[4830-01-u] Published January 25, 2000

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 301, and 602

RIN 1545-AU77

[TD 8869]

Subchapter S Subsidiaries

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that relate to the treatment of corporate subsidiaries of S corporations and interpret the rules added to the Internal Revenue Code by section 1308 of the Small Business Job Protection Act of 1996. These regulations provide the public with guidance needed to comply with applicable law and will affect S corporations and their shareholders.

DATES: Effective Date: These regulations are effective January 20, 2000.

Applicability Date: For dates of applicability, see §§1.1361-4(a)(3)(iii), 1.1361-4(a)(5)(i), 1.1361-5(c)(2), 1.1361-6, 1.1362-8(e), and 301.6109-1(i)(4).

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SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have 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 1545-1590.

Responses to these collections of information are required to determine the manner in which a corporate subsidiary of an S corporation will be treated under the Internal Revenue Code.

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 assigned by the Office of Management and Budget.

The estimated annual burden per respondent/recordkeeper varies from 45 minutes to 1 hour, depending on individual circumstances, with an estimated average of 57 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this 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.

Background

On April 22, 1998, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG-251698-96, 63 FR 19864) concerning the treatment of corporate subsidiaries of S corporations. The regulations interpreted rules added to the Internal Revenue Code (Code) by section 1308 of the Small Business Job Protection Act of 1996, Public Law 104-188, 110 Stat. 1755 (the Act), as amended by section 1601 of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788 (the 1997 Act). The Act modified section 1361 of the Code to permit an S corporation (1) to own 80 percent or more of the stock of a C corporation, and (2) to elect to treat a wholly owned subsidiary as a qualified subchapter S subsidiary (QSub). The 1997 Act made a technical correction to section 1361 to provide regulatory authority to make exceptions to the general tax treatment of an election to be a QSub.

Written comments were received in response to the notice of proposed rulemaking, and a public hearing was held on October 14, 1998. After consideration of all the comments, the proposed regulations under sections 1361, 1362, and 1374 are adopted, as revised by this Treasury decision. The comments received and the revisions are discussed below. In addition, regulations under section 6109 are adopted to provide additional guidance consistent with the QSub provisions.

On January 13, 1997, the IRS published Notice 97-4, 1997-1 C.B. 351, to provide a temporary procedure for making a QSub (formerly QSSS) election. Taxpayers should continue to follow Notice 97-4 when making a QSub election until the QSub election form is published.

Explanation of Provisions

1. Step Transaction Doctrine

a. QSub Election

The proposed regulations provide that, when an S corporation makes a valid QSub election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the parent S corporation immediately before the QSub election is effective. The tax treatment of this liquidation, alone or in the context of any larger transaction (for example, a transaction that also includes the acquisition of the subsidiary's stock), generally is determined under all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine. However, the proposed regulations include a special transition rule that applies to certain elections effective prior to the date that is 60 days after publication of final regulations in the **Federal Register**. The transition rule suspends the application of the step transaction doctrine with respect to the acquisition of stock followed by a QSub election in cases where the S corporation and the subsidiary are related (as described in section 267(b)) prior to the acquisition of the subsidiary's stock.

Commentators expressed concern over the application of the step transaction doctrine to transactions that include the deemed liquidation that occurs as the result of a QSub election. These commentators argued that applying step transaction to the acquisition of stock that precedes a QSub election can cause the transaction to be recast as an asset acquisition under section 368 with results that may be inconsistent with the expectations of some taxpayers. Under step transaction principles, for example, if, pursuant to a plan, a shareholder contributes the stock of one wholly owned S corporation (S2) to another wholly owned S corporation (S1), and makes a QSub election for S2, the transaction generally would be a reorganization under section 368(a)(1)(D), with the possibility of gain recognition under section 357(c). See generally, Rev. Rul. 67-274 (1967-2 C.B. 141). In the opinion of these commentators, the legislative history of the QSub provisions indicates that the deemed liquidation that is incident to a QSub election should be respected as an independent, tax-free liquidation under section 332, rather than recast under the principles of the step transaction doctrine.

After consideration of all of the comments, Treasury and the IRS believe that the proposed regulations are consistent with the legislative history of the QSub provisions, conform the results of the deemed liquidation to the results that would obtain if an actual liquidation occurred, and follow the approach taken in other provisions of the tax law. (In regulations published on November 29, 1999 (64 FR 66580), rules for elective changes in the classification of an entity for Federal tax purposes also provide that the tax treatment of a change in the classification of an entity by election is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law, including the step transaction doctrine.) Accordingly, the final regulations provide that general principles of tax law, including step transaction, apply to determine the tax consequences of the transactions that include a QSub election. The final regulations provide examples illustrating the results of applying step transaction in the context of a QSub election.

The final regulations also provide for an extended transition period during which step transaction will be suspended. During the extended transition period, it is anticipated that proposed regulations published in the Federal Register on June 14, 1999, relating to the tax treatment of partially controlled subsidiaries under section 368(a)(1)(C) (64 FR 31770), will be finalized. These regulations generally reverse the IRS's position that the acquisition of assets of a partially controlled subsidiary does not qualify as a tax-free reorganization under section 368(a)(1)(C). See Bausch & Lomb Optical Co. v. Commissioner, 30 T.C. 602 (1958), aff'd 267 F.2d 75 (2d Cir.), cert. denied, 361 U.S. 835 (1959); Rev. Rul. 54-396, 1954-2 C.B. 147. The regulations provide that preexisting ownership of a portion of a target corporation's stock by an acquiring corporation generally will not prevent the solely for voting stock requirement in a "C" reorganization from being satisfied. See also Notice 2000-1, 2000-2 I.R.B. 288, which provides that the proposed regulations, when finalized, will provide that the regulations generally will apply to transactions occurring after December 31, 1999, with an exception for transactions pursuant to binding agreements. The finalization of these regulations will provide additional certainty as to the tax consequences of making a QSUB election in situations where an S corporation acquires the remainder of a partially controlled subsidiary in exchange for stock of the S corporation and immediately thereafter elects QSUB status with respect to the subsidiary.

b. QSUB Termination

Section 1361(b)(3)(C) provides that, if a QSUB election terminates, the corporation is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from the S corporation in exchange for stock of the new corporation immediately before the termination. The proposed regulations provide that the tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Code and general principles of tax law, including the step transaction doctrine. The proposed regulations include examples illustrating the application of the step transaction doctrine in the context of the termination of a QSUB election.

Commentators recommended that step transaction not apply to the termination of a QSUB election. Those commentators argue that the application of the step transaction doctrine causes inappropriate tax results in some situations. One example cited is the sale of 21 percent of the stock of a QSUB, thereby terminating the QSUB election. Under step transaction principles, the deemed formation of a new corporation that occurs as a result of the QSub termination fails to qualify under section 351 because the S corporation parent is not in control of the new corporation as defined in section 368(c) after the disposition. As a result of the failure to qualify under section 351, gain would be recognized on all of the QSub’s assets.

Treasury and the IRS believe that it is appropriate to apply the step transaction doctrine to the termination of a QSub election. Applying the step transaction principles to the control requirement of section 351 after the disposition of QSub stock is completed is consistent with the legislative history of the QSub termination provisions. S. Rep. No. 104-281, 104th Cong., 2d Sess. 52 n.59 (1996). Moreover, in many cases, application of the step transaction doctrine will provide a more taxpayer favorable result than giving separate effect to each step. This may occur, for example, if 100 percent of the stock of a QSub is sold. In that case, applying step transaction principles would result in a fair market value basis for the former QSub’s assets, rather than a lower carryover basis that would result (absent a section 338 election) from treating the deemed formation of the new corporation as an independent step qualifying under section 351. In order to assist taxpayers to understand the effect of QSub terminations, the final regulations include two examples that illustrate the contrasting tax consequences of purchasing 21 percent of the stock of a QSub as opposed to the tax consequences of contributing property to the QSub in exchange for 21 percent of the former QSub’s stock. The final regulations include additional examples illustrating the consequences of revoking the QSub election prior to sale of the QSub’s stock and of merging a QSub into a disregarded entity prior to such sale.

2. <u>“F” Reorganizations During the Transition Period</u>.

As noted above, commentators generally oppose applying the step transaction doctrine to the acquisition of the stock of a corporation followed immediately by a QSub election. Some commentators, however, suggested that, for policy and other reasons, during the transition period, the formation of a new shell S corporation (Newco) by the shareholders of an existing S corporation, followed by the contribution of the stock of the existing S corporation to Newco, coupled with an immediate QSub election for the existing corporation, should be characterized as a reorganization under section 368(a)(1)(F) if all of the other requisites of that section are met. Treating the transaction as an “F” reorganization (as opposed to a stock acquisition followed by a section 332 liquidation) can be beneficial to taxpayers. For example, the existing S corporation’s taxable year does not close if it undergoes an “F” reorganization.

