

Internal Revenue Code and the regulations thereunder. See §1.6041-1(f) for rules relating to the amount to be reported when fees, expenses, or commissions owed by a payee to a third party are deducted from a payment.

(e) *Examples.* The provisions of this section may be illustrated by the following examples:

*Example 1.* P enters into a contract with S for the purchase of residential property owned by S for the price of \$200,000. P is required to deposit \$10,000 of earnest money into an escrow. At closing, the \$10,000 and the interest earned thereon will be credited against the purchase price of the property. The escrow is a pre-closing escrow. P is taxable on the interest earned on the pre-closing escrow prior to closing.

*Example 2.* X and Y enter into a contract in which X agrees to exchange certain construction equipment for residential property owned by Y. The contract requires X and Y to each deposit \$10,000 of earnest money into an escrow. At closing, \$10,000 and the interest earned thereon will be paid to X and \$10,000 and the interest earned thereon will be paid to Y. The escrow is a pre-closing escrow. X is taxable on the interest earned prior to closing on the \$10,000 of funds X deposited in the pre-closing escrow. Similarly, Y is taxable on the interest earned prior to closing on the \$10,000 of funds Y deposited in the pre-closing escrow.

(f) *Effective dates*—(1) *In general.* This section applies to pre-closing escrows established after February 3, 2006.

(2) *Transition rule.* With respect to a pre-closing escrow established after August 16, 1986, but on or before February 3, 2006, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the escrow or a reasonable, consistently applied method for reporting the income.

[T.D. 9249, 71 FR 6202, Feb. 7, 2006]

#### § 1.468B-8 Contingent-at-closing escrows. [Reserved]

#### § 1.468B-9 Disputed ownership funds.

(a) *Scope.* This section provides rules under section 468B(g) relating to the current taxation of income of a disputed ownership fund.

(b) *Definitions.* For purposes of this section—

(1) *Disputed ownership fund* means an escrow account, trust, or fund that—

(i) Is established to hold money or property subject to conflicting claims of ownership;

(ii) Is subject to the continuing jurisdiction of a court;

(iii) Requires the approval of the court to pay or distribute money or property to, or on behalf of, a claimant, transferor, or transferor-claimant; and

(iv) Is not a qualified settlement fund under §1.468B-1, a bankruptcy estate (or part thereof) resulting from the commencement of a case under title 11 of the United States Code, or a liquidating trust under §301.7701-4(d) of this chapter (except as provided in paragraph (c)(2)(ii) of this section);

(2) *Administrator* means a person designated as such by a court having jurisdiction over a disputed ownership fund, however, if no person is designated, the administrator is the escrow agent, escrow holder, trustee, receiver, or other person responsible for administering the fund;

(3) *Claimant* means a person who claims ownership of, in whole or in part, or a legal or equitable interest in, money or property immediately before and immediately after that property is transferred to a disputed ownership fund;

(4) *Court* means a court of law or equity of the United States or of any state (including the District of Columbia), territory, possession, or political subdivision thereof;

(5) *Disputed property* means money or property held in a disputed ownership fund subject to the claimants' conflicting claims of ownership;

(6) *Related person* means any person that is related to a transferor within the meaning of section 267(b) or 707(b)(1);

(7) *Transferor* means, in general, a person that transfers disputed property to a disputed ownership fund, except that—

(i) If disputed property is transferred by an agent, fiduciary, or other person acting in a similar capacity, the transferor is the person on whose behalf the agent, fiduciary, or other person acts; and

(ii) A payor of interest or other income earned by a disputed ownership fund is not a transferor within the

meaning of this section (unless the payor is also a claimant);

(8) *Transferor-claimant* means a transferor that claims ownership of, in whole or in part, or a legal or equitable interest in, the disputed property immediately before and immediately after that property is transferred to the disputed ownership fund. Because a transferor-claimant is both a transferor and a claimant, generally the terms *transferor* and *claimant* also include a transferor-claimant. See paragraph (d) of this section for rules applicable only to transferors that are not transferor-claimants and paragraph (e) of this section for rules applicable only to transferors that are also transferor-claimants.

