

Subchapter S—Tax Treatment of S Corporations and Their Shareholders

Part	
I.	In general.
II.	Tax treatment of shareholders.
III.	Special rules.
IV.	Definitions; miscellaneous.

PART I—IN GENERAL

Sec.	
1361.	S corporation defined.
1362.	Election; revocation; termination.
1363.	Effect of election on corporation.

§ 1361. S corporation defined

(a) S corporation defined

(1) In general

For purposes of this title, the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for such year.

(2) C corporation

For purposes of this title, the term “C corporation” means, with respect to any taxable year, a corporation which is not an S corporation for such year.

(b) Small business corporation

(1) In general

For purposes of this subchapter, the term “small business corporation” means a domestic corporation which is not an ineligible corporation and which does not—

- (A) have more than 100 shareholders,
- (B) have as a shareholder a person (other than an estate, a trust described in subsection (c)(2), or an organization described in subsection (c)(6)) who is not an individual,
- (C) have a nonresident alien as a shareholder, and
- (D) have more than 1 class of stock.

(2) Ineligible corporation defined

For purposes of paragraph (1), the term “ineligible corporation” means any corporation which is—

- (A) a financial institution which uses the reserve method of accounting for bad debts described in section 585,
- (B) an insurance company subject to tax under subchapter L, or
- (C) a DISC or former DISC.

(3) Treatment of certain wholly owned subsidiaries

(A) In general

Except as provided in regulations prescribed by the Secretary, for purposes of this title—

- (i) a corporation which is a qualified subchapter S subsidiary shall not be treated as a separate corporation, and
- (ii) all assets, liabilities, and items of income, deduction, and credit of a qualified subchapter S subsidiary shall be treated as assets, liabilities, and such items (as the case may be) of the S corporation.

(B) Qualified subchapter S subsidiary

For purposes of this paragraph, the term “qualified subchapter S subsidiary” means

any domestic corporation which is not an ineligible corporation (as defined in paragraph (2)), if—

- (i) 100 percent of the stock of such corporation is held by the S corporation, and
- (ii) the S corporation elects to treat such corporation as a qualified subchapter S subsidiary.

(C) Treatment of terminations of qualified subchapter S subsidiary status

(i) In general

For purposes of this title, if any corporation which was a qualified subchapter S subsidiary ceases to meet the requirements of subparagraph (B), such corporation shall be treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before such cessation from the S corporation in exchange for its stock.

(ii) Termination by reason of sale of stock

If the failure to meet the requirements of subparagraph (B) is by reason of the sale of stock of a corporation which is a qualified subchapter S subsidiary, the sale of such stock shall be treated as if—

- (I) the sale were a sale of an undivided interest in the assets of such corporation (based on the percentage of the corporation's stock sold), and
- (II) the sale were followed by an acquisition by such corporation of all of its assets (and the assumption by such corporation of all of its liabilities) in a transaction to which section 351 applies.

(D) Election after termination

If a corporation's status as a qualified subchapter S subsidiary terminates, such corporation (and any successor corporation) shall not be eligible to make—

- (i) an election under subparagraph (B)(ii) to be treated as a qualified subchapter S subsidiary, or
- (ii) an election under section 1362(a) to be treated as an S corporation,

before its 5th taxable year which begins after the 1st taxable year for which such termination was effective, unless the Secretary consents to such election.

(E) Information returns

Except to the extent provided by the Secretary, this paragraph shall not apply to part III of subchapter A of chapter 61 (relating to information returns).

(c) Special rules for applying subsection (b)

(1) Members of a family treated as 1 shareholder

(A) In general

For purposes of subsection (b)(1)(A), there shall be treated as one shareholder—

- (i) a husband and wife (and their estates), and
- (ii) all members of a family (and their estates).

(B) Members of a family

For purposes of this paragraph—

(i) In general

The term “members of a family” means a common ancestor, any lineal descendant of such common ancestor, and any spouse or former spouse of such common ancestor or any such lineal descendant.

(ii) Common ancestor

An individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than 6 generations removed from the youngest generation of shareholders who would (but for this subparagraph) be members of the family. For purposes of the preceding sentence, a spouse (or former spouse) shall be treated as being of the same generation as the individual to whom such spouse is (or was) married.

(iii) Applicable date

The term “applicable date” means the latest of—

(I) the date the election under section 1362(a) is made,

(II) the earliest date that an individual described in clause (i) holds stock in the S corporation, or

(III) October 22, 2004.

(C) Effect of adoption, etc.

Any legally adopted child of an individual, any child who is lawfully placed with an individual for legal adoption by the individual, and any eligible foster child of an individual (within the meaning of section 152(f)(1)(C)), shall be treated as a child of such individual by blood.

(2) Certain trusts permitted as shareholders**(A) In general**

For purposes of subsection (b)(1)(B), the following trusts may be shareholders:

(i) A trust all of which is treated (under subpart E of part I of subchapter J of this chapter) as owned by an individual who is a citizen or resident of the United States.

(ii) A trust which was described in clause (i) immediately before the death of the deemed owner and which continues in existence after such death, but only for the 2-year period beginning on the day of the deemed owner's death.

(iii) A trust with respect to stock transferred to it pursuant to the terms of a will, but only for the 2-year period beginning on the day on which such stock is transferred to it.

(iv) A trust created primarily to exercise the voting power of stock transferred to it.

(v) An electing small business trust.

(vi) In the case of a corporation which is a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)), a trust which constitutes an individual retirement account under section 408(a), including one designated as a Roth IRA under section 408A, but only to the extent of the stock held by such trust in such bank or company as of the date of the enactment of this clause.

This subparagraph shall not apply to any foreign trust.

(B) Treatment as shareholders

For purposes of subsection (b)(1)—

(i) In the case of a trust described in clause (i) of subparagraph (A), the deemed owner shall be treated as the shareholder.

(ii) In the case of a trust described in clause (ii) of subparagraph (A), the estate of the deemed owner shall be treated as the shareholder.

(iii) In the case of a trust described in clause (iii) of subparagraph (A), the estate of the testator shall be treated as the shareholder.

(iv) In the case of a trust described in clause (iv) of subparagraph (A), each beneficiary of the trust shall be treated as a shareholder.

(v) In the case of a trust described in clause (v) of subparagraph (A), each potential current beneficiary of such trust shall be treated as a shareholder; except that, if for any period there is no potential current beneficiary of such trust, such trust shall be treated as the shareholder during such period. This clause shall not apply for purposes of subsection (b)(1)(C).

(vi) In the case of a trust described in clause (vi) of subparagraph (A), the individual for whose benefit the trust was created shall be treated as the shareholder.

(3) Estate of individual in bankruptcy may be shareholder

For purposes of subsection (b)(1)(B), the term “estate” includes the estate of an individual in a case under title 11 of the United States Code.

(4) Differences in common stock voting rights disregarded

For purposes of subsection (b)(1)(D), a corporation shall not be treated as having more than 1 class of stock solely because there are differences in voting rights among the shares of common stock.

(5) Straight debt safe harbor**(A) In general**

For purposes of subsection (b)(1)(D), straight debt shall not be treated as a second class of stock.

(B) Straight debt defined

For purposes of this paragraph, the term “straight debt” means any written unconditional promise to pay on demand or on a specified date a sum certain in money if—

(i) the interest rate (and interest payment dates) are not contingent on profits, the borrower's discretion, or similar factors,

(ii) there is no convertibility (directly or indirectly) into stock, and

(iii) the creditor is an individual (other than a nonresident alien), an estate, a trust described in paragraph (2), or a person which is actively and regularly engaged in the business of lending money.

(C) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to

provide for the proper treatment of straight debt under this subchapter and for the coordination of such treatment with other provisions of this title.

(6) Certain exempt organizations permitted as shareholders

For purposes of subsection (b)(1)(B), an organization which is—

- (A) described in section 401(a) or 501(c)(3), and
- (B) exempt from taxation under section 501(a),

may be a shareholder in an S corporation.

(d) Special rule for qualified subchapter S trust

(1) In general

In the case of a qualified subchapter S trust with respect to which a beneficiary makes an election under paragraph (2)—

(A) such trust shall be treated as a trust described in subsection (c)(2)(A)(i),

(B) for purposes of section 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under paragraph (2) is made, and

(C) for purposes of applying sections 465 and 469 to the beneficiary of the trust, the disposition of the S corporation stock by the trust shall be treated as a disposition by such beneficiary.

(2) Election

(A) In general

A beneficiary of a qualified subchapter S trust (or his legal representative) may elect to have this subsection apply.

(B) Manner and time of election

(i) Separate election with respect to each corporation

An election under this paragraph shall be made separately with respect to each corporation the stock of which is held by the trust.

(ii) Elections with respect to successive income beneficiaries

If there is an election under this paragraph with respect to any beneficiary, an election under this paragraph shall be treated as made by each successive beneficiary unless such beneficiary affirmatively refuses to consent to such election.

(iii) Time, manner, and form of election

Any election, or refusal, under this paragraph shall be made in such manner and form, and at such time, as the Secretary may prescribe.

(C) Election irrevocable

An election under this paragraph, once made, may be revoked only with the consent of the Secretary.

(D) Grace period

An election under this paragraph shall be effective up to 15 days and 2 months before the date of the election.

(3) Qualified subchapter S trust

For purposes of this subsection, the term “qualified subchapter S trust” means a trust—

(A) the terms of which require that—

(i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust,

(ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary,

(iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary’s death or the termination of the trust, and

(iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and

(B) all of the income (within the meaning of section 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

A substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of this subsection and subsection (c).

(4) Trust ceasing to be qualified

(A) Failure to meet requirements of paragraph (3)(A)

If a qualified subchapter S trust ceases to meet any requirement of paragraph (3)(A), the provisions of this subsection shall not apply to such trust as of the date it ceases to meet such requirement.

(B) Failure to meet requirements of paragraph (3)(B)

If any qualified subchapter S trust ceases to meet any requirement of paragraph (3)(B) but continues to meet the requirements of paragraph (3)(A), the provisions of this subsection shall not apply to such trust as of the first day of the first taxable year beginning after the first taxable year for which it failed to meet the requirements of paragraph (3)(B).

(e) Electing small business trust defined

(1) Electing small business trust

For purposes of this section—

(A) In general

Except as provided in subparagraph (B), the term “electing small business trust” means any trust if—

(i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in paragraph (2), (3), (4), or (5) of section 170(c), or (IV) an organization described in section 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary,

(ii) no interest in such trust was acquired by purchase, and

(iii) an election under this subsection applies to such trust.

(B) Certain trusts not eligible

The term “electing small business trust” shall not include—

(i) any qualified subchapter S trust (as defined in subsection (d)(3)) if an election under subsection (d)(2) applies to any corporation the stock of which is held by such trust,

(ii) any trust exempt from tax under this subtitle, and

(iii) any charitable remainder annuity trust or charitable remainder unitrust (as defined in section 664(d)).

(C) Purchase

For purposes of subparagraph (A), the term “purchase” means any acquisition if the basis of the property acquired is determined under section 1012.

(2) Potential current beneficiary

For purposes of this section, the term “potential current beneficiary” means, with respect to any period, any person who at any time during such period is entitled to, or at the discretion of any person may receive, a distribution from the principal or income of the trust (determined without regard to any power of appointment to the extent such power remains unexercised at the end of such period). If a trust disposes of all of the stock which it holds in an S corporation, then, with respect to such corporation, the term “potential current beneficiary” does not include any person who first met the requirements of the preceding sentence during the 1-year period ending on the date of such disposition.

(3) Election

An election under this subsection shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

(4) Cross reference

For special treatment of electing small business trusts, see section 641(c).

(f) Restricted bank director stock

(1) In general

Restricted bank director stock shall not be taken into account as outstanding stock of the S corporation in applying this subchapter (other than section 1368(f)).

(2) Restricted bank director stock

For purposes of this subsection, the term “restricted bank director stock” means stock in a bank (as defined in section 581) or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))), if such stock—

(A) is required to be held by an individual under applicable Federal or State law in order to permit such individual to serve as a director; and

(B) is subject to an agreement with such bank or company (or a corporation which controls (within the meaning of section 368(c)) such bank or company) pursuant to which the holder is required to sell back such stock (at the same price as the individual acquired such stock) upon ceasing to hold the office of director.

(3) Cross reference

For treatment of certain distributions with respect to restricted bank director stock, see section 1368(f).

(g) Special rule for bank required to change from the reserve method of accounting on becoming S corporation

In the case of a bank which changes from the reserve method of accounting for bad debts described in section 585 or 593 for its first taxable year for which an election under section 1362(a) is in effect, the bank may elect to take into account any adjustments under section 481 by reason of such change for the taxable year immediately preceding such first taxable year.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1669; amended Pub. L. 98-369, div. A, title VII, § 721(c), (f), July 18, 1984, 98 Stat. 967; Pub. L. 99-514, title IX, § 901(d)(4)(G), title XVIII, § 1879(m)(1)(A), Oct. 22, 1986, 100 Stat. 2380, 2910; Pub. L. 100-647, title I, § 1018(q)(2), Nov. 10, 1988, 102 Stat. 3585; Pub. L. 101-239, title VII, § 7811(c)(6), Dec. 19, 1989, 103 Stat. 2407; Pub. L. 104-188, title I, §§ 1301-1302(c), 1303, 1304, 1308(a), (b), (d)(1), 1315, 1316(a), (e), 1616(b)(15), Aug. 20, 1996, 110 Stat. 1777, 1779, 1782, 1783, 1785, 1786, 1857; Pub. L. 105-34, title XVI, § 1601(c)(1), (3), (4)(B), (C), Aug. 5, 1997, 111 Stat. 1087; Pub. L. 105-206, title VI, § 6007(f)(3), July 22, 1998, 112 Stat. 810; Pub. L. 106-554, § 1(a)(7) [title III, § 316(b)], Dec. 21, 2000, 114 Stat. 2763, 2763A-644; Pub. L. 108-357, title II, §§ 231(a), 232(a), 233(a), (b), 234(a), 236(a), 239(a), Oct. 22, 2004, 118 Stat. 1433-1435, 1437; Pub. L. 109-135, title IV, §§ 403(b), 413(a)(1), (c), Dec. 21, 2005, 119 Stat. 2620, 2641; Pub. L. 110-28, title VIII, §§ 8232(a), 8233(a), 8234(a), May 25, 2007, 121 Stat. 197, 198; Pub. L. 115-97, title I, § 13541(a), Dec. 22, 2017, 131 Stat. 2154; Pub. L. 115-141, div. U, title I, § 109(a), title IV, § 401(a)(190), (d)(1)(D)(xvi), Mar. 23, 2018, 132 Stat. 1171, 1193, 1208.)

REFERENCES IN TEXT

The date of the enactment of this clause, referred to in subsec. (c)(2)(A)(vi), is the date of enactment of Pub. L. 108-357, which was approved Oct. 22, 2004.

PRIOR PROVISIONS

A prior section 1361, acts Aug. 16, 1954, ch. 736, 68A Stat. 350; Oct. 10, 1962, Pub. L. 87-792, § 7(h), 76 Stat. 829; Feb. 26, 1964, Pub. L. 88-272, title II, § 225(k)(5), 78 Stat. 94; Apr. 14, 1966, Pub. L. 89-389, § 4(a), 80 Stat. 115, related to election of certain partnerships and proprietorships to be taxed as domestic corporations, prior to repeal by Pub. L. 89-389, § 4(b)(1), Apr. 14, 1966, 80 Stat. 116, effective Jan. 1, 1969.

AMENDMENTS

2018—Subsec. (b)(2)(C), (D). Pub. L. 115-141, § 401(d)(1)(D)(xvi), redesignated subpar. (D) as (C) and struck out former subpar. (C) which read as follows: “a corporation to which an election under section 936 applies, or”.

Subsec. (c)(2)(B)(vi). Pub. L. 115-141, § 109(a), substituted “the shareholder” for “a shareholder”.

Subsec. (f)(2). Pub. L. 115-141, § 401(a)(190), substituted “1813(w)(1)),” for “1813(w)(1)),” in introductory provisions.

2017—Subsec. (c)(2)(B)(v). Pub. L. 115-97 inserted at end “This clause shall not apply for purposes of subsection (b)(1)(C).”

2007—Subsec. (b)(3)(C). Pub. L. 110-28, § 8234(a), designated existing provisions as cl. (i), inserted cl. (i) heading, and added cl. (ii).

Subsec. (f). Pub. L. 110-28, § 8232(a), added subsec. (f).
 Subsec. (g). Pub. L. 110-28, § 8233(a), added subsec. (g).
 2005—Subsec. (b)(3)(A). Pub. L. 109-135, § 413(c)(1), struck out “and in the case of information returns required under part III of subchapter A of chapter 61” after “Secretary”.

Subsec. (b)(3)(E). Pub. L. 109-135, § 413(c)(2), added subpar. (E).

Subsec. (c)(1). Pub. L. 109-135, § 403(b), reenacted heading without change and amended text generally. Prior to amendment, text consisted of subpars. (A) to (D) relating to treatment as 1 shareholder, family members, adoption, and election.

Subsec. (c)(2)(A)(vi). Pub. L. 109-135, § 413(a)(1), inserted “or a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)))” after “a bank (as defined in section 581)” and “or company” after “such bank”.

2004—Subsec. (b)(1)(A). Pub. L. 108-357, § 232(a), substituted “100” for “75”.

Subsec. (b)(3)(A). Pub. L. 108-357, § 239(a), inserted “and in the case of information returns required under part III of subchapter A of chapter 61” after “Secretary”.

Subsec. (c)(1). Pub. L. 108-357, § 231(a), amended heading and text of par. (1) generally. Prior to amendment, text read as follows: “For purposes of subsection (b)(1)(A), a husband and wife (and their estates) shall be treated as 1 shareholder.”

Subsec. (c)(2)(A)(vi). Pub. L. 108-357, § 233(a), added cl. (vi).

Subsec. (c)(2)(B)(vi). Pub. L. 108-357, § 233(b), added cl. (vi).

Subsec. (d)(1)(C). Pub. L. 108-357, § 236(a), added subpar. (C).

Subsec. (e)(2). Pub. L. 108-357, § 234(a), inserted “(determined without regard to any power of appointment to the extent such power remains unexercised at the end of such period)” after “of the trust” and substituted “1-year” for “60-day”.

2000—Subsec. (e)(1)(A)(i)(IV). Pub. L. 106-554 added subcl. (IV).

1998—Subsec. (e)(4). Pub. L. 105-206 substituted “section 641(c)” for “section 641(d)”.

1997—Subsec. (b)(1)(B). Pub. L. 105-34, § 1601(c)(4)(C), substituted “subsection (c)(6)” for “subsection (c)(7)”.

