

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, § 1361; 1.1361-1.)

Rev. Proc. 98-23

SECTION 1. PURPOSE

This revenue procedure provides guidance on (1) the conversion of a qualified subchapter S trust (QSST) to an electing small business trust (ESBT), and (2) the conversion of an ESBT to a QSST.

SECTION 2. BACKGROUND

Section 1361(a)(1) of the Internal Revenue Code defines an "S corporation", with respect to any taxable year, as a small business corporation for which an S election is in effect for that year.

Section 1361(b) defines "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not have (A) more than 75 shareholders, (B) as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) a nonresident alien as a shareholder, and (D) more than one class of stock.

Section 1361(d)(1)(A) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust will be treated as a trust described in

§ 1361(c)(2)(A)(i) (relating to trusts that may be shareholders of a small business corporation under § 1361(b)(1)).

Section 1361(d)(2)(C) provides that a QSST election under § 1361(d), once made, may be revoked only with the consent of the Secretary.

Section 1361(c)(2)(A)(v) provides that an ESBT (as defined in § 1361(e)) is a permitted S corporation shareholder.

Section 1361(e)(1)(B) provides that the term ESBT does not include any QSST if an election under § 1361(d)(2) applies to any corporation the stock of which is held by the trust.

Section 1361(e)(3) provides that an ESBT election under § 1361(e) applies to the taxable year of the trust for which made and all subsequent taxable years of the trust unless revoked with the consent of the Secretary.

Section 1377(a) provides rules for determining a shareholder's pro rata share of any item for any taxable year.

SECTION 3. SCOPE

Section 4 of this revenue procedure provides guidance on how to convert a QSST to an ESBT. Section 5 of this revenue procedure provides guidance on how to convert an ESBT to a QSST. A trust that wishes to convert within 36 months of a previous conversion must submit an application for consent to revoke the QSST or ESBT election to the Internal Revenue Service in the form of a letter ruling request under Rev. Proc. 98-1, 1998-1 I.R.B. 7 (or its successor). The application must be signed by the current income beneficiary and the trustee.

This revenue procedure does not provide guidance on whether a trust qualifies as a QSST or an ESBT. In particular, the Internal Revenue Service is currently studying whether a trust qualifies as an ESBT if any portion of the trust is treated as owned by the grantor or another person under the provisions of subpart E (section 671 and following), part I, subchapter J, chapter 1 of the Internal Revenue Code.

SECTION 4. CONVERSION OF A QSST TO AN ESBT

.01 Prerequisites for Conversion from QSST to ESBT. A trust is eligible to convert from a QSST to an ESBT if it meets the following requirements:

(1) The trust meets all of the requirements to be an ESBT under § 1361(e), except for the requirement under § 1361(e)(1)(B) that the trust not have a QSST election in place under § 1361(d)(2).

(2) The trustee and the current income beneficiary of the trust make the ESBT election pursuant to section 4.02 of this revenue procedure with respect to the stock of each S corporation held by the trust.

(3) The trust has not converted from an ESBT to a QSST within the 36 month period preceding the effective date of the new ESBT election.

(4) Except as provided in section 6 of this revenue procedure, the date on which the ESBT election is to be effective can not be more than 15 days and 2 months prior to the date on which the election is filed and can not be more than 12 months

after the date on which the election is filed. If an election specifies an effective date more than 15 days and 2 months prior to the date on which the election is filed, it will be effective 15 days and 2 months prior to the date on which it is filed. If an election specifies an effective date more than 12 months after the date on which the election is filed, it will be effective 12 months after the date it was filed.

.02 Procedural Requirements for Conversion from QSST to ESBT.

The current income beneficiary and the trustee of the trust must sign an ESBT election and file it with the service center where the S corporation files its income tax return. This ESBT election must state at the top of the document "ATTENTION ENTITY CONTROL - CONVERSION OF A QSST TO AN ESBT PURSUANT TO REV. PROC. 98-23" and include all information otherwise required for an ESBT election (see Notice 97-12, 1997-3 I.R.B. 11). A separate election must be made with respect to the stock of each S corporation held by the trust.

.03 Conversion from QSST to ESBT.

Pursuant to § 1361(d)(2)(C), the consent of the Commissioner to revoke a QSST election as of the effective date of the ESBT election is hereby granted to any QSST that satisfies the requirements of sections 4.01 and 4.02 of this revenue procedure. For purposes of § 1377(a), the QSST will be treated as terminating its interest in the S corporation and the new ESBT will be treated as a new shareholder of the S corporation. The last day the QSST will be a shareholder is the day before the

effective date of the ESBT election, and the new ESBT will be a shareholder beginning on the effective date of the ESBT election.

SECTION 5. CONVERSION OF AN ESBT TO A QSST

.01 Prerequisites for Conversion from ESBT to QSST. A trust is eligible to convert from an ESBT to a QSST if it meets the following requirements:

(1) The trust meets all of the requirements to be a QSST under § 1361(d).

(2) The trustee and current income beneficiary of the trust make the QSST election pursuant to section 5.02 of this revenue procedure with respect to the stock of each S corporation held by the trust.

(3) The trust has not converted from a QSST to an ESBT within the 36 month period preceding the effective date of the new QSST election.

(4) Except as provided in section 6 of this revenue procedure, the date on which the QSST election is to be effective can not be more than 15 days and 2 months prior to the date on which the election is filed and can not be more than 12 months after the date on which the election is filed. If an election specifies an effective date more than 15 days and 2 months prior to the date on which the election is filed, it will be effective 15 days and 2 months prior to the date on which it is filed. If an election specifies an effective date more than 12 months after the date on which the election is filed, it will be effective 12 months after the date it was filed.

.02 Procedural Requirements for Conversion from ESBT to QSST.

The current income beneficiary and the trustee of the trust must sign a QSST election and file it with the service center where the S corporation files its income tax return. This QSST election must state at the top of the document "ATTENTION ENTITY CONTROL - CONVERSION OF AN ESBT TO A QSST PURSUANT TO REV. PROC. 98-23" and include all information otherwise required for a QSST election (see § 1.1361-1(j)(6) of the Income Tax Regulations). A separate election must be made with respect to the stock of each S corporation held by the trust.

.03 Conversion from ESBT to QSST.

Pursuant to § 1361(e)(3), the consent of the Commissioner to revoke an ESBT election as of the effective date of the QSST election is hereby granted to any ESBT that satisfies the requirements of sections 5.01 and 5.02 of this revenue procedure. For purposes of § 1377(a), the ESBT will be treated as terminating its interest in the S corporation and the new QSST will be treated as a new shareholder of the S corporation. The last day the ESBT will be a shareholder is the day before the effective date of the QSST election, and the new QSST will be a shareholder beginning on the effective date of the QSST election.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 1996. An election can be made effective as of any date on or after January 1, 1997, and before

March 9, 1998, if it is filed not more than 15 days and 2 months after March 9, 1998.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure 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 1545-1591.

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 collections of information in this revenue procedure are in sections 4.02 and 5.02. This information is required by the Internal Revenue Service to assure compliance with the new provisions of the Small Business Job Protection Act of 1996. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 2500 hours.

The estimated average annual burden per respondent is one hour. The estimated number of respondents is 2500.

The estimated frequency of responses is once.

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.

DRAFTING INFORMATION

The principal author of this revenue procedure is Steven R. Schneider of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Steven R. Schneider at (202) 622-3060 (not a toll-free call).