[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 8844]

RIN 1545-AV16

Treatment of Changes in Elective Entity Classification

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations describing how elective changes in classification will be treated for federal tax purposes. The final regulations affect business entities and their members. The final regulations provide guidance to taxpayers who elect to change an entity's classification for federal tax purposes.

DATES: Effective Date: These regulations are effective November 29, 1999.

Applicability Dates: These regulations apply on or after November 29, 1999. However, taxpayers may choose to apply certain provisions in these regulations before November 29, 1999 as specified in §301.7701-2(e) and §301.7701-3(g)(4).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Dan Carmody, (202) 622-3080 (not a toll-free number); concerning international issues, Mark Harris, (202) 622-3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On October 28, 1997, proposed amendments to the regulations under §§301.6109-1, 301.7701-2, and 301.7701-3 [REG-105162-97] were published in the **Federal Register** (62 FR 55768). A number of comments were received on the proposed regulations. The public hearing scheduled for February 24, 1998, was canceled because no one requested to speak. After considering the submitted comments, the IRS and Treasury adopt the proposed amendments to the regulations under §§301.6109-1, 301.7701-2, and 301.7701-3 as revised by this Treasury decision.

Explanation of Provisions

I. Characterization of Elective Changes in Classification

There are four possible changes in classification of an eligible entity by election under §301.7701-3: (i) a partnership elects to be an association taxable as a corporation (association); (ii) an association elects to be a partnership; (iii) an association elects to be disregarded as an entity separate from its owner (disregarded entity); and (iv) a disregarded entity elects to be an association. The proposed regulations provide a form that each elective conversion would be treated as having for federal tax purposes. Under the proposed regulations, there is only one form for each elective conversion, and taxpayers could not elect to have a different form apply to the elective conversion.

A. Elective Conversions Treated as Having One Form

Commentators recommended that taxpayers be allowed to choose which form to apply to an elective conversion. This would allow

taxpayers to avoid having to take the actual steps of a conversion to produce the most favorable tax results. A commentator suggested that the lack of choice in the proposed regulations is inconsistent with the intent of the check-the-box regulations, which adopted an elective regime for classifying eligible entities.

Because elective conversions are transactions without actual form, the IRS and Treasury believe that it is appropriate to provide that only one transaction form will be applied to each type of elective conversion. Furthermore, while the check-the-box regulations provide an elective regime for classifying eligible entities, the elective regime was not intended to substitute for actual transactions in all situations. Instead, the purpose of implementing the regime was to simplify an area of the law where legal distinctions previously drawn in determining an entity's classification were no longer meaningful. While the factors considered under prior law did not meaningfully distinguish between business organizations, taxpayers still were required to expend considerable resources to ensure that they obtained the classification they desired. Small business organizations often lacked the resources and expertise to achieve their desired tax classification. This was viewed as unfair. The IRS was also expending considerable resources providing guidance on these classification issues. These same concerns generally are not present in determining the form of a conversion transaction. Therefore, the final regulations maintain only one

form for each type of elective conversion.

B. Form of Conversion From Association to Partnership

The proposed regulations provide that an elective conversion of an association to a partnership is deemed to have the following form: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.

A commentator suggested that the proposed form for an elective conversion of an association to a partnership may not minimize the tax consequences of such a conversion under certain circumstances. The commentator suggested that the proposed form should be available as an election, but that the default form should be a deemed transfer of assets and liabilities from the electing corporation to a newly formed partnership for interests in the partnership followed immediately by a liquidation of the electing corporation.

The IRS and Treasury believe that under current law a voluntary formless change from an association to a partnership should be treated as a liquidation of the corporation followed by a contribution of assets to the partnership. See Rev. Rul. 63-107 (1963-2 C.B. 71). Moreover, if the assets were deemed contributed by the electing corporation to the partnership for partnership interests followed by a liquidation of the corporation, the application of section 704(c) (contribution of

appreciated property), section 708 (partnership termination), and section 754 (elective adjustments to the basis of partnership assets) could be somewhat complex and difficult for taxpayers and the IRS to administer. Therefore, the proposed form for the elective conversion of an association to a partnership is adopted without change.

C. Timing of Elective Changes in Classification

The proposed regulations provide that a classification election takes effect at the start of the day for which the election is effective. Any transactions that are deemed to occur because of a change in classification are treated as occurring immediately before the close of the day before the effective date of the election. The owners of the entity when the election is effective may be different from the owners of the entity when the conversion transactions are deemed to occur. To ensure that the taxpayers who recognize the tax consequences of a conversion election approve of the election, the proposed regulations require that the election be signed by every owner on the date of the deemed conversion transactions.

