

Seggerman Farms, Inc. v. Commissioner
(recognition of gain when liabilities exceed basis of assets on
incorporation)

Taxpayers had to recognize gain upon incorporation when transferred liabilities exceeded asset basis even though liabilities were personally guaranteed.

Facts. The taxpayers incorporated their family farming business, which had previously been operated as a joint venture. As part of the incorporation, various farm assets were transferred to the corporation. The corporation assumed the farm liabilities, and some of the property was transferred subject to liability. The adjusted **basis of the assets was less than the liabilities assumed plus the amount of liabilities to which property was subject. However, the taxpayers were personally liable for all the debt before and after the incorporation.**

Issue. Whether taxpayers must recognize a gain on the transfer of assets to the corporation under I.R.C. §357 to the extent that the amount of liabilities that were assumed plus the amount of liabilities to which the property was subject exceeds the total of the adjusted basis of the property that was transferred to the corporation.

Analysis. In general, I.R.C. §357(c)(1)(A) provides that in the case of an exchange to which I.R.C. §351 applies, if the sum of the amount of the liabilities assumed, plus the amount of the 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.

In *Rosen v. Commissioner*, 62 T.C. (CCH) 11 (1974), *aff'd without published opinion*, 515 F.2d 507 (3rd Cir. 1975), the court addressed the same issue in similar circumstances. The taxpayer, in *Rosen*, transferred all of the assets and liabilities of a sole proprietorship to a corporation in which he owned 100% of the outstanding stock. The liabilities exceeded the adjusted basis of the assets that were transferred, and the taxpayer remained personally liable for the liabilities that were transferred. The court ruled, in *Rosen*, that the even though the taxpayer remained personally liable for the payment of the liabilities, there is no requirement in I.R.C. §357(c)(1) that the transferor be relieved of liability and held that the taxpayer had to recognize a gain under I.R.C. §357(c).

The taxpayers rely on two Court of Appeals decisions in which the Courts of Appeals granted taxpayers relief from recognizing a gain under I.R.C. §357(c). In *Lessinger v. Commissioner*, 872 F.2d 519 (2nd Cir. 1989), *rev'g* 85 T.C. (CCH) 824 (1985), the difference between the adjusted basis of the assets and the liabilities that were transferred was recorded as a loan receivable from the taxpayer to the corporation. As a result of including the face value of the loan

receivable in the assets, the Second Circuit ruled there was no I.R.C. §357 gain. In *Peracchi v. Commissioner*, 143 F.3d 487 (9th Cir. 1998), *rev'g*, 71 T.C.M. (CCH) 2830, in a similar situation, the difference in liabilities and asset basis was recorded as a personal note from the taxpayer to the corporation. The Ninth Circuit, in *Peracchi*, held that the taxpayer had a basis in the personal note equal to the face value of the note and that there was no gain to recognize under I.R.C. 357(c).

The IRS argued that the structure of the taxpayers' I.R.C. §351 transaction was not the same as the structure of the taxpayers' transactions in *Lessinger* and *Peracchi*. Agreeing with the IRS, the court concluded that **personal guaranties of corporate debt are not the same as incurring indebtedness to the corporation** because a guaranty is merely a promise to pay in the future if certain events should occur and taxpayers' guaranties do not constitute economic outlays.

Holding. The Tax Court held that under I.R.C. §357, taxpayers must recognize a gain on the transfer of assets to the corporation.

[*Seggerman Farms, Inc. v. Commissioner*, 81 T.C.M. (CCH) 1543 (2001)]