

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, §§ 1361, 1362; 1.1361-1, 1.1362-4, 1.1362-6, 301.9100-1, 301.9100-3.)

Rev. Proc. 98-55

SECTION 1. PURPOSE

This revenue procedure amplifies and supersedes the provisions of Rev. Proc. 94-23, 1994-1 C.B. 609, and Rev. Proc. 97-40, 1997-33 I.R.B. 50. This revenue procedure is intended to provide guidance for taxpayers requesting relief for late S corporation elections and certain untimely elections required to be filed by or with respect to an S corporation. Accompanying this document is a flowchart designed to aid taxpayers in applying this revenue procedure.

SECTION 2. BACKGROUND

Section 1361(a)(1) of the Internal Revenue Code defines an "S corporation," with respect to any taxable year, as a small business corporation for which an S corporation election is in effect for that year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a)(1) provides that, except in a situation described in § 1362(g), a small business corporation may elect to be treated as an S corporation.

Section 1362(b)(1) provides that the corporation may make an election to be treated as an S corporation (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year. Under § 1362(b)(3), if an S corporation election is made for a taxable year after the 15th day of the 3rd month of that taxable year and on or before the 15th day of the 3rd month of the following taxable year, then the S corporation election is treated as made for the following taxable year.

Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)) after the date prescribed by § 1362(b) for making the election for the taxable year or no election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

Rev. Proc. 97-40 provides a special procedure to request relief for a late S corporation election. That revenue procedure applies only to a corporation (1) that has not filed a timely S corporation election under § 1362(a)(1), (2) for which an S corporation election is filed within 6 months of the original due date for the election, and (3) for which the due date of the tax

return (excluding extensions) for the first year the corporation intended to be an S corporation has not passed.

Rev. Proc. 97-48, 1997-43 I.R.B. 19, provides special procedures to obtain automatic relief for certain late S corporation elections in two situations. In both situations, relief is available only where the due date for the tax return for the first year the corporation intended to be an S corporation has passed and other eligibility requirements are met. Rev. Proc. 97-48 does not provide relief for late electing small business trust (ESBT), qualified subchapter S trust (QSST), or qualified subchapter S subsidiary (QSub) elections.

Section 1362(f) grants the Service authority to provide relief in situations where a corporation's S election was not effective for the taxable year for which it was made by reason of a failure to meet the requirements of § 1361(b), or where the corporation's S election terminates under § 1362(d)(2) or (3). A corporation is eligible for relief under this provision if (1) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (2) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the S corporation is a small business corporation, and (3) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S

corporation) as may be required by the Secretary with respect to the period. If a corporation is eligible for relief under this provision, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4 of the Income Tax Regulations sets forth additional guidance regarding inadvertent termination relief. Section 1.1362-4(b) provides that the corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard against such an event, tends to establish that the termination was inadvertent. Section 1.1362-4(c) provides that a taxpayer may request inadvertent termination relief by submitting a request for a private letter ruling. Section 1.1362-4(d) provides that the Commissioner may condition the granting of a ruling request on any adjustments that are appropriate. Section 1.1362-4(e) requires the corporation and all persons who were shareholders of the corporation at any time during the time specified by the Commissioner to consent to any adjustments that the Commissioner may require.

Section 1361(d)(1)(A) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust will be treated as a trust described in § 1361(c)(2)(A)(i) (relating to trusts that may be a shareholder of a small business corporation under § 1361(b)(1)). Pursuant to § 1361(d)(2)(A) and § 1.1361-1(j)(6)(i), the election by a current income beneficiary of a QSST may be made by the beneficiary's legal representative (or a natural or an adoptive parent of the current income beneficiary if a legal representative has not been appointed and the current income beneficiary is a minor).

Section 1361(d)(2) provides for the time and manner in which the beneficiary of a QSST may elect to have the provisions of § 1361(d) apply. Included is the requirement that the QSST election must be filed within the 2 month and 16 day period beginning on the day that the stock is transferred to the trust.

