

to forego previously taxed income under paragraph (f)(4) of this section or to make a deemed dividend under paragraph (f)(3) of this section, consent by each "affected shareholder," as defined in section 1368(e)(3)(B), is required.

(iii) [Reserved]. For further guidance, see § 1.1368-1T(f)(5)(iii).

(iv) *Irrevocable elections.* The elections under this paragraph (f) are irrevocable and are effective only for the taxable year for which they are made. In applying the preceding sentence to elections under this paragraph (f), an election to terminate the taxable year under section 1377(a)(2) or § 1.1368-1(g)(2) is disregarded.

(g) *Special rule—(1) Election to terminate year under § 1.1368-1(g)(2).* If an election is made under paragraph (g)(2) of this section to terminate the year when there is 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 there is a qualifying disposition of stock.

(2) *Election in case of a qualifying disposition—(i) In general.* In the case of a qualifying disposition, a corporation may elect under this paragraph (g)(2)(i) to treat the year as if it consisted of separate taxable years, the first of which ends at the close of the day on which the qualifying disposition occurs. A *qualifying disposition* is—

(A) A disposition by a shareholder of 20 percent or more of the outstanding stock of the corporation in one or more transactions during any thirty-day period during the corporation's taxable year;

(B) A redemption treated as an exchange under section 302(a) or section 303(a) of 20 percent or more of the outstanding stock of the corporation from a shareholder in one or more transactions during any thirty-day period during the corporation's taxable year; or

(C) An issuance of an amount of stock equal to or greater than 25 percent of the previously outstanding stock to one or more new shareholders during any thirty-day period during the corporation's taxable year.

(ii) *Effect of the election.* A corporation making an election under paragraph (g)(2)(i) of this section must

treat the taxable year as separate taxable years for purposes of allocating items of income and loss; making adjustments to the AAA, earnings and profits, and basis; and determining the tax effect of distributions under section 1368 (b) and (c). An election made under paragraph (g)(2)(i) of this section may be made upon the occurrence of any qualifying disposition. Dispositions of stock that are taken into account as part of a qualifying disposition are not taken into account in determining whether a subsequent qualifying disposition has been made.

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

(iv) *Coordination with election under section 1377(a)(2).* If the event resulting in a qualifying disposition also results in a termination of a shareholder's entire interest as described in § 1.1377-1(b)(4), the election under this paragraph (g)(2) cannot be made. Rather, the election under section 1377(a)(2) and § 1.1377-1(b) may be made. See § 1.1377-1(b) (concerning the election under section 1377(a)(2)).

[T.D. 8508, 59 FR 19, Jan. 3, 1994, as amended by T.D. 8696, 61 FR 67455, Dec. 23, 1996; T.D. 8852, 64 FR 71650, Dec. 22, 1999; T.D. 9100, 68 FR 70706, Dec. 19, 2003]

§ 1.1368-1T Distributions by S corporations (temporary).

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

(f)(5)(iii) *Corporate statement regarding elections.* A corporation makes an election for a taxable year under § 1.1368-1(f) by attaching a statement to a timely filed original or amended return required to be filed under section 6037 for that taxable year. In the statement, the corporation must identify the election it is making under § 1.1368-1(f) and must state that each shareholder consents to the election. In the case of elections for taxable years beginning before January 1, 2003, an officer of the corporation must sign under penalties of perjury the statement on behalf of the corporation. In the case of elections for taxable years beginning after December 31, 2002, the statement described in this paragraph (f)(5)(iii) shall be verified by signing the return. A statement of election to make a

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