

(2) recognized built-in capital gain of \$75,000.

(ii) Y's net recognized built-in gain for 1996 computed without partnership 1374 items is \$115,000 ($\$40,000 + \$75,000 = \$115,000$) and with partnership 1374 items is \$65,000 ($\$40,000 + \$25,000 = \$65,000$). Thus, Y's partnership RBIL is \$50,000 for the year except as limited under paragraph (i)(2)(ii) of this section. Because Y's RBIL limitation is \$0, Y's partnership RBIL of \$50,000 is limited to \$0 and Y's net recognized built-in gain is \$115,000.

Example 7. Disposition of partnership interest. X is a C corporation that elects to become an S corporation on January 1, 1996. On that date, X owns a 50 percent interest in partnership P with a RBIG limitation of \$200,000 and a RBIL limitation of \$0. P owns (among other assets) Blackacre with a basis of \$20,000 and a value of \$140,000. In 1996, P sells Blackacre for \$140,000 and recognizes a gain of \$120,000 of which \$60,000 is included in X's distributive share and treated as a partnership 1374 item. X's net recognized built-in gain for 1996 computed without partnership 1374 items is \$95,000 and with partnership 1374 items is \$155,000. Thus, X has a partnership RBIG of \$60,000. In 1999, X sells its entire interest in P for \$350,000 and recognizes a gain of \$250,000. Under paragraph (i)(3) of this section, X's recognized built-in gain on the sale is limited by its RBIG limitation to \$140,000 ($\$200,000 - \$60,000 = \$140,000$).

Example 8. Section 704(c) case. Y is a C corporation that elects to become an S corporation on January 1, 1996. On that date, Y contributes Asset 1, 5-year property with a value of \$40,000 and a basis of \$0, and an unrelated party contributes \$40,000 in cash, each for a 50 percent interest in partnership P. The partnership adopts the traditional method under § 1.704-3(b). If P sold Asset 1 for \$40,000 immediately after it was contributed by Y, P's \$40,000 gain would be allocated to Y under section 704(c). Instead, Asset 1 is sold by P in 1999 for \$36,000 and P recognizes gain of \$36,000 ($\$36,000 - \$0 = \$36,000$) on the sale. However, because book depreciation of \$8,000 per year has been taken on Asset 1 in 1996, 1997, and 1998, Y is allocated only \$16,000 of P's \$36,000 gain ($\$40,000 - (3 \times \$8,000) = (\$16,000 - \$0) = \$16,000$) under section 704(c). The remaining \$20,000 of P's \$36,000 gain ($\$36,000 - \$16,000 = \$20,000$) is allocated 50 percent to each partner under section 704(b). Thus, a total of \$26,000 ($\$16,000 + \$10,000 = \$26,000$) of P's \$36,000 gain is allocated to Y. However, under paragraph (i)(6) of this section, Y treats \$36,000 as a partnership 1374 item on P's sale of Asset 1.

Example 9. Disposition of distributed partnership asset. X is a C corporation that elects to become an S corporation on January 1, 1996. On that date, X owns a fifty percent interest in partnership P and P owns (among other assets) Blackacre with a basis of \$20,000 and

a value of \$40,000. On January 1, 1998, P distributes Blackacre to X, when Blackacre has a basis of \$20,000 and a value of \$50,000. Under section 732(a)(1), X has a transferred basis of \$20,000 in Blackacre. On January 1, 1999, X sells Blackacre for \$60,000 and recognizes a gain of \$40,000. Under paragraph (i)(7) of this section and section 1374(d)(3), X has recognized built-in gain from the sale of \$20,000, the amount of built-in gain in Blackacre on the first day of the recognition period.

[T.D. 8579, 59 FR 66464, Dec. 27, 1994]

§ 1.1374-5 Loss carryforwards.

(a) *In general.* The loss carryforwards allowed as deductions against net recognized built-in gain under section 1374(b)(2) are allowed only to the extent their use is allowed under the rules applying to C corporations. Any other loss carryforwards, such as charitable contribution carryforwards under section 170(d)(2), are not allowed as deductions against net recognized built-in gain.

(b) *Example.* The rules of this section are illustrated by the following example.

Example: Section 382 limitation. X is a C corporation that has an ownership change under section 382(g)(1) on January 1, 1994. On that date, X has a fair market value of \$500,000, NOL carryforwards of \$400,000, and a net unrealized built-in gain under section 382(h)(3)(A) of \$0. Assume X's section 382 limitation under section 382(b)(1) is \$40,000. X elects to become an S corporation on January 1, 1998. On that date, X has NOL carryforwards of \$240,000 (having used \$160,000 of its pre-change net operating losses in its 4 preceding taxable years) and a section 1374 net unrealized built-in gain of \$250,000. In 1998, X has net recognized built-in gain of \$100,000. X may use \$40,000 of its NOL carryforwards as a deduction against its \$100,000 net recognized built-in gain, because X's section 382 limitation is \$40,000.

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§ 1.1374-6 Credits and credit carryforwards.

(a) *In general.* The credits and credit carryforwards allowed as credits against the section 1374 tax under section 1374(b)(3) are allowed only to the extent their use is allowed under the rules applying to C corporations. Any other credits or credit carryforwards, such as foreign tax credits under section 901, are not allowed as credits against the section 1374 tax.