Section 1361(d)(3) sets forth the provisions a trust instrument must contain for the trust to qualify as a QSST. Under § 1361(d)(3)(A), the terms of the trust must require that: (i) during the life of the current income beneficiary, there is only one income beneficiary; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to that beneficiary; (iii) the current income beneficiary's interest terminates on the earlier of the beneficiary's death or the trust's termination; and (iv) if the trust terminates during the current income beneficiary's life, the trust assets must be

distributed to that beneficiary. In addition, § 1361(d)(3)(B) requires that the trust must distribute all of its income (within the meaning of § 643(b)) currently to one individual who is a United States resident or citizen.

Rev. Proc. 94-23 provides automatic inadvertent termination relief to certain corporations whose S corporation election terminates because stock of the corporation was transferred to a trust whose current income beneficiary (or the legal representative of the current income beneficiary) inadvertently failed to file a timely election with respect to a QSST under § 1361(d)(2). Section 4 of that revenue procedure provides the prerequisites for automatic relief and the procedural requirements for obtaining it.

Section 1361(c)(2)(A)(v) provides that an ESBT (as defined in § 1361(e)) is a permitted S corporation shareholder. Generally, an ESBT is any trust if: (1) the trust does not have as a beneficiary any person other than an individual, an estate, or an organization described in § 170(c)(2), (3), (4), or (5); (2) no interest in the trust was acquired by purchase; and (3) an election to be an ESBT has been filed with respect to the trust.

Section 1361(b)(3)(B) provides that a QSub is a domestic corporation that is not an ineligible corporation, if (1) an S corporation holds 100 percent of the stock of the corporation, and (2) that S corporation elects to treat the subsidiary as a QSub.

Under § 301.9100-1(c) of the Procedure and Administration Regulations, the Commissioner may grant a reasonable extension of time to make a regulatory election or certain statutory elections under all subtitles of the Code, except subtitles E, G, H, and I, if the taxpayer demonstrates to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting the relief will not prejudice the interests of the Government. Section 301.9100-1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

SECTION 3. SCOPE

.01 In General. This revenue procedure extends the special procedure for late S corporation elections described in Rev. Proc. 97-40 from 6 months to 12 months (but in no event later than the unextended due date of the tax return for the first year the corporation intended to be an S corporation), provides similar relief for certain QSub elections, and extends the application of Rev. Proc. 94-23 to ESBT elections.

.02 Late S Corporation Elections. With respect to late S corporation elections, this revenue procedure applies only to a corporation (1) that has not filed a timely S corporation election under § 1362(a)(1), (2) for which an S corporation election is filed within 12 months of the original due date for the election, and (3) for which the due date for the tax return

(excluding extensions) for the first year the corporation intended to be an S corporation has not passed. Section 4 of this revenue procedure describes a simplified method for obtaining relief where the corporation can demonstrate reasonable cause for the failure to file a timely S corporation election. Section 4 also provides automatic relief for ESBT, QSST, and QSub elections intended to be effective as of the first date the corporation intended to elect S corporation status for itself.

.03 Untimely QSub Elections. This revenue procedure also applies to certain QSub elections for which the automatic relief described above is not available because the parent corporation's S election was timely filed. For those situations, this revenue procedure applies only to a corporation (1) for which a timely QSub election under § 1361(b)(3)(B) was not filed for the desired effective date, (2) for which a QSub election is filed within 12 months of the date that an election for the desired effective date should have been filed, and (3) for which the due date for the S corporation's tax return (excluding extensions) for the first taxable year for which the S corporation desired QSub status for the subsidiary has not passed. Section 5 of this revenue procedure describes a simplified method, similar to that for a late S corporation election, for filing an untimely QSub election.

.04 Late ESBT and QSST Elections. For late ESBT or QSST elections, this revenue procedure applies to corporations that, but for (1) a trust beneficiary's inadvertent failure to make a

timely QSST election or (2) a trustee's inadvertent failure to make a timely ESBT election, would otherwise meet or continue to meet the criteria for S corporation status. Section 6.02 of this revenue procedure provides an automatic grant of relief for certain corporations that satisfy the criteria therein.

