

Internal Revenue Code Section 1361(c)(5)(B)

S Corporation defined.

...

(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) [IRC Sec. 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) [IRC Sec. 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 [IRC Sections 671 et seq.]) 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 [IRC Sec. 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) [IRC Sec. 408(a)], including one designated as a Roth IRA under section 408A [IRC Sec. 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 [enacted Oct. 22, 2004].

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.


(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 a 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 [IRC Sections 1361 et seq.] 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) [IRC Sec. 401(a) or 501(c)(3)], and

(B) exempt from taxation under section 501(a) [IRC Sec. 501(a)],
may be a shareholder in an S corporation.