

Internal Revenue Code Section 1362(d)

Election; revocation; termination.

(d) Termination.

(1) By revocation.

(A) In general. An election under subsection (a) may be terminated by revocation.

(B) More than one-half of shares must consent to revocation. An election may be revoked only if shareholders holding more than one-half of the shares of stock of the corporation on the day on which the revocation is made consent to the revocation.

(C) When effective. Except as provided in subparagraph (D)—

(i) a revocation made during the taxable year and on or before the 15th day of the 3d month thereof shall be effective on the 1st day of such taxable year, and

(ii) a revocation made during the taxable year but after such 15th day shall be effective on the 1st day of the following taxable year.

(D) Revocation may specify prospective date. If the revocation specifies a date for revocation which is on or after the day on which the revocation is made, the revocation shall be effective on and after the date so specified.

(2) By corporation ceasing to be small business corporation.

(A) In general. An election under subsection (a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

(B) When effective. Any termination under this paragraph shall be effective on and after the date of cessation.

(3) Where passive investment income exceeds 25 percent of gross receipts for 3 consecutive taxable years and corporation has accumulated earnings and profits.

(A) Termination.

- (i) In general. An election under subsection (a) shall be terminated whenever the corporation—
 - (I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and
 - (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.
 - (ii) When effective. Any termination under this paragraph shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in clause (i).
 - (iii) Years taken into account. A prior taxable year shall not be taken into account under clause (i) unless—
 - (I) such taxable year began after December 31, 1981, and
 - (II) the corporation was an S corporation for such taxable year.
- (B) Gross receipts from the sales of certain assets. For purposes of this paragraph—
- (i) in the case of dispositions of capital assets (other than stock and securities), gross receipts from such dispositions shall be taken into account only to the extent of the capital gain net income therefrom, and
 - (ii) in the case of sales or exchanges of stock or securities, gross receipts shall be taken into account only to the extent of the gains therefrom.
- (C) Passive investment income defined.
- (i) In general. Except as otherwise provided in this subparagraph, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, and annuities.
 - (ii) Exception for interest on notes from sales of inventory. The term "passive investment income" shall not include interest on any obligation acquired in the ordinary course of the corporation's trade or business from its sale of property described in section 1221(a)(1) [IRC Sec. 1221(a)(1)].
 - (iii) Treatment of certain lending or finance companies. If the S corporation meets the requirements of section 542(c)(6) [IRC Sec. 542(c)(6)] for the taxable year, the term "passive investment

income" shall not include gross receipts for the taxable year which are derived directly from the active and regular conduct of a lending or finance business (as defined in section 542(d)(1) [IRC Sec. 542(d)(1)]).

(iv) Treatment of certain dividends. If an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2) [IRC Sec. 1504(a)(2)], the term "passive investment income" shall not include dividends from such C corporation to the extent such dividends are attributable to the earnings and profits of such C corporation derived from the active conduct of a trade or business.

(v) Exception for banks, etc. In the case of 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))), the term "passive investment income" shall not include—

(I) interest income earned by such bank or company, or

(II) dividends on assets required to be held by such bank or company, including stock in the Federal Reserve Bank, the Federal Home Loan Bank, or the Federal Agricultural Mortgage Bank or participation certificates issued by a Federal Intermediate Credit Bank.