Subsec. (b)(3)(A). Pub. L. 105-34, § 1601(c)(3), substituted “Except as provided in regulations prescribed by the Secretary, for purposes of this title” for “For purposes of this title”.

Subsec. (c)(6), (7). Pub. L. 105-34, § 1601(c)(4)(B), redesignated par. (7) as (6).

Subsec. (e)(1)(B)(iii). Pub. L. 105-34, § 1601(c)(1), added cl. (iii).

1996—Subsec. (b)(1)(A). Pub. L. 104-188, § 1301, substituted “75” for “35”.

Subsec. (b)(1)(B). Pub. L. 104-188, § 1316(a)(1), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “have as a shareholder a person (other than an estate and other than a trust described in subsection (c)(2)) who is not an individual.”

Subsec. (b)(2)(A). Pub. L. 104-188, § 1315, amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “a financial institution to which section 585 applies (or would apply but for subsection (c) thereof).”

Pub. L. 104-188, § 1308(a), redesignated subpar. (B) as (A) and struck out former subpar. (A) which read as follows: “a member of an affiliated group (determined under section 1504 without regard to the exceptions contained in subsection (b) thereof).”

Subsec. (b)(2)(B). Pub. L. 104-188, § 1308(a), redesignated subpar. (C) as (B). Former subpar. (B) redesignated (A).

Pub. L. 104-188, § 1616(b)(15), struck out “or to which section 593 applies” after “subsection (c) thereof”.

Subsec. (b)(2)(C) to (E). Pub. L. 104-188, § 1308(a), redesignated subpars. (D) and (E) as (C) and (D), respectively. Former subpar. (C) redesignated (B).

Subsec. (b)(3). Pub. L. 104-188, § 1308(b), added par. (3).

Subsec. (c)(2)(A)(ii). Pub. L. 104-188, § 1303, substituted “2-year period” for “60-day period” in first sentence and struck out at end “If a trust is described in the preceding sentence and if the entire corpus of the trust is includible in the gross estate of the deemed owner, the preceding sentence shall be applied by substituting ‘2-year period’ for ‘60-day period’.”

Subsec. (c)(2)(A)(iii). Pub. L. 104-188, § 1303(1), substituted “2-year period” for “60-day period”.

Subsec. (c)(2)(A)(v). Pub. L. 104-188, § 1302(a), added cl. (v).

Subsec. (c)(2)(B)(v). Pub. L. 104-188, § 1302(b), added cl. (v).

Subsec. (c)(5)(B)(iii). Pub. L. 104-188, § 1304, substituted “a trust described in paragraph (2), or a person which is actively and regularly engaged in the business of lending money” for “or a trust described in paragraph (2)”.

Subsec. (c)(6). Pub. L. 104-188, § 1308(d)(1), struck out par. (6) which read as follows:

“(6) OWNERSHIP OF STOCK IN CERTAIN INACTIVE CORPORATIONS.—For purposes of subsection (b)(2)(A), a corporation shall not be treated as a member of an affiliated group during any period within a taxable year by reason of the ownership of stock in another corporation if such other corporation—

“(A) has not begun business at any time on or before the close of such period, and

“(B) does not have gross income for such period.”

Subsec. (c)(7). Pub. L. 104-188, § 1316(a)(2), added par. (7).

Subsec. (e). Pub. L. 104-188, § 1302(c), added subsec. (e).

Subsec. (e)(1)(A)(i). Pub. L. 104-188, § 1316(e), struck out “which holds a contingent interest and is not a potential current beneficiary” after “170(c)”.

1989—Subsec. (b)(2)(B). Pub. L. 101-239 amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “a financial institution which is a bank (as defined in section 585(a)(2)) or to which section 593 applies.”

1988—Subsec. (d)(3). Pub. L. 100-647 substituted “with-in the meaning of” for “treated as a separate trust under” in last sentence.

1986—Subsec. (b)(2)(B). Pub. L. 99-514, § 901(d)(4)(G), substituted “which is a bank (as defined in section 585(a)(2)) or to which section 593 applies” for “to which section 585 or 593 applies”.

Subsec. (d)(3). Pub. L. 99-514, § 1879(m)(1)(A), inserted at end “A substantially separate and independent share of a trust treated as a separate trust under section 663(c) shall be treated as a separate trust for purposes of this subsection and subsection (c).”

1984—Subsec. (c)(6). Pub. L. 98-369, § 721(c), amended par. (6) generally, substituting “during any period within a taxable year” for “during any taxable year” in provisions preceding subpar. (A), and substituting “on or before the close of such period” for “on or after the date of its incorporation and before the close of such taxable year” in subpar. (A), and “does not have gross income for such period” for “does not have taxable income for the period included within such taxable year” in subpar. (B).

Subsec. (d)(2)(B)(i). Pub. L. 98-369, § 721(f)(3), substituted “corporation” for “S corporation” in heading and text.

Subsec. (d)(2)(D). Pub. L. 98-369, § 721(f)(1), substituted “15 days and 2 months” for “60 days”.

Subsec. (d)(3). Pub. L. 98-369, § 721(f)(2), in amending par. (3) generally, redesignated subpar. (C) as (A), substituted a period for “, and” at end of subpar. (B), and struck out former subpar. (A) which read “which owns stock in 1 or more S corporations”.

Subsec. (d)(4). Pub. L. 98-369, § 721(f)(2), in amending par. (4) generally, redesignated existing provisions as subpar. (A), inserted “Failure to meet requirements of paragraph (3)(A)” as subpar. (A) heading, substituted “of paragraph (3)(A)” for “under paragraph (3)”, and added subpar. (B).

EFFECTIVE DATE 2018 AMENDMENT

Amendment by section 109(a) of Pub. L. 115–141 effective as if included in section 319 of the American Jobs Creation Act of 2004, Pub. L. 108–357, see section 109(c) of Pub. L. 115–141, set out as a note under section 501 of this title.

EFFECTIVE DATE OF 2017 AMENDMENT

Pub. L. 115–97, title I, §13541(b), Dec. 22, 2017, 131 Stat. 2154, provided that: “The amendment made by this section [amending this section] shall take effect on January 1, 2018.”

EFFECTIVE DATE OF 2007 AMENDMENT

Pub. L. 110–28, title VIII, §8232(c), May 25, 2007, 121 Stat. 198, provided that:

“(1) IN GENERAL.—The amendments made by this section [amending this section and section 1368 of this title] shall apply to taxable years beginning after December 31, 2006.

“(2) SPECIAL RULE FOR TREATMENT AS SECOND CLASS OF STOCK.—In the case of any taxable year beginning after December 31, 1996, restricted bank director stock (as defined in section 1361(f) of the Internal Revenue Code of 1986, as added by this section) shall not be taken into account in determining whether an S corporation has more than 1 class of stock.”

Pub. L. 110–28, title VIII, §8233(b), May 25, 2007, 121 Stat. 198, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2006.”

Pub. L. 110–28, title VIII, §8234(b), May 25, 2007, 121 Stat. 199, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2006.”

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by section 403(b) of Pub. L. 109–135 effective as if included in the provision of the American Jobs Creation Act of 2004, Pub. L. 108–357, to which such amendment relates, see section 403(nn) of Pub. L. 109–135, set out as a note under section 26 of this title.

Pub. L. 109–135, title IV, §413(d), Dec. 21, 2005, 119 Stat. 2642, provided that: “The amendments made by this section [amending this section and sections 1362 and 4975 of this title] shall take effect as if included in the provisions of the American Jobs Creation Act of 2004 [Pub. L. 108–357] to which they relate.”

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108–357, title II, §231(c)(1), Oct. 22, 2004, 118 Stat. 1433, provided that: “The amendment made by subsection (a) [amending this section] shall apply to taxable years beginning after December 31, 2004.”

Pub. L. 108–357, title II, §232(b), Oct. 22, 2004, 118 Stat. 1434, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2004.”

Amendment by section 233(a), (b) of Pub. L. 108–357 effective Oct. 22, 2004, see section 233(e) of Pub. L. 108–357, set out as a note under section 512 of this title.

Pub. L. 108–357, title II, §234(b), Oct. 22, 2004, 118 Stat. 1435, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2004.”

Pub. L. 108–357, title II, §236(b), Oct. 22, 2004, 118 Stat. 1435, provided that: “The amendments made by this section [amending this section] shall apply to transfers made after December 31, 2004.”

Pub. L. 108–357, title II, §239(b), Oct. 22, 2004, 118 Stat. 1437, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2004.”

EFFECTIVE DATE OF 2000 AMENDMENT

Amendment by Pub. L. 106–554 effective as if included in the provisions of the Small Business Job Protection Act of 1996, Pub. L. 104–188, to which such amendment

relates, see section 1(a)(7) [title III, §316(e)] of Pub. L. 106–554, set out as a note under section 51 of this title.

EFFECTIVE DATE OF 1998 AMENDMENT

Amendment by Pub. L. 105–206 effective, except as otherwise provided, as if included in the provisions of the Taxpayer Relief Act of 1997, Pub. L. 105–34, to which such amendment relates, see section 6024 of Pub. L. 105–206, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105–34 effective as if included in the provisions of the Small Business Job Protection Act of 1996, Pub. L. 104–188, to which it relates, see section 1601(j) of Pub. L. 105–34, set out as a note under section 23 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by sections 1301–1302(c), 1303, 1304, 1308(a), (b), (d)(1), and 1315 of Pub. L. 104–188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104–188, set out as a note under section 641 of this title.

Amendment by sections 1316(a), (e) of Pub. L. 104–188 applicable to taxable years beginning after Dec. 31, 1997, see section 1316(f) of Pub. L. 104–188, set out as a note under section 170 of this title.

Amendment by section 1616(b)(15) of Pub. L. 104–188 applicable to taxable years beginning after Dec. 31, 1995, see section 1616(c) of Pub. L. 104–188, set out as a note under section 593 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101–239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100–647, to which such amendment relates, see section 7817 of Pub. L. 101–239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100–647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99–514, to which such amendment relates, see section 1019(a) of Pub. L. 100–647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 901(d)(4)(G) of Pub. L. 99–514 applicable to taxable years beginning after Dec. 31, 1986, see section 901(e) of Pub. L. 99–514, set out as a note under section 166 of this title.

Pub. L. 99–514, title XVIII, §1879(m)(2), Oct. 22, 1986, 100 Stat. 2910, provided that: “The amendments made by this subsection [amending this section and section 1368 of this title] shall apply to taxable years beginning after December 31, 1982.”

EFFECTIVE DATE OF 1984 AMENDMENT

Pub. L. 98–369, div. A, title VII, §721(y), July 18, 1984, 98 Stat. 972, as amended by Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(1) IN GENERAL.—Except as otherwise provided in this subsection, any amendment made by this section [amending this section, sections 48, 108, 267, 318, 465, 1362, 1363, 1367, 1368, 1371, 1374, 1375, 1378, 1379, 6362, and 6659 and provisions set out as a note under this section] shall take effect as if included in the Subchapter S Revision Act of 1982 [Pub. L. 97–354].

“(2) AMENDMENT MADE BY SUBSECTION (b)(2).—Subparagraph (C) of section 108(d)(7) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as amended by subsection (b)(2)) shall apply to contributions to capital after December 31, 1980, in taxable years ending after such date.

“(3) AMENDMENT MADE BY SUBSECTION (g)(1).—If—

“(A) any portion of a qualified stock purchase is pursuant to a binding contract entered into on or

after October 19, 1982, and before the date of the enactment of this Act [July 18, 1984], and

“(B) the purchasing corporation establishes by clear and convincing evidence that such contract was negotiated on the contemplation that, with respect to the deemed sale under section 338 of the Internal Revenue Code of 1986, paragraph (2) of section 1362(e) of such Code would apply, then the amendment made by paragraph (1) of subsection (g) [amending section 1362 of this title] shall not apply to such qualified stock purchase.

“(4) AMENDMENTS MADE BY SUBSECTION (I).—The amendments made by subsection (I) [amending section 1362 of this title] shall apply to any election under section 1362 of the Internal Revenue Code of 1986 (or any corresponding provision of prior law) made after October 19, 1982.

“(5) AMENDMENT MADE BY SUBSECTION (t).—If—

“(A) on or before the date of the enactment of this Act [July 18, 1984] 50 percent or more of the stock of an S corporation has been sold or exchanged in 1 or more transactions, and

“(B) the person (or persons) acquiring such stock establish by clear and convincing evidence that such acquisitions were negotiated on the contemplation that paragraph (2) of section 1362(e) of the Internal Revenue Code of 1986 would apply to the S termination year in which such sales or exchanges occur, then the amendment made by subsection (t) [amending section 1362 of this title] shall not apply to such S termination year.”

EFFECTIVE DATE

Pub. L. 97-354, §6, Oct. 19, 1982, 96 Stat. 1697, as amended by Pub. L. 97-448, title III, §305(d)(1)(A), Jan. 12, 1983, 96 Stat. 2399; Pub. L. 98-369, div. A, title VII, §721(i), (k), July 18, 1984, 98 Stat. 969; Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

“(a) IN GENERAL.—Except as otherwise provided in this section, the amendments made by this Act [enacting this section and sections 1362, 1363, 1366 to 1368, 1371 to 1375, 1377 to 1379, and 6241 to 6245 of this title, amending sections 31, 44D to 44F, 46, 48, 50A, 50B, 52, 53, 55, 57, 58, 62, 108, 163, 168, 170, 172, 179, 183, 189, 194, 267, 280, 280A, 291, 447, 464, 465, 613A, 992, 1016, 1101, 1212, 1251, 1254, 1256, 3453, 3454, 4992, 4996, 6037, 6042, 6362, and 6661 of this title and section 1108 of Title 29, Labor, omitting section 1376 of this title, and enacting provisions set out as a note under section 1 of this title] shall apply to taxable years beginning after December 31, 1982.

“(b) TRANSITIONAL RULES.—

“(1) SECTIONS 1379 AND 62(9) CONTINUE TO APPLY FOR 1983.—Sections 1379 and 62(9) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] (as in effect before the date of the enactment of this Act [Oct. 19, 1982]) shall remain in effect for years beginning before January 1, 1984.

“(2) ALLOWANCE OF EXCLUSION OF DEATH BENEFIT.—Notwithstanding section 241(b) of the Tax Equity and Fiscal Responsibility Act of 1982 [section 241(b) of Pub. L. 97-248, set out as a note under section 416 of this title] in the case of amounts received under a plan of an S corporation, the amendment made by section 239 of such Act [section 239 of Pub. L. 97-248, amending section 101 of this title] shall apply with respect to decedents dying after December 31, 1982.

“(3) NEW PASSIVE INCOME RULES APPLY TO TAXABLE YEARS BEGINNING DURING 1982.—In the case of a taxable year beginning during 1982—

“(A) sections 1362(d)(3), 1366(f)(3), and 1375 of the Internal Revenue Code of 1986 (as amended by this Act [Pub. L. 97-354]) shall apply, and

“(B) section 1372(e)(5) of such Code (as in effect on the day before the date of the enactment of this Act [Oct. 19, 1982]) shall not apply.

The preceding sentence shall not apply in the case of any corporation which elects (at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe) to have such sentence not apply. Subsection (e) shall not apply to any termi-

nation resulting from an election under the preceding sentence.

“(c) GRANDFATHER RULES.—

“(1) SUBSIDIARIES WHICH ARE FOREIGN CORPORATIONS OR DISC'S.—In the case of any corporation which on September 28, 1982, would have been a member of the same affiliated group as an electing small business corporation but for paragraph (3) or (7) of section 1504(b) of the Internal Revenue Code of 1986, subparagraph (A) of section 1361(b)(2) of such Code (as amended by section 2) shall be applied by substituting ‘without regard to the exceptions contained in paragraphs (1), (2), (4), (5), and (6) of subsection (b) thereof’ for ‘without regard to the exceptions contained in subsection (b) thereof’.

“(2) CASUALTY INSURANCE COMPANIES.—

“(A) IN GENERAL.—In the case of any qualified casualty insurance electing small business corporation—

“(i) the amendments made by this Act shall not apply, and

“(ii) subchapter S (as in effect on July 1, 1982) of chapter 1 of the Internal Revenue Code of 1986 [former sections 1371 to 1379 of this title] and part III of subchapter L of chapter 1 of such Code [section 831 et seq. of this title] shall apply.

“(B) QUALIFIED CASUALTY INSURANCE ELECTING SMALL BUSINESS CORPORATION.—The term ‘qualified casualty insurance electing small business corporation’ means any corporation described in section 831(a) of the Internal Revenue Code of 1986 if—

“(i) as of July 12, 1982, such corporation was an electing small business corporation and was described in section 831(a) of such Code,

“(ii) such corporation was formed before April 1, 1982, and proposed (through a written private offering first circulated to investors before such date) to elect to be taxed as a subchapter S corporation and to be operated on an established insurance exchange, or

“(iii) such corporation is approved for membership on an established insurance exchange pursuant to a written agreement entered into before December 31, 1982, and such corporation is described in section 831(a) of such Code as of December 31, 1984.

A corporation shall not be treated as a qualified casualty insurance electing small business corporation unless an election under subchapter S of chapter 1 of such Code is in effect for its first taxable year beginning after December 31, 1984.

“(3) CERTAIN CORPORATIONS WITH OIL AND GAS PRODUCTION.—

“(A) IN GENERAL.—In the case of any qualified oil corporation—

“(i) the amendments made by this Act shall not apply, and

“(ii) subchapter S (as in effect on July 1, 1982) of chapter 1 of the Internal Revenue Code of 1986 [former sections 1371 to 1379 of this title] shall apply.

“(B) QUALIFIED OIL CORPORATION.—For purposes of this paragraph, the term ‘qualified oil corporation’ means any corporation if—

“(i) as of September 28, 1982, such corporation—

“(I) was an electing small business corporation, or

“(II) was a small business corporation which made an election under section 1372(a) after December 31, 1981, and before September 28, 1982,

“(ii) for calendar year 1982, the combined average daily production of domestic crude oil or natural gas of such corporation and any one of its substantial shareholders exceeds 1,000 barrels, and

“(iii) such corporation makes an election under this subparagraph at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe.

“(C) AVERAGE DAILY PRODUCTION.—For purposes of subparagraph (B), the average daily production of

domestic crude oil or domestic natural gas shall be determined under section 613A(c)(2) of such Code without regard to the last sentence thereof.

“(D) SUBSTANTIAL SHAREHOLDER.—For purposes of subparagraph (B), the term ‘substantial shareholder’ means any person who on July 1, 1982, owns more than 40 percent (in value) of the stock of the corporation.

