

HTSUS	Tariff shift and/or other requirements
3808.20	A change to subheading 3808.20 from any other subheading, except from fungicides of Chapter 28 or 29.
3808.30	A change to subheading 3808.30 from any other subheading, except from herbicides, antisprouting products and plant-growth regulators of Chapter 28 or 29; or A change to a mixture of subheading 3808.30 from any other subheading, provided that the mixture is made from two or more active ingredients and a domestic active ingredient constitutes no less than 40 percent by weight of the total active ingredients.
3808.40	A change to subheading 3808.40 from any other subheading.
3808.90	A change to subheading 3808.90 from any other subheading, except from rodenticides and other pesticides of Chapter 28 or 29; or A change to a mixture of subheading 3808.90 from any other subheading, provided that the mixture is made from two or more active ingredients and a domestic active ingredient constitutes no less than 40 percent by weight of the total active ingredients.

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Chapter 72 Note: Notwithstanding the specific rules of this chapter, hot-rolled flat-rolled steel which is cold-reduced (by cold rolling) shall be treated as a good of the country in which the cold-rolled steel is produced.

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George J. Weise,

Commissioner of Customs.

Approved: June 19, 1995.

John P. Simpson,

Deputy Assistant Secretary of the Treasury.

[FR Doc. 95-17064 Filed 7-11-95; 8:45 am]

BILLING CODE 4820-02-P

19 CFR Part 162

RIN 1515-AB72

Search Warrants

AGENCY: U.S. Customs Service, Department of the Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document proposes to amend the Customs Regulations by removing a regulation limiting the authority of Customs officers to whom search warrants are issued. The current regulation restricts such officers from removing letters, documents and other

records in certain circumstances. The regulation is inconsistent with the current state of the law.

DATES: Comments must be received on or before September 11, 1995.

ADDRESSES: Written comments (preferably in triplicate) may be submitted to the Regulations Branch, Office of Regulations and Rulings, U.S. Customs Service, 1301 Constitution Avenue NW., Washington, DC 20229. Comments submitted may be inspected at the Regulations Branch, Office of Regulations and Rulings, 1099 14th Street NW., Suite 4000, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Lars-Erik Hjelm, Office of the Chief Counsel (202-927-6900).

SUPPLEMENTARY INFORMATION:

Background

Section 162.14, Customs Regulations (19 CFR 162.14) provides that Customs officers to whom a search warrant is issued may not remove letters, other documents and records, unless such letters, other documents and records are instruments of crime which are seized pursuant to a lawful arrest. The authority for this regulation, which has been in effect since at least 1915, is 19 U.S.C. 1595. Until 1986, section 1595 only authorized Customs to obtain warrants for merchandise.

In 1986, section 1595 was expanded to allow Customs to seize “* * * any document * * * which is evidence of a violation of * * * any law enforced or administered by the United States Customs Service.” Public Law 99-570, October 27, 1986.

Another statute indicating that the authority of Customs officers with warrants to seize documents has expanded is 19 U.S.C. 1589a(2). This statute makes it clear that Customs officers have authority for any warrant, including a Federal Rules of Criminal Procedure Rule 41 warrant. A Rule 41 warrant can be issued for documents constituting evidence of crimes. See Public Law 98-573, October 30, 1984; Fed. R. Crim. Proc. Rule 41. The sources cited clearly indicate Congress’ intent to provide Customs with the authority to search for and seize documentary evidence.

The Supreme Court has made it clear that officers may seize incriminating evidence in plain view during the course of a lawful search. See *United States v. Thompson*, 495 F. 2d 165 (D.C. Cir. 1974); *United States v. Michaelian*, 803 F. 2d 1042 (9th Cir. 1986). Also see *Horton v. California*, 496 U.S. 128 (1990), in which the Supreme Court held that the Fourth Amendment does

not prohibit the warrantless seizure of evidence in plain view even though the discovery of the evidence was not inadvertent. Although inadvertence is a characteristic of most legitimate plain-view searches, it is not a necessary condition.

Proposal

Inasmuch as § 162.14, Customs Regulations, no longer reflects the state of the law regarding the search and seizure authority of Customs officers, Customs intends to delete § 162.14 from the Customs Regulations.

Comments

Before adopting this proposal, consideration will be given to any written comments timely submitted to Customs. Comments submitted will be available for public inspection in accordance with the Freedom of Information Act (5 U.S.C. 552), § 1.4, Treasury Department Regulations (31 CFR 1.4), and § 103.11(b), Customs Regulations (19 CFR 103.11(b)), on regular business days between the hours of 9:00 a.m. and 4:30 p.m. at the Regulations Branch, Suite 4000, 1099 14th Street NW., Washington, DC.

Authority: This change is proposed under the authority of 5 U.S.C. 301 and 19 U.S.C. 66, 1624.

The Regulatory Flexibility Act and Executive Order 12866

Pursuant to the provisions of the Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) and based upon the information set forth above, it is certified that the proposed change in the regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, the proposed change is not subject to the regulatory analysis or other requirements of 5 U.S.C. 603 and 604.

