

revisions to such drawings, they are controlled under Category VIII(h).

* * * * *

(h) Components, parts, accessories, attachments, and associated equipment (including ground support equipment) specifically designed or modified for the articles in paragraphs (a) through (d) of this category, excluding aircraft tires and propellers used with reciprocating engines.

Note: The Export Administration Regulations (EAR) administered by the Department of Commerce control any component, part, accessory, attachment, and associated equipment (including propellers) designed exclusively for civil, non-military aircraft (see § 121.3 of this subchapter for the definition of military aircraft) and control any component, part, accessory, attachment, and associated equipment designed exclusively for civil, non-military aircraft engines. The International Traffic in Arms Regulations administered by the Department of State control any component, part, accessory, attachment, and associated equipment designed, developed, configured, adapted or modified for military aircraft, and control any component, part, accessory, attachment, and associated equipment designed, developed, configured, adapted or modified for military aircraft engines. For components and parts that do not meet the above criteria, including those that may be used on either civil or military aircraft, the following requirements apply. A non-SME component or part (as defined in §§ 121.8(b) and (d) of this subchapter) that is not controlled under another category of the USML, that: (a) Is standard equipment; (b) is covered by a civil aircraft type certificate (including amended type certificates and supplemental type certificates) issued by the Federal Aviation Administration for a civil, non-military aircraft (this expressly excludes military aircraft certified as restricted and any type certification of Military Commercial Derivative Aircraft); and (c) is an integral part of such civil aircraft, is subject to the jurisdiction of the EAR. In the case of any part or component designated as SME in this or any other USML category, a determination that such item may be excluded from USML coverage based on the three criteria above always requires a commodity jurisdiction determination by the Department of State under § 120.4 of this subchapter. The only exception to this requirement is where a part or component designated as SME in this category was integral to civil aircraft prior to August 14, 2008. For such part or component, U.S. exporters are not required to seek a commodity jurisdiction determination from State, unless doubt exists as to whether the item meets the three criteria above (See § 120.3 and § 120.4 of this subchapter). Also, U.S. exporters are not required to seek a commodity jurisdiction determination from State regarding any non-SME component or part (as defined in §§ 121.8(b) and (d) of this subchapter) that is not controlled under another category of the USML, unless doubt exists as to whether the item meets the three criteria above (See § 120.3 and § 120.4 of this

subchapter). These commodity jurisdiction determinations will ensure compliance with this section and the criteria of Section 17(c) of the Export Administration Act of 1979. In determining whether the three criteria above have been met, consider whether the same item is common to both civil and military applications without modification of the item's form, fit, or function. Some examples of parts or components that are not common to both civil and military applications are tail hooks, rotodomes, and low observable rotor blades. "Standard equipment" is defined as a part or component manufactured in compliance with an established and published industry specification or an established and published government specification (e.g., AN, MS, NAS, or SAE). Parts and components that are manufactured and tested to established but unpublished civil aviation industry specifications and standards are also "standard equipment," e.g., pumps, actuators, and generators. A part or component is not standard equipment if there are any performance, manufacturing or testing requirements beyond such specifications and standards. Simply testing a part or component to meet a military specification or standard for civil purposes does not in and of itself change the jurisdiction of such part or component. Integral is defined as a part or component that is installed in an aircraft. In determining whether a part or component may be considered as standard equipment and integral to a civil aircraft (e.g., latches, fasteners, grommets, and switches) it is important to carefully review all of the criteria noted above. For example, a part approved solely on a non-interference/provisions basis under a type certificate issued by the Federal Aviation Administration would not qualify. Similarly, unique application parts or components not integral to the aircraft would also not qualify.

* * * * *

Dated: August 4, 2008.

John C. Rood,

Acting Under Secretary for Arms Control and International Security, Department of State.

[FR Doc. E8-18844 Filed 8-13-08; 8:45 am]

BILLING CODE 4710-25-P

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9422]

RIN 1545-BE95

S Corporation Guidance Under AJCA of 2004 and GOZA of 2005

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance

regarding certain changes made to the rules governing S corporations under the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005. The final regulations replace obsolete references in the current regulations and allow taxpayers to make proper use of the provisions that made changes to prior law. The final regulations include guidance on the S corporation family shareholder rules, the definitions of "powers of appointment" and "potential current beneficiaries" (PCBs) with regard to electing small business trusts (ESBTs), the allowance of suspended losses to the spouse or former spouse of an S corporation shareholder, and relief for inadvertently terminated or invalid qualified subchapter S subsidiary (QSub) elections. The final regulations affect S corporations and their shareholders.