“(4) CONTINUITY REQUIRED.—

“(A) IN GENERAL.—This subsection shall cease to apply with respect to any corporation after—

“(i) any termination of the election of the corporation under subchapter S of chapter 1 of such Code, or

“(ii) the first day on which more than 50 percent of the stock of the corporation is newly owned stock within the meaning of section 1378(c)(2) of such Code (as amended by this Act [Pub. L. 97-354]).

“(B) SPECIAL RULES FOR PARAGRAPH (2).—

“(i) Paragraph (2) shall also cease to apply with respect to any corporation after the corporation ceases to be described in section 831(a) of such Code.

“(ii) For purposes of determining under subparagraph (A)(i) whether paragraph (2) ceases to apply to any corporation, section 1378(c)(2) of such Code (as amended by this Act [Pub. L. 97-354]) shall be applied by substituting ‘December 31, 1984’ for ‘December 31, 1982’ each place it appears therein.

“(d) TREATMENT OF EXISTING FRINGE BENEFIT PLANS.—

“(1) IN GENERAL.—In the case of existing fringe benefits of a corporation which as of September 28, 1982, was an electing small business corporation, section 1372 of the Internal Revenue Code of 1986 (as added by this Act [Pub. L. 97-354]) shall apply only with respect to taxable years beginning after December 31, 1987.

“(2) REQUIREMENTS.—This subsection shall cease to apply with respect to any corporation after whichever of the following first occurs:

“(A) the first day of the first taxable year beginning after December 31, 1982, with respect to which the corporation does not meet the requirements of section 1372(e)(5) of such Code (as in effect on the day before the date of the enactment of this Act [Oct. 19, 1982]),

“(B) any termination after December 31, 1982, of the election of the corporation under subchapter S of chapter 1 of such Code, or

“(C) the first day on which more than 50 percent of the stock of the corporation is newly owned stock within the meaning of section 1378(c)(2) of such Code (as amended by this Act [Pub. L. 97-354]).

“(3) EXISTING FRINGE BENEFIT.—For purposes of this subsection, the term ‘existing fringe benefit’ means any employee fringe benefit of a type which the corporation provided to its employees as of September 28, 1982.

“(e) TREATMENT OF CERTAIN ELECTIONS UNDER PRIOR LAW.—For purposes of section 1362(g) of the Internal Revenue Code of 1986, as amended by this Act [Pub. L. 97-354] (relating to no election permitted within 5 years after termination of prior election), any termination or revocation under section 1372(e) of such Code (as in effect on the day before the date of the enactment of this Act [Oct. 19, 1982]) shall not be taken into account.

“(f) TAXABLE YEAR OF S CORPORATIONS.—Section 1378 of the Internal Revenue Code of 1986 (as added by this Act [Pub. L. 97-354]) shall take effect on the day after the date of the enactment of this Act [Oct. 19, 1982]. For purposes of applying such section, the reference in subsection (a)(2) of such section to an election under section 1362(a) shall include a reference to an election under section 1372(a) of such Code as in effect on the day before the date of the enactment of this Act [Oct. 19, 1982].”

SAVINGS PROVISION

For provisions that nothing in amendment by section 401(d)(1)(D)(xvi) of Pub. L. 115-141 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Mar. 23, 2018, for purposes of determining liability for tax for periods ending after Mar. 23, 2018, see section 401(e) of Pub. L. 115-141, set out as a note under section 23 of this title.

ELIMINATION OF ALL EARNINGS AND PROFITS ATTRIBUTABLE TO PRE-1983 YEARS FOR CERTAIN CORPORATIONS

Pub. L. 110-28, title VIII, §8235, May 25, 2007, 121 Stat. 199, provided that: “In the case of a corporation which is—

“(1) described in section 1311(a)(1) of the Small Business Job Protection Act of 1996 [Pub. L. 104-188, set out below], and

“(2) not described in section 1311(a)(2) of such Act, the amount of such corporation’s accumulated earnings and profits (for the first taxable year beginning after the date of the enactment of this Act [May 25, 2007]) shall be reduced by an amount equal to the portion (if any) of such accumulated earnings and profits which were accumulated in any taxable year beginning before January 1, 1983, for which such corporation was an electing small business corporation under subchapter S of the Internal Revenue Code of 1986.”

ELIMINATION OF CERTAIN EARNINGS AND PROFITS

Pub. L. 104-188, title I, §1311(a), Aug. 20, 1996, 110 Stat. 1784, provided that: “If—

“(1) a corporation was an electing small business corporation under subchapter S of chapter 1 of the Internal Revenue Code of 1986 for any taxable year beginning before January 1, 1983, and

“(2) such corporation is an S corporation under subchapter S of chapter 1 of such Code for its first taxable year beginning after December 31, 1996, the amount of such corporation’s accumulated earnings and profits (as of the beginning of such first taxable year) shall be reduced by an amount equal to the portion (if any) of such accumulated earnings and profits which were accumulated in any taxable year beginning before January 1, 1983, for which such corporation was an electing small business corporation under such subchapter S.”

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

TRANSITIONAL PROVISIONS

Pub. L. 97-448, title III, §305(d)(1)(B), Jan. 12, 1983, 96 Stat. 2399, as amended by Pub. L. 99-514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that: “If—

“(i) after September 30, 1982, and on or before the date of the enactment of this Act [Jan. 12, 1983], stock or securities were transferred to a small business corporation (as defined in section 1361(b) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954] as amended by the Subchapter S Revision Act of 1982 [Pub. L. 97-354]) in a transaction to which section 351 of such Code applies, and

“(ii) such corporation is liquidated under section 333 of such Code before March 1, 1983, then such stock or securities shall not be taken into account under section 333(e)(2) of such Code.”

§ 1362. Election; revocation; termination**(a) Election****(1) In general**

Except as provided in subsection (g), a small business corporation may elect, in accordance with the provisions of this section, to be an S corporation.

(2) All shareholders must consent to election

An election under this subsection shall be valid only if all persons who are shareholders in such corporation on the day on which such election is made consent to such election.

(b) When made**(1) In general**

An election under subsection (a) may be made by a small business corporation for any taxable year—

(A) at any time during the preceding taxable year, or

(B) at any time during the taxable year and on or before the 15th day of the 3d month of the taxable year.

(2) Certain elections made during 1st 2½ months treated as made for next taxable year

If—

(A) an election under subsection (a) is made for any taxable year during such year and on or before the 15th day of the 3d month of such year, but

(B) either—

(i) on 1 or more days in such taxable year before the day on which the election was made the corporation did not meet the requirements of subsection (b) of section 1361, or

(ii) 1 or more of the persons who held stock in the corporation during such taxable year and before the election was made did not consent to the election,

then such election shall be treated as made for the following taxable year.

(3) Election made after 1st 2½ months treated as made for following taxable year

If—

(A) a small business corporation makes an election under subsection (a) for any taxable year, and

(B) such election is made after the 15th day of the 3d month of the taxable year and on or before the 15th day of the 3d month of the following taxable year,

then such election shall be treated as made for the following taxable year.

(4) Taxable years of 2½ months or less

For purposes of this subsection, an election for a taxable year made not later than 2 months and 15 days after the first day of the taxable year shall be treated as timely made during such year.

(5) Authority to treat late elections, etc., as timely

If—

(A) an election under subsection (a) is made for any taxable year (determined with-

out regard to paragraph (3)) after the date prescribed by this subsection for making such election for such taxable year or no such election is made for any taxable year, and

(B) the Secretary determines that there was reasonable cause for the failure to timely make such election,

the Secretary may treat such an election as timely made for such taxable year (and paragraph (3) shall not apply).

(c) Years for which effective

An election under subsection (a) shall be effective for the taxable year of the corporation for which it is made and for all succeeding taxable years of the corporation, until such election is terminated under subsection (d).

(d) Termination**(1) By revocation****(A) In general**

An election under subsection (a) may be terminated by revocation.

(B) More than one-half of shares must consent to revocation

An election may be revoked only if shareholders holding more than one-half of the shares of stock of the corporation on the day on which the revocation is made consent to the revocation.

(C) When effective

Except as provided in subparagraph (D)—

(i) a revocation made during the taxable year and on or before the 15th day of the 3d month thereof shall be effective on the 1st day of such taxable year, and

(ii) a revocation made during the taxable year but after such 15th day shall be effective on the 1st day of the following taxable year.

(D) Revocation may specify prospective date

If the revocation specifies a date for revocation which is on or after the day on which the revocation is made, the revocation shall be effective on and after the date so specified.

(2) By corporation ceasing to be small business corporation**(A) In general**

An election under subsection (a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

(B) When effective

Any termination under this paragraph shall be effective on and after the date of cessation.

(3) Where passive investment income exceeds 25 percent of gross receipts for 3 consecutive taxable years and corporation has accumulated earnings and profits**(A) Termination****(i) In general**

An election under subsection (a) shall be terminated whenever the corporation—

(I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and

(II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

(ii) When effective

Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in clause (i).

(iii) Years taken into account

A prior taxable year shall not be taken into account under clause (i) unless the corporation was an S corporation for such taxable year.

(B) Gross receipts from the sales of certain assets

For purposes of this paragraph—

(i) in the case of dispositions of capital assets (other than stock and securities), gross receipts from such dispositions shall be taken into account only to the extent of the capital gain net income therefrom, and

(ii) in the case of sales or exchanges of stock or securities, gross receipts shall be taken into account only to the extent of the gains therefrom.

(C) Passive investment income defined

(i) In general

Except as otherwise provided in this subparagraph, the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, and annuities.

(ii) Exception for interest on notes from sales of inventory

The term “passive investment income” shall not include interest on any obligation acquired in the ordinary course of the corporation’s trade or business from its sale of property described in section 1221(a)(1).

(iii) Treatment of certain lending or finance companies

If the S corporation meets the requirements of section 542(c)(6) for the taxable year, the term “passive investment income” shall not include gross receipts for the taxable year which are derived directly from the active and regular conduct of a lending or finance business (as defined in section 542(d)(1)).

(iv) Treatment of certain dividends

If an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term “passive investment income” shall not include dividends from such C corporation to the extent such dividends are attributable to the earnings and profits of such C corporation derived from the active conduct of a trade or business.

(v) Exception for banks, etc.

In the case of a bank (as defined in section 581) or a depository institution hold-

ing company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1))), the term “passive investment income” shall not include—

(I) interest income earned by such bank or company, or

(II) dividends on assets required to be held by such bank or company, including stock in the Federal Reserve Bank, the Federal Home Loan Bank, or the Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank.

(e) Treatment of S termination year

(1) In general

In the case of an S termination year, for purposes of this title—

(A) S short year

The portion of such year ending before the 1st day for which the termination is effective shall be treated as a short taxable year for which the corporation is an S corporation.

(B) C short year

The portion of such year beginning on such 1st day shall be treated as a short taxable year for which the corporation is a C corporation.

(2) Pro rata allocation

Except as provided in paragraph (3) and subparagraphs (C) and (D) of paragraph (6), the determination of which items are to be taken into account for each of the short taxable years referred to in paragraph (1) shall be made—

(A) first by determining for the S termination year—

(i) the amount of each of the items of income, loss, deduction, or credit described in section 1366(a)(1)(A), and

(ii) the amount of the nonseparately computed income or loss, and

(B) then by assigning an equal portion of each amount determined under subparagraph (A) to each day of the S termination year.

(3) Election to have items assigned to each short taxable year under normal tax accounting rules

(A) In general

A corporation may elect to have paragraph (2) not apply.

(B) Shareholders must consent to election

An election under this subsection shall be valid only if all persons who are shareholders in the corporation at any time during the S short year and all persons who are shareholders in the corporation on the first day of the C short year consent to such election.

(4) S termination year

For purposes of this subsection, the term “S termination year” means any taxable year of a corporation (determined without regard to this subsection) in which a termination of an

election made under subsection (a) takes effect (other than on the 1st day thereof).

(5) Tax for C short year determined on annualized basis

(A) In general

The taxable income for the short year described in subparagraph (B) of paragraph (1) shall be placed on an annual basis by multiplying the taxable income for such short year by the number of days in the S termination year and by dividing the result by the number of days in the short year. The tax shall be the same part of the tax computed on the annual basis as the number of days in such short year is of the number of days in the S termination year.

(B) Section 443(d)(2) to apply

Subsection (d) of section 443 shall apply to the short taxable year described in subparagraph (B) of paragraph (1).

(6) Other special rules

For purposes of this title—

(A) Short years treated as 1 year for carry-over purposes

The short taxable year described in subparagraph (A) of paragraph (1) shall not be taken into account for purposes of determining the number of taxable years to which any item may be carried back or carried forward by the corporation.

(B) Due date for S year

The due date for filing the return for the short taxable year described in subparagraph (A) of paragraph (1) shall be the same as the due date for filing the return for the short taxable year described in subparagraph (B) of paragraph (1) (including extensions thereof).

(C) Paragraph (2) not to apply to items resulting from section 338

Paragraph (2) shall not apply with respect to any item resulting from the application of section 338.

(D) Pro rata allocation for S termination year not to apply if 50-percent change in ownership

Paragraph (2) shall not apply to an S termination year if there is a sale or exchange of 50 percent or more of the stock in such corporation during such year.

(f) Inadvertent invalid elections or terminations

If—

(1) an election under subsection (a) or section 1361(b)(3)(B)(ii) by any corporation—

(A) was not effective for the taxable year for which made (determined without regard to subsection (b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or

(B) was terminated under paragraph (2) or (3) of subsection (d) or section 1361(b)(3)(C),

(2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent,

(3) no later than a reasonable period of time after discovery of the circumstances resulting

in such ineffectiveness or termination, steps were taken—

(A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or

(B) to acquire the required shareholder consents, and

(4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to such period,

then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be, during the period specified by the Secretary.

(g) Election after termination

If a small business corporation has made an election under subsection (a) and if such election has been terminated under subsection (d), such corporation (and any successor corporation) shall not be eligible to make an election under subsection (a) for any taxable year before its 5th taxable year which begins after the 1st taxable year for which such termination is effective, unless the Secretary consents to such election.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1672; amended Pub. L. 98-369, div. A, title I, § 102(d)(2), title VII, § 721(g), (h), (i), (t), July 18, 1984, 98 Stat. 623, 968, 969, 971; Pub. L. 100-647, title I, §§ 1006(f)(6), 1007(g)(9), Nov. 10, 1988, 102 Stat. 3406, 3435; Pub. L. 104-188, title I, §§ 1305(a), (b), 1308(c), 1311(b)(1), Aug. 20, 1996, 110 Stat. 1779, 1780, 1783, 1784; Pub. L. 106-170, title V, § 532(c)(2)(T), Dec. 17, 1999, 113 Stat. 1931; Pub. L. 108-357, title II, §§ 231(b), 237(a), 238(a), Oct. 22, 2004, 118 Stat. 1433, 1436; Pub. L. 109-135, title IV, § 413(b), Dec. 21, 2005, 119 Stat. 2641; Pub. L. 110-28, title VIII, § 8231(a), May 25, 2007, 121 Stat. 196; Pub. L. 110-172, § 11(a)(25), Dec. 29, 2007, 121 Stat. 2487; Pub. L. 113-295, div. A, title II, § 221(a)(88), Dec. 19, 2014, 128 Stat. 4050; Pub. L. 115-141, div. U, title IV, § 401(a)(190), (191), Mar. 23, 2018, 132 Stat. 1193.)

AMENDMENTS

2018—Subsec. (d)(3)(C)(v). Pub. L. 115-141, § 401(a)(190), substituted “1813(w)(1)),” for “1813(w)(1),” in introductory provisions.

Subsec. (f). Pub. L. 115-141, § 401(a)(191), substituted “may be, during” for “may be during” in concluding provisions.

2014—Subsec. (d)(3)(A)(iii). Pub. L. 113-295 substituted “unless the corporation was an S corporation for such taxable year.” for “unless—

“(I) such taxable year began after December 31, 1981, and

“(II) the corporation was an S corporation for such taxable year.”

2007—Subsec. (d)(3)(B) to (F). Pub. L. 110-28 added subpars. (B) and (C) and struck out former subpar. (B), which related to gross receipts from dispositions of capital assets (other than stock and securities) being taken into account only to the extent of the capital gain net income therefrom, subpar. (C), which defined passive investment income, subpar. (D), which provided that, in the case of any options dealer or commodities dealer, passive investment income was to be determined by not taking into account any gain or loss from any section 1256 contract or property related to such a contract, subpar. (E), which related to certain dividends not being treated as passive investment income if an S corporation held stock in a C corporation meeting the requirements of section 1504(a)(2), and subpar. (F), which related to the exception from passive investment income for banks and depository institution holding companies.

Subsec. (f)(1). Pub. L. 110-172 substituted “or section 1361(b)(3)(B)(ii)” for “, section 1361(b)(3)(B)(ii), or section 1361(c)(1)(A)(ii)” in introductory provisions and “or section 1361(b)(3)(C)” for “, section 1361(b)(3)(C), or section 1361(c)(1)(D)(iii)” in subpar. (B).

2005—Subsec. (d)(3)(F). Pub. L. 109-135 substituted “a depository institution holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)))” for “a bank holding company (within the meaning of section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a))), or a financial holding company (within the meaning of section 2(p) of such Act)”.

2004—Subsec. (d)(3)(F). Pub. L. 108-357, § 237(a), added subpar. (F).

Subsec. (f). Pub. L. 108-357, § 238(a)(5), inserted “or a qualified subchapter S subsidiary, as the case may be” after “S corporation” in concluding provisions.

Subsec. (f)(1). Pub. L. 108-357, § 238(a)(1), inserted “, section 1361(b)(3)(B)(ii),” after “subsection (a)” in introductory provisions.

Pub. L. 108-357, § 231(b)(1), inserted “or section 1361(c)(1)(A)(ii)” after “section 1361(b)(3)(B)(ii),” in introductory provisions.

Subsec. (f)(1)(B). Pub. L. 108-357, § 238(a)(2), inserted “, section 1361(b)(3)(C),” after “subsection (d)”.

Pub. L. 108-357, § 231(b)(2), inserted “or section 1361(c)(1)(D)(iii)” after “section 1361(b)(3)(C),”.

Subsec. (f)(3)(A). Pub. L. 108-357, § 238(a)(3), amended subpar. (A) generally. Prior to amendment, subpar. (A) read as follows: “so that the corporation is a small business corporation, or”.

Subsec. (f)(4). Pub. L. 108-357, § 238(a)(4), amended par. (4) generally. Prior to amendment, par. (4) read as follows: “the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period.”.

1999—Subsec. (d)(3)(C)(ii). Pub. L. 106-170 substituted “section 1221(a)(1)” for “section 1221(1)”.

1996—Subsec. (b)(5). Pub. L. 104-188, § 1305(b), added par. (5).

