

corporation with respect to the shareholder. Such allocation shall be made according to any reasonable method, including a method based on the relative fair market value of the shareholder's stock in the distributing and controlled corporations immediately after the distribution, a method based on the relative adjusted basis of the assets in the distributing and controlled corporations immediately after the distribution, or, in the case of losses and deductions clearly attributable to either the distributing or controlled corporation, any method that allocates such losses and deductions accordingly.

[T.D. 8852, 64 FR 71646, Dec. 22, 1999]

§ 1.1366-3 Treatment of family groups.

(a) *In general.* Under section 1366(e), if an individual, who is a member of the family of one or more shareholders of an S corporation, renders services for, or furnishes capital to, the corporation without receiving reasonable compensation, the Commissioner shall prescribe adjustments to those items taken into account by the individual and the shareholders as may be necessary to reflect the value of the services rendered or capital furnished. For these purposes, in determining the reasonable value for services rendered, or capital furnished, to the corporation, consideration will be given to all the facts and circumstances, including the amount that ordinarily would be paid in order to obtain comparable services or capital from a person (other than a member of the family) who is not a shareholder in the corporation. In addition, for purposes of section 1366(e), if a member of the family of one or more shareholders of the S corporation holds an interest in a passthrough entity (e.g., a partnership, S corporation, trust, or estate), that performs services for, or furnishes capital to, the S corporation without receiving reasonable compensation, the Commissioner shall prescribe adjustments to the passthrough entity and the corporation as may be necessary to reflect the value of the services rendered or capital furnished. For purposes of section 1366(e), the term *family* of any shareholder includes only the shareholder's spouse, ancestors, lineal descendants, and any

trust for the primary benefit of any of these persons.

(b) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. The stock of an S corporation is owned 50 percent by F and 50 percent by T, the minor son of F. For the taxable year, the corporation has items of taxable income equal to \$70,000. Compensation of \$10,000 is paid by the corporation to F for services rendered during the taxable year, and no compensation is paid to T, who rendered no services. Based on all the relevant facts and circumstances, reasonable compensation for the services rendered by F would be \$30,000. In the discretion of the Internal Revenue Service, up to an additional \$20,000 of the \$70,000 of the corporation's taxable income, for tax purposes, may be allocated to F as compensation for services rendered. If the Internal Revenue Service allocates \$20,000 of the corporation's taxable income to F as compensation for services, taxable income of the corporation would be reduced by \$20,000 to \$50,000, of which F and T each would be allocated \$25,000. F would have \$30,000 of total compensation paid by the corporation for services rendered.

Example 2. The stock of an S corporation is owned by A and B. For the taxable year, the corporation has paid compensation to a partnership that rendered services to the corporation during the taxable year. The spouse of A is a partner in that partnership. Consequently, if based on all the relevant facts and circumstances the partnership did not receive reasonable compensation for the services rendered to the corporation, the Internal Revenue Service, in its discretion, may make adjustments to those items taken into account by the partnership and the corporation as may be necessary to reflect the value of the services rendered.

[T.D. 8852, 64 FR 71648, Dec. 22, 1999]

§ 1.1366-4 Special rules limiting the passthrough of certain items of an S corporation to its shareholders.

(a) *Passthrough inapplicable to section 34 credit.* Section 1.1366-1(a) does not apply to any credit allowable under section 34 (relating to certain uses of gasoline and special fuels).

(b) *Reduction in passthrough for tax imposed on built-in gains.* For purposes of § 1.1366-1(a), if for any taxable year of the S corporation a tax is imposed on the corporation under section 1374, the amount of the tax imposed is treated as a loss sustained by the S corporation during the taxable year. The character of the deemed loss is determined

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by allocating the loss proportionately among the net recognized built-in gains giving rise to the tax and attributing the character of each net recognized built-in gain to the allocable portion of the loss.

(c) *Reduction in passthrough for tax imposed on excess net passive income.* For purposes of § 1.1366-1(a), if for any taxable year of the S corporation a tax is imposed on the corporation under section 1375, each item of passive investment income shall be reduced by an amount that bears the same ratio to the amount of the tax as the net amount of the item bears to the total net passive investment income for that taxable year.

[T.D. 8852, 64 FR 71648, Dec. 22, 1999; 65 FR 12471, Mar. 9, 2000]

§ 1.1366-5 Effective date.

Sections 1.1366-1 through 1.1366-4 apply to taxable years of an S corporation beginning on or after August 18, 1998.

[T.D. 8852, 64 FR 71648, Dec. 22, 1999]

§ 1.1367-0 Table of contents.

The following table of contents is provided to facilitate the use of §§ 1.1367-1 through 1.1367-3.

§ 1.1367-1 Adjustments to basis of shareholder's stock in an S corporation.

- (a) In general.
 - (1) Adjustments under section 1367.
 - (2) Applicability of other Internal Revenue Code provisions.
- (b) Increase in basis of stock.
 - (1) In general.
 - (2) Amount of increase in basis of individual shares.
- (c) Decrease in basis of stock.
 - (1) In general.
 - (2) Noncapital, nondeductible expenses.
 - (3) Amount of decrease in basis of individual shares.
- (d) Time at which adjustments to basis of stock are effective.
 - (1) In general.
 - (2) Adjustment for nontaxable item.
 - (3) Effect of election under section 1377(a)(2) or § 1.1368-1(g)(2).
- (e) Ordering rules for taxable years beginning before January 1, 1997.
- (f) Ordering rules for taxable years beginning on or after August 18, 1998.
- (g) Elective ordering rule.
- (h) Examples.
- (i) [Reserved]

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(j) Adjustments for items of income in respect of a decedent.

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

- (a) In general.
- (b) Reduction in basis of indebtedness.
 - (1) General rule.
 - (2) Termination of shareholder's interest in corporation during taxable year.
 - (3) Multiple indebtedness.
- (c) Restoration of basis.
 - (1) General rule.
 - (2) Multiple indebtedness.
- (d) Time at which adjustments to basis of indebtedness are effective.
 - (1) In general.
 - (2) Effect of election under section 1377(a)(2) or § 1.1368-1(g)(2).
- (e) Examples.

§ 1.1367-3 Effective date and transition rule.

[T.D. 8508, 59 FR 15, Jan. 3, 1994, as amended by T.D. 8852, 64 FR 71648, Dec. 22, 1999]

§ 1.1367-1 Adjustments to basis of shareholder's stock in an S corporation.

(a) *In general*—(1) *Adjustments under section 1367.* This section provides rules relating to adjustments required by section 1367 to the basis of a shareholder's stock in an S corporation. Paragraph (b) of this section provides rules concerning increases in the basis of a shareholder's stock, and paragraph (c) of this section provides rules concerning decreases in the basis of a shareholder's stock.

(2) *Applicability of other Internal Revenue Code provisions.* In addition to the adjustments required by section 1367 and this section, the basis of stock is determined or adjusted under other applicable provisions of the Internal Revenue Code.

(b) *Increase in basis of stock*—(1) *In general.* Except as provided in § 1.1367-2(c) (relating to restoration of basis of indebtedness to the shareholder), the basis of a shareholder's stock in an S corporation is increased by the sum of the items described in section 1367(a)(1). The increase in basis described in section 1367(a)(1)(C) for the excess of the deduction for depletion over the basis of the property subject to depletion does not include the depletion deduction attributable to oil or gas property. See section 613(A)(c)(11).