In light of the underlying purpose of the transition rule as a relief provision for the benefit of taxpayers, during the extended transition period provided in the final regulations, the IRS will not challenge taxpayers who, through application of the step transaction doctrine to an acquisition of stock followed by a QSub election, obtain tax treatment similar to that applied in a valid reorganization under section 368(a)(1)(F) if, without regard to the transition rule, the transaction would properly qualify as such a reorganization.

3. Timing of Adoption of Plan of Liquidation

Under section 332(a), no gain or loss shall be 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 80 percent or more of the stock of the liquidating corporation.

A QSub election results in a constructive liquidation for Federal tax purposes. Formally adopting a plan of liquidation for the QSub, however, is potentially incompatible with the QSub provisions of the Code, which allow the state-law entity to continue to exist while liquidating only for Federal tax purposes. In order to provide tax treatment for the constructive liquidation incident to a QSub election that is compatible with the requirements of section 332, the proposed regulations include a provision that the making of a QSub election satisfies the requirement of adopting a plan of liquidation.

One commentator asked that the regulations provide a safe harbor with respect to the timing of the adoption of the plan of liquidation for purposes of section 332. The commentator argued that, where the acquisition of stock followed by the deemed liquidation does not constitute a reorganization (after appropriate application of step-transaction principles), the regulations should provide that, for purposes of applying section 332 to the liquidation incident to a QSub election, the S corporation will be deemed to adopt a plan of liquidation for its subsidiary as of the effective date of the election, which should not precede the acquisition by the S corporation of 100 percent of the stock of the subsidiary.

The timing of the adoption of the plan of liquidation is important in the context of section 332 because only liquidating distributions to a corporation that owns 80 percent or more of the stock of the subsidiary when the plan is adopted qualify for tax-free treatment. A QSub election cannot be effective until the parent S corporation owns 100 percent of the subsidiary. Thus, the constructive liquidation incident to a QSub election cannot commence before that level of ownership is attained. Furthermore, providing certainty with respect to the deemed timing of the adoption of the plan of liquidation facilitates the efficient administration and use of the QSub provisions. Accordingly, to provide tax treatment of a QSub election that is compatible with the requirements of section 332, the final regulations provide that, for purposes of satisfying the requirement of section 332(b) that the parent corporation own stock in the subsidiary meeting the requirements of section 1504(a)(2) on the date of adoption of the plan of liquidation of the subsidiary, the plan of liquidation is deemed adopted immediately before the deemed liquidation incident to a QSub election unless a formal plan of liquidation that contemplates the filing of the QSub election is adopted on an earlier date. (Although no similar rule is contained in the rules for elective changes in the classification of an entity for Federal tax purposes, Treasury and the IRS intend to amend those regulations to include such a rule.) However, if as a result of the application of general tax principles the transactions that include the QSub election are treated as an asset acquisition, section 332 is not applicable and this rule has no relevance.

4. Insolvent Subsidiaries

In general, section 332 does not apply to the liquidation of an insolvent corporation, because the parent corporation does not receive at least partial payment for the stock of its subsidiary. See, e.g., §1.332-2(b) and Rev. Rul. 68-602 (1968-2 C.B. 135). One commentator recommended that a QSub election made for an insolvent subsidiary be eligible for tax-free treatment under section 332. The commentator argued that the legislative history of the QSub provisions makes it clear that a QSub election should qualify as a liquidation under section 332 unless regulations provide otherwise and that taxpayers may be unaware of the harsh results of making a QSub election for an insolvent corporation.

Treasury and the IRS do not agree that the legislative history indicates that section 332 applies to the liquidation of an insolvent corporation. In order to assist taxpayers, an example illustrates the effect of a QSub election for an insolvent corporation.

5. Definition of Stock of the QSub

Commentators recommended that, for purposes of determining whether a subsidiary is wholly owned by the parent S corporation, arrangements that are not considered to be stock under the one-class-of-stock rules of §1.1361-1(l) should be disregarded. The commentators noted that applying the principles of these regulations would provide certainty with respect to the subsidiary's eligibility to be a QSub and avoid difficult debt/equity determinations.

The final regulations adopt the position recommended by the commentators. The final regulations provide that, for purposes of determining whether the deemed liquidation of the subsidiary qualifies under section 332, the deemed exercise of an option under §1.1504-4 and any instrument, obligation, or arrangement that would not be considered stock under the one-class-of-stock rules of §1.1361-1(l) are disregarded in determining if the stock ownership requirements of section 332(b) are met. For example, an option that would not be treated as stock under §1.1361-1, but that would be treated as exercised under §1.1504-4, is disregarded. Similarly, if a QSub election terminates, in determining the applicability of section 351, the determination of whether stock ownership of the newly formed corporation satisfies the control requirement of section 368(c) is made without regard to instruments, obligations, or other arrangements that are not treated as stock for purposes of the 100 percent stock ownership requirement for the election.

The rule regarding options under §1.1504-4 is included for purposes of applying section 332 because section 332 explicitly incorporates the affiliation rules of section 1504. See §1.1504-4(a)(1) (the option rules apply to all provisions under the Code and the regulations to which affiliation within the meaning of section 1504(a) is relevant). The affiliation rules are not relevant for purposes of applying the rules regarding the 100 percent stock ownership requirement in section 1361(b)(3)(B)(i). Accordingly, the rule concerning the treatment of stock in applying the 100 percent stock ownership requirement does not refer to the option rules under §1.1504-4.

6. Section 1374 and Excess Loss Accounts

Commentary on the proposed regulations identified certain discrepancies in the treatment of tiered groups of corporations when QSub elections are made for some or all of the members of the group and certain unintended implications of the sentence added to §1.1374-8(b) in the proposed regulations.

a. Section 1374

Section 1374(d)(8) and §1.1374-8(a) generally provide that, if an S corporation acquires assets in a transaction in which the S corporation's basis in the assets is determined (in whole or in part) by reference to a C corporation's basis in the assets (or any other property) (a section 1374(d)(8) transaction), section 1374 applies to the net recognized built-in gain attributable to the assets acquired in such a transaction. Section 1.1374-8(b) provides that, for purposes of the tax imposed under section 1374(d)(8), a separate determination of tax is made with respect to the assets the S corporation acquires in one section 1374(d)(8) transaction from the assets the S corporation acquires in another section

1374(d)(8) transaction and from the assets the corporation held when it became an S corporation.

A corporation’s section 1374 attributes (loss carryforwards, credits, and credit carryforwards as provided in §1.1374-1(c)) may be used only to reduce the section 1374 tax imposed on the disposition of assets held by the S corporation at the time it converted from C status. Likewise, section 1374 attributes acquired in one section 1374(d)(8) transaction may be used only to reduce tax on the disposition of assets acquired in that transaction. This results in separate section 1374 pools for purposes of calculating the tax imposed by section 1374.

One commentator noted that §1.1374-8(b) of the proposed regulations implies that a QSub election for two or more corporations results in a section 1374(d)(8) transaction for each subsidiary and that this implication is contrary to the general timing rules of §1.1361-4(b)(1). Those general timing rules provide that the deemed liquidation of a tiered group of C corporations that elect S and QSub status effective on the same day occurs at the close of the day before the effective date of the elections, while the parent is a C corporation. As a result of the operation of the general timing rules, there is a single section 1374 pool when the parent corporation’s S election is effective. Moreover, the commentator noted that a literal reading of §1.1374-8(b) of the proposed regulations may cause the assets of an S corporation that is acquired by a C corporation to become subject to section 1374 when the acquiring C corporation immediately makes an S election for itself and a QSub election for the acquired S corporation. Finally, the commentator requested that the final regulations provide that when an S corporation acquires a tiered group of corporations and makes QSub elections effective on the same date for some or all of the corporations, the assets deemed acquired by the S corporation will be treated as acquired in a single section 1374(d)(8) transaction, consistent with the apparent intent of the general timing rules of §1.1361-4(b)(1) of the proposed regulations.

b. Excess loss accounts

Section 1.1502-19 of the Income Tax Regulations provides rules requiring, in certain instances, a member (X) of a consolidated group of corporations to include in income its excess loss account (ELA) in the stock of another member (Y) of the group. An ELA reflects X’s negative adjustments with respect to Y’s stock to the extent the negative adjustments exceed X’s basis in the stock. An ELA must be included in X’s income if X is treated as disposing of Y’s stock. See §1.1502-19(b)(1). A merger or liquidation of X into an S corporation or an S election by X is treated as a disposition that triggers income recognition with respect to an ELA in Y stock. In contrast, X’s income or gain in certain cases is subject to any nonrecognition or deferral rules applicable, including section 332. As a result, if Y liquidates into X in a transaction subject to section 332, there is no income recognition with respect to an ELA in Y’s stock. See §1.1502-19(b)(2)(i).