This document does meet the criteria for a “significant regulatory action” as specified in Executive Order 12866.

Drafting Information

The principal author of this document was Janet L. Johnson, Regulations Branch. However, personnel from other offices participated in its development.

George J. Weise,

Commissioner of Customs.

Approved: June 20, 1995.

John P. Simpson,

Deputy Assistant Secretary of the Treasury.

[FR Doc. 95-17063 Filed 7-11-95; 8:45 am]

BILLING CODE 4820-02-P

Internal Revenue Service**26 CFR Parts 1 and 18**

[PS-268-82]

RIN 1545-AE94

Definitions Under Subchapter S of the Internal Revenue Code

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations for S corporations and their shareholders relating to the definitions and the special rule provided in section 1377 of the Internal Revenue Code of 1986. The proposed regulations reflect changes to the law made by the Subchapter S Revision Act of 1982. The proposed regulations are necessary to provide guidance needed by taxpayers to comply with the law.

DATES: Written comments and requests for a public hearing must be received by October 10, 1995.

ADDRESSES: Send submissions to: CC:DOM:CORP:T:R (PS-268-82), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:T:R (PS-268-82), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Brian J. O'Connor, (202) 622-3060; concerning submissions and the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION**Paperwork Reduction Act**

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act (44 U.S.C. 3504(h)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224.

A collection of information is required under § 1.1377-1(b). This information is required by the IRS to verify the event giving rise to the

making of an election under section 1377(a)(2) by an S corporation. The likely respondents and/or recordkeepers will be S corporations and shareholders of S corporations.

Estimated total annual reporting burden: 1,000 hours.

The estimated annual burden per respondent varies from .2 hour to .5 hour, depending on individual circumstances, with an estimated average of .25 hour.

Estimated number of respondents: 4,000.

Estimated annual frequency of responses: 1.

Background

This document proposes amendments to the Income Tax Regulations (26 CFR part 1) under section 1377 of the Internal Revenue Code (Code). Section 18.1377-1 was issued by TD 7872 (48 FR 3590). The proposed regulations would conform the regulations to the addition of section 1377 to the Code by section 2 of the Subchapter S Revision Act of 1982, Pub. L. 97-354 (1982-2 C.B. 702, 710).

Explanation of Provisions*Shareholder's Pro Rata Share of Items of Income, Loss, Deduction, and Credit*

Section 1366(a)(1) requires a shareholder of an S corporation to take into account the shareholder's pro rata share of the corporation's items of income, loss, deduction, and credit. The proposed regulations provide that, except in the case of an election under section 1377(a)(2), each shareholder's pro rata share of an item for a taxable year is the sum of the amounts determined with respect to the shareholder by assigning an equal portion of the item to each day of the S corporation's taxable year, and then dividing that portion pro rata among the shares outstanding on that day.

The proposed regulations contain several special rules for determining a shareholder's pro rata share. First, solely for purposes of determining a shareholder's pro rata share of an item, an S corporation's taxable year does not include any day on which the corporation has no shareholders. This rule ensures that the full amount of all items of the S corporation will be allocated to the corporation's shareholders. Second, a shareholder who disposes of stock of an S corporation is treated as the shareholder for the day of the disposition. Finally, a shareholder who dies is treated as the shareholder for the day of the shareholder's death.

Election To Treat Taxable Year as Separate Taxable Years

Under section 1377(a)(2), if a shareholder's interest in an S corporation is terminated during the taxable year and all persons who are shareholders during the taxable year agree, the corporation may elect (terminating election) to apply section 1377(a)(1) as if the taxable year of the S corporation consisted of two taxable years, the first of which ends on the date of the termination. The proposed regulations provide rules concerning the time and manner of making a terminating election and, therefore, it is proposed that § 18.1377-1 (which provides temporary rules concerning the time and manner of making a terminating election) be removed. The proposed regulations also provide that the terminating election is irrevocable and is effective only for the terminating event for which it is made.

The proposed regulations clarify that a terminating election may be made only if a shareholder's entire interest as a shareholder in the S corporation is terminated. A shareholder's entire interest as a shareholder is terminated under the proposed regulations on the occurrence of any event through which a shareholder's entire stock ownership in the S corporation ceases, including a sale, exchange, or other disposition of all of the stock held by the shareholder; a gift under section 102(a) of all the shareholder's stock; a spousal transfer under section 1041(a) of all the shareholder's stock; a redemption, as defined in section 317(b), of all of the shareholder's stock, regardless of the tax treatment of the redemption under section 302; and the death of the shareholder. A shareholder's entire interest in an S corporation is not terminated under the proposed regulations if the shareholder retains ownership of any stock that would result in the shareholder continuing to be considered a shareholder of the corporation for purposes of section 1362(a)(2). Thus, in determining whether a shareholder's entire interest in an S corporation has been terminated, any options held by the shareholder (other than options that are treated as stock under § 1.1361-1(l)(4)(iii)) and any interest in the S corporation held by the shareholder as a creditor, employee, director, or in any other non-shareholder capacity are disregarded.

