

Part III - Administrative, Procedural, and Miscellaneous

S Corporation Family Shareholder Election

Notice 2005-91

PURPOSE

The purpose of this notice is to inform taxpayers that Treasury and the Internal Revenue Service intend to issue future guidance regarding the election under § 1361(c)(1)(D) of the Internal Revenue Code, which allows members of a family to be treated as a single S corporation shareholder (hereinafter, the election). The election was created by § 231 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (the Act), which was enacted on October 22, 2004. The guidance will provide that the election is made in a manner similar to that described in this notice. Until such guidance is issued, taxpayers may rely on this notice.

BACKGROUND

Section 231 of the Act allows any family member to make an election under new § 1361(c)(1)(D) of the Internal Revenue Code to treat all members of the family as one shareholder of an S corporation for purposes of determining the number of shareholders of the corporation. The election is relevant only to the determination of whether the

corporation has no more than 100 shareholders as required under §1361(b)(1)(A) and has no impact on any other existing requirement for qualification as an S corporation.

The term "members of the family" is defined in §1361(c)(1)(B) to include (i) the common ancestor, (ii) the lineal descendants of the common ancestor, and (iii) the spouses (or former spouses) of the lineal descendants or of the common ancestor. The common ancestor may not be more than six generations removed from the youngest generation of shareholders who would be members of the common ancestor's family (but for the six-generation limit for identifying the common ancestor). This test is applied as of the later of the effective date of § 1361(c)(1), as amended by the Act, or the time the S corporation election under § 1362(a) (the S corporation election) is made.

The election may be made (except as provided in Treasury regulations) by any member of the family. The election does not affect the requirement under § 1362(a)(2) that an S corporation election must be consented to by all shareholders, whether or not "members of the family," who are shareholders at the time of the S corporation election.

The election may be made for taxable years of the S corporation beginning after December 31, 2004. The election will be effective as of the first day of the S corporation's taxable year identified in the election as the first taxable year of the corporation for which the election is effective, and shall remain in effect until terminated as provided in regulations prescribed by the Secretary.

FAMILY SHAREHOLDER ELECTION

A member of the family who is (or is treated under § 1361 and the regulations thereunder as) a shareholder of the S corporation may make the election. The election

is made by notifying the corporation to which the election applies. The notification shall identify by name the member of the family making the election, the "common ancestor" of the family to which the election applies, and the first taxable year of the corporation for which the election is to be effective.

For purposes of identifying the common ancestor (who does not have to be alive at the time the election is made) any spouse or former spouse of the common ancestor will be treated as being in the same generation as the common ancestor, and any spouse or former spouse of a lineal descendant of the common ancestor will be treated as being in the same generation as the lineal descendant to whom that spouse is or was married.

For purposes of the election, the estate of a deceased member of the family will be considered to be a member of the family during the period in which the estate, or a trust described in § 1361(c)(2)(A)(iii), holds stock in the S corporation.

Additionally, for purposes of the election, the members of the family will include:

(1) Each potential current beneficiary of an electing small business trust (ESBT) who is a member of the family,

(2) The income beneficiary of a qualified subchapter S trust (QSST) who makes the QSST election, if that income beneficiary is a member of the family,

(3) Each beneficiary of a trust who is a member of the family, if the trust was created primarily to exercise the voting power of stock transferred to it,

(4) The member of the family for whose benefit a trust described in § 1361(c)(2)(A)(vi) was created,

(5) The deemed owner of a trust treated as wholly owned under subpart E of Part I of subchapter J of Chapter 1 of Subtitle A of the Internal Revenue Code, if that deemed owner is a member of the family, and

(6) The owner of an entity disregarded as an entity separate from its owner under § 301.7701-3 of the Procedure and Administration Regulations, if that owner is a member of the family.

If a corporation has two or more elections in effect and the members of one family for which the election has been made (the inclusive family) include all the members of another family for which the election was also made (the subsumed family), then the members of the inclusive family will be counted as one shareholder for purposes of § 1361(b)(1)(A) as long as the inclusive family's election is in effect, and the members of the subsumed family will not be counted as a separate and additional shareholder.

The election will be effective as of the first day of the corporation's taxable year designated by the shareholder making the election. Any election will remain in effect until terminated as provided in regulations.

Taxpayers may have already taken certain actions in order to make this election by various forms of notification to the corporation or to the IRS. In order for the election to be effective for taxable years beginning after December 31, 2004, taxpayers will need to provide the information described in this guidance to the corporation (to the extent not already provided to the corporation).

The corporation is required to keep records in accordance with § 6001 and the

regulations thereunder.

The principal author of this notice is Bradford R. Poston of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Bradford R. Poston at (202) 622-3060 (not a toll-free call).