

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 section 7701 of the Internal Revenue Code.

The regulations apply to subsidiary corporations that elect to change their classification for federal tax purposes from a corporation to either a partnership or disregarded entity.

DATES: *Effective Date:* These regulations are effective December 17, 2001.

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

SUPPLEMENTARY INFORMATION:

**Background**

On November 29, 1999, final regulations were published in the **Federal Register** (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 disregarded as an entity separate from its owner. This amendment to the final regulations 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 requirement of section 332 that a plan of liquidation has been adopted at the time of a liquidating 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 liquidation that contemplates the filing of a QSub election is adopted on an earlier date. The preamble to the QSub regulations provides that Treasury and the IRS intend to amend the section 7701 regulations regarding elective changes in entity classification to provide a similar rule concerning the timing of the plan of liquidation.

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 comments 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 purposes. Section 301.7701-3(g)(1)(ii) provides 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 distributed assets and liabilities to a newly formed partnership. Section 301.7701-3(g)(1)(iii) provides that an elective conversion 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 distributed 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 meeting the requirements of section 1504(a)(2) (*i.e.*, 80 percent of vote and value). The elective change from an association to a partnership or to a disregarded entity results in a constructive liquidation of the association for federal tax purposes. Formally adopting a plan of liquidation for the entity, however, is potentially incompatible with an elective change under section 301.7701-3, which allows the local law entity to remain in existence while liquidating only for federal 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)

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