Under the general timing rules of §1.1361-4(b)(1), if the common parent elects S status, the deemed liquidations of the subsidiary members of the consolidated group for which QSub elections are made (effective on the same date as the S election) occur as of the close of the day before the QSub elections are effective, while the S electing parent corporation is still a C corporation. As a result, there is no triggering of income with respect to ELAs in the stock of the subsidiary corporations if the liquidations qualify under section 332. In contrast, if a consolidated group of corporations is acquired by an S corporation and the acquiring S corporation makes QSub elections for the parent and members of the consolidated group, a deemed liquidation of the parent prior to the deemed liquidation of other members of the consolidated group may be a disposition that triggers income recognition with respect to ELAs in the subsidiaries’ stock.

c. Modifications adopted in the final regulations

The final regulations remove the proposed amendment to §1.1374-8(b). Furthermore, an amendment to the general timing rules under §1.1361-4(b)(1) for acquired S corporations clarifies that an acquired S corporation liquidates into an acquiring corporation as of the beginning of the day of acquisition, after the parent’s S election, if any, is effective. There is no section 1374(d)(8) transaction when an S corporation acquires assets from another S corporation, if the acquired S corporation has no C corporation history. The modification to the timing rule also clarifies that there is no period during which an acquired S corporation is a C corporation if the QSub election is made effective as of the time of the acquisition.

As noted in the commentary, the order of the deemed liquidations for a tiered group of corporations for which QSub elections are made (effective on the same date) is significant for purposes of section 1374 and under §1.1502-19. In many situations, it is preferable to have the deemed liquidations occur in order from the lowest tier subsidiary to the highest tier subsidiary, a bottom-up liquidation order. As a result of that ordering, the final liquidation of the highest tier subsidiary results in a single section 1374 pool for the group. In addition, in the case of a consolidated group of corporations, because the deemed liquidation of the common parent follows the deemed liquidation of its subsidiaries, there is no deconsolidation for purposes of §1.1502-19 and no triggering of ELAs. In other circumstances, however, a top to bottom liquidation of a tiered group of subsidiaries may be preferable. Therefore, the final regulations allow the S corporation to specify the order of the deemed liquidations when QSub elections are made (effective on the same day) for a tiered group of subsidiaries. In default of an election, the deemed liquidations occur in succession on the effective date of the election, beginning with the lowest tier subsidiary.

7. Timing

One commentator noted a potential lack of coordination in the regulations that determine the timing of the termination of the S election of an acquired S corporation and the deemed liquidation incident to a QSub election for that S corporation. The commentator acknowledged that the intent of the proposed regulations is to provide that an acquired S corporation for which a QSub election is made effective immediately on acquisition should have no intervening C period.

Other timing issues can arise with respect to the termination of a QSub election. The regulations provide rules that govern the timing of the deemed liquidation incident to a QSub election and of the termination of a QSub election. The regulations also provide examples illustrating those rules. The regulations generally are intended to provide that a corporation may move between S and QSub status without an intervening C period, if the appropriate election is made effective as of the termination of the previous S or QSub election. The regulations are coordinated with provisions under section 338 and §§1.1362-2 and 1.1502-76 that have differing timing provisions.

8. Inadvertent QSub Election and Inadvertent Termination Relief One commentator requested that the regulations provide inadvertent invalid QSub election relief similar to the relief that is available under section 1362(f) for inadvertent invalid S elections and inadvertent S terminations. The proposed regulations include a provision indicating that inadvertent QSub termination relief may be available under standards established by the Commissioner for inadvertent termination of an S election under §1.1362-4.

The QSub provisions include no section analogous to section 1362(f) that allows the IRS to determine that a corporation is a QSub during a period when the corporation does not satisfy the requirement of section 1361(b)(3)(B)(i). For example, if the parent corporation inadvertently transfers one share of QSub stock to another person, the QSub election terminates. The subsidiary is not eligible to have a QSub election in effect for the period during which the parent does not own 100 percent of its stock. If the QSub election terminates because of the inadvertent termination of the parent's S election, however, relief may be available under section 1362(f). A favorable determination under that section causes the subsidiary to continue to satisfy the requirements of section 1361(b)(3)(B)(ii) during the period when the parent is accorded relief for inadvertent termination of its S election. Moreover, if the parent fails to make a timely QSub election, relief may be available under the procedures applicable under §301.9100-1 and §301.9100-3.

The final regulations do not include the provision relating to the inadvertent termination of a QSub election. The removal of that provision is not intended to suggest that relief under section 1362(f) is not available in appropriate circumstances (such as those discussed above), but is intended to avoid confusion with respect to the scope of the IRS's statutory authority under section 1362(f).

9. Ordering Rule for Termination of QSub Elections

Commentators requested that the final regulations provide an ordering rule for the simultaneous termination of QSub elections as the result of the termination of an upper-tier subsidiary's QSub election. The final regulations provide that the terminations occur in succession, beginning with the upper-tier subsidiary, and include examples to illustrate the effect of simultaneous QSub terminations.

10. Banking Provisions

Consistent with the proposed regulations, the final regulations provide that any special rules applicable to banks under the Code continue to apply separately to banks as if the deemed liquidation incident to a QSub election had not occurred (the banking provisions). Commentators requested that the banking provisions be retroactive to the effective date of the Act, by election. As authorized by section 1601 of the 1997 Act, and as first announced in Notice 97-5 (1997-1 C.B. 352), the final regulations provide that the banking provisions apply to taxable years beginning after December 31, 1996. This rule applies to all taxpayers and is not subject to an election. The banking provisions also include a reference to other published guidance for section 265(b); see Rev. Rul. 90-44 (1990-1 C.B. 54, 57).

11. Taxpayer Identifying Numbers

The regulations provide clarification regarding employer identification numbers (EINs) for QSubs. The regulations restate the general rules that (1) when an entity's classification changes as a result of an election, it retains its EIN; and (2) unless regulations or published guidance provide otherwise, a disregarded entity (including a QSub) must use its owner's EIN for Federal tax purposes.

Notice 99-6 (1999-3 I.R.B. 12) provides guidance that, under limited circumstances, a disregarded entity may use its own EIN. If a QSub wishes to use its own EIN in accordance with Notice 99-6 but did not have an EIN prior to becoming a QSub, it must apply for a new EIN.

If a subsidiary's QSub election terminates, the new corporation formed as a result of that termination must use its own EIN for Federal tax purposes. If the new corporation had an EIN before the effective date of its QSub election or during its QSub status, it should use that EIN. Otherwise, the new corporation must apply for a new EIN.

12. Effective Date and Transition rules

The regulations generally apply to taxable years that begin on or after January 20, 2000; however, taxpayers may elect to apply the regulations in whole, but not in part (aside from those sections with special dates of applicability), for taxable years beginning on or after January 1, 2000, provided the corporation and all affected taxpayers apply the regulations in a consistent manner. To make the election, the corporation and all affected taxpayers must file a return or an amended return that is consistent with these rules for the taxable year for which the election is made. For purposes of this section, affected taxpayers means all taxpayers whose returns are affected by the election to apply the regulations. The rules relating to the treatment of banks apply to all taxable years beginning after December 31, 1996; see §1.1361-4(a)(3)(iii). The provision relating to transitional relief from the step transaction applies to certain QSub elections effective on or before the end of calendar year 2000; see §1.1361-4(a)(5)(i). Section 1.1361-5(c)(2), relating to automatic consent for an S or QSub election made for a corporation whose QSub election has terminated within the five-year period described in section 1361(b)(3)(D), applies to certain QSub elections effective after December 31, 1996. Section 301.6109-1(i), relating to EINs, applies on or after January 20, 2000.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant impact on a substantial number of small businesses. This certification is based upon the fact that the economic burden imposed on taxpayers by the collection of information and recordkeeping requirements of these regulations is insignificant. For example, the estimated average annual burden per respondent is less than one hour. Furthermore, most taxpayers will only have to respond to the requests for information contained in §§1.1361-3 and 1.1361-5 one time in the life of the corporation. Therefore, a Regulatory Flexibility Analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). 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 Jeanne M. Sullivan and David J. Sotos of the Office of the Assistant Chief Counsel (Passthroughs & Special Industries); and Michael N. Kaibni of the Office of the Assistant Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1--INCOME TAXES

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

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

Par. 2. Amend §1.1361-0 as follows:

1. Revise the introductory text.

2. Remove the entry for §1.1361-1(d)(3).

3. Add entries for §§1.1361-2, 1.1361-3, 1.1361-4, 1.1361-5, and 1.1361-6.

The revisions and additions read as follows:

<u>§1.1361-0 Table of contents</u>.

This section lists captions contained in §§1.1361-1, 1.1361-2, 1.1361-3, 1.1361-4, 1.1361-5, and 1.1361-6.

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<u>§1.1361-2 Definitions relating to S corporation subsidiaries</u>.

<u>§1.1361-3 QSub election</u>.

<u>§1.1361-4 Effect of QSub election</u>.

(i) General rule.
(ii) Examples.
(b) Timing of the liquidation.
(1) In general.
(2) Application to elections in tiered situations.
(3) Acquisitions.
(i) In general.
(ii) Special rules for acquired S corporations.
(4) Coordination with section 338 election.
(c) Carryover of disallowed losses and deductions.
(d) Examples.

§1.1361-5 Termination of QSub election.

