

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Part 1**

[TD 9428]

RIN 1545-BD72

**Section 1367 Regarding Open Account Debt****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations relating to the treatment of open account debt between S corporations and their shareholders. These final regulations provide rules regarding the definition of open account debt and the adjustments in basis of any indebtedness of an S corporation to a shareholder under section 1367(b)(2) of the Internal Revenue Code (Code) for shareholder advances and repayments on advances of open account debt. The regulations affect shareholders of S corporations and are necessary to provide guidance needed to comply with the applicable tax law.

**DATES:**

*Effective Date:* These regulations are effective on October 20, 2008.

*Applicability Date:* For dates of applicability, see § 1.1367-3.

**FOR FURTHER INFORMATION CONTACT:**

Stacy L. Short or Deane M. Burke, (202) 622-3070 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:****Background**

This document amends § 1.1367-2 of the Income Tax Regulations (26 CFR part 1) regarding the definition of open account debt and adjustments in basis of indebtedness for shareholder advances and repayments on advances of open account debt.

Section 1367(a)(1) provides that the basis of each shareholder's stock in an S corporation is increased by the shareholder's pro rata share of the S corporation's income (separately and nonseparately computed items of income) and the excess of the deductions for depletion over the basis of the property subject to depletion. Section 1367(a)(2) provides that the basis of each shareholder's stock in the S corporation is decreased by the shareholder's distributions not includible in income of the shareholder by reason of section 1368 (nontaxable distributions), and the shareholder's pro rata share of the losses and deductions (separately and nonseparately computed losses), any expense of the corporation

that is not deductible and not properly chargeable to capital account, and certain deductions for depletion for any oil and gas property held by the S corporation. Under section 1367(b)(2)(A), if for any taxable year the amounts specified in section 1367(a)(2) (other than distributions) exceed the amount which reduces the shareholder's basis to zero, such excess losses and deductions shall be applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. Section 1367(b)(2)(B) provides that if a shareholder's basis in indebtedness is reduced for any taxable year, any net increase (the amount by which the items described in section 1367(a)(1) exceed the items described in section 1367(a)(2)) for any subsequent taxable year is applied to restore the reduction in basis in indebtedness before any of the excess is used to increase basis in stock.

On January 3, 1994, the Treasury Department and the IRS published final regulations under section 1367 of the Code (TD 8508, 59 FR 12, amended on December 22, 1999 (TD 8852, 64 FR 71641)). Those final regulations relate, in part, to adjustments to basis in both stock of shareholders and indebtedness of an S corporation to its shareholders. Section 1.1367-2 of the Income Tax Regulations provides specific rules for required adjustments (reductions and restorations) to basis in any indebtedness of an S corporation to a shareholder. Section 1.1367-2(a) also provides that for purposes of adjustments to basis of indebtedness to shareholders, shareholder advances not evidenced by separate written instruments and repayments on the advances (open account debt) are treated as a single indebtedness. The basis adjustment rules under the final regulations apply to all indebtedness of an S corporation to a shareholder, whether the indebtedness is evidenced by a written instrument or is open account debt. Taxpayers should also remember that all advances to an S corporation by a shareholder are subject to the general tax principles for debt, whether evidenced by a written instrument or not.

On August 25, 2005, the Tax Court issued its decision in *Brooks v. Commissioner*, TC Memo. 2005-204, involving open account debt. Under its interpretation of § 1.1367-2, the court in *Brooks* held "that the basis of the open account indebtedness is properly computed by netting at the close of the year advances of open account debt during the year and repayments of open account debt during the year." This

allowed the taxpayer in *Brooks* to defer indefinitely the recognition of income on any repayment of his open account debt over the several years during which the taxpayer and the S corporation made advances and repayments, respectively.

