

Internal Revenue Code Section 1374(d)(2)

Tax imposed on certain built-in gains.

(a) General rule. If for any taxable year beginning in the recognition period an S corporation has a net recognized built-in gain there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation for such taxable year.

(b) Amount of tax.

(1) In general. The amount of the tax imposed by subsection (a) shall be computed by applying the highest rate of tax specified in section 11(b) to the net recognized built-in gain of the S corporation for the taxable year.

(2) Net operating loss carryforwards from C years allowed. Notwithstanding section 1371(b)(1), any net operating loss carryforward arising in a taxable year for which the corporation was a C corporation shall be allowed for purposes of this section as a deduction against the net recognized built-in gain of the S corporation for the taxable year. For purposes of determining the amount of any such loss which may be carried to subsequent taxable years, the amount of the net recognized built-in gain shall be treated as taxable income. Rules similar to the rules of the preceding sentences of this paragraph shall apply in the case of a capital loss carryforward arising in a taxable year for which the corporation was a C corporation.

(3) Credits.

(A) In general. Except as provided in subparagraph (B), no credit shall be allowable under part IV of subchapter A of this chapter (other than under section 34 [IRC Sec. 34]) against the tax imposed by subsection (a).

(B) Business credit carryforwards from C years allowed. Notwithstanding section 1371(b)(1), any business credit carryforward under section 39 arising in a taxable year for which the corporation was a C corporation shall be allowed as a credit against the tax imposed by subsection (a) in the same manner as if it were imposed by section 11. A similar rule shall apply in the case of the minimum tax credit under section 53 to the extent attributable to taxable years for which the corporation was a C corporation.

(4) Coordination with section 1201(a). For purposes of section 1201(a) --

(A) the tax imposed by subsection (a) shall be treated as if it were imposed by section 11, and

(B) the amount of the net recognized built-in gain shall be treated as the taxable income.

(c) Limitations.

(1) Corporations which were always S corporations. Subsection (a) shall not apply to any corporation if an election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years. Except as provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of the preceding sentence.

(2) Limitation on amount of net recognized built-in gain. The amount of the net recognized built-in gain taken into account under this section for any taxable year shall not exceed the excess (if any) of--

(A) the net unrealized built-in gain, over


(B) the net recognized built-in gain for prior taxable years beginning in the recognition period.

(d) Definitions and special rules. For purposes of this section--

(1) Net unrealized built-in gain. The term "net unrealized built-in gain" means the amount (if any) by which--

(A) the fair market value of the assets of the S corporation as of the beginning of its 1st taxable year for which an election under section 1362(a) is in effect, exceeds

(B) the aggregate adjusted bases of such assets at such time.

 (2) Net recognized built-in gain.

(A) In general. The term "net recognized built-in gain" means, with respect to any taxable year in the recognition period, the lesser of

(i) the amount which would be the taxable income of the S corporation for such taxable year if only recognized built-in gains and recognized built-in losses were taken into account, or

(ii) such corporation's taxable income for such taxable year (determined as provided in section 1375(b)(1)(B)).

(B) Carryover. If, for any taxable year described in subparagraph (A), the amount referred to in clause (i) of subparagraph (A) exceeds the amount referred to in clause (ii) of subparagraph (A), such excess shall be treated as a recognized built-in gain in the succeeding taxable year. The preceding sentence shall apply only in the case of a corporation treated as an S corporation by reason of an election made on or after March 31, 1988.

(3) Recognized built-in gain. The term "recognized built-in gain" means any gain recognized during the recognition period on the disposition of any asset except to the extent that the S corporation establishes that--

(A) such asset was not held by the S corporation as of the beginning of the 1st taxable year for which it was an S corporation, or

(B) such gain exceeds the excess (if any) of--

(i) the fair market value of such asset as of the beginning of such 1st taxable year, over

(ii) the adjusted basis of the asset as of such time.

(4) Recognized built-in losses. The term "recognized built-in loss" means any loss recognized during the recognition period on the disposition of any asset to the extent that the S corporation establishes that--

(A) such asset was held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3), and

(B) such loss does not exceed the excess of

(i) the adjusted basis of such asset as of the beginning of such 1st taxable year, over

(ii) the fair market value of such asset as of such time.

(5) Treatment of certain built-in items.

(A) Income items. Any item of income which is properly taken into account during the recognition period but which is attributable to periods before the 1st taxable year for which the corporation was an S corporation shall be treated as a recognized built-in gain for the taxable year in which it is properly taken into account.

(B) Deduction items. Any amount which is allowable as a deduction during the recognition period (determined without regard to any carryover) but which is attributable to periods before the 1st taxable year referred to in subparagraph (A) shall be treated as a recognized built-in loss for the taxable year for which it is allowable as a deduction.

(C) Adjustment to net unrealized built-in gain. The amount of the net unrealized built-in gain shall be properly adjusted for amounts which would be treated as recognized built-in gains or

losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period.

(6) Treatment of certain property. If the adjusted basis of any asset is determined (in whole or in part) by reference to the adjusted basis of any other asset held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3)--

(A) such asset shall be treated as held by the S corporation as of the beginning of such 1st taxable year, and

(B) any determination under paragraph (3)(B) or (4)(B) with respect to such asset shall be made by reference to the fair market value and adjusted basis of such other asset as of the beginning of such 1st taxable year.

(7) Recognition period.

(A) In general. The term "recognition period" means the 10-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation.

(B) Special rules for 2009, 2010, and 2011. No tax shall be imposed on the net recognized built-in gain of an S corporation--

(i) in the case of any taxable year beginning in 2009 or 2010, if the 7th taxable year in the recognition period preceded such taxable year, or

(ii) in the case of any taxable year beginning in 2011, if the 5th year in the recognition period preceded such taxable year.

The preceding sentence shall be applied separately with respect to any asset to which paragraph (8) applies.

(C) Special rule for 2012 and 2013. For purposes of determining the net recognized built-in gain for taxable years beginning in 2012 or 2013, subparagraphs (A) and (D) shall be applied by substituting "5-year" for "10-year".

(D) Special rule for distributions to shareholders. For purposes of applying this section to any amount includible in income by reason of distributions to shareholders pursuant to section 593(e) [IRC Sec. 593(e)]--

(i) subparagraph (A) shall be applied without regard to the phrase "10-year", and

(ii) subparagraph (B) shall not apply.

(E) Installment sales. If an S corporation sells an asset and reports the income from the sale using the installment method under section 453, the treatment of all payments received shall be governed by the provisions of this paragraph applicable to the taxable year in which such sale was made.

(8) Treatment of transfer of assets from C corporation to S corporation.

(A) In general. Except to the extent provided in regulations, if

(i) an S corporation acquires any asset, and

(ii) the S corporation's basis in such asset is determined (in whole or in part) by reference to the basis of such asset (or any other property) in the hands of a C corporation,

then a tax is hereby imposed on any net recognized built-in gain attributable to any such assets for any taxable year beginning in the recognition period. The amount of such tax shall be determined under the rules of this section as modified by subparagraph (B).

(B) Modifications. For purposes of this paragraph, the modifications of this subparagraph are as follows:

(i) In general. The preceding paragraphs of this subsection shall be applied by taking into account the day on which the assets were acquired by the S corporation in lieu of the beginning of the 1st taxable year for which the corporation was an S corporation.

(ii) Subsection (c)(1) not to apply. Subsection (c)(1) shall not apply.

(9) Reference to 1st taxable year. Any reference in this section to the 1st taxable year for which the corporation was an S corporation shall be treated as a reference to the 1st taxable year

for which the corporation was an S corporation pursuant to its most recent election under section 1362.

(e) Regulations. The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section including regulations providing for the appropriate treatment of successor corporations.