

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

the C corporation is payable in four equal installments. The C corporation must pay the first installment of this payment by the due date of its return, determined without regard to extensions, for the last taxable year it operated as a C corporation if paragraph (a)(1) of this section applies, or for the taxable year of the transfer if paragraph (a)(2) of this section applies. The three succeeding installments must be paid—

(1) For a transaction described in paragraph (a)(1) of this section, by the corporation (that made the election under section 1362(a) to be an S corporation) on or before the due date for the corporation's returns (determined without regard to extensions) for the succeeding three taxable years; and

(2) For a transaction described in paragraph (a)(2) of this section, by the transferee S corporation on or before the due date for the transferee corporation's returns (determined without regard to extensions) for the succeeding three taxable years.

(c) *Basis adjustments.* Appropriate adjustments to the basis of inventory are to be made to reflect any amount included in income under this section.

(d) *Effective dates.* (1) The provisions of paragraph (a)(1) of this section apply to S elections made after December 17, 1987. For an exception, see section 10227(b)(2) of the Revenue Act of 1987.

(2) The provisions of paragraph (a)(2) of this section apply to transfers made after August 18, 1993.

[T.D. 8567, 59 FR 51106, Oct. 7, 1994]

§ 1.1366-0 Table of contents.

The following table of contents is provided to facilitate the use of §§ 1.1366-1 through 1.1366-5:

§ 1.1366-1 Shareholder's share of items of an S corporation.

(a) Determination of shareholder's tax liability.

- (1) In general.
- (2) Separately stated items of income, loss, deduction, or credit.
- (3) Nonseparately computed income or loss.
- (4) Separate activities requirement.
- (5) Aggregation of deductions or exclusions for purposes of limitations.

(b) Character of items constituting pro rata share.

- (1) In general.
- (2) Exception for contribution of noncapital gain property.
- (3) Exception for contribution of capital loss property.
 - (c) Gross income of a shareholder.
 - (1) In general.
 - (2) Gross income for substantial omission of items.
 - (d) Shareholders holding stock subject to community property laws.
 - (e) Net operating loss deduction of shareholder of S corporation.
 - (f) Cross-reference.

§ 1.1366-2 Limitations on deduction of pass-through items of an S corporation to its shareholders.

- (a) In general.
 - (1) Limitation on losses and deductions.
 - (2) Carryover of disallowance.
 - (3) Basis limitation amount.
 - (i) Stock portion.
 - (ii) Indebtedness portion.
 - (4) Limitation on losses and deductions allocated to each item.
 - (5) Nontransferability of losses and deductions.

(6) Basis of stock acquired by gift.

- (b) Special rules for carryover of disallowed losses and deductions to post-termination transition period described in section 1377(b).

- (1) In general.
- (2) Limitation on losses and deductions.
- (3) Limitation on losses and deductions allocated to each item.
- (4) Adjustment to the basis of stock.
 - (c) Carryover of disallowed losses and deductions in the case of liquidations, reorganizations, and divisions.
 - (1) Liquidations and reorganizations.
 - (2) Corporate separations to which section 368(a)(1)(D) applies.

§ 1.1366-3 Treatment of family groups.

- (a) In general.
- (b) Examples.

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

- (a) Passthrough inapplicable to section 34 credit.
- (b) Reduction in passthrough for tax imposed on built-in gains.
- (c) Reduction in passthrough for tax imposed on excess net passive income.

§ 1.1366-5 Effective date.

[T.D. 8852, 64 FR 71644, Dec. 22, 1999]