§ 1.1374–6 Credits and credit carryforwards.

(a) In general. The credits and credit carryforwards allowed as credits against the section 1374 tax under section 1374(b)(3) are allowed only to the extent their use is allowed under the rules applying to C corporations. Any other credits or credit carryforwards, such as foreign tax credits under section 901, are not allowed as credits against the section 1374 tax.

(b) Limitations. The amount of business credit carryforwards and minimum tax credit allowed against the section 1374 tax are subject to the limitations described in section 38(c) and section 53(c), respectively, as modified by this paragraph. The tentative tax determined under paragraph (a)(3) of § 1.1374–1 is treated as the regular tax liability described in sections 38(c)(1) and 53(c)(1), and as the net income tax and net regular tax liability described in section 38(c)(1). The tentative minimum tax described in section 55(b) is determined using the rate of tax applicable to corporations and without regard to any alternative minimum tax.

2, modified to take into account the adjustments of sections 56 and 58 applicable to corporations and the preferences of section 57, as the alternative minimum taxable income described in section 55(b)(2).

(c) Examples. The rules of this section are illustrated by the following examples.

Example 1. Business credit carryforward. X is a C corporation that elects to become an S corporation effective January 1, 1996. On that date, X has a $500,000 business credit carryforward from a C year and Asset #1 with a fair market value of $400,000, a basis for regular tax purposes of $150,000, and a basis for alternative minimum tax purposes of $150,000. In 1996, X has net recognized built-in gain of $305,000 from selling Asset #1 for $5,000,000. Thus, X's tentative tax under paragraph (a)(3) of §1.1374–1 and regular tax liability under paragraph (b) of this section is $106,750 ($400,000 – $305,000 = $95,000, assuming a 35 percent tax rate). Also, X's tentative minimum tax determined under paragraph (b) of this section is $47,000 ($400,000 – $150,000 = $250,000 × .20 = $47,000, assuming a 20 percent tax rate). Thus, X's section 1374 tax is $47,000 ($106,750 – $47,000) for 1996 and X has a $59,750 ($106,750 – $47,000) corporate exemption amount for $400,000. Thus, X's tentative tax under paragraph (a)(3) of §1.1374–1 and regular tax liability under paragraph (b) of this section is $106,750 ($400,000 – $305,000 = $81,750, assuming a 35 percent tax rate). Also, X's tentative minimum tax determined under paragraph (b) of this section is $47,000 ($400,000 – $150,000 = $250,000 × .20 = $47,000, assuming a 20 percent tax rate). Thus, the business credit limitation under section 38(c) is $59,750 ($106,750 – $47,000) (the greater of $47,000 or $20,438 (.25 × $81,750 ($106,750 – $25,000 = $81,750)) = $59,750). As a result, X's section 1374 tax is $47,000 ($106,750 – $59,750 = $47,000) for 1996 and X has $303,000 ($350,000 – $47,000 = $303,000) of business credit carryforwards for succeeding taxable years.

Example 2. Minimum tax credit. Y is a C corporation that elects to become an S corporation effective January 1, 1996. On that date, Asset #1 has a fair market value of $5,000,000, a basis for regular tax purposes of $4,000,000, and a basis for alternative minimum tax purposes of $4,750,000. Y also has a minimum tax credit of $310,000 from 1995. Y has no other assets, no net operating or capital loss carryforwards, and no business credit carryforwards. In 1996, Y's only transaction is the sale of Asset #1 for $5,000,000. Therefore, Y has net recognized built-in gain in 1996 of $1,050,000 ($5,000,000 – $4,000,000 = $1,050,000) and a tentative tax under paragraph (a)(3) of §1.1374–1 of $350,000 ($1,050,000 × .35 = $350,000, assuming a 35 percent tax rate). Also, Y's tentative minimum tax determined under paragraph (b) of this section is $47,000 ($350,000 – $150,000 = $250,000 × .20 = $47,000, assuming a 20 percent tax rate). Thus, Y may use its minimum tax credit in the amount of $303,000 ($350,000 – $47,000 = $303,000) to offset its section 1374 tentative tax. As a result, Y's section 1374 tax is $47,000 ($350,000 – $303,000 = $47,000) in 1996 and Y has a minimum tax credit attributable to years for which Y was a C corporation of $7,000 ($310,000 – $303,000 = $7,000).


§ 1.1374–7 Inventory.

(a) Valuation. The fair market value of the inventory of an S corporation on the first day of the recognition period equals the amount that a willing buyer would pay a willing seller for the inventory in a purchase of all the S corporation's assets by a buyer that expects to continue to operate the S corporation's business. For purposes of the preceding sentence, the buyer and seller are presumed not to be under any compulsion to buy or sell and to have reasonable knowledge of all relevant facts.

(b) Identity of dispositions. The inventory method used by an S corporation for tax purposes must be used to identify whether the inventory it disposes of during the recognition period is inventory it held on the first day of that period. Thus, a corporation using the LIFO method does not dispose of inventory it held on the first day of the recognition period unless the carrying value of its inventory for a taxable year during that period is less than the carrying value of its inventory on the first day of the recognition period (determined using the LIFO method as described in section 472). However, if a corporation changes its method of accounting for inventory (for example, from the FIFO method to the LIFO method or from the LIFO method to the FIFO method) with a principal purpose of avoiding the tax imposed under section 1374, it must use its former method to identify its dispositions of inventory.


§ 1.1374–8 Section 1374(d)(8) transactions.

(a) In general. If any S corporation acquires any asset in a transaction in which the S corporation's basis in the asset is determined (in whole or in part) by reference to a C corporation's basis in the assets (or any other property) (a section 1374(d)(8) transaction),