On April 12, 2007, the Treasury Department and the IRS published a notice of proposed rulemaking and a notice of public hearing (REG-144859-04, 2007-20 IRB 1245) in the **Federal Register** (72 FR 18417) proposing amendments to the regulations relating to the treatment of open account debt between S corporations and their shareholders. A public hearing on the proposed regulations was scheduled for July 31, 2007, but was cancelled because no one requested to speak. However, comments responding to the proposed regulations were received. After consideration of these comments, the proposed regulations are adopted as revised by this Treasury decision. These final regulations generally retain the provisions of the proposed regulations with the modifications discussed in the preamble.

**Summary of Comments and Explanation of Revisions***1. Need for Regulatory Change*

All of the comments received in response to the proposed regulations suggested that the regulations were overly broad and should be withdrawn. Two commentators suggested that amending the regulations for open account debt is not an appropriate approach for the Treasury Department and the IRS to address concerns regarding transactions similar to that in *Brooks*. Instead, the commentators asserted, such concerns should be addressed through established judicial doctrines such as substance over form, business purpose, sham transaction, and economic substance. One commentator alternatively recommended a narrowly tailored anti-abuse rule targeting open account debt instead of broader rules that would apply to all such debt.

The Treasury Department and the IRS continue to believe that regulatory guidance on open account debt is necessary. The Treasury Department and the IRS believe that the treatment of open account debt as interpreted in *Brooks* permits tax consequences that are inconsistent with the original purpose of § 1.1367-2 and is not conducive to sound tax administration. Neither established judicial doctrines alone nor a narrowly tailored anti-abuse rule suggested by the commentators would adequately address these concerns, though the Treasury Department and the IRS continue to

recognize the applicability of the judicial doctrines in appropriate cases in addition to these final regulations.

## 2. Aggregate Principal Threshold Amount

The proposed regulations defined open account debt as shareholder advances not evidenced by separate written instruments for which the principal amount of the aggregate advances (net of repayments on advances) did not exceed \$10,000 per shareholder at the close of any day during the S corporation's taxable year. Shareholders were required to determine for open account debt purposes whether shareholder advances and repayments on the advances exceeded the \$10,000 aggregate principal threshold on any day during the S corporation's taxable year. To make such a determination, shareholders were required to maintain a "running balance" of shareholder advances and repayments on advances, and the outstanding principal amount of the open account debt. If the resulting aggregate principal of the running balance exceeded \$10,000 at the close of any day during the S corporation's taxable year, the entire principal amount of the indebtedness would no longer constitute open account debt effective at the close of that day.

Commentators suggested that the proposed regulations' aggregate principal threshold of \$10,000 was too low for most businesses. One commentator asserted that establishing any aggregate principal threshold dollar amount for open account debt in final regulations would be arbitrary and would impose a certain compliance burden on smaller businesses. However, that commentator also suggested that increasing the aggregate principal threshold dollar amount would mitigate the compliance burden. The commentators suggested that if the final regulations adopt any threshold dollar amount for open account debt, such a threshold amount should be increased to an amount ranging from \$100,000 to \$1 million.

After considering the comments on the aggregate principal threshold dollar amount, and on recognizing customary business practices as noted by the commentators, the Treasury Department and the IRS have concluded that the aggregate principal threshold dollar amount for open account debt should be increased and that other changes are necessary. Therefore, the final regulations adopt a \$25,000 aggregate principal threshold amount per shareholder for open account debt. For example, an S corporation with ten

shareholders could receive up to \$250,000 of open account debt as long as no single shareholder advanced more than \$25,000. The Treasury Department and the IRS believe that the \$25,000 threshold, together with certain other changes noted below, balances concerns over deferral potential with normal business practices. Under the final regulations, for any particular shareholder advances and repayments on those advances for which, as of the specified determination date, the aggregate principal balance exceeds the \$25,000 aggregate principal threshold amount will no longer constitute open account debt, but instead will be treated as debt evidenced by a separate written instrument subject to the basis adjustment and repayment accounting rules applicable to S corporation shareholder debt generally.