A commentator indicated that purchasers who wish to make a classification election effective as of their first day of ownership may endure a burden in obtaining the consents of previous owners. The commentator recommended that the deemed conversion transactions be treated as occurring at the start of the day for which the election is effective, eliminating the need to obtain the consent of prior owners. Under this suggestion,

purchasers of an association who wish to elect partnership treatment effective as of the first day of ownership would be treated as owning both stock and partnership interests on that first day of ownership. This would result in the purchasers being responsible for a corporate return for their transitory period of corporate ownership. See §1.6012-2.

The IRS and Treasury intended that the proposed timing rule generally would be beneficial for taxpayers. The IRS and Treasury believe that any burden imposed by this rule is outweighed by the transactional flexibility that this rule provides. Accordingly, the suggested change to the timing rule is not adopted.

Another commentator noted a conflict between the proposed timing rule and the deemed transactions under section 338. Section 338 allows a purchasing corporation to treat its stock purchase of another corporation as an asset purchase. Under section 338, a purchasing corporation may elect to treat the target corporation as (1) selling its assets at fair market value on the acquisition date, and (2) a new corporation that purchased all of the assets at the beginning of the day after the acquisition date. If the purchaser also makes a classification election for the target effective for the purchaser’s first day of ownership, the timing of the deemed liquidation under §301.7701-3(g)(1) would conflict with the timing of the deemed transactions required by section 338.

To address the issue, the final regulations specify that if

section 338 applies, an election to convert the target corporation's classification cannot be effective before the day after the acquisition date of the target corporation. Additionally, the deemed liquidation and conversion under §301.7701-3(g)(1) will occur immediately after the completion of the section 338 transactions. These rules follow the approach of §1.338-2(c)(1)(i), which provides that when a target corporation liquidates on the acquisition date, the liquidation is treated as occurring on the following day and immediately after the deemed purchase of assets. If a taxpayer makes an election under section 338 (without a section 338(h)(10) election) regarding a target corporation that is subsequently deemed liquidated under these final regulations, the target corporation must file a final or deemed sale return as a C corporation reflecting the deemed sale. See §1.338-1(e).

Commentators also expressed concern over the effect the proposed timing rule would have on a sequence of elections when a number of corporations are owned through a single ownership chain. If the elections are all effective for the same date, the effect of the interaction of the timing rule with section 332 is unclear. For example, P corporation owns 100 percent of the interest of an eligible entity classified as an association (S1), which owns directly 100 percent of the interest of an eligible entity classified as an association (S2). P wants to convert S1 and S2 to disregarded entities on the same day; however, if both deemed liquidations are treated as occurring simultaneously, it

is not clear that section 332 nonrecognition treatment would be available for both liquidations. The final regulations clarify that in such a situation, unless another order is specified for the elections, S1 will be treated as liquidating into P immediately before S2 liquidates into P.

Commentators suggested that this situation could be addressed by allowing taxpayers to make elections effective by the hour, instead of only at the start of the day. The IRS and Treasury believe that the clarification in the final regulations appropriately addresses the treatment of successive elections. Therefore, the final regulations maintain the rule that conversion elections take effect at the start of the day on which the election is effective.

II. Taxpayer Identifying Numbers and Disregarded Entities

The proposed regulations provide clarification of the rules regarding taxpayer identifying numbers (TINs). The proposed regulations restate the rule that when an entity's classification changes under §301.7701-3, it retains its employer identification number (EIN). The proposed regulations also clarified the rule that a disregarded entity must use its owner's TIN for federal tax purposes. Furthermore, when a disregarded entity becomes respected as a separate entity, it must use its own EIN and not the TIN of the single owner.

One commentator asked for clarification regarding the use of TINs and EINs in the proposed regulations. TINs include EINs, social security numbers (SSNs), and IRS individual taxpayer

identification numbers (ITINs). The regulations require that a disregarded entity report under the owner's TIN. The regulations refer to a taxpayer's TIN because the term TIN encompasses not only an EIN, but also an SSN and an ITIN.

