

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Section 1367 Regarding Open Account Debt

REG-144859-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document proposes amendments to the regulations relating to the treatment of open account debt between S corporations and their shareholders. These proposed regulations provide rules regarding the definition of open account debt and the adjustments in basis of any indebtedness of an S corporation to a shareholder under section 1367(b)(2) of the Internal Revenue Code (Code) for shareholder advances and repayments on advances of open account debt. The proposed regulations affect shareholders of S corporations and are necessary to provide guidance needed to comply with the applicable tax law. This document also provides notice of a public hearing.

DATES: Written or electronic comments and requests for a public hearing must be received by July 11, 2007. Outlines of topics to be discussed at the public hearing scheduled for July 31, 2007, at 10 a.m., must be received by July 10, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-144859-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-144859-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-144859-04). The public hearing will be held in the IRS Auditorium,

Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Stacy L. Short or Deane M. Burke, (202) 622-3070; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst at (202) 622-2949 (TDD Telephone) (not toll-free numbers) and his e-mail address is Richard.A.Hurst@irs.counsel.treas.gov, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). Comments on the collections of information should be sent to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attention: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224.

The recordkeeping requirement in these proposed regulations is in §1.1367-2(a)(2)(i). This information must be maintained by the shareholder to ensure that the indebtedness of the S corporation to the shareholder continues to meet the definition of open account debt found in §1.1367-2(a)(2)(i). The recordkeepers will be S corporation shareholders who have open account debt.

The following estimates are an approximation of the average time expected to be necessary for a collection of information. They are based on the information that is available to the Internal Revenue Service. Individual recordkeepers may require greater or less time, depending on their particular circumstances.

Estimated total annual recordkeeping burden: 250 hours.

Estimated average annual burden: hours per recordkeeper varies from .75 to 1.25 hours, depending on individual circumstances, with an estimated average of 1 hour.

Estimated number of recordkeepers: 250.

Estimated annual frequency of record-keeping: On occasion.

Background

This document proposes to amend §1.1367-2 of the Income Tax Regulations (26 CFR part 1) regarding the definition of open account debt and adjustments in basis of indebtedness for shareholder advances and repayments on advances of open account debt.

Section 1367(a)(1) provides that the basis of each shareholder's stock in an S corporation is increased by the shareholder's *pro rata* share of the S corporation's income (separately and nonseparately computed items of income) and the excess of the deductions for depletion over the basis of the property subject to depletion. Section 1367(a)(2) provides that the basis of each shareholder's stock in the S corporation is decreased by the shareholder's *pro rata* share of distributions not includible in income of the shareholder by reason of section 1368 (nontaxable distributions), losses and deductions (separately and non-separately computed losses), any expense of the corporation that is not deductible and not properly chargeable to capital account, and certain deductions for depletion for any oil and gas property held by the S corporation. Under section 1367(b)(2)(A), if for any taxable year the amounts specified in section 1367(a)(2) (other than distributions) exceed the amount which reduces the shareholder's basis to zero, such excess losses and deductions shall be applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder. Section 1367(b)(2)(B) provides that if a shareholder's basis in indebtedness is reduced for any taxable year, any net increase (the amount by which the items described in section 1367(a)(1) exceed the items described in section 1367(a)(2)) for any subsequent taxable year is applied to re-

store the reduction in basis in indebtedness before any of the excess is used to increase basis in stock.

On January 3, 1994, the Treasury Department and the IRS published final regulations under section 1367 of the Code (T.D. 8508, 1994-1 C.B. 219 [59 FR 12], amended on December 22, 1999 (T.D. 8852, 2000-1 C.B. 253 [64 FR 71641])). Those final regulations relate, in part, to adjustments to basis in both stock of shareholders and indebtedness of an S corporation to its shareholders. Section 1.1367-2 of the Income Tax Regulations provides specific rules for required adjustments (reductions and restorations) to basis in any indebtedness of an S corporation to a shareholder. Section 1.1367-2(a) also provides that for purposes of adjustments to basis of indebtedness to shareholders, shareholder advances not evidenced by separate written instruments and repayments on the advances (open account debt) are treated as a single indebtedness. Further, §1.1367-2(a) provides that the basis of indebtedness of the S corporation to a shareholder is reduced as provided in §1.1367-2(b) and restored as provided in §1.1367-2(c). Thus, the basis adjustment rules under the final regulations apply to all indebtedness of an S corporation to a shareholder, whether the indebtedness is evidenced by a written instrument or is open account debt.

