

Section 444.—Election of Taxable Year Other Than Required Taxable Year

26 CFR 1.444-4T: Tiered structure (temporary).

T.D. 8915

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Tiered Structures-Electing Small Business Trusts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations amending the temporary regulations under section 444 of the Internal Revenue Code (Code) relating to the election of a taxable year other than the required taxable year. The temporary regulations provide that solely with respect to an S corporation shareholder, an electing small business trust (ESBT) and a trust that is described in section 401(a) or section 501(c)(3) and is exempt from taxation under section 501(a) is not a deferral entity for purposes of §1.444-2T. The temporary regulations affect S corporations, ESBTs that own S corporation stock, and trusts that are described in section 401(a) or section 501(c)(3) and exempt from taxation under section 501(a) that own S corporation stock. The text of these temporary regulations serves as the text of the proposed regulations set forth in the notice of proposed rulemaking in REG-251701-96, page 396.

DATES: *Effective Date:* These regulations are effective December 29, 2000.

Applicability Dates: For dates of applicability, see §1.444-4T of these regulations.

FOR FURTHER INFORMATION CONTACT: Bradford Poston and James A. Quinn (202) 622-3060 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) relating to the election of a taxable year other than the required taxable year under section 444. Section 444(d)(3) and §1.444-2T generally prohibit an S corporation that is a member of a tiered structure from making an election under section 444 for taxable years beginning after December 31, 1986. An S corporation is considered to be a member of a tiered structure if the S corporation owns any portion of a deferral entity, or a deferral entity owns any portion of an S corporation. Section 1.444-2T(b)(2) defines deferral entity to include any entity that is a trust with the exception of certain grantor trusts (including qualified subchapter S trusts within the meaning of section 1361(d)(1)(A)).

Section 1302 of the Small Business Job Protection Act of 1996, Public Law 104-188 (110 Stat. 1755) (August 20, 1996), modified sections 641 and 1361 of the Internal Revenue Code (Code) to permit an electing small business trust (ESBT) to be an S corporation shareholder and also modified section 1361 to allow an organization (including a trust) that is described in section 401(a) or section 501(c)(3) and that is exempt from taxation under section 501(a) to be a shareholder of an S corporation. The temporary regulations under section 444 are also being issued as proposed regulations (REG-251701-96) on page 396 of this Bulletin.

Explanation of Provisions

The temporary regulations modify the temporary regulations under section 444 to provide that an ESBT and a trust that is described in section 401(a) or section 501(c)(3) that is exempt from taxation under section 501(a) is not a deferral entity for purposes of §1.444-2T. Therefore, an S corporation with a section 444 election may have an ESBT or a trust that is described in section 401(a) or section 501(c)(3) that is exempt from taxation under section 501(a) as a shareholder. An ESBT is not a deferral entity within the

meaning of §1.444-2T because under section 641(c) the portion of the ESBT consisting of stock in one or more S corporations is taxed to the deemed owner under subpart E, part I, subchapter J of the Code or is subject to taxation at the trust level without a deduction for amounts distributed or required to be distributed from that portion of the trust. A trust described in section 401(a) (other than an employee stock ownership plan described in section 4975(e)(7)), or a trust described in section 501(c)(3) that is exempt from taxation under section 501(a) is not a deferral entity within the meaning of §1.444-2T because with respect to such trust all items of income, loss, or deduction taken into account under section 1366(a) and any gain or loss on the disposition of the stock in the S corporation is treated as unrelated business taxable income of such trust under section 512(e)(1) and is subject to taxation under section 511. A trust described in section 401(a) that is an employee stock ownership plan described in section 4975(e)(7) is not a deferral entity within the meaning of §1.444-2T because such trust does not defer taxation but rather is exempt from taxation under section 501(a) and is not treated as having unrelated business taxable income pursuant to section 512(e)(3). The temporary regulations are effective as of December 29, 2000. However taxpayers may voluntarily apply these temporary regulations to taxable years of S corporations beginning after December 31, 1996, for S corporations that have ESBTs as shareholders, and for taxable years beginning after December 31, 1997, for S corporations that have trusts described in section 401(a) or section 501(c)(3) that are exempt from taxation under section 501(a) as shareholders.

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 regula-

tions, 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, these temporary regulations will be submitted to the Small Business Administration for comment on the regulation's impact on small business.

Drafting Information

The principal authors of these regulations are Bradford Poston and James A. Quinn of the Office of the Associate Chief Counsel (Passthroughs and 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 part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.444-4T is also issued under 26 U.S.C. 444(g). * * *

Par. 2. Section 1.444-4T is added under the undesignated centerheading "Accounting Periods" to read as follows:

§1.444-4T Tiered structure (temporary).

(a) *Electing small business trusts.* For purposes of §1.444-2T, solely with respect to an S corporation shareholder, the term *deferral entity* does not include a trust that is treated as an electing small business trust under section 1361(e). An S corporation with an electing small business trust as a shareholder may make an election under section 444. This paragraph (a) is applicable beginning December 29, 2000, however taxpayers may voluntarily apply it to taxable years of S corporations beginning after December 31, 1996.

(b) *Certain tax-exempt trusts.* For purposes of §1.444-2T, solely with respect to an S corporation shareholder, the term *deferral entity* does not include a trust that is described in section 401(a) or section 501(c)(3) that is exempt from taxation under section 501(a). An S corporation

with a trust that is described in section 401(a) or section 501(c)(3) that is exempt from taxation under section 501(a) as a shareholder may make an election under section 444. This paragraph (b) is applicable beginning December 29, 2000, however taxpayers may voluntarily apply it to taxable years of S corporations beginning after December 31, 1997.

Robert E. Wenzel,
*Deputy Commissioner
of Internal Revenue.*

Approved December 13, 2000.

Jonathan Talisman,
*Acting Assistant Secretary
of the Treasury.*

(Filed by the Office of the Federal Register on December 28, 2000, 8:45 a.m., and published in the issue of the Federal Register for December 29, 2000, 65 F.R. 82926)