Subsec. (d)(3). Pub. L. 104-188, § 1311(b)(1)(A), in heading substituted “accumulated” for “subchapter C”.

Subsec. (d)(3)(A)(i)(I). Pub. L. 104-188, § 1311(b)(1)(B), substituted “accumulated” for “subchapter C”.

Subsec. (d)(3)(B) to (E). Pub. L. 104-188, § 1311(b)(1)(C), redesignated subpars. (C) to (F) as (B) to (E), respectively, and struck out former subpar. (B) which read as follows:

“(B) SUBCHAPTER C EARNINGS AND PROFITS.—For purposes of subparagraph (A), the term ‘subchapter C earnings and profits’ means earnings and profits of any corporation for any taxable year with respect to which an election under section 1362(a) (or under section 1372 of prior law) was not in effect.”

Subsec. (d)(3)(F). Pub. L. 104-188, § 1311(b)(1)(C), redesignated subpar. (F) as (E).

Pub. L. 104-188, § 1308(c), added subpar. (F).

Subsec. (f). Pub. L. 104-188, § 1305(a), amended subsec. (f) generally. Prior to amendment, subsec. (f) read as follows:

“(f) INADVERTENT TERMINATIONS.—If—

“(1) an election under subsection (a) by any corporation was terminated under paragraph (2) or (3) of subsection (d),

“(2) the Secretary determines that the termination was inadvertent,

“(3) no later than a reasonable period of time after discovery of the event resulting in such termination, steps were taken so that the corporation is once more a small business corporation, and

“(4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period,

then, notwithstanding the terminating event, such corporation shall be treated as continuing to be an S corporation during the period specified by the Secretary.”

1988—Subsec. (d)(3)(D)(v). Pub. L. 100-647, § 1006(f)(6)(A), struck out cl. (v) which related to special rule for options and commodities dealers.

Subsec. (d)(3)(E). Pub. L. 100-647, § 1006(f)(6)(B), added subpar. (E).

Subsec. (e)(5)(B). Pub. L. 100-647, § 1007(g)(9), substituted “Subsection (d)” for “Subsection (d)(2)”.

1984—Subsec. (b)(3)(B). Pub. L. 98-369, § 721(l)(2), substituted “on or before the 15th day of the 3rd month of the following taxable year” for “on or before the last day of such taxable year”.

Subsec. (b)(4). Pub. L. 98-369, § 721(l)(1), added par. (4).

Subsec. (d)(3)(D)(v). Pub. L. 98-369, § 102(d)(2), added cl. (v).

Subsec. (e)(2). Pub. L. 98-369, § 721(g)(2), substituted “as provided in paragraph (3) and subparagraphs (C) and (D) of paragraph (6)” for “as provided in paragraph (3)”.

Subsec. (e)(3)(B). Pub. L. 98-369, § 721(h), struck out “All” in heading, and substituted “subsection” for “paragraph” and “S short year and all persons who are shareholders in the corporation on the first day of the C short year” for “S termination year” in text.

Subsec. (e)(6)(C). Pub. L. 98-369, § 721(g)(1), added subpar. (C).

Subsec. (e)(6)(D). Pub. L. 98-369, § 721(t), added subpar. (D).

EFFECTIVE DATE OF 2014 AMENDMENT

Amendment by Pub. L. 113-295 effective Dec. 19, 2014, subject to a savings provision, see section 221(b) of Pub. L. 113-295, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 2007 AMENDMENT

Pub. L. 110-28, title VIII, § 8231(b), May 25, 2007, 121 Stat. 197, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after the date of the enactment of this Act [May 25, 2007].”

EFFECTIVE DATE OF 2005 AMENDMENT

Amendment by Pub. L. 109-135 effective as if included in the provision of the American Jobs Creation Act of 2004, Pub. L. 108-357, to which such amendment relates, see section 413(d) of Pub. L. 109-135, set out as a note under section 1361 of this title.

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108-357, title II, § 231(c)(2), Oct. 22, 2004, 118 Stat. 1434, provided that: “The amendments made by subsection (b) [amending this section] shall apply to elections and terminations made after December 31, 2004.”

Pub. L. 108-357, title II, § 237(b), Oct. 22, 2004, 118 Stat. 1436, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2004.”

Pub. L. 108-357, title II, § 238(b), Oct. 22, 2004, 118 Stat. 1436, provided that: “The amendments made by this

section [amending this section] shall apply to elections made and terminations made after December 31, 2004.”

EFFECTIVE DATE OF 1999 AMENDMENT

Amendment by Pub. L. 106-170 applicable to any instrument held, acquired, or entered into, any transaction entered into, and supplies held or acquired on or after Dec. 17, 1999, see section 532(d) of Pub. L. 106-170, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Pub. L. 104-188, title I, §1305(c), Aug. 20, 1996, 110 Stat. 1780, provided that: “The amendments made by subsections (a) and (b) [amending this section] shall apply with respect to elections for taxable years beginning after December 31, 1982.”

Amendment by sections 1308(c) and 1311(b)(1) of Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 102(d)(2) of Pub. L. 98-369 applicable to positions established after July 18, 1984, in taxable years ending after that date except as otherwise provided, see section 102(f), (g) of Pub. L. 98-369, set out as a note under section 1256 of this title.

Amendment by section 721(g), (h), (i), (t) of Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, except that amendment by section 721(g)(1) is not applicable to certain qualified stock purchases, amendment by section 721(i) is applicable to any election under this section (or any corresponding provision of prior law) made after Oct. 19, 1982, and amendment by section 721(t) is not applicable to certain S termination years, see section 721(y) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, except that in the case of a taxable year beginning during 1982, subsec. (d)(3) of this section and sections 1366(f)(3) and 1375 of this title shall apply, and section 1372(e)(5) of this title as in effect on the day before Oct. 19, 1982, shall not apply, see section 6(a), (b)(3) of Pub. L. 97-354, set out as a note under section 1361 of this title. For additional provisions relating to the treatment of certain elections under prior law for purposes of subsec. (g) of this section, see section 6(e) of Pub. L. 97-354, set out as a note under section 1361 of this title.

TREATMENT OF CERTAIN ELECTIONS UNDER PRIOR LAW

Pub. L. 104-188, title I, §1317(b), Aug. 20, 1996, 110 Stat. 1787, provided that: “For purposes of section 1362(g) of the Internal Revenue Code of 1986 (relating to election after termination), any termination under section 1362(d) of such Code in a taxable year beginning before January 1, 1997, shall not be taken into account.”

SUBCHAPTER S ELECTION

Pub. L. 98-369, div. A, title I, §102(d)(3), July 18, 1984, 98 Stat. 623, as amended by Pub. L. 99-514, §2, title XVIII, §1808(a)(2), Oct. 22, 1986, 100 Stat. 2095, 2817, provided that: “If a commodities dealer or an options dealer—

“(A) becomes a small business corporation (as defined in section 1361(b) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954]) at any time before the close of the 75th day after the date of the enactment of this Act [July 18, 1984], and

“(B) makes the election under section 1362(a) of such Code before the close of such 75th day, then such dealer shall be treated as having received approval for and adopted a taxable year beginning on the first day during 1984 on which it was a small business corporation (as so defined) or such other day as may be permitted under regulations and ending on the date determined under section 1378 of such Code and such election shall be effective for such taxable year.”

§ 1363. Effect of election on corporation

(a) General rule

Except as otherwise provided in this subchapter, an S corporation shall not be subject to the taxes imposed by this chapter.

(b) Computation of corporation's taxable income

The taxable income of an S corporation shall be computed in the same manner as in the case of an individual, except that—

(1) the items described in section 1366(a)(1)(A) shall be separately stated,

(2) the deductions referred to in section 703(a)(2) shall not be allowed to the corporation,

(3) section 248 shall apply, and

(4) section 291 shall apply if the S corporation (or any predecessor) was a C corporation for any of the 3 immediately preceding taxable years.

(c) Elections of the S corporation

(1) In general

Except as provided in paragraph (2), any election affecting the computation of items derived from an S corporation shall be made by the corporation.

(2) Exceptions

In the case of an S corporation, elections under the following provisions shall be made by each shareholder separately—

(A) section 617 (relating to deduction and recapture of certain mining exploration expenditures), and

(B) section 901 (relating to taxes of foreign countries and possessions of the United States).

(d) Recapture of LIFO benefits

(1) In general

If—

(A) an S corporation was a C corporation for the last taxable year before the first taxable year for which the election under section 1362(a) was effective, and

(B) the corporation inventoried goods under the LIFO method for such last taxable year,

the LIFO recapture amount shall be included in the gross income of the corporation for such last taxable year (and appropriate adjustments to the basis of inventory shall be made to take into account the amount included in gross income under this paragraph).

(2) Additional tax payable in installments

(A) In general

Any increase in the tax imposed by this chapter by reason of this subsection shall be payable in 4 equal installments.

(B) Date for payment of installments

The first installment under subparagraph (A) shall be paid on or before the due date

(determined without regard to extensions) for the return of the tax imposed by this chapter for the last taxable year for which the corporation was a C corporation and the 3 succeeding installments shall be paid on or before the due date (as so determined) for the corporation's return for the 3 succeeding taxable years.

(C) No interest for period of extension

Notwithstanding section 6601(b), for purposes of section 6601, the date prescribed for the payment of each installment under this paragraph shall be determined under this paragraph.

(3) LIFO recapture amount

For purposes of this subsection, the term “LIFO recapture amount” means the amount (if any) by which—

(A) the inventory amount of the inventory asset under the first-in, first-out method authorized by section 471, exceeds

(B) the inventory amount of such assets under the LIFO method.

For purposes of the preceding sentence, inventory amounts shall be determined as of the close of the last taxable year referred to in paragraph (1).

(4) Other definitions

For purposes of this subsection—

(A) LIFO method

The term “LIFO method” means the method authorized by section 472.

(B) Inventory assets

The term “inventory assets” means stock in trade of the corporation, or other property of a kind which would properly be included in the inventory of the corporation if on hand at the close of the taxable year.

(C) Method of determining inventory amount

The inventory amount of assets under a method authorized by section 471 shall be determined—

(i) if the corporation uses the retail method of valuing inventories under section 472, by using such method, or

(ii) if clause (i) does not apply, by using cost or market, whichever is lower.

(D) Not treated as member of affiliated group

Except as provided in regulations, the corporation referred to in paragraph (1) shall not be treated as a member of an affiliated group with respect to the amount included in gross income under paragraph (1).

(5) Special rule

Sections 1367(a)(2)(D) and 1371(c)(1) shall not apply with respect to any increase in the tax imposed by reason of this subsection.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1676; amended Pub. L. 98-369, div. A, title VII, § 721(a), (b)(1), (p), July 18, 1984, 98 Stat. 966, 970; Pub. L. 99-514, title V, § 511(d)(2)(C), title VI, § 632(b), title VII, § 701(e)(4)(J), Oct. 22, 1986, 100 Stat. 2249, 2277, 2343; Pub. L. 100-203, title X, § 10227(a), Dec. 22, 1987, 101 Stat. 1330-416; Pub. L. 100-647, title I, § 1006(f)(7), title II, § 2004(n), Nov.

10, 1988, 102 Stat. 3407, 3608; Pub. L. 109-135, title IV, § 411(a), Dec. 21, 2005, 119 Stat. 2636.)

AMENDMENTS

2005—Subsec. (d)(5). Pub. L. 109-135 added par. (5).

1988—Subsec. (d). Pub. L. 100-647, § 1006(f)(7), struck out subsec. (d) which related to distributions of appreciated property.

Subsec. (d)(4)(D). Pub. L. 100-647, § 2004(n), added subpar. (D).

Subsec. (e). Pub. L. 100-647, § 1006(f)(7), struck out subsec. (e) which provided that subsec. (d) not apply to reorganizations, etc.

1987—Subsec. (d). Pub. L. 100-203 added subsec. (d) relating to recapture of LIFO benefits.

1986—Subsec. (a). Pub. L. 99-514, § 701(e)(4)(J), struck out “and in section 58(d)” after “this subchapter”.

Subsec. (c)(2). Pub. L. 99-514, § 511(d)(2)(C), redesignated subpars. (B) and (C) as (A) and (B), respectively, and struck out former subpar. (A) which read as follows: “section 163(d) (relating to limitation on interest on investment indebtedness).”

Subsec. (e). Pub. L. 99-514, § 632(b), amended subsec. (e) generally, substituting “reorganizations, etc.” for “complete liquidations and reorganizations”, in heading and in text struck out reference to property in complete liquidation of the corporation.

1984—Subsec. (b)(4). Pub. L. 98-369, § 721(p), added par. (4).

Subsec. (c)(2). Pub. L. 98-369, § 721(b)(1), redesignated subpars. (B) to (D) as (A) to (C), respectively, and struck out subpar. (A) which provided “subsection (b)(5) or (d)(4) of section 108 (relating to income from discharge of indebtedness).”

Subsec. (d). Pub. L. 98-369, § 721(a)(2), substituted “Except as provided in subsection (e), if” for “If”.

Subsec. (e). Pub. L. 98-369, § 721(a)(1), added subsec. (e).

EFFECTIVE DATE OF 2005 AMENDMENT

Pub. L. 109-135, title IV, § 411(b), Dec. 21, 2005, 119 Stat. 2636, provided that: “The amendment made by this section [amending this section] shall take effect as if included in section 10227 of the Omnibus Budget Reconciliation Act of 1987 [Pub. L. 100-203].”

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by section 1006(f)(7) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

Amendment by section 2004(n) of Pub. L. 100-647 effective, except as otherwise provided, as if included in the provisions of the Revenue Act of 1987, Pub. L. 100-203, title X, to which such amendment relates, see section 2004(u) of Pub. L. 100-647, set out as a note under section 56 of this title.

EFFECTIVE DATE OF 1987 AMENDMENT

Pub. L. 100-203, title X, § 10227(b), Dec. 22, 1987, 101 Stat. 1330-417, provided that:

“(1) IN GENERAL.—Except as provided in paragraph (2) the amendment made by subsection (a) [amending this section] shall apply in the case of elections made after December 17, 1987.

“(2) EXCEPTION.—The amendment made by subsection (a) shall not apply in the case of any election made by a corporation after December 17, 1987, and before January 1, 1989, if, on or before December 17, 1987—

“(A) there was a resolution adopted by the board of directors of such corporation to make an election under subchapter S of chapter 1 of the Internal Revenue Code of 1986, or

“(B) there was a ruling request with respect to the business filed with the Internal Revenue Service expressing an intent to make such an election.”

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 511(d)(2)(C) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31,

1986, see section 511(e) of Pub. L. 99-514, set out as a note under section 163 of this title.

Amendment by section 632(b) of Pub. L. 99-514 applicable to any distribution in complete liquidation, and any sale or exchange, made by a corporation after July 31, 1986, unless such corporation is completely liquidated before Jan. 1, 1987, any transaction described in section 338 of this title for which the acquisition date occurs after Dec. 31, 1986, and any distribution, not in complete liquidation, made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, set out as an Effective Date note under section 336 of this title.

Amendment by section 701(e)(4)(J) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 701(f) of Pub. L. 99-514, set out as an Effective Date note under section 55 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

APPLICABILITY OF CERTAIN AMENDMENTS BY PUB. L. 99-514 IN RELATION TO TREATY OBLIGATIONS OF UNITED STATES

For applicability of amendment by section 701(e)(4)(J) of Pub. L. 99-514 notwithstanding any treaty obligation of the United States in effect on Oct. 22, 1986, with provision that for such purposes any amendment by title I of Pub. L. 100-647 be treated as if it had been included in the provision of Pub. L. 99-514 to which such amendment relates, see section 1012(aa)(2), (4) of Pub. L. 100-647, set out as a note under section 861 of this title.

PART II—TAX TREATMENT OF SHAREHOLDERS

Sec.	
1366.	Pass-thru of items to shareholders.
1367.	Adjustments to basis of stock of shareholders, etc.
1368.	Distributions.

§ 1366. Pass-thru of items to shareholders

(a) Determination of shareholder's tax liability

(1) In general

In determining the tax under this chapter of a shareholder for the shareholder's taxable year in which the taxable year of the S corporation ends (or for the final taxable year of a shareholder who dies, or of a trust or estate which terminates, before the end of the corporation's taxable year), there shall be taken into account the shareholder's pro rata share of the corporation's—

(A) items of income (including tax-exempt income), loss, deduction, or credit the separate treatment of which could affect the liability for tax of any shareholder, and

(B) nonseparately computed income or loss.

For purposes of the preceding sentence, the items referred to in subparagraph (A) shall include amounts described in paragraph (4) or (6) of section 702(a).

(2) Nonseparately computed income or loss defined

For purposes of this subchapter, the term "nonseparately computed income or loss"

means gross income minus the deductions allowed to the corporation under this chapter, determined by excluding all items described in paragraph (1)(A).

(b) Character passed thru

The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.

(c) Gross income of a shareholder

In any case where it is necessary to determine the gross income of a shareholder for purposes of this title, such gross income shall include the shareholder's pro rata share of the gross income of the corporation.

(d) Special rules for losses and deductions

(1) Cannot exceed shareholder's basis in stock and debt

The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of—

(A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to paragraphs (1) and (2)(A) of section 1367(a) for the taxable year), and

(B) the shareholder's adjusted basis of any indebtedness of the S corporation to the shareholder (determined without regard to any adjustment under paragraph (2) of section 1367(b) for the taxable year).

(2) Indefinite carryover of disallowed losses and deductions

(A) In general

Except as provided in subparagraph (B), any loss or deduction which is disallowed for any taxable year by reason of paragraph (1) shall be treated as incurred by the corporation in the succeeding taxable year with respect to that shareholder.

(B) Transfers of stock between spouses or incident to divorce

In the case of any transfer described in section 1041(a) of stock of an S corporation, any loss or deduction described in subparagraph (A) with respect such stock shall be treated as incurred by the corporation in the succeeding taxable year with respect to the transferee.

(3) Carryover of disallowed losses and deductions to post-termination transition period

(A) In general

If for the last taxable year of a corporation for which it was an S corporation a loss or deduction was disallowed by reason of paragraph (1), such loss or deduction shall be treated as incurred by the shareholder on the last day of any post-termination transition period.

(B) Cannot exceed shareholder's basis in stock

The aggregate amount of losses and deductions taken into account by a shareholder

under subparagraph (A) shall not exceed the adjusted basis of the shareholder's stock in the corporation (determined at the close of the last day of the post-termination transition period and without regard to this paragraph).

(C) Adjustment in basis of stock

The shareholder's basis in the stock of the corporation shall be reduced by the amount allowed as a deduction by reason of this paragraph.