.05 Alternate Relief. This revenue procedure provides alternatives to the letter ruling process ordinarily used to obtain relief for late S corporation and related elections under § 1362(b)(5), § 1362(f), or §§ 301.9100-1 and 301.9100-3. Accordingly, user fees do not apply to corrective action under this revenue procedure. However, a corporation or trust that does not meet the requirements for relief or is denied relief under this revenue procedure may request inadvertent termination, inadvertent invalid election, or late election relief (as appropriate) by requesting a private letter ruling. The Service will not ordinarily issue a private letter ruling if the period of limitations on assessment under § 6501(a) has lapsed for any taxable year for which an election should have been made or any taxable year that would have been affected by the election had it been timely made. The procedural requirements for requesting a private letter ruling are described in Rev. Proc. 98-1, 1998-1 I.R.B. 7 (or its successor).

SECTION 4. RELIEF FOR LATE S CORPORATION ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 Relief When Late S Election is Sole Defect.

(1) Eligibility for Relief. A corporation is eligible for relief under section 4.03 of this revenue procedure if the following requirements are met:

(a) The corporation fails to qualify as an S corporation on the first day that S corporation status was desired solely because the Form 2553 (Election by a Small Business Corporation) was not filed timely pursuant to § 1362(b)(1),

(b) The due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation has not passed, and

(c) The corporation has reasonable cause for its failure to timely make the S corporation election.

(2) Procedural Requirements for Relief. Within 12 months of the original due date for the S corporation election (but in no event later than the due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation), the corporation must file with the applicable service center a completed Form 2553, signed by an officer of the corporation authorized to sign and all persons who were shareholders at any time during the period that began on the first day of the taxable year for which the election is to be effective and ends on the day the election is made. For purposes of signing the shareholder consent, any trust that qualifies for relief under section 6 of this revenue procedure, but did not hold stock on the first day the corporation intended S corporation status, is considered an eligible shareholder. In

this situation, the corporation must also file a request for relief pursuant to section 6 of this revenue procedure and attach it to the Form 2553. The Form 2553 must state at the top of the document "FILED PURSUANT TO REV. PROC. 98-55." Attached to the Form 2553 must be a statement explaining the reason for the failure to file a timely S corporation election.

.02 Relief for Late S Election and Automatic Relief for Invalid Elections and Late Elections.

(1) Eligibility for Relief.

(a) Late S Election and Late ESBT or QSST Election. A corporation is eligible for relief under section 4.03 of this revenue procedure, and the trustee of a trust that would otherwise qualify as an ESBT or the beneficiary of a QSST is eligible to make an ESBT or QSST election, respectively, effective on the first day of the relevant corporation's first taxable year as an S corporation under section 4.04 of this revenue procedure, if the following requirements are met:

(i) The corporation fails to qualify as an S corporation because the Form 2553 was not filed timely pursuant to § 1362(b)(1);

(ii) The trust fails to qualify as an ESBT or to be taxable as described in § 1361(d)(1)(B) (relating to a QSST and its current income beneficiary) on the first day of the related corporation's first taxable year as an S corporation solely because a proper ESBT or QSST election, whichever is applicable, was not filed timely;

(iii) The due date for the tax return of the corporation (excluding extensions) for the first taxable year the corporation intended to be an S corporation has not passed; and

(iv) The corporation has reasonable cause for its failure to timely make the S corporation election.

(b) Late S Election and Untimely QSub Election. A parent corporation is eligible for relief under section 4.03 of this revenue procedure, and may make a QSub election with respect to a subsidiary effective on the first day of the parent corporation's first taxable year as an S corporation under section 4.04 of this revenue procedure, if the following requirements are met:

(i) The parent corporation fails to qualify as an S corporation because the Form 2553 was not filed timely pursuant to § 1362(b)(1);

(ii) The subsidiary corporation fails to qualify as a QSub on the first day of the parent corporation's first taxable year as an S corporation solely because a proper QSub election was not filed timely (after giving effect to the relief provided in section 4.03 of this revenue procedure);

(iii) The due date for the parent S corporation's tax return (excluding extensions) for the first taxable year the parent corporation intended to be an S corporation has not passed; and

(iv) The parent corporation has reasonable cause for its failure to timely make the S corporation election.

