6, 1997, to July 24, 1997 (200 days), and 25 percent from July 25, 1997, to December 31, 1997 (160 days), and C owned 25 percent from July 25, 1997, to December 31, 1997 (160 days).

(ii) Because B's entire interest in X is not terminated when B sells 50 shares to C on July 24, 1997, X cannot make a terminating election under section 1377(a)(2) and paragraph (b) of this section for B's sale of 50 shares to C. Although B's sale of 50 shares to C is a qualifying disposition under §1.1368–1(g)(2)(i), X does not make an election to terminate its taxable year under §1.1368–1(g)(2). During its 1997 taxable year, X has nonseparately computed income of $720,000.

(iii) For each day in X's 1997 taxable year, A's daily pro rata share of X's nonseparately computed income is $1,000 ($720,000/360 days×50%). Thus, A's pro rata share of X's nonseparately computed income for 1997 is $360,000 ($1,000×360 days). B's daily pro rata share of X's nonseparately computed income is $1,000 ($720,000/360×50%) for the first 200 days of X's 1997 taxable year, and $500 ($720,000/360×25%) for the following 160 days in 1997. Thus, B's pro rata share of X's nonseparately computed income for 1997 is $280,000 (($1,000×200 days) + ($500×160 days)). C's daily pro rata share of X's nonseparately computed income is $500 ($720,000/360×25%) for 160 days in 1997. Thus, C's pro rata share of X's nonseparately computed income for 1997 is $80,000 ($500×160 days).

Example 2. Shareholder's pro rata share when an S corporation makes a terminating election under section 1377(a)(2). (i) On January 6, 1997, X incorporates as a calendar year corporation, issues 100 shares of common stock to each of A and B, and files an election to be an S corporation for its 1997 taxable year. On July 24, 1997, B sells B's entire 100 shares of X stock to C. With the consent of B and C, X makes an election under section 1377(a)(2) and paragraph (b) of this section for the termination of B's entire interest arising from B's sale of 100 shares to C. As a result of the election, the pro rata shares of B and C are determined as if X's taxable year consisted of two separate taxable years, the first of which ends on July 24, 1997, the date B's entire interest in X terminates. Because A is not an affected shareholder as defined by section 1377(a)(2)(B) and paragraph (b)(2) of this section, the treatment as separate taxable years does not apply to A.

(ii) During its 1997 taxable year, X has nonseparately computed income of $720,000. Under X's normal method of accounting, $200,000 of the $720,000 of nonseparately computed income is allocable to the period of January 6, 1997, through July 24, 1997 (the first deemed taxable year), and the remaining $520,000 is allocable to the period of July 25, 1997, through December 31, 1997 (the second deemed taxable year).

(iii) B's pro rata share of the $200,000 of nonseparately computed income for the first deemed taxable year is determined by assigning the $200,000 of nonseparately computed income to each day of the first deemed taxable year ($200,000/200 days = $1,000 per day). Because B held 50% of X's authorized and issued shares on each day of the first deemed taxable year, B's daily pro rata share for each day of the first deemed taxable year is $500 ($1,000 per day × 50%). Thus, B's pro rata share of the $200,000 of nonseparately computed income for the first deemed taxable year is $100,000 ($500 per day × 200 days). B must report this amount for B's taxable year with or within which X's full taxable year ends (December 31, 1997).

(iv) C's pro rata share of the $520,000 of nonseparately computed income for the second deemed taxable year is determined by assigning the $520,000 of nonseparately computed income to each day of the second deemed taxable year ($520,000/160 days = $3,250 per day). Because C held 50% of X's authorized and issued shares on each day of the second deemed taxable year, C's daily pro rata shares for each day of the second deemed taxable year is $1,625 ($3,250 per day × 50%). Therefore, C's pro rata share of the $520,000 of nonseparately computed income is $260,000 ($1,625 per day × 160 days). C must report this amount for C's taxable year with or within which X's full taxable year ends (December 31, 1997).

