

§ 1.374-1

Example (1). On January 1, 1935, the Y Corporation, a taxpayer making its returns on the calendar year basis, acquired depreciable property from the X Corporation as the result of a transaction described in section 372(a). On January 1, 1935, the property had, in the hands of the X Corporation, a basis of \$200,000, an adjusted basis of \$150,000, a fair market value as of January 1, 1935 of \$80,000, and an estimated remaining life of 20 years. The 1935 transaction was treated as a taxable exchange and, accordingly, the Y Corporation claimed and was allowed depreciation in the amount of \$4,000 for each of the eight taxable years 1935 through 1942, inclusive. For each of the twelve taxable years 1943 through 1954, inclusive, the Y Corporation claimed and was allowed depreciation in the amount of \$7,500. On December 31, 1954, the property was sold for \$10,000 cash. The amount of the gain realized upon the sale is computed as follows:

Basis to X Corporation	\$200,000
Adjustment for depreciation in the hands of X Corporation (sec. 1016)	50,000
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Adjusted basis for depreciation in the hands of both X and Y Corporations (sec. 372(b))	150,000
Deduct:	
Depreciation allowable in amount of \$7,500 per year (1/20 of \$150,000) for 8 years, from Jan. 1, 1935, through Dec. 31, 1942	\$60,000
Depreciation allowable Jan. 1, 1943, to Dec. 31, 1954 (12 years at \$7,500)	90,000
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	150,000
Adjusted basis for computing gain or loss	0
Sale price	10,000
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Gain realized	10,000

For the taxable year 1943 and succeeding taxable years, the Y Corporation is entitled to deductions for depreciation in respect of such property in the amounts of \$7,500 in the determination of its tax liabilities for such years. But no change in the tax liability is authorized for preceding taxable years by reason of the difference between the \$7,500 depreciation allowable and the \$4,000 deduction previously allowed.

Example (2). Assume the same facts as in *Example (1)*, except that the property acquired by the Y Corporation had a fair market value as of January 1, 1935, of \$180,000, instead of \$80,000, and the Y Corporation claimed and was allowed depreciation in the amount of \$9,000 for each of the eight taxable years 1935 to 1942, inclusive, and in the amount of \$6,500 for the taxable years 1943 to 1954, inclusive. In such case, the amount of the gain realized upon the sale of the property would be computed as follows:

Adjusted basis for depreciation in the hands of Y Corporation as computed in <i>Example (1)</i> ..	\$150,000
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Deduct:

Depreciation allowed in the amount of \$9,000 per year for 8 years Jan. 1, 1935 to Dec. 31, 1942	\$72,000
Depreciation allowable Jan. 1, 1943, to Dec. 31, 1954, inclusive (12 times \$6,500)	78,000
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	150,000
Adjusted basis for computing gain or loss	0
Sale price	\$10,000
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Gain realized	10,000

No change in the tax liability is authorized for taxable years preceding 1943 by reason of the difference between the \$7,500 depreciation allowable and the \$9,000 deduction previously allowed.

§ 1.374-1 Exchanges by insolvent railroad corporations.

(a) *Exchange solely for stock or securities.* (1) Section 374(a)(1) provides for the nonrecognition of gain or loss by an insolvent railroad corporation upon certain exchanges made in connection with the reorganization of the corporation. In order to qualify as a section 374(a) reorganization, the transaction must satisfy the express statutory requirements as well as the underlying assumptions and purposes for which the exchange is excepted from the general rule requiring the recognition of gain or loss upon the exchange of property.

(2) Section 374(a)(1) applies only with respect to a reorganization effected in one of two specified types of court proceedings: (i) Receivership proceedings, or (ii) proceedings under section 77 of the Bankruptcy Act (11 U.S.C. 205). The specific statutory requirements are the transfer after July 31, 1955, of property of a railroad corporation, as defined in section 77(m) of the Bankruptcy Act (11 U.S.C. 205(m)), in pursuance of an order of the court having jurisdiction of the corporation in such proceeding, to another railroad corporation, as defined in section 77(m) of the Bankruptcy Act, organized or made use of to effectuate a plan of reorganization approved by the court in such proceeding, in exchange solely for stock or securities in such other railroad corporation. If the consideration for the transfer consists of other property or money as well as stock and securities, see section 374(a)(2) and (3) and paragraph (b) of

this section. As to the assumption of liabilities in an exchange described in section 374(a), see section 357 and paragraph (a)(1) and (2) of § 1.357-1 and paragraph (a) of § 1.357-2.

(3) The application of section 374(a)(1) is to be strictly limited to a transaction of the character set forth in such section. Hence, the section is inapplicable unless there is a bona fide plan of reorganization approved by the court having jurisdiction of the proceeding and the transfer of the property of the insolvent railroad corporation is made pursuant to such plan. It is unnecessary that the transfer be a direct transfer from the insolvent railroad corporation; it is sufficient if the transfer is an integral step in the consummation of the reorganization plan approved by the court. By its terms, the section has no application to a reorganization consummated by adjustment of the capital or debt structure of the insolvent railroad corporation without the transfer of its assets to another railroad corporation.

