

deemed dividend under § 1.1368-1(f) must include the amount of the deemed dividend that is distributed to each shareholder.

(f)(5)(iv) through (g)(2)(ii) [Reserved]. For further guidance, see § 1.1368-1(f)(5)(iv) through (g)(2)(ii).

(g)(2)(iii) *Time and manner of making election.* A corporation makes an election under § 1.1368-1(g)(2)(i) for a taxable year by attaching a statement to a timely filed original or amended return required to be filed under section 6037 for a taxable year (without regard to the election under § 1.1368-1(g)(2)(i)). In the statement, the corporation must state that it is electing for the taxable year under § 1.1368-1(g)(2)(i) to treat the taxable year as if it consisted of separate taxable years. The corporation also must set forth facts in the statement relating to the qualifying disposition (e.g., sale, gift, stock issuance, or redemption), and state that each shareholder who held stock in the corporation during the taxable year (without regard to the election under § 1.1368-1(g)(2)(i)) consents to this election. For purposes of this election, a shareholder of the corporation for the taxable year is a shareholder as described in section 1362(a)(2). A single election statement may be filed for all elections made under § 1.1368-1(g)(2)(i) for the taxable year. An election made under § 1.1368-1(g)(2)(i) of this section is irrevocable. In the case of elections for taxable years beginning before January 1, 2003, the statement through which a corporation makes an election under § 1.1368-1(g)(2)(i) must be signed by an officer of the corporation under penalties of perjury. In the case of elections for taxable years beginning after December 31, 2002, the statement described in the preceding sentence shall be verified by signing the return.

(g)(2)(iv) [Reserved]. For further guidance, see § 1.1368-1(g)(2)(iv).

[T.D. 9100, 68 FR 70706, Dec. 19, 2003]

**§ 1.1368-2 Accumulated adjustments account (AAA).**

(a) *Accumulated adjustments account—(1) In general.* The accumulated adjustments account is an account of the S corporation and is not apportioned among shareholders. The AAA is relevant for all taxable years beginning

on or after January 1, 1983, for which the corporation is an S corporation. On the first day of the first year for which the corporation is an S corporation, the balance of the AAA is zero. The AAA is increased in the manner provided in paragraph (a)(2) of this section and is decreased in the manner provided in paragraph (a)(3) of this section. For the adjustments to the AAA in the case of redemptions, liquidations, reorganizations, and corporate separations, see paragraph (d) of this section.

(2) *Increases to the AAA.* The AAA is increased for the taxable year of the corporation by the sum of the following items with respect to the corporation for the taxable year:

(i) The items of income described in section 1366(a)(1)(A) other than income that is exempt from tax;

(ii) Any nonseparately computed income determined under section 1366(a)(1)(B); and

(iii) The excess of the deductions for depletion over the basis of property subject to depletion unless the property is an oil or gas property the basis of which has been allocated to shareholders under section 613A(c)(11).

(3) *Decreases to the AAA—(i) In general.* The AAA is decreased for the taxable year of the corporation by the sum of the following items with respect to the corporation for the taxable year—

(A) The items of loss or deduction described in section 1366(a)(1)(A);

(B) Any nonseparately computed loss determined under section 1366(a)(1)(B);

(C) Any expense of the corporation not deductible in computing its taxable income and not properly chargeable to a capital account, other than—

(1) Federal taxes attributable to any taxable year in which the corporation was a C corporation; and

(2) Expenses related to income that is exempt from tax; and

(D) The sum of the shareholders' deductions for depletion for any oil or gas property held by the corporation described in section 1367(a)(2)(E).

(ii) *Extent of allowable reduction.* The AAA may be decreased under paragraph (a)(3)(i) of this section below zero. The AAA is decreased by noncapital, nondeductible expenses under paragraph (a)(3)(i)(C) of this section

even though a portion of the noncapital, nondeductible expenses is not taken into account by a shareholder under § 1.1367-1(g) (relating to the elective ordering rule). The AAA is also decreased by the entire amount of any loss or deduction even though a portion of the loss or deduction is not taken into account by a shareholder under section 1366(d)(1) or is otherwise not currently deductible under the Internal Revenue Code. However, in any subsequent taxable year in which the loss, deduction, or noncapital, nondeductible expense is treated as incurred by the corporation with respect to the shareholder under section 1366(d)(2) or § 1.1367-1(g) (or in which the loss or deduction is otherwise allowed to the shareholder), no further adjustment is made to the AAA.

(iii) *Decrease to the AAA for distributions.* The AAA is decreased (but not below zero) by any portion of a distribution to which section 1368 (b) or (c)(1) applies.

(4) *Ordering rules for the AAA for taxable years beginning before January 1, 1997.* For any taxable year beginning before January 1, 1997, the adjustments to the AAA are made in the following order—

(i) The AAA is increased under paragraph (a)(2) of this section before it is decreased under paragraph (a)(3) of this section for the taxable year;

(ii) The AAA is decreased under paragraph (a)(3)(i) of this section before it is decreased under paragraph (a)(3) (ii) of this section;

(iii) The AAA is decreased (but not below zero) by any portion of an ordinary distribution to which section 1368 (b) or (c)(1) applies; and

(iv) The AAA is adjusted (whether negative or positive) for redemption distributions under paragraph (d)(1) of this section.