(2) Procedural Requirements for Relief. Within 12 months of the original due date for the S corporation election (but in no event later than the due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation), the corporation must file with the applicable service center a completed Form 2553, signed by an officer of the corporation authorized to sign and all persons who were shareholders at any time during the period that began on the first day of the taxable year for which the election is to be effective and ends on the day the election is made. Accompanying the Form 2553 must be all applicable ESBT, QSST, or QSub elections, completed in accordance with the proper procedure for the election as provided in regulation, revenue procedure, or notice. All of the above elections must state at the top of the document "FILED PURSUANT TO REV. PROC. 98-55." Attached to the Form 2553 must be a statement explaining the reason for the failure to file a timely S corporation election.

.03 Relief for Late S Corporation Election. Upon receipt of a completed application requesting relief under section 4.01 or 4.02 of this revenue procedure, the Service will determine whether the requirements for granting an additional time to file an S corporation election have been satisfied and will notify the corporation of the result of this determination.

.04 Automatic Relief for Late ESBT, QSST, and QSub Elections. If relief for a late S corporation election is granted pursuant to section 4.03 of this revenue procedure, any request for relief

submitted pursuant to the terms of section 4.02 of this revenue procedure will be automatically approved by the Service.

.05 Automatic Relief for Late S Corporation Elections Provided in Other Documents. Certain corporations may be eligible for automatic late S corporation election relief pursuant to Rev. Proc. 97-48.

SECTION 5. RELIEF FOR CERTAIN QSUB ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 Eligibility for Relief. A corporation that is not requesting relief under section 4 of this revenue procedure (because the corporation has a valid S corporation election) may be granted additional time under section 5.03 of this revenue procedure to file a QSub election with respect to a subsidiary if the following requirements are met:

(1) The subsidiary corporation fails to qualify as a QSub on the desired effective date solely because the parent S corporation failed to file a timely (with respect to the desired effective date) election to treat the subsidiary as a QSub;

(2) The due date for the S corporation's tax return (excluding extensions) for the first taxable year of the S corporation for which it intended to treat the subsidiary as a QSub has not passed; and

(3) The S corporation has reasonable cause for its failure to timely make the QSub election.

.02 Procedural Requirements for Relief. Within 12 months of the due date for filing a QSub election to be effective on the

desired effective date (but in no event later than the due date for the S corporation's tax return (excluding extensions) for the first taxable year of the S corporation for which the S corporation intended to treat the subsidiary as a QSub), the corporation must file with the applicable service center a completed QSub election. The QSub election must state at the top of the form "FILED PURSUANT TO REV. PROC. 98-55." Attached to the form must be a statement explaining the reason for the failure to file a QSub election within the time period required for the desired effective date. For purposes of this section 5, if a corporation is seeking (or has sought) relief under section 4.01 of this revenue procedure for a late S corporation election, and also did not make a timely (with respect to the desired effective date) election to treat a subsidiary as a QSub effective on a date other than the first day the corporation intended to be an S corporation, the corporation will be treated as having made a valid S corporation election. In this situation, the corporation must also file (or have filed) a request for relief pursuant to section 4.01 of this revenue procedure.

.03 Grant of Additional Time for Filing Certain QSub Elections. Upon receipt of a completed application requesting relief under section 5.02 of this revenue procedure, the Service will determine whether the requirements for granting an additional time to file a QSub election have been satisfied and will notify the corporation of the result of this determination.

SECTION 6. RELIEF FOR CERTAIN LATE ESBT AND QSST ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 Eligibility for Automatic Relief. A corporation is eligible for inadvertent invalid election relief or inadvertent termination relief under section 6.03 of this revenue procedure if it meets the following requirements:

(1) The corporation's S corporation election was invalid or terminated solely because the beneficiary of a QSST (or the beneficiary's legal representative) failed to file a timely QSST election pursuant to § 1361(d)(2) or the trustee of a trust that would otherwise qualify as an ESBT failed to file a timely ESBT election pursuant to § 1361(e)(3);

(2) All taxpayers whose tax liability and tax returns would be affected by the QSST or ESBT election (including the trust itself and, in the case of a QSST, the beneficiary of the trust) have reported their income (on all affected returns) consistent with the corporation's S corporation election for the year the QSST or ESBT election should have been made, as well as for any subsequent year;

(3) The failure to file a timely QSST or ESBT election was inadvertent; and

(4) Within 24 months of the original due date of the election, the beneficiary of the QSST or the trustee of the ESBT files the election pursuant to this revenue procedure.