DATES: Effective Date: These regulations are effective on August 14, 2008.

Applicability Dates: For dates of applicability, see §§ 1.1361-4(a)(9)(ii), 1.1361-6, 1.1362-4(g) and 1.1366-5.

FOR FURTHER INFORMATION CONTACT: Charles J. Langley, Jr., (202) 622-3060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2114.

The collection of information is required by § 1.1361-1(m)(2)(ii)(A) of these final regulations. This information is required to enable the IRS to verify whether the corporation is an eligible S corporation.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) concerning S corporations under sections 1361, 1362, and 1366 of the Internal Revenue Code (Code). These

sections were amended by sections 231, 232, 233, 234, 235, 236, 237, 238, and 239 of the American Jobs Creation Act of 2004 (Pub. L. 108–357, 118 Stat. 1418) (the 2004 Act) and sections 403 and 413 of the Gulf Opportunity Zone Act of 2005 (Pub. L. 109–135) (the 2005 Act). This document does not address other amendments made by the 2004 Act or the 2005 Act. In addition, this document contains additional amendments to the regulations under Code section 1362 necessary to conform the regulations to the changes made by section 1305(a) of the Small Business Job Protection Act of 1996 (Pub. L. 104–188, 110 Stat. 1755) (the 1996 Act).

On September 28, 2007, a notice of proposed rulemaking and a notice of public hearing (REG–143326–05) were published in the **Federal Register** (72 FR 55132).

No one requested to speak at the public hearing. Accordingly, the public hearing scheduled for January 16, 2008, was cancelled in a notice published in the **Federal Register** (73 FR 1131) on January 7, 2008. No one submitted written or electronic comments, which were due by December 27, 2007. Thus, the proposed regulations are adopted as revised by this Treasury decision, which make only administrative or ministerial changes to the proposed regulations.

The proposed regulations conformed references in the regulations to the specific numbers of S corporation shareholders permissible under section 1361. For purposes of determining the number of shareholders of an S corporation under Code section 1361(b)(1)(A), the proposed regulations provided rules relating to stock owned by family members.

Pursuant to section 1361(c)(2)(A)(vi), the proposed regulations provided rules regarding limited instances in which individual retirement accounts (including Roth IRAs), qualify as eligible shareholders of banks or depository institution holding companies.

The proposed regulations provided that a disposition of the S corporation stock by a QSST shall be treated as a disposition by the income beneficiary for purposes of applying sections 465 and 469 to the income beneficiary of a QSST.

The proposed regulations described information that is required to be included in the ESBT election statement if the trust includes a power of appointment or other power to make distributions to certain organizations. The proposed regulations provided rules under which a person that may receive a distribution under a power of appointment will not be treated as a

PCB. Also, the proposed regulations provided rules under which a class of organizations described in section 1361(c)(6) will be treated as one PCB if the fiduciary has a power (other than a power of appointment) to make distributions to one or more members of the class. Also, the proposed regulations provided rules that any person who first met the definition of a PCB one year before the disposition by an ESBT of all of the stock of the S corporation will not be treated as a PCB or a shareholder of the S corporation.

The proposed regulations provided that the Commissioner may provide relief for inadvertent invalid elections to be an S corporation or QSub or for inadvertent terminations of valid elections to be an S corporation or QSub and described the requirements to obtain that relief.

Finally, with regard to a transfer of stock under Code section 1041(a), between spouses or incident to a divorce, the proposed regulations provided for the treatment of losses or deductions with respect to the transferred shares that are subject to the basis limitation under Code section 1366(d)(1).

Summary of Comments and Explanation of Revisions

No comments were received. All revisions are administrative or ministerial and substantively conform to the proposed regulations.

Effect on Other Documents

The following publication is obsolete as of *August 14, 2008*: Notice 2005–91 (2005–2 CB 1164).

