

June 2003, the CPI has increased from 156.7 to 183.7, or 17.2%. Applying this percentage increase to currently adjusted civil penalty amounts, the FTC is adjusting civil penalty amounts currently set at \$5,500 under two statutes: Clayton Act § 11(I), for violations of cease-and-desist orders issued under § 11(b) of that Act; and § 525(a) of the Energy Policy and Conservation Act, for recycled oil labeling violations. Each will be adjusted to \$6,500, in accordance with the rounding rules of the adjustment statute, and the FTC is amending paragraphs (b) and (I) of Rule 1.98 to reflect these adjustments, which will become effective thirty days following publication. The FTC is thus deleting the second sentence of the Rule's introductory text, regarding the prior effective date, which is potentially confusing and, in any event, superfluous.

The statute's rounding rules do not authorize the FTC at this time to increase the amounts of the other civil penalties within its jurisdiction. Increases in civil penalties of greater than \$10,000 and less than or equal to \$100,000 must be in \$5,000 increments, and the increase in the CPI was not high enough to round up any adjustment to \$5,000. Likewise, increases in civil penalties of greater than \$100 and less than or equal to \$1,000 must be in \$100 increments, and the increase in the CPI was not high enough to round up any adjustment to \$100. Accordingly, all other paragraphs of Rule 1.98 remain unchanged.

Likewise, the FTC is not adding any new adjustments to the rule for other statutory civil penalty amounts that have been enacted since the last adjustments, such as § 621(a)(2) of the Fair Credit Reporting Act, 15 U.S.C. 1681s, or § 1115(a) of the Medicare Act, Pub. L. 108-173. These authorities are too recent to warrant adjustments for inflation.

In light of the ministerial nature of the adjustments, the public comment requirements of the Administrative Procedure Act (APA) do not apply to this action. 5 U.S.C. 553(b)(B) (exception when public comment is unnecessary). For this reason, the requirements of the Regulatory Flexibility Act also do not apply. 5 U.S.C. 603, 604 (no regulatory flexibility analyses required where the APA does not require public comment).

List of Subjects for 16 CFR Part 1

Administrative practice and procedure, Penalties, Trade practices.

■ For the reasons set forth in the preamble, the Federal Trade Commission amends Title 16, chapter I, subchapter A, of the Code of Federal Regulations, as follows:

PART 1—GENERAL PROCEDURES

Subpart L—Civil Penalty Adjustments Under the Federal Civil Penalties Inflation Adjustment Act of 1990 as Amended by the Debt Collection Improvement Act of 1996

■ 1. The authority citation for subpart L continues to read as follows:

Authority: 28 U.S.C. 2461 note.

■ 2. Revise the introductory text of § 1.98 and paragraphs (b) and (I) to read as follows:

§ 1.98 Adjustment of civil monetary penalty amounts.

This section makes inflation adjustments in the dollar amounts of civil monetary penalties within the Commission's jurisdiction.

* * * * *

(b) Section 11(I) of the Clayton Act, 15 U.S.C. 21(I)—\$6,500;

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(I) Sections 525(a) and (b) of the Energy Policy and Conservation Act, 42 U.S.C. 6395(a) and (b), respectively—\$6,500 and \$11,000, respectively; and

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By direction of the Commission.

Donald S. Clark,
Secretary.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9170]

RIN 1545-BD99

Section 1374 Effective Dates

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: These temporary regulations provide guidance concerning the applicability of section 1374 to S corporations that acquire assets in carryover basis transactions from C corporations on or after December 27, 1994, and to certain corporations that terminate S corporation status and later elect again to become S corporations.

The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: *Effective Date:* These regulations are effective December 22, 2004.

Applicability Dates: Section 1.1374-8T applies to any transaction described in section 1374(d)(8) that occurs on or after December 27, 1994. Section 1.1374-10T applies for taxable years beginning after December 22, 2004. The applicability of § 1.1374(d)-8T and § 1.1374(d)-10T will expire on or before December 21, 2007.