(a) In general.
(1) Effective date.
(2) Information to be provided upon termination of QSub election by failure to qualify as a QSub.
(3) QSub joins a consolidated group.
(4) Examples.
(b) Effect of termination of QSub election.
(1) Formation of new corporation.
(i) In general.
(ii) Termination for tiered QSubs.
(2) Carryover of disallowed losses and deductions.
(3) Examples.
(c) Election after QSub termination.
(1) In general.
(2) Exception.
(3) Examples.

§1.1361-6 Effective date.

Par. 3. Amend §1.1361-1 as follows:

1. Revise paragraph (b)(1)(i).

2. Remove paragraph (d)(1)(i).

3. Redesignate paragraphs (d)(1)(ii), (d)(1)(iii), (d)(1)(iv), and (d)(1)(v) as paragraphs (d)(1)(i), (d)(1)(ii), (d)(1)(iii), and (d)(1)(iv), respectively.

4. Revise newly designated paragraph (d)(1)(i).

5. Remove paragraph (d)(3).

6. Revise the first sentence of paragraph (e)(1).

The revisions read as follows:

<u>§1.1361-1 S corporation defined</u>.

* * * * *

(b) * * *

(1) * * *

(i) More than 75 shareholders (35 for taxable years beginning before January 1, 1997);

* * * * *

(d) * * *

(1) * * *

(i) For taxable years beginning on or after January 1, 1997, a financial institution that uses the reserve method of accounting for bad debts described in section 585 (for taxable years beginning prior to January 1, 1997, a financial institution to which section 585 applies (or would apply but for section 585(c)) or to which section 593 applies);

* * * * *

(e) * * *

(1) <u>General rule</u>. A corporation does not qualify as a small business corporation if it has more than 75 shareholders (35 for taxable years beginning prior to January 1, 1997). * * *

* * * * *

Par. 4. Add §§1.1361-2, 1.1361-3, 1.1361-4, 1.1361-5, and 1.1361-6 to read as follows:

<u>§1.1361-2 Definitions relating to S corporation subsidiaries</u>.

(a) <u>In general</u>. The term <u>qualified subchapter S subsidiary</u> (QSub) means any domestic corporation that is not an ineligible corporation (as defined in section 1361(b)(2) and the regulations thereunder), if--

(1) 100 percent of the stock of such corporation is held by an S corporation; and

(2) The S corporation properly elects to treat the subsidiary as a QSub under §1.1361-3.

(b) <u>Stock treated as held by S corporation</u>. For purposes of satisfying the 100 percent stock ownership requirement in section 1361(b)(3)(B)(i) and paragraph (a)(1) of this section--

(1) Stock of a corporation is treated as held by an S corporation if the S corporation is the owner of that stock for Federal income tax purposes; and

(2) Any outstanding instruments, obligations, or arrangements of the corporation which would not be considered stock for purposes of section 1361(b)(1)(D) if the corporation were an S corporation are not treated as outstanding stock of the QSub.

(c) <u>Straight debt safe harbor</u>. Section 1.1361-1(l)(5)(iv) and (v) apply to an obligation of a corporation for which a QSub election is made if that obligation would satisfy the definition of straight debt in §1.1361-1(l)(5) if issued by the S corporation.

(d) Examples. The following examples illustrate the application of this section:

Example 1. X, an S corporation, owns 100 percent of Y, a corporation for which a valid QSub election is in effect for the taxable year. Y owns 100 percent of Z, a corporation otherwise eligible for QSub status. X may elect to treat Z as a QSub under section 1361(b)(3)(B)(ii).

Example 2. Assume the same facts as in Example 1, except that Y is a business entity that is disregarded as an entity separate from its owner under §301.7701-2(c)(2) of this chapter. X may elect to treat Z as a QSub.

Example 3. Assume the same facts as in Example 1, except that Y owns 50 percent of Z, and X owns the other 50 percent. X may elect to treat Z as a QSub.

Example 4. Assume the same facts as in Example 1, except that Y is a C corporation. Although Y is a domestic corporation that is otherwise eligible to be a QSub, no QSub election has been made for Y. Thus, X is not treated as holding the stock of Z. Consequently, X may not elect to treat Z as a QSub.

Example 5. Individuals A and B own 100 percent of the stock of corporation X, an S corporation, and, except for C's interest (described below), X owns 100 percent of corporation Y, a C corporation. Individual C holds an instrument issued by Y that is considered to be equity under general principles of tax law but would satisfy the definition of straight debt under §1.1361-1(l)(5) if Y were an S corporation. In determining whether X owns 100 percent of Y for purposes of making the QSub election, the instrument held by C is not considered outstanding stock. In addition, under §1.1361-1(l)(5)(v), the QSub election is not treated as an exchange of debt for stock with respect to such instrument, and §1.1361-1(l)(5)(iv) applies to determine the tax treatment of payments on the instrument while Y's QSub election is in effect.

§1.1361-3 QSub election.

(a) Time and manner of making election--(1) In general. The corporation for which the QSub election is made must meet all the requirements of section 1361(b)(3)(B) at the time the election is made and for all periods for which the election is to be effective.

(2) Manner of making election. Except as provided in section 1361(b)(3)(D) and §1.1361-5(c) (five-year prohibition on re-election), an S corporation may elect to treat an eligible subsidiary as a QSub by filing a completed form to be prescribed by the IRS. The election form must be signed by a person authorized to sign the S corporation's return required to be filed under section 6037. Unless the election form provides otherwise, the election must be submitted to the service center where the subsidiary filed its most recent tax return (if applicable), and, if an S corporation forms a subsidiary and makes a valid QSub election (effective upon the date of the subsidiary's formation) for the subsidiary, the election should be submitted to the service center where the S corporation filed its most recent return.

(3) Time of making election. A QSub election may be made by the S corporation parent at any time during the taxable year.

(4) Effective date of election. A QSub election will be effective on the date specified on the election form or on the date the election form is filed if no date is specified. The effective date specified on the form cannot be more than two months and 15 days prior to the date of filing and cannot be more than 12 months after the date of filing. For this purpose, the definition of the term month found in §1.1362-

6(a)(2)(ii)(C) applies. If an election form specifies an effective date more than two months and 15 days prior to the date on which the election form is filed, it will be effective two months and 15 days prior to the date it is filed. If an election form specifies an effective date more than 12 months after the date on which the election is filed, it will be effective 12 months after the date it is filed.

(5) Example. The following example illustrates the application of paragraph (a)(4) of this section:

Example. X has been a calendar year S corporation engaged in a trade or business for several years. X acquires the stock of Y, a calendar year C corporation, on April 1, 2002. On August 10, 2002, X makes an election to treat Y as a QSub. Unless otherwise specified on the election form, the election will be effective as of August 10, 2002. If specified on the election form, the election may be effective on some other date that is not more than two months and 15 days prior to August 10, 2002, and not more than 12 months after August 10, 2002.

(6) Extension of time for making a QSub election. An extension of time to make a QSub election may be available under the procedures applicable under §§301.9100-1 and 301.9100-3 of this chapter.

(b) Revocation of QSub election--(1) Manner of revoking QSub election. An S corporation may revoke a QSub election under section 1361 by filing a statement with the service center where the S corporation's most recent tax return was properly filed. The revocation statement must include the names, addresses, and taxpayer identification numbers of both the parent S corporation and the QSub, if any. The statement must be signed by a person authorized to sign the S corporation's return required to be filed under section 6037.

(2) Effective date of revocation. The revocation of a QSub election is effective on the date specified on the revocation statement or on the date the revocation statement is filed if no date is specified. The effective date specified on the revocation statement cannot be more than two months and 15 days prior to the date on which the revocation statement is filed and cannot be more than 12 months after the date on which the revocation statement is filed. If a revocation statement specifies an effective date more than two months and 15 days prior to the date on which the statement is filed, it will be effective two months and 15 days prior to the date it is filed. If a revocation statement specifies an effective date more than 12 months after the date on which the statement is filed, it will be effective 12 months after the date it is filed.

(3) Revocation after termination. A revocation may not be made after the occurrence of an event that renders the subsidiary ineligible for QSub status under section 1361(b)(3)(B).

(4) Revocation before QSub election effective. For purposes of Section 1361(b)(3)(D) and §1.1361-5(c) (five-year prohibition on re-election), a revocation effective on the first day the QSub election was to be effective will not be treated as a termination of a QSub election.

§1.1361-4 Effect of QSub election.

(a) Separate existence ignored--(1) In general. Except as otherwise provided in paragraph (a)(3) of this section, for Federal tax purposes--

(i) A corporation which is a QSub shall not be treated as a separate corporation; and

(ii) All assets, liabilities, and items of income, deduction, and credit of a QSub shall be treated as assets, liabilities, and items of income, deduction, and credit of the S corporation.

(2) Liquidation of subsidiary--(i) In general. If an S corporation makes a valid QSub election with respect to a subsidiary, the subsidiary is deemed to have liquidated into the S corporation. Except as provided in paragraph (a)(5) of this section, the tax treatment of the liquidation or of a larger transaction that includes the liquidation will be determined under the Internal Revenue Code and general principles of tax law, including the step transaction doctrine. Thus, for example, if an S corporation forms a subsidiary and makes a valid QSub election (effective upon the date of the subsidiary's formation) for the subsidiary, the transfer of assets to the subsidiary and the deemed liquidation are disregarded, and the corporation will be deemed to be a QSub from its inception.