Effective Applicability Date

These regulations are effective on *August 14, 2008*.

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Further, it has been determined that these regulations are not subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6) because the collection of information required by these regulations is imposed on electing small business trusts and such entities are not “small entities” for purposes of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Additionally, the information collection burden imposed on the electing small business trusts is

minimal. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rule making preceding this regulation 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 proposed regulations is Charles J. Langley, Jr. of the Office of Associate Chief Counsel (Passthroughs and Special Industries).

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 1 and 602 are 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 1.1361–0 is amended by adding a new entry in the table of contents for § 1.1361–1(e)(3) to read as follows:

§ 1.1361–0 Table of contents.

* * * * *

§ 1.1361–1 S Corporation defined.

* * * * *

(e) * * *

(3) Special rules relating to stock owned by members of a family.

* * * * *

■ **Par. 3.** Section 1.1361–1 is amended by:

- 1. Revising paragraphs (b)(1)(i) and (e)(1).
- 2. Adding paragraphs (e)(3), (h)(1)(vii), and (h)(3)(i)(G).
- 3. Adding a new sentence to the end of paragraphs (j)(8) and (k)(2)(i).
- 4. Revising paragraphs (m)(2)(ii)(A), (m)(4)(iii), and (m)(4)(vi).
- 5. Revising paragraphs (m)(8), *Example 2* and *Example 7*.
- 6. Revising the seventh sentence of paragraph (m)(8), *Example 5*.
- 7. Adding paragraphs (m)(8), *Example 8* and *Example 9*.
- 8. Adding a sentence to the end of paragraph (m)(9).

The revisions and additions read as follows:

§ 1.1361-1 S Corporation defined.

* * * * *

(b) * * *

(1) * * *

(i) More than the number of shareholders provided in section 1361(b)(1)(A);

* * * * *

(e) *Number of shareholders*—(1)

General rule. A corporation does not qualify as a small business corporation if it has more than the number of shareholders provided in section 1361(b)(1)(A). Ordinarily, the person who would have to include in gross income dividends distributed with respect to the stock of the corporation (if the corporation were a C corporation) is considered to be the shareholder of the corporation. For example, if stock (owned other than by a husband and wife or members of a family described in section 1361(c)(1)) is owned by tenants in common or joint tenants, each tenant in common or joint tenant is generally considered to be a shareholder of the corporation. (For special rules relating to stock owned by husband and wife or members of a family, see paragraphs (e)(2) and (3) of this section, respectively; for special rules relating to restricted stock, see paragraphs (b)(3) and (6) of this section.) The person for whom stock of a corporation is held by a nominee, guardian, custodian, or an agent is considered to be the shareholder of the corporation for purposes of this paragraph (e) and paragraphs (f) and (g) of this section. For example, a partnership may be a nominee of S corporation stock for a person who qualifies as a shareholder of an S corporation. However, if the partnership is the beneficial owner of the stock, then the partnership is the shareholder, and the corporation does not qualify as a small business corporation. In addition, in the case of stock held for a minor under a uniform transfers to minors act or similar statute, the minor and not the custodian is the shareholder. Except as otherwise provided in paragraphs (h) and (j) of this section, and for purposes of this paragraph (e) and paragraphs (f) and (g) of this section, if stock is held by a decedent's estate or a trust described in section 1361(c)(2)(A)(ii) or (iii), the estate or trust (and not the beneficiaries of the estate or trust) is considered to be the shareholder; however, if stock is held by a subpart E trust (which includes a voting trust) or an electing QSST described in section 1361(d)(1), the deemed owner of the trust is considered to be the shareholder. If stock is held by an ESBT described in section 1361(c)(2)(A)(v),

each potential current beneficiary of the trust shall be treated as a shareholder, except that the trust shall be treated as the shareholder during any period in which there is no potential current beneficiary of the trust. If stock is held by a trust described in section 1361(c)(2)(A)(vi), the individual for whose benefit the trust was created shall be treated as the shareholder. See paragraph (h) of this section for special rules relating to trusts.