(c) *Taxation of a disputed ownership fund*—(1) *In general.* For Federal income tax purposes, a disputed ownership fund is treated as the owner of all assets that it holds. A disputed ownership fund is treated as a C corporation for purposes of subtitle F of the Internal Revenue Code, and the administrator of the fund must obtain an employer identification number for the fund, make all required income tax and information returns, and deposit all tax payments. Except as otherwise provided in this section, a disputed ownership fund is taxable as—

(i) A C corporation, unless all the assets transferred to the fund by or on behalf of transferors are passive investment assets. For purposes of this section, passive investment assets are assets of the type that generate portfolio income within the meaning of § 1.469-2T(c)(3)(i); or

(ii) A qualified settlement fund, if all the assets transferred to the fund by or on behalf of transferors are passive investment assets. A disputed ownership fund taxable as a qualified settlement fund under this section is subject to all the provisions contained in § 1.468B-2, except that the rules contained in paragraphs (c)(3), (4), and (c)(5)(i) of this section apply in lieu of the rules in § 1.468B-2(b)(1), (d), (e), (f) and (j).

(2) *Exceptions.* (i) The claimants to a disputed ownership fund may submit a private letter ruling request proposing a method of taxation different than the method provided in paragraph (c)(1) of this section.

(ii) The trustee of a liquidating trust established pursuant to a plan confirmed by the court in a case under title 11 of the United States Code may, in the liquidating trust's first taxable year, elect to treat an escrow account, trust, or fund that holds assets of the liquidating trust that are subject to disputed claims as a disputed ownership fund. Pursuant to this election, creditors holding disputed claims are not treated as transferors of the money or property transferred to the disputed ownership fund. A trustee makes the election by attaching a statement to the timely filed Federal income tax return of the disputed ownership fund for the taxable year for which the election becomes effective. The election statement must include a statement that the trustee will treat the escrow account, trust, or fund as a disputed ownership fund and must include a legend, “§ 1.468B-9(c) Election,” at the top of the page. The election may be revoked only upon consent of the Commissioner by private letter ruling.

(3) *Property received by the disputed ownership fund*—(i) *Generally excluded from income.* In general, a disputed ownership fund does not include an amount in income on account of a transfer of disputed property to the disputed ownership fund. However, the accrual or receipt of income from the disputed property in a disputed ownership fund is not a transfer of disputed property to the fund. Therefore, a disputed ownership fund must include in income all income received or accrued from the disputed property, including items such as—

(A) Payments to a disputed ownership fund made in compensation for late or delayed transfers of money or property;

(B) Dividends on stock of a transferor (or a related person) held by the fund; and

(C) Interest on debt of a transferor (or a related person) held by the fund.

(ii) *Basis and holding period.* In general, the initial basis of property transferred by, or on behalf of, a transferor to a disputed ownership fund is the fair market value of the property on the date of transfer to the fund, and the fund's holding period begins on the date of the transfer. However, if the

transferor is a transferor-claimant, the fund's initial basis in the property is the same as the basis of the transferor-claimant immediately before the transfer to the fund, and the fund's holding period for the property is determined under section 1223(2).

(4) *Property distributed by the disputed ownership fund*—(i) *Computing gain or loss.* Except in the case of a distribution or deemed distribution described in paragraph (e)(3) of this section, a disputed ownership fund must treat a distribution of disputed property as a sale or exchange of that property for purposes of section 1001(a). In computing gain or loss, the amount realized by the disputed ownership fund is the fair market value of that property on the date of distribution.

(ii) *Denial of deduction.* A disputed ownership fund is not allowed a deduction for a distribution of disputed property or of the net after-tax income earned by the disputed ownership fund made to or on behalf of a transferor or claimant.

(5) *Taxable year and accounting method.* (i) A disputed ownership fund taxable as a C corporation under paragraph (c)(1)(i) of this section may compute taxable income under any accounting method allowable under section 446 and is not subject to the limitations contained in section 448. A disputed ownership fund taxable as a C corporation may use any taxable year allowable under section 441.

(ii) A disputed ownership fund taxable as a qualified settlement fund under paragraph (c)(1)(ii) of this section may compute taxable income under any accounting method allowable under section 446 and may use any taxable year allowable under section 441.