(D) At-risk limitations

To the extent that any increase in adjusted basis described in subparagraph (B) would have increased the shareholder's amount at risk under section 465 if such increase had occurred on the day preceding the commencement of the post-termination transition period, rules similar to the rules described in subparagraphs (A) through (C) shall apply to any losses disallowed by reason of section 465(a).

(4) Application of limitation on charitable contributions

In the case of any charitable contribution of property to which the second sentence of section 1367(a)(2) applies, paragraph (1) shall not apply to the extent of the excess (if any) of—

(A) the shareholder's pro rata share of such contribution, over

(B) the shareholder's pro rata share of the adjusted basis of such property.

(e) Treatment of family group

If an individual who is a member of the family (within the meaning of section 704(e)(2) of one or more shareholders of an S corporation renders services for the corporation or furnishes capital to the corporation without receiving reasonable compensation therefor, the Secretary shall make such adjustments in the items taken into account by such individual and such shareholders as may be necessary in order to reflect the value of such services or capital.

(f) Special rules

(1) Subsection (a) not to apply to credit allowable under section 34

Subsection (a) shall not apply with respect to any credit allowable under section 34 (relating to certain uses of gasoline and special fuels).

(2) Treatment of tax imposed on built-in gains

If any tax is imposed under section 1374 for any taxable year on an S corporation, for purposes of subsection (a), the amount so imposed shall be treated as a loss sustained by the S corporation during such taxable year. The character of such loss shall be determined by allocating the loss proportionately among the recognized built-in gains giving rise to such tax.

(3) Reduction in pass-thru for tax imposed on excess net passive income

If any tax is imposed under section 1375 for any taxable year on an S corporation, for purposes of subsection (a), each item of passive investment income shall be reduced by an

amount which bears the same ratio to the amount of such tax as—

(A) the amount of such item, bears to

(B) the total passive investment income for the taxable year.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1677; amended Pub. L. 98-369, div. A, title IV, § 474(r)(26), title VII, § 735(c)(16), July 18, 1984, 98 Stat. 844, 985; Pub. L. 99-514, title VI, § 632(c)(2), title VII, § 701(e)(4)(K), Oct. 22, 1986, 100 Stat. 2277, 2343; Pub. L. 100-647, title I, § 1006(f)(5)(E), Nov. 10, 1988, 102 Stat. 3406; Pub. L. 101-239, title VII, § 7811(c)(7), Dec. 19, 1989, 103 Stat. 2407; Pub. L. 104-188, title I, §§ 1302(e), 1307(c)(3)(A), 1309(a)(1), 1312, Aug. 20, 1996, 110 Stat. 1779, 1782, 1783, 1784; Pub. L. 108-357, title II, § 235(a), Oct. 22, 2004, 118 Stat. 1435; Pub. L. 110-172, § 3(b), Dec. 29, 2007, 121 Stat. 2474; Pub. L. 115-141, div. U, title IV, § 401(a)(192), Mar. 23, 2018, 132 Stat. 1193.)

AMENDMENTS

2018—Subsec. (e). Pub. L. 115-141 substituted “section 704(e)(2)” for “section 704(e)(3)”.

2007—Subsec. (d)(4). Pub. L. 110-172 added par. (4).

2004—Subsec. (d)(2). Pub. L. 108-357 reenacted heading without change and amended text of par. (2) generally. Prior to amendment, text read as follows: “Any loss or deduction which is disallowed for any taxable year by reason of paragraph (1) shall be treated as incurred by the corporation in the succeeding taxable year with respect to that shareholder.”

1996—Subsec. (a)(1). Pub. L. 104-188, § 1302(e), inserted “, or of a trust or estate which terminates,” after “who dies” in introductory provisions.

Subsec. (d)(1)(A). Pub. L. 104-188, § 1309(a)(1), substituted “paragraphs (1) and (2)(A)” for “paragraph (1)”.

Subsec. (d)(3)(D). Pub. L. 104-188, § 1312, added subpar. (D).

Subsec. (g). Pub. L. 104-188, § 1307(c)(3)(A), struck out subsec. (g) which provided a cross reference to subchapter D of chapter 63 of this title.

1989—Subsec. (f)(2). Pub. L. 101-239 substituted “Treatment of tax imposed on built-in gains” for “Reduction in pass-thru for tax imposed on built-in gains” in heading and amended text generally. Prior to amendment, text read as follows: “If any tax is imposed under section 1374 for any taxable year on an S corporation, for purposes of subsection (a), the amount of each recognized built-in gain (within the meaning of section 1374) for such taxable year shall be reduced by its proportionate share of such tax.”

1988—Subsec. (f)(2). Pub. L. 100-647 substituted “with-in the meaning of section 1374” for “as defined in section 1374(d)(2)”.

1986—Subsec. (f)(2). Pub. L. 99-514, § 632(c)(2), amended par. (2) generally. Prior to amendment, par. (2), reduction in pass-thru for tax imposed on capital gain, read as follows: “If any tax is imposed under section 1374 for any taxable year on an S corporation, for purposes of subsection (a)—

“(A) the amount of the corporation's long-term capital gains for the taxable year shall be reduced by the amount of such tax, and

“(B) if the amount of such tax exceeds the amount of such long-term capital gains, the corporation's gains from sales or exchanges of property described in section 1231 shall be reduced by the amount of such excess.

For purposes of the preceding sentence, the term ‘long-term capital gain’ shall not include any gain from the sale or exchange of property described in section 1231.”

Pub. L. 99-514, § 701(e)(4)(K), struck out “56 or” before “1374”.

1984—Subsec. (f). Pub. L. 98-369, § 474(r)(26), substituted “section 34” for “section 39” in heading and text.

Subsec. (f)(1). Pub. L. 98-369, §735(c)(16), substituted “and special fuels” for “, special fuels, and lubricating oil”.

EFFECTIVE DATE OF 2007 AMENDMENT

Amendment by Pub. L. 110-172 effective as if included in the provisions of the Pension Protection Act of 2006, Pub. L. 109-280, to which such amendment relates, see section 3(j) of Pub. L. 110-172, set out as a note under section 170 of this title.

EFFECTIVE DATE OF 2004 AMENDMENT

Pub. L. 108-357, title II, §235(b), Oct. 22, 2004, 118 Stat. 1435, as amended by Pub. L. 109-135, title IV, §403(c), Dec. 21, 2005, 119 Stat. 2620, provided that: “The amendment made by this section [amending this section] shall apply to transfers after December 31, 2004.”

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, to which such amendment relates, see section 7817 of Pub. L. 101-239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 632(c)(2) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, but only in cases where the return for the taxable year is filed pursuant to an S election made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, as amended, set out as an Effective Date note under section 336 of this title.

Amendment by section 701(e)(4)(K) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, with certain exceptions and qualifications, see section 701(f) of Pub. L. 99-514, set out as an Effective Date note under section 55 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 474(r)(26) of Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, and to carrybacks from such years, see section 475(a) of Pub. L. 98-369, set out as a note under section 21 of this title.

Amendment by section 735(c)(16) of Pub. L. 98-369 effective, except as otherwise provided, as if included in the provisions of the Highway Revenue Act of 1982, title V of Pub. L. 97-424, to which such amendment relates, see section 736 of Pub. L. 98-369, set out as a note under section 4051 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, except that in the case of a taxable year beginning during 1982, subsec. (f)(3) of this section and sections 1362(d)(3) and 1375 of this title shall apply, and section 1372(e)(5) of this title as in effect on the day before Oct. 19, 1982, shall not apply, see section 6(a), (b)(3) of Pub. L. 97-354, set out as a note under section 1361 of this title.

APPLICABILITY OF CERTAIN AMENDMENTS BY PUB. L. 99-514 IN RELATION TO TREATY OBLIGATIONS OF UNITED STATES

For applicability of amendment by section 701(e)(4)(K) of Pub. L. 99-514 notwithstanding any trea-

ty obligation of the United States in effect on Oct. 22, 1986, with provision that for such purposes any amendment by title I of Pub. L. 100-647 be treated as if it had been included in the provision of Pub. L. 99-514 to which such amendment relates, see section 1012(aa)(2), (4) of Pub. L. 100-647, set out as a note under section 861 of this title.

§ 1367. Adjustments to basis of stock of shareholders, etc.

(a) General rule

(1) Increases in basis

The basis of each shareholder's stock in an S corporation shall be increased for any period by the sum of the following items determined with respect to that shareholder for such period:

- (A) the items of income described in subparagraph (A) of section 1366(a)(1),
- (B) any nonseparately computed income determined under subparagraph (B) of section 1366(a)(1), and
- (C) the excess of the deductions for depletion over the basis of the property subject to depletion.

(2) Decreases in basis

The basis of each shareholder's stock in an S corporation shall be decreased for any period (but not below zero) by the sum of the following items determined with respect to the shareholder for such period:

- (A) distributions by the corporation which were not includible in the income of the shareholder by reason of section 1368,
- (B) the items of loss and deduction described in subparagraph (A) of section 1366(a)(1),
- (C) any nonseparately computed loss determined under subparagraph (B) of section 1366(a)(1),
- (D) any expense of the corporation not deductible in computing its taxable income and not properly chargeable to capital account, and
- (E) the amount of the shareholder's deduction for depletion for any oil and gas property held by the S corporation to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such shareholder under section 613A(c)(11)(B).

The decrease under subparagraph (B) by reason of a charitable contribution (as defined in section 170(c)) of property shall be the amount equal to the shareholder's pro rata share of the adjusted basis of such property.

(b) Special rules

(1) Income items

An amount which is required to be included in the gross income of a shareholder and shown on his return shall be taken into account under subparagraph (A) or (B) of subsection (a)(1) only to the extent such amount is included in the shareholder's gross income on his return, increased or decreased by any adjustment of such amount in a redetermination of the shareholder's tax liability.

(2) Adjustments in basis of indebtedness**(A) Reduction of basis**

If for any taxable year the amounts specified in subparagraphs (B), (C), (D), and (E) of subsection (a)(2) exceed the amount which reduces the shareholder's basis to zero, such excess shall be applied to reduce (but not below zero) the shareholder's basis in any indebtedness of the S corporation to the shareholder.

(B) Restoration of basis

If for any taxable year beginning after December 31, 1982, there is a reduction under subparagraph (A) in the shareholder's basis in the indebtedness of an S corporation to a shareholder, any net increase (after the application of paragraphs (1) and (2) of subsection (a)) for any subsequent taxable year shall be applied to restore such reduction in basis before any of it may be used to increase the shareholder's basis in the stock of the S corporation.

(3) Coordination with sections 165(g) and 166(d)

This section and section 1366 shall be applied before the application of sections 165(g) and 166(d) to any taxable year of the shareholder or the corporation in which the security or debt becomes worthless.

(4) Adjustments in basis of inherited stock**(A) In general**

If any person acquires stock in an S corporation by reason of the death of a decedent or by bequest, devise, or inheritance, section 691 shall be applied with respect to any item of income of the S corporation in the same manner as if the decedent had held directly his pro rata share of such item.

(B) Adjustments to basis

The basis determined under section 1014 of any stock in an S corporation shall be reduced by the portion of the value of the stock which is attributable to items constituting income in respect of the decedent.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1679; amended Pub. L. 98-369, div. A, title VII, §§ 721(d), (w), 722(e)(2), July 18, 1984, 98 Stat. 967, 971, 974; Pub. L. 104-188, title I, §§ 1313(a), 1702(h)(14), Aug. 20, 1996, 110 Stat. 1785, 1874; Pub. L. 109-280, title XII, § 1203(a), Aug. 17, 2006, 120 Stat. 1066; Pub. L. 110-343, div. C, title III, § 307(a), Oct. 3, 2008, 122 Stat. 3869; Pub. L. 111-312, title VII, § 752(a), Dec. 17, 2010, 124 Stat. 3321; Pub. L. 112-240, title III, § 325(a), Jan. 2, 2013, 126 Stat. 2333; Pub. L. 113-295, div. A, title I, § 137(a), Dec. 19, 2014, 128 Stat. 4019; Pub. L. 114-113, div. Q, title I, § 115(a), Dec. 18, 2015, 129 Stat. 3049.)

AMENDMENTS

2015—Subsec. (a)(2). Pub. L. 114-113 struck out “The preceding sentence shall not apply to contributions made in taxable years beginning after December 31, 2014.” at end of concluding provisions.

2014—Subsec. (a)(2). Pub. L. 113-295 substituted “December 31, 2014” for “December 31, 2013” in concluding provisions.

2013—Subsec. (a)(2). Pub. L. 112-240 substituted “December 31, 2013” for “December 31, 2011” in concluding provisions.

2010—Subsec. (a)(2). Pub. L. 111-312 substituted “December 31, 2011” for “December 31, 2009” in concluding provisions.

2008—Subsec. (a)(2). Pub. L. 110-343 substituted “December 31, 2009” for “December 31, 2007” in concluding provisions.

2006—Subsec. (a)(2). Pub. L. 109-280, which directed the addition of concluding provisions to section 1367(a)(2), without specifying the act to be amended, was executed to subsec. (a)(2) of this section, which is section 1367 of the Internal Revenue Code of 1986, to reflect the probable intent of Congress.

1996—Subsec. (a)(2)(E). Pub. L. 104-188, § 1702(h)(14), substituted “section 613A(c)(11)(B)” for “section 613A(c)(13)(B)”.

Subsec. (b)(4). Pub. L. 104-188, § 1313(a), added par. (4).

1984—Subsec. (a)(2)(E). Pub. L. 98-369, § 722(e)(2), substituted “for any oil and gas property held by the S corporation to the extent such deduction does not exceed the proportionate share of the adjusted basis of such property allocated to such shareholder under section 613A(c)(13)(B)” for “under section 611 with respect to oil and gas wells”.

Subsec. (b)(2)(B). Pub. L. 98-369, § 721(w), substituted “for any taxable year beginning after December 31, 1982, there is” for “for any taxable year there is”.

Subsec. (b)(3). Pub. L. 98-369, § 721(d), inserted “and 166(d)” in heading and text.

EFFECTIVE DATE OF 2015 AMENDMENT

Pub. L. 114-113, div. Q, title I, § 115(b), Dec. 18, 2015, 129 Stat. 3049, provided that: “The amendment made by this section [amending this section] shall apply to contributions made in taxable years beginning after December 31, 2014.”

EFFECTIVE DATE OF 2014 AMENDMENT

Pub. L. 113-295, div. A, title I, § 137(b), Dec. 19, 2014, 128 Stat. 4020, provided that: “The amendment made by this section [amending this section] shall apply to contributions made in taxable years beginning after December 31, 2013.”

EFFECTIVE DATE OF 2013 AMENDMENT

Pub. L. 112-240, title III, § 325(b), Jan. 2, 2013, 126 Stat. 2333, provided that: “The amendment made by this section [amending this section] shall apply to contributions made in taxable years beginning after December 31, 2011.”

EFFECTIVE DATE OF 2010 AMENDMENT

Pub. L. 111-312, title VII, § 752(b), Dec. 17, 2010, 124 Stat. 3321, provided that: “The amendment made by this section [amending this section] shall apply to contributions made in taxable years beginning after December 31, 2009.”

EFFECTIVE DATE OF 2008 AMENDMENT

Pub. L. 110-343, div. C, title III, § 307(b), Oct. 3, 2008, 122 Stat. 3869, provided that: “The amendment made by this section [amending this section] shall apply to contributions made in taxable years beginning after December 31, 2007.”

EFFECTIVE DATE OF 2006 AMENDMENT

Pub. L. 109-280, title XII, § 1203(b), Aug. 17, 2006, 120 Stat. 1066, provided that: “The amendment made by this section [amending this section] shall apply to contributions made in taxable years beginning after December 31, 2005.”

EFFECTIVE DATE OF 1996 AMENDMENT

Pub. L. 104-188, title I, § 1313(b), Aug. 20, 1996, 110 Stat. 1785, provided that: “The amendment made by subsection (a) [amending this section] shall apply in the case of decedents dying after the date of the enactment of this Act [Aug. 20, 1996].”

Amendment by section 1702(h)(14) of Pub. L. 104-188 effective, except as otherwise expressly provided, as if

included in the provision of the Revenue Reconciliation Act of 1990, Pub. L. 101-508, title XI, to which such amendment relates, see section 1702(i) of Pub. L. 104-188, set out as a note under section 38 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 721(d), (w) of Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

Pub. L. 98-369, div. A, title VII, § 722(e)(3)(B), July 18, 1984, 98 Stat. 974, provided that: “The amendment made by paragraph (2) [amending this section] shall apply to taxable years beginning after December 31, 1982.”

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

§ 1368. Distributions

(a) General rule

A distribution of property made by an S corporation with respect to its stock to which (but for this subsection) section 301(c) would apply shall be treated in the manner provided in subsection (b) or (c), whichever applies.

(b) S corporation having no earnings and profits

In the case of a distribution described in subsection (a) by an S corporation which has no accumulated earnings and profits—

(1) Amount applied against basis

The distribution shall not be included in gross income to the extent that it does not exceed the adjusted basis of the stock.

(2) Amount in excess of basis

If the amount of the distribution exceeds the adjusted basis of the stock, such excess shall be treated as gain from the sale or exchange of property.

(c) S corporation having earnings and profits

In the case of a distribution described in subsection (a) by an S corporation which has accumulated earnings and profits—

(1) Accumulated adjustments account

That portion of the distribution which does not exceed the accumulated adjustments account shall be treated in the manner provided by subsection (b).

(2) Dividend

That portion of the distribution which remains after the application of paragraph (1) shall be treated as a dividend to the extent it does not exceed the accumulated earnings and profits of the S corporation.

(3) Treatment of remainder

Any portion of the distribution remaining after the application of paragraph (2) of this subsection shall be treated in the manner provided by subsection (b).

Except to the extent provided in regulations, if the distributions during the taxable year exceed the amount in the accumulated adjustments account at the close of the taxable year, for purposes of this subsection, the balance of such account shall be allocated among such distributions in proportion to their respective sizes.

(d) Certain adjustments taken into account

Subsections (b) and (c) shall be applied by taking into account (to the extent proper)—

(1) the adjustments to the basis of the shareholder's stock described in section 1367, and

(2) the adjustments to the accumulated adjustments account which are required by subsection (e)(1).

In the case of any distribution made during any taxable year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in paragraph (1) of section 1367(a) for the taxable year.

(e) Definitions and special rules

For purposes of this section—

(1) Accumulated adjustments account

(A) In general

Except as otherwise provided in this paragraph, the term “accumulated adjustments account” means an account of the S corporation which is adjusted for the S period in a manner similar to the adjustments under section 1367 (except that no adjustment shall be made for income (and related expenses) which is exempt from tax under this title and the phrase “(but not below zero)” shall be disregarded in section 1367(a)(2)) and no adjustment shall be made for Federal taxes attributable to any taxable year in which the corporation was a C corporation.