FOR FURTHER INFORMATION CONTACT: Stephen R. Cleary; (202) 622-7750, (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

1. Section 1374 and Its Effective Dates

Under the *General Utilities* doctrine, see *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935), a C corporation, in certain cases, could distribute appreciated assets to its shareholders or sell appreciated assets without recognizing gain. Section 1374 of the Internal Revenue Code of 1986 (Code), amended in the Tax Reform Act of 1986 (TRA) as part of the repeal of the *General Utilities* doctrine, prevents a corporation from circumventing *General Utilities* repeal by converting to S corporation status before distributing appreciated assets to its shareholders or selling appreciated assets.

Section 1374 generally imposes a corporate level tax on an S corporation's net recognized built-in gain attributable to assets that it held on the date it converted from a C corporation to an S corporation. This tax is imposed on built-in gain recognized during the 10-year period beginning on the first day the corporation is an S corporation. Section 1374(d)(8), which was added by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), imposes a corporate level tax on an S corporation's net recognized built-in gain attributable to assets that it acquired in a carryover basis transaction from a C corporation for the 10-year recognition period beginning on the day of the carryover basis transaction.

Under section 1374(d)(9), which also was added by TAMRA, any reference in section 1374 to the first taxable year the corporation was an S corporation is a reference to the first taxable year it was an S corporation pursuant to its most recent S corporation election under section 1362.

Section 1019 of TAMRA states that, except as otherwise provided, any amendments made by TAMRA are effective as if included in the provision of TRA to which such amendment relates.

The current version of section 1374 replaced a prior version of section 1374 that generally only taxed income or gain recognized within the three year period following the date the corporation converted from C to S status. Section 633 of TRA, as amended by TAMRA, provides the effective dates of the current version of section 1374. Specifically, section 633(b)(1) of TRA, as amended by TAMRA, provides that the amendments to section 1374 apply to taxable years beginning after December 31, 1986, but only in cases where the return for the taxable year is filed pursuant to an S election made after December 31, 1986. Section 633(d)(8) of TRA, as amended by TAMRA, provides a transition rule granting a limited postponement of the above effective date for "qualified corporations", which are certain small corporations as defined in that section. Under the transition rule, if a C corporation that is a qualified corporation makes an election to be an S corporation under section 1362 before January 1, 1989, then it is subject to former section 1374 for dispositions of long-term capital gain assets and current section 1374 for dispositions of short-term capital gain assets and ordinary income assets, without regard to whether such corporation is completely liquidated.

2. Section 1374(d)(8)

As discussed above, the general effective date of current section 1374, which is contained in section 633(b)(1) of the TRA, as amended by TAMRA, provides that current section 1374 applies to tax years beginning after December 31, 1986, but only in cases where the return for the taxable year is filed pursuant to an S election made after December 31, 1986. In TAMRA, Congress added subsection (d)(8) to section 1374, and provided that the provision was effective as if included in TRA.

Section 1.1374-8 provides regulations interpreting section 1374(d)(8). Example 1 of § 1.1374-8(d) applies section 1374(d)(8) to a merger of a C corporation into an S corporation that elected S status before the effective date of TRA amendments, as further amended by TAMRA, to section 1374. Section 1.1374-10(a) provides that § 1.1374-8 applies for taxable years ending on or after December 27, 1994, but only in cases where the corporation's tax return

is filed pursuant to an S election or a section 1374(d)(8) transaction occurring after December 27, 1994 (emphasis added).

Despite the provisions of § 1.1374-8 and the effective date provisions of § 1.1374-10, the IRS understands that some taxpayers contend that section 1374(d)(8) does not apply to carryover basis transfers from S corporations to S corporations that filed S elections before January 1, 1987, because the provisions in TAMRA that added section 1374(d)(8) indicated that the amendment was effective only if the return for the taxable year was filed pursuant to an S election made after December 31, 1986.

