

purposes of this section, affected taxpayers means all taxpayers whose returns are affected by the election to apply the regulations.

[T.D. 8869, 65 FR 3854, Jan. 25, 2000; 65 FR 16318, Mar. 28, 2000]

**§ 1.1363-1 Effect of election on corporation.**

(a) *Exemption of corporation from income tax*—(1) *In general.* Except as provided in this paragraph (a), a small business corporation that makes a valid election under section 1362(a) is exempt from the taxes imposed by chapter 1 of the Internal Revenue Code with respect to taxable years of the corporation for which the election is in effect.

(2) *Corporate level taxes.* An S corporation is not exempt from the tax imposed by section 1374 (relating to the tax imposed on certain built-in gains), or section 1375 (relating to the tax on excess passive investment income). See also section 1363(d) (relating to the recapture of LIFO benefits) for the rules regarding the payment by an S corporation of LIFO recapture amounts.

(b) *Computation of corporate taxable income.* The taxable income of an S corporation is computed as described in section 1363(b).

(c) *Elections of the S corporation*—(1) *In general.* Any elections (other than those described in paragraph (c)(2) of this section) affecting the computation of items derived from an S corporation are made by the corporation. For example, elections of methods of accounting, of computing depreciation, of treating soil and water conservation expenditures, and the option to deduct as expenses intangible drilling and development costs, are made by the corporation and not by the shareholders separately. All corporate elections are applicable to all shareholders.

(2) *Exceptions.* (i) Each shareholder's pro rata share of expenses described in section 617 paid or accrued by the S corporation is treated according to the shareholder's method of treating those expenses, notwithstanding the treatment of the expenses by the corporation.

(ii) Each shareholder may elect to amortize that shareholder's pro rata share of any qualified expenditure de-

scribed in section 59(e) paid or accrued by the S corporation.

(iii) Each shareholder's pro rata share of taxes described in section 901 paid or accrued by the S corporation to foreign countries or possessions of the United States (according to its method of treating those taxes) is treated according to the shareholder's method of treating those taxes, and each shareholder may elect to use the total amount either as a credit against tax or as a deduction from income.

(d) *Effective date.* This section applies to taxable years of corporations beginning after December 31, 1992. For taxable years to which this section does not apply, corporations and shareholders subject to the provisions of section 1363 must take reasonable return positions taking into consideration the statute, its legislative history and these regulations. See Notice 92-56, 1992-49 I.R.B. (see § 601.601(d)(2)(ii)(b) of this chapter), for additional guidance regarding reasonable return positions for taxable years to which this section does not apply.

[T.D. 8449, 57 FR 55456, Nov. 25, 1992]

**§ 1.1363-2 Recapture of LIFO benefits.**

(a) *In general.* A C corporation must include the LIFO recapture amount (as defined in section 1363(d)(3)) in its gross income—

(1) In its last taxable year as a C corporation if the corporation inventoried assets under the LIFO method for its last taxable year before its S corporation election becomes effective; or

(2) In the year of transfer by the C corporation to an S corporation of the LIFO inventory assets if paragraph (a)(1) of this section does not apply and the C corporation—

(i) Inventoried assets under the LIFO method during the taxable year of the transfer of those LIFO inventory assets; and

(ii) Transferred the LIFO inventory assets to the S corporation in a non-recognition transaction (within the meaning of section 7701(a)(45)) in which the transferred assets constitute transferred basis property (within the meaning of section 7701(a)(43)).

(b) *Payment of tax.* Any increase in tax caused by including the LIFO recapture amount in the gross income of