(B) Amount of adjustment in the case of redemptions

In the case of any redemption which is treated as an exchange under section 302(a) or 303(a), the adjustment in the accumulated adjustments account shall be an amount which bears the same ratio to the balance in such account as the number of shares redeemed in such redemption bears to the number of shares of stock in the corporation immediately before such redemption.

(C) Net loss for year disregarded

(i) In general

In applying this section to distributions made during any taxable year, the amount in the accumulated adjustments account as of the close of such taxable year shall be determined without regard to any net negative adjustment for such taxable year.

(ii) Net negative adjustment

For purposes of clause (i), the term “net negative adjustment” means, with respect to any taxable year, the excess (if any) of—

(I) the reductions in the account for the taxable year (other than for distributions), over

(II) the increases in such account for such taxable year.

(2) S period

The term “S period” means the most recent continuous period during which the corporation has been an S corporation. Such period shall not include any taxable year beginning before January 1, 1983.

(3) Election to distribute earnings first

(A) In general

An S corporation may, with the consent of all of its affected shareholders, elect to have

paragraph (1) of subsection (c) not apply to all distributions made during the taxable year for which the election is made.

(B) Affected shareholder

For purposes of subparagraph (A), the term “affected shareholder” means any shareholder to whom a distribution is made by the S corporation during the taxable year.

(f) Restricted bank director stock

If a director receives a distribution (not in part or full payment in exchange for stock) from an S corporation with respect to any restricted bank director stock (as defined in section 1361(f)), the amount of such distribution—

(1) shall be includible in gross income of the director, and

(2) shall be deductible by the corporation for the taxable year of such corporation in which or with which ends the taxable year in which such amount is included in the gross income of the director.

(Added Pub. L. 97-354, §2, Oct. 19, 1982, 96 Stat. 1680; amended Pub. L. 97-448, title III, §305(d)(2), Jan. 12, 1983, 96 Stat. 2399; Pub. L. 98-369, div. A, title VII, §721(r), July 18, 1984, 98 Stat. 970; Pub. L. 99-514, title XVIII, §1879(m)(1)(B), Oct. 22, 1986, 100 Stat. 2910; Pub. L. 104-188, title I, §1309(a)(2)–(c), Aug. 20, 1996, 110 Stat. 1783; Pub. L. 110-28, title VIII, §8232(b), May 25, 2007, 121 Stat. 197; Pub. L. 115-141, div. U, title IV, §401(a)(193), Mar. 23, 2018, 132 Stat. 1193.)

AMENDMENTS

2018—Subsec. (f)(2). Pub. L. 115-141 substituted “is included” for “in included”.

2007—Subsec. (f). Pub. L. 110-28 added subsec. (f).

1996—Subsec. (d). Pub. L. 104-188, §1309(a)(2), inserted at end “In the case of any distribution made during any taxable year, the adjusted basis of the stock shall be determined with regard to the adjustments provided in paragraph (1) of section 1367(a) for the taxable year.”

Subsec. (e)(1)(A). Pub. L. 104-188, §1309(c), substituted “as otherwise provided in this paragraph” for “as provided in subparagraph (B)” and “section 1367(a)(2)” for “section 1367(b)(2)(A)”.

Subsec. (e)(1)(C). Pub. L. 104-188, §1309(b), added subpar. (C).

1986—Subsec. (e)(1)(A). Pub. L. 99-514 inserted “and no adjustment shall be made for Federal taxes attributable to any taxable year in which the corporation was a C corporation” before period at end.

1984—Subsec. (c). Pub. L. 98-369, §721(r)(2), inserted “Except to the extent provided in regulations, if the distributions during the taxable year exceed the amount in the accumulated adjustments account at the close of the taxable year, for purposes of this subsection, the balance of such account shall be allocated among such distributions in proportion to their respective sizes.”

Subsec. (e)(1)(A). Pub. L. 98-369, §721(r)(1), substituted “(except that no adjustment shall be made for income (and related expenses) which is exempt from tax under this title and the phrase ‘(but not below zero)’ shall be disregarded in section 1367(b)(2)(A))” for “(except that no adjustment shall be made for income which is exempt from tax under this title and no adjustment shall be made for any expense not deductible in computing the corporation’s taxable income and not properly chargeable to capital account)”.

1983—Subsec. (e)(3). Pub. L. 97-448 added par. (3).

EFFECTIVE DATE OF 2007 AMENDMENT

Amendment by Pub. L. 110-28 applicable to taxable years beginning after Dec. 31, 2006, with special rule for

treatment as second class of stock, see section 8232(c) of Pub. L. 110-28, set out as a note under section 1361 of this title.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1982, see section 1879(m)(2) of Pub. L. 99-514, set out as a note under section 1361 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Pub. L. 97-448, title III, §311(c)(4), Jan. 12, 1983, 96 Stat. 2411, provided that: “The amendments made by subsection (d) of section 305 [amending this section and sections 221, 1374, and 4975 of this title, enacting provisions set out as a note under section 1361 of this title, and amending provisions set out as a note under section 1361 of this title] shall take effect on the date of the enactment of the Subchapter S Revision Act of 1982 [Oct. 19, 1982].”

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

**PLAN AMENDMENTS NOT REQUIRED UNTIL
JANUARY 1, 1989**

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

PART III—SPECIAL RULES

Sec.	
1371.	Coordination with subchapter C.
1372.	Partnership rules to apply for fringe benefit purposes.
1373.	Foreign income.
1374.	Tax imposed on certain built-in gains.
1375.	Tax imposed when passive investment income of corporation having accumulated earnings and profits exceeds 25 percent of gross receipts.

AMENDMENTS

1996—Pub. L. 104-188, title I, §1311(b)(2)(D), Aug. 20, 1996, 110 Stat. 1784, substituted “accumulated” for “subchapter C” in item 1375.

1986—Pub. L. 99-514, title VI, §632(d), Oct. 22, 1986, 100 Stat. 2277, substituted “built-in” for “capital” in item 1374.

§ 1371. Coordination with subchapter C

(a) Application of subchapter C rules

Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders.

(b) No carryover between C year and S year**(1) From C year to S year**

No carryforward, and no carryback, arising for a taxable year for which a corporation is a C corporation may be carried to a taxable year for which such corporation is an S corporation.

(2) No carryover from S year

No carryforward, and no carryback, shall arise at the corporate level for a taxable year for which a corporation is an S corporation.

(3) Treatment of S year as elapsed year

Nothing in paragraphs (1) and (2) shall prevent treating a taxable year for which a corporation is an S corporation as a taxable year for purposes of determining the number of taxable years to which an item may be carried back or carried forward.

(c) Earnings and profits**(1) In general**

Except as provided in paragraphs (2) and (3) and subsection (d)(3), no adjustment shall be made to the earnings and profits of an S corporation.

(2) Adjustments for redemptions, liquidations, reorganizations, divisives, etc.

In the case of any transaction involving the application of subchapter C to any S corporation, proper adjustment to any accumulated earnings and profits of the corporation shall be made.

(3) Adjustments in case of distributions treated as dividends under section 1368(c)(2)

Paragraph (1) shall not apply with respect to that portion of a distribution which is treated as a dividend under section 1368(c)(2).

(d) Coordination with investment credit recapture**(1) No recapture by reason of election**

Any election under section 1362 shall be treated as a mere change in the form of conducting a trade or business for purposes of the second sentence of section 50(a)(4).

(2) Corporation continues to be liable

Notwithstanding an election under section 1362, an S corporation shall continue to be liable for any increase in tax under section 49(b) or 50(a) attributable to credits allowed for taxable years for which such corporation was not an S corporation.

(3) Adjustment to earnings and profits for amount of recapture

Paragraph (1) of subsection (c) shall not apply to any increase in tax under section 49(b) or 50(a) for which the S corporation is liable.

(e) Cash distributions during post-termination transition period**(1) In general**

Any distribution of money by a corporation with respect to its stock during a post-termination transition period shall be applied against and reduce the adjusted basis of the

stock, to the extent that the amount of the distribution does not exceed the accumulated adjustments account (within the meaning of section 1368(e)).

(2) Election to distribute earnings first

An S corporation may elect to have paragraph (1) not apply to all distributions made during a post-termination transition period described in section 1377(b)(1)(A). Such election shall not be effective unless all shareholders of the S corporation to whom distributions are made by the S corporation during such post-termination transition period consent to such election.

(f) Cash distributions following post-termination transition period

In the case of a distribution of money by an eligible terminated S corporation (as defined in section 481(d)) after the post-termination transition period, the accumulated adjustments account shall be allocated to such distribution, and the distribution shall be chargeable to accumulated earnings and profits, in the same ratio as the amount of such accumulated adjustments account bears to the amount of such accumulated earnings and profits.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1681; amended Pub. L. 98-369, div. A, title VII, § 721(e), (o), (x)(3), July 18, 1984, 98 Stat. 967, 970, 971; Pub. L. 99-514, title XVIII, § 1899A(33), (34), Oct. 22, 1986, 100 Stat. 2960; Pub. L. 101-508, title XI, § 11813(b)(23), Nov. 5, 1990, 104 Stat. 1388-555; Pub. L. 104-188, title I, § 1310, Aug. 20, 1996, 110 Stat. 1784; Pub. L. 115-97, title I, § 13543(b), Dec. 22, 2017, 131 Stat. 2155.)

PRIOR PROVISIONS

A prior section 1371, added Pub. L. 85-866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1650; amended Pub. L. 86-376, § 2(a), Sept. 23, 1959, 73 Stat. 699; Pub. L. 88-272, title II, § 233(a), Feb. 26, 1964, 78 Stat. 112; Pub. L. 94-455, title IX, § 902(a)(1), (2), (c)(1), (2), Oct. 4, 1976, 90 Stat. 1608, 1609; Pub. L. 95-600, title III, §§ 341, 342, title VII, § 701(y)(1), Nov. 6, 1978, 92 Stat. 2843, 2921; Pub. L. 96-589, § 5(d), Dec. 24, 1980, 94 Stat. 3406; Pub. L. 97-34, title II, §§ 233(a), 234(a), (b), Aug. 13, 1981, 95 Stat. 250, 251; Pub. L. 97-448, title I, § 102(i)(1), Jan. 12, 1983, 96 Stat. 2372, related to definitions applicable to election of small business corporations as to taxable status, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

AMENDMENTS

2017—Subsec. (f). Pub. L. 115-97 added subsec. (f).
1996—Subsec. (a). Pub. L. 104-188 reenacted heading without change and amended text generally. Prior to amendment, text read as follows:

“(1) IN GENERAL.—Except as otherwise provided in this title, and except to the extent inconsistent with this subchapter, subchapter C shall apply to an S corporation and its shareholders.

“(2) S CORPORATION AS SHAREHOLDER TREATED LIKE INDIVIDUAL.—For purposes of subchapter C, an S corporation in its capacity as a shareholder of another corporation shall be treated as an individual.”

1990—Subsec. (d)(1). Pub. L. 101-508, § 11813(b)(23)(A), substituted “section 50(a)(4)” for “section 47(b)”.

Subsec. (d)(2), (3). Pub. L. 101-508, § 11813(b)(23)(B), substituted “section 49(b) or 50(a)” for “section 47”.

1986—Subsec. (e)(1). Pub. L. 99-514, § 1899A(33), inserted “(within the meaning of section 1368(e))”.

Subsec. (e)(2). Pub. L. 99-514, § 1899A(34), struck out “(within the meaning of section 1368(e))” after “to such election”.

1984—Subsec. (c)(1). Pub. L. 98-369, §621(e)(2), substituted “paragraphs (2) and (3) and subsection (d)(3)” for “paragraphs (2) and (3)”.

Subsec. (d)(3). Pub. L. 98-369, §721(e)(1), added par. (3).
 Subsec. (e). Pub. L. 98-369, §721(o), amended subsec. (e) generally, designating existing provisions as par. (1) and adding par. (2).

Subsec. (e)(2). Pub. L. 98-369, §721(x)(3), inserted “(within the meaning of section 1368(e))”.

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE OF 1990 AMENDMENT

Amendment by Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 45K of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI [§§1101-1147 and 1171-1177] or title XVIII [§§1800-1899A] of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

§ 1372. Partnership rules to apply for fringe benefit purposes

(a) General rule

For purposes of applying the provisions of this subtitle which relate to employee fringe benefits—

- (1) the S corporation shall be treated as a partnership, and
- (2) any 2-percent shareholder of the S corporation shall be treated as a partner of such partnership.

(b) 2-percent shareholder defined

For purposes of this section, the term “2-percent shareholder” means any person who owns (or is considered as owning within the meaning

of section 318) on any day during the taxable year of the S corporation more than 2 percent of the outstanding stock of such corporation or stock possessing more than 2 percent of the total combined voting power of all stock of such corporation.

(Added Pub. L. 97-354, §2, Oct. 19, 1982, 96 Stat. 1682.)

PRIOR PROVISIONS

A prior section 1372, added Pub. L. 85-866, title I, §64(a), Sept. 2, 1958, 72 Stat. 1650; amended Pub. L. 87-29, §2, May 4, 1961, 75 Stat. 64; Pub. L. 89-389, §§2(b)(2), 3(a), Apr. 14, 1966, 80 Stat. 114; Pub. L. 91-683, §1(a), Jan. 12, 1971, 84 Stat. 2067; Pub. L. 94-455, title IX, §902(c)(3), title XIX, §§1901(a)(149), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1609, 1788, 1834; Pub. L. 95-600, title III, §343, Nov. 6, 1978, 92 Stat. 2843; Pub. L. 95-628, §5(a), (b), Nov. 10, 1978, 92 Stat. 3628, related to manner, effect, termination, etc., of an election not to be subject to taxes imposed under this chapter, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, except that in the case of a taxable year beginning during 1982, sections 1362(d)(3), 1366(f)(3), and 1375 of this title shall apply and subsec. (e)(5) of this section as in effect on the day before Oct. 19, 1982, shall not apply, see section 6(a), (b)(3), of Pub. L. 97-354, set out as a note under section 1361 of this title. For additional provisions relating to the treatment of existing fringe benefit plans and the application of this section, see section 6(d) of Pub. L. 97-354, set out as a note under section 1361 of this title.

§ 1373. Foreign income

(a) S corporation treated as partnership, etc.

For purposes of subparts A and F of part III, and part V, of subchapter N (relating to income from sources without the United States)—

- (1) an S corporation shall be treated as a partnership, and
- (2) the shareholders of such corporation shall be treated as partners of such partnership.

(b) Recapture of overall foreign loss

For purposes of section 904(f) (relating to recapture of overall foreign loss), the making or termination of an election to be treated as an S corporation shall be treated as a disposition of the business.

(Added Pub. L. 97-354, §2, Oct. 19, 1982, 96 Stat. 1682.)

PRIOR PROVISIONS

A prior section 1373, added Pub. L. 85-866, title I, §64(a), Sept. 2, 1958, 72 Stat. 1652; amended Pub. L. 89-389, §2(b)(3), Apr. 14, 1966, 80 Stat. 114; Pub. L. 91-172, title III, §301(b)(10), Dec. 30, 1969, 83 Stat. 586, related to taxation of corporation undistributed taxable income to shareholders, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

§ 1374. Tax imposed on certain built-in gains

(a) General rule

If for any taxable year beginning in the recognition period an S corporation has a net rec-

ognized built-in gain, there is hereby imposed a tax (computed under subsection (b)) on the income of such corporation for such taxable year.

(b) Amount of tax

(1) In general

The amount of the tax imposed by subsection (a) shall be computed by applying the highest rate of tax specified in section 11(b) to the net recognized built-in gain of the S corporation for the taxable year.

(2) Net operating loss carryforwards from C years allowed

Notwithstanding section 1371(b)(1), any net operating loss carryforward arising in a taxable year for which the corporation was a C corporation shall be allowed for purposes of this section as a deduction against the net recognized built-in gain of the S corporation for the taxable year. For purposes of determining the amount of any such loss which may be carried to subsequent taxable years, the amount of the net recognized built-in gain shall be treated as taxable income. Rules similar to the rules of the preceding sentences of this paragraph shall apply in the case of a capital loss carryforward arising in a taxable year for which the corporation was a C corporation.

(3) Credits

(A) In general

Except as provided in subparagraph (B), no credit shall be allowable under part IV of subchapter A of this chapter (other than under section 34) against the tax imposed by subsection (a).

(B)¹ Business credit carryforwards from C years allowed

Notwithstanding section 1371(b)(1), any business credit carryforward under section 39 arising in a taxable year for which the corporation was a C corporation shall be allowed as a credit against the tax imposed by subsection (a) in the same manner as if it were imposed by section 11. A similar rule shall apply in the case of the minimum tax credit under section 53 to the extent attributable to taxable years for which the corporation was a C corporation.

(c) Limitations

(1) Corporations which were always S corporations

Subsection (a) shall not apply to any corporation if an election under section 1362(a) has been in effect with respect to such corporation for each of its taxable years. Except as provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of the preceding sentence.

(2) Limitation on amount of net recognized built-in gain

The amount of the net recognized built-in gain taken into account under this section for any taxable year shall not exceed the excess (if any) of—

- (A) the net unrealized built-in gain, over
- (B) the net recognized built-in gain for prior taxable years beginning in the recognition period.

(d) Definitions and special rules

For purposes of this section—

(1) Net unrealized built-in gain

The term “net unrealized built-in gain” means the amount (if any) by which—

- (A) the fair market value of the assets of the S corporation as of the beginning of its 1st taxable year for which an election under section 1362(a) is in effect, exceeds
- (B) the aggregate adjusted bases of such assets at such time.

(2) Net recognized built-in gain

(A) In general

The term “net recognized built-in gain” means, with respect to any taxable year in the recognition period, the lesser of—

- (i) the amount which would be the taxable income of the S corporation for such taxable year if only recognized built-in gains and recognized built-in losses were taken into account, or
- (ii) such corporation’s taxable income for such taxable year (determined as provided in section 1375(b)(1)(B)).

(B) Carryover

If, for any taxable year described in subparagraph (A), the amount referred to in clause (i) of subparagraph (A) exceeds the amount referred to in clause (ii) of subparagraph (A), such excess shall be treated as a recognized built-in gain in the succeeding taxable year.

(3) Recognized built-in gain

The term “recognized built-in gain” means any gain recognized during the recognition period on the disposition of any asset except to the extent that the S corporation establishes that—

- (A) such asset was not held by the S corporation as of the beginning of the 1st taxable year for which it was an S corporation, or
- (B) such gain exceeds the excess (if any) of—

- (i) the fair market value of such asset as of the beginning of such 1st taxable year, over
- (ii) the adjusted basis of the asset as of such time.

