

**Subchapter S—Tax Treatment of S Corporations and Their Shareholders**

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**§ 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—