(4) As used in section 374(a)(1), the term *reorganization* is not controlled by the definition of *reorganization* contained in section 368. However, certain basic requirements, implicit in the statute, which are essential to a reorganization under section 368, are likewise essential to qualify a transaction as a reorganization under section 374(a)(1). Among these requirements are a continuity of the business enterprise under the modified corporate form and a continuity of interest therein on the part of those persons who were the owners of the enterprise prior to the reorganization. Thus, the nonrecognition accorded by section 374(a)(1) applies only to a genuine reorganization as distinguished from a liquidation and sale of property to either new or old interests supplying new capital and discharging the obligations of the old railroad corporation. For the purpose of determining whether the requisite continuity of interest exists, the interest of creditors who have, by appropriate legal steps, obtained effective command of the property of an insolvent railroad corporation is considered as the equivalent of a proprietary interest. But the mere possibility of a proprietary interest is not its equiva-

lent. In general, any transaction will be subject to nonrecognition of gain or loss as prescribed by section 374(a)(1) where the property is transferred to a railroad corporation and the stock and securities of such corporation are transferred to persons who were shareholders or creditors of the transferor railroad corporation as if such stock or securities had been transferred to such persons as shareholders pursuant to the nonrecognition provisions of part III, subchapter C, chapter 1 of the Code. The determinative and controlling factors are the railroad corporation's insolvency and the effective command by the creditors over its property. The term *insolvent* as used in this section refers to insolvency at any time during the course of the proceeding referred to in section 374(a)(1), either in the sense of excess of liabilities over assets or in the sense of inability to meet obligations as they mature.

(5) A short-term purchase money note is not a security within the meaning of this section, and the transfer of the properties of the insolvent railroad corporation for cash and deferred payment obligations of the transferee evidenced by short-term notes is a sale and not an exchange.

(b) *Exchange for stock or securities and other property or money.* If an exchange would be within the provisions of section 374(a)(1) if it were not for the fact that the consideration for the transfer of the property of the insolvent railroad corporation consists not only of stock or securities but also of other property or money, then, as provided in section 374(a)(2), if the other property or money received by the railroad corporation is distributed by it pursuant to the plan of reorganization, no gain to the railroad corporation will be recognized. Property is distributed within the meaning of this section if it is paid over or distributed to shareholders or creditors who have by appropriate legal steps obtained effective command of the property of the railroad corporation. If the other property or money received by the railroad corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the railroad corporation from the exchange will be recognized in an amount not in excess of the sum of

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money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized (see section 374(a)(3)). See section 354(c) relative to exchanges by stock or security holders.

[T.D. 6528, 26 FR 400, Jan. 19, 1961]

§ 1.374-2 Basis of property acquired after December 31, 1938, by railroad corporation in a receivership or railroad reorganization proceeding.

Section 374(b)(1) provides that if property of a railroad corporation, as defined in section 77(m) of the Bankruptcy Act (11 U.S.C. 205(m)), was acquired after July 31, 1955, in pursuance of an order of the court having jurisdiction of such corporation in either a receivership proceeding or a proceeding under section 77 of the Bankruptcy Act, and the acquiring corporation is also a railroad corporation as defined in section 77(m) of such Act, organized or availed of to effectuate a plan of reorganization approved by the court in such proceeding, the basis shall be the same as it would be in the hands of the transferor railroad corporation, increased in the amount of gain recognized to the transferor under section 374(a)(2) and paragraph (b) of § 1.374-1. For purposes of section 374(b)(1), it is unnecessary that the acquisition in question be a direct transfer from the corporation undergoing reorganization or that such reorganization constitute a reorganization within the meaning of section 368(a) since that section does not apply to part IV, subchapter C, chapter 1 of the Code. It is sufficient if the acquisition is in pursuance of an order of the court and is an integral step in the consummation of a reorganization plan approved by the court having jurisdiction of the proceeding. If the transaction falls within the provisions of section 374(b)(1), the basis of the property involved shall be determined pursuant to such provisions, notwithstanding that the transaction might also fall within another basis provision.

[T.D. 6528, 26 FR 401, Jan. 19, 1961, as amended by T.D. 7616, 44 FR 26870, May 8, 1979]

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§ 1.374-3 Records to be kept and information to be filed.

(a) *Return information.* Each railroad corporation a party to a section 374(a) reorganization shall furnish a complete statement of all facts pertinent to the recognition or nonrecognition of gain or loss in connection with the exchange, including:

(1) A certified copy of the plan of reorganization approved by the court in the proceeding, together with a statement showing in full the purposes thereof and in detail all transactions incident, or pursuant, to the plan;

(2) A complete statement of the cost or other basis of all property, including all stock or securities, transferred incident to the plan;

(3) A statement of the amount of stock or securities and other property or money received in the exchange, including a statement of all distributions or other disposition made thereof. The amount of each kind of stock or securities or other property shall be stated on the basis of the fair market value thereof at the date of the exchange;

(4) A statement of the amount and nature of any liabilities assumed upon the exchange.

The information required by this paragraph shall be filed as a part of each railroad corporation's return for its taxable year within which the reorganization occurred.

(b) *Permanent records.* Permanent records in substantial form must be kept by every railroad corporation which participates in a tax-free exchange in connection with a section 374(a) reorganization showing the cost or other basis of the transferred property and the amount of stock or securities and other property or money received (including any liabilities assumed upon the exchange), in order to facilitate the determination of gain or loss from a subsequent disposition of such stock or securities and other property received from the exchange.

[T.D. 6528, 26 FR 401, Jan. 19, 1961]

§ 1.374-4 Property acquired by electric railway corporation in corporate reorganizing proceeding.

Subject to the limitations and conditions set forth in section 374(b)(2), if