

T.D. 8970

DEPARTMENT OF THE
TREASURY
Internal Revenue Service
26 CFR Part 301

Amendment, Check the Box
Regulations

AGENCY: Internal Revenue Service
(IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains
final regulations relating to elective
changes in entity classification under sec-
tion 7701 of the Internal Revenue Code.

The regulations apply to subsidiary cor-
porations that elect to change their classi-
fication for federal tax purposes from a
corporation to either a partnership or dis-
regarded entity.

DATES: *Effective Date:* These regula-
tions are effective December 17, 2001.

FOR FURTHER INFORMATION CON-
TACT: Beverly Katz, (202) 622-3050
(not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On November 29, 1999, final regula-
tions were published in the **Federal Reg-
ister** (T.D. 8844, 1999-2 C.B. 661 [64 FR
66580]) describing the transactions that
are deemed to occur when an entity elects
to change its classification for Federal tax
purposes. Those regulations did not
address certain requirements of section
332 as applied to the deemed liquidation
incident to an association's election to be
classified as a partnership or to be disre-
garded as an entity separate from its
owner. This amendment to the final regu-
lations addresses those requirements.

On January 25, 2000, final regulations
were published in the **Federal Register**
(T.D. 8869, 2000-6 I.R.B. 498 [65 FR
3843]) relating to qualified subchapter S
subsidiaries (QSub). In order to permit
the deemed transaction resulting from a
QSub election to comply with the require-
ment of section 332 that a plan of liquida-
tion has been adopted at the time of a liq-
uidating distribution, the final regulations
provide that a plan of liquidation is
deemed adopted immediately before the
deemed liquidation incident to the QSub
election, unless a formal plan of liquida-
tion that contemplates the filing of a
QSub election is adopted on an earlier
date. The preamble to the QSub regula-
tions provides that Treasury and the IRS
intend to amend the section 7701 regula-
tions regarding elective changes in entity
classification to provide a similar rule
concerning the timing of the plan of liq-
uidation.

Consistent with the commitment in the
preamble to the QSub regulations, on
January 17, 2001, proposed regulations
were published in the **Federal Register**
(REG-110659-00, 66 FR 3959 (2001-12

I.R.B. 917)) under section 7701. No com-
ments were received from the public in
response to the proposed regulations. No
public hearing was requested or held. The
proposed regulations are adopted by this
Treasury decision.

Explanation of Provisions

Section 301.7701-3(g)(1) describes
how elective changes in the classification
of an entity will be treated for tax pur-
poses. Section 301.7701-3(g)(1)(ii) pro-
vides that an elective conversion of an
association to a partnership is deemed to
have the following form: the association
distributes all of its assets and liabilities
to its shareholders in liquidation of the
association, and immediately thereafter,
the shareholders contribute all of the dis-
tributed assets and liabilities to a newly
formed partnership. Section 301.7701-
3(g)(1)(iii) provides that an elective con-
version of an association to an entity that
is disregarded as an entity separate from
its owner is deemed to have the following
form: the association distributes all of its
assets and liabilities to its single owner in
liquidation of the association.

Section 332 may be relevant to the
deemed liquidation of an association if it
has a corporate owner. Under section 332,
no gain or loss is recognized on the
receipt by a corporation of property dis-
tributed in complete liquidation of
another corporation if the requirements of
section 332(b) are satisfied. Those
requirements include the adoption of a
plan of liquidation at a time when the
corporation receiving the distribution owns
stock of the liquidating corporation meet-
ing the requirements of section
1504(a)(2) (*i.e.*, 80 percent of vote and
value). The elective change from an asso-
ciation to a partnership or to a disre-
garded entity results in a constructive liq-
uidation of the association for federal tax
purposes. Formally adopting a plan of liq-
uidation for the entity, however, is poten-
tially incompatible with an elective
change under section 301.7701-3, which
allows the local law entity to remain in
existence while liquidating only for fed-
eral tax purposes. Accordingly, to provide
tax treatment of an association's deemed
liquidation that is compatible with the

requirements of section 332, the regulations state that, for purposes of satisfying the requirement of adoption of a plan of liquidation under section 332(b), a plan of liquidation is deemed adopted immediately before the deemed liquidation incident to an elective change in entity classification, unless a formal plan of liquidation that contemplates the filing of the elective change in entity classification is adopted on an earlier date.

Effective Date

These regulations apply to elections filed on or after December 17, 2001; however, taxpayers may apply the amendments retroactively if the corporate owner claiming treatment under section 332 and its subsidiary making the election take consistent positions with respect to the federal tax consequences of the election.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 533(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Beverly M. Katz of the Office of Associate Chief Counsel (Passthroughs &

Special Industries) and David J. Sotos of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.7701-3 is amended as follows:

- 1. Redesignating the text of paragraph (g)(2) as paragraph (g)(2)(i) and adding a heading for newly designated paragraph (g)(2)(i).
- 2. Adding a new paragraph (g)(2)(ii).
- 3. Revising the first sentence of paragraph (g)(4).

The additions and revision read as follows:

§ 301.7701-3 *Classification of certain business entities.*

* * * * *

(g) * * *

(2) *Effect of elective changes—(i) In general.* * * *

(ii) *Adoption of plan of liquidation.* For purposes of satisfying the requirement of adoption of a plan of liquidation under section 332, unless a formal plan of liquidation that contemplates the election to be classified as a partnership or to be disregarded as an entity separate from its owner is adopted on an earlier date, the making, by an association, of an election under paragraph (c)(1)(i) of this section to

be classified as a partnership or to be disregarded as an entity separate from its owner is considered to be the adoption of a plan of liquidation immediately before the deemed liquidation described in paragraph (g)(1)(ii) or (iii) of this section. This paragraph (g)(2)(ii) applies to elections filed on or after December 17, 2001. Taxpayers may apply this paragraph (g)(2)(ii) retroactively to elections filed before December 17, 2001, if the corporate owner claiming treatment under section 332 and its subsidiary making the election take consistent positions with respect to the federal tax consequences of the election.

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(4) *Effective date.* Except as otherwise provided in paragraph (g)(2)(ii) of this section, this paragraph (g) applies to elections that are filed on or after November 29, 1999.***

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 10, 2001.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 14, 2001, 8:45 a.m., and published in the issue of the Federal Register for December 17, 2001, 66 F.R. 64911)
