

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.

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§ 1.1368-3 Examples.

§ 1.1368-4 Effective date and transition rule.

[T.D. 8508, 59 FR 18, Jan. 3, 1994, as amended by T.D. 8696, 61 FR 67455, Dec. 23, 1996; T.D. 8852, 64 FR 71649, Dec. 22, 1999; T.D. 8869, 65 FR 3855, Jan. 25, 2000]

§ 1.1368-1 Distributions by S corporations.

(a) *In general.* This section provides rules for distributions made by an S corporation with respect to its stock which, but for section 1368(a) and this section, would be subject to section 301(c) and other rules of the Internal Revenue Code that characterize a distribution as a dividend.

(b) *Date distribution made.* For purposes of section 1368, a distribution is taken into account on the date the corporation makes the distribution, regardless of when the distribution is treated as received by the shareholder.

(c) *S corporation with no earnings and profits.* A distribution made by an S corporation that has no accumulated earnings and profits as of the end of the taxable year of the S corporation in which the distribution is made is treated in the manner provided in section 1368(b).

(d) *S corporation with earnings and profits—(1) General treatment of distribution.* Except as provided in paragraph (d)(2) of this section, a distribution made with respect to its stock by an S corporation that has accumulated earnings and profits as of the end of the taxable year of the S corporation in which the distribution is made is treated in the manner provided in section 1368(c). See section 316 and § 1.316-2 for provisions relating to the alloca-

tion of earnings and profits among distributions.

(2) *Previously taxed income.* This paragraph (d)(2) applies to distributions by a corporation that has both accumulated earnings and profits and previously taxed income (within the meaning of section 1375(d)(2), as in effect prior to its amendment by the Subchapter S Revision Act of 1982, and the regulations thereunder) with respect to one or more shareholders. In the case of such a distribution, that portion remaining after the application of section 1368(c)(1) (relating to distributions from the accumulated adjustments account (AAA) as defined in § 1.1368-2(a)) is treated in the manner provided in section 1368(b) (relating to S corporations without earnings and profits) to the extent that portion is a distribution of money and does not exceed the shareholder's net share immediately before the distribution of the corporation's previously taxed income. The AAA and the earnings and profits of the corporation are not decreased by that portion of the distribution. Any distribution remaining after the application of this paragraph (d)(2) is treated in the manner provided in section 1368(c)(2) and (3).

(e) *Certain adjustments taken into account—(1) Taxable years beginning before January 1, 1997.* For any taxable year of the corporation beginning before January 1, 1997, paragraphs (c) and (d) of this section are applied only after taking into account—

(i) The adjustments to the basis of the shares of a shareholder's stock described in section 1367 (without regard to section 1367(a)(2)(A) (relating to decreases attributable to distributions not includible in income)) for the S corporation's taxable year; and

(ii) The adjustments to the AAA required by section 1368(e)(1)(A) (but without regard to the adjustments for distributions under § 1.1368-2(a)(3)(iii)) for the S corporation's taxable year.

(2) *Taxable years beginning on or after August 18, 1998.* For any taxable year of the corporation beginning on or after August 18, 1998, paragraphs (c) and (d) of this section are applied only after taking into account—