

My Dog Ate the S Election, Now What?

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Overview

To qualify as an S Corporation for the current tax year, a corporation must make an election: (1) at any time during the entity's preceding tax year; or (2) at any time before the 15th day of the 3rd month of the current tax year. If a corporation fails to make a timely election, it is considered a "late S election" and it will not qualify as an S Corporation for the intended tax year.

The consequences of a late S election or failing to file an S election can be severe. First, the corporation will be taxed as a C Corporation and subject to corporate income taxes. Second, the corporation may be subject to late filing and payment penalties, and interest on unpaid taxes. Finally, if the corporation filed IRS Forms 1120S as if it were an S Corporation, then all prior tax years would be subject to IRS examination because the tax years remain open.

Prior Revenue Procedures

In 1996, Congress recognized the failure to timely file an S election could lead to severe consequences and gave the IRS authority to issue rules providing relief for late S elections. In 1997, the IRS issued Rev. Proc. 97-40 and Rev. Proc. 97-48. In later years, the IRS expanded late filing relief in Rev. Proc. 98-55, Rev. Proc. 2003-43, Rev. Proc. 2004-48, and Rev. Proc. 2007-62.

Generally, these Revenue Procedures applied to late S corporation, Electing Small Business Trust, Qualified Subchapter S Trust, and Qualified Subchapter S Subsidiary elections. The requirements were fairly straightforward and each subsequent Revenue Procedure expanded the leniency for late elections.

Rev. Proc. 2013-30

Effective September 3, 2013, Rev. Proc. 2013-30 simplifies how to obtain late filing relief and increases the time period for which retroactive relief may be obtained.

Pursuant to Rev. Proc. 2013-30, the time period for which retroactive relief may be obtained for late S elections is extended to 3 years and 75 days after the intended effective date of the S election. Revenue Procedure 2013-30 also provides similar relief for late:

Qualified Subchapter S Trust elections;
Electing Small Business Trust elections;
Subchapter S Subsidiary elections; and
Corporate classification elections.

The requirements for relief in these situations are similar to the requirements discussed below for late S elections. However, there are some differences. If you are faced with any of these late filings, a careful review of Rev. Proc. 2013-30 is required.

Late S Election Relief Requirements

To obtain relief for a late S election, the corporation must file IRS Form 2553 and include at the top of the form "FILED PURSUANT TO REV. PROC. 2013-30." In addition, the following requirements must be satisfied:

1. Late filing is the sole defect;
2. The entity qualified as an S Corporation for the period relief is sought;
3. The entity intended to be an S Corporation;
4. The request for relief is filed within 3 years and 75 days after the intended effective date of the S election;
5. The request for relief contains a statement describing why reasonable cause exists for the late election and the entity acted diligently to correct the mistake upon discovery; and
6. All shareholders reported their income on all affected returns consistent with an S election in effect and statements from all shareholders attesting to this must be attached.

There is also relief available if the request is made more than 3 years and 75 days after the intended effective date of the S election. In such instances, in addition to satisfying the above requirements, the following requirements must be met:

1. At least 6 months have elapsed since the corporation filed its IRS Form 1120S for the first tax year it intended to be an S Corporation;
2. Neither the corporation nor any shareholder was notified by the IRS of any problems regarding S Corporation status within 6 months of the filing of its IRS Form 1120S for the first tax year it intended to be an S Corporation; and
3. The entity is not seeking a late entity classification election (e.g., an LLC that "checks-the-

box” to be taxed as a corporation and then makes an S election).

Reasonable Cause

While most of the requirements