Another commentator suggested that the proposed regulations were too restrictive and prohibited a disregarded entity from applying for and receiving its own TIN. The regulations do not prevent a single member disregarded entity from applying for and receiving its own TIN. The regulations merely provide that, except as otherwise provided in regulations or other guidance, the single owner disregarded entity must use the owner's TIN for federal tax purposes and not the EIN of the disregarded entity. Notice 99-6 (1999-3 I.R.B. 1) provides guidance on the limited circumstances under which a disregarded entity may use its own EIN.

III. Rules for Foreign Entities

These final regulations also contain rules relating to certain foreign entities.

A. Foreign Per Se Entities

The final check-the-box regulations provided a list of the names of certain foreign business entities that are treated as corporations for federal tax purposes. In response to comments from taxpayers, the proposed regulations clarified those provisions. Specifically, clarifications were made with respect to certain business entities formed in Finland, Malaysia, Malta, Mexico, and Norway. These final regulations adopt the proposed

regulation's clarifications.

These final regulations also clarify the treatment of an entity formed in Trinidad and Tobago that is specified in the final check-the-box regulations. Prior to April 1997, Trinidad and Tobago's Companies Act distinguished between public and private limited companies. Effective April 1997, Trinidad and Tobago's Companies Act was amended and now only provides for limited companies (and no longer provides for private limited companies). Accordingly, these final regulations have been modified to take into account that change. The effective date of these final regulations with regard to an entity formed in Trinidad and Tobago has been modified so as not to disadvantage taxpayers who relied on the final check-the-box regulations. These final regulations provide that the rule with regard to an entity formed in Trinidad and Tobago will be effective on or after November 29, 1999. Accordingly, this rule only affects those entities which were formed (or made affirmative elections) on or after November 29, 1999.

These regulations also clarify the exception to *per se* corporate treatment for Canadian companies and corporations. When the final check-the-box regulations were promulgated, the only company or corporation that could be formed where the liability of all of its members was unlimited pursuant to any federal or provincial statute (as opposed to through side agreements of the members), was a Nova Scotia Unlimited Liability Company (NSULC). However, in order to avoid changing the

regulations if any other province, or the federal government, subsequently allowed for the formation of unlimited liability companies by statute, these regulations did not specifically list the NSULC. In response to questions from taxpayers, the regulation is clarified, with effect from January 1, 1997, by specifically naming the NSULC, while still providing for any other unlimited liability company that might subsequently be allowed by any other federal or provincial statute.

B. Foreign Eligible Entities

Proposed regulations that provide a special rule for certain foreign eligible entities are published elsewhere in this issue of the **Federal Register**. In addition, the IRS and Treasury are still studying what, if any, consequences occur when a foreign eligible entity that is not relevant for federal tax purposes files an entity classification election. The IRS and Treasury continue to request comments on this topic.

IV. Changes in Number of Members of an Entity

The proposed regulations provide that an entity's classification may change as a result of a change in the number of its members. Specifically, an eligible entity classified as a partnership will become a disregarded entity when the entity's membership is reduced to one member, and a disregarded entity will be classified as a partnership when the entity has more than one member. The final regulations adopt these provisions without substantive change. Guidance on the federal tax consequences of such changes has been provided in Rev. Rul. 99-5 (1999-6 I.R.B.

8) and Rev. Rul. 99-6 (1999-6 I.R.B. 6).

Effective Date

These regulations are applicable on or after November 29, 1999. In response to comments, however, the final regulations include a provision allowing taxpayers to apply the regulations retroactively for elective entity conversions that occurred before November 29, 1999. Taxpayers may apply the final regulations retroactively only if all taxpayers involved in the transaction follow the regulations. The rules contained in §301.6109-1(h) are applicable as of January 1, 1997. Certain changes to §301.7701-2(b)(8) may be applied before the effective date as specified in §301.7701-2(e).

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. 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 Dan Carmody and Jeff Erickson, Office of Chief Counsel (Passthroughs and Special Industries) and Mark Harris and Philip Tretiak, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 301

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

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301--PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6109-1 is amended as follows:

1. Paragraph (d)(2)(ii) is removed and reserved.

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

3. A new paragraph (h) is added.

The addition reads as follows:

§301.6109-1 Identifying numbers.

* * * * *

(h) Special rules for certain entities under §301.7701-3--(1) General rule. Any entity that has an employer identification number (EIN) will retain that EIN if its federal tax classification changes under §301.7701-3.

