

Section 7701.—Definitions

301.7701-2: *Business entities; definitions.*

T.D. 9183

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 1 and 301

Modification of Check the Box

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations that clarify that qualified REIT subsidiaries, qualified subchapter S subsidiaries, and single owner eligible entities that are disregarded as entities separate from their owners are treated as separate entities for purposes of any Federal tax liability for which the entity is liable. These regulations affect disregarded entities that are liable for Federal taxes with respect to tax periods during which they were not disregarded or because they are successors or transferees of taxable entities.

DATES: *Effective Date:* These regulations are effective April 1, 2004.

Applicability Dates: For dates of applicability, see §§1.856-9(c), 1.1361-4(a)(6)(iii), and 301.7701-2(e).

FOR FURTHER INFORMATION CONTACT: Martin Schäffer, (202) 622-3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR parts 1 and 301. The amendments to 26 CFR part 1 are under sections 856 and 1361 of the Internal Revenue Code (Code). Section 856(i) was added by the Tax Reform Act of 1986 (Public Law 99-514, 100 Stat. 2085). Section 1361(b)(3) was added by the Small

Business Job Protection Act of 1996 (Public Law 104-188, 110 Stat. 1755). The amendments to 26 CFR part 301 are to §301.7701-2, first promulgated by T.D. 8697, 1997-1 C.B. 215 [61 FR 66584] (December 18, 1996). On April 1, 2004, a notice of proposed rulemaking (REG-106681-02, 2004-18 I.R.B. 852) relating to the taxation of disregarded entities was published in the **Federal Register** (69 FR 17117). A notice of correction was published in the **Federal Register** (69 FR 22463) on April 26, 2004. No comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested, and accordingly, no hearing was held. This Treasury decision adopts the language of the proposed regulations with only minor clarifying changes.

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 the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is James M. Gergurich of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

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

PART 1—INCOME TAX

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

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

Par. 2. Section 1.856-9 is added to read as follows:

§1.856-9 Treatment of certain qualified REIT subsidiaries.

(a) *In general.* A qualified REIT subsidiary, even though it is otherwise not treated as a corporation separate from the REIT, is treated as a separate corporation for purposes of:

(1) Federal tax liabilities of the qualified REIT subsidiary with respect to any taxable period for which the qualified REIT subsidiary was treated as a separate corporation.

(2) Federal tax liabilities of any other entity for which the qualified REIT subsidiary is liable.

(3) Refunds or credits of Federal tax.

(b) *Examples.* The following examples illustrate the application of paragraph (a) of this section:

Example 1. X, a calendar year taxpayer, is a domestic corporation 100 percent of the stock of which is acquired by Y, a real estate investment trust, in 2002. X was not a member of a consolidated group at any time during its taxable year ending in December 2001. Consequently, X is treated as a qualified REIT subsidiary under the provisions of section 856(i) for 2002 and later periods. In 2004, the Internal Revenue Service ("IRS") seeks to extend the period of limitations on assessment for X's 2001 taxable year. Because X was treated as a separate corporation for its 2001 taxable year, X is the proper party to sign the consent to extend the period of limitations.

Example 2. The facts are the same as in *Example 1*, except that upon Y's acquisition of X, Y and X jointly elect under section 856(l) to treat X as a taxable REIT subsidiary of Y. In 2003, Y and X jointly revoke that election. Consequently, X is treated as a qualified REIT subsidiary under the provisions of section 856(i) for 2003 and later periods. In 2004, the IRS determines that X miscalculated and underreported its income tax liability for 2001. Because X was treated as a separate corporation for its 2001 taxable year, the deficiency may be assessed against X and, in the event that X fails to pay the liability after notice and demand, a general tax lien will arise against all of X's property and rights to property.

Example 3. X is a qualified REIT subsidiary of Y under the provisions of section 856(i). In 2001, Z, a domestic corporation that reports its taxes on a calendar year basis, merges into X in a state law merger. Z was not a member of a consolidated group at any time during its taxable year ending in December 2000. Under the applicable state law, X is the successor to Z and is liable for all of Z's debts. In 2004, the IRS seeks to extend the period of limitations on assessment for Z's 2000 taxable year. Because X is the

successor to Z and is liable for Z's 2000 taxes that remain unpaid, X is the proper party to sign the consent to extend the period of limitations.

(c) *Effective date.* This section applies on or after April 1, 2004.

Par. 3. Section 1.1361-4 is amended as follows:

1. In paragraph (a)(1) introductory text, the first sentence is amended by removing the language "paragraph (a)(3)" and adding "paragraphs (a)(3) and (a)(6)" in its place.