As noted in the preamble to the proposed regulations, the \$10,000 aggregate principal threshold amount for open account debt for purposes of § 1.1367-2 was modeled after section 7872(c)(3) and the de minimis exception for corporation-shareholder loans in § 1.7872-9 of the proposed regulations. However, the Treasury Department and the IRS do not believe it is necessary that the threshold amount for open account debt be modeled after the rules under § 1.7872-9 regarding corporate-shareholder loans. Nevertheless, despite the \$25,000 threshold amount for open account debt in these final regulations, the provisions under section 7872 and related regulations for corporate-shareholder loans in excess of \$10,000 separately apply to open account debt in excess of \$10,000 for each advance if the corporation is not obligated to pay a market rate of interest on the advances.

## 3. Monitoring the Aggregate Principal Threshold Amount

The proposed regulations effectively required day-to-day monitoring of open account debt. For purposes of determining compliance with the aggregate principal threshold amount for open account debt, the shareholder was required to maintain a daily running balance of shareholder advances and repayments on such advances, and the outstanding principal amount of the open account debt. Some of the commentators suggested that the daily monitoring requirement would impose an unreasonable burden on shareholders and recommended that the running balance requirement be tested quarterly, annually or when the corporation maintains and updates its other books and records. One commentator described the practice by many closely held corporations of

reconciling and accounting only once a year and noted that only then would such an S corporation and its shareholder(s) know what payments are legitimately charged to the corporation as opposed to those appropriately charged to the shareholder(s).

Another commentator suggested that with daily monitoring, a maximum threshold rule for open account debt is too harsh for shareholders insofar as it immediately changes the treatment of such debt the principal balance of which exceeds the threshold by a single cent on any day, resulting in a "cliff" effect. The commentator suggested that in order to mitigate this "cliff" effect, the final regulations should adopt a second prong to the aggregate principal threshold amount test so that advances would fail to meet the definition of open account debt only if both the aggregate principal of the running balance exceeded the applicable aggregate principal threshold dollar amount on any given day of the year and the balance at the end of the year exceeded the average of the daily balances throughout the year. The commentator provided examples of intended beneficiaries of such an "averaging" rule, for example, shareholders who need to advance their S corporation more funds on a short-time basis but end the year with an outstanding principal amount of the open account debt below the threshold level.

After careful consideration of these comments, the Treasury Department and the IRS have concluded that extending the period for which a shareholder determines whether shareholder advances and repayments exceed the aggregate principal threshold dollar amount for open account debt would reduce both the complexity of the regulations and any perceived burden on shareholders in making such determinations. In addition, such a modified rule should alleviate concerns over any potential "cliff" effect resulting from a day-to-day determination of threshold amount as required in the proposed regulations. The Treasury Department and the IRS also recognize that shareholder advances made to an S corporation and subsequently repaid during the same taxable year of the S corporation are not available for inclusion in the shareholder's basis in the indebtedness for purposes of passing through additional losses to the shareholder at the end of the taxable year.

Therefore, the final regulations do not adopt a daily determination of whether shareholder advances and repayments on the advances exceed the \$25,000 threshold amount. Instead, the final

regulations provide that a determination of whether the threshold balance of \$25,000 is exceeded will be made at the end of the taxable year of the S corporation. Under these final regulations, however, if open account debt is disposed of in whole or in part before the end of the S corporation's taxable year, the determination of whether the advances and repayments have exceeded the designated aggregate principal threshold amount must be made immediately before the disposition of the debt during that taxable year. Moreover, if a shareholder with open account debt is no longer a shareholder at the end of the S corporation's taxable year, the determination must be made immediately before the shareholder's interest in the S corporation is terminated.

#### *4. Character of Income/Gain Recognition*

One of the commentators suggested that the final regulations address the issue of how to characterize any income or gain that is recognized upon repayment of both open account debt and indebtedness evidenced by a written instrument. While recognizing the commentators' concerns, the Treasury Department and the IRS believe that the characterization issue is beyond the scope of these final regulations. However, the Treasury Department and the IRS intend to continue considering the characterization issue.