Section 1.1367-2(b) provides the rules for the reduction of basis of indebtedness of an S corporation to a shareholder. Generally, under §1.1367-2(b)(1), if the basis of a shareholder's stock in the S corporation has been reduced to zero under section 1367(a)(2), the excess of certain losses and deductions specified in section 1367(a)(2) is applied to reduce (but not below zero) the basis of any indebtedness of the S corporation to the shareholder held by the shareholder at the close of the S corporation's taxable year. Any indebtedness of the S corporation to the shareholder that has been satisfied by the S corporation, or disposed of or forgiven by the shareholder during the taxable year, is not held by the shareholder at the close of that year and is not subject to basis reduction. Further, §1.1367-2(b)(2) provides that if the interest of the shareholder in the S corporation is terminated during the taxable year, the rules in §1.1367-2(b) are applied to any indebtedness of the S corporation to the

shareholder held by the shareholder immediately before the termination of the shareholder's interest in the S corporation. If a shareholder holds more than one indebtedness at the close of the taxable year (or, if applicable, immediately prior to the termination of the shareholder's interest in the corporation), the basis of each indebtedness is reduced under §1.1367-2(b)(3) in the same proportion that the basis of each indebtedness bears to the aggregate bases of the indebtedness of the S corporation to the shareholder.

Section 1.1367-2(c) provides the rules for restoring basis of indebtedness of an S corporation to a shareholder. Generally, under §1.1367-2(c)(1), if, for any taxable year of the S corporation, there has been a reduction in the basis of an indebtedness of the S corporation to a shareholder, any net increase in any subsequent taxable year of the S corporation is applied to restore that reduction. For purposes of §1.1367-2, a net increase is the amount by which the shareholder's *pro rata* share of S corporation items described in section 1367(a)(1) exceed the items described in section 1367(a)(2) for the taxable year. The restoration rules apply only to indebtedness held by the shareholder as of the beginning of the taxable year in which the net increase arises. Further, the reduction in basis of indebtedness must be restored before a net increase is used to restore the shareholder's basis in stock. The shareholder's basis in indebtedness may not be restored above the adjusted basis of the indebtedness under section 1016(a) (excluding any prior year's adjustments under section 1367), determined as of the beginning of the taxable year in which the net increase arises.

Under §1.1367-2(c)(2), if a shareholder holds more than one indebtedness as of the beginning of an S corporation's taxable year, any net increase is applied first to restore the reduction of basis in any indebtedness repaid (in whole or in part) in that taxable year to the extent necessary to offset any gain that would otherwise be realized on the repayment. Any remaining net increase is applied to restore each outstanding indebtedness in proportion to the amount that the basis of each outstanding indebtedness has been reduced and not restored.

Section 1.1367-2(d) provides rules for the time at which adjustments to

basis of indebtedness under section 1367(b)(2) are effective. Generally, under §1.1367-2(d)(1) the amount of the adjustments to basis of indebtedness are determined and effective as of the close of an S corporation's taxable year. However, if the shareholder is not a shareholder in the S corporation at that time, the adjustments are effective immediately before the shareholder's interest in the S corporation is terminated. Moreover, if a debt is disposed of or repaid, in whole or in part, before the close of the taxable year, the basis of that debt is restored effective immediately before the disposition or the first repayment on the debt during the taxable year.

On August 25, 2005, the Tax Court issued its decision in *Brooks v. Commissioner*, TC Memo. 2005-204. In *Brooks*, the taxpayer borrowed money from a bank and advanced that money as open account debt to his S corporation in one taxable year and reduced basis in that open account debt for losses passed through to the taxpayer at the end of that same year. In the first few weeks of the subsequent taxable year, the S corporation repaid the open account debt (the taxpayer then repaid his debt for the borrowed money). Late in that subsequent year, the taxpayer advanced additional money (again, amounts borrowed from a bank) in an amount that offset the repayment of advances to avoid the recognition of gain from repayment of the indebtedness. Also, the taxpayer's advances increased the shareholder's basis in the indebtedness and allowed losses for that year to pass through to the taxpayer shareholder. Taxpayer and the S corporation made these repayments and advances for several taxable years and deferred indefinitely the recognition of income on any repayment of his open account debt.

The court in *Brooks* held "that the basis of the open account indebtedness is properly computed by netting at the close of the year advances of open account debt during the year and repayments of open account debt during the year."

Explanation of Provisions

The Treasury Department and the IRS believe that the concept of "open account debt" as defined in §1.1367-2(a) was intended to provide administrative simplicity for S corporations but was not

intended to permit the deferral allowed in *Brooks*. The IRS and Treasury Department are proposing these amendments to narrow the definition of open account debt and to modify the rules for adjustments of basis in indebtedness for the more narrowly defined open account debt.