2. Paragraph (a)(6) is added.

The additions read as follows:

§1.1361-4 Effect of Qsub election.

(a) * * *

(6) *Treatment of certain QSubs—(i) In general.* A QSub, even though it is generally not treated as a corporation separate from the S corporation, is treated as a separate corporation for purposes of:

(A) Federal tax liabilities of the QSub with respect to any taxable period for which the QSub was treated as a separate corporation.

(B) Federal tax liabilities of any other entity for which the QSub is liable.

(C) Refunds or credits of Federal tax.

(ii) *Examples.* The following examples illustrate the application of paragraph (a)(6)(i) of this section:

Example 1. X has owned all of the outstanding stock of Y, a domestic corporation that reports its taxes on a calendar year basis, since 2001. X and Y do not report their taxes on a consolidated basis. For 2003, X makes a timely S election and simultaneously makes a QSub election for Y. In 2004, the Internal Revenue Service ("IRS") seeks to extend the period of limitations on assessment for Y's 2001 taxable year. Because Y was treated as a separate corporation for its 2001 taxable year, Y is the proper party to sign the consent to extend the period of limitations.

Example 2. The facts are the same as in *Example 1*, except that in 2004, the IRS determines that Y miscalculated and underreported its income tax liability for 2001. Because Y was treated as a separate corporation for its 2001 taxable year, the deficiency for Y's 2001 taxable year may be assessed against Y and, in the event that Y fails to pay the liability after notice and demand, a general tax lien will arise against all of Y's property and rights to property.

Example 3. X is a QSub of Y. In 2001, Z, a domestic corporation that reports its taxes on a calendar year basis, merges into X in a state law merger. Z was not a member of a consolidated group at any time during its taxable year ending in December 2000. Under the applicable state law, X is the successor to Z and

is liable for all of Z's debts. In 2003, the IRS seeks to extend the period of limitations on assessment for Z's 2000 taxable year. Because X is the successor to Z and is liable for Z's 2000 taxes that remain unpaid, X is the proper party to execute the consent to extend the period of limitations on assessment.

(iii) *Effective date.* This paragraph (a)(6) applies on or after April 1, 2004.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read, in part, as follows:

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

Par. 5. Section 301.7701-2 is amended as follows:

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

2. Paragraph (e) is revised.

The addition and revision read as follows:

§301.7701-2 Business entities; definitions.

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(c) * * *

(2) * * *

(iii) *Tax liabilities of certain disregarded entities—(A) In general.* An entity that is otherwise disregarded as separate from its owner is treated as an entity separate from its owner for purposes of:

(1) Federal tax liabilities of the entity with respect to any taxable period for which the entity was not disregarded.

(2) Federal tax liabilities of any other entity for which the entity is liable.

(3) Refunds or credits of Federal tax.

(B) *Examples.* The following examples illustrate the application of paragraph (c)(2)(iii)(A) of this section:

Example 1. In 2001, X, a domestic corporation that reports its taxes on a calendar year basis, merges into Z, a domestic LLC wholly owned by Y that is disregarded as an entity separate from Y, in a state law merger. X was not a member of a consolidated group at any time during its taxable year ending in December 2000. Under the applicable state law, Z is the successor to X and is liable for all of X's debts. In 2004, the Internal Revenue Service ("IRS") seeks to extend the period of limitations on assessment for X's 2000 taxable year. Because Z is the successor to X and is liable for X's 2000 taxes that remain unpaid, Z is the proper party to sign the consent to extend the period of limitations.

Example 2. The facts are the same as in *Example 1*, except that in 2002, the IRS determines that X mis-

calculated and underreported its income tax liability for 2000. Because Z is the successor to X and is liable for X's 2000 taxes that remain unpaid, the deficiency may be assessed against Z and, in the event that Z fails to pay the liability after notice and demand, a general tax lien will arise against all of Z's property and rights to property.

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(e) *Effective date.* (1) Except as otherwise provided in this paragraph (e), the rules of this section apply as of January 1, 1997, except that paragraph (b)(6) of this section applies on or after January 14, 2002, to a business entity wholly owned by a foreign government regardless of any prior entity classification, and paragraph (c)(2)(ii) of this section applies to taxable years beginning after January 12, 2001. 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.

(2) Paragraph (c)(2)(iii) of this section applies on or after April 1, 2004.

Mark E. Matthews,
Deputy Commissioner for
Services and Enforcement.

Approved February 15, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 24, 2005, 8:45 a.m., and published in the issue of the Federal Register for February 25, 2005, 70 F.R. 9220)