[T.D. 8696, 61 FR 67456, Dec. 23, 1996]

§1.1377–2 Post-termination transition period.

(a) *In general.* For purposes of subchapter S of chapter 1 of the Internal Revenue Code (Code) and this section, the term *post-termination transition period* means—

(1) The period beginning on the day after the last day of the corporation's last taxable year as an S corporation and ending on the later of—

(i) The day which is 1 year after such last day; or

(ii) The due date for filing the return for the last taxable year as an S corporation (including extensions);

(2) The 120-day period beginning on the date of any determination pursuant to an audit of the taxpayer which follows the termination of the corporation's election and which adjusts a subchapter S item of income, loss, or deduction of the corporation arising during the S period (as defined in section 1368(e)(2)); and

(3) The 120-day period beginning on the date of a determination that the corporation's election under section

1362(a) had terminated for a previous taxable year.

(b) *Special rules for post-termination transition period.* Pursuant to section 1377(b)(1) and paragraph (a)(1) of this section, a post-termination transition period arises the day after the last day that an S corporation was in existence if a C corporation acquires the assets of the S corporation in a transaction to which section 381(a)(2) applies. However, if an S corporation acquires the assets of another S corporation in a transaction to which section 381(a)(2) applies, a post-termination transition period does not arise. (See §1.1368–2(d)(2) for the treatment of the acquisition of the assets of an S corporation by another S corporation in a transaction to which section 381(a)(2) applies.) The special treatment under section 1371(e)(1) of distributions of money by a corporation with respect to its stock during the post-termination transition period is available only to those shareholders who were shareholders in the S corporation at the time of the termination.

(c) *Determination defined.* For purposes of section 1377(b)(1) and paragraph (a) of this section, the term *determination* means—

(1) A determination as defined in section 1313(a);

(2) A written agreement between the corporation and the Commissioner (including a statement acknowledging that the corporation's election to be an S corporation terminated under section 1362(d)) that the corporation failed to qualify as an S corporation;

(3) For a corporation subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A of the Code, the expiration of the period specified in section 6226 for filing a petition for readjustment of a final S corporation administrative adjustment finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period; and

(4) For a corporation not subject to the audit and assessment provisions of subchapter C of chapter 63 of subtitle A of the Code, the expiration of the period for filing a petition under section 6213 for the shareholder's taxable year for which the Commissioner has made a finding that the corporation failed to qualify as an S corporation, provided that no petition was timely filed before the expiration of the period.

(d) *Date a determination becomes effective*—(1) *Determination under section 1313(a).* A determination under paragraph (c)(1) of this section becomes effective on the date prescribed in section 1313 and the regulations thereunder.

(2) *Written agreement.* A determination under paragraph (c)(2) of this section becomes effective when it is signed by the district director having jurisdiction over the corporation (or by another Service official to whom authority to sign the agreement is delegated) and by an officer of the corporation authorized to sign on its behalf. Neither the request for a written agreement nor the terms of the written agreement suspend the running of any statute of limitations.

(3) *Implied agreement.* A determination under paragraph (c) (3) or (4) of this section becomes effective on the day after the date of expiration of the period specified under section 6226 or 6213, respectively.

[T.D. 8696, 61 FR 67457, Dec. 23, 1996]

§ 1.1377–3 Effective date.

Sections 1.1377–1 and 1.1377–2 apply to taxable years of an S corporation beginning after December 31, 1996.

[T.D. 8696, 61 FR 67458, Dec. 23, 1996]

SECTION 1374 BEFORE THE TAX REFORM ACT OF 1986

§ 1.1374–1A Tax imposed on certain capital gains.

(a) *General rule.* Except as otherwise provided in paragraph (c) of this section, if for a taxable year beginning after 1982 of an S corporation—

(1) The net capital gain of such corporation exceeds $25,000, and

(2) The net capital gain of such corporation exceeds 50 percent of its taxable income (as defined in paragraph (d) of this section) for such year, and

(3) The taxable income of such corporation (as defined in paragraph (d) of this section) for such year exceeds $25,000,