**8794. Who can be a shareholder in an S corporation? What restrictions apply to 2 percent shareholders in an S corporation?**

An S corporation may have up to 100 shareholders (none of whom are nonresident aliens) who are individuals, estates, and certain trusts.

Members of a family are treated as one shareholder. “Members of a family,” for this purpose, means “the common ancestor, lineal descendants of the common ancestor, and the spouses (or former spouses) of such lineal descendants or common ancestor.” Generally, the common ancestor may not be more than six generations removed from the youngest generation of shareholders who would be considered members of the family.[[1]](#footnote-1)

Only certain trusts can qualify as S corporation shareholders. These trusts include: (1) a trust all of which is treated as owned by an individual who is a citizen or resident of the United States under the grantor trust rules; (2) a trust that was described in (1) above immediately prior to the deemed owner’s death that continues in existence after such death may continue to be an S corporation shareholder for up to two years after the owner’s death; (3) a trust to which stock is transferred pursuant to a will may be an S corporation shareholder for up to two years after the date of the stock transfer; (4) a trust created primarily to exercise the voting power of stock transferred to it; (5) a qualified subchapter S trust (QSST), see below; (6) an electing small business trust (ESBT), see below; and (7) in the case of an S corporation that is a bank, an IRA or Roth IRA.[[2]](#footnote-2) An estate can continue to be an eligible shareholder during the reasonable period of administration. This can continue for the duration of payments being made under Sec. 6166 (relating to the deferral of the estate tax relating to closely held business).3

A QSST is a trust that has only one current income beneficiary (who must be a citizen or resident of the U.S.), all income must be distributed currently, and the trust corpus may not be distributed to anyone else during the life of such beneficiary. The income interest must terminate upon the earlier of the beneficiary’s death or termination of the trust. If the trust terminates during the lifetime of the income beneficiary, all trust assets must be distributed to that beneficiary. The beneficiary must make an election for the trust to be treated as a QSST.[[3]](#footnote-3)

An ESBT is a trust in which all of the beneficiaries are individuals, estates, or charitable organizations.[[4]](#footnote-4) Each potential current beneficiary of an ESBT is treated as a shareholder for purposes of the 100 shareholder limitation.[[5]](#footnote-5) A potential current beneficiary is generally, with respect to any period, someone who is entitled to, or in the discretion of any person may receive, a distribution of principal or interest of the trust. In addition, a person treated as an owner of a trust under the grantor trust rules is a potential current beneficiary.[[6]](#footnote-6) If there is no potential current beneficiary of an ESBT during any period, the ESBT itself is treated as the S corporation shareholder.[[7]](#footnote-7) Trusts exempt from income tax, QSSTs, charitable remainder annuity trusts, and charitable remainder unitrusts may not be ESBTs. An interest in an ESBT may not be obtained by purchase.[[8]](#footnote-8) If any portion of the basis in the beneficiary’s interest is determined under the cost basis rules, the interest is treated as though it was acquired by purchase.[[9]](#footnote-9) An ESBT is taxed at the highest individual income tax rate (39.6 percent in 2013 and beyond).[[10]](#footnote-10)

1. . IRC Sec. 1361(c)(1). [↑](#footnote-ref-1)
2. . IRC Secs. 1361(c)(2), 1361(d).

3. IRC Sec. 1361(b)(1)(B); Rev. Rul 76-23; Plr 200226031 [↑](#footnote-ref-2)
3. . IRC Sec. 1361(d). [↑](#footnote-ref-3)
4. . IRC Sec. 1361(e). [↑](#footnote-ref-4)
5. . IRC Sec. 1361(c)(2)(B)(v). [↑](#footnote-ref-5)
6. . Treas. Reg. §1.1361-1(m)(4). [↑](#footnote-ref-6)
7. . Treas. Reg. §1.1361-1(h)(3)(i)(F). [↑](#footnote-ref-7)
8. . IRC Sec. 1361(e). [↑](#footnote-ref-8)
9. . Treas. Reg. §1.1361-1(m)(1)(iii). [↑](#footnote-ref-9)
10. . IRC Secs. 641(c), 1(e). [↑](#footnote-ref-10)