(iii) Appropriate adjustments must be made by a disputed ownership fund or transferors to the fund to prevent the fund and the transferors from taking into account the same item of income, deduction, gain, loss, or credit (including capital gains and losses) more than once or from omitting such items. For example, if a transferor that is not a transferor-claimant uses the cash receipts and disbursements method of accounting and transfers an account receivable to a disputed owner-

ship fund that uses an accrual method of accounting, at the time of the transfer of the account receivable to the disputed ownership fund, the transferor must include in its gross income the value of the account receivable because, under paragraph (c)(3)(ii) of this section, the disputed ownership fund will take a fair market value basis in the receivable and will not include the fair market value in its income when received from the transferor or when paid by the customer. If the account receivable were transferred to the disputed ownership fund by a transferor-claimant using the cash receipts and disbursements method, however, the disputed ownership fund would take a basis in the receivable equal to the transferor's basis, or \$0, and would be required to report the income upon collection of the account.

(6) *Unused carryovers.* Upon the termination of a disputed ownership fund, if the fund has an unused net operating loss carryover under section 172, an unused capital loss carryover under section 1212, or an unused tax credit carryover, or if the fund has, for its last taxable year, deductions in excess of gross income, the claimant to which the fund's net assets are distributable will succeed to and take into account the fund's unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year of the fund. If the fund's net assets are distributable to more than one claimant, the unused net operating loss carryover, unused capital loss carryover, unused tax credit carryover, or excess of deductions over gross income for the last taxable year must be allocated among the claimants in proportion to the value of the assets distributable to each claimant from the fund. Unused carryovers described in this paragraph (c)(6) are not money or other property for purposes of paragraph (e)(3)(ii) of this section and thus are not deemed transferred to a transferor-claimant before being transferred to the claimants described in this paragraph (c)(6).

(d) *Rules applicable to transferors that are not transferor-claimants.* The rules in this paragraph (d) apply to transferors (as defined in paragraph (b)(7) of this

section) that are not transferor-claimants (as defined in paragraph (b)(8) of this section).

(1) *Transfer of property.* A transferor must treat a transfer of property to a disputed ownership fund as a sale or other disposition of that property for purposes of section 1001(a). In computing the gain or loss on the disposition, the amount realized by the transferor is the fair market value of the property on the date the transfer is made to the disputed ownership fund.

(2) *Economic performance*—(i) *In general.* For purposes of section 461(h), if a transferor using an accrual method of accounting has a liability for which economic performance would otherwise occur under § 1.461-4(g) when the transferor makes payment to the claimant or claimants, economic performance occurs with respect to the liability when and to the extent that the transferor makes a transfer to a disputed ownership fund to resolve or satisfy that liability.

(ii) *Obligations of the transferor.* Economic performance does not occur when a transferor using an accrual method of accounting issues to a disputed ownership fund its debt (or provides the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt. Economic performance does not occur when the transferor provides to a disputed ownership fund its obligation (or the obligation of a related person) to provide property or services in the future or to make a payment described in § 1.461-4(g)(1)(ii)(A). Instead, economic performance occurs with respect to such an obligation as property or services are provided or payments are made to the disputed ownership fund or a claimant. With regard to interest on a debt issued or provided to a disputed ownership fund, economic performance occurs as determined under § 1.461-4(e).

(3) *Distributions to transferors*—(i) *In general.* Except as provided in section 111(a) and paragraph (d)(3)(ii) of this section, the transferor must include in gross income any distribution to the transferor (including a deemed distribution described in paragraph (d)(3)(iii) of this section) from the disputed ownership fund. If property is

distributed, the amount includible in gross income and the basis in that property are generally the fair market value of the property on the date of distribution.

(ii) *Exception.* A transferor is not required to include in gross income a distribution of money or property that it previously transferred to the disputed ownership fund if the transferor did not take into account, for example, by deduction or capitalization, an amount with respect to the transfer either at the time of the transfer to, or while the money or property was held by, the disputed ownership fund. The transferor's gross income does not include a distribution of money from the disputed ownership fund equal to the net after-tax income earned on money or property transferred to the disputed ownership fund by the transferor while that money or property was held by the fund. Money distributed to a transferor by a disputed ownership fund will be deemed to be distributed first from the money or property transferred to the disputed ownership fund by that transferor, then from the net after-tax income of any money or property transferred to the disputed ownership fund by that transferor, and then from other sources.