#### *5. Effective Date Operation*

The effective date in the proposed regulations provided that the proposed rules for open account debt applied to any shareholder advances to the S corporation made on or after the date the regulations were published as final regulations and repayments on those advances by the S corporation. Thus, all open account debt (net of repayments) prior to the publication of the final regulation was outside the scope of the proposed regulations, irrespective of the outstanding principal amount.

One of the commentators believed that the effective date language in the proposed regulations was subject to two interpretations. Under the first interpretation, the rules under these final regulations (New Rules) would apply only to open account debt created on or after the effective date, that is, shareholder advances made on or after the effective date and repayments on those same advances. The rules under the prior final regulations (as contained in the 26 CFR edition revised April 1, 2007) (Old Rules) would apply to open

account debt created before the effective date, that is, shareholder advances with respect to pre-effective date open account debt and repayments on those prior advances. Accordingly, a shareholder could have open account debt, subject to the Old Rules, and open account debt, subject to the New Rules, to which new shareholder advances and repayments on those advances could be made after the effective date.

Under the second interpretation, a shareholder could not make additional advances with respect to open account debt created before the effective date but could receive repayments on that debt under the Old Rules. Accordingly, the New Rules would apply to all shareholder advances on and after the effective date, as well as repayments on those advances, and the Old Rules would apply only to repayments on pre-effective date open account debt.

The Treasury Department and the IRS intend that the rules under these final regulations (New Rules) apply to any and all shareholder advances made on and after the effective date. The rules under these final regulations (New Rules) also apply to repayments on such advances. However, if a shareholder has open account debt (net of prior repayments in the taxable year) outstanding prior to the effective date of these final regulations, the rules under the prior final regulations (Old Rules) apply to any repayments on such pre-effective date open account debt. Accordingly, that pre-effective date open account debt will not be subject to any aggregate principal threshold dollar amount. The shareholder may not make additional advances with respect to the pre-effective date open account debt (because all shareholder advances made on or after the effective date of these final regulations constitute new open account debt subject to these final regulations).

For instance, assume that the effective date of these final regulations falls within the taxable year of shareholder A's S corporation. Also assume that, at the beginning of the S corporation's taxable year, A will have existing open account debt with an outstanding principal balance of \$12,000. Assume further that A will make an additional advance of \$3,000 to and will receive a \$2,000 repayment from his S corporation prior to the effective date. Thus, as of the effective date, A will have existing open account debt with an outstanding principal balance of \$13,000 (A would net the pre-effective date advance and repayment for the taxable year and combine that net advance of \$1,000 with the \$12,000 outstanding aggregate principal balance

of the then existing open account debt). This \$13,000 pre-effective date open account debt would not be subject to these final regulations and, thus, would not be subject to any aggregate principal threshold dollar amount and would be repaid under the rules of the prior final regulations. If, on or after the effective date of these final regulations, A were to both make an advance of \$5,000 to his S corporation and receive a \$1,000 repayment on that advance, the advance and repayment would constitute separate new open account debt subject to the rules under these final regulations.

Shareholders also have the option to apply these rules to shareholder advances to the S corporation and repayments on those advances by the S corporation made before the effective date of these regulations. Using the example above, A would have the option to net the \$5,000 advance and \$1,000 repayment.

#### **Effective/Applicability Date**

The regulations apply to any and all shareholder advances to the S corporation made on or after October 20, 2008, and repayments on those advances by the S corporation.

#### **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 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. Because these 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 final regulations are Stacy L. Short and Deane M. Burke of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the 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 \* \* \*  
Section 1.1367-2 also issued under 26 U.S.C. 1367(b)(2). \* \* \*

■ **Par. 2.** Section 1.1367-2 is amended as follows:

■ 1. Paragraph (a) is revised. paragraph (a)(2) is added.

■ 2. Paragraphs (c)(2) and (d)(1) are revised.

■ 3. Paragraph (d)(2) is redesignated as paragraph (d)(3) and new paragraph (d)(2) is added.

