

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 3rd 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 without 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 holding company (as defined in section 3(w)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(w)(1)),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 shareholder-

¹So in original. Another closing parenthesis probably should precede the comma.

ers 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 be² 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), (l), (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.)

AMENDMENTS

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

² So in original. Probably should be followed by a comma.

“(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), (l), (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(l) 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, pro-

vided 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).