(iii) *Deemed distributions.* If a disputed ownership fund makes a distribution of money or property on behalf of a transferor to a person that is not a claimant, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to make a payment to the actual recipient.

(e) *Rules applicable to transferor-claimants.* The rules in this paragraph (e) apply to transferor-claimants (as defined in paragraph (b)(8) of this section).

(1) *Transfer of property.* A transfer of property by a transferor-claimant to a disputed ownership fund is not a sale or other disposition of the property for purposes of section 1001(a).

(2) *Economic performance*—(i) *In general.* For purposes of section 461(h), if a transferor-claimant using an accrual method of accounting has a liability for which economic performance would otherwise occur under § 1.461-4(g) when the transferor-claimant makes payment to another claimant, economic

performance occurs with respect to the liability when and to the extent that the disputed ownership fund transfers money or property to the other claimant to resolve or satisfy that liability.

(ii) *Obligations of the transferor-claimant.* Economic performance does not occur when a disputed ownership fund transfers the debt of a transferor-claimant (or of a person related to the transferor-claimant) to another claimant. Instead, economic performance occurs as principal payments on the debt are made to the other claimant. Economic performance does not occur when a disputed ownership fund transfers to another claimant the obligation of a transferor-claimant (or of a person related to the transferor-claimant) to provide property or services in the future or to make a payment described in § 1.461-4(g)(1)(ii)(A). Instead, economic performance occurs with respect to such an obligation as property or services are provided or payments are made to the other claimant. With regard to interest on a debt issued or provided to a disputed ownership fund, economic performance occurs as determined under § 1.461-4(e).

(3) *Distributions to transferor-claimants*—(i) *In general.* The gross income of a transferor-claimant does not include a distribution to the transferor-claimant (including a deemed distribution described in paragraph (e)(3)(ii) of this section) of money or property from a disputed ownership fund that the transferor-claimant previously transferred to the fund, or the net after-tax income earned on that money or property while it was held by the fund. If such property is distributed to the transferor-claimant by the disputed ownership fund, then the transferor-claimant's basis in the property is the same as the disputed ownership fund's basis in the property immediately before the distribution.

(ii) *Deemed distributions.* If a disputed ownership fund makes a distribution of money or property to a claimant or makes a distribution of money or property on behalf of a transferor-claimant to a person that is not a claimant, the distribution is deemed made by the fund to the transferor-claimant. The transferor-claimant, in turn, is deemed

to make a payment to the actual recipient.

(f) *Distributions to claimants other than transferor-claimants.* Whether a claimant other than a transferor-claimant must include in gross income a distribution of money or property from a disputed ownership fund generally is determined by reference to the claim in respect of which the distribution is made.

(g) *Statement to the disputed ownership fund and the Internal Revenue Service with respect to transfers of property other than cash*—(1) *In general.* By February 15 of the year following each calendar year in which a transferor (or other person acting on behalf of a transferor) makes a transfer of property other than cash to a disputed ownership fund, the transferor must provide a statement to the administrator of the fund setting forth the information described in paragraph (g)(3) of this section. The transferor must attach a copy of this statement to its return for the taxable year of transfer.

(2) *Combined statements.* If a disputed ownership fund has more than one transferor, any two or more transferors may provide a combined statement to the administrator. If a combined statement is used, each transferor must attach a copy of the combined statement to its return and maintain with its books and records a schedule describing each asset that the transferor transferred to the disputed ownership fund.

(3) *Information required on the statement.* The statement required by paragraph (g)(1) of this section must include the following information—

- (i) A legend, “§ 1.468B-9 Statement,” at the top of the first page;
- (ii) The transferor's name, address, and taxpayer identification number;
- (iii) The disputed ownership fund's name, address, and employer identification number;
- (iv) A statement declaring whether the transferor is a transferor-claimant;
- (v) The date of each transfer;
- (vi) A description of the property (other than cash) transferred; and

(vii) The disputed ownership fund's basis in the property and holding period on the date of transfer as determined under paragraph (c)(3)(ii) of this section.