(ii) Examples. The following examples illustrate the application of this paragraph (a)(2)(i) of this section:

Example 1. Corporation X acquires all of the outstanding stock of solvent corporation Y from an unrelated individual for cash and short-term notes. Thereafter, as part of the same plan, X immediately makes an S election and a QSub election for Y. Because X acquired all of the stock of Y in a qualified stock purchase within the meaning of section 338(d)(3), the liquidation described in paragraph (a)(2) of this section is respected as an independent step separate from the stock acquisition, and the tax consequences of the liquidation are determined under sections 332 and 337.

Example 2. Corporation X, pursuant to a plan, acquires all of the outstanding stock of corporation Y from the shareholders of Y solely in exchange for 10 percent of the voting stock of X. Prior to the transaction, Y and its shareholders are unrelated to X. Thereafter, as part of the same plan, X immediately makes an S election and a QSub election for Y. The transaction is a reorganization described in section 368(a)(1)(C), assuming the other conditions for reorganization treatment (e.g., continuity of business enterprise) are satisfied.

Example 3. After the expiration of the transition period provided in paragraph (a)(5)(i) of this section, individual A, pursuant to a plan, contributes all of the outstanding stock of Y to his wholly owned S corporation, X, and immediately causes X to make a QSub election for Y. The transaction is a reorganization under section 368(a)(1)(D), assuming the other conditions for reorganization treatment (e.g., continuity of business enterprise) are satisfied. If the sum of the amount of liabilities of Y treated as assumed by X exceeds the total of the adjusted basis of the property of Y, then section 357(c) applies and such excess is considered as gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

(iii) 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 QSub election is adopted on an earlier date, the making of the QSub election is considered to be the adoption of a plan of liquidation immediately before the deemed liquidation described in paragraph (a)(2)(i) of this section.

(iv) Example. The following example illustrates the application of paragraph (a)(2)(iii) of this section:

Example. Corporation X owns 75 percent of a solvent corporation Y, and individual A owns the remaining 25 percent of Y. As part of a plan to make a QSub election for Y, X causes Y to redeem A’s 25 percent interest on June 1 for cash and makes a QSub election for Y effective on June 3. The making of the QSub election is considered to be the adoption of a plan of liquidation immediately before the deemed liquidation. The deemed liquidation satisfies the requirements of section 332.

(v) Stock ownership requirements of section 332. The deemed exercise of an option under §1.1504-4 and any instruments, obligations, or arrangements that are not considered stock under §1.1361-2(b)(2) are disregarded in determining if the stock ownership requirements of section 332(b) are met with respect to the deemed liquidation provided in paragraph (a)(2)(i) of this section.

(3) Treatment of banks--(i) In general. If an S corporation is a bank, or if an S corporation makes a valid QSub election for a subsidiary that is a bank, any special rules applicable to banks under the Internal Revenue Code continue to apply separately to the bank parent or bank subsidiary as if the deemed liquidation of any QSub under paragraph (a)(2) of this section had not occurred (except as other published guidance may apply section 265(b) and section 291(a)(3) and (e)(1)(B) not only to the bank parent or bank subsidiary but also to any QSub deemed to have liquidated under paragraph (a)(2) of this section). For any QSub that is a bank, however, all assets, liabilities, and items of income, deduction, and credit of the QSub, as determined in accordance with the special bank rules, are treated as assets, liabilities, and items of income, deduction, and credit of the S corporation. For purposes of this paragraph (a)(3)(i), the term bank has the same meaning as in section 581.

(ii) Examples. The following examples illustrate the application of this paragraph (a)(3):

Example 1. X, an S corporation, is a bank as defined in section 581. X owns 100 percent of Y and Z, corporations for which valid QSub elections are in effect. Y is a bank as defined in section 581, and Z is not a financial institution. Pursuant to paragraph (a)(3)(i) of this section, any special rules applicable to banks under the Internal Revenue Code continue to apply separately to X and Y and do not apply to Z. Thus, for example, section 265(b), which provides special rules for interest expense deductions of banks, applies separately to X and Y. That is, X and Y each must make a separate determination under section 265(b) of interest expense allocable to tax-exempt interest, and no deduction is allowed for that interest expense. Section 265(b) does not apply to Z except as published guidance may provide otherwise.

Example 2. X, an S corporation, is a bank holding company and thus is not a bank as defined in section 581. X owns 100 percent of Y, a corporation for which a valid QSub election is in effect. Y is a bank as defined in section 581. Pursuant to paragraph (a)(3)(i) of this section, any special rules applicable to banks under the Internal Revenue Code continue to apply to Y and do not apply to X. However, all of Y's assets, liabilities, and items of income, deduction, and credit, as determined in accordance with the special bank rules, are treated as those of X. Thus, for example, section 582(c), which provides special rules for sales and exchanges of debt by banks, applies only to sales and exchanges by Y. However, any gain or loss on such a transaction by Y that is considered ordinary income or ordinary loss pursuant to section 582(c) is treated as ordinary income or ordinary loss of X.

(iii) Effective date. This paragraph (a)(3) applies to taxable years beginning after December 31, 1996.

(4) Treatment of stock of QSub. Except for purposes of section 1361(b)(3)(B)(i) and §1.1361-2(a)(1), the stock of a QSub shall be disregarded for all Federal tax purposes.

(5) Transitional relief--(i) General rule. If an S corporation and another corporation (the related corporation) are persons specified in section 267(b) prior to an acquisition by the S corporation of some or all of the stock of the related

corporation followed by a QSub election for the related corporation, the step transaction doctrine will not apply to determine the tax consequences of the acquisition. This paragraph (a)(5) shall apply to QSub elections effective before January 1, 2001.

(ii) Examples. The following examples illustrate the application of this paragraph (a)(5):

Example 1. Individual A owns 100 percent of the stock of X, an S corporation. X owns 79 percent of the stock of Y, a solvent corporation, and A owns the remaining 21 percent. On May 4, 1998, A contributes its Y stock to X in exchange for X stock. X makes a QSub election with respect to Y effective immediately following the transfer. The liquidation described in paragraph (a)(2) of this section is respected as an independent step separate from the stock acquisition, and the tax consequences of the liquidation are determined under sections 332 and 337. The contribution by A of the Y stock qualifies under section 351, and no gain or loss is recognized by A, X, or Y.

Example 2. Individual A owns 100 percent of the stock of two solvent S corporations, X and Y. On May 4, 1998, A contributes the stock of Y to X. X makes a QSub election with respect to Y immediately following the transfer. The liquidation described in paragraph (a)(2) of this section is respected as an independent step separate from the stock acquisition, and the tax consequences of the liquidation are determined under sections 332 and 337. The contribution by A of the Y stock to X qualifies under section 351, and no gain or loss is recognized by A, X, or Y. Y is not treated as a C corporation for any period solely because of the transfer of its stock to X, an ineligible shareholder. Compare Example 3 of §1.1361-4(a)(2)(ii).

(b) Timing of the liquidation--(1) In general. Except as otherwise provided in paragraph (b)(3) or (4) of this section, the liquidation described in paragraph (a)(2) of this section occurs at the close of the day before the QSub election is effective. Thus, for example, if a C corporation elects to be treated as an S corporation and makes a QSub election (effective the same date as the S election) with respect to a subsidiary, the liquidation occurs immediately before the S election becomes effective, while the S electing parent is still a C corporation.

(2) Application to elections in tiered situations. When QSub elections for a tiered group of subsidiaries are effective on the same date, the S corporation may specify the order of the liquidations. If no order is specified, the liquidations that are deemed to occur as a result of the QSub elections will be treated as occurring first for the lowest tier entity and proceed successively upward until all of the liquidations under paragraph (a)(2) of this section have occurred. For example, S, an S corporation, owns 100 percent of C, the common parent of an affiliated group of corporations that includes X and Y. C owns all of the stock of X and X owns all of the stock of Y. S elects under §1.1361-3 to treat C, X and Y as QSubs effective on the same date. If no order is specified for the elections, the following liquidations are deemed to occur as a result of the elections, with each successive liquidation occuring on the same day immediately after the preceding liquidation: Y is treated as liquidating into X, then X is treated as liquidating into C, and finally C is treated as liquidating into S.

(3) Acquisitions. (i) In general. If an S corporation does not own 100 percent of the stock of the subsidiary on the day before the QSub election is effective, the liquidation described in paragraph (a)(2) of this section occurs immediately after the

time at which the S corporation first owns 100 percent of the stock.

