

1362(a) had terminated for a previous taxable year.

(b) *Special rules for post-termination transition period.* Pursuant to section 1377(b)(1) and paragraph (a)(1) of this section, a post-termination transition period arises the day after the last day that an S corporation was in existence if a C corporation acquires the assets of the S corporation in a transaction to which section 381(a)(2) applies. However, if an S corporation acquires the assets of another S corporation in a transaction to which section 381(a)(2) applies, a post-termination transition period does not arise. (See §1.1368-2(d)(2) for the treatment of the acquisition of the assets of an S corporation by another S corporation in a transaction to which section 381(a)(2) applies.) The special treatment under section 1371(e)(1) of distributions of money by a corporation with respect to its stock during the post-termination transition period is available only to those shareholders who were shareholders in the S corporation at the time of the termination.

(c) *Determination defined.* For purposes of section 1377(b)(1) and paragraph (a) of this section, the term *determination* means—

(1) A determination as defined in section 1313(a);

(2) A written agreement between the corporation and the Commissioner (including a statement acknowledging that the corporation's election to be an S corporation terminated under section 1362(d) that the corporation failed to qualify as an S corporation;

(3) For a corporation subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A of the Code, the expiration of the period specified in section 6226 for filing a petition for readjustment of a final S corporation administrative adjustment finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period; and

(4) For a corporation not subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A of the Code, the expiration of the period for filing a petition under section 6213 for the shareholder's taxable year for which the Commissioner has made

a finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period.

(d) *Date a determination becomes effective—*(1) *Determination under section 1313(a).* A determination under paragraph (c)(1) of this section becomes effective on the date prescribed in section 1313 and the regulations thereunder.

(2) *Written agreement.* A determination under paragraph (c)(2) of this section becomes effective when it is signed by the district director having jurisdiction over the corporation (or by another Service official to whom authority to sign the agreement is delegated) and by an officer of the corporation authorized to sign on its behalf. Neither the request for a written agreement nor the terms of the written agreement suspend the running of any statute of limitations.

(3) *Implied agreement.* A determination under paragraph (c) (3) or (4) of this section becomes effective on the day after the date of expiration of the period specified under section 6226 or 6213, respectively.

[T.D. 8696, 61 FR 67457, Dec. 23, 1996]

§ 1.1377-3 Effective date.

Sections 1.1377-1 and 1.1377-2 apply to taxable years of an S corporation beginning after December 31, 1996.

[T.D. 8696, 61 FR 67458, Dec. 23, 1996]

SECTION 1374 BEFORE THE TAX REFORM ACT OF 1986

§ 1.1374-1A Tax imposed on certain capital gains.

(a) *General rule.* Except as otherwise provided in paragraph (c) of this section, if for a taxable year beginning after 1982 of an S corporation—

(1) The net capital gain of such corporation exceeds \$25,000, and

(2) The net capital gain of such corporation exceeds 50 percent of its taxable income (as defined in paragraph (d) of this section) for such year, and

(3) The taxable income of such corporation (as defined in paragraph (d) of this section) for such year exceeds \$25,000,

section 1374 imposes a tax (computed under paragraph (b) of this section) on the income of such corporation. The tax is imposed on the S corporation and not on the shareholders.

(b) *Amount of tax.* The amount of tax shall be the lower of—

(1) An amount equal to the tax, determined as provided in section 1201(a)(2), on the amount by which the net capital gain of the corporation for the taxable year exceeds \$25,000, or

(2) An amount equal to the tax which would be imposed by section 11 on the taxable income of the corporation (as defined in paragraph (d) of this section) for the taxable year were it not an S corporation.

No credit shall be allowable under part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (other than under section 34) against the tax imposed by section 1374(a) and this section. See section 1375(c)(2) and § 1.1375-1(c)(2) for a special rule that reduces the amount of the net capital gain of the corporation for purposes of this paragraph (b) in cases where a net capital gain is taxed as excess net passive income under section 1375. See section 1374(c)(3) and paragraph (c)(1)(ii) of this section for a special rule that limits the amount of tax on property with a substituted basis in certain cases.

(c) *Exceptions to taxation*—(1) *New corporations and corporations with election in effect for 3 immediately preceding years*—(i) *In general.* If an S corporation would be subject to the tax imposed by section 1374 for a taxable year pursuant to paragraph (a) of this section, the corporation shall, nevertheless, not be subject to such tax for such year, if:

(A) The election under section 1362(a) which is in effect with respect to such corporation for such year has been in effect for the corporation's three immediately preceding taxable years, or

(B) An election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years for which it has been in existence, unless there is a net capital gain for the taxable year which is attributable to property with a substituted basis within the meaning of paragraph (c)(1)(iii) of this section.