The proposed regulations also describe the effects of a terminating election. Under the proposed regulations, an S corporation that makes a terminating election must treat its taxable year as two separate taxable

years for purposes of computing and allocating to each shareholder items of income (including tax-exempt income), loss, deduction, and credit; making adjustments to the accumulated adjustments account (AAA), earnings and profits, and basis; and determining the tax effect of a distribution to the shareholders. This treatment is required to give full effect to treating the taxable year as two separate taxable years. The proposed regulations also require the S corporation to assign items of income, loss, deduction, and credit to each deemed separate taxable year using the corporation's normal method of accounting as determined under section 446(a). The proposed regulations provide that a terminating election does not affect the due date of the S corporation's tax return for the taxable year or the time when the shareholders must include their pro rata allocations of items from the S corporation. The proposed regulations also provide that a terminating election by an S corporation that is a partner in a partnership is treated as a sale or exchange of the corporation's entire interest in the partnership for purposes of section 706(c) (closing of the partnership's taxable year) if the taxable year of the partnership ends after the shareholder's interest is terminated and within the full taxable year of the S corporation for which the terminating election is made. This rule conforms terminating elections with the rule for S termination years. See § 1.1362-3(c)(1).

The proposed regulations coordinate the application of the terminating election under section 1377(a)(2) with the election under section 1362(e)(3) (election to have items assigned to each short taxable year of an S termination year under normal accounting rules rather than pro rata) and the election under § 1.1368-1(g)(2) (election to terminate the taxable year when there is a qualifying disposition). Under the proposed regulations, if a transfer results in a termination of the shareholder's entire interest as a shareholder and the transfer also constitutes a qualifying disposition under § 1.1368-1(g)(2)(i), the terminating election rules under these proposed regulations take precedence and a qualifying disposition election cannot be made. If a termination of a shareholder's entire interest results in a termination under section 1362(d)(2) of the corporation's election to be an S corporation, however, the proposed regulations provide that the corporation may not make a terminating election. When a corporation's election to be an S corporation terminates, the portion of

the corporation's taxable year ending at the close of the day preceding the day for which the terminating event is effective is treated as an S short year, and the remainder is treated as a C short year. Thus, because the day upon which a terminating event occurs is the first day of a C short year, as of that date there is no S corporation taxable year that may be divided into two separate years under section 1377(a)(2). Under section 1362(e)(2), the income or loss for the entire S termination year is allocated on a pro rata basis between the S and C short years. However, if the corporation makes an election under section 1362(e)(3), the corporation allocates income and loss to each short taxable year under the corporation's normal tax accounting rules. Thus, when a corporation makes an election under section 1362(e)(3), a shareholder of an S corporation may achieve a result similar to the result of an election under section 1377(a)(2) and these proposed regulations (which also require an allocation of income and loss to each short taxable year under normal accounting rules).

Post-Termination Transition Period

Section 1377(b) provides that the term *post-termination transition period* (PTTP) for purposes of subchapter S of chapter 1 of the Code means: (1) the period beginning on the day after the last day of the corporation's last taxable year as an S corporation and ending on the later of the day which is 1 year after such last day, or the due date for filing the return for the last taxable year as an S corporation (including extensions); and (2) the 120-day period beginning on the date of a determination that the corporation's election under section 1362(a) had terminated for a previous taxable year. The PTTP is relevant for purposes of section 1366(d)(3) (carryover of disallowed losses after the last taxable year for which a corporation is an S corporation) and section 1371(e) (distributions of money by a corporation with respect to its stock after termination of S corporation status).

The proposed regulations clarify that a PTTP arises following the termination under section 1362(d) of a corporation's S election. For example, a PTTP arises in the case of a C corporation that acquires the assets of an S corporation in a transaction to which section 381(a)(2) applies. However, if an S corporation acquires the assets of another S corporation in a transaction to which section 381(a)(2) applies, a PTTP does not arise. Instead, under § 1.1368-2(d)(2), the acquiring S corporation succeeds to and merges its AAA with

the AAA of the distributor or transferor S corporation.

The proposed regulations clarify that the last day of a corporation's last taxable year as an S corporation is the last day of the short S taxable year under section 1362(e)(1)(A) or the date of transfer in the event that a C corporation acquires the assets of an S corporation in a transaction to which section 381(a)(2) applies. The proposed regulations also provide that the special treatment under section 1371(e)(1) is available only to those shareholders who were shareholders in the S corporation at the time of the termination.

The proposed regulations provide additional guidance on the definition of a determination for purposes of ascertaining when a PTTP begins under section 1377(b)(1)(B). Under the proposed regulations, a determination includes a written agreement between an S corporation and the Commissioner that the corporation failed to qualify as an S corporation. The agreement must be signed by the appropriate district director and an authorized officer of the corporation. In addition, if there is no written agreement, a determination results from the expiration of the period specified in section 6226 for filing a petition for readjustment of a final S corporation administrative adjustment finding that the corporation failed to qualify as an S corporation, provided that no petition is filed prior to the expiration of the period. For corporations not subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A (dealing with the tax treatment of partnership items) a determination results from the expiration of the period for filing a petition under section 6213 for the shareholder's taxable year for which the Commissioner has made a finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period.

