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Part I

Section 1361(b).—Small business corporation

26 CFR 1.1362-6: Elections and consents

(Also: Sections 7701, 301.7701-1, 301.7701-2, 301.7701-3)

Rev. Rul. 2009-15

ISSUE

In Situations 1 and 2 below, when an unincorporated entity taxed as a partnership becomes a corporation for federal tax purposes, is the corporation eligible to elect to be taxed as an S corporation effective its first taxable year?

FACTS

Situation 1

On January 1, 2009, X, a calendar year taxpayer, is organized in State as an unincorporated entity that is classified as a partnership for federal tax purposes. X elects under § 301.7701-3(c)(1)(i) of the Procedure and Administrative Regulations to be treated as an association for federal tax purposes, effective January 1, 2010. On

February 1, 2010, X files an election under section 1362(a) of the Internal Revenue Code to be taxed as an S corporation, effective January 1, 2010. There is no person who held stock in X on January 1, 2010, who does not hold stock at the time the election is made.

### Situation 2

On January 1, 2009, Y, a calendar year taxpayer, is organized in State as an unincorporated entity that is classified as a partnership for federal tax purposes. Y converts into a corporation under a state law formless conversion statute, effective January 1, 2010. As a result of the conversion, Y is classified as a corporation for federal tax purposes. On February 1, 2010, Y files an election under section 1362(a) to be taxed as an S corporation, effective January 1, 2010. There is no person who held stock in Y on January 1, 2010, who does not hold stock at the time the election is made.

### LAW

Section 1361(a)(1) provides that the term “S corporation” means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for that year.

Section 1361(b)(1)(B) provides that an S corporation cannot have as a shareholder a person (other than an estate, a trust described in section 1361(c)(2), or an organization described in section 1361(c)(6)) that is not an individual.

Section 1362(a) provides that a small business corporation may elect to be an S corporation.

Section 1362(b)(1) provides that a small business corporation may make an election to be treated as an S corporation for any taxable year (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the third month of the taxable year.

Section 1.1362-6(a)(2)(ii)(B) of the Income Tax Regulations provides that a timely election made by a small business corporation during the taxable year for which it is intended to be effective is nonetheless treated as made for the following taxable year if (1) the corporation is not a small business corporation during the entire portion of the taxable year that occurs before the date the election is made; or (2) any person who held stock in the corporation at any time during the portion of the taxable year that occurs before the time the election is made, and who does not hold stock at the time the election is made, does not consent to the election.

Section 7701(a)(2) provides that the term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation.

Section 7701(a)(3) provides that the term “corporation” includes associations, joint-stock companies, and insurance companies.

Section 301.7701-2(b)(1) defines the term “corporation” to include a business entity organized under a federal or state statute, or under a statute of a federally recognized Indian tribe, if the statute describes or refers to the entity as incorporated or as a corporation, body corporate, or body politic.

Section 301.7701-3(a) provides that a business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7) or (8) (an eligible entity), can elect its classification for federal tax purposes.

Section 301.7701-3(g)(1)(i) provides that, if an eligible entity classified as a partnership elects under § 301.7701-3(c)(1)(i) 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.

Section 301.7701-3(g)(3)(i) provides that an election under § 301.7701-3(c)(1)(i) 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 § 301.7701-3(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 § 301.7701-3(g)(1)(ii) (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.

Rev. Rul. 2004-59, 2004-1 C.B. 1050, explains the federal tax consequences where an unincorporated entity classified as a partnership for federal tax purposes

converts into a state law corporation under a state law formless conversion statute. Rev. Rul. 2004-59 concludes that for federal tax purposes, an unincorporated entity classified as a partnership that converts to a corporation under a state law formless conversion statute will be treated in the same manner as one that makes an election to be classified as an association under § 301.7701-3(c)(1)(i).

## ANALYSIS

### Situation 1

When X, an entity classified as a partnership for federal tax purposes, elects under § 301.7701-3(c)(1)(i) to be classified as an association for federal tax purposes, the following steps are deemed to occur: X contributes all of its assets and liabilities to the association in exchange for stock in the association, and immediately thereafter X liquidates by distributing the stock of the association to its partners. Under § 301.7701-3(g)(3)(i), these deemed steps are treated as occurring immediately before the close of the day before the election is effective. Thus, the partnership's taxable year ends on December 31, 2009, and the association's first taxable year begins on January 1, 2010. Therefore, the partnership will not be deemed to own the stock of the association during any portion of the association's first taxable year beginning January 1, 2010, and X is eligible to elect to be an S corporation effective January 1, 2010. Additionally, because the partnership's taxable year ends immediately before the close of the day on December 31, 2009, and the association's first taxable year begins at the start of the day on January 1, 2010, the deemed steps will not cause X to have an intervening short taxable year in which it was a C corporation.

## Situation 2

Rev. Rul. 2004-59 provides that the conversion of a partnership into a state law corporation under a state law formless conversion statute is treated in the same manner as if the entity had made an election to be treated as an association under § 301.7701-3(c)(1)(i). Therefore, Y is deemed to contribute all of its assets and liabilities to the corporation in exchange for stock in the corporation, and immediately thereafter Y liquidates by distributing the stock of the corporation to its partners. As in Situation 1, the partnership will not be deemed to own the stock of the corporation during any portion of the corporation's first taxable year beginning January 1, 2010, and Y is eligible to elect to be an S corporation effective January 1, 2010. Additionally, because the partnership's taxable year ends immediately before the close of the day on December 31, 2009, and the corporation's first taxable year begins at the start of the day on January 1, 2010, the deemed steps will not cause Y to have an intervening short taxable year in which it was a C corporation.

## HOLDINGS

In Situations 1 and 2, when an unincorporated entity taxed as a partnership becomes a corporation for federal tax purposes, the corporation is eligible to elect to be taxed as an S corporation effective its first taxable year. Additionally, the corporation will not be deemed to have an intervening short taxable year in which it was a C corporation.

## DRAFTING INFORMATION

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