

26 CFR Part 1**[PS-7-89]****RIN 1545-AM98****Treatment of Gain From the Disposition of Interest in Certain Natural Resource Recapture Property by S Corporations and Their Shareholders****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 1254 of the Internal Revenue Code relating to the tax treatment by S corporations and their shareholders of gain from the disposition by an S corporation (and a former S corporation) of certain natural resource recapture property (section 1254 property after enactment of the Tax Reform Act of 1986 and oil, gas, or geothermal property before enactment of the Tax Reform Act of 1986), and also rules relating to the disposition of stock in an S corporation that holds certain natural resource recapture property. Changes to the applicable tax law were made by the Tax Reform Act of 1986, and the Subchapter S Revision Act of 1982. The regulations provide the public with guidance in complying with the changed tax laws.

DATES: Written comments and requests for a public hearing must be received by February 20, 1996.

ADDRESSES: Send comments and requests for a public hearing to: CC:DOM:CORP:R (PS-7-89), room 5228, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand-delivered to CC:DOM:CORP:R (PS-7-89), Room 5228, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: James A. Quinn, 202-622-3060 (not a toll-free number).

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 (OMB) for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507).

Comments on the collection 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. Comments on the collection of information should be received by January 22, 1996.

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

The collection of information is contained in § 1.1254-4(c) of the proposed regulations. This information is required by the Internal Revenue Service to verify that taxpayers have reported the appropriate amount of gain as ordinary income under section 1254 when a shareholder sells stock in an S corporation that holds natural resource recapture property. The likely respondents are individuals and businesses and other for-profit institutions.

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

Estimated total annual reporting burden: 1,000 hours. The estimated annual burden per respondent varies from .5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of respondents: 1,000.

Estimated annual frequency of responses: On occasion.

Background

On June 11, 1980, proposed amendments to the Income Tax Regulations, 26 CFR part 1, under sections 170, 301, 312, 341, 453, 751, 1254, and 1502 of the Internal Revenue Code of 1954 (Code) were published in the Federal Register (45 FR 39512). These amendments were proposed to conform the regulations to section 205(a), (b), (c)(1) and (2) of the Tax Reform Act of 1976, Public Law 94-455, 90 Stat. 1533, and section 402(c) of the Energy Tax Act of 1978, Public Law 95-618, 92 Stat. 3202, and to make certain other technical amendments to the regulations to conform them to section 1(c) of the Act of September 12, 1966, Public Law 89-570, 80 Stat. 762, section 211(b)(6) of the Tax Reform Act of 1969, Public Law 91-172, 83 Stat. 570, and sections 1042(c)(2), 1101(d)(2), 1901(a)(93), and 2110(a) of the Tax Reform Act of 1976, 90 Stat. 1637, 1658,

1780, 1905. Section 1.1254-3 of the proposed regulations provided rules relating to the sale or exchange of stock in an electing small business corporation (hereinafter referred to as an S corporation). Because of the substantial changes in the tax treatment of S corporations since the proposed regulations were issued, the proposed regulations contained in § 1.1254-3 needed to be completely revised.

This document revises and repropose § 1.1254-3 of the above-referenced notice of proposed rulemaking as amendments to the Income Tax Regulations, 26 CFR part 1, under section 1254 of the Code, relating to S corporations (redesignated as § 1.1254-4). These amendments are proposed to conform the regulations to section 5(a)(37) of the Subchapter S Revision Act of 1982, Public Law 97-354, 96 Stat. 1669, and sections 411 and 413 of the Tax Reform Act of 1986, Public Law 99-514, 100 Stat. 2225, 2227. The amendments are to be issued under the authority contained in sections 1254(b) and 7805 of the Code.

Explanation of Provisions

These proposed regulations contain rules for applying the provisions of section 1254 to the disposition of natural resource recapture property by an S corporation (and a former S corporation) and the disposition of S corporation stock.

The proposed regulations provide that the recognition of ordinary income under section 1254 upon the disposition of natural resource recapture property by an S corporation is generally computed at the shareholder level. Determining the amount of ordinary income to be recognized under section 1254 at the shareholder level is appropriate because the determination of section 1254 costs can be affected by shareholder elections and characteristics. See, for example, sections 59(e) and 1363(c)(2)(A). Similarly, in the case of oil and gas properties, gain on the disposition of the property and depletion with respect to the property are computed at the shareholder level. See section 613A(c)(11).

The proposed regulations also contain rules relating to the recognition of ordinary income under section 1254 upon a sale or exchange of S corporation stock. Under section 1254(b)(2), rules similar to the rules of section 751 are to be applied to that portion of the excess of the amount realized over the adjusted basis of the stock that is attributable to section 1254 costs. Pursuant to section 1254(b)(2), the proposed regulations provide that, as a general rule, a