Section 337(d)(1) authorizes the Secretary to prescribe regulations to prevent the circumvention of the purposes of the repeal of the *General Utilities* doctrine through the use of any provision of law or regulations. The Treasury Department and the IRS believe that these temporary regulations are necessary to implement *General Utilities* repeal to prevent the use of corporations with pre-1987 S elections as a method for C corporations to transfer appreciated assets out of C corporation solution without gain recognition. Accordingly, these regulations confirm that section 1374(d)(8) applies to any transaction described in that section that occurs on or after December 27, 1994, the effective date of § 1.1374-8, regardless of the date of the S corporation's election under section 1362.

3. Revocation and Re-Election of S Corporation Status

As discussed above, section 633(d)(8) of TRA, as amended by TAMRA, provides a transition rule granting a limited postponement of the general effective date of current section 1374 for qualified corporations that make an election to be an S corporation under section 1362 before January 1, 1989. In *Colorado Gas Compression, Inc. v. Commissioner*, 366 F.3d 863 (10th Cir. 2004), reversing and remanding 116 T.C. 1 (2001), a qualified corporation eligible for the special transition rule elected S corporation status on February 1, 1988 (before the extended effective date of January 1, 1989), revoked S status on December 1, 1989, and subsequently re-elected S status effective on January 1, 1994. During the years 1994 through 1996, the taxpayer sold assets. The Tax Court held that such sales were subject to current section 1374, and that the transition rule did not preclude the application of current section 1374 because the taxpayer's most recent S election was

made after 1989. The Tax Court concluded that section 1374(d)(9) requires that the 1994 election, the taxpayer's most recent election, be the election considered for effective date purposes. The Tenth Circuit reversed the Tax Court, holding that, because the 1988 election was made before the extended effective date, the corporation was exempt from current section 1374 despite the intervening revocation of S status.

The Treasury Department and the IRS believe that the Tenth Circuit's holding is inconsistent with the legislative history and underlying policy of section 663 of TRA, as amended by TAMRA, and believe the Tax Court was correct in holding that a corporation's most recent S election must have been made before the deadline of the transition rule (*i.e.*, before January 1, 1989) in order for the corporation to be entitled to the benefit of the transition rule. As indicated above, section 337(d)(1) authorizes the Secretary to prescribe regulations to prevent the circumvention of the purposes of the repeal of the *General Utilities* doctrine through the use of any provision of law or regulations. The Treasury Department and the IRS believe that these temporary regulations are necessary to implement *General Utilities* repeal to prevent avoidance of corporate level tax on appreciation in the assets of a C corporation attributable to periods after the extended effective date of January 1, 1989. Accordingly, these regulations provide that the transition rule regarding qualified corporations in section 633(d)(8) of TRA, as amended by TAMRA, applies only if the corporation's most recent S election was made before January 1, 1989. Although these regulations apply to built-in gain recognized in taxable years beginning after December 22, 2004, the IRS will continue to assert this position for prior taxable years.

In summary, the temporary regulations provide that (1) section 1374(d)(8) applies to any transaction described in that section that occurs on or after December 27, 1994, regardless of the date of the S corporation's election under section 1362, and (2) for purposes of section 633(d)(8) of TRA, as amended by TAMRA, a corporation's most recent S election, not an earlier election that has been revoked or terminated, determines whether or not it is subject to current section 1374.

Special Analyses

It has been determined that this temporary regulation is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It

also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to § 1.1374-8T(a)(2) of these regulations. With respect to § 1.1374-10T(c) of these regulations, it has been determined, pursuant to 5 U.S.C. 553(b)(B), that it would be contrary to the public interest to issue the regulations with notice and public procedure and, pursuant to 5 U.S.C. 553(d)(3), that good cause exists to dispense with a delayed effective date. The regulations are necessary to provide immediate guidance to taxpayers with respect to the application of the transition rule regarding qualified corporations in section 633(d)(8) of TRA, as amended by TAMRA, and, accordingly, with respect to the application of current section 1374 to asset dispositions which occur during taxable years beginning after December 22, 2004. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the Special Analysis section of the Notice of Proposed Rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these temporary regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Stephen R. Cleary of the Office of Associate Chief Counsel (Corporate). Other personnel from Treasury and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.1374-8T also issued under 26 U.S.C. 337(d) and 1374(e). * * *
Section 1.1374-10T also issued under 26 U.S.C. 337(d) and 1374(e). * * *

■ **Par. 2.** Section 1.1374-8 is amended by redesignating paragraph (a) as paragraph (a)(1) and adding paragraph (a)(2) to read as follows:

§ 1.1374-8 **Section 1374(d)(8) transactions**
(a)(1) * * *

(2) (Reserved) For further guidance see § 1.1374-8T(a)(2).