(ii) <u>Special rules for acquired S corporations</u>. Except as provided in paragraph (b)(4) of this section, if a corporation (Y) for which an election under section 1362(a) was in effect is acquired, and a QSub election is made effective on the day Y is acquired, Y is deemed to liquidate into the S corporation at the beginning of the day the termination of its S election is effective. As a result, if corporation X acquires Y, an S corporation, and makes an S election for itself and a QSub election for Y effective on the day of acquisition, Y liquidates into X at the beginning of the day when X's S election is effective, and there is no period between the termination of Y's S election and the deemed liquidation of Y during which Y is a C corporation. Y's taxable year ends for all Federal income tax purposes at the close of the preceding day. Furthermore, if Y owns Z, a corporation for which a QSub election was in effect prior to the acquisition of Y by X, and X makes QSub elections for Y and Z, effective on the day of acquisition, the transfer of assets to Z and the deemed liquidation of Z are disregarded. See §§1.1361-4(a)(2) and 1.1361-5(b)(1)(i).

(4) <u>Coordination with section 338 election</u>. An S corporation that makes a qualified stock purchase of a target may make an election under section 338 with respect to the acquisition if it meets the requirements for the election, and may make a QSub election with respect to the target. If an S corporation makes

an election under section 338 with respect to a subsidiary acquired in a qualified stock purchase, a QSub election made with respect to that subsidiary is not effective before the day after the acquisition date (within the meaning of section 338(h)(2)). If the QSub election is effective on the day after the acquisition date, the liquidation under paragraph (a)(2) of this section occurs immediately after the deemed asset purchase by the new target corporation under section 338. If an S corporation makes an election under section 338 (without a section 338(h)(10) election) with respect to a target, the target must file a final or deemed sale return as a C corporation reflecting the deemed sale. See §1.338-10T(a).

(c) Carryover of disallowed losses and deductions. If an S corporation (S1) acquires the stock of another S corporation (S2), and S1 makes a QSub election with respect to S2 effective on the day of the acquisition, see §1.1366-2(c)(1) for provisions relating to the carryover of losses and deductions with respect to a former shareholder of S2 that may be available to that shareholder as a shareholder of S1.

(d) Examples. The following examples illustrate the application of this section:

Example 1. X, an S corporation, owns 100 percent of the stock of Y, a C corporation. On June 2, 2002, X makes a valid QSub election for Y, effective June 2, 2002. Assume that, under general principles of tax law, including the step transaction doctrine, X's acquisition of the Y stock and the subsequent QSub election would not be treated as related. The liquidation described in paragraph (a)(2) of this section occurs at the close of the day on June 1, 2002, the day before the QSub election is effective, and the plan of liquidation is considered adopted on that date. Y's taxable year and separate existence for Federal tax purposes end at the close of June 1, 2002.

Example 2. X, a C corporation, owns 100 percent of the stock of Y, another C corporation. On December 31, 2002, X makes an election under section 1362 to be treated as an S corporation and a valid QSub election for Y, both effective January 1, 2003. Assume that, under general principles of tax law, including the step transaction doctrine, X's acquisition of the Y stock and the subsequent QSub election would not be treated as related. The liquidation described in paragraph (a)(2) of this section occurs at the close of December 31, 2002, the day before the QSub election is effective. The QSub election for Y is effective on the same day that X's S election is effective, and the deemed liquidation is treated as occurring before the S election is effective, when X is still a C corporation. Y's taxable year ends at the close of December 31, 2002. See §1.381(b)-1.

Example 3. On June 1, 2002, X, an S corporation, acquires 100 percent of the stock of Y, an existing S corporation, for cash in a transaction meeting the requirements of a qualified stock purchase (QSP) under section 338. X immediately makes a QSub election for Y effective June 2, 2002, and also makes a joint election under section 338(h)(10) with the shareholder of Y. Under section 338(a) and §1.338(h)(10)-1T(d)(3), Y is treated as having sold all of its assets at the close of the acquisition date, June 1, 2002. Y is treated as a new corporation which purchased all of those assets as of the beginning of June 2, 2002, the day after the acquisition date. Section 338(a)(2). The QSub election is effective on June 2, 2002, and the liquidation under paragraph (a)(2) of this section occurs immediately after the deemed asset purchase by the new corporation.

Example 4. X, an S corporation, owns 100 percent of Y, a corporation for which a QSub election is in effect. On May 12, 2002, a date on which the QSub election is in effect, X issues Y a $10,000 note under state law that matures in ten years with a market rate of interest. Y is not treated as a separate corporation, and X's issuance of the note to Y on May 12, 2002, is disregarded for Federal tax purposes.

Example 5. X, an S corporation, owns 100 percent of the stock of Y, a C corporation. At a time when Y is indebted to X in an amount that exceeds the fair market value of Y's assets, X makes a QSub election effective on the date it is filed with respect to Y. The liquidation described in paragraph (a)(2) of this section does not qualify under sections 332 and 337 and, thus, Y recognizes gain or loss on the assets distributed, subject to the limitations of section 267.

§1.1361-5 Termination of QSub election.

(a) In general--(1) Effective date. The termination of a QSub election is effective--

(i) On the effective date contained in the revocation statement if a QSub election is revoked under §1.1361-3(b);

(ii) At the close of the last day of the parent's last taxable year as an S corporation if the parent's S election terminates under §1.1362-2; or

(iii) At the close of the day on which an event (other than an event described in paragraph (a)(1)(ii) of this section) occurs that renders the subsidiary ineligible for QSub status under section 1361(b)(3)(B).

(2) Information to be provided upon termination of QSub election by failure to qualify as a QSub. If a QSub election terminates because an event renders the subsidiary ineligible for QSub status, the S corporation must attach to its return for the taxable year in which the termination occurs a notification that a QSub election has terminated, the date of the termination, and the names, addresses, and employer identification numbers of both the parent corporation and the QSub.

(3) QSub joins a consolidated group. If a QSub election terminates because the S corporation becomes a member of a consolidated group (and no election under section 338(g) is made) the principles of §1.1502-76(b)(1)(ii)(A)(2) (relating to a special rule for S corporations that join a consolidated group) apply to any QSub of the S corporation that also becomes

a member of the consolidated group at the same time as the S corporation. See Example 4 of paragraph (a)(4) of this section.

(4) Examples. The following examples illustrate the application of this paragraph (a):

Example 1. Termination because parent's S election terminates. X, an S corporation, owns 100 percent of Y. A QSub election is in effect with respect to Y for 2001. Effective on January 1, 2002, X revokes its S election. Because X is no longer an S corporation, Y no longer qualifies as a QSub at the close of December 31, 2001.

Example 2. Termination due to transfer of QSub stock. X, an S corporation, owns 100 percent of Y. A QSub election is in effect with respect to Y. On December 10, 2002, X sells one share of Y stock to A, an individual. Because X no longer owns 100 percent of the stock of Y, Y no longer qualifies as a QSub. Accordingly, the QSub election made with respect to Y terminates at the close of December 10, 2002.

Example 3. No termination on stock transfer between QSub and parent. X, an S corporation, owns 100 percent of the stock of Y, and Y owns 100 percent of the stock of Z. QSub elections are in effect with respect to both Y and Z. Y transfers all of its Z stock to X. Because X is treated as owning the stock of Z both before and after the transfer of stock solely for purposes of determining whether the requirements of section 1361(b)(3)(B)(i) and §1.1361-2(a)(1) have been satisfied, the transfer of Z stock does not terminate Z's QSub election. Because the stock of Z is disregarded for all other Federal tax purposes, no gain is recognized under section 311.

Example 4. Termination due to acquisition of S parent by a consolidated group. X, an S corporation, owns 100 percent of Y, a corporation for which a QSub election is in effect. Z, the common parent of a consolidated group of corporations, acquires 80 percent of the stock of X on June 1, 2002. Z does not make an election under section 338(g) with respect to the purchase of X stock. X’s S election terminates as of the close of the preceding day, May 31, 2002. Y’s QSub election also terminates at the close of May 31, 2002. Under §1.1502-76(b)(1)(ii)(A)(2) and paragraph (a)(3) of this section, X and Y become members of Z’s consolidated group of corporations as of the beginning of the day June 1, 2002.

Example 5. Termination due to acquisition of QSub by a consolidated group. The facts are the same as in Example 4, except that Z acquires 80 percent of the stock of Y (instead of X) on June 1, 2002. In this case, Y’s QSub election terminates as of the close of June 1, 2002, and, under §1.1502-

76(b)(1)(ii)(A)(1), Y becomes a member of the consolidated group at that time.

(b) Effect of termination of QSub election--(1) Formation of new corporation--(i) In general. If a QSub election terminates under paragraph (a) of this section, the former QSub is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the termination from the S corporation parent in exchange for stock of the new corporation. The tax treatment of this transaction or of a larger transaction that includes this transaction will be determined under the Internal Revenue Code and general principles of tax law, including the step transaction doctrine. For purposes of determining the application of section 351 with respect to this transaction, instruments, obligations, or other arrangements that are not treated as stock of the QSub under §1.1361-2(b) are disregarded in determining control for purposes of section 368(c) even if they are equity under general principles of tax law.

(ii) Termination for tiered QSubs. If QSub elections terminate for tiered QSubs on the same day, the formation of any higher tier subsidiary precedes the formation of its lower tier subsidiary. See Example 6 in paragraph (b)(3) of this section.