(5) *Ordering rules for the AAA for taxable years beginning on or after August 18, 1998.* For any taxable year of the S corporation beginning on or after August 18, 1998, the adjustments to the AAA are made in the following order—

(i) The AAA is increased under paragraph (a)(2) of this section before it is decreased under paragraph (a)(3)(i) of this section for the taxable year;

(ii) The AAA is decreased under paragraph (a)(3)(i) of this section (without taking into account any net negative adjustment (as defined in section 1368(e)(1)(C)(ii)) before it is decreased under paragraph (a)(3)(iii) of this section;

(iii) The AAA is decreased (but not below zero) by any portion of an ordinary distribution to which section 1368(b) or (c)(1) applies;

(iv) The AAA is decreased by any net negative adjustment (as defined in section 1368(e)(1)(C)(ii)); and

(v) The AAA is adjusted (whether negative or positive) for redemption distributions under paragraph (d)(1) of this section.

(b) *Distributions in excess of the AAA—*  
(1) *In general.* A portion of the AAA (determined under paragraph (b)(2) of this section) is allocated to each of the distributions made for the taxable year if—

(i) An S corporation makes more than one distribution of property with respect to its stock during the taxable year of the corporation (including an S short year as defined under section 1362(e)(1)(A));

(ii) The AAA has a positive balance at the close of the year; and

(iii) The sum of the distributions made during the corporation's taxable year exceeds the balance of the AAA at the close of the year.

(2) Amount of the AAA allocated to each distribution. The amount of the AAA allocated to each distribution is determined by multiplying the balance of the AAA at the close of the current taxable year by a fraction, the numerator of which is the amount of the distribution and the denominator of which is the amount of all distributions made during the taxable year. For purposes of this paragraph (b)(2), the term *all distributions made during the taxable year* does not include any distribution treated as from earnings and profits or previously taxed income pursuant to an election made under section 1368(e)(3) and § 1.1368-1(f)(2). See paragraph (d)(1) of this section for rules relating to the adjustments to the AAA for redemptions and distributions in the year of a redemption.

(c) *Distribution of money and loss property—*(1) *In general.* The amount of the

AAA allocated to a distribution under this section must be further allocated (under paragraph (c)(2) of this section) if the distribution—

(i) Consists of property the adjusted basis of which exceeds its fair market value on the date of the distribution and money;

(ii) Is a distribution to which § 1.1368-1(d)(1) applies; and

(iii) Exceeds the amount of the corporation's AAA properly allocable to that distribution.

(2) *Allocating the AAA to loss property.* The amount of the AAA allocated to the property other than money is equal to the amount of the AAA allocated to the distribution multiplied by a fraction, the numerator of which is the fair market value of the property other than money on the date of distribution and the denominator of which is the amount of the distribution. The amount of the AAA allocated to the money is equal to the amount of the AAA allocated to the distribution reduced by the amount of the AAA allocated to the property other than money.

(d) *Adjustment in the case of redemptions, liquidations, reorganizations, and divisions—(1) Redemptions—(i) General rule.* In the case of a redemption distribution by an S corporation that is treated as an exchange under section 302(a) or section 303(a) (a *redemption distribution*), the AAA of the corporation is adjusted in an amount equal to the ratable share of the corporation's AAA (whether negative or positive) attributable to the redeemed stock as of the date of the redemption.

(ii) *Special rule for years in which a corporation makes both ordinary and redemption distributions.* In any year in which a corporation makes one or more distributions to which section 1368(a) applies (*ordinary distributions*) and makes one or more redemption distributions, the AAA of the corporation is adjusted first for any ordinary distributions and then for any redemption distributions.

(iii) *Adjustments to earnings and profits.* Earnings and profits are adjusted under section 312 independently of any adjustments made to the AAA.

(2) *Liquidations and reorganizations.* An S corporation acquiring the assets

of another S corporation in a transaction to which section 381(a) applies will succeed to and merge its AAA (whether positive or negative) with the AAA (whether positive or negative) of the distributor or transferor S corporation as of the close of the date of distribution or transfer. Thus, the AAA of the acquiring corporation after the transaction is the sum of the AAAs of the corporations prior to the transaction.

(3) *Corporate separations to which section 368(a)(1)(D) applies.* If an S corporation with accumulated earnings and profits transfers a part of its assets constituting an active trade or business to another corporation in a transaction to which section 368(a)(1)(D) applies, and immediately thereafter the stock and securities of the controlled corporation are distributed in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applies, the AAA of the distributing corporation immediately before the transaction is allocated between the distributing corporation and the controlled corporation in a manner similar to the manner in which the earnings and profits of the distributing corporation are allocated under section 312 (h). See § 1.312-10(a).

(e) *Election to terminate year under section 1377(a)(2) or § 1.1368-1(g)(2).* If an election is made under section 1377(a)(2) (to terminate the year in the case of termination of a shareholder's interest) or § 1.1368-1(g)(2) (to terminate the year in the case of a qualifying disposition), this section applies as if the taxable year consisted of separate taxable years, the first of which ends at the close of the day on which the shareholder terminated his or her interest in the corporation or makes a substantial disposition of stock, whichever the case may be.

[T.D. 8508, 59 FR 20, Jan. 3, 1994, as amended by T.D. 8852, 64 FR 71650, Dec. 22, 1999; T.D. 8869, 65 FR 3855, Jan. 25, 2000]

### § 1.1368-3 Examples.

The principles of §§ 1.1368-1 and 1.1368-2 are illustrated by the examples below. In each example Corporation S is a calendar year corporation:

*Example 1. Distributions by S corporations without C corporation earnings and profits for*