Effective Date

The regulations under section 1377 are proposed to apply to taxable years of an S corporation beginning after the date of publication as final regulations in the **Federal Register**.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 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) and the Regulatory

Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Brian J. O'Connor, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Parts 1 and 18

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 18 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

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

Section 1.1377-1 also issued under 26 U.S.C. 1377 (a)(2) and (c).

Par. 2. Sections 1.1377-0, 1.1377-1, 1.1377-2, and 1.1377-3 are added under the heading "Small Business Corporations and Their Shareholders" to read as follows:

§ 1.1377-0 Table of contents.

The following table of contents is provided to facilitate the use of §§ 1.1377-1 through 1.1377-3:

Sec. 1.1377-1 *Pro rata share.*

- (a) Computation of pro rata shares.
- (1) In general.
- (2) Special rules.

- (i) Days without shareholders.
- (ii) Determining shareholder for day of stock disposition.
- (b) Election to terminate year.
- (1) In general.
- (2) Effect of the terminating election.
- (i) In general.
- (ii) Due date of S corporation return.
- (iii) Taxable year of inclusion by shareholder.
- (iv) S Corporation that is a partner in a partnership.
- (3) Determination of whether an S shareholder's entire interest has terminated.
- (4) Time and manner of making terminating election.
- (i) In general.
- (ii) Shareholders required to consent.
- (iii) More than one terminating election.
- (c) Examples.

Sec. 1.1377-2 *Post-termination transition period.*

- (a) In general.
- (b) When a post-termination transition period arises.
- (c) Last day of last taxable year.
- (d) Determination defined.
- (e) Time of determination.
- (1) Court decision.
- (2) Closing agreement.
- (3) Written agreement.
- (4) Implied agreement.

Sec. 1.1377-3 *Effective date.*

§ 1.1377-1 *Pro rata share.*

(a) *Computation of pro rata shares—*
(1) *In general.* For purposes of subchapter S of chapter 1 of the Code and this section, each shareholder's pro rata share of any S corporation item described in section 1366(a) for any taxable year is the sum of the amounts determined with respect to the shareholder by assigning an equal portion of the item to each day of the S corporation's taxable year, and then dividing that portion pro rata among the shares outstanding on that day. See paragraph (b) of this section for rules pertaining to the computation of each shareholder's pro rata share when an election is made under section 1377(a)(2) to treat the taxable year of an S corporation as if it consisted of two taxable years in the case of a termination of a shareholder's entire interest in the corporation.

(2) *Special rules—*(i) *Days without shareholders.* Solely for purposes of determining a shareholder's pro rata share of an item for a taxable year under section 1377(a) and this section, an S corporation's taxable year does not include any day on which the corporation has no shareholders.

(ii) *Determining shareholder for day of stock disposition.* A shareholder who disposes of stock in an S corporation is treated as the shareholder for the day of the disposition. A shareholder who dies

is treated as the shareholder for the day of the shareholder's death.

(b) *Election to terminate year—*(1) *In general.* If a shareholder's entire interest in an S corporation is terminated during the S corporation's taxable year and all persons who are shareholders during the taxable year agree (as prescribed in paragraph (b)(4) of this section), the S corporation may elect under section 1377(a)(2) and this paragraph (b) (terminating election) to treat its taxable year as if it consisted of two separate taxable years, the first of which ends at the close of the day on which the shareholder's entire interest in the S corporation is terminated. If the event resulting in the termination of the shareholder's entire interest also constitutes a qualifying disposition as described in § 1.1368-1(g)(2), the election under § 1.1368-1(g)(2) cannot be made. An S corporation may not make a terminating election if the cessation of a shareholder's interest occurs in a transaction which results in a termination under section 1362(d)(2) of the corporation's election to be an S corporation. (See section 1362(e)(3) for an election to have items assigned to each short taxable year under normal tax accounting rules in the case of a termination of a corporation's election to be an S corporation.) A terminating election is irrevocable and is effective only for the terminating event for which it is made.

(2) *Effect of the terminating election—*
(i) *In general.* An S corporation that makes a terminating election for a taxable year must treat the taxable year as separate taxable years for purposes of allocating items of income (including tax-exempt income), loss, deduction, and credit; making adjustments to the accumulated adjustments account, earnings and profits, and basis; and determining the tax effect of a distribution to the shareholders. An S corporation that makes a terminating election must assign items of income (including tax-exempt income), loss, deduction, and credit to each deemed separate taxable year using its normal method of accounting as determined under section 446(a).

(ii) *Due date of S corporation return.* A terminating election does not affect the due date of the S corporation's return required to be filed under section 6037(a) for a taxable year (determined without regard to a terminating election).

(iii) *Taxable year of inclusion by shareholder.* A terminating election does not affect the taxable year in which a shareholder (including any shareholder whose entire interest in the corporation has terminated during the

corporation's taxable year) must take into account the shareholder's pro rata share of the S corporation's items of income, loss, deduction, and credit.

