

of gain recognized would be \$5,000. In any suit or proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as "other property or money" under section 357, which is the case if the Commissioner determines that the taxpayer's purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose, and the taxpayer contests such determination by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove his case by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6528, 26 FR 399, Jan. 19, 1961]

#### § 1.357-2 Liabilities in excess of basis.

(a) Section 357(c) provides in general that in an exchange to which section 351 (relating to a transfer to a corporation controlled by the transferor) is applicable, or to which section 361 (relating to the nonrecognition of gain or loss to corporations) is applicable by reason of a section 368(a)(1)(D) reorganization, if the sum of the amount of liabilities assumed plus the amount of liabilities to which the property is subject exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset as the case may be. Thus, if an individual transfers, under section 351, properties having a total basis in his hands of \$20,000, one of which has a basis of \$10,000 but is subject to a mortgage of \$30,000, to a corporation controlled by him, such individual will be subject to tax with respect to \$10,000, the excess of the amount of the liability over the total adjusted basis of all the properties in his hands. The same result will follow whether or not the liability is assumed by the transferee. The determination of whether a gain resulting from the transfer of capital assets is long-term or short-term capital gain shall be made by reference to the hold-

ing period to the transferor of the assets transferred. An exception to the general rule of section 357(c) is made (1) for any exchange as to which under section 357(b) (relating to assumption of liabilities for tax-avoidance purposes) the entire amount of the liabilities is treated as money received and (2) for an exchange to which section 371 (relating to reorganizations in certain receivership and bankruptcy proceedings) or section 374 (relating to gain or loss not recognized in certain railroad reorganizations) is applicable.

(b) The application of paragraph (a) of this section may be illustrated by the following examples:

*Example 1.* If all such assets transferred are capital assets and if half the assets (ascertained by reference to their fair market value at the time of the transfer) have been held for less than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), and the remaining half for more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977), half the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as short-term capital gain, and the remaining half shall be treated as long-term capital gain.

*Example 2.* If half of the assets (ascertained by reference to their fair market value at the time of the transfer) transferred are capital assets and half are assets other than capital assets, then half of the excess of the amount of the liability over the total of the adjusted basis of the property transferred pursuant to the exchange shall be treated as capital gain, and the remaining half shall be treated as gain from the sale or exchange of assets other than capital assets.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6528, 26 FR 399, Jan. 19, 1961; T.D. 7728, 45 FR 72650, Nov. 3, 1980]

#### § 1.358-1 Basis to distributees.

(a) In the case of an exchange to which section 354 or 355 applies in which, under the law applicable to the year in which the exchange is made, only nonrecognition property is received, immediately after the transaction, the sum of the basis of all of the stock and securities received in the transaction shall be the same as the basis of all the stock and securities in such corporation surrendered in the transaction, allocated in the manner