(2) Carryover of disallowed losses and deductions. If a QSub terminates because the S corporation distributes the QSub stock to some or all of the S corporation's shareholders in a transaction to which section 368(a)(1)(D) applies by reason of section 355 (or so much of section 356 as relates to section

355), see §1.1366-2(c)(2) for provisions relating to the carryover of disallowed losses and deductions that may be available.

(3) Examples. The following examples illustrate the application of this paragraph (b):

Example 1. X, an S corporation, owns 100 percent of the stock of Y, a corporation for which a QSub election is in effect. X sells 21 percent of the Y stock to Z, an unrelated corporation, for cash, thereby terminating the QSub election. Y is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) in exchange for Y stock immediately before the termination from the S corporation. The deemed exchange by X of assets for Y stock does not qualify under section 351 because X is not in control of Y within the meaning of section 368(c) immediately after the transfer as a result of the sale of stock to Z. Therefore, X must recognize gain, if any, on the assets transferred to Y in exchange for its stock. X's losses, if any, on the assets transferred are subject to the limitations of section 267.

Example 2. (i) X, an S corporation, owns 100 percent of the stock of Y, a corporation for which a QSub election is in effect. As part of a plan to sell a portion of Y, X causes Y to merge into T, a limited liability company wholly owned by X that is disregarded an as entity separate from its owner for Federal tax purposes. X then sells 21 percent of T to Z, an unrelated corporation, for cash. Following the sale, no entity classification election is made under §301.7701-3(c) of this chapter to treat the limited liability company as an association for Federal tax purposes.

(ii) The merger of Y into T causes a termination of Y’s QSub election. The new corporation (Newco) that is formed as a result of the termination is immediately merged into T, an entity that is disregarded for Federal tax purposes. Because, at the end of the series of transactions, the assets continue to be held by X for Federal tax purposes, under step transaction principles, the formation of Newco and the transfer of assets pursuant to the merger of Newco into T are disregarded. The sale of 21 percent of T is treated as a sale of a 21 percent undivided interest in each of T’s assets. Immediately thereafter, X and Z are treated as contributing their respective interests in those assets to a partnership in exchange for ownership interests in the partnership.

(iii) Under section 1001, X recognizes gain or loss from the deemed sale of the 21 percent interest in each asset of the limited liability company to Z. Under section 721(a), no gain or loss is recognized by X and Z as a result of the deemed contribution of their respective interests in the assets to the partnership in exchange for ownership interests in the partnership.

Example 3. Assume the same facts as in Example 1, except that, instead of purchasing Y stock, Z contributes to Y an operating asset in exchange for 21 percent of the Y stock. Y is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) in exchange for Y stock immediately before the termination. Because X and Z are co-transferors that control the transferee immediately after the transfer, the transaction qualifies under section 351.

Example 4. X, an S corporation, owns 100 percent of the stock of Y, a corporation for which a QSub election is in effect. X distributes all of the Y stock pro rata to its shareholders, and the distribution terminates the QSub election. The transaction can qualify as a distribution to which sections 368(a)(1)(D) and 355 apply if the transaction otherwise satisfies the requirements of those sections.

Example 5. X, an S corporation, owns 100 percent of the stock of Y, a corporation for which a QSub election is in effect. X subsequently revokes the QSub election. Y is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) immediately before the revocation from its S corporation parent in a deemed exchange for Y stock. On a subsequent date, X sells 21 percent of the stock of Y to Z, an unrelated corporation, for cash. Assume that under general principles of tax law including the step transaction doctrine, the sale is not taken into account in determining whether X is in control of Y immediately after the deemed exchange of assets for stock. The deemed exchange by X of assets for Y stock and the deemed assumption by Y of its liabilities qualify under section 351 because, for purposes of that section, X is in control of Y within the meaning of section 368(c) immediately after the transfer.

Example 6. (i) X, an S corporation, owns 100 percent of the stock of Y, and Y owns 100 percent of the stock of Z. Y and Z are corporations for which QSub elections are in effect. X subsequently revokes the QSub elections and the effective date specified on each revocation statement is June 26, 2002, a date that is less than 12 months after the date on which the revocation statements are filed.

(ii) Immediately before the QSub elections terminate, Y is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) directly from X in exchange for the stock of Y. Z is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) directly from Y in exchange for the stock of Z.

Example 7. (i) The facts are the same as in Example 6, except that, prior to June 26, 2002 (the effective date of the revocations), Y distributes the Z stock to X under state law.

(ii) Immediately before the QSub elections terminate, Y is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) directly from X in exchange for the stock of Y. Z is also treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) directly from X in exchange for the stock of Z.

Example 8. Merger of parent into QSub. X, an S corporation, owns 100 percent of the stock of Y, a corporation for which a QSub election is in effect. X merges into Y under state law, causing the QSub election for Y to terminate, and Y survives the merger. The formation of the new corporation, Y, and the merger of X into Y can qualify as a reorganization described in section 368(a)(1)(F) if the transaction otherwise satisfies the requirements of that section.

Example 9. Transfer of 100 percent of QSub. X, an S corporation, owns 100 percent of the stock of Y, a corporation for which a QSub election is in effect. Z, an unrelated C corporation, acquires 100 percent of the stock of Y. The deemed formation of Y by X (as a consequence of the termination of Y’s QSub election) is disregarded for Federal income tax purposes. The transaction is treated as a transfer of the assets of Y to Z, followed by Z’s transfer of these assets to the capital of Y in exchange for Y stock. Furthermore, if Z is an S corporation and makes a QSub election for Y effective as of the acquisition, Z’s transfer of the assets of Y in exchange for Y stock, followed by the immediate liquidation of Y as a consequence of the QSub election are disregarded for Federal income tax purposes.

(c) Election after QSub termination--(1) In general.

Absent the Commissioner's consent, and except as provided in paragraph (c)(2) of this section, a corporation whose QSub election has terminated under paragraph (a) of this section (or a successor corporation as defined in §1.1362-5(b)) may not make an S election under section 1362 or have a QSub election under section 1361(b)(3)(B)(ii) made with respect to it for five taxable years (as described in section 1361(b)(3)(D)). The Commissioner may permit an S election by the corporation or a new QSub election with respect to the corporation before the five-year period expires. The corporation requesting consent to make the election has the burden of establishing that, under the relevant facts and circumstances, the Commissioner should consent to a new election.

(2) Exception. In the case of S and QSub elections effective after December 31, 1996, if a corporation's QSub election terminates, the corporation may, without requesting the Commissioner's consent, make an S election or have a QSub election made with respect to it before the expiration of the five-year period described in section 1361(b)(3)(D) and paragraph (c)(1) of this section, provided that--

(i) Immediately following the termination, the corporation (or its successor corporation) is otherwise eligible to make an S election or have a QSub election made for it; and

(ii) The relevant election is made effective immediately following the termination of the QSub election.

(3) Examples. The following examples illustrate the application of this paragraph (c):

Example 1. Termination upon distribution of QSub stock to shareholders of parent. X, an S corporation, owns Y, a QSub. X distributes all of its Y stock to X's shareholders. The distribution terminates the QSub election because Y no longer satisfies the requirements of a QSub. Assuming Y is otherwise eligible to be treated as an S corporation, Y's shareholders may elect to treat Y as an S corporation effective on the date of the stock distribution without requesting the Commissioner's consent.

Example 2. Sale of 100 percent of QSub stock. X, an S corporation, owns Y, a QSub. X sells 100 percent of the stock of Y to Z, an unrelated S corporation. Z may elect to treat Y as a QSub effective on the date of purchase without requesting the Commissioner's consent.

§1.1361-6 Effective date.

Except as provided in §§1.1361-4(a)(3)(iii), 1.1361-4(a)(5)(i), and 1.1361-5(c)(2), the provisions of §§1.1361-2 through 1.1361-5 apply to taxable years beginning on or after January 20, 2000; however, taxpayers may elect to apply the regulations in whole, but not in part (aside from those sections with special dates of applicability), for taxable years beginning on or after January 1, 2000, provided all affected taxpayers apply the regulations in a consistent manner. To make this election, the corporation and all affected taxpayers must file a return or an amended return that is consistent with these rules for the taxable year for which the election is made. For purposes of this section, affected taxpayers means all taxpayers whose returns are affected by the election to apply the regulations.

Par. 5. Amend §1.1362-0 by adding an entry for §1.1362-8 to read as follows:

§1.1362-0 Table of contents.

* * * * *

§1.1362-8 Dividends received from affiliated subsidiaries.

(4) Special rules for consolidated groups.
(d) Examples.
(e) Effective date.

Par. 6. Section 1.1362-2 is amended by adding a sentence to the end of the paragraph (c)(5)(ii)(C) to read as follows:

<u>§1.1362-2 Termination of election</u>.

* * * * *

(c) * * *

(5) * * *

(ii) * * *

(C) * * * See §1.1362-8 for special rules regarding the treatment of dividends received by an S corporation from a C corporation in which the S corporation holds stock meeting the requirements of section 1504(a)(2).