(iv) *S corporation that is a partner in a partnership.* A terminating election by an S corporation that is a partner in a partnership is treated as a sale or exchange of the corporation's entire interest in the partnership for purposes of section 706(c) (relating to closing the partnership taxable year), if the taxable year of the partnership ends after the shareholder's interest is terminated and within the taxable year of the S corporation (determined without regard to any terminating election) for which the terminating election is made.

(3) *Determination of whether an S shareholder's entire interest has terminated.* For purposes of section 1377(a)(2) and paragraph (b) of this section, a shareholder's entire interest in an S corporation is terminated on the occurrence of any event through which a shareholder's entire stock ownership in the S corporation ceases, including a sale, exchange, or other disposition of all of the stock held by the shareholder; a gift under section 102(a) of all the shareholder's stock; a spousal transfer under section 1041(a) of all the shareholder's stock; a redemption, as defined in section 317(b), of all the shareholder's stock, regardless of the tax treatment of the redemption under section 302; and the death of the shareholder. A shareholder's entire interest in an S corporation is not terminated if the shareholder retains ownership of any stock that would result in the shareholder continuing to be considered a shareholder of the corporation for purposes of section 1362(a)(2). Thus, in determining whether a shareholder's entire interest in an S corporation has been terminated, any options held by the shareholder (other than options that are treated as stock under § 1.1361-1(l)(4)(iii) and any interest held by the shareholder as a creditor, employee, director, or in any other non-shareholder capacity are disregarded. (See § 1.1361-1(l)(4)(iii) for circumstances under which an option is treated as stock of the corporation and, therefore, the holder of the option is treated as owning a stock interest in the corporation.)

(4) *Time and manner of making terminating election—(i) In general.* An S corporation makes a terminating election by attaching a statement to its timely filed original or amended return required to be filed under section 6037(a) (that is, a Form 1120S) for the taxable year during which a shareholder's entire interest is terminated. A single election statement

may be filed by the S corporation for all terminating elections for the taxable year. The election statement must include—

(A) A declaration by the S corporation that it is electing under section 1377(a)(2) and § 1.1377-1(b) to treat the taxable year as if it consisted of two separate taxable years;

(B) Information setting forth when and how the shareholder's entire interest was terminated (for example, a sale or gift);

(C) The signature on behalf of the S corporation of an authorized officer of the corporation under penalties of perjury; and

(D) A notice of consent, signed by each person who is a shareholder in the S corporation during the taxable year (determined without regard to the terminating election), including any shareholder whose entire interest terminates during the taxable year, in which each shareholder consents to the S corporation making the terminating election.

(ii) *Shareholders required to consent.* For purposes of paragraph (b)(4)(i)(D) of this section, a shareholder of the S corporation for the taxable year is a shareholder as described in section 1362(a)(2). For example, the person who under § 1.1362-6(b)(2) must consent to a corporation's S election in certain special cases is the person who must consent to the terminating election. In addition, an executor or administrator of an estate of a deceased shareholder may consent to the terminating election on behalf of the deceased shareholder.

(iii) *More than one terminating election.* A shareholder whose entire interest in an S corporation is terminated in an event for which a terminating election was made is not required to consent to a terminating election made with respect to a subsequent termination within the same taxable year of the entire interest of another shareholder.

(c) *Examples.* The following examples illustrate the provisions of this section.

Example 1. General rule. (i) On January 2, 1997, X, a calendar year corporation, is incorporated. On January 4, 1997, X acquires assets. On January 6, 1997, X issues 100 shares of common stock to each of A and B and files an election to be an S corporation effective for its 1997 taxable year. During its 1997 taxable year, X has nonseparately computed income (as defined in section 1366(a)(2)) of \$720,000.

(ii) Each shareholder's pro rata share of X's nonseparately computed income for 1997 is determined by assigning an equal portion of the income to each day of X's taxable year on which X had shareholders. In the present case, there are only 360 days on which X had shareholders because X had no shareholders

until January 6, 1997. Thus, \$2,000 of nonseparately computed income is assigned to each day that X had shareholders ($\$720,000/360 \text{ days} = \$2,000 \text{ per day}$). The amount assigned to each day is multiplied by the percentage of shares held by the shareholder on that day. Because A and B each owned 50 percent of the shares of stock outstanding on each day that X had shareholders, each shareholder's daily pro rata share of X's nonseparately computed income is \$1,000 ($\$2,000 \text{ per day} \times 50\%$). Finally, the amounts of each shareholder's daily pro rata shares are aggregated to produce the shareholder's pro rata share of X's nonseparately computed income for 1997. During 1997, A and B each held X stock for 360 days. Thus, each shareholder's pro rata share of X's nonseparately computed income for 1997 is \$360,000 ($\$1,000 \text{ per day} \times 360 \text{ days}$).

