(1) of this section applies. For example, if a state, a political subdivision thereof, or an entity any portion of whose income is excluded from gross income under section 115, acquires the stock of a taxable corporation and thereafter any of the taxable corporation’s income is excluded from gross income under section 115, the taxable corporation will be treated as if it transferred all of its assets to a tax-exempt entity immediately before the stock acquisition.
- (3) **Exceptions for certain changes in status—(i)** To whom available. Paragraph (a)(2) of this section does not apply to the following corporations—
 - (A) **A corporation previously tax-exempt under section 501(a) which regains its tax-exempt status under section 501(a) within three years from the later of a final adverse adjudication on the corporation’s tax exempt status, or the filing by**

the corporation, or by the Secretary or his delegate under section 6020(b), of a federal income tax return of the type filed by a taxable corporation;

- (B) **A corporation previously tax-exempt under section 501(a) or that applied for but did not receive recognition of exemption under section 501(a) before January 15, 1997, if such corporation is tax-exempt under section 501(a) within three years from January 28, 1999;**
 - (C) **A newly formed corporation that is tax-exempt under section 501(a) (other than an organization described in section 501(c)(7)) within three taxable years from the end of the taxable year in which it was formed;^a**
 - (D) **A newly formed corporation that is tax-exempt under section 501(a) as an organization described in section 501(c)(7) within seven taxable years from the end of the taxable year in which it was formed;**
 - (E) A corporation previously tax-exempt under section 501(a) as an organization described in section 501(c)(12), which, in a given taxable year or years prior to again becoming tax-exempt, is a taxable corporation solely because less than 85 percent of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses; if, in a taxable year, such a corporation would be a taxable corporation even if 85 percent or more of its income consists of amounts collected from members for the sole purpose of meeting losses and expenses (a non-85 percent violation), paragraph (a)(3)(i)(A) of this section shall apply as if the corporation became a taxable corporation in its first taxable year that a non-85 percent violation occurred; or
 - (F) A corporation previously taxable that becomes tax-exempt under section 501(a) as an organization described in section 501(c)(15) if during each taxable year in which it is described in section 501(c)(15) the organization is the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding; if such a corporation continues to be described in section 501(c)(15) in a taxable year when it is no longer the subject of a court supervised rehabilitation, conservatorship, liquidation, or similar state proceeding, paragraph (a)(2) of this section shall apply as if the corporation first became tax-exempt for such taxable year.
 - (i) Application for recognition. An organization is deemed to have or regain tax-exempt status within one of the periods described in paragraph (a)(3)(i)(A), (B), (C), or (D) of this section if it files an application for recognition of exemption with the Commissioner within the applicable period and the application either results in a determination by the Commissioner or a final adjudication that the organization is tax-exempt under section 501(a) during any part of the applicable period. The preceding sentence does not require the filing of an application for recognition of exemption by any organization not otherwise required, such as by §1.501(a)-1, §1.505(c)-1T, and §1.508-1(a), to apply for recognition of exemption.
 - (ii) Anti-abuse rule. This paragraph (a)(3) does not apply to a corporation that, with a principal purpose of avoiding the application of paragraph (a)(1) or (a)(2) of this section, acquires all or substantially all of the assets of another taxable corporation and then changes its status to that of a tax-exempt entity.
- (4) Related transactions. This section applies to any series of related transactions having an effect similar to any of the transactions to which this section applies.

(b) Exceptions. Paragraph (a) of this section does not apply to—

- (1) **Any assets transferred to a tax-exempt entity to the extent that the assets are used in an activity the income from which is subject to tax under section 511(a)** (referred to hereinafter as a "section 511(a) activity"). However, if assets used to any extent in a section 511(a) activity are disposed of by the tax-exempt entity, then, notwithstanding any other provision of law (except section 1031 or section 1033), any gain (not in excess of the amount not recognized by reason of the preceding sentence) shall be included in the tax-exempt entity's unrelated business taxable income. To the extent that the tax-exempt entity ceases to use the assets in a section 511(a) activity, the entity will be treated for purposes of this paragraph (b)(1) as having disposed of the assets on the date of the cessation for their fair market value. For purposes of paragraph (a)(1) of this section and this paragraph (b)(1)—
 - (i) If during the first taxable year following the transfer of an asset or the corporation's change to tax-exempt status the asset will be used by the tax-exempt entity partly or wholly in a section 511(a) activity, the taxable corporation will recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as 100 percent reduced by the percentage of use for such taxable year in the section 511(a) activity bears to 100 percent. For purposes of determining the gain or loss, if any, to be recognized, the taxable corporation may rely on a written representation from the tax-exempt entity estimating the percentage of the asset's anticipated use in a section 511(a) activity for such taxable year, using a reasonable method of allocation, unless the taxable corporation has reason to believe that the tax-exempt entity's representation is not made in good faith;
 - (ii) If for any taxable year the percentage of an asset's use in a section 511(a) activity decreases from the estimate used in computing gain or loss recognized under paragraph (b)(1)(i) of this section, adjusted for any decreases taken into account under this paragraph (b)(1)(ii) in prior taxable years, the tax-exempt entity shall recognize an amount of gain or loss that bears the same ratio to the asset's built-in gain or loss as the percentage point decrease in use in the section 511(a) activity for the taxable year bears to 100 percent;