(h) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* (i) X Corporation petitions the United States Tax Court in 2006 for a re-determination of its tax liability for the 2003 taxable year. In 2006, the Tax Court determines that X Corporation is liable for an income tax deficiency for the 2003 taxable year. X Corporation files an appellate bond in accordance with section 7485(a) and files a notice of appeal with the appropriate United States Court of Appeals. In 2006, the Court of Appeals affirms the decision of the Tax Court and the United States Supreme Court denies X Corporation's petition for a writ of certiorari.

(ii) The appellate bond that X Corporation files with the court for the purpose of staying assessment and collection of deficiencies pending appeal is not an escrow account, trust or fund established to hold property subject to conflicting claims of ownership. Although X Corporation was found liable for an income tax deficiency, ownership of the appellate bond is not disputed. Rather, the bond serves as security for a disputed liability. Therefore, the bond is not a disputed ownership fund.

*Example 2.* (i) The facts are the same as *Example 1*, except that X Corporation deposits United States Treasury bonds with the Tax Court in accordance with section 7845(c)(2) and 31 U.S.C. 9303.

(ii) The deposit of United States Treasury bonds with the court for the purpose of staying assessment and collection of deficiencies while X Corporation prosecutes an appeal does not create a disputed ownership fund because ownership of the bonds is not disputed.

*Example 3.* (i) Prior to A's death, A was the insured under a life insurance policy issued by X, an insurance company. X uses an accrual method of accounting. Both A's current spouse and A's former spouse claim to be the beneficiary under the policy and entitled to the policy proceeds (\$1 million). In 2005, X files an interpleader action and deposits \$1 million into the registry of the court. On June 1, 2006, a final determination is made that A's current spouse is the beneficiary under the policy and entitled to the money held in the registry of the court. The interest earned on the registry account is \$12,000. The money in the registry account is distributed to A's current spouse.

(ii) The money held in the registry of the court consisting of the policy proceeds and the earnings thereon are a disputed ownership fund taxable as if it were a qualified set-

tlement fund. See paragraphs (b)(1) and (c)(1)(ii) of this section. The fund's gross income does not include the \$1 million transferred to the fund by X, however, the \$12,000 interest is included in the fund's gross income in accordance with its method of accounting. See paragraph (c)(3)(i) of this section. Under paragraph (c)(4)(ii) of this section, the fund is not allowed a deduction for a distribution to A's current spouse of the \$1 million or the interest income earned by the fund.

(iii) X is a transferor that is not a transferor-claimant. See paragraphs (b)(7) and (b)(8) of this section.

(iv) Whether A's current spouse must include in income the \$1 million insurance proceeds and the interest received from the fund is determined under other provisions of the Internal Revenue Code. See paragraph (f) of this section.

*Example 4.* (i) Corporation B and unrelated individual C claim ownership of certain rental property. B uses an accrual method of accounting. The rental property is property used in a trade or business. B claims to have purchased the property from C's father. However, C asserts that the purported sale to B was ineffective and that C acquired ownership of the property through intestate succession upon the death of C's father. For several years, B has maintained and received the rent from the property.

(ii) Pending the resolution of the title dispute between B and C, the title to the rental property is transferred to a court-supervised registry account on February 1, 2005. On that date the court appoints R as receiver for the property. R collects the rent earned on the property and hires employees necessary for the maintenance of the property. The rents paid to R cannot be distributed to B or C without the court's approval.

(iii) On June 1, 2006, the court makes a final determination that the rental property is owned by C. The court orders C to refund to B the purchase price paid by B to C's father plus interest on that amount from February 1, 2005. The court also orders that a distribution be made to C of all funds held in the court registry consisting of the rent collected by R and the income earned thereon. C takes title to the rental property.

(iv) The rental property and the funds held by the court registry are a disputed ownership fund under paragraph (b)(1) of this section. The fund is taxable as if it were a C corporation because the rental property is not a passive investment asset within the meaning of paragraph (c)(1)(i) of this section.