■ 4. Paragraph (e) is amended by adding *Examples 6, 7 and 8.*

The revisions and additions read as follows:

**§ 1.1367-2 Adjustments to basis of indebtedness to shareholder.**

(a) *In general*—(1) *Adjustments under section 1367.* This section provides rules relating to adjustments required by subchapter S to the basis of indebtedness (including open account debt as described in paragraph (a)(2) of this section) of an S corporation to a shareholder. The basis of indebtedness of the S corporation to a shareholder is reduced as provided in paragraph (b) of this section and restored as provided in paragraph (c) of this section in accordance with the timing rules in paragraph (d) of this section.

(2) *Open Account Debt*—(i) *General rule.* The term *open account debt* means shareholder advances not evidenced by separate written instruments and repayments on the advances, the aggregate outstanding principal of which does not exceed \$25,000 of indebtedness of the S corporation to the shareholder at the close of the S corporation's taxable year. Advances and repayments on open account debt are treated as a single indebtedness.

(ii) *Exception.* If the shareholder advances not evidenced by a separate written instrument, net of repayments, exceeds an aggregate outstanding principal amount of \$25,000 at the close of the S corporation's taxable year, for any subsequent taxable year the aggregate principal amount of that indebtedness is treated in the same manner as indebtedness evidenced by a separate written instrument for purposes of this section. For any subsequent taxable year, that

indebtedness is not open account debt and is subject to all basis adjustment rules applicable to basis of indebtedness of an S corporation to a shareholder in this section.

\* \* \* \* \*

(c) \* \* \*

(2) *Multiple indebtedness.* If a shareholder holds more than one indebtedness (including any open account debt and any debt treated as a single indebtedness under paragraph (a)(2)(ii) of this section) as of the beginning of an S corporation's taxable year, any net increase is applied first to restore the reduction of basis in any indebtedness repaid (in whole or in part) in that taxable year to the extent necessary to offset any gain that would otherwise be realized on the repayment. Any remaining net increase is applied to restore each outstanding indebtedness (including any open account debt and any debt treated as a single indebtedness under paragraph (a)(2)(ii) of this section) in proportion to the amount that the basis of each outstanding indebtedness has been reduced under section 1367(b)(2)(A) and paragraph (b) of this section and not restored under section 1367(b)(2)(B) and this paragraph (c).

(d) *Time at which adjustments to basis of indebtedness are effective*—

(1) *In general.* The amounts of the adjustments to basis of indebtedness (including open account debt) provided in section 1367(b)(2) and this section are determined as of the close of the S corporation's taxable year, and the adjustments are generally effective as of the close of the S corporation's taxable year. However, if the shareholder is not a shareholder in the S corporation at that time, these adjustments are effective immediately before the shareholder terminates his or her interest in the S corporation. Except as provided in paragraph (d)(2) of this section, if a debt is disposed of or repaid in whole or in part before the close of the taxable year, the basis of that indebtedness is restored under paragraph (c) of this section, effective immediately before the disposition or the first repayment on the debt during the taxable year. To the extent any indebtedness of the S corporation to the shareholder is disposed of or repaid (in whole or in part) during the taxable year and the shareholder's basis in that indebtedness has been reduced under paragraph (b) of this section and is not restored completely under paragraph (c) of this section, the disposition or repayment is a recognition event effective immediately before the

indebtedness is disposed of or repaid (in whole or in part).

(2) *Open account debt*—(i) *In general.* All advances and repayments on open account debt (as described in paragraph (a)(2)(i) of this section) during the S corporation's taxable year are netted at the close of the S corporation's taxable year to determine the amount of any net advance or net repayment. The net advance or net repayment is combined with the outstanding aggregate principal balance of the existing open account debt and that amount is carried forward to the beginning of the subsequent taxable year as the outstanding aggregate principal amount of the open account debt (unless the aggregate principal amount meets the exception defined in paragraph (a)(2)(ii) of this section at the close of the taxable year). However, if the shareholder in the S corporation is not a shareholder of the S corporation at the close of the S corporation's taxable year, such advances and repayments on open account debt are netted, and the basis of that indebtedness is restored under paragraph (c) of this section, effective immediately before the shareholder terminates his or her interest in the S corporation. If any open account debt is disposed of before or upon the close of the taxable year, the disposition is effective at the close of the S corporation's taxable year, and all advances and repayments are netted immediately prior to the disposition and the basis of that indebtedness is restored under paragraph (c) of this section, effective at the close of the S corporation's taxable year.

