benefit of the Institution's offsetting losses.

The IRS and Treasury agree that the toll charge is more appropriately included in the income of the Institution (i.e., the entity that is reimbursed by Agency for its loss), because the toll charge represents accelerated FFA income. Thus, the final regulations provide that the Institution, rather than its member shareholders, takes the toll charge into income.

Toll charge deduction. Under the proposed regulations, the Institution does not recognize built-in losses on disaffiliation. One commentator suggested the final regulations provide for a ''toll charge deduction'' for the excess of the Institution's adjusted basis over its liabilities. According to the commentator, such a deduction is appropriate because the Institution incurred economic loss while it was a member of the consolidated group, before the Institution was placed in receivership by Agency.

The commentator's recommendation is not adopted in the final regulations because a toll charge deduction would accelerate recognition of losses in advance of realization. Such a deduction is particularly inappropriate because federal banking laws now permit placing solvent institutions in receivership. In such cases, it is uncertain whether the loss represented by such a deduction will ever be realized.

Worthless stock deduction. Under the proposed regulations, if an election to disaffiliate is made, the members of the consolidated group are treated as having disposed of their stock in the Institution. One commentator suggested that the final regulations clarify that, upon disaffiliation, the Institution's stock is worthless.

The final regulations address the commentator's concerns by providing that, as a consequence of the election, the members of the consolidated group treat their stock in the Institution as worthless if the Institution is factually insolvent on the date the Institution is placed in receivership (or on the date the consolidated group is deemed to make the election to disaffiliate). This rule preempts otherwise applicable tests for worthlessness under section 165 and § 1.1502–19. Any worthless stock deduction is subject to the limitations of the loss disallowance regulations (§§ 1.337(d)–1 and 1.1502–20).

Consistency rule. Under the proposed regulations, a consolidated group could elect to disaffiliate a subsidiary Institution only if the Institution was its first subsidiary placed in Agency receivership after the enactment of FIRREA. The election made for the first subsidiary bound all future subsidiaries placed in Agency receivership. To address the concern that the scope of the proposed consistency rule was too broad, the final regulations modify the consistency rule to require, generally, that a consolidated group must elect consistently only for subsidiary Institutions placed in Agency receivership within five years of each other.

Section 1.597–5 Taxable Transfers

Section 597 applies to FFA and transactions in connection with which FFA is provided. The proposed regulations generally define a Taxable Transfer as a transfer of deposit liabilities or stock while an Institution is under Agency Control. However, IRS and Treasury now understand that it is possible for Agency to resolve an Institution under its control without providing assistance, or to provide assistance without placing an Institution under its control. In light of this information, the final regulations refine the definition of a Taxable Transfer.

Under the final regulations, Taxable Transfers include the transfer of any deposit liability in connection with which FFA is provided or the transfer of any asset for which Agency has an obligation (e.g., assets covered by Loss Guarantees). Certain transfers of stock cause a Taxable Transfer if FFA is provided in connection with the transfer, if the Institution is a Bridge Bank or if the Institution has a balance in its deferred FFA account. The phrase ''in connection with'' should be interpreted broadly. If any party to a transaction receives FFA, all parties and all related transactions are within the scope of these regulations. To provide certainty regarding tax treatment for purchasers of stock of subsidiaries of Institutions under Agency Control, the final regulations treat all transactions in which such a subsidiary leaves its group as Taxable Transfers.

Section 1.597–6 Limitation on Collection of Income Tax

Limitation where tax is borne by Agency. The proposed regulations provided that income tax attributable to the receipt of FFA or gain on a Taxable Transfer would not be collected from an Institution without Continuing Equity if Agency would bear the burden of the tax. Commentators suggested that the limitation on noncollection in cases of Continuing Equity is inappropriate because it requires Agency to gross-up any assistance paid to cover the tax thereon.

The final regulations retain the limitation on noncollection in cases of Continuing Equity. The IRS and Treasury believe that the limitation is appropriate for transactions in which Agency assists an Institution while allowing old shareholders to retain their ownership. Noncollection should not inure to the benefit of the Institution's old shareholders, who would have use of the Institution's losses while escaping responsibility for the tax on related FFA income. The congressional purpose in FIRREA to eliminate any tax subsidy for assisted transactions requires that the IRS not waive its rights as a creditor in cases where all other creditors and equity holders retain their rights.

Transferee liability. The proposed regulations limited the collection of a failed Institution's income taxes from a transferee in a Taxable Transfer (i.e., a New Entity or Acquiring). This rule would not apply if (similar to the Continuing Equity rule discussed above under the heading ''Deferral formula with Continuing Equity'') there is a five percent overlap in the ownership of the transferor Institution and the New Entity or Acquiring.

Commentators suggested that the final regulations should not include the five percent overlap exception because the exception appears to punish former owners of Institutions, Institutions have difficulty tracking ownership, and the exception contains no limits on aggregation.

Because good faith purchasers of assets for value generally do not have transferee liability, the final regulations clarify that Acquiring (the purchaser of Institution's assets in an actual Taxable Transfer) is not subject to such liability in any case. This rule applies even if shareholders of Acquiring were shareholders of the selling Institution.

The final regulations do not, however, except a New Entity (the resulting corporation in a deemed Taxable Transfer) from collection if the Institution's previous equity interests remain outstanding in the New Entity, or are reacquired or exchanged for consideration. As in those cases in which a Taxable Transfer does not occur, the IRS should remain a creditor if all other creditors retain their interests and the Institution's previous equity interests had retained value. However, by focusing on whether previous equity interests retain value, the final regulations eliminate the need to track or aggregate ownership and do not penalize any particular potential acquirors.