.02 Procedural Requirements for Automatic Relief.

The current income beneficiary (in the case of a QSST) or

the trustee (in the case of an ESBT) of the trust must sign and file the appropriate election with the applicable service center. This election must state at the top "FILED PURSUANT TO REV. PROC. 98-55" and include the following material:

(1) The names, addresses, and taxpayer identification numbers of the current income beneficiary (in the case of a QSST), the trust, and the corporation;

(2) A statement identifying the election as an election under § 1361(d)(2) or § 1361(e)(3);

(3) The date on which the stock of the corporation was originally transferred to the trust;

(4) In the case of a QSST, an affidavit from the trustee stating that the trust satisfies the QSST requirements of § 1361(d)(3) and that the income distribution requirements have been and will continue to be met;

(5) In the case of an ESBT, an affidavit from the trustee stating that all potential current beneficiaries meet the shareholder requirements of § 1361(b)(1) and that the trust satisfies the requirements of an ESBT under § 1361(e)(1) other than the requirement to make an ESBT election;

(6) An affidavit from the current income beneficiary (in the case of a QSST) or the trustee (in the case of an ESBT) stating that the failure to file the relevant election was inadvertent and that the beneficiary or trustee acted diligently to correct the mistake upon its discovery;

(7) Affidavits from all shareholders during the period between the date the S corporation election terminated or was to have become effective and the date the completed election was filed (including the trust itself and, in the case of a QSST, the beneficiary of the trust) stating that they have reported their income (on all affected returns) consistent with the S corporation election for the year the election should have been made and for any subsequent year; and

(8) A dated declaration, signed by the current income beneficiary (in the case of a QSST) or the trustee (in the case of an ESBT), which states: "Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented in support of this election are true, correct, and complete."

.03 Automatic Relief for Late ESBT and QSST Elections.

Corporations that satisfy the requirements of sections 6.01 and 6.02 of this revenue procedure will automatically be granted relief pursuant to the provisions of § 1362(f). Thus, the corporation will be treated as an S corporation for the period beginning on the date of termination or the date on which the election was to have become effective, whichever applies, and ending on the date the completed ESBT or QSST election is filed, and thereafter, unless the S corporation election is otherwise terminated under § 1362(d). In addition, during such period, the trust will be treated as a trust described in § 1361(c)(2)(A), and the rules applicable to ESBTs or QSSTs will apply. In the

case of a QSST, the beneficiary of the trust will be treated, for purposes of § 678, as the owner of that portion of the trust consisting of S corporation stock.

SECTION 7. DEEMED SHAREHOLDERS

Any reference in this revenue procedure to a shareholder of an S corporation shall be treated as including a reference to those persons whose consent is required under § 1.1362-6(b).

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 94-23 and Rev. Proc. 97-40 are amplified and superseded.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for all applications (including those applications now being considered by the Service) for relief satisfying the requirements of sections 4, 5, or 6 of this revenue procedure (including those filed pursuant to either Rev. Proc. 94-23 or Rev. Proc. 97-40).

SECTION 10. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1548.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information in this revenue procedure are in sections 4.01(2), 4.02(2), 5.02, and 6.02. This information

is required to be submitted to the applicable service center in order to obtain relief for late or inadvertently invalid S corporation elections, as well as other late elections. This information will be used to determine whether the eligibility requirements for obtaining relief have been met. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 500 hours.

The estimated annual burden per respondent varies from .5 hours to 7 hours, depending on individual circumstances, with an estimated average burden of 1 hour to complete the statement. The estimated number of respondents is 500.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Mark D. Harris and Deanna L. Walton of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Ms. Walton at (202) 622-3050 (not a toll-free call).