* * * * *

■ **Par. 3.** Section 1.1374-8T is added to read as follows:

§ 1374-8T 1374(d)(8) transactions (temporary)

(a)(1) (Reserved) For further guidance see § 1374-8(a).

(2) Section 1374(d)(8) transaction, as defined in paragraph (a)(1) of this regulation, that occurs on or after December 27, 1994, without regard to the date of the corporation's election to be an S corporation under section 1362.

(b) through (d) (Reserved) For further guidance see § 1.1374-8(b) through (d).

■ **Par. 4.** Section 1.1374-10 is amended by adding paragraph (c) to read as follows:

§ 1.1374-10 Effective date and additional rules

* * * * *

(c) (Reserved) For further guidance see § 1.1374-10T(c).

■ **Par. 5.** Section 1.1374-10T is added to read as follows:

§ 1.1374-10T Effective date and additional rules (temporary)

(a) through (b)(4) (Reserved) For further guidance see § 1.1374-10(a) through (b)(4).

(c) *Revocation and re-election of S corporation status*—(1) *In general.* For purposes of section 633(d)(8) of the Tax Reform Act of 1986, as amended, any reference to an election to be an S corporation under section 1362 shall be treated as a reference to the corporation's most recent election to be an S corporation under section 1362. This paragraph (c) applies for taxable years beginning after December 22, 2004 without regard to the date of the corporation's most recent election to be an S corporation under section 1362.

(2) *Example.* The following example illustrates the rules of this paragraph(c):

Example. (i) On February 1, 1988, X, a C corporation that is a qualified corporation under section 633(d) of the Tax Reform Act of 1986, as amended, elects to be an S corporation under section 1362. On December 1, 1989, X revokes its S status and becomes a C corporation. On January 1, 2004, X again elects to be an S corporation under section 1362. X disposes of assets in 2006, 2007, and 2008, recognizing gain.

(ii) X is not eligible for treatment under the Transition rule of section 633(d)(8) of the Tax Reform Act of 1986, as amended, with respect to these assets. Accordingly, X is subject to section 1374, as amended by the Tax Reform Act of 1986 and TAMRA, and the 10-year recognition period begins January 1, 2004.

(iii) To the extent the gain that X recognizes on the asset sales in 2006, 2007,

and 2008 reflects built-in gain inherent in such assets in X's hands on January 1, 2004, such gain is subject to tax under section 1374 as amended by the Tax Reform Act of 1986 and TAMRA.

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.

Approved: December 15, 2004.

Gregory F. Jenner,

Acting Assistant Secretary of the Treasury.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9168]

RIN 1545-BC13

Optional 10-Year Writeoff of Certain Tax Preferences

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations relating to the optional 10-year writeoff of certain tax preference items under section 59(e) of the Internal Revenue Code (Code). The final regulations affect taxpayers who utilize section 59(e) for the optional 10-year writeoff of certain tax preferences. These final regulations provide guidance on the time and manner of making an election under section 59(e). The regulations also provide guidance on revoking an election under section 59(e). The regulations reflect changes to the law made by the Tax Reform Act of 1986, the Technical and Miscellaneous Revenue Act of 1988, and the Omnibus Budget Reconciliation Act of 1989.

DATES: *Effective Date:* This rule is effective December 22, 2004.

Applicability Date: These regulations apply to a section 59(e) election made for a taxable year ending, or a request to revoke a section 59(e) election submitted, on or after December 22, 2004.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1903. Responses to this collection of