

amount of the items provided in section 1367(a)(1) do not exceed the amount of the items provided in section 1367(a)(2).

(ii) Because there is no net increase with respect to D for 1998, none of the 1997 reduction in D's basis in the indebtedness is restored. The \$10,000 increase in basis under section 1367(a)(1) is applied to increase D's basis in his S stock. Under section 1367(a)(2)(A), the \$11,000 distribution with respect to D's stock reduces D's basis in his shares of S stock to \$0. See section 1368 and § 1.1368-1 (c) and (d) for the tax treatment of the \$1,000 distribution in excess of D's basis.

Example 5. Distributions less than increase in basis. (i) The facts are the same as in *Example 4*, except that in 1998 S makes distributions to D totaling \$8,000. On these facts, for 1998, there is a net increase with respect to D of \$2,000 (the amount by which the items provided in section 1367(a)(1) exceed the amount of the items provided in section 1367(a)(2)).

(ii) Because there is a net increase of \$2,000 with respect to D for 1998, \$2,000 of the \$10,000 increase in basis under section 1367(a)(1) is first applied to restore D's basis in the indebtedness to \$10,000 (\$8,000 + \$2,000). Accordingly, on December 31, 1998, D has a basis in his shares of S stock of \$0 (\$0 + \$8,000 (increase in basis remaining after restoring basis in indebtedness)—\$8,000 (distribution)) and a basis in the note of \$10,000.

[T.D. 8508, 59 FR 16, Jan. 3, 1994]

§ 1.1367-3 Effective date and transition rule.

Except for § 1.1367-1(f), (h) *Example 2* and *Example 5*, and (j), §§ 1.1367-1 and 1.1367-2 apply to taxable years of the corporation beginning on or after January 1, 1994. Section 1.1367-1(f), (h) *Example 2* and *Example 5*, and (j) apply only to taxable years of the corporation beginning on or after August 18, 1998. For taxable years beginning before January 1, 1994, and taxable years beginning on or after January 1, 1997, and before August 18, 1998, the basis of a shareholder's stock must be determined in a reasonable manner, taking into account the statute and legislative history. Except for § 1.1367-1(f), (h) *Example 2* and *Example 5*, and (j), return positions consistent with §§ 1.1367-1 and 1.1367-2 are reasonable for taxable years beginning before January 1, 1994. Return positions consistent with § 1.1367-1(f), (h) *Example 2* and *Example 5*, and (j) are reasonable for taxable years beginning on or after January 1, 1997, and before August 18, 1998.

[T.D. 8852, 64 FR 71649, Dec. 22, 1999]

§ 1.1368-0 Table of contents.

The following table of contents is provided to facilitate the use of §§ 1.1368-1 through 1.1368-4.

§ 1.1368-1 Distributions by S corporations.

- (a) In general.
- (b) Date distribution made.
- (c) S corporation with no earnings and profits.
- (d) S corporation with earnings and profits.
 - (1) General treatment of distribution.
 - (2) Previously taxed income.
- (e) Certain adjustments taken into account.
 - (1) Taxable years beginning before January 1, 1997.
 - (2) Taxable years beginning on or after August 18, 1998.
- (f) Elections relating to source of distributions.
 - (1) In general.
 - (2) Election to distribute earnings and profits first.
 - (i) In general.
 - (ii) Previously taxed income.
 - (iii) Corporation with subchapter C and subchapter S earnings and profits.
 - (3) Election to make a deemed dividend.
 - (4) Election to forego previously taxed income.
 - (5) Time and manner of making elections.
 - (i) For earnings and profits.
 - (ii) For previously taxed income and deemed dividends.
 - (iii) Corporate statement regarding elections.
 - (iv) Irrevocable elections.
 - (g) Special rule.
 - (1) Election to terminate year under § 1.1368-1(g)(2).
 - (2) Election in case of a qualifying disposition.
 - (i) In general.
 - (ii) Effect of the election.
 - (iii) Time and manner of making election.
 - (iv) Coordination with election under section 1377(a)(2).

§ 1.1368-2 Accumulated adjustments account (AAA).

- (a) Accumulated adjustments account.
 - (1) In general.
 - (2) Increases to the AAA.
 - (3) Decreases to the AAA.
 - (i) In general.
 - (ii) Extent of allowable reduction.
 - (iii) Decrease to the AAA for distributions.
 - (4) Ordering rules for the AAA for taxable years beginning before January 1, 1997.
 - (5) Ordering rules for the AAA for taxable years beginning on or after August 18, 1998.
 - (b) Distributions in excess of the AAA.
 - (1) In general.
 - (2) Amount of the AAA allocated to each distribution.