

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—