(v) The fund's gross income does not include the value of the rental property transferred to the fund by B. See paragraph (c)(3)(i) of this section. Under paragraph (c)(3)(ii) of this section, the fund's initial basis in the property is the same as B's adjusted basis immediately before the transfer

to the fund and the fund's holding period is determined under section 1223(2). The fund's gross income includes the rents collected by R and any income earned thereon. For the period between February 1, 2005, and June 1, 2006, the fund may be allowed deductions for depreciation and for the costs of maintenance of the property because the fund is treated as owning the property during this period. See sections 162, 167, and 168. Under paragraph (c)(4)(ii) of this section, the fund may not deduct the distribution to C of the property, or the rents (or any income earned thereon) collected from the property while the fund holds the property. No gain or loss is recognized by the fund from this distribution or from the fund's transfer of the rental property to C pursuant to the court's determination that C owns the property. See paragraphs (c)(4)(i) and (e)(3) of this section.

(vi) B is the transferor to the fund. Under paragraphs (b)(8) and (e)(1) of this section, B is a transferor-claimant and does not recognize gain or loss under section 1001(a) on transfer of the property to the disputed ownership fund. The money and property distributed from the fund to C is deemed to be distributed first to B and then transferred from B to C. See paragraph (e)(3)(ii) of this section. Under paragraph (e)(2)(i) of this section, economic performance occurs when the disputed ownership fund transfers the property and any earnings thereon to C. The income tax consequences of the deemed transfer from B to C as well as the income tax consequences of C's refund to B of the purchase price paid to C's father and interest thereon are determined under other provisions of the Internal Revenue Code.

(i) [Reserved]

(j) *Effective dates*—(1) *In general.* This section applies to disputed ownership funds established after February 3, 2006.

(2) *Transition rule.* With respect to a disputed ownership fund established after August 16, 1986, but on or before February 3, 2006, the Internal Revenue Service will not challenge a reasonable, consistently applied method of taxation for income earned by the fund, transfers to the fund, and distributions made by the fund.

[T.D. 9249, 71 FR 6202, Feb. 7, 2006]

#### § 1.469-0 Table of contents.

This section lists the captions that appear in the regulations under section 469.

##### § 1.469-1 General rules.

(a)–(c)(7) [Reserved]

(c)(8) Consolidated groups.

(c)(9)–(d)(1) [Reserved]

(2) Coordination with sections 613A(d) and 1211.

(d)(3)–(e)(1) [Reserved]

(2) Trade or business activity.

(e)(3)(i)–(e)(3)(ii) [Reserved]

(iii) Average period of customer use.

(A) In general.

(B) Average use factor.

(C) Average period of customer use for class of property.

(D) Period of customer use.

(E) Class of property.

(F) Gross rental income and daily rent.

(e)(3)(iv)–(e)(3)(vi)(C) [Reserved]

(D) Lodging rented for convenience of employer.

(E) Unadjusted basis.

(e)(3)(vii)–(e)(4)(iii) [Reserved]

(iv) Definition of “working interest.”

(e)(4)(v)–(vi) [Reserved]

(5) Rental of dwelling unit.

(e)(6)–(f)(3)(iii) [Reserved]

(4) Carryover of disallowed deductions and credits.

(i) In general.

(ii) Operations continued through C corporations or similar entities.

(iii) Examples.

(g)(1)–(g)(4)(ii)(B) [Reserved]

(4)(ii)(C) (no paragraph heading)

(5) [Reserved]

(h)(1) In general.

(2) Definitions.

(3) [Reserved]

(4) Status and participation of members.

(i) Determination by reference to status and participation of group.

(ii) Determination of status and participation of consolidated group.

(5) [Reserved]

(6) Intercompany transactions.

(i) In general.

(ii) Example.

(iii) Effective dates.

(h)(7)–(k) [Reserved]

##### § 1.469-1T General rules (temporary).

(a) Passive activity loss and credit disallowed.

(1) In general.

(2) Exceptions.

(b) Taxpayers to whom these rules apply.

(c) Cross references.

(1) Definition of passive activity.

(2) Passive activity loss.

(3) Passive activity credit.

(4) Effect of rules for other purposes.

(5) Special rule for oil and gas working interests.

(6) Treatment of disallowed losses and credits.

(7) Corporations subject to section 469.

(8) [Reserved]

(9) Joint returns.

(10) Material participation.

(11) Effective date and transition rules.