(ii) *Amount of tax on net capital gain attributable to property with a substituted basis.* If for a taxable year of an S corporation either paragraph (c)(1)(i) (A) or (B) of this section is satisfied, but the S corporation has a net capital gain for such taxable year which is attributable to property with a substituted basis (within the meaning of paragraph (c)(1)(iii) of this section), then paragraph (a) of this section shall apply for the taxable year, but the amount of tax determined under paragraph (b) of this section shall not exceed a tax, determined as provided in section 1201 (a), on the net capital gain attributable to property with a substituted basis.

(iii) *Property with substituted basis.* For purposes of this section, the term *property with a substituted basis* means:

(A) Property acquired by a corporation (*the acquiring corporation*) during the period beginning 36 months before the first day of the acquiring corporation's taxable year and ending on the last day of such year;

(B) The basis of such property in the hands of the acquiring corporation is determined in whole or in part by reference to the basis of any property in the hands of another corporation; and

(C) Such other corporation was not an S corporation throughout the period beginning the later of:

(1) 36 months before the first day of the acquiring corporation's taxable year, or

(2) The time such other corporation came into existence,

and ending on the date such other corporation transferred the property, the basis of which is used to determine, in whole or in part, the basis of the property in the hands of the acquiring corporation. An S corporation and any predecessor corporation shall not be treated as one corporation for purposes of this paragraph (c) (1).

(iv) *Existence of a corporation.* For purposes of this section, a corporation shall not be considered to be in existence for any month which precedes the first month in which such corporation has shareholders or acquires assets or begins business, whichever is first to occur.

(v) *References to prior law included.* For purposes of this paragraph (c), the

term *S corporation* shall include an electing small business corporation under prior subchapter S law, and the term *election under section 1362 (a)* shall include an election under section 1372 of prior subchapter S law.

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

Example 1. M Corporation was organized and began business in 1977. M subsequently made an election under section 1362 (a) which was effective for its 1984 taxable year. If such election does not terminate under section 1362 for its taxable years 1984, 1985, and 1986, M is not subject to the tax imposed by section 1374 for its taxable year 1987, or for any subsequent year for which such election remains in effect, unless it has, for any such year, an excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis. If there is such an excess for any such year, and the requirements of paragraph (a) of this section are met, M will be subject to the tax for such year. If there is no such excess for any year after 1986, M will not be subject to the tax for any such year even though the requirements of paragraph (a) of this section are met.

Example 2. N corporation was organized in 1983, and was an S corporation for its first taxable year. N is not subject to the tax imposed by section 1374 for 1983, or for any subsequent year for which its original election under section 1362 (a) has not terminated under section 1362(d), unless, for any such year, it has an excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis and the requirements of paragraph (a) of this section are met.

(2) *Treatment of certain gains of options and commodities dealers—(i) Exclusion of certain capital gains.* For purposes of this section, the net capital gain of any options dealer or commodities dealer shall be determined by not taking into account any gain or loss (in the normal course of the taxpayer's activity of dealing in or trading section 1256 contracts) from any section 1256 contract or property related to such a contract.

(ii) *Definitions.* For purposes of this paragraph (c)(2)—

(A) *Options dealer.* The term *options dealer* has the meaning given to such term by section 1256(g)(8).

(B) *Commodities dealer.* The term *commodities dealer* means a person who is actively engaged in trading section 1256 contracts and is registered with a do-

mestic board of trade which is designated as a contract market by the Commodities Futures Trading Commission.

(C) *Section 1256 contracts.* The term *section 1256 contracts* has the meaning given to such term by section 1256(b).

(iii) *Effective dates—(A) In general.* Except as otherwise provided in this paragraph (c)(2)(iii), this paragraph (c)(2) shall apply to positions established after July 18, 1984, in taxable years ending after such date.

(B) *Special rule for options on regulated futures contracts.* In the case of any option with respect to a regulated futures contract (within the meaning of section 1256), this paragraph (c)(2) shall apply to positions established after October 31, 1983, in taxable years ending after such date.

(C) *Elections with respect to property held on or before July 18, 1984.* See §§1.1256 (h)-1T and 1.1256(h)-2T for rules concerning an election to have this paragraph (c)(2) apply to certain property held on or before July 18, 1984.

(d) *Determination of taxable income—*

(1) *General rule.* For purposes of this section, taxable income of the corporation shall be determined under section 63(a) as if the corporation were a C corporation rather than an S corporation, except that the following deductions shall not apply in the computation—

(i) The deduction allowed by section 172 (relating to net operating loss deduction), and

(ii) The deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures).