(4) Recognized built-in losses

The term “recognized built-in loss” means any loss recognized during the recognition period on the disposition of any asset to the extent that the S corporation establishes that—

- (A) such asset was held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3), and
- (B) such loss does not exceed the excess of—

- (i) the adjusted basis of such asset as of the beginning of such 1st taxable year, over
- (ii) the fair market value of such asset as of such time.

¹ See Amendment of Subsection (b)(3)(B) note below.

(5) Treatment of certain built-in items**(A) Income items**

Any item of income which is properly taken into account during the recognition period but which is attributable to periods before the 1st taxable year for which the corporation was an S corporation shall be treated as a recognized built-in gain for the taxable year in which it is properly taken into account.

(B) Deduction items

Any amount which is allowable as a deduction during the recognition period (determined without regard to any carryover) but which is attributable to periods before the 1st taxable year referred to in subparagraph (A) shall be treated as a recognized built-in loss for the taxable year for which it is allowable as a deduction.

(C) Adjustment to net unrealized built-in gain

The amount of the net unrealized built-in gain shall be properly adjusted for amounts which would be treated as recognized built-in gains or losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period.

(6) Treatment of certain property

If the adjusted basis of any asset is determined (in whole or in part) by reference to the adjusted basis of any other asset held by the S corporation as of the beginning of the 1st taxable year referred to in paragraph (3)—

(A) such asset shall be treated as held by the S corporation as of the beginning of such 1st taxable year, and

(B) any determination under paragraph (3)(B) or (4)(B) with respect to such asset shall be made by reference to the fair market value and adjusted basis of such other asset as of the beginning of such 1st taxable year.

(7) Recognition period**(A) In general**

The term “recognition period” means the 5-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation. For purposes of applying this section to any amount includible in income by reason of distributions to shareholders pursuant to section 593(e), the preceding sentence shall be applied without regard to the phrase “5-year”.

(B) Installment sales

If an S corporation sells an asset and reports the income from the sale using the installment method under section 453, the treatment of all payments received shall be governed by the provisions of this paragraph applicable to the taxable year in which such sale was made.

(8) Treatment of transfer of assets from C corporation to S corporation**(A) In general**

Except to the extent provided in regulations, if—

(i) an S corporation acquires any asset, and

(ii) the S corporation's basis in such asset is determined (in whole or in part) by reference to the basis of such asset (or any other property) in the hands of a C corporation,

then a tax is hereby imposed on any net recognized built-in gain attributable to any such assets for any taxable year beginning in the recognition period. The amount of such tax shall be determined under the rules of this section as modified by subparagraph (B).

(B) Modifications

For purposes of this paragraph, the modifications of this subparagraph are as follows:

(i) In general

The preceding paragraphs of this subsection shall be applied by taking into account the day on which the assets were acquired by the S corporation in lieu of the beginning of the 1st taxable year for which the corporation was an S corporation.

(ii) Subsection (c)(1) not to apply

Subsection (c)(1) shall not apply.

(9) Reference to 1st taxable year

Any reference in this section to the 1st taxable year for which the corporation was an S corporation shall be treated as a reference to the 1st taxable year for which the corporation was an S corporation pursuant to its most recent election under section 1362.

(e) Regulations

The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section including regulations providing for the appropriate treatment of successor corporations.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1683; amended Pub. L. 97-448, title III, § 305(d)(3), Jan. 12, 1983, 96 Stat. 2400; Pub. L. 98-369, div. A, title I, § 102(d)(1), title IV, § 474(r)(27), title VII, § 721(u), July 18, 1984, 98 Stat. 623, 844, 971; Pub. L. 99-514, title VI, § 632(a), Oct. 22, 1986, 100 Stat. 2275; Pub. L. 100-647, title I, § 1006(f)(1)–(5)(A), Nov. 10, 1988, 102 Stat. 3403, 3404; Pub. L. 101-239, title VII, § 7811(c)(4), (5)(B), (8), Dec. 19, 1989, 103 Stat. 2407, 2408; Pub. L. 105-34, title XVI, § 1601(f)(5)(B), Aug. 5, 1997, 111 Stat. 1091; Pub. L. 111-5, div. B, title I, § 1251(a), Feb. 17, 2009, 123 Stat. 342; Pub. L. 111-240, title II, § 2014(a), Sept. 27, 2010, 124 Stat. 2556; Pub. L. 112-240, title III, § 326(a), (b), Jan. 2, 2013, 126 Stat. 2334; Pub. L. 113-295, div. A, title I, § 138(a), Dec. 19, 2014, 128 Stat. 4020; Pub. L. 114-113, div. Q, title I, § 127(a), Dec. 18, 2015, 129 Stat. 3054; Pub. L. 115-97, title I, §§ 12002(c), 13001(b)(2)(N), Dec. 22, 2017, 131 Stat. 2095, 2097; Pub. L. 115-141, div. U, title IV, § 401(b)(33), Mar. 23, 2018, 132 Stat. 1204.)

AMENDMENT OF SUBSECTION (b)(3)(B)

Pub. L. 115-97, title I, § 12002(c), (d), Dec. 22, 2017, 131 Stat. 2095, amended subsection (b)(3)(B) of this section, applicable to taxable years beginning after Dec. 31, 2021. After amendment, subsection (b)(3)(B) reads as follows:

(B) *Business credit carryforwards from C years allowed*

Notwithstanding section 1371(b)(1), any business credit carryforward under section 39 arising in a taxable year for which the corporation was a C corporation shall be allowed as a credit against the tax imposed by subsection (a) in the same manner as if it were imposed by section 11. See 2017 Amendment note below.

PRIOR PROVISIONS

A prior section 1374, added Pub. L. 85-866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1653; amended Pub. L. 86-376, § 2(b), Sept. 23, 1959, 73 Stat. 699; Pub. L. 94-455, title XIX, § 1901(a)(150), Oct. 4, 1976, 90 Stat. 1788, related to allowance to shareholders of corporation net operating loss, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

AMENDMENTS

2018—Subsec. (d)(2)(B). Pub. L. 115-141 struck out at end “The preceding sentence shall apply only in the case of a corporation treated as an S corporation by reason of an election made on or after March 31, 1988.”

2017—Subsec. (b)(3)(B). Pub. L. 115-97, § 12002(c), struck out at end “A similar rule shall apply in the case of the minimum tax credit under section 53 to the extent attributable to taxable years for which the corporation was a C corporation.”

Subsec. (b)(4). Pub. L. 115-97, § 13001(b)(2)(N), struck out par. (4). Text read as follows: “For purposes of section 1201(a)—

“(A) the tax imposed by subsection (a) shall be treated as if it were imposed by section 11, and

“(B) the amount of the net recognized built-in gain shall be treated as the taxable income.”

2015—Subsec. (d)(7). Pub. L. 114-113 amended par. (7) generally. Prior to amendment, par. (7) defined recognition period, with special rules for certain years and for distributions to shareholders.

2014—Subsec. (d)(7)(C). Pub. L. 113-295 substituted “2012, 2013, and 2014” for “2012 and 2013” in heading and “2012, 2013, or 2014” for “2012 or 2013” in text.

2013—Subsec. (d)(2)(B). Pub. L. 112-240, § 326(b), inserted “described in subparagraph (A)” after “for any taxable year”.

Subsec. (d)(7)(C), (D). Pub. L. 112-240, § 326(a)(1), (2), added subpar. (C) and redesignated former subpar. (C) as (D).

Subsec. (d)(7)(E). Pub. L. 112-240, § 326(a)(3), added subpar. (E).

2010—Subsec. (d)(7)(B). Pub. L. 111-240 amended subpar. (B) generally. Prior to amendment, text read as follows: “In the case of any taxable year beginning in 2009 or 2010, no tax shall be imposed on the net recognized built-in gain of an S corporation if the 7th taxable year in the recognition period preceded such taxable year. The preceding sentence shall be applied separately with respect to any asset to which paragraph (8) applies.”

2009—Subsec. (d)(7). Pub. L. 111-5 amended par. (7) generally. Prior to amendment, text read as follows: “The term ‘recognition period’ means the 10-year period beginning with the 1st day of the 1st taxable year for which the corporation was an S corporation. For purposes of applying this section to any amount includible in income by reason of section 593(e), the preceding sentence shall be applied without regard to the phrase ‘10-year.’”

1997—Subsec. (d)(7). Pub. L. 105-34 inserted at end “For purposes of applying this section to any amount includible in income by reason of section 593(e), the preceding sentence shall be applied without regard to the phrase ‘10-year.’”

1989—Subsec. (b)(3)(B). Pub. L. 101-239, § 7811(c)(8), inserted at end “A similar rule shall apply in the case of the minimum tax credit under section 53 to the extent attributable to taxable years for which the corporation was a C corporation.”

Subsec. (d)(2)(A)(i). Pub. L. 101-239, § 7811(c)(4), struck out “(except as provided in subsection (b)(2))” after “taxable year if”.

Subsec. (d)(5)(B). Pub. L. 101-239, § 7811(c)(5)(B)(i), inserted “(determined without regard to any carryover)” after “during the recognition period”.

Subsec. (d)(5)(C). Pub. L. 101-239, § 7811(c)(5)(B)(ii), substituted “which would be treated as recognized built-in gains or losses under this paragraph if such amounts were properly taken into account (or allowable as a deduction) during the recognition period” for “treated as recognized built-in gains or losses under this paragraph”.

1988—Subsec. (a). Pub. L. 100-647, § 1006(f)(1), inserted “net” before “recognized”.

Subsec. (b)(1). Pub. L. 100-647, § 1006(f)(2), added par. (1) and struck out former par. (1) which read as follows: “The tax imposed by subsection (a) shall be a tax computed by applying the highest rate of tax specified in section 11(b) to the lesser of—

“(A) the recognized built-in gains of the S corporation for the taxable year, or

“(B) the amount which would be the taxable income of the corporation for such taxable year if such corporation were not an S corporation.”

Subsec. (b)(2). Pub. L. 100-647, § 1006(f)(2), added par. (2) and struck out former par. (2) which read as follows:

“Notwithstanding section 1371(b)(1), any net operating loss carryforward arising in a taxable year for which the corporation was a C corporation shall be allowed as a deduction against the lesser of the amounts referred to in subparagraph (A) or (B) of paragraph (1). For purposes of determining the amount of any such loss which may be carried to subsequent taxable years, the lesser of the amounts referred to in subparagraph (A) or (B) of paragraph (1) shall be treated as taxable income.”

Subsec. (b)(4)(B). Pub. L. 100-647, § 1006(f)(3), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: “the lower of the amounts specified in subparagraphs (A) and (B) of paragraph (1) shall be treated as the taxable income.”

Subsec. (c)(2). Pub. L. 100-647, § 1006(f)(4), which directed amendment of par. (2) by substituting “net recognized built-in gain” for “recognized built-in gains” wherever appearing, was executed by making the substitution in heading as well as in introductory provisions and in subpar. (B), to reflect the probable intent of Congress.

Subsec. (d)(2) to (9). Pub. L. 100-647, § 1006(f)(5)(A), added pars. (2) to (9) and struck out former pars. (2), (3), and (4), which related to recognized built-in gain, recognition period, and taxable income, respectively.

Subsec. (e). Pub. L. 100-647, § 1006(f)(5)(A), added subsec. (e).

1986—Pub. L. 99-514 amended section generally, substituting provisions imposing tax on certain built-in gains for provisions imposing tax on certain capital gains which had declared in: subsec. (a), general rule for capital gains tax on S corporations; subsec. (b), amount of tax; subsec. (c), general rule as to exceptions from subsec. (a) in par. (1), exception as to new corporations in par. (2), provisions relating to property with substituted basis in par. (3), and treatment of certain gains of options and commodities dealers in par. (4); and subsec. (d), determination of taxable income of corporation.

1984—Subsec. (b). Pub. L. 98-369, § 474(r)(27), substituted “section 34” for “section 39” in provisions following par. (2).

Subsec. (c)(2). Pub. L. 98-369, § 721(u), struck out “(and any predecessor corporation)” before “has been in existence” in subpar. (A), and inserted provision that to the extent provided in regulations, an S corporation and any predecessor corporation shall be treated as 1 corporation for purposes of this paragraph and paragraph (1).

Subsec. (c)(4). Pub. L. 98-369, § 102(d)(1), added par. (4).

1983—Subsec. (d). Pub. L. 97-448 substituted “this section” for “subsections (a)(2) and (b)(2)”.

EFFECTIVE DATE OF 2017 AMENDMENT

Amendment by section 12002 of Pub. L. 115-97 applicable in general to taxable years beginning after Dec. 31, 2017, and amendment by section 12002(c) applicable to taxable years beginning after Dec. 31, 2021, see section 12002(d) of Pub. L. 115-97, set out as a note under section 53 of this title.

Amendment by section 13001(b)(2)(N) of Pub. L. 115-97 applicable to taxable years beginning after Dec. 31, 2017, see section 13001(c)(1) of Pub. L. 115-97, set out as a note under section 11 of this title.

EFFECTIVE DATE OF 2015 AMENDMENT

Pub. L. 114-113, div. Q, title I, §127(b), Dec. 18, 2015, 129 Stat. 3054, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2014.”

EFFECTIVE DATE OF 2014 AMENDMENT

Pub. L. 113-295, div. A, title I, §138(b), Dec. 19, 2014, 128 Stat. 4020, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2013.”

EFFECTIVE DATE OF 2013 AMENDMENT

Pub. L. 112-240, title III, §326(c), Jan. 2, 2013, 126 Stat. 2334, provided that: “The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2011.”

EFFECTIVE DATE OF 2010 AMENDMENT

Pub. L. 111-240, title II, §2014(b), Sept. 27, 2010, 124 Stat. 2556, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2010.”

EFFECTIVE DATE OF 2009 AMENDMENT

Pub. L. 111-5, div. B, title I, §1251(b), Feb. 17, 2009, 123 Stat. 342, provided that: “The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2008.”

EFFECTIVE DATE OF 1997 AMENDMENT

Amendment by Pub. L. 105-34 effective as if included in the provisions of the Small Business Job Protection Act of 1996, Pub. L. 104-188, to which it relates, see section 1601(j) of Pub. L. 105-34, set out as a note under section 23 of this title.

EFFECTIVE DATE OF 1989 AMENDMENT

Amendment by Pub. L. 101-239 effective, except as otherwise provided, as if included in the provision of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100-647, to which such amendment relates, see section 7817 of Pub. L. 101-239, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, but only in cases where the return for the taxable year is filed pursuant to an S election made after Dec. 31, 1986, and with provision that, in the case of any taxable year of an S corporation which begins after Dec. 31, 1986, and to which the amendments by section 632 (other than subsec. (b) thereof) of Pub. L. 99-514 do not apply, subsec. (b)(1) of this section (as in effect on the date before Oct. 22, 1986) shall apply as if it read as follows: “an amount equal to 34 percent of the amount by which the net capital gain of the corporation for the taxable year exceeds

\$25,000, or”, and with other exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, as amended, set out as an Effective Date note under section 336 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 102(d)(1) of Pub. L. 98-369 applicable to positions established after July 18, 1984, in taxable years ending after that date, except as otherwise provided, see section 102(f), (g) of Pub. L. 98-369 set out as a note under section 1256 of this title.

Amendment by section 474(r)(27) of Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, and to carrybacks from such years, see section 475(a) of Pub. L. 98-369, set out as a note under section 21 of this title.

Amendment by section 721(u) of Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by Pub. L. 97-448 effective on date of enactment of Subchapter S Revision Act of 1982 [Oct. 19, 1982], see section 311(c)(4) of Pub. L. 97-448, set out as a note under section 1368 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 115-141 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Mar. 23, 2018, for purposes of determining liability for tax for periods ending after Mar. 23, 2018, see section 401(e) of Pub. L. 115-141, set out as a note under section 23 of this title.

§ 1375. Tax imposed when passive investment income of corporation having accumulated earnings and profits exceeds 25 percent of gross receipts

(a) General rule

If for the taxable year an S corporation has—

- (1) accumulated earnings and profits at the close of such taxable year, and
- (2) gross receipts more than 25 percent of which are passive investment income,

then there is hereby imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in section 11(b).

(b) Definitions

For purposes of this section—

(1) Excess net passive income

(A) In general

Except as provided in subparagraph (B), the term “excess net passive income” means an amount which bears the same ratio to the net passive income for the taxable year as—

- (i) the amount by which the passive investment income for the taxable year exceeds 25 percent of the gross receipts for the taxable year, bears to
- (ii) the passive investment income for the taxable year.

(B) Limitation

The amount of the excess net passive income for any taxable year shall not exceed

the amount of the corporation's taxable income for such taxable year as determined under section 63(a)—

- (i) without regard to the deductions allowed by part VIII of subchapter B (other than the deduction allowed by section 248, relating to organization expenditures), and
- (ii) without regard to the deduction under section 172.

(2) Net passive income

The term "net passive income" means—

- (A) passive investment income, reduced by
- (B) the deductions allowable under this chapter which are directly connected with the production of such income (other than deductions allowable under section 172 and part VIII of subchapter B).

(3) Passive investment income, etc.

The terms "passive investment income" and "gross receipts" have the same respective meanings as when used in paragraph (3) of section 1362(d).

(4) Coordination with section 1374

Notwithstanding paragraph (3), the amount of passive investment income shall be determined by not taking into account any recognized built-in gain or loss of the S corporation for any taxable year in the recognition period. Terms used in the preceding sentence shall have the same respective meanings as when used in section 1374.

(c) Credits not allowable

No credit shall be allowed under part IV of subchapter A of this chapter (other than section 34) against the tax imposed by subsection (a).

(d) Waiver of tax in certain cases

If the S corporation establishes to the satisfaction of the Secretary that—

- (1) it determined in good faith that it had no accumulated earnings and profits at the close of a taxable year, and
- (2) during a reasonable period of time after it was determined that it did have accumulated earnings and profits at the close of such taxable year such earnings and profits were distributed,

the Secretary may waive the tax imposed by subsection (a) for such taxable year.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1684; amended Pub. L. 98-369, div. A, title IV, § 474(r)(28), title VII, § 721(v), July 18, 1984, 98 Stat. 844, 971; Pub. L. 99-514, title VI, § 632(c)(3), Oct. 22, 1986, 100 Stat. 2277; Pub. L. 100-647, title I, § 1006(f)(5)(B)-(D), Nov. 10, 1988, 102 Stat. 3406; Pub. L. 104-188, title I, § 1311(b)(2)(A)-(C), Aug. 20, 1996, 110 Stat. 1784; Pub. L. 109-135, title IV, § 412(qq), Dec. 21, 2005, 119 Stat. 2640.)