In these proposed regulations, open account debt is defined as shareholder advances not evidenced by separate written instruments for which the principal amount of the aggregate advances (net of repayments on the advances) does not exceed \$10,000 at the close of any day during the S corporation's taxable year. Included within that definition are separate advances under a line of credit agreement if the advances are not evidenced by a separate written instrument. Open account debt is treated as a single indebtedness. This \$10,000 limitation on open account debt for the purposes of the §1.1367-2 regulations is modeled after section 7872(c)(3) and the §1.7872-9 proposed regulations, which provide a \$10,000 *de minimis* exception to the treatment of loans with below-market interest rates for compensation-related or corporation-shareholder loans.

Under these proposed regulations, to determine whether shareholder advances and repayments on the advances exceed the \$10,000 aggregate principal threshold on any day during the S corporation's taxable year for open account debt, the shareholder will have to maintain a "running balance" of those advances and repayments, and the outstanding principal amount of the open account debt. If the resulting aggregate principal of the running balance does not exceed \$10,000 at the close of any day during the S corporation's taxable year, the advances and repayments on advances would constitute open account debt, would be treated as a single indebtedness, and would be accounted for at the close of the taxable year (as explained in this preamble). However, if the resulting aggregate principal of the running balance exceeds \$10,000 at the close of any day during the S corporation's taxable year, the entire principal amount of that indebtedness would no longer constitute open account debt effective at the close of the day on the date the amount of the running balance exceeds \$10,000. This principal amount would be treated as indebtedness evidenced by a written in-

strument for that taxable year, and would be accounted for according to the timing rules in §1.1367-2(d) for that taxable year and subsequent taxable years. Any new shareholder advances not evidenced by a written instrument and repayments on those advances within the \$10,000 aggregate principal threshold amount during the taxable year would constitute a new open account debt.

The proposed regulations also modify the manner in which repayments on open account debt are accounted for under the existing final §1.1367-2 regulations. These rules are separate from the maintenance of a running balance of the advances and repayments to determine if a shareholder has exceeded the \$10,000 threshold amount. For purposes of accounting for open account debt, each shareholder, at the end of the S corporation's taxable year, must determine if that shareholder has made a net advance or received a net repayment on open account debt for that taxable year. To determine if a net advance or a net repayment has occurred, each shareholder, at the end of the S corporation's taxable year, must net all advances and repayments made during the year without regard to the outstanding principal amount of the open account debt. If, at the end of the taxable year, a net repayment exists, the net repayment must be taken into account effective at the close of the S corporation's taxable year under the general basis adjustment rules in the existing final §1.1367-2 regulations. If, at the end of the taxable year, a net advance exists, the net advance is combined with the outstanding aggregate principal balance of the existing open account debt and that amount is carried forward to the beginning of the subsequent taxable year as the outstanding aggregate principal amount of the open account debt. If at any time during the taxable year the resulting aggregate principal of the running balance exceeds the \$10,000 threshold amount so the entire principal amount of the indebtedness no longer constitutes open account debt, the running balance must be reconciled effective at the close of the day the balance exceeds \$10,000 to determine the aggregate principal amount of the indebtedness, and for the remainder of the taxable year that principal amount is treated in the same manner as indebted-

ness evidenced by a written instrument for the purposes of this section.

Proposed Effective Date

The regulations, as proposed, apply to any shareholder advances to the S corporation made on or after the date of publication of a Treasury decision adopting these rules as final regulations in the **Federal Register** and repayments on those advances by the S corporation.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for July 31, 2007, beginning at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name

placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 606.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and time to be devoted to each topic (a signed original and eight (8) copies) by July 10, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Stacy L. Short and Deane M. Burke of the Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAX

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1367-2 also issued under 26 U.S.C. 1367(b)(2).* * *

Par. 2. Section 1.1367-2 is amended as follows:

1. Paragraph (a) is revised and redesignated as paragraph (a)(1) and paragraph (a)(2) is added.

2. Paragraphs (c)(2) and (d)(1) are revised.

3. Paragraph (d)(2) is redesignated as paragraph (d)(3).

4. New paragraph (d)(2) is added.

5. Paragraph (e) is amended by adding *Examples 6 and 7*.

The revisions and additions read as follows:

§1.1367-2 Adjustments to basis of indebtedness to shareholder.

(a) *In general*—(1) *Adjustments under section 1367*. This section provides rules relating to adjustments required by subchapter S to the basis of indebtedness (including open account debt as described in paragraph (a)(2) of this section) of an S corporation to a shareholder. The basis of indebtedness of the S corporation to a shareholder is reduced as provided in paragraph (b) of this section and restored as provided in paragraph (c) of this section in accordance with the timing rules in paragraph (d) of this section.