* * * * *

Par. 7. Section 1.1362-8 is added to read as follows:

<u>§1.1362-8 Dividends received from affiliated subsidiaries</u>.

(a) <u>In general</u>. For purposes of section 1362(d)(3), if an S corporation holds stock in a C corporation meeting the requirements of section 1504(a)(2), the term <u>passive investment income</u> does not include dividends from the C corporation to the extent those dividends are attributable to the earnings and profits of the C corporation derived from the active conduct of a trade or business (active earnings and profits). For purposes of applying section 1362(d)(3), earnings and profits of a C corporation are active earnings and profits to the extent that the earnings and profits are derived from activities that would not produce passive investment income (as defined in section 1362(d)(3)) if the C corporation were an S corporation.

(b) Determination of active or passive earnings and profits--(1) In general. An S corporation may use any reasonable method to determine the amount of dividends that are not treated as passive investment income under section 1362(d)(3)(E). Paragraph (b)(5) of this section describes a method of determining the amount of dividends that are not treated as passive investment income under section 1362(d)(3)(E) that is deemed to be reasonable under all circumstances.

(2) Lower tier subsidiaries. If a C corporation subsidiary (upper tier corporation) holds stock in another C corporation (lower tier subsidiary) meeting the requirements of section 1504(a)(2), the upper tier corporation's gross receipts attributable to a dividend from the lower tier subsidiary are considered to be derived from the active conduct of a trade or business to the extent the lower tier subsidiary's earnings and profits are attributable to the active conduct of a trade or business by the subsidiary under paragraph (b)(1), (3), (4), or (5) of this section. For purposes of this section, distributions by the lower tier subsidiary will be considered attributable to active earnings and profits according to the rule in paragraph (c) of this section. This paragraph (b)(2) does not apply to any member of a consolidated group (as defined in §1.1502-1(h)).

(3) De minimis exception. If less than 10 percent of a C corporation's earnings and profits for a taxable year are

derived from activities that would produce passive investment income if the C corporation were an S corporation, all earnings and profits produced by the corporation during that taxable year are considered active earnings and profits.

(4) Special rules for earnings and profits accumulated by a C corporation prior to 80 percent acquisition. A C corporation may treat all earnings and profits accumulated by the corporation in all taxable years ending before the S corporation held stock meeting the requirements of section 1504(a)(2) as active earnings and profits in the same proportion as the C corporation's active earnings and profits for the three taxable years ending prior to the time when the S corporation acquired 80 percent of the C corporation bears to the C corporation's total earnings and profits for those three taxable years.

(5) Gross receipts safe harbor. A corporation may treat its earnings and profits for a year as active earnings and profits in the same proportion as the corporation's gross receipts (as defined in §1.1362-2(c)(4)) derived from activities that would not produce passive investment income (if the C corporation were an S corporation), including those that do not produce passive investment income under paragraphs (b)(2) through (b)(4) of this section, bear to the corporation's total gross receipts for the year in which the earnings and profits are produced.

(c) Allocating distributions to active or passive earnings and profits--(1) Distributions from current earnings and profits. Dividends distributed by a C corporation from current earnings and profits are attributable to active earnings and profits in the same proportion as current active earnings and profits bear to total current earnings and profits of the C corporation.

(2) Distributions from accumulated earnings and profits. Dividends distributed by a C corporation out of accumulated earnings and profits for a taxable year are attributable to active earnings and profits in the same proportion as accumulated active earnings and profits for that taxable year bear to total accumulated earnings and profits for that taxable year immediately prior to the distribution.

(3) Adjustments to active earnings and profits. For purposes of applying paragraph (c)(1) or (2) of this section to a distribution, the active earnings and profits of a corporation shall be reduced by the amount of any prior distribution properly treated as attributable to active earnings and profits from the same taxable year.

(4) Special rules for consolidated groups. For purposes of applying section 1362(d)(3) and this section to dividends received by an S corporation from the common parent of a consolidated group (as defined in §1.1502-1(h)), the following rules apply --

(i) The current earnings and profits, accumulated earnings and profits, and active earnings and profits of the common parent shall be determined under the principles of §1.1502-33 (relating to earnings and profits of any member of a consolidated group owning stock of another member); and

(ii) The gross receipts of the common parent shall be the sum of the gross receipts of each member of the consolidated group (including the common parent), adjusted to eliminate gross receipts from intercompany transactions (as defined in §1.1502-13(b)(1)(i)).

(d) Examples. The following examples illustrate the principles of this section:

Example 1. (i) X, an S corporation, owns 85 percent of the one class of stock of Y. On December 31, 2002, Y declares a dividend of $100 ($85 to X), which is equal to Y's current earnings and profits. In 2002, Y has total gross receipts of $1,000, $200 of which would be passive investment income if Y were an S corporation.

(ii) One-fifth ($200/$1,000) of Y's gross receipts for 2002 is attributable to activities that would produce passive investment income. Accordingly, one-fifth of the $100 of earnings and profits is passive, and $17 (1/5 of $85) of the dividend from Y to X is passive investment income.

Example 2. (i) The facts are the same as in Example 1, except that Y owns 90 percent of the stock of Z. Y and Z do not join in the filing of a consolidated return. In 2002, Z has gross receipts of $15,000, $12,000 of which are derived from activities that would produce passive investment income. On December 31, 2002, Z declares a dividend of $1,000 ($900 to Y) from current earnings and profits.

(ii) Four-fifths ($12,000/$15,000) of the dividend from Z to Y are attributable to passive earnings and profits. Accordingly, $720 (4/5 of $900) of the dividend from Z to Y is considered gross receipts from an activity that would produce passive investment income. The $900 dividend to Y gives Y a total of $1,900 ($1,000 + $900) in gross receipts, $920 ($200 + $720) of which is attributable to passive investment income-producing activities. Under these facts, $41 ($920/$1,900 of $85) of Y's distribution to X is passive investment income to X.

(e) Effective date. This section applies to dividends received in taxable years beginning on or after January 20, 2000; however, taxpayers may elect to apply the regulations in whole, but not in part, for taxable years beginning on or after

January 1, 2000, provided all affected taxpayers apply the regulations in a consistent manner. To make this election, the corporation and all affected taxpayers must file a return or an amended return that is consistent with these rules for the taxable year for which the election is made. For purposes of this section, affected taxpayers means all taxpayers whose returns are affected by the election to apply the regulations.

§1.1368-0 [Amended]

Par. 8. Amend §1.1368-0 in the entry for §1.1368-2(d)(2) by revising "Reorganizations" to read "Liquidations and reorganizations".

§1.1368-2 [Amended]

Par. 9. Amend §1.1368-2 in paragraph (d)(2) by revising "Reorganizations" to read "Liquidations and reorganizations" in the heading and by revising "section 381(a)(2)" to read "section 381(a)" in the first sentence.

Par. 10. Amend §1.1374-8 by adding one sentence to the end of paragraph (b) to read as follows:

<u>§1.1374-8 Section 1374(d)(8) transactions</u>.

* * * * *

(b) <u>Separate determination of tax</u>. * * * If an S corporation makes QSub elections under section 1361(b)(3) for a tiered group of subsidiaries effective on the same day, see §1.1361-4(b)(2).

PART 301--PROCEDURE AND ADMINISTRATION

Par. 11. The authority citation for part 301 continues to read in part as follows:

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

Par. 12. Section 301.6109-1 is amended as follows:

1. Paragraph (i) is redesignated as paragraph (j) and the first sentence of newly designated paragraph (j)(1) is amended by removing the language “paragraph (i)” and adding “paragraph (j)” in its place.

2. A new paragraph (i) is added.

The addition reads as follows:

§301.6109-1 Identifying numbers.

* * * * *

(i) Special rule for qualified subchapter S subsidiaries (QSubs)--(1) General rule. Any entity that has an employer identification number (EIN) will retain that EIN if a QSub election is made for the entity under §1.1361-3 or if a QSub election that was in effect for the entity terminates under §1.1361-5.

(2) EIN while QSub election in effect. Except as otherwise provided in regulations or other published guidance, a QSub must use the parent S corporation’s EIN for Federal tax purposes.

(3) EIN when QSub election terminates. If an entity’s QSub election terminates, it may not use the EIN of the parent S corporation after the termination. If the entity had an EIN prior to becoming a QSub or obtained an EIN while it was a QSub in accordance with regulations or other published guidance, the entity must use that EIN. If the entity had no EIN, it must obtain an EIN upon termination of the QSub election.

(4) Effective date. The rules of this paragraph (i) apply on January 20, 2000.

Part 602--OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 13. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 14. In §602.101, paragraph (b) is amended by adding entries for §§1.1361-3, 1.1361-5, and 1.1362-8 to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part of section where identified and described	Current OMB control No.
* * * * *	
1.1361-3	1545-1590
1.1361-5	1545-1590* * *
1.1362-8	1545-1590
* * * * *	

/s/ Robert E. Wenzel
Deputy Commissioner Internal Revenue Service

Approved:January 14, 2000

/s/ Jonathan Talisman

Acting Assistant Secretary of the Treasury