* * * * *

(3) *Special rules relating to stock owned by members of a family*—(i) *In general.* For purposes of paragraph (e)(1) of this section, stock owned by members of a family is treated as owned by one shareholder. Members of a family include a common ancestor, any lineal descendant of the common ancestor (without any generational limit), and any spouse (or former spouse) of the common ancestor or of any lineal descendants of the common ancestor. An individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than six generations removed from the youngest generation of shareholders who would be members of the family determined by deeming that individual as the common ancestor. For purposes of this six-generation test, a spouse (or former spouse) is treated as being of the same generation as the individual to whom the spouse is or was married. This test is applied on the latest of the date the election under section 1362(a) is made for the corporation, the earliest date that a member of the family (determined by deeming that individual as the common ancestor) holds stock in the corporation, or October 22, 2004. For this purpose, the date the election under section 1362(a) is made for the corporation is the effective date of the election, not the date it is signed or received by any person. The test is only applied as of the applicable date, and lineal descendants (and spouses) more than six generations removed from the common ancestor will be treated as members of the family even if they acquire stock in the corporation after that date. The members of a family are treated as one shareholder under this paragraph (e)(3) solely for purposes of section 1361(b)(1)(A), and not for any other purpose, whether under section 1361 or any other provision. Specifically, each member of the family who owns or is deemed to own stock must meet the requirements of sections 1361(b)(1)(B) and (C) (regarding permissible shareholders) and section 1362(a)(2) (regarding shareholder consents to an S corporation election).

Although a person may be a member of more than one family under this paragraph (e)(3), each family (not all of whose members are also members of the other family) will be treated as one shareholder. For purposes of this paragraph (e)(3), any legally adopted child of an individual, any child who is lawfully placed with an individual for legal adoption by that individual, and any eligible foster child of an individual (within the meaning of section 152(f)(1)(C)), shall be treated as a child of such individual by blood.

(ii) *Certain entities treated as members of a family.* For purposes of this paragraph (e)(3), the estate or trust (described in section 1361(c)(2)(A)(ii) or (iii)) of a deceased member of the family will be considered to be a member of the family during the period in which the estate or such trust (if the trust is described in section 1361(c)(2)(A)(ii) or (iii)), holds stock in the S corporation. The members of the family also will include—

- (A) In the case of an ESBT, each potential current beneficiary who is a member of the family;
- (B) In the case of a QSST, the income beneficiary who makes the QSST election, if that income beneficiary is a member of the family;
- (C) In the case of a trust created primarily to exercise the voting power of stock transferred to it, each beneficiary who is a member of the family;
- (D) The individual for whose benefit a trust described in section 1361(c)(2)(A)(vi) was created, if that individual is a member of the family;
- (E) The deemed owner of a trust described in section 1361(c)(2)(A)(i) if that deemed owner is a member of the family; and
- (F) The owner of an entity disregarded as an entity separate from its owner under § 301.7701-3 of this chapter, if that owner is a member of the family.

* * * * *

(h) * * *

(1) * * *

(vii) *Individual retirement accounts.* In the case of a corporation which is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank or company as of October 22, 2004. Individual retirement accounts

(including Roth IRAs) are not otherwise eligible S corporation shareholders.

* * * * *

(3) * * *

(i) * * *

(G) If stock in an S corporation bank or depository institution holding company is held by an individual retirement account (including a Roth IRA) described in paragraph (h)(1)(vii) of this section, the individual for whose benefit the trust was created shall be treated as the shareholder.

* * * * *

(j) * * *

(8) * * * However, solely for purposes of applying sections 465 and 469 to the income beneficiary, a disposition of S corporation stock by a QSST shall be treated as a disposition by the income beneficiary.

* * * * *

(k) * * *

(2) * * *

(i) * * * Paragraphs (b)(1)(i), (e)(1), (e)(3), (h)(1)(vii), (h)(3)(i)(G), and the fifth sentence of paragraph (j)(8) are effective on August 14, 2008.

* * * * *

(m) * * *

(2) * * *

(ii) * * *

(A) The name, address, and taxpayer identification number of the trust, the potential current beneficiaries, and the S corporations in which the trust currently holds stock. If the trust includes a power described in paragraph (m)(4)(vi)(B) of this section, then the election statement must include a statement that such a power is included in the instrument, but does not need to include the name, address, or taxpayer identification number of any particular charity or any other information regarding the power.