(2) *Open Account Debt*—(i) *General rule*. The term *open account debt* means shareholder advances not evidenced by separate written instruments and repayments on the advances, the aggregate outstanding principal of which does not exceed \$10,000 of indebtedness of the S corporation to the shareholder at the close of any day during the S corporation's taxable year. Advances and repayments on open account debt are treated as a single indebtedness. For purposes of determining if shareholder advances not evidenced by separate written instruments and repayments on those advances exceed an aggregate outstanding principal of \$10,000, a shareholder must maintain a running daily balance of all advances and repayments on those advances and the outstanding principal amount of the open account debt at the close of each day during the S corporation's taxable year.

(ii) *Exception*. If a shareholder's running balance exceeds an aggregate outstanding principal amount of \$10,000 at the close of any day during the S corporation's taxable year, effective on the close of the day on which the shareholder's running balance exceeds \$10,000, the running balance must be reconciled to determine the aggregate principal amount of indebtedness. For the remainder of the taxable year, that aggregate principal amount of indebtedness is treated in the same manner as indebtedness evidenced by a separate written instrument for purposes of this section. For the remainder of that taxable year and subsequent taxable years, the indebtedness is not open account debt and is subject to all basis adjustment rules applicable to basis of indebtedness of an S corporation to a shareholder in this section.

* * * * *

(c) * * * (1) * * *

(2) *Multiple indebtedness*. If a shareholder holds more than one indebtedness (including any open account debt and any debt treated as a single indebtedness under paragraph (a)(2)(ii)) as of the beginning of an S corporation's taxable year, any net increase is applied first to restore the reduction of basis in any indebtedness repaid (in whole or in part) in that taxable year to the extent necessary to offset any gain that would otherwise be realized on the repayment. Any remaining net increase is applied to restore each outstanding indebtedness (including any open account debt and any debt treated as a single indebtedness under paragraph (a)(2)(ii) of this section) in proportion to the amount that the basis of each outstanding indebtedness has been reduced under section 1367(b)(2)(A) and paragraph (b) of this section and not restored under section 1367(b)(2)(B) and this paragraph (c).

(d) *Time at which adjustments to basis of indebtedness are effective*—(1) *In general*. Except as provided in paragraph (d)(2) of this section, the amounts of the adjustments to basis of indebtedness provided in section 1367(b)(2) and this section are determined as of the close of the S corporation's taxable year, and the adjustments are generally effective as of the close of the S corporation's taxable year. However, if the shareholder is not a shareholder in the S corporation at that time, these adjustments are effective immediately before the shareholder terminates his or her interest in the S corporation. If a debt (including any open account debt and any debt treated as a single indebtedness under paragraph (a)(2)(ii) of this section) is disposed of or repaid in whole or in part before the close of the taxable year, the basis of that indebtedness is restored under paragraph (c) of this section, effective immediately before the disposition or the first repayment on the debt (or the net repayment on open account debt) during the taxable year. To the extent any reduction of basis in indebtedness under paragraph (b) of this section that is disposed of or repaid (in whole or in part) during the taxable year is not restored completely under paragraph (c) of this section, gain is realized on the repayment effective immediately before the indebtedness is disposed of or repaid (in whole or in part).

(2) *Open account debt*—(i) *In general.* All advances and repayments on open account debt (as described in paragraph (a)(2)(i) of this section) during the taxable year are netted continuously as the advances and repayments occur. The amount of any net advance or net repayment on open account debt for the S corporation's taxable year is determined at the close of the taxable year. If the shareholder advances, and repayments on the advances, during the S corporation's taxable year result in a net advance or net repayment, the basis of the open account debt is reduced as provided in paragraph (b) of this section and restored as provided in paragraph (c) of this section effective at the close of the taxable year. To the extent any reduction of basis of open account debt under paragraph (b) of this section that is disposed of or repaid (in whole or in part) during the taxable year is not restored completely under paragraph (c) of this section, income is realized on the net repayment at the close of the taxable year in which the open account debt is disposed of or repaid (in whole or in part).

(ii) *Exception.* On the close of the day on which the shareholder's running balance exceeds an aggregate outstanding principal amount of \$10,000, the shareholder's running balance is reconciled to determine an aggregate principal amount of indebtedness. The resulting aggregate principal amount of indebtedness is treated as the principal amount of a debt evidenced by a separate written instrument for the remainder of that taxable year and any subsequent taxable year, and is no longer subject

to the open account debt provisions of this section.