PRIOR PROVISIONS

A prior section 1375, added Pub. L. 85-866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1654; amended Pub. L. 88-272, title II, §§ 201(d)(13), 233(b), Feb. 26, 1964, 78 Stat. 32, 112; Pub. L. 89-389, §§ 1(a), (b), 2(b)(4), Apr. 14, 1966, 80 Stat. 111, 114; Pub. L. 91-172, title III, § 301(b)(11), Dec. 30, 1969, 83 Stat. 586; Pub. L. 94-455, title XIX, §§ 1901(a)(151), (b)(33)(Q), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1788, 1802, 1834; Pub. L. 95-600, title VII, § 703(j)(6), Nov. 6, 1978, 92 Stat. 2941, related to special rules appli-

cable to distributions of electing small business corporations, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

A prior section 1376, added Pub. L. 85-866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1655, related to adjustment to basis of stock of, and indebtedness owing, shareholders, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

AMENDMENTS

2005—Subsec. (d)(1), (2). Pub. L. 109-135 substituted "accumulated" for "subchapter C".

1996—Pub. L. 104-188, § 1311(b)(2)(C), substituted "accumulated" for "subchapter C" in section catchline.

Subsec. (a)(1). Pub. L. 104-188, § 1311(b)(2)(A), substituted "accumulated" for "subchapter C".

Subsec. (b)(3). Pub. L. 104-188, § 1311(b)(2)(B), amended par. (3) generally. Prior to amendment, par. (3) read as follows:

"(3) PASSIVE INVESTMENT INCOME; ETC.—The terms 'subchapter C earnings and profits', 'passive investment income', and 'gross receipts' shall have the same respective meanings as when used in paragraph (3) of section 1362(d)."

1988—Subsec. (b)(1)(B). Pub. L. 100-647, § 1006(f)(5)(B), amended subpar. (B) generally. Prior to amendment, subpar. (B) read as follows: "The amount of the excess net passive income for any taxable year shall not exceed the corporation's taxable income for the taxable year (determined in accordance with section 1374(d)(4))."

Subsec. (b)(4). Pub. L. 100-647, § 1006(f)(5)(C), added par. (4).

Subsec. (c). Pub. L. 100-647, § 1006(f)(5)(D), amended subsec. (c) generally, in heading substituting "Credits not allowable" for "Special rules", and in text substituting "No credit" for "(1) DISALLOWANCE OF CREDIT.—No credit", and striking out par. (2) which related to coordination with section 1374.

1986—Subsec. (b)(1)(B). Pub. L. 99-514 substituted "section 1374(d)(4)" for "section 1374(d)".

1984—Subsec. (c)(1). Pub. L. 98-369, § 474(r)(28), substituted "section 34" for "section 39".

Subsec. (d). Pub. L. 98-369, § 721(v), added subsec. (d).

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, but only in cases where the return for the taxable year is filed pursuant to an S election made after Dec. 31, 1986, with exceptions and special and transitional rules, see section 633 of Pub. L. 99-514, as amended, set out as an Effective Date note under section 336 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by section 474(r)(28) of Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, and to carrybacks from such years, see section 475(a) of Pub. L. 98-369, set out as a note under section 21 of this title.

Amendment by section 721(v) of Pub. L. 98-369 effective as if included in the Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE

This section applicable to taxable years beginning after Dec. 31, 1982, except that in the case of a taxable

year beginning during 1982, this section and sections 1362(d)(3) and 1366(f)(3) of this title shall apply, and section 1372(e)(5) of this title as in effect on the day before Oct. 19, 1982, shall not apply, see section 6(a), (b)(3) of Pub. L. 97-354, set out as a note under section 1361 of this title.

PART IV—DEFINITIONS; MISCELLANEOUS

Sec.	
1377.	Definitions and special rule.
1378.	Taxable year of S corporation.
1379.	Transitional rules on enactment.

§ 1377. Definitions and special rule

(a) Pro rata share

For purposes of this subchapter—

(1) In general

Except as provided in paragraph (2), each shareholder's pro rata share of any item for any taxable year shall be the sum of the amounts determined with respect to the shareholder—

- (A) by assigning an equal portion of such item to each day of the taxable year, and
- (B) then by dividing that portion pro rata among the shares outstanding on such day.

(2) Election to terminate year

(A) In general

Under regulations prescribed by the Secretary, if any shareholder terminates the shareholder's interest in the corporation during the taxable year and all affected shareholders and the corporation agree to the application of this paragraph, paragraph (1) shall be applied to the affected shareholders as if the taxable year consisted of 2 taxable years the first of which ends on the date of the termination.

(B) Affected shareholders

For purposes of subparagraph (A), the term “affected shareholders” means the shareholder whose interest is terminated and all shareholders to whom such shareholder has transferred shares during the taxable year. If such shareholder has transferred shares to the corporation, the term “affected shareholders” shall include all persons who are shareholders during the taxable year.

(b) Post-termination transition period

(1) In general

For purposes of this subchapter, the term “post-termination transition period” means—

- (A) 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 such last year as an S corporation (including extensions),
- (B) 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

(C) 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.

(2) Determination defined

For purposes of paragraph (1), the term “determination” means—

- (A) a determination as defined in section 1313(a), or
- (B) an agreement between the corporation and the Secretary that the corporation failed to qualify as an S corporation.

(3) Special rules for audit related post-termination transition periods

(A) No application to carryovers

Paragraph (1)(B) shall not apply for purposes of section 1366(d)(3).

(B) Limitation on application to distributions

Paragraph (1)(B) shall apply to a distribution described in section 1371(e) only to the extent that the amount of such distribution does not exceed the aggregate increase (if any) in the accumulated adjustments account (within the meaning of section 1368(e)) by reason of the adjustments referred to in such paragraph.

(c) Manner of making elections, etc.

Any election under this subchapter, and any revocation under section 1362(d)(1), shall be made in such manner as the Secretary shall by regulations prescribe.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1685; amended Pub. L. 104-188, title I, §§ 1306-1307(b), Aug. 20, 1996, 110 Stat. 1780; Pub. L. 108-311, title IV, § 407(a), Oct. 4, 2004, 118 Stat. 1190.)

PRIOR PROVISIONS

A prior section 1377, added Pub. L. 85-866, title I, § 64(a), Sept. 2, 1958, 72 Stat. 1656; amended Pub. L. 94-455, title IX, § 902(b)(1), title XIX, § 1901(b)(32)(B)(iv), Oct. 4, 1976, 90 Stat. 1608, 1800, related to special rules applicable to earnings and profits of electing small business corporations, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

AMENDMENTS

2004—Subsec. (b)(3). Pub. L. 108-311 added par. (3).
 1996—Subsec. (a)(2). Pub. L. 104-188, § 1306, reenacted heading without change and amended text generally. Prior to amendment, text read as follows: “Under regulations prescribed by the Secretary, if any shareholder terminates his interest in the corporation during the taxable year and all persons who are shareholders during the taxable year agree to the application of this paragraph, paragraph (1) shall be applied as if the taxable year consisted of 2 taxable years the first of which ends on the date of the termination.”

Subsec. (b)(1)(A) to (C). Pub. L. 104-188, § 1307(a), struck out “and” at end of subpar. (A)(ii), added subpar. (B), and redesignated former subpar. (B) as (C).

Subsec. (b)(2)(A) to (C). Pub. L. 104-188, § 1307(b), added subpar. (A), redesignated subpar. (C) as (B), and struck out former subpars. (A) and (B) which read as follows:

- “(A) a court decision which becomes final,
- “(B) a closing agreement, or”.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by Pub. L. 108-311 effective as if included in the provisions of the Small Business Job Protection

Act of 1996, Pub. L. 104-188, to which such amendment relates, see section 407(c) of Pub. L. 108-311, set out as a note under section 401 of this title.

EFFECTIVE DATE OF 1996 AMENDMENTS

Pub. L. 105-34, title XVI, §1601(c)(2), Aug. 5, 1997, 111 Stat. 1087, provided that:

“(A) Notwithstanding section 1317 of the Small Business Job Protection Act of 1996 [Pub. L. 104-188, enacting provisions set out as notes under sections 641 and 1362 of this title], the amendments made by subsections (a) and (b) of section 1307 of such Act [amending this section] shall apply to determinations made after December 31, 1996.

“(B) In no event shall the 120-day period referred to in section 1377(b)(1)(B) of the Internal Revenue Code of 1986 (as added by such section 1307) expire before the end of the 120-day period beginning on the date of the enactment of this Act [Aug. 5, 1997].”

Amendment by Pub. L. 104-188 applicable to taxable years beginning after Dec. 31, 1996, see section 1317(a) of Pub. L. 104-188, set out as a note under section 641 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

§ 1378. Taxable year of S corporation

(a) General rule

For purposes of this subtitle, the taxable year of an S corporation shall be a permitted year.

(b) Permitted year defined

For purposes of this section, the term “permitted year” means a taxable year which—

- (1) is a year ending December 31, or
- (2) is any other accounting period for which the corporation establishes a business purpose to the satisfaction of the Secretary.

For purposes of paragraph (2), any deferral of income to shareholders shall not be treated as a business purpose.

(Added Pub. L. 97-354, §2, Oct. 19, 1982, 96 Stat. 1685; amended Pub. L. 98-369, div. A, title VII, §721(m), (q), July 18, 1984, 98 Stat. 969, 970; Pub. L. 99-514, title VIII, §806(b), Oct. 22, 1986, 100 Stat. 2363.)

PRIOR PROVISIONS

A prior section 1378, added Pub. L. 89-389, §2(a), Apr. 14, 1966, 80 Stat. 113; amended Pub. L. 91-172, title V, §511(c)(4), Dec. 30, 1969, 83 Stat. 638; Pub. L. 94-455, title XIX, §1901(a)(152), (b)(33)(R), Oct. 4, 1976, 90 Stat. 1789, 1802, related to tax imposed on certain capital gains, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

AMENDMENTS

1986—Subsec. (a). Pub. L. 99-514, §806(b)(1), amended subsec. (a) generally. Prior to amendment, subsec. (a) read as follows: “For purposes of this subtitle—

“(1) an S corporation shall not change its taxable year to any accounting period other than a permitted year, and

“(2) no corporation may make an election under section 1362(a) for any taxable year unless such taxable year is a permitted year.”

Subsec. (b). Pub. L. 99-514, §806(b)(2), inserted at end “For purposes of paragraph (2), any deferral of income to shareholders shall not be treated as a business purpose.”

Subsec. (c). Pub. L. 99-514, §806(b)(3), struck out subsec. (c) which required existing S corporations to use permitted year after 50-percent shift in ownership.

1984—Subsec. (c)(1). Pub. L. 98-369, §721(m), substituted “which includes December 31, 1982 (or which is an S corporation for a taxable year beginning during 1983 by reason of an election made on or before October 19, 1982)” for “which includes December 31, 1982”.

Subsec. (c)(3)(B)(i). Pub. L. 98-369, §721(q), substituted “who (or whose estate) held” for “who held”.

EFFECTIVE DATE OF 1986 AMENDMENT

Pub. L. 99-514, title VIII, §806(e), Oct. 22, 1986, 100 Stat. 2364, as amended by Pub. L. 100-647, title I, §1008(e)(7), (8), (10), Nov. 10, 1988, 102 Stat. 3441, provided that:

“(1) IN GENERAL.—The amendments made by this section [amending this section and sections 267, 441, and 706 of this title] shall apply to taxable years beginning after December 31, 1986.

“(2) CHANGE IN ACCOUNTING PERIOD.—In the case of any partnership, S corporation, or personal service corporation required by the amendments made by this section to change its accounting period for the taxpayer's first taxable year beginning after December 31, 1986—

“(A) such change shall be treated as initiated by the partnership, S corporation, or personal service corporation,

“(B) such change shall be treated as having been made with the consent of the Secretary, and

“(C) with respect to any partner or shareholder of an S corporation which is required to include the items from more than 1 taxable year of the partnership or S corporation in any 1 taxable year, income in excess of expenses of such partnership or corporation for the short taxable year required by such amendments shall be taken into account ratably in each of the first 4 taxable years beginning after December 31, 1986, unless such partner or shareholder elects to include all such income in the the [sic] partner's or shareholder's taxable year with or within which the partnership's or S corporation's short taxable year ends.

Subparagraph (C) shall apply to a shareholder of an S corporation only if such corporation was an S corporation for a taxable year beginning in 1986.

“(3) BASIS, ETC. RULES—

“(A) BASIS RULE.—The adjusted basis of any partner's interest in a partnership or shareholder's stock in an S corporation shall be determined as if all of the income to be taken into account ratably in the 4 taxable years referred to in paragraph (2)(C) were included in gross income for the 1st of such taxable years.

“(B) TREATMENT OF DISPOSITIONS.—If any interest in a partnership or stock in an S corporation is disposed of before the last taxable year in the spread period, all amounts which would be included in the gross income of the partner or shareholder for subsequent taxable years in the spread period under paragraph (2)(C) and attributable to the interest or stock disposed of shall be included in gross income for the taxable year in which the disposition occurs. For purposes of the preceding sentence, the term ‘spread period’ means the period consisting of the 4 taxable years referred to in paragraph (2)(C).”

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as a note under section 1361 of this title.

CONSTRUCTION OF SECTION 806 OF PUB. L. 99-514

Pub. L. 100-647, title I, §1008(e)(9), Nov. 10, 1988, 102 Stat. 3441, provided that: “Nothing in section 806 of the Reform Act [Pub. L. 99-514, amending this section and

sections 267, 441, and 706 of this title and enacting provisions set out above) or in any legislative history relating thereto shall be construed as requiring the Secretary of the Treasury or his delegate to permit an automatic change of a taxable year."

§ 1379. Transitional rules on enactment

(a) Old elections

Any election made under section 1372(a) (as in effect before the enactment of the Subchapter S Revision Act of 1982) shall be treated as an election made under section 1362.

(b) References to prior law included

Any references in this title to a provision of this subchapter shall, to the extent not inconsistent with the purposes of this subchapter, include a reference to the corresponding provision as in effect before the enactment of the Subchapter S Revision Act of 1982.

(c) Distributions of undistributed taxable income

If a corporation was an electing small business corporation for the last preenactment year, subsections (f) and (d) of section 1375 (as in effect before the enactment of the Subchapter S Revision Act of 1982) shall continue to apply with respect to distributions of undistributed taxable income for any taxable year beginning before January 1, 1983.

(d) Carryforwards

If a corporation was an electing small business corporation for the last preenactment year and is an S corporation for the 1st postenactment year, any carryforward to the 1st postenactment year which arose in a taxable year for which the corporation was an electing small business corporation shall be treated as arising in the 1st postenactment year.

(e) Preenactment and postenactment years defined

For purposes of this subsection—

(1) Last preenactment year

The term "last preenactment year" means the last taxable year of a corporation which begins before January 1, 1983.

(2) 1st postenactment year

The term "1st postenactment year" means the 1st taxable year of a corporation which begins after December 31, 1982.

(Added Pub. L. 97-354, § 2, Oct. 19, 1982, 96 Stat. 1686; amended Pub. L. 98-369, div. A, title VII, § 721(n), July 18, 1984, 98 Stat. 969.)

REFERENCES IN TEXT

The enactment of the Subchapter S Revision Act of 1982, referred to in subsecs. (a) to (c), is the enactment of Pub. L. 97-354, which was approved Oct. 19, 1982.

PRIOR PROVISIONS

A prior section 1379, added Pub. L. 91-172, title V, § 531(a), Dec. 30, 1969, 83 Stat. 654; amended Pub. L. 93-406, title II, § 2001(b), Sept. 2, 1974, 88 Stat. 952; Pub. L. 97-34, title III, § 312(c)(6), Aug. 13, 1981, 95 Stat. 284; Pub. L. 97-248, title II, § 238(c), Sept. 3, 1982, 96 Stat. 513, related to certain qualified pension, etc., plans, prior to the general revision of this subchapter by section 2 of Pub. L. 97-354.

AMENDMENTS

1984—Subsec. (b). Pub. L. 98-369 struck out "In applying this subchapter to any taxable year beginning after

December 31, 1982," and substituted "Any references in this title to a provision" for "any reference in this subchapter to another provision".

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in Subchapter S Revision Act of 1982, Pub. L. 97-354, see section 721(y)(1) of Pub. L. 98-369, set out as a note under section 1361 of this title.

EFFECTIVE DATE

Section applicable to taxable years beginning after Dec. 31, 1983, except that this section as in effect before Oct. 19, 1982, to remain in effect for years beginning before Jan. 1, 1984, see section 6(a), (b)(1) of Pub. L. 97-354, set out as a note under section 1361 of this title.

COORDINATION OF REPEALS OF CERTAIN SECTIONS

Subsec. (b) of this section as in effect on day before Sept. 3, 1982, inapplicable to any section 401(j) plan, see section 713(d)(8) of Pub. L. 98-369, set out as a note under section 404 of this title.

Subchapter T—Cooperatives and Their Patrons

Part

- I. Tax treatment of cooperatives.
- II. Tax treatment by patrons of patronage dividends and per-unit retain allocations.
- III. Definitions; special rules.

AMENDMENTS

1966—Pub. L. 89-809, title II, § 211(b)(5), Nov. 13, 1966, 80 Stat. 1582, inserted "and per-unit retain allocations" in heading of part II.

1962—Pub. L. 87-834, § 17(a), Oct. 16, 1962, 76 Stat. 1045, added headings of subchapter T and of parts I to III.

PART I—TAX TREATMENT OF COOPERATIVES

Sec.

- 1381. Organizations to which part applies.
- 1382. Taxable income of cooperatives.
- 1383. Computation of tax where cooperative redeems nonqualified written notices of allocation or nonqualified per-unit retain certificates.

AMENDMENTS

1966—Pub. L. 89-809, title II, § 211(a)(8), Nov. 13, 1966, 80 Stat. 1582, inserted "or nonqualified per-unit retain certificates" in item 1383.

1962—Pub. L. 87-834, § 17(a), Oct. 16, 1962, 76 Stat. 1045, added heading of part I and items 1381 to 1383.

§ 1381. Organizations to which part applies

(a) In general

This part shall apply to—

(1) any organization exempt from tax under section 521 (relating to exemption of farmers' cooperatives from tax), and

(2) any corporation operating on a cooperative basis other than an organization—

(A) which is exempt from tax under this chapter,

(B) which is subject to the provisions of—

(i) part II of subchapter H (relating to mutual savings banks, etc.), or

(ii) subchapter L (relating to insurance companies), or

(C) which is engaged in furnishing electric energy, or providing telephone service, to persons in rural areas.

(b) Tax on certain farmers' cooperatives

An organization described in subsection (a)(1) shall be subject to the tax imposed by section 11.