* * * * *

(4) * * *

(iii) *Special rule for dispositions of stock.* Notwithstanding the provisions of paragraph (m)(4)(i) of this section, if a trust disposes of all of the stock which it holds in an S corporation, then, with respect to that corporation, any person who first met the definition of a potential current beneficiary during the 1-year period ending on the date of such disposition is not a potential current beneficiary and thus is not a shareholder of that corporation.

* * * * *

(vi) *Currently exercisable powers of appointment and other powers—(A) Powers of appointment.* A person to whom a distribution may be made during any period pursuant to a power of appointment (as described for transfer

tax purposes in section 2041 and § 20.2041–1(b) of this chapter and section 2514 and § 25.2514–1(b) of this chapter) is not a potential current beneficiary unless the power is exercised in favor of that person during the period. It is immaterial for purposes of this paragraph (m)(4)(vi)(A) whether such power of appointment is a “general power of appointment” for transfer tax purposes as described in §§ 20.2041–1(c) and 25.2514–1(c) of this chapter. The mere existence of one or more powers of appointment during the lifetime of a power holder that would permit current distributions from the trust to be made to more than the number of persons described in section 1361(b)(1)(A) or to a person described in section 1361(b)(1)(B) or (C) will not cause the S corporation election to terminate unless one or more of such powers are exercised, collectively, in favor of an excessive number of persons or in favor of a person who is ineligible to be an S corporation shareholder. For purposes of this paragraph (m)(4)(vi)(A), a “power of appointment” includes a power, regardless of by whom held, to add a beneficiary or class of beneficiaries to the class of potential current beneficiaries, but generally does not include a power held by a fiduciary who is not also a beneficiary of the trust to spray or sprinkle trust distributions among beneficiaries. Nothing in this paragraph (m)(4)(vi)(A) alters the definition of “power of appointment” for purposes of any provision of the Internal Revenue Code or the regulations.

(B) *Powers to distribute to certain organizations not pursuant to powers of appointment.* If a trustee or other fiduciary has a power (that does not constitute a power of appointment for transfer tax purposes as described in §§ 20.2041–1(b) and 25.2514–1(b) of this chapter) to make distributions from the trust to one or more members of a class of organizations described in section 1361(c)(6), such organizations will be counted collectively as only one potential current beneficiary for purposes of this paragraph (m), except that each organization receiving a distribution also will be counted as a potential current beneficiary. This paragraph (m)(4)(vi)(B) shall not apply to a power to currently distribute to one or more particular charitable organizations described in section 1361(c)(6). Each of such organizations is a potential current beneficiary of the trust.

* * * * *

(8) * * *

Example 2. (i) Invalid potential current beneficiary. Effective January 1, 2005, Trust makes a valid ESBT election. On January 1, 2006, A, a nonresident alien, becomes a potential current beneficiary of Trust. Trust does not dispose of all of its S corporation stock within one year after January 1, 2006. As of January 1, 2006, A is the potential current beneficiary of Trust and therefore is treated as a shareholder of the S corporation. Because A is not an eligible shareholder of an S corporation under section 1361(b)(1), the S corporation election of any corporation in which Trust holds stock terminates effective January 1, 2006. Relief may be available under section 1362(f).

(ii) *Invalid potential current beneficiary and disposition of S stock.* Assume the same facts as in *Example 2* (i) except that within one year after January 1, 2006, trustee of Trust disposes of all Trust’s S corporation stock. A is not considered a potential current beneficiary of Trust and therefore is not treated as a shareholder of any S corporation in which Trust previously held stock.

* * * * *

Example 5. * * * Trust-2 itself will not be counted toward the shareholder limit of section 1361(b)(1)(A).

* * * * *

Example 7. Potential current beneficiaries and powers of appointment. M creates Trust from which A has a right to all net income and funds it with S corporation stock. A also has a currently exercisable power to appoint income or principal to anyone except A, A’s creditors, A’s estate, and the creditors of A’s estate. The potential current beneficiaries of Trust for any period will be A and each person who receives a distribution from Trust pursuant to A’s exercise of A’s power of appointment during that period.