(ii) *Exception.* Shareholder indebtedness that is open account debt at the beginning of the taxable year but meets the exception defined in paragraph (a)(2)(ii) of this section at the close of the taxable year, adjustments to the basis of the indebtedness for that taxable year follow the provisions for open account debt. The resulting aggregate principal amount of indebtedness is treated as the principal amount of a debt evidenced by a separate written instrument for any subsequent taxable year, and is no longer subject to the open account debt provisions of this section.

\* \* \* \* \*

(e) \* \* \*

*Example 6. The \$25,000 Aggregate Principal Amount Applies to Each Shareholder.* (i) A and B have been the two shareholders in Corporation S since 2000. As of the end of the 2008 taxable year, the bases of A's and B's stock are both zero. On June 1, 2009, A advances S \$16,000, which is not evidenced by a written instrument. On August 1, 2009, B advances S \$22,000, which

is not evidenced by a written instrument. Both the \$16,000 advance and the \$22,000 advance are open account debt and remain outstanding at those amounts during 2009. There is no net increase under paragraph (c) of this section in year 2009.

(ii) At the close of the 2009 taxable year, A's open account debt does not exceed \$25,000. A therefore carries forward to the beginning of the 2010 taxable year the \$16,000 as open account debt.

(iii) At the close of the 2009 taxable year, B's open account debt does not exceed \$25,000. B therefore carries forward to the beginning of the 2010 taxable year the \$22,000 as open account debt.

*Example 7. Treatment of open account debt.* (i) The facts are the same as in Example 6, in addition to which, on December 31, 2009, A's basis in the open account debt is reduced under paragraph (b) of this section to \$8,000. On April 1, 2010, S repays A \$4,000 of the open account indebtedness. On September 1, 2010, A advances S an additional \$1,000, which is not evidenced by a written instrument. There is no net increase under paragraph (c) of this section in year 2010.

(ii) The \$4,000 April repayment S makes to A and A's \$1,000 September advance are netted to result in a net repayment of \$3,000 for the taxable year on A's \$16,000 open account debt carried forward from 2009. Because there is no net increase in 2010, no basis of indebtedness is restored for the 2010 taxable year, and A realizes \$1,500 of income on the \$3,000 net repayment at the close of the 2010 taxable year.

(iii) At close of the 2010 taxable year, A's open account debt does not exceed \$25,000. The net repayment of \$3,000 for the taxable year on A's \$16,000 open account debt carried forward from 2009, leaves A with an open account debt of \$13,000 to carry forward as open account debt to the beginning of the 2011 taxable year.

*Example 8. Treatment of shareholder indebtedness not evidenced by a written instrument which exceeds \$25,000.* (i) The facts are the same as in Example 7, in addition to which, on February 1, 2011, S repays \$5,000 of the open account debt and on March 1, 2011, A advances S \$20,000, which is not evidenced by a written instrument.

(ii) At the close of the 2010 taxable year, A has an open account debt of \$13,000 to carry forward as open account debt to the beginning of the 2011 taxable year.

(iii) The 2011 advances and repayments are netted to result in a net advance of \$15,000 on A's \$13,000 open account debt carried forward from 2010, increasing A's open account debt to \$28,000 as of the close of the 2011 taxable year. Because A's open account debt exceeds \$25,000, for any subsequent taxable year the \$28,000 indebtedness will be treated in the same manner as indebtedness evidenced by a separate written instrument for the purposes of this section. Because there is no net increase in 2011, no basis of indebtedness is restored for the 2011 taxable year.