(2) Special rules for entities that are disregarded as entities separate from their owners--(i) When an entity becomes disregarded as an entity separate from its owner. Except as otherwise provided in regulations or other guidance, a single owner entity that is disregarded as an entity separate from its owner under §301.7701-3, must use its owner's taxpayer identifying number (TIN) for federal tax purposes.

(ii) When an entity that was disregarded as an entity separate from its owner becomes recognized as a separate entity. If a single owner entity's classification changes so that it is recognized as a separate entity for federal tax purposes, and that entity had an EIN, then the entity must use that EIN and not the TIN of the single owner. If the entity did not already have its own EIN, then the entity must acquire an EIN and not use the TIN of the single owner.

(3) Effective date. The rules of this paragraph (h) are applicable as of January 1, 1997.

* * * * *

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

1. Paragraph (b)(8)(i) is amended by revising the entries for Finland, Malta, Norway, and Trinidad and Tobago.

2. Paragraph (b)(8)(ii)(A) is redesignated as paragraph (b)(8)(ii)(A)(1) and is revised.

3. Paragraph (b)(8)(ii)(B) is redesignated as paragraph (b)(8)(ii)(A)(2).

4. Paragraph (b)(8)(ii) heading and introductory text are redesignated as paragraph (b)(8)(ii)(A) heading and introductory text, and a new paragraph heading is added for paragraph (b)(8)(ii).

5. Paragraphs (b)(8)(ii)(A)(3) and (b)(8)(ii)(B) are added.

6. Paragraphs (b)(8)(iii), (b)(8)(iv), and (e) are revised.

The revisions and additions read as follows:

§301.7701-2 Business entities; definitions.

* * * * *

(b) * * *

(8) * * *

(i) * * *

Finland, Julkinen Osakeyhtio/Publikt Aktiebolag
* * * * *
Malta, Public Limited Company
* * * * *
Norway, Allment Aksjeselskap
* * * * *
Trinidad and Tobago, Limited Company
* * * * *

(ii) Clarification of list of corporations in paragraph (b)(8)(i) of this section--(A) Exceptions in certain cases. * * *

* * * * *

(1) With regard to Canada, a Nova Scotia Unlimited Liability Company (or any other company or corporation all of whose owners have unlimited liability pursuant to federal or provincial law).

* * * * *

(3) With regard to Malaysia, a Sendirian Berhad.

(B) Inclusions in certain cases. With regard to Mexico, the term Sociedad Anonima includes a Sociedad Anonima that chooses to apply the variable capital provision of Mexican corporate law (Sociedad Anonima de Capital Variable).

(iii) Public companies. For purposes of paragraph (b)(8)(i) of this section, with regard to Cyprus, Hong Kong, and Jamaica, the term Public Limited Company includes any Limited Company that is not defined as a private company under the corporate laws of those jurisdictions. In all other cases, where the term Public Limited Company is not defined, that term shall include any Limited Company defined as a public company under the corporate laws of the relevant jurisdiction.

(iv) Limited companies. For purposes of this paragraph (b)(8), any reference to a Limited Company includes, as the case may be, companies limited by shares and companies limited by guarantee.

* * * * *

(e) Effective date. Except as otherwise provided in this paragraph (e), the rules of this section apply as of January 1, 1997. The reference to the Finnish, Maltese, and Norwegian entities in paragraph (b)(8)(i) of this section is applicable on November 29, 1999. The reference to the Trinidadian entity in paragraph (b)(8)(i) of this section applies to entities formed on or after November 29, 1999. Any Maltese or Norwegian entity that

becomes an eligible entity as a result of paragraph (b)(8)(i) of this section in effect on November 29, 1999, may elect by February 14, 2000, to be classified for federal tax purposes as an entity other than a corporation retroactive to any period from and including January 1, 1997. Any Finnish entity that becomes an eligible entity as a result of paragraph (b)(8)(i) of this section in effect on November 29, 1999, may elect by February 14, 2000, to be classified for federal tax purposes as an entity other than a corporation retroactive to any period from and including September 1, 1997.

Par. 4. Section 301.7701-3 is amended as follows:

1. A sentence is added at the end of paragraph (c)(1)(iii).

2. A sentence is added at the end of paragraph (c)(1)(iv).

3. Paragraph (c)(2)(iii) is added.

4. A heading is added to paragraph (d)(1).

5. Paragraph (f) is redesignated as paragraph (h) and newly designated paragraph (h)(1) is revised.

6. Paragraphs (f) and (g) are added.

The revision and additions read as follows:

§301.7701-3 Classification of certain business entities.