Example 8. Power to distribute to an unlimited class of charitable organizations not pursuant to a power of appointment. M creates Trust from which A has a right to all net income and funds it with S corporation stock. In addition, the trustee of Trust, who is not A or a descendant of M, has the power to make discretionary distributions of principal to the living descendants of M and to any organizations described in section 1361(c)(6). The potential current beneficiaries of Trust for any period will be A, each then-living descendant of M, and each exempt organization described in section 1361(c)(6) that receives a distribution during that period. In addition, the class of exempt organizations will be counted as one potential current beneficiary.

Example 9. Power to distribute to a class of named charitable organizations not pursuant to a power of appointment. M creates Trust from which A has a right to all net income and funds it with S corporation stock. In addition, the trustee of Trust, who is not A or a descendant of M, has the power to make discretionary distributions of principal to the living descendants of M and to X, Y, and Z, each of which is an organization described in section 1361(c)(6). The potential current beneficiaries of Trust for any period will be A, X, Y, Z, and each living descendant of M.

(9) *Effective/applicability date.* * * * Paragraphs (m)(2)(ii)(A), (m)(4)(iii) and

(vi), and (m)(8), Example 2, Example 5, Example 7, Example 8, and Example 9 of this section are effective on August 14, 2008.

■ Par. 4. Section 1.1361-4 is amended by revising paragraph (a)(1) and adding new paragraph (a)(9) to read as follows:

§ 1.1361-4 Effect of QSub election.

(a) Separate existence ignored—(1) In general. Except as otherwise provided in paragraphs (a)(3), (a)(6), (a)(7), (a)(8), and (a)(9) of this section, for Federal tax purposes—

(i) A corporation that is a QSub shall not be treated as a separate corporation; and

(ii) All assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and items of income, deduction, and credit of the S corporation.

* * * * *

(9) Information returns—(i) In general. Except to the extent provided by the Secretary or Commissioner in guidance (including forms or instructions), paragraph (a)(1) of this section shall not apply to part III of subchapter A of chapter 61, relating to information returns.

(ii) Effective/applicability date. This paragraph (a)(9) is effective on August 14, 2008.

* * * * *

■ Par. 5. Section 1.1361-6 is amended by revising the first sentence to read as follows:

§ 1.1361-6 Effective date.

Except as provided in §§ 1.1361-4(a)(3)(iii), 1.1361-4(a)(5)(i), 1.1361-4(a)(6)(iii), 1.1361-4(a)(7)(ii), 1.1361-4(a)(8)(ii), 1.1361-4(a)(9), and 1.1361-5(c)(2), the provisions of §§ 1.1361-2 through 1.1361-5 apply to taxable years beginning on or after January 20, 2000; however, taxpayers may elect to apply the regulations in whole, but not in part (aside from those sections with special dates of applicability), for taxable years beginning on or after January 1, 2000, provided all affected taxpayers apply the regulations in a consistent manner.

* * *

■ Par. 6. Section 1.1362-0 is amended by revising the heading of the table of contents for § 1.1362-4 and adding a new entry in the table of contents for § 1.1362-4(g) to read as follows:

§ 1.1362-0 Table of contents.

* * * * *

§ 1.1362-4 Inadvertent terminations and inadvertently invalid elections.

* * * * *

(g) Effective/applicability date.

* * * * *

■ Par. 7. Section 1.1362-4 is amended by:

■ 1. Revising the section heading and paragraphs (a), (b), (c), (d), and (f).

■ 2. Adding paragraph (g).

The addition and revisions read as follows:

§ 1.1362-4 Inadvertent terminations and inadvertently invalid elections.

(a) In general. A corporation is treated as continuing to be an S corporation or a QSub (or, an invalid election to be either an S corporation or a QSub is treated as valid) during the period specified by the Commissioner if—

(1) The corporation made a valid election under section 1362(a) or section 1361(b)(3) and the election terminated or the corporation made an election under section 1362(a) or section 1361(b)(3) that was invalid;

(2) The Commissioner determines that the termination or invalidity was inadvertent;

(3) Within a reasonable period of time after discovery of the terminating event or invalid election, steps were taken so that the corporation for which the election was made or the termination occurred is a small business corporation or a QSub, as the case may be, or to acquire the required shareholder consents; and

(4) The corporation and shareholders agree to adjustments that the Commissioner may require for the period.