■ **Par. 3.** Section 1.1367-3 is revised to read as follows:

#### **§ 1.1367-3 Effective/Applicability date.**

Section 1.1367-2(a), (c)(2), (d)(2), and (e) *Example 6*, *Example 7*, and *Example 8* apply to any shareholder advances to the S corporation made on or after October 20, 2008 and repayments on those advances by the S corporation. The rules that apply with respect to shareholder advances to the S corporation made before October 20, 2008, are contained in § 1.1367-3 in effect prior to October 20, 2008. (See 26 CFR part 1 revised as of April 1, 2007.) Shareholders have the option to apply these rules to shareholder advances to the S corporation made before October 20, 2008, and repayments on those advances by the S corporation.

Approved: September 25, 2008.

**Linda E. Stuff,**

*Deputy Commissioner for Services and Enforcement.*

**Eric Solomon,**

*Assistant Secretary of the Treasury (Tax Policy).*

[FR Doc. E8-24926 Filed 10-17-08; 8:45 am]

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## **DEPARTMENT OF THE TREASURY**

### **Internal Revenue Service**

#### **26 CFR Part 1**

**[TD 9424]**

**RIN 1545-BB61**

#### **Unified Rule for Loss on Subsidiary Stock; Correction**

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

**ACTION:** Final regulations; Correction.

**SUMMARY:** This document contains corrections to final regulations (TD 9424) that were published in the **Federal Register** on Wednesday, September 17, 2008 (73 FR 53934) under sections 358, 362(e)(2), and 1502 of the Internal Revenue Code. The final regulations apply to corporations filing consolidated returns, and corporations that enter into certain tax-free reorganizations. The final regulations provide rules for determining the tax consequences of a member's transfer (including by deconsolidation and worthlessness) of loss shares of subsidiary stock. In addition, the final regulations provide that section 362(e)(2) generally does not apply to transactions between members of a consolidated group. Finally, the final regulations conform or clarify various provisions of the consolidated return regulations, including those relating to adjustments to subsidiary stock basis.

**DATES:** This correction is effective October 20, 2008, and is applicable on September 17, 2008.

**FOR FURTHER INFORMATION CONTACT:** Marcie P. Barese, (202) 622-7790, Sean P. Duffley, (202) 622-7770, or Theresa Abell (202) 622-7700 (none of the numbers are toll-free).

#### **SUPPLEMENTARY INFORMATION:**

##### **Background**

The final regulations that are the subject of this document are under sections 337, 358, 362, 1502 of the Internal Revenue Code.

##### **Need for Correction**

As published, final regulations (TD 9424) contain errors that may prove to be misleading and are in need of clarification.

##### **Correction of Publication**

Accordingly, the publication of the final regulations (TD 9424), which were the subject of FR Doc. E8-21006, is corrected as follows:

1. On page 53937, column 3, in the preamble, under the paragraph heading "vii. Adjustments for Section 362(e)(2) Transactions", first paragraph, line 9, the language "not elect to apply the rule in the final" is corrected to read "not apply the rule in the final".

2. On page 53938, column 3, in the preamble, under the paragraph heading "B. Section 1.1502-36(b): Basis Redetermination Rule", first paragraph of the column, line 1, the language "have no correlation to unrecognized loss" is corrected to read "have no correlation to unrecognized gain or loss".

3. On page 53938, column 3, in the preamble, under the paragraph heading "B. Section 1.1502-36(b): Basis Redetermination Rule", first paragraph of the column, line 17, the language "contributions of assets in exchanged for" is corrected to read "contributions of assets in exchange for".

4. On page 53938, column 3, in the preamble, under the paragraph heading "i. Exceptions to Basis Redetermination Rule", last paragraph of the column, line 7, the language "to a nonmember in a one or more fully" is corrected to read "to a nonmember in one or more fully".

5. On page 53939, column 3, in the preamble, under the paragraph heading "i. Treatment of Intercompany Debt", first paragraph, line 7, the language "more like to capital transactions than" is corrected to read "more like capital transactions than".

6. On page 53940, column 3, in the preamble, under the paragraph heading "i. Lower-Tier Subsidiary Rules", second paragraph, line 7, the language