* * * * *
(e) * * * * *
* * * * *

Example 6. Treatment of open account debt. (i) A has been the sole shareholder in Corporation S since 2000. In 2007, A advances S \$8,000, which is not evidenced by a written instrument. The \$8,000 advance is open account debt and remains outstanding at that amount during 2007. On December 31, 2007, the basis of A's stock is zero; and the basis of the open account debt is reduced under paragraph (b) of this section to \$4,000. On April 1, 2008, S repays \$3,000 of the open account indebtedness. On September 1, 2008, A advances S an additional \$2,000, which is not evidenced by a written instrument. There is no net increase under paragraph (c) of this section in year 2007 or 2008.

(ii) At no time during the 2007 taxable year does the running balance of A's open account debt exceed \$10,000. As of December 31, 2007, A's basis in the open account debt is reduced under paragraph (b) of this section to \$4,000.

(iii) At no time during the 2008 taxable year does the running balance of A's open account debt exceed \$10,000. On April 1, 2008, S's \$3,000 repayment is applied to A's running balance for open account debt carried forward from 2007 in the amount of \$8,000 to reduce the running balance to \$5,000. On September 1, 2008, A's advance to S of \$2,000, which is not evidenced by a written instrument, is applied to A's running balance to bring A's aggregate outstanding principal on A's open account indebtedness to \$7,000.

(iv) At the close of the 2008 taxable year, the \$3,000 April repayment S makes to A and A's \$2,000 September advance are netted to result in a net repayment of \$1,000 for the taxable year on A's \$8,000 open account debt carried forward from 2007. Because there is no net increase in 2008, no basis of indebtedness is restored for the 2008 taxable year.

Example 7. Treatment of shareholder indebtedness not evidenced by a written instrument which exceeds \$10,000. (i) The facts are the same as in *Example 6*, in addition to which, on February 1, 2008, S

repays \$1,000 of the open account debt and on March 1, 2008, A advances S \$5,000, which is not evidenced by a written instrument.

(ii) At no time during the 2007 taxable year does the running balance of A's open account debt exceed \$10,000. As of December 31, 2007, the basis of the open account debt is reduced under paragraph (b) of this section to \$4,000.

(iii) The running balance of A's open account debt does exceed \$10,000 during the 2008 taxable year. On February 1, 2008, S's \$1,000 repayment is applied to A's running balance for open account debt carried forward from 2007 in the amount of \$8,000 to reduce the running balance to \$7,000. On March 1, 2008, A's advance to S of \$5,000, which is not evidenced by a written instrument, is applied to A's running balance to bring A's aggregate outstanding principal on A's open account debt to \$12,000. Because this amount exceeds the \$10,000 threshold amount, effective at the close of the day on March 1, 2008, A's running balance must be reconciled to determine an aggregate principal amount of indebtedness.

(iv) As of March 1, 2008, S had made a \$1,000 repayment on A's open account debt, and A had advanced an additional \$5,000 which was not evidenced by a written instrument. To reconcile A's running balance, the \$1,000 repayment and \$5,000 advance are netted first to result in a \$4,000 net advance that is then added with A's existing principal amount of open account debt of \$8,000 to determine the aggregate principal amount of indebtedness of \$12,000. As of March 1, 2008, S's indebtedness to A that is not evidenced by a written instrument has a principal balance of \$12,000 and a basis of \$8,000 (\$4,000 basis on December 31, 2007 + \$4,000 net advance). On April 1, 2008, S repays \$3,000 of that new indebtedness.

(v) On September 1, 2008, A advances S an additional \$2,000, which is not evidenced by a written instrument. The \$2,000 advance is considered new open account debt. On December 31, 2008, A's basis in his stock is zero and the outstanding principal in the two remaining debts are as follows:

	3/1/08 principal	4/1/08 repayment	9/1/08 advance	12/31/08 principal
Indebtedness treated as if evidenced by written instrument	\$12,000	\$3,000		\$9,000
Open account debt			\$2,000	\$2,000

Par. 3. Section 1.1367-3 is amended as follows:

- The section heading is revised.
- The first sentence of the paragraph is revised.
- A new second and last sentence are added.

The revisions and additions read as follows:

§1.1367-3 Effective dates and transitional rules.

Section 1.1367-2(a), (c)(2), (d)(2), and (e) *Example 6* and *Example 7* apply to any shareholder advances to the S corporation made on or after the date these regulations are published as final regulations in the **Federal Register** and repayments on those advances by the S corporation.

Kevin M. Brown,
Deputy Commissioner for
Services and Enforcement.

(Filed by the Office of the Federal Register on April 11, 2007, 8:45 a.m., and published in the issue of the Federal Register for April 12, 2007, 72 F.R. 18417)