(b) Inadvertent termination or inadvertently invalid election. For purposes of paragraph (a) of this section, the determination of whether a termination or invalid election was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination or invalid election was inadvertent. The fact that the terminating event or invalidity of the election was not reasonably within the control of the corporation and, in the case of a termination, was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination or invalidity of the election was inadvertent.

(c) Corporation's request for determination of an inadvertent termination or invalid election. A corporation that believes that the termination or invalidity of its election was inadvertent may request a

determination from the Commissioner that the termination or invalidity of its election was inadvertent. The request is made in the form of a ruling request and should set forth all relevant facts pertaining to the event or circumstance including, but not limited to, the facts described in paragraph (b) of this section, the date of the corporation's election (or intended election) under section 1362(a) or 1361(b)(3), a detailed explanation of the event or circumstance causing the termination or invalidity, when and how the event or circumstance was discovered, and the steps taken under paragraph (a)(3) of this section.

(d) Adjustments. The Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation or QSub during the period specified by the Commissioner. In the case of stock held by an ineligible shareholder that causes an inadvertent termination or invalid election for an S corporation under section 1362(f), the Commissioner may require the ineligible shareholder to be treated as a shareholder of the S corporation during the period the ineligible shareholder actually held stock in the corporation. Moreover, the Commissioner may require protective adjustments that prevent the loss of any revenue due to the holding of stock by an ineligible shareholder (for example, a nonresident alien).

* * * * *

(f) Status of corporation. The status of the corporation after the terminating event or invalid election and before the determination of inadvertence is determined by the Commissioner. Inadvertent termination or inadvertent invalid election relief may be granted retroactively for all years for which the terminating event or circumstance giving rise to invalidity is effective, in which case the corporation is treated as if its election was valid or had not terminated. Alternatively, relief may be granted only for the period in which the corporation became eligible for subchapter S or QSub treatment, in which case the corporation is treated as a C corporation or, in the case of a QSub with an inadvertently terminated or invalid election, as a separate C corporation, during the period for which the corporation was not eligible for its intended status.

(g) Effective/applicability date. Paragraphs (a), (b), (c), (d), and (f) of this section are effective on August 14, 2008.

■ Par. 8. Section 1.1366-0 is amended by adding new entries in the table of

contents for § 1.1366-2(a)(5)(i), (a)(5)(ii) and (a)(5)(iii) to read as follows:

§ 1.1366-0 Table of contents.

* * * * *

§ 1.1366-2 Limitations on deduction of passthrough items of an S corporation to its shareholders.

(a) * * *
(5) * * *

(i) *In general.*

(ii) *Exceptions for transfers of stock under section 1041(a).*

(iii) *Examples.*

■ **Par. 9.** Section 1.1366-2(a)(5) is amended by:

■ 1. Redesignating paragraph (a)(5) as (a)(5)(i).

■ 2. Adding a heading and revising the first sentence of paragraph (a)(5)(i).

■ 3. Adding paragraphs (a)(5)(ii) and (a)(5)(iii).

The revisions and additions read as follows:

§ 1.1366-2 Limitations on deduction of passthrough items of an S corporation to its shareholders.

(a) *In general.* * * *

(5) *Nontransferability of losses and deductions—(i) In general.* Except as provided in paragraph (a)(5)(ii) of this section, any loss or deduction disallowed under paragraph (a)(1) of this section is personal to the shareholder and cannot in any manner be transferred to another person. * * *

(ii) *Exceptions for transfers of stock under section 1041(a).* If a shareholder transfers stock of an S corporation after December 31, 2004, in a transfer described in section 1041(a), any loss or deduction with respect to the transferred stock that is disallowed to the transferring shareholder under paragraph (a)(1) of this section shall be treated as incurred by the corporation in the following taxable year with respect to the transferee spouse or former spouse. The amount of any loss or deduction with respect to the stock transferred shall be determined by prorating any losses or deductions disallowed under paragraph (a)(1) of this section for the year of the transfer between the transferor and the spouse or former spouse based on the stock ownership at the beginning of the following taxable year. If a transferor claims a deduction for losses in the taxable year of transfer, then under paragraph (a)(4) of this section, if the transferor's pro rata share of the losses and deductions in the year of transfer exceeds the transferor's basis in stock and the indebtedness of the corporation to the transferor, then the limitation must be allocated among the transferor

spouse's pro rata share of each loss or deduction, including disallowed losses and deductions carried over from the prior year.