Example 2. Shareholder's pro rata share in the case of a partial disposition of stock. (i) X, a newly incorporated calendar year corporation, issues 100 shares of common stock on January 6, 1997, to each of A and B and files an election to be an S corporation for its 1997 taxable year. On July 24, 1997, B sells 50 shares of X stock to C. Thus, in 1997, A owned 50 percent of the outstanding shares of X on each day of X's 1997 taxable year on which X had shareholders, B owned 50 percent on each day from January 6, 1997, to July 24, 1997 (200 days), and 25 percent from July 25, 1997, to December 31, 1997 (160 days), and C owned 25 percent from July 25, 1997, to December 31, 1997 (160 days).

(ii) Because B's entire interest in X is not terminated when B sells 50 shares to C on July 24, 1997, X cannot make a terminating election under section 1377(a)(2) and paragraph (b) of this section for B's sale of 50 shares to C. Although B's sale of 50 shares to C is a qualifying disposition under § 1.1368-1(g)(2)(i), X does not make an election to terminate its taxable year under § 1.1368-1(g)(2). During its 1997 taxable year, X has nonseparately computed income of \$720,000.

(iii) For each day in X's 1997 taxable year, A's daily pro rata share of X's nonseparately computed income is \$1,000 ($\$720,000/360 \text{ days} \times 50\%$). Thus, A's pro rata share of X's nonseparately computed income for 1997 is \$360,000 ($\$1,000 \times 360 \text{ days}$). B's daily pro rata share of X's nonseparately computed income is \$1,000 ($\$720,000/360 \times 50\%$) for the first 200 days of X's taxable year on which X has shareholders, and \$500 ($\$720,000/360 \times 25\%$) for the following 160 days in 1997. Thus, B's pro rata share of X's nonseparately computed income for 1997 is \$280,000 ($(\$1,000 \times 200 \text{ days}) + (\$500 \times 160 \text{ days})$). C's daily pro rata share of X's nonseparately computed income is \$500 ($\$720,000/360 \times 25\%$) for 160 days in 1997. Thus, C's pro rata share of X's nonseparately computed income for 1997 is \$80,000 ($\$500 \times 160 \text{ days}$).

Example 3. Shareholder's pro rata share when an S corporation makes a terminating election under section 1377(a)(2). (i) On January 6, 1997, X, a newly incorporated calendar year corporation, issues 100 shares of common stock to each of A and B and files an election to be treated as an S corporation for its 1997 taxable year. On July 24, 1997,

B sells B's entire 100 shares of X corporation stock to C. During its 1997 taxable year, X has nonseparately computed income of \$720,000. X makes an election under section 1377(a)(2) and paragraph (b) of this section for the termination of B's entire interest arising from B's sale of 100 shares to C. As a result of the election, each shareholder's pro rata share is determined as if X's taxable year consisted of two separate taxable years, the first of which ends on July 24, 1997, the date B's entire interest in X terminates.

(ii) Under X's normal method of accounting, \$200,000 of the \$720,000 of nonseparately computed income is allocable to the period of January 6, 1997, through July 24, 1997 (the first deemed taxable year), and the remaining \$520,000 is allocable to the period of July 25, 1997, through December 31, 1997 (the second deemed taxable year).

(iii) The pro rata share of the \$200,000 of nonseparately computed income for each of A and B for the first deemed taxable year is determined by assigning the \$200,000 of nonseparately computed income to each day of the first deemed taxable year ($\$200,000/200 \text{ days}=\$1,000 \text{ per day}$). Thus, for each day of the first deemed taxable year, \$1,000 is allocated between A and B based on their proportionate stock ownership. Because A and B each held 50% of X's authorized and issued shares on each day of the first deemed taxable year, the daily pro rata share for each of A and B for each day of the first deemed taxable year is \$500 ($\$1,000 \text{ per day} \times 50\%$). Thus, each shareholder's pro rata share of the \$200,000 of nonseparately computed income for the first deemed taxable year is \$100,000 ($\$500 \text{ per day} \times 200 \text{ days}$). A and B must report these amounts for their respective taxable years with or within which X's full taxable year ends (December 31, 1997).

(iv) The pro rata share of the \$520,000 of nonseparately computed income for each of A and C for the second deemed taxable year is determined by assigning the \$520,000 of nonseparately computed income to each day of the second deemed taxable year ($\$520,000/160 \text{ days}=\$3,250 \text{ per day}$). Thus, for each day of the second deemed taxable year, \$3,250 is allocated between A and C based on their proportionate ownership. Because A and C each held 50% of X's authorized and issued shares on each day of the second deemed taxable year, the daily pro rata shares for each of A and C for each day of the second deemed taxable year is \$1,625 ($\$3,250 \text{ per day} \times 50\%$). Therefore, each shareholder's pro rata share of the \$520,000 nonseparately computed income is \$260,000 ($\$1,625 \text{ per day} \times 160 \text{ days}$). A and C must report these amounts for their respective taxable years with or within which X's full taxable year ends (December 31, 1997).

