

§ 1.1374-9

26 CFR Ch. I (4-1-04 Edition)

[\$10,000 × (\$5,000/\$20,000) = \$2,500]. Y's net recognized built-in gain on the assets Y acquired from Z is \$7,500 [\$10,000 × (\$15,000/\$20,000) = \$7,500]. Therefore, Y has a section 1374 tax of \$3,500 [(\$2,500 + \$7,500) × .35 = \$3,500, assuming a 35 percent tax rate] for its 1997 taxable year.

[T.D. 8579, 59 FR 66469, Dec. 27, 1994, as amended by T.D. 8869, 65 FR 3856, Jan. 25, 2000]

§ 1.1374-9 Anti-stuffing rule.

If a corporation acquires an asset before or during the recognition period with a principal purpose of avoiding the tax imposed under section 1374, the asset and any loss, deduction, loss carryforward, credit, or credit carryforward attributable to the asset is disregarded in determining the S corporation's pre-limitation amount, taxable income limitation, net unrealized built-in gain limitation, deductions against net recognized built-in gain, and credits against the section 1374 tax.

[T.D. 8579, 59 FR 66470, Dec. 27, 1994]

§ 1.1374-10 Effective date and additional rules.

(a) *In general.* Sections 1.1374-1 through 1.1374-9 apply for taxable years ending on or after December 27, 1994, but only in cases where the S corporation's return for the taxable year is filed pursuant to an S election or a section 1374(d)(8) transaction occurring on or after December 27, 1994.

(b) *Additional rules.* This paragraph (b) provides rules applicable to certain S corporations, assets, or transactions to which §§ 1.1374-1 through 1.1374-9 do not apply.

(1) *Certain transfers to partnerships.* If a corporation transfers an asset to a partnership in a transaction to which section 721(a) applies and the transfer is made in contemplation of an S election or during the recognition period, section 1374 applies on a disposition of the asset by the partnership as if the S corporation had disposed of the asset itself. This paragraph (b)(1) applies as of the effective date of section 1374, unless the recognition period with respect to the contributed asset is pursuant to an S election or a section 1374(d)(8) transaction occurring on or after December 27, 1994.

(2) *Certain inventory dispositions.* For purposes of section 1374(d)(2)(A), the inventory method used by the taxpayer for tax purposes (FIFO, LIFO, etc.) must be used to identify whether goods disposed of following conversion to S corporation status were held by the corporation at the time of conversion. Thus, for example, a corporation using the LIFO inventory method will not be subject to the built-in gain tax with respect to sales of inventory except to the extent that a LIFO layer existing prior to the beginning of the first taxable year as an S corporation is invaded after the beginning of that year. This paragraph (b)(2) applies as of the effective date of section 1374, unless the recognition period with respect to the inventory is pursuant to an S election or a section 1374(d)(8) transaction occurring on or after December 27, 1994.

(3) *Certain contributions of built-in loss assets.* If a built-in loss asset (that is, an asset with an adjusted tax basis in excess of its fair market value) is contributed to a corporation within 2 years before the earlier of the beginning of its first taxable year as an S corporation, or the filing of its S election, the loss inherent in the asset will not reduce net unrealized built-in gain, as defined in section 1374(d)(1), unless the taxpayer demonstrates a clear and substantial relationship between the contributed property and the conduct of the corporation's current or future business enterprises. This paragraph (b)(3) applies as of the effective date of section 1374, unless the recognition period with respect to the contributed asset is pursuant to an S election or a section 1374(d)(8) transaction occurring on or after December 27, 1994.

(4) *Certain installment sales—(i) In general.* If a taxpayer sells an asset either prior to or during the recognition period and recognizes income either during or after the recognition period from the sale under the installment method, the income will, when recognized, be taxed under section 1374 to the extent it would have been so taxed in prior taxable years if the selling corporation had made the election under section 453(d) not to report the income under the installment method. For purposes of determining the extent to which the income would have been subject to tax