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From:
Sent: Thursday, March 03, 2016 3:45:06 PM
To:
Cc:
Bcc:
Subject: Your question about IRC secs. 597 and 7507

You have raised a question about the application of I.R.C. § 7507 in cases in which Federal Financial Assistance ("FFA") was provided to a failed bank ("Bank") that also reported taxable income unrelated to the receipt of FFA.

Due to its insolvency, Bank was closed and a bank regulatory agency ("Agency") was appointed as receiver. Pursuant to this transaction, Bank's assets and liabilities were transferred to another bank, and Agency provided FFA to Bank (as set forth in I.R.C. § 597 and the accompanying regulations). Agency, in its fiduciary capacity as Bank's receiver, filed Bank's tax return for the taxable year in issue. Bank reported taxable income attributable to a "litigation recovery," which, in turn, generated a tax liability. None of Bank's tax liability is attributable to its receipt of FFA. Bank (through Agency, acting as Bank's fiduciary) asserts that § 7507 prevents the Service from pursuing collection on the tax liability. We conclude that Bank's position is correct, and you have requested that we clarify our views in writing.

Section 7507(a) provides that in the case of a bank that "has ceased to do business by reason of bankruptcy or insolvency, no tax shall be assessed or collected . . . on account of such bank, which shall diminish the assets thereof necessary for the full payment of all its depositors . . . ." There is no dispute as to whether Bank qualifies as a "bank" for purposes of § 7507. The regulations under § 7507, however, seem to preclude application of § 7507 in cases where the bankrupt or insolvent bank has transferred assets or liabilities to any person in a transaction in which FFA is provided. See Treas. Reg. § 301.7507-1(b)(4)(iii) (explaining that a bank will not be considered to have "ceased to do business" under § 7507 on account of a transaction in which FFA is provided). Thus, it appears that Bank cannot rely upon § 7507 in this case because Bank transferred assets and liabilities as part of a transaction in which FFA was provided, and, thus, Bank never "ceased to do business" for purposes of § 7507(a). This reading, however, is erroneous.

The regulations under § 7507, insofar as they address transactions involving FFA, were amended to reflect Congressional intent upon enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. 101-73 ("FIRREA"). The

legislative history for FIRREA describes the intended application of § 7507 to FFA transactions as follows:

> [F]inancial 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 (or deemed receipt) of financial assistance.
>
> [T]he net operating losses and built-in losses of a financially troubled institution may not always be sufficient to offset the amount of financial assistance received (or deemed received) by the troubled institution. In this regard, the conferees intend that the regulatory authority granted by the bill . . . may be exercised to limit the potential applicability of section 7507 of the Code in cases where financially troubled financial institutions are acquired in transactions in which Federal financial assistance is provided. Nonetheless, the conferees understand that the Treasury Department may exercise the regulatory authority provided to it in this bill to issue regulations or other guidance providing that, in certain circumstances, no net tax liability would be payable by financially troubled financial institutions as a result of the receipt of Federal financial assistance.

H.R. Rep. No 101-222 (August 4, 1989), at pp. 463-64 [footnotes omitted]. Accordingly, Congress intended that FFA would be taxable to failed banks, but no net tax liability would generally result. In instances where inclusion of FFA in a failed bank's income resulted in a tax liability, Congress intended that Service would be able to assess and collect tax even if § 7507 would otherwise apply, and authorized the Service to issue regulations to determine when assessment would be appropriate. In this regard, the regulations cited previously under § 301.7507-1 were amended at the same time that regulations under § 597 were issued. See T.D. 8641, 1996-1 C.B. 103 (final regs.). Section 1.597-6(a) provides:

> If an Institution . . . is liable for income tax that is attributable to the inclusion in income of FFA . . . the tax will not be collected if it will be borne by Agency. The final determination of whether the tax would be borne by Agency is within the sole discretion of the Commissioner.

The Treasury Department in 1992 proposed the regulations that later became finalized as Treas. Reg. §§ 1.597-6 and 301.7507-1(b)(4), -9(d). See FI-46-89, 57 Fed. Reg. 14794, 1992-1 C.B. 1037 (proposed regs.). The Notice of Proposed Rulemaking ("NPRM") accompanying issuance of the Proposed Regulations explains the "noncollection policy" eventually finalized in §§ 1.597-6 and 301.7507-1(b), as follows:

> The proposed amendments to §§ 301.7507-1(b) and 301.7507-9(d) are intended to clarify the existing regulations under section 7507 and to reflect the changes made by FIRREA that Congress intended to affect section 7507. [Text omitted]
>
> Section 301.7507-1(b)(4)(iii) is intended to prevent any Institution from avoiding the income tax consequences of receipt of FFA.

1992-1 C.B. at 1041.

Thus, the language of § 301.7507-1(b)(4)(iii) must be read to preclude application of § 7507 only in cases where the item of income generating the tax liability is attributable to FFA. Bank's income for "litigation recovery" is not FFA income, but merely happens to arise with respect to a taxpayer that also received FFA. Even if the tax in issue arose from FFA income, the Service would be required under § 1.597-6 to determine whether the tax would be borne by Agency before collecting the tax. Therefore, we conclude that Bank (through Agency acting as Bank's fiduciary) can raise § 7507 to the extent that collection of tax would diminish assets necessary for paying Bank's depositors.