Example 4. Interaction between the terminating election under section 1377(a)(2) and section 1362(e). (i) On January 1, 1997, X, a calendar year S corporation, has two shareholders, A and B, owning 60 shares and 40 shares, respectively. On June 29, 1997, B sells B's 40 shares to C. On July 20, 1997, C sells C's 40 shares to P, a partnership, causing a termination under section 1362(d)(2) of X's election to be an S corporation. X makes an election under section 1377(a)(2) and paragraph (b) of this

section with regard to the termination of B's entire interest on June 29, 1997. Because the termination on July 20, 1997, of C's entire interest results in a termination of X's election to be an S corporation, X cannot make a terminating election under section 1377(a)(2) and paragraph (b) of this section with regard to C's sale of 40 shares to P. However, X makes an election under section 1362(e)(3) to assign items to each short taxable year of the S termination year under X's normal method of accounting. X has nonseparately computed income of \$530,000 for its 1997 taxable year.

(ii) As a result of the election under section 1362(e)(3), the portion of X's taxable year ending at the close of the day prior to the termination of X's S corporation election (January 1, 1997, through July 19, 1997) is treated as a short taxable year for which X is an S corporation, and the portion of the year beginning on the day the termination is effective (July 20, 1997, through December 31, 1997) is treated as a short taxable year for which X is a C corporation. Under X's normal method of accounting, \$200,000 of the \$530,000 of X's taxable income is allocable to the S short year and the remaining \$330,000 is allocable to the C short year. Of the \$200,000 allocable to the S short year, \$90,000 is allocable to the first deemed taxable year (January 1, 1997, through June 29, 1997) (180 days), and \$110,000 is allocable to the second deemed taxable year (June 30, 1997, through July 19, 1997) (20 days) under X's normal method of accounting.

(iii) Each shareholder's pro rata share of X's income for the first deemed taxable year within the S short year is determined as follows. Because A owns 60% of the stock outstanding during the first deemed taxable year, A's pro rata share for that period is \$54,000 ($\$90,000/180 \text{ days in the period} \times 60\% \times 180 \text{ days}$). B's pro rata share for that period, reflecting B's 40% ownership, is \$36,000 ($\$90,000/180 \text{ days in the period} \times 40\% \times 180 \text{ days}$). A and B must report these amounts for their respective taxable years with or within which the S termination year ends (December 31, 1997).

(iv) Each shareholder's pro rata share of X's income for the second deemed taxable year within the S short year is determined as follows. Because A owns 60% of the stock outstanding during the second deemed taxable year, A's pro rata share for that period is \$66,000 ($\$110,000/20 \text{ days in the period} \times 60\% \times 20 \text{ days}$). C's pro rata share for that period, reflecting C's 40% ownership, is \$44,000 ($\$110,000/20 \text{ days in the period} \times 40\% \times 20 \text{ days}$). A and C must report these amounts for their respective taxable years with or within which the S termination year ends (December 31, 1997).

§ 1.1377-2 Post-termination transition period.

(a) *In general.* For purposes of subchapter S of chapter 1 of the Code and this section, the term post-termination transition period means—

(1) The period beginning on the day after the last day of the corporation's last taxable year as an S corporation and ending on the later of—

(i) The day which is 1 year after such last day; or

(ii) The due date for filing the return for the last taxable year as an S corporation (including extensions); and

(2) The 120-day period beginning on the date of a determination that the corporation's election under section 1362(a) had terminated for a previous taxable year.

(b) *When a post-termination transition period arises.* A post-termination transition period arises following the termination under section 1362(d) of a corporation's S election. For example, a post-termination transition period arises if a C corporation acquires the assets of an S corporation in a transaction to which section 381(a)(2) applies. However, if an S corporation acquires the assets of another S corporation in a transaction to which section 381(a)(2) applies, a post-termination transition period does not arise. (See § 1.1368-2(d)(2) for the treatment of the acquisition of the assets of an S corporation by another S corporation in a transaction to which section 381(a)(2) applies.) The special treatment under section 1371(e)(1) of distributions of money by a corporation with respect to its stock during the post-termination transition period is available only to those shareholders who were shareholders in the S corporation at the time of the termination.

(c) *Last day of last taxable year.* For purposes of section 1377(b)(1)(A) and paragraph (a)(1) of this section, the last day of a corporation's last taxable year as an S corporation is—

(1) The last day of the short S taxable year under section 1362(e)(1)(A); or

(2) The date of transfer (within the meaning of section 381(a)(2)) in the event that a C corporation acquires the assets of an S corporation in a transaction to which section 381(a)(2) applies.

(d) *Determination defined.* For purposes of section 1377(b)(1)(B) and paragraph (a)(2) of this section, the term determination means—

(1) A court decision rendered by a court of competent jurisdiction;

(2) A closing agreement entered into between the Secretary and the taxpayer pursuant to section 7121;

(3) A written agreement between the corporation and the Commissioner (including a statement acknowledging that the corporation's election to be an S corporation terminated under section 1362(d)) that the corporation failed to qualify as an S corporation;

(4) For a corporation subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A,

the expiration of the period specified in section 6226 for filing a petition for readjustment of a final S corporation administrative adjustment finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period; and

(5) For a corporation not subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A, the expiration of the period for filing a petition under section 6213 for the shareholder's taxable year for which the Commissioner has made a finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period.

