

Example 14. On October 1, 1971, A, an author, and Corporation M, a publisher, executed an agreement under which A granted to M the exclusive right to print, publish and sell a book he had written. The agreement provides that M will pay to A specified royalties based on the actual cash received from the sale of the published work, render semi-annual statements of the sales, and at the time of rendering each statement make settlement for the amount due. On the same day, another agreement was signed by A and M, mutually agreeing that, in consideration of, and notwithstanding, any contrary provisions contained in the first contract, M shall not pay A more than \$100x in any one calendar year. Under this supplemental contract, sums in excess of \$100x accruing in any one calendar year are to be carried over by M into succeeding years. For the calendar year 1971, royalties payable to A under the basic agreement amount to \$100x and this sum is paid to A. For the calendar year 1972, royalties of \$120x are payable to A under the basic agreement, but by reason of the supplemental agreement, only \$100x of this sum is actually paid to A. For each of the calendar years 1973 and 1974, royalties of \$100x are payable to A under the basic agreement, and this sum is paid to A. For the calendar year 1975, royalties of \$80x are payable to A under the basic agreement, and this sum, plus \$20x carried over from 1972, or \$100x, is paid to A. The \$100x paid to A in each of the years 1971, 1972, 1973, and 1974, and \$80x of the \$100x paid to A in 1975 constitute earned income. The additional \$20x carried over from 1972 and paid to A in 1975 constitutes deferred compensation under this paragraph (b) because it was paid to A later than the end of the year following the year (i.e., 1972) in which A's right to receive the amount was not subject to a substantial risk of forfeiture.

Example 15. Corporation M is the producer and owner of a feature length motion picture which is distributed to exhibitors by Corporation N pursuant to a distribution agreement between M and N providing for current payments to M of a given percentage of the current net profits derived by N from the exhibition and exploitation of the picture. A was employed by M as the leading actor in the picture for fixed compensation payable at the rate of \$10x per week during the production period plus additional compensation equal to a given percentage of the net profits derived from the exhibition and exploitation of the picture. A's additional compensation is payable at the time that M receives payments from N under the terms of the distribution agreement. The additional compensation paid to A does not constitute deferred compensation since it is attributable to and measured by current net profits derived from the use of property created in part by A's efforts.

Example 16. A, a boxer entered into an agreement with M boxing club to fight a particular opponent on June 19, 1971. The agreement provided in part, that for his performance A was to receive 16 percent of the gross receipts derived from the match. Simultaneously, A and M executed a separate agreement providing for payment of A's share of the receipts from the match as follows: 25 percent thereof not later than August 15, 1971, and 25 percent thereof during each of the years 1972, 1973, and 1974 in equal semi-annual installments. A's share of the gross receipts derived from the match was \$100x, of which 25 percent was paid to him in 1971 and a total of \$25x in each of the years 1972, 1973, and 1974. Under the particular facts and circumstances, A and M are not acting as partners or joint venturers. Thus, A is taxable upon his share of such gross receipts only in the years in which such share is actually paid to him under the terms of the separate agreement. The payments of \$25x in each of the years 1971 and 1972 constitute earned income. The payments of \$25x in each of the years 1973 and 1974 would not constitute earned income because they constitute deferred compensation received later than the end of the first taxable year (i.e., 1972) following the year in which A's right to receive such amounts was not subject to a substantial risk of forfeiture.

[T.D. 7446, 41 FR 55339, Dec. 20, 1976]

SMALL BUSINESS CORPORATIONS AND THEIR SHAREHOLDERS

§ 1.1361-0 Table of contents.

This section lists captions contained in §§ 1.1361-1, 1.1361-2, 1.1361-3, 1.1361-4, 1.1361-5, and 1.1361-6.

§ 1.1361-1 S Corporation defined.

- (a) In general.
- (b) Small business corporation defined.
 - (1) In general.
 - (2) Estate in bankruptcy.
 - (3) Treatment of restricted stock.
 - (4) Treatment of deferred compensation plans.
 - (5) Treatment of straight debt.
 - (6) Effective date provisions.
- (c) Domestic corporation.
- (d) Ineligible corporation.
 - (1) General rule.
 - (2) Exceptions.
 - (e) Number of shareholders.
 - (1) General rule.
 - (2) Special rules relating to stock owned by husband and wife.
 - (3) Special rules relating to stock owned by members of a family.
 - (f) Shareholder must be an individual or estate.
 - (g) No nonresident alien shareholder.