* * * * *

(c) * * *

(1) * * *

(iii) Effective date of election. * * * If a purchasing corporation makes an election under section 338 regarding an acquired subsidiary, an election under paragraph (c)(1)(i) of

this section for the acquired subsidiary can be effective no earlier than the day after the acquisition date (within the meaning of section 338(h)(2)).

(iv) Limitation. * * * An election by a newly formed eligible entity that is effective on the date of formation is not considered a change for purposes of this paragraph (c)(1)(iv).

* * * * *

(2) * * *

(iii) Changes in classification. For paragraph (c)(2)(i) of this section, if an election under paragraph (c)(1)(i) of this section is made to change the classification of an entity, each person who was an owner on the date that any transactions under paragraph (g) of this section are deemed to occur, and who is not an owner at the time the election is filed, must also sign the election. This paragraph (c)(2)(iii) applies to elections filed on or after November 29, 1999.

(d) Special rules for foreign eligible entities--(1) Definition of relevance. * * *

* * * * *

(f) Changes in number of members of an entity--(1) Associations. The classification of an eligible entity as an association is not affected by any change in the number of members of the entity.

(2) Partnerships and single member entities. An eligible entity classified as a partnership becomes disregarded as an entity separate from its owner when the entity's membership is

reduced to one member. A single member entity disregarded as an entity separate from its owner is classified as a partnership when the entity has more than one member. If an elective classification change under paragraph (c) of this section is effective at the same time as a membership change described in this paragraph (f)(2), the deemed transactions in paragraph (g) of this section resulting from the elective change preempt the transactions that would result from the change in membership.

(3) Effect on sixty month limitation. A change in the number of members of an entity does not result in the creation of a new entity for purposes of the sixty month limitation on elections under paragraph (c)(1)(iv) of this section.

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

Example 1. A, a U.S. person, owns a domestic eligible entity that is disregarded as an entity separate from its owner. On January 1, 1998, B, a U.S. person, buys a 50 percent interest in the entity from A. Under this paragraph (f), the entity is classified as a partnership when B acquires an interest in the entity. However, A and B elect to have the entity classified as an association effective on January 1, 1998. Thus, B is treated as buying shares of stock on January 1, 1998. (Under paragraph (c)(1)(iv) of this section, this election is treated as a change in classification so that the entity generally cannot change its classification by election again during the sixty months succeeding the effective date of the election.) Under paragraph (g)(1) of this section, A is treated as contributing the assets and liabilities of the entity to the newly formed association immediately before the close of December 31, 1997. Because A does not retain control of the association as required by section 351, A's contribution will be a taxable event. Therefore, under section 1012, the association will take a fair market value basis in the assets contributed by A, and A will have a fair market value basis in the stock received. A will have no additional gain upon the sale of stock to B, and B will have a cost basis in the stock purchased from A.

Example 2. (i) On April 1, 1998, A and B, U.S. persons,

form X, a foreign eligible entity. X is treated as an association under the default provisions of paragraph (b)(2)(i) of this section, and X does not make an election to be classified as a partnership. A subsequently purchases all of B's interest in X.

(ii) Under paragraph (f)(1) of this section, X continues to be classified as an association. X, however, can subsequently elect to be disregarded as an entity separate from A. The sixty month limitation of paragraph (c)(1)(iv) of this section does not prevent X from making an election because X has not made a prior election under paragraph (c)(1)(i) of this section.

Example 3. (i) On April 1, 1998, A and B, U.S. persons, form X, a foreign eligible entity. X is treated as an association under the default provisions of paragraph (b)(2)(i) of this section, and X does not make an election to be classified as a partnership. On January 1, 1999, X elects to be classified as a partnership effective on that date. Under the sixty month limitation of paragraph (c)(1)(iv) of this section, X cannot elect to be classified as an association until January 1, 2004 (i.e., sixty months after the effective date of the election to be classified as a partnership).

(ii) On June 1, 2000, A purchases all of B's interest in X. After A's purchase of B's interest, X can no longer be classified as a partnership because X has only one member. Under paragraph (f)(2) of this section, X is disregarded as an entity separate from A when A becomes the only member of X. X, however, is not treated as a new entity for purposes of paragraph (c)(1)(iv) of this section. As a result, the sixty month limitation of paragraph (c)(1)(iv) of this section continues to apply to X, and X cannot elect to be classified as an association until January 1, 2004 (i.e., sixty months after January 1, 1999, the effective date of the election by X to be classified as a partnership).