(e) *Time of determination*—(1) *Court decision*. A court decision becomes a determination on the date the decision becomes final under rules applicable to the court rendering the decision.

(2) *Closing agreement*. A closing agreement becomes a determination on the date of its approval by the Commissioner.

(3) *Written agreement*. A written agreement described in paragraph (d)(3) of this section becomes a determination when it is signed by the district director having jurisdiction over the corporation (or by another Service official to whom authority to sign the agreement is delegated) and by an officer of the corporation authorized to sign on its behalf. Neither the request for a written agreement nor the terms of the written agreement suspend the running of any statute of limitations.

(4) *Implied agreement*. A determination under paragraph (d)(4) or (d)(5) of this section becomes effective on the day after the date of expiration of the period specified under section 6226 or 6213, respectively.

§ 1.1377-3 Effective date.

Sections 1.1377-1 and 1.1377-2 apply to taxable years of an S corporation beginning after [the date of publication as final regulations in the **Federal Register**].

PART 18—TEMPORARY INCOME TAX REGULATIONS UNDER THE SUBCHAPTER S REVISION ACT OF 1982

Par. 3. The authority citation for part 18 continues to read as follows:

Authority: 26 U.S.C. 7805 sec. (6)(c)(3)(B)(iii) of the Subchapter S Revision Act of 1982.

§ 18.1377-1 [Removed]

Par. 4. Section 18.1377-1 is removed.

Margaret Milner Richardson,

Commissioner of Internal Revenue.

[FR Doc. 95-16653 Filed 7-11-95; 8:45 am]

BILLING CODE 4830-01-U

DEPARTMENT OF THE INTERIOR

National Park Service

36 CFR Part 7

RIN 1024-AC29

Cape Lookout National Seashore; Operation of Aircraft

AGENCY: National Park Service.

ACTION: Proposed rule.

SUMMARY: The National Park Service (NPS) is proposing to close the Portsmouth Village Airstrip at Cape Lookout National Seashore, North Carolina, to the operation of aircraft. This action is necessary to prevent aircraft accidents and eliminate a use that is incompatible with preserving the historic scene in Portsmouth Village, a historic district listed on the National Register of Historic Places. The primary intent of this proposed rule is to protect the flying public by closing an airstrip that does not comply with Federal Aviation Administration and North Carolina Department of Transportation safety standards. Secondary goals include reducing the potential for an aircraft accident destroying one or more irreplaceable historic structures, eliminating the anachronistic intrusion of aircraft in a historic village and providing for the safety of park visitors who cross the runway as they walk from the Village to the beach. Aircraft noise and the visual intrusions detract from the visitor's opportunity to experience Portsmouth Village in a quiet setting, appropriate to the period it represents.

DATES: Written comments will be accepted through September 11, 1995.

ADDRESSES: All comments should be addressed to: Mr. William A. Harris, Superintendent, 131 Charles Street, Harkers Island, North Carolina 28531.

FOR FURTHER INFORMATION CONTACT: Charles F. Harris, Chief of Park Operations, 131 Charles Street, Harkers Island, North Carolina 28531; (919) 240-1409.

SUPPLEMENTARY INFORMATION:

Background

The Portsmouth Village Airstrip (Airstrip) is located on the northeast corner of Portsmouth Village (Village), NC. The Village is geographically

remote because of its location on a part of the outer banks (Core Banks) that is not connected to the mainland by bridge. The origins of Portsmouth Village can be traced back to 1752, when it was authorized by the Colonial Legislature of North Carolina. There are no permanent residents in this well-preserved "ghost town." The historical significance of Portsmouth Village is underscored by its listing on the National Register of Historic Places. Approximately 2,000+ people visit the Village annually.

Long-term residents in the Portsmouth Village area report that the unpaved Airstrip was constructed by private individuals for recreational use shortly after World War II. In this earlier period, the Airstrip was not as long as it is today, but was leveled and extended to its present approximate length of 1640 feet in 1959.

The NPS began managing the Airstrip after North Carolina ceded Core Banks to the Federal government to establish Cape Lookout National Seashore (Seashore) in 1976. Seashore management has maintained the grass surface and trimmed back encroaching woody vegetation to the extent that limited funding allows. In 1984, the NPS composed a regulation, Section 7.98(a), in Title 36, Code of Federal Regulations, legalizing aircraft operations on the Airstrip.

The NPS recently became concerned about potential hazards related to aircraft operations on the Airstrip. These concerns stem from a report by an inspector of the North Carolina Department of Transportation, Division of Aviation, that the airstrip does not meet the following Federal Aviation Administration runway standards:

Standard	Description
FAA, Part 77	Each end of the runway should have a 20 to 1 approach slope. (Obstacles should not exceed more than one foot of rise for every 20-foot increment of horizontal distance from the end of a runway).
FAA AC 150/5300-1300.	Each side of the runway centerline should be clear of obstacles by at least 125 feet.

Instead, brush and small trees up to 12 feet tall grow on the south end of the airstrip. Dense brush and trees growing on the airstrip edges narrow the area clear of obstacles from the centerline to an average of only 59 feet, less than half the recommended width.