I. **Election**: An S Corporation is an entity for which an election by all shareholders has been made and which:

A. Is not an ineligible corporation, §§1361(b)(1), 1361(b)(2);

B. Does not have more than 100 families as shareholders, §§1361(b)(1)(A), 1361(c)(1);

C. Has only natural persons, certain qualifying trusts, and certain exempt organizations as shareholders, §1361(b)(1)(B);

D. Does not have a nonresident alien as a shareholder, §1361(b)(1)(C); and

E. Does not have more than one class of stock, §§1361(b)(1)(D), 1361(c)(4).

II. **Formation**: There are no special Subchapter S rules so §351 and related provisions apply. See §1371(a).

III. **Operation**: An S Corporation without a C Corporation history is not a taxpayer. §1366(a). It computes its income as if it were a taxpayer, see §1463(b), files an informational return (form 1120-S), and then its items of income and deduction are passed through to and reported by its shareholders on a per share/per day basis (using schedule K-1 for form 1120-S), §1366(a), with character preserved. §1366(b). Pass-thru income increases a shareholder’s basis in the corporation, §1367(a)(1), and pass-thru deduction reduces a shareholder’s basis, §1367(a)(2). Pass-thru losses in excess of basis are suspended until additional basis arises. §1366(d).

IV. **Nonliquidating Distributions**: There are no special rules governing the *corporate-leve*l taxation of S Corporations making distributions to their shareholders with respect to the shareholder’s stock. Accordingly, if property is distributed, gain is recognized at the corporate level, §311(b), and loss cannot be recognized at the corporate level, §311(a). Of course, to the extent gain is recognized, it is passed-thru to and included by the shareholders.

A. **Not in Redemption**: If a shareholder receives a distribution of cash or property, the “amount” of the distribution, see §301(b), is not included in income, §1368(b)(1) but rather is treated as a return of basis, §1367(a)(2)(a). Amounts received in excess of basis are treated as gain from the sale or exchange of property. §1368(b)(2). Note that the order of basis adjustments is (1) pass-thru income; (2) distributions; (3) pass-thru deductions. §§1367(d) (including final flush language), 1367(a).

B. **Redemptions**:

1. **Definition**: A “redemption” is the acquisition by a corporation from a shareholder of the corporation’s stock in exchange for property of the corporation. §317(b).

2. **Taxation**: A distribution in redemption of stock is taxable to the shareholder as an exchange if the distribution is described in §302(b). If the redemption is not described in §302(b), it is taxed as a distribution. §302(d). To the corporation, a redemption is just a distribution.

a. **Taxation as a Distribution**: If the redemption is taxed as a distribution, then no loss can be recognized and gain will be recognized only to the extent that the amount of the distribution exceeds the shareholder’s *entire* basis. See Reg. §1.1367-1(c)(3). See also Reg. §1.1367-1(d)(1).

b. **Taxation as an Exchange**: If the redemption is taxed as an exchange, gain or loss is recognized by the shareholder by comparing the amount of the distribution with the shareholder’s adjusted basis *in the shares redeemed*.

V. **Liquidating Distributions**: An S Corporation, like a C Corporation, can recognize gain and (subject to significant restrictions) loss on a liquidating distribution. §336. To the shareholders, the distribution is taxed as an exchange. §331(a). Of course, to the extent the corporation recognizes gain or loss on the distribution, that gain or loss affects the shareholder’s adjusted basis for computation of gain or loss on the liquidating distribution.