

Inadvertent Invalid S Elections and Late S Elections

Announcement 97-4

This announcement informs taxpayers of a recently enacted Internal Revenue Code provision that allows the Internal Revenue Service (IRS) to treat a late subchapter S election as timely made and to waive the defects in an inadvertent invalid S election.

Section 1305 of the Small Business Job Protection Act, Pub. L. No. 104-188, 110 Stat. 1755, enacted August 20, 1996, amends §§ 1362(b) and (f) of the

Internal Revenue Code, effective for taxable years beginning after December 31, 1982.

I. LATE SUBCHAPTER S ELECTIONS

A small business corporation must elect to be an S corporation no later than the 15th day of the third month of the taxable year for which the election is effective. Under prior law, the IRS did not have the authority to validate a late election.

New § 1362(b)(5) of the Code allows the Secretary to treat an election to be an S corporation as timely filed if either the election is made after the date prescribed or no such election was made, provided the Secretary determines there was reasonable cause for the failure to timely file the S election.

Generally, in order to obtain relief under § 1362(b)(5) of the Code, a taxpayer must receive a private letter ruling from the IRS. The procedural requirements for requesting a ruling are described in Revenue Procedure 97-1, 1997-1 I.R.B.

However, a special transition rule for seeking relief under § 1362(b)(5) is provided for untimely S corporation elections made for a taxable year beginning in 1996. Under this rule, taxpayers who did not file an S corporation election in a timely fashion for the 1996 taxable year may seek relief under § 1362(b)(5) of the Code by submitting on or before February 15, 1997, an S corporation election to the applicable service center as well as a letter explaining the reasonable cause for the untimely S corporation election.

Any taxpayer who is not eligible for the relief under the special transition rule described above may request relief by applying for a private letter ruling.

II. INADVERTENT INVALID S CORPORATION ELECTIONS

Under prior law, if the IRS determined that a corporation's subchapter S election was inadvertently terminated, the IRS could waive the effect of the terminating event for any period if the corporation timely corrected the event and if the shareholders agreed to be treated as if the election had been in effect for that period. Such waivers generally are obtained through the issuance of a private letter ruling. Prior law did not grant the IRS the ability to waive the effect of an inadvertent invalid subchapter S election.

New § 1362(f) of the Code applies the inadvertent termination relief rules in situations where an election by a corporation to be treated as a small business corporation was invalid due to a failure to meet the requirements of an S corporation found in § 1361(b) or to obtain all of the shareholder consents.

Generally, in order to obtain relief for inadvertent invalid elections, the corporation must request a private letter ruling from the IRS. Sections 1.1362-4(c) through (f) of the Income Tax Regulations provide rules for corporations requesting inadvertent termination relief under § 1362(f). These rules will also apply to corporations requesting inadvertent invalid election relief.

In situations where taxpayers fail to obtain all of the necessary shareholder consents on Form 2553, section 1.1362-6(b)(3)(iii) provides rules for obtaining § 1362(f) relief from the district director or director of the service center with which the corporation files its income tax return.

III. PAPERWORK REDUCTION ACT

The collection of information contained in this announcement has 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 1545-1524.

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.

The collection of information in this announcement is in part I. LATE SUBCHAPTER S ELECTIONS. This information is required to be submitted to the applicable service center in order to obtain late S corporation election relief. This information will be used to determine if the reasonable cause requirement in § 1362(b)(5) has been met. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 800 hours.

The estimated annual burden per respondent is 1 hour. The estimated number of respondents is 800.

This announcement provides for a

single response that must be completed by February 15, 1997.

Books or records relating to a 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.

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World Wide Web (http://www.irs.ustreas.gov) or by modem directly to 703-321-8020 (not a toll-free number). You may also order Form 8832 by calling 1-800-TAX-FORM (1-800-829-3676).