(5) Effective date. This paragraph (f) applies as of November 29, 1999.

(g) Elective changes in classification--(1) Deemed treatment of elective change--(i) Partnership to association. If an eligible entity classified as a partnership elects under paragraph (c)(1)(i) of this section to be classified as an association, the following is deemed to occur: The partnership contributes all of its assets and liabilities to the association

in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners.

(ii) Association to partnership. If an eligible entity classified as an association elects under paragraph (c)(1)(i) of this section to be classified as a partnership, the following is deemed to occur: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.

(iii) Association to disregarded entity. If an eligible entity classified as an association elects under paragraph (c)(1)(i) of this section to be disregarded as an entity separate from its owner, the following is deemed to occur: The association distributes all of its assets and liabilities to its single owner in liquidation of the association.

(iv) Disregarded entity to an association. If an eligible entity that is disregarded as an entity separate from its owner elects under paragraph (c)(1)(i) of this section to be classified as an association, the following is deemed to occur: The owner of the eligible entity contributes all of the assets and liabilities of the entity to the association in exchange for stock of the association.

(2) Effect of elective changes. The tax treatment of a change in the classification of an entity for federal tax

purposes by election under paragraph (c)(1)(i) of this section is determined under all relevant provisions of the Internal Revenue Code and general principles of tax law, including the step transaction doctrine.

(3) Timing of election--(i) In general. An election under paragraph (c)(1)(i) of this section that changes the classification of an eligible entity for federal tax purposes is treated as occurring at the start of the day for which the election is effective. Any transactions that are deemed to occur under this paragraph (g) as a result of a change in classification are treated as occurring immediately before the close of the day before the election is effective. For example, if an election is made to change the classification of an entity from an association to a partnership effective on January 1, the deemed transactions specified in paragraph (g)(1)(ii) of this section (including the liquidation of the association) are treated as occurring immediately before the close of December 31 and must be reported by the owners of the entity on December 31. Thus, the last day of the association's taxable year will be December 31 and the first day of the partnership's taxable year will be January 1.

(ii) Coordination with section 338 election. A purchasing corporation that makes a qualified stock purchase of an eligible entity taxed as a corporation may make an election under section 338 regarding the acquisition if it satisfies the requirements for the election, and may also make an election to change the

classification of the target corporation. If a taxpayer makes an election under section 338 regarding its acquisition of another entity taxable as a corporation and makes an election under paragraph (c) of this section for the acquired corporation (effective at the earliest possible date as provided by paragraph (c)(1)(iii) of this section), the transactions under paragraph (g) of this section are deemed to occur immediately after the deemed asset purchase by the new target corporation under section 338.

(iii) Application to successive elections in tiered situations. When elections under paragraph (c)(1)(i) of this section for a series of tiered entities are effective on the same date, the eligible entities may specify the order of the elections on Form 8832. If no order is specified for the elections, any transactions that are deemed to occur in this paragraph (g) as a result of the classification change will be treated as occurring first for the highest tier entity's classification change, then for the next highest tier entity's classification change, and so forth down the chain of entities until all the transactions under this paragraph (g) have occurred. For example, Parent, a corporation, wholly owns all of the interest of an eligible entity classified as an association (S1), which wholly owns another eligible entity classified as an association (S2), which wholly owns another eligible entity classified as an association (S3). Elections under paragraph (c)(1)(i) of this section are filed to classify S1, S2, and S3

each as disregarded as an entity separate from its owner effective on the same day. If no order is specified for the elections, the following transactions are deemed to occur under this paragraph (g) as a result of the elections, with each successive transaction occurring on the same day immediately after the preceding transaction: S1 is treated as liquidating into Parent, then S2 is treated as liquidating into Parent, and finally S3 is treated as liquidating into Parent.

(4) Effective date. This paragraph (g) applies to elections that are filed on or after November 29, 1999. Taxpayers may apply this paragraph (g) retroactively to elections filed before November 29, 1999 if all taxpayers affected by the deemed transactions file consistently with this paragraph (g).

(h) Effective date--(1) In general. Except as otherwise provided in this section, the rules of this section are applicable as of January 1, 1997.

* * * * *

Deputy Commissioner of Internal Revenue

Approved:

Assistant Secretary of the Treasury (Tax Policy)