- (iii) If property on which all or a portion of the gain or loss is not recognized by reason of the first sentence of paragraph (b)(1) of this section is disposed of in a transaction that qualifies for nonrecognition treatment under section 1031 or section 1033, the tax-exempt entity must treat the replacement property as remaining subject to paragraph (b)(1) of this section to the extent that the exchanged or involuntarily converted property was so subject;
 - (iv) The tax-exempt entity must use the same reasonable method of allocation for determining the percentage that it uses the assets in a section 511(a) activity as it uses for other tax purposes, such as determining the amount of depreciation deductions. The tax-exempt entity also must use this same reasonable method of allocation for each taxable year that it holds the assets; and
 - (v) An asset's built-in gain or loss is the amount that would be recognized under paragraph (a)(1) of this section except for this paragraph (b)(1);
- (2) Any transfer of assets to the extent gain or loss otherwise is recognized by the taxable corporation on the transfer. See, for example, sections 336, 337(b)(2), 367, and 1001;^b
 - (3) Any transfer of assets to the extent the transaction qualifies for nonrecognition treatment under section 1031 or section 1033; or
 - (4) Any forfeiture of a taxable corporation's assets in a criminal or civil action to the United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing; or any expropriation of a taxable corporation's assets by the government of a foreign country.
- (c) **Definitions. For purposes of this section:**
- (1) **Taxable corporation.** A taxable corporation is any corporation that is not a tax-exempt entity as defined in paragraph (c)(2) of this section.
 - (2) **Tax-exempt entity.** A tax-exempt entity is—^c
 - i Any entity that is exempt from tax under section 501(a) or section 529;
 - ii A charitable remainder annuity trust or charitable remainder unitrust as defined in section 664(d);
 - iii The United States, the government of a possession of the United States, a state, the District of Columbia, the government of a foreign country, or a political subdivision of any of the foregoing;
 - iv An Indian Tribal Government as defined in section 7701(a)(40), a subdivision of an Indian Tribal Government determined in accordance with section 7871(d), or an agency or instrumentality of an Indian Tribal Government or subdivision thereof;
 - v An Indian Tribal Corporation organized under section 17 of the Indian Reorganization Act of 1934, 25 U.S.C. 477, or section 3 of the Oklahoma Welfare Act, 25 U.S.C. 503;
 - vi An international organization as defined in section 7701(a)(18);
 - vii An entity any portion of whose income is excluded under section 115; or
 - viii An entity that would not be taxable under the Internal Revenue Code for reasons substantially similar to those applicable to any entity listed in this paragraph (c)(2) unless otherwise explicitly made exempt from the application of this section by statute or by action of the Commissioner.
 - (3) Substantially all. The term substantially all has the same meaning as under section 368(a)(1)(C).
- (d) **Loss limitation rule.** For purposes of determining the amount of gain or loss recognized by a taxable corporation on the transfer of its assets to a tax-exempt entity under paragraph (a) of this section, if assets are acquired by the taxable corporation in a transaction to which section 351 applied or as a contribution to capital, or assets are distributed from the taxable corporation to a shareholder or another member of the taxable corporation's affiliated group, and in either case such acquisition or distribution is made as part of a plan a principal purpose of which is to recognize loss by the taxable corporation on the transfer of such assets to the tax-exempt entity, the losses recognized by the taxable corporation on such assets transferred to the tax-exempt entity will be disallowed. For purposes of the preceding sentence, the principles of section 336(d)(2) apply.
- (e) **Effective date.** This section is applicable to transfers of assets as described in paragraph (a) of this section occurring after January 28, 1999, unless the transfer is pursuant to a written agreement which is (subject to customary conditions) binding on or before January 28, 1999.

Notes:

- ^a This includes Sec. 501(c)(4) organizations. Thus, application for exempt status under this exempt section will generate the "transfer tax."

- b For example, a golf course has a fair market value of \$10,000,000 but no tax basis because it was transferred to the association by the developer. The transfer would be subject to a tax of \$3,900,000 upon gaining exempt status.
- c Treasury Decision (TD) 8802 dated January 25, 1999 clarifies that Sec. 528 (Appendix 2K) entities are *excluded* from the definition of tax-exempt entities for purposes of Treasury Regulation 1.337(d)-4 (Appendix 5G) by stating the following:

Some commentators proposed removing section 528 homeowners associations from the list of tax-exempt entities subject to the regulations because dispositions of assets by a homeowners association are subject to tax. Under section 528, homeowners associations are subject to tax on all of their income except for exempt function income, which is defined as fees, dues, or assessments from homeowners. Gains from the sale of a homeowners association's property are taxable In addition, the properties that become the subject of section 528 homeowners associations generally are developed as business ventures, and the developer has substantial incentive to realize the increase in value of its assets in connection with their transfer to the association. Also, a homeowners association may alternate between taxable and tax-exempt status because its exemption is based on a year-by-year election under section 528(c)(1)(E). In a given year, a homeowners association may prefer taxable status to tax-exempt status under section 528 because a section 528 organization is taxed at a 30 percent flat rate on income other than membership fees, dues, or assessments, while a taxable homeowners association is subject to tax on all income but at the progressive rates of section 11 (15 to 35 percent). The tax on non-exempt income under section 528 may exceed the tax the association would pay as a taxable corporation. Congress anticipated that these entities may alternate between taxable and tax-exempt status and that the assets of these entities will remain subject to tax on transfer. Imposing a tax on appreciated property each time such an entity converts its status could inhibit this flexibility. For this reason . . . the IRS and Treasury Department believe that an organization's election to be treated under section 528 for a tax year should not trigger gain recognition. *Accordingly, the final regulations do not treat section 528 homeowners associations as tax-exempt entities for purposes of section 337(d)*