§ 1.1361-0

26 CFR Ch. I (4-1-09 Edition)

- (1) General rule.
- (2) Special rule for dual residents.
- (h) Special rules relating to trusts.
 - (1) General rule.
 - (2) Foreign trust.
 - (3) Determination of shareholders.
 - (i) [Reserved]
 - (j) Qualified subchapter S trust.
 - (1) Definition.
 - (2) Special rules.
 - (3) Separate and independent shares of a trust.
 - (4) Qualified terminable interest property trust.
 - (5) Ceasing to meet the QSST requirements.
 - (6) Qualified subchapter S trust election.
 - (7) Treatment as shareholder.
 - (8) Coordination with grantor trust rules.
 - (9) Successive income beneficiary.
 - (10) Affirmative refusal to consent.
 - (11) Revocation of QSST election.
 - (12) Converting a QSST to an ESBT.
 - (k)(1) Examples.
 - (2) Effective date.
 - (1) Classes of stock.
 - (1) General rule.
 - (2) Determination of whether stock confers identical rights to distribution and liquidation proceeds.
 - (3) Stock taken into account.
 - (4) Other instruments, obligations, or arrangements treated as a second class of stock.
 - (5) Straight debt safe harbor.
 - (6) Inadvertent terminations.
 - (7) Effective date
 - (m) Electing small business trust (ESBT).
 - (1) Definition.
 - (2) ESBT election.
 - (3) Effect of ESBT election.
 - (4) Potential current beneficiaries.
 - (5) ESBT terminations.
 - (6) Revocation of ESBT election.
 - (7) Converting an ESBT to a QSST.
 - (8) Examples.
 - (9) Effective date.

§ 1.1361-2 Definitions relating to S corporation subsidiaries.

- (a) In general.
- (b) Stock treated as held by S corporation.
- (c) Straight debt safe harbor.
- (d) Examples.

§ 1.1361-3 QSub election.

- (a) Time and manner of making election.
 - (1) In general.
 - (2) Manner of making election.
 - (3) Time of making election.
 - (4) Effective date of election.
 - (5) Example.
 - (6) Extension of time for making a QSub election.
- (b) Revocation of QSub election.
 - (1) Manner of revoking QSub election.

- (2) Effective date of revocation.
- (3) Revocation after termination.
- (4) Revocation before QSub election effective.

§ 1.1361-4 Effect of QSub election.

- (a) Separate existence ignored.
 - (1) In general.
 - (2) Liquidation of subsidiary.
 - (i) In general.
 - (ii) Examples
 - (iii) Adoption of plan of liquidation.
 - (iv) Example.
 - (v) Stock ownership requirements of section 332.
- (3) Treatment of banks.
 - (i) In general.
 - (ii) Examples.
 - (iii) Effective date.
- (4) Treatment of stock of QSub.
- (5) Transitional relief.
 - (i) General rule.
 - (ii) Examples.
 - (b) Timing of the liquidation.
 - (1) In general.
 - (2) Application to elections in tiered situations.
 - (3) Acquisitions.
 - (i) In general.
 - (ii) Special rules for acquired S corporations.
 - (4) Coordination with section 338 election.
 - (c) Carryover of disallowed losses and deductions.
 - (d) Examples.

§ 1.1361-5 Termination of QSub election.

- (a) In general.
 - (1) Effective date.
 - (2) Information to be provided upon termination of QSub election by failure to qualify as a QSub.
 - (3) QSub joins a consolidated group.
 - (4) Examples.
 - (b) Effect of termination of QSub election.
 - (1) Formation of new corporation.
 - (i) In general.
 - (ii) Termination for tiered QSubs.
 - (2) Carryover of disallowed losses and deductions.
 - (3) Examples.
 - (c) Election after QSub termination.
 - (1) In general.
 - (2) Exception.
 - (3) Examples.

§ 1.1361-6 Effective date.

[T.D. 8600, 60 FR 37581, July 21, 1995, as amended by T.D. 8869, 65 FR 3848, Jan. 25, 2000; T.D. 8994, 67 FR 34397, May 14, 2002; T.D. 9422, 73 FR 47527, Aug. 14, 2008]