

**§ 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 applicable 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.