

qualify as a small business corporation if it has more than 35 shareholders. Ordinarily, the person who would have to include in gross income dividends distributed with respect to the stock of the corporation (if the corporation were a C corporation) is considered to be the shareholder of the corporation. For example, if stock (owned other than by a husband and wife) is owned by tenants in common or joint tenants, each tenant in common or joint tenant is generally considered to be a shareholder of the corporation. (For special rules relating to stock owned by husband and wife, see paragraph (e)(2) of this section; for special rules relating to restricted stock, see paragraphs (b) (3) and (6) of this section.) The person for whom stock of a corporation is held by a nominee, guardian, custodian, or an agent is considered to be the shareholder of the corporation for purposes of this paragraph (e) and paragraphs (f) and (g) of this section. For example, a partnership may be a nominee of S corporation stock for a person who qualifies as a shareholder of an S corporation. However, if the partnership is the beneficial owner of the stock, then the partnership is the shareholder, and the corporation does not qualify as a small business corporation. In addition, in the case of stock held for a minor under a uniform gifts to minors or similar statute, the minor and not the custodian is the shareholder. For purposes of this paragraph (e) and paragraphs (f) and (g) of this section, if stock is held by a decedent's estate, the estate (and not the beneficiaries of the estate) is considered to be the shareholder; however, if stock is held by a subpart E trust (which includes voting trusts), the deemed owner is considered to be the shareholder.

(2) *Special rules relating to stock owned by husband and wife.* For purposes of paragraph (e)(1) of this section, stock owned by a husband and wife (or by either or both of their estates) is treated as if owned by one shareholder, regardless of the form in which they own the stock. For example, if husband and wife are owners of a subpart E trust, they will be treated as one individual. Both husband and wife must be U.S. citizens or residents, and a decedent spouse's estate must not be a foreign estate as defined in section 7701(a)(31). The treatment described in this paragraph (e)(2) will cease upon dissolution of the marriage for any reason other than death.

(f) *Shareholder must be an individual or estate.* Except as otherwise provided in paragraph (e)(1) (relating to nominees and paragraph (h) (relating to certain

trusts) of this section, a corporation in which any shareholder is a corporation, partnership, or trust does not qualify as a small business corporation.

(g) *Nonresident alien shareholder—(1) General rule.* (i) A corporation having a shareholder who is a nonresident alien as defined in section 7701(b)(1)(B) does not qualify as a small business corporation. If a U.S. shareholder's spouse is a nonresident alien who has a current ownership interest (as opposed, for example, to a survivorship interest) in the stock of the corporation by reason of any applicable law, such as a state community property law or a foreign country's law, the corporation does not qualify as a small business corporation from the time the nonresident alien spouse acquires the interest in the stock. If a corporation's S election is inadvertently terminated as a result of a nonresident alien spouse being considered a shareholder, the corporation may request relief under section 1362(f).

(ii) The following examples illustrate this paragraph (g)(1)(i):

*Example 1.* In 1990, W, a U.S. citizen, married H, a citizen of a foreign country. At all times H is a nonresident alien under section 7701(b)(1)(B). Under the foreign country's law, all property acquired by a husband and wife during the existence of the marriage is community property and owned jointly by the husband and wife. In 1996 while residing in the foreign country, W formed X, a U.S. corporation, and X simultaneously filed an election to be an S corporation. X issued all of its outstanding stock in W's name. Under the foreign country's law, X's stock became the community property of and jointly owned by H and W. Thus, X does not meet the definition of a small business corporation and therefore could not file a valid S election because H, a nonresident alien, has a current interest in the stock.

*Example 2.* Assume the same facts as *Example 1*, except that in 1991, W and H filed a section 6013(g) election allowing them to file a joint U.S. tax return and causing H to be treated as a U.S. resident for purposes of chapters 1, 5, and 24 of the Internal Revenue Code. The section 6013(g) election applies to the taxable year for which made and to all subsequent taxable years until terminated. Because H is treated as a U.S. resident under section 6013(g), X does meet the definition of a small business corporation. Thus, the election filed by X to be an S corporation is valid.

(2) *Special rule for dual residents.* [Reserved]

(h) *Special rules relating to trusts—(1) General rule.* In general, a trust is not a permitted small business corporation shareholder. However, except as provided in paragraph (h)(2) of this section, the following trusts are permitted shareholders:

(i) *Qualified Subpart E trust.* A trust all of which is treated (under subpart E, part I, subchapter J, chapter 1) as owned by an individual (whether or not the grantor) who is a citizen or resident of the United States (a qualified subpart E trust). This requirement applies only during the period that the trust holds S corporation stock.

(ii) *Subpart E trust ceasing to be a qualified subpart E trust after the death of deemed owner.* A trust which was a qualified subpart E trust immediately before the death of the deemed owner and which continues in existence after the death of the deemed owner, but only for the 60-day period beginning on the day of the deemed owner's death. However, if a trust is described in the preceding sentence and the entire corpus of the trust is includible in the gross estate of the deemed owner, the trust is a permitted shareholder for the 2-year period beginning on the day of the deemed owner's death. A trust is considered to continue in existence if the trust continues to hold the stock of the S corporation during the period of administration of the decedent's estate or if, after the period of administration, the trust continues to hold the stock pursuant to the terms of the will or the trust agreement. See § 1.641(b)-3 for rules concerning the termination of estates and trusts for federal income tax purposes. If the trust consists of community property, and the decedent's community property interest in the trust is includible in the decedent's gross estate under chapter 11 (section 2001 and following, relating to estate tax), then the entire corpus of the trust will be deemed includible in the decedent's gross estate. Further, for the purpose of determining whether the entire corpus of the trust is includible in the gross estate of the deemed owner, if the decedent's spouse was treated as an owner of a portion of the trust under subpart E immediately before the decedent's death, the surviving spouse's portion is disregarded.

(iii) *Electing Qualified subchapter S trusts.* A qualified subchapter S trust (QSST) that has a section 1361(d)(2) election in effect (an electing QSST). See paragraph (j) of this section for rules concerning QSSTs including the manner for making the section 1361(d)(2) election.

(iv) *Testamentary trusts.* A trust (other than a qualified subpart E trust or an electing QSST) to which S corporation stock is transferred pursuant to the terms of a will, but only for the 60-day period beginning on the day the stock is transferred to the trust.

(v) *Qualified Voting trusts.* A trust created primarily to exercise the voting