

*Example 4. Adjustment to net unrealized built-in gain in case of prior gain recognition.*

(i) X, a calendar year C corporation, elects to become an S corporation effective January 1, 2005. On that date, X's assets (the first pool of assets) have a net unrealized built-in gain of \$30,000. Among the assets in the first pool of assets is all of the outstanding stock of Y, a C corporation, with a fair market value of \$45,000 and an adjusted basis of \$10,000. Y has no current or accumulated earnings and profits. On April 1, 2007, Y distributes \$18,000 to X, \$8,000 of which is treated as gain to X from the sale or exchange of property under section 301(c)(3). That \$8,000 is recognized built-in gain to X under section 1374(d)(3), and results in \$8,000 of net recognized built-in gain to X for 2007. X's net unrealized built-in gain limitation for 2008 is \$22,000. On June 1, 2009, Y transfers its assets to X in a liquidation to which sections 332 and 337(a) apply.

(ii) Under paragraph (b) of this section, the net unrealized built-in-gain of the first pool of assets is adjusted to account for the elimination of the Y stock in the liquidation. The net unrealized built-in gain of that pool of assets, however, can only be adjusted to reflect the amount of built-in gain that was inherent in the Y stock on January 1, 2005 that has not resulted in recognized built-in gain during the recognition period. In this case, therefore, the net unrealized built-in gain of the first pool of assets cannot be reduced by more than \$27,000 (\$35,000, the amount by which the fair market value of the Y stock exceeded its adjusted basis as of January 1, 2005, minus \$8,000, the recognized built-in gain with respect to the stock during the recognition period). Accordingly, for taxable years ending after June 1, 2009, the net unrealized built-in gain of the first pool of assets is \$3,000. The net unrealized built-in gain limitation for 2009 is \$0.

**Par. 3.** Paragraph (a) of § 1.1374-10 is revised to read as follows:

**§ 1.1374-10 Effective date and additional rules.**

(a) *In general.* Sections 1.1374-1 through 1.1374-9, other than § 1.1374-3(b) and (c) *Examples 2 through 4*, 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. Section 1.1374-3(b) and (c) *Examples 2 through 4* apply to section 1374(d)(8) transactions that occur in taxable years beginning after February 23, 2005. In addition, an S corporation may apply § 1.1374-3(b) and (c) *Examples 2 through 4* to section 1374(d)(8) transactions that occur in taxable years beginning on or before February 23, 2005, if the S corporation (and any predecessors or successors) and all affected shareholders file original or amended returns that are consistent with these provisions for

taxable years of the S corporation during the recognition period of the pool of assets the net unrealized built-in gain of which would be adjusted pursuant to those provisions that are not closed as of the first date after February 23, 2005, that the S corporation files an original or amended return. For purposes of this section, affected shareholders means all shareholders who received distributive shares of S corporation items in such taxable years. However, the Commissioner may, in appropriate circumstances, permit taxpayers to apply these provisions even if all affected shareholders cannot file consistent returns. In addition, for this purpose, a predecessor of an S corporation is a corporation that transfers its assets to the S corporation in a transaction to which section 381 applies. A successor of an S corporation is a corporation to which the S corporation transfers its assets in a transaction to which section 381 applies.

\* \* \* \* \*

**Mark E. Matthews,**

*Deputy Commissioner for Services and Enforcement.*

Approved: February 14, 2005.

**Eric Solomon,**

*Acting Deputy Assistant Secretary of the Treasury.*

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**DEPARTMENT OF THE TREASURY**

**Internal Revenue Service**

**26 CFR Part 1**

[TD 9179]

RIN 1545-BB62

**Uniform Capitalization of Interest Expense in Safe Harbor Sale and Leaseback Transactions**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains amendments to regulations relating to the capitalization of interest expense incurred in sale and leaseback transactions under the Economic Recovery Tax Act of 1981 (ERTA) safe harbor leasing provisions. The regulations affect taxpayers that provide purchase money obligations in connection with these transactions.

**DATES: Effective Date:** These regulations are effective February 23, 2005.

**Applicability Dates:** For dates of applicability, see § 1.263A-15(a)(3).

**FOR FURTHER INFORMATION CONTACT:** Christian Wood, 202-622-4930 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Background**

This document contains amendments to 26 CFR part 1. On May 20, 2004, the IRS and Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG-148399-02; 69 FR 29113) by cross reference to temporary regulations (TD 9129; 69 FR 29066) under section 263A(f) of the Internal Revenue Code (Code). These amendments pertain to the treatment of certain interest expense incurred by the lessor in a sale and leaseback transaction under the ERTA safe harbor leasing provisions (former section 168(f)(8), as enacted by section 201(a) of ERTA, Public Law 97-34, 95 Stat. 214). No comments in response to the proposed regulations or requests to speak at a public hearing were received, and no hearing was held. The proposed regulations under section 263A(f) are adopted by this Treasury decision.

**Effective Date**

These final regulations generally apply to interest incurred in taxable years beginning on or after May 20, 2004. In the case of property that is inventory in the hands of the taxpayer, these regulations apply to taxable years beginning on or after May 20, 2004. Taxpayers may elect to apply these regulations to interest incurred in taxable years beginning on or after January 1, 1995, or, in the case of property that is inventory in the hands of the taxpayer, to taxable years beginning on or after January 1, 1995 (the general effective date of the interest capitalization regulations).