(iii) *Examples.* The following examples illustrates the provisions of paragraph (a)(5)(ii) of this section:

Example 1. A owns all 100 shares in X, a calendar year S corporation. For X's taxable year ending December 31, 2006, A has zero basis in the shares and X does not have any indebtedness to A. For the 2006 taxable year, X had \$100 in losses that A cannot use because of the basis limitation in section 1366(d)(1) and that are treated as incurred by the corporation with respect to A in the following taxable year. Halfway through the 2007 taxable year, A transfers 50 shares to B, A's former spouse in a transfer to which section 1041(a) applies. In the 2007 taxable year, X has \$80 in losses. On A's 2007 individual income tax return, A may use the entire \$100 carryover loss from 2006, as well as A's share of the \$80 2007 loss determined under section 1377(a) (\$60), assuming A acquires sufficient basis in the X stock. On B's 2007 individual income tax return, B may use B's share of the \$80 2007 loss determined under section 1377(a) (\$20), assuming B has sufficient basis in the X stock. If any disallowed 2006 loss is disallowed to A under section 1366(d)(1) in 2007, that loss is prorated between A and B based on their stock ownership at the beginning of 2008. On B's 2008 individual income tax return, B may use that loss, assuming B acquires sufficient basis in the X stock. If neither A nor B acquires any basis during the 2007 taxable year, then as of the beginning of 2008, the corporation will be treated as incurring \$50 of loss with respect to A and \$50 of loss with respect to B for the \$100 of disallowed 2006 loss, and the corporation will be treated as incurring \$60 of loss with respect to A and \$20 with respect to B for the \$80 of disallowed 2007 loss.

Example 2. Assume the same facts as *Example 1*, except that during the 2007 taxable year, A acquires \$10 of basis in A's shares in X. For the 2007 taxable year, A may claim a \$10 loss deduction, which represents \$6.25 of the disallowed 2006 loss of \$100 and \$3.75 of A's 2007 loss of \$60. The disallowed 2006 loss is reduced to \$93.75. As of the beginning of 2008, the corporation will be treated as incurring half of the remaining \$93.75 of loss with respect to A and half of that loss with respect to B for the remaining \$93.75 of disallowed 2006 loss, and if B does not acquire any basis during 2007, the corporation will be treated as incurring \$56.25 of loss with respect to A and \$20 with respect to B for the remaining disallowed 2007 loss.

* * * * *

■ **Par. 10.** Section 1.1366-5 is amended by adding a new sentence at the end to read as follows:

§ 1.1366-5 Effective/applicability date.

* * * Sections 1.1366-2(a)(5)(i), (ii) and (iii) are effective on August 14, 2008.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ **Par. 11.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ **Par. 12.** Section 602.101, paragraph (b) is amended by adding the entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *
(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	* * * * *
1.1361-1	1545-2114
* * * * *	* * * * *

Sherri L. Brown,

Acting Deputy Commissioner for Services and Enforcement.

Approved: August 5, 2008.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E8-18782 Filed 8-13-08; 8:45 am]

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DEPARTMENT OF HOMELAND SECURITY

Coast Guard

33 CFR Part 100

[Docket No. USCG-2008-0789]

RIN 1625-AA08

Special Local Regulation; Cape Fear Dragon Boat Festival, Wilmington, NC

AGENCY: Coast Guard, DHS.

ACTION: Temporary final rule.

SUMMARY: The Cape Fear Dragon Boat Festival will take place on the Cape Fear River in Wilmington, North Carolina on September 27, 2008. This event will consist of four 45 foot long Dragon boats racing a 250 meter course.

DATES: This rule is effective from 8 a.m. to 6 p.m. on September 27, 2008.

ADDRESSES: Documents indicated in this preamble as being available in the docket are part of docket USCG-2008-0789 and are available online at www.regulations.gov. They are also available for inspection or copying at two locations: the Docket Management Facility (M-30), U.S. Department of