For any taxable year in which a tax under this section is imposed on an S corporation, the S corporation shall attach a Form 1120 completed in accordance with this paragraph (d) and the instructions to Form 1120S to its tax return filed for such taxable year.

(2) *Special rule for net capital gains taxed as excess net passive income under section 1375.* See section 1375 (c) (2) and §1.1375-1(c)(2) for a special rule that reduces the taxable income of the corporation for purposes of section 1374(b)(2) and §1.1374-1(b)(2) in cases where a net capital gain is taxed as excess net passive income under section 1375.

(e) *Reduction in pass-thru for tax imposed on capital gain.* See section 1366(f)(2) for a special rule reducing the S corporation's long-term capital gains and the corporation's gain from sales or exchanges of property described in section 1231 for purposes of section 1366(a) by an amount of tax imposed under section 1374 and this section.

(f) *Examples.* The following examples illustrate the principles of this section and assume that a tax will not be imposed under section 1375:

Example 1. Corporation M is an S corporation for its taxable year beginning January 1, 1983. For 1983, M has an excess of net long-term capital gain over net short-term capital loss in the amount of \$30,000. However, its taxable income for the year is only \$20,000 as a result of other deductions in excess of other income. Thus, although the excess of the net long-term capital gain over the net short-term capital loss exceeds \$25,000 and also exceeds 50 percent of taxable income, M is not subject to the tax imposed by section 1374 for 1983 because its taxable income does not exceed \$25,000.

Example 2. Corporation N is an S Corporation for its 1983 taxable year. For 1983, N has an excess of net long-term capital gain over net short-term capital loss in the amount of \$30,000, and taxable income of \$65,000. Thus, although N's net capital gain (\$30,000) exceeds \$25,000, it does not exceed 50 percent of the corporation's taxable income for the year (50 percent of \$65,000, or \$32,500), and therefore N is not subject to the tax imposed by section 1374 for such year.

Example 3. Assume that Corporation O, an S corporation, is subject to the tax imposed by section 1374 for its taxable year 1983. For 1983, O has an excess of net long-term capital gain over net short-term capital loss in the amount of \$73,000, and taxable income within the meaning of section 1374, which includes capital gains and losses, of \$100,000. The amount of tax computed under paragraph (b)(1) of this section is 28 percent of \$48.00 (\$73,000—\$25,000), or \$13,440. Since this is lower than the amount computed under paragraph (b)(2) of this section, which is \$25,750 (\$3,750+\$4,500+\$7,500+\$10,000), \$13,440 is the amount of tax imposed by section 1374.

Example 4. Assume that in example (3) the taxable income of O for 1983 is \$35,000. This results from an excess of deductions over income with respect to items which were not included in determining the excess of the net long-term capital gain over the net short-term capital loss. In such case, the amount of tax, computed under paragraph (b)(2) of this section, is \$5,550. Since this is lower than the amount computed under paragraph

(b)(1) of this section, \$5,550 is the amount of tax imposed by section 1374.

Example 5. Corporation P, an S corporation, for its taxable year 1983 has an excess of net long-term capital gain over net short-term capital loss in the amount of \$65,000 and has taxable income of \$80,000. P's election under section 1362 has been in effect for its three immediately preceding taxable years, but P, nevertheless, is subject to the tax imposed by section 1374 for 1983 since it has an excess of net long-term capital gain over net short-term capital loss (in the amount of \$20,000) attributable to property with a substituted basis. The tax computed under paragraph (b)(1) of this section, \$11,200 (28 percent of \$40,000 (\$65,000—\$25,000)), is less than the tax computed under paragraph (b)(2) of this section, \$17,750. However, under the limitation provided in paragraph (c) of this section which is applicable in this factual situation, the tax imposed by section 1374 for 1983 may not exceed \$5,600 (28 percent of \$20,000, the excess of net long-term capital gain over net short-term capital loss attributable to property with a substituted basis).

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COOPERATIVES AND THEIR PATRONS

Tax Treatment of Cooperatives

§ 1.1381-1 Organizations to which part applies.

(a) *In general.* Except as provided in paragraph (b) of this section, part I, subchapter T, chapter 1 of the Code, applies to any corporation operating on a cooperative basis and allocating amounts to patrons on the basis of the business done with or for such patrons.

(b) *Exceptions.* Part I of such subchapter T does not apply to:

(1) Any organization which is exempt from income taxes under chapter 1 of the Code (other than an exempt farmers' cooperative described in section 521);

(2) Any organization which is subject to the provisions of part II (section 591 and following), subchapter H, chapter 1 of the Code (relating to mutual savings banks, etc.);

(3) Any organization which is subject to the provisions of subchapter L (section 801 and following), chapter 1 of the Code (relating to insurance companies); or