In addition, for purposes of § 1.263A-15(a)(2), the exclusion of purchase money obligations given by the lessor to the lessee (or a party related to the lessee) in a sale and leaseback transaction under former section 168(f)(8) as enacted by ERTA will be considered to be a reasonable position for the application of section 263A(f) in taxable years beginning before January 1, 1995. Consequently, a taxpayer changing a method of accounting for property that is not inventory in the hands of the taxpayer to conform to these regulations may elect to include interest incurred after December 31, 1986, in taxable years beginning on or after December 31, 1986 (the general effective date of section 263A), and before January 1, 1995, in the determination of its adjustment under section 481(a). A taxpayer changing a method of accounting for property that

is inventory in the hands of the taxpayer to conform to these regulations must compute a section 481(a) adjustment and revalue its beginning inventory in the year of change as if the new method of accounting had been in effect during all prior years.

**Special Analyses**

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking that preceded 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 authors of these regulations are Christian Wood and Grant Anderson of the Office of Associate Chief Counsel (Income Tax & Accounting). 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.

**Proposed Amendments to the Regulations**

n Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—INCOME TAXES**

n **Paragraph 1.** The authority citation for part 1 continues to read, in part, as follows:

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

n **Par. 2.** In § 1.263A-9, paragraph (a)(4)(ix) is added to read as follows:

**§ 1.263A-9 The avoided cost method.**

- (a) \* \* \*
- (4) \* \* \*

(ix) A purchase money obligation given by the lessor to the lessee (or a party that is related to the lessee) in a sale and leaseback transaction involving an agreement qualifying as a lease under § 5c.168(f)(8)-1 through § 5c.168(f)(8)-11 of this chapter. See § 5c.168(f)(8)-1(e) *Example (2)* of this chapter.

\* \* \* \* \*

**§ 1.263A-9T [Removed]**

n **Par. 3.** Section 1.263A-9T is removed.

n **Par. 4.** In § 1.263A-15, paragraph (a)(3) is added to read as follows:

**§ 1.263A-15 Effective dates, transitional rules, and anti-abuse rule.**

- (a) \* \* \*

(3) Section 1.263A-9(a)(4)(ix) generally applies to interest incurred in taxable years beginning on or after May 20, 2004. In the case of property that is inventory in the hands of the taxpayer, § 1.263A-9(a)(4)(ix) applies to taxable years beginning on or after May 20, 2004. Taxpayers may elect to apply § 1.263A-9(a)(4)(ix) to interest incurred in taxable years beginning on or after January 1, 1995, or, in the case of property that is inventory in the hands of the taxpayer, to taxable years beginning on or after January 1, 1995. A change in a taxpayer's treatment of interest to a method consistent with § 1.263A-9(a)(4)(ix) is a change in method of accounting to which sections 446 and 481 apply.

\* \* \* \* \*

**§ 1.263A-15T [Removed]**

n **Par. 5.** Section 1.263A-15T is removed.

**Mark E. Mathews,**  
*Deputy Commissioner for Services and Enforcement.*

Approved: February 15, 2005.

**Eric Solomon,**  
*Acting, Deputy Assistant Secretary of the Treasury (Tax Policy).*

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**DEPARTMENT OF HOMELAND SECURITY**

**Coast Guard**

**33 CFR Part 117**

[CGD11-05-009]

**Drawbridge Operation Regulations; Sacramento River, CA**

**AGENCY:** Coast Guard, DHS.

**ACTION:** Notice of temporary deviation from regulations.

**SUMMARY:** The Commander, Eleventh Coast Guard District, has issued a temporary deviation from the regulation governing the operation of the I Street Drawbridge across the Sacramento River, mile 59.4, at Sacramento, CA. This deviation allows the bridge to remain in the closed-to-navigation position. The deviation is necessary to

repair the operating machinery to prevent unexpected drawspan failure.

**DATES:** This deviation is effective from 8 a.m. March 10, 2005, through 5 p.m. on March 17, 2005.

**ADDRESSES:** Materials referred to in this document are available for inspection or copying at Commander (oan), Eleventh Coast Guard District, Building 50-3, Coast Guard Island, Alameda, CA 94501-5100, between 8 a.m. and 4 p.m., Monday through Friday, except Federal holidays. The telephone number is (510) 437-3516.

**FOR FURTHER INFORMATION CONTACT:** David Sulouff, Bridge Section, (510) 437-3516.

**SUPPLEMENTARY INFORMATION:** The Union Pacific Railroad Company requested to secure the I Street Drawbridge, mile 59.4, Sacramento River, at Sacramento, CA, in the closed-to-navigation position from 8 a.m. March 10, 2005, through 5 p.m. on March 17, 2005, during essential operating machinery repair, to prevent unexpected failure of the draw span. The drawbridge provides 109 ft. vertical clearance in the full open-to-navigation position, and 30 ft. vertical clearance above Mean High Water when closed. The drawbridge normally opens on signal from approaching vessels, as required by 33 CFR 117.189.

The proposed work was coordinated with waterway users. It was determined that potential navigational impacts will be reduced if the repairs are performed during March 2005, resulting in Coast Guard approval of the proposed work from 8 a.m. March 10, 2005, through 5 p.m. March 17, 2005.

During these times, the drawspan may be secured in the closed-to-navigation position and need not open for vessels.

The drawspan will resume normal operation at the conclusion of the essential repair work. Mariners may contact the I Street Drawbridge by telephone at (916) 444-8999, in advance, to determine conditions at the bridge.

The drawspan will be unable to open during the repair. Vessels that can safely pass through the closed drawbridge may continue to do so at any time.

In accordance with 33 CFR 117.35(c), this work will be performed with all due speed to return the drawbridge to normal operation as soon as possible. This deviation from the operating regulations is approved under the provisions of 33 CFR 117.35.

Dated: February 14, 2005.

**Kevin J. Eldridge,**  
*Rear Admiral, U.S. Coast Guard, Commander, Eleventh Coast Guard District.*

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