

[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 8842]

RIN 1545-AW32

Acquisition of an S Corporation by a Member of a Consolidated Group

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 1502 of the Internal Revenue Code. These final regulations provide specific rules that apply to the acquisition of the stock of an S corporation by a member of a consolidated group. These rules eliminate the compliance burdens associated with filing a separate return for the day that an S corporation is acquired by a consolidated group. Additionally, the regulations clarify the rules for the filing of the separate return for a corporation's items for the period not included in the consolidated return.

DATES: Effective Date: These regulations are effective November 10, 1999.

Applicability Date: For dates of applicability, see §1.1502-76(b)(6)(i).

FOR FURTHER INFORMATION CONTACT: Vincent Daly, (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

On December 17, 1998, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG-106219-98, 63 FR 69581), concerning acquisitions by a consolidated group of at least eighty percent of the stock of an S corporation. Although a comment was received questioning the advisability of a special rule for the acquisition of an S corporation, the IRS and Treasury have determined the rules are necessary to eliminate the administrative burden of filing a separate tax return for the day the S corporation is acquired. The proposed regulations are adopted by this Treasury decision.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations will provide administrative relief to small entities by removing the administrative burden of filing a separate one-day return currently required for certain acquisitions. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Jeffrey L. Vogel of the Office of the Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department 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 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1362-3 is amended by adding a sentence to the end of paragraph (a) to read as follows:

§1.1362-3 Treatment of S termination year.

(a) In general. * * * See, however, §1.1502-76(b)(1)(ii)(A)(2) for special rules for an S election that terminates under section 1362(d) immediately before the S corporation becomes a member of a consolidated group (within the meaning of §1.1502-1(h)).

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Par. 3. Section 1.1502-76 is amended as follows:

1. The text of paragraph (b)(1)(ii)(A) following the paragraph heading is redesignated as paragraph (b)(1)(ii)(A)(1).

2. A paragraph heading for newly designated paragraph (b)(1)(ii)(A)(1) is added.

3. The first sentence of newly designated paragraph (b)(1)(ii)(A)(1) is revised.

4. Paragraph (b)(1)(ii)(A)(2) is added.

5. Paragraph (b)(2)(v) is redesignated as paragraph (b)(2)(vi).

6. New paragraph (b)(2)(v) is added.

7. Paragraphs (b)(4) and (b)(5) are redesignated as paragraphs (b)(5) and (b)(6), respectively.

8. New paragraph (b)(4) is added.

9. Newly designated paragraph (b)(5) is amended as follows:

a. Example 6(b), first sentence is revised.

b. Example 6(c), second sentence is revised.

c. Example 7 is added.

10. Newly designated paragraph (b)(6)(i) is revised.

The revisions and additions read as follows:

§1.1502-76 Taxable year of members of group.

* * * * *

(b) * * * (1) * * *

(ii) * * *(A) End of the day rule. (1) In general. If a corporation (S), other than one described in paragraph (b)(1)(ii)(A)(2) of this section, becomes or ceases to be a member during a consolidated return year, it becomes or ceases to be a member at the end of the day on which its status as a member

changes, and its tax year ends for all Federal income tax purposes at the end of that day. * * *

(2) Special rule for former S corporations. If S becomes a member in a transaction other than in a qualified stock purchase for which an election under section 338(g) is made, and immediately before becoming a member an election under section 1362(a) was in effect, then S will become a member at the beginning of the day the termination of its S corporation election is effective. S's tax year ends for all Federal income tax purposes at the end of the preceding day. This paragraph (b)(1)(ii)(A)(2) applies to transactions occurring after November 10, 1999.

* * * * *

(2) * * *

(v) Acquisition of S corporation. If a corporation is acquired in a transaction to which paragraph (b)(1)(ii)(A)(2) of this section applies, then paragraphs (b)(2)(ii) and (iii) of this section do not apply and items of income, gain, loss, deduction, and credit are assigned to each short taxable year on the basis of the corporation's normal method of accounting as determined under section 446. This paragraph (b)(2)(v) applies to transactions occurring after November 10, 1999.

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(4) Determination of due date for separate return.

Paragraph (c) of this section contains rules for the filing of

the separate return referred to in this paragraph (b). In applying paragraph (c) of this section, the due date for the filing of S's separate return shall also be determined without regard to the ending of the tax year under paragraph (b)(1)(ii) of this section or the deemed cessation of its existence under paragraph (b)(2)(i) of this section.

(5) * * *

Example 6. Allocation of partnership items. * * *

(b) Analysis. Under paragraph (b)(2)(vi)(A) of this section, T is treated, solely for purposes of determining T's tax year in which the partnership's items are included, as selling or exchanging its entire interest in the partnership as of P's sale of T's stock. * * *

(c) Controlled partnership. * * * Under paragraph (b)(2)(vi)(B) of this section, T's distributive share of the partnership items is treated as T's items for purposes of paragraph (b)(2) of this section. * * *

Example 7. Acquisition of S corporation. (a) Facts. Z is a small business corporation for which an election under section 1362(a) was in effect at all times since Year 1. At all times, Z had only 100 shares of stock outstanding, all of which were owned by individual A. On July 1 of Year 3, P acquired all of the Z stock. P does not make an election under section 338(g) with respect to its purchase of the Z stock.

(b) Analysis. As a result of P's acquisition of the Z stock, Z's election under section 1362(a) terminates. See sections 1361(b)(1)(B) and 1362(d)(2). Z is required to join in the filing of the P consolidated return. See §1.1502-75. Z's tax year ends for all Federal income tax purposes on June 30 of Year 3. If no extension of time is sought, Z must file a separate return for the period from January 1 through June 30 of Year 3 on or before March 15 of Year 4. See paragraph (b)(4) of this section. Z will become a member of the P consolidated group as of July 1 of Year 3. See paragraph (b)(1)(ii)(A)(2) of this section. P group's Year 3 consolidated return will include Z's items from July 1 to December 31 of Year 3.

(6) Effective date--(i) General rule. Except as provided in paragraphs (b)(1)(ii)(A)(2) and (b)(2)(v) of this section, this paragraph (b) applies to corporations becoming or ceasing to be members of consolidated groups on or after January 1, 1995.

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Deputy Commissioner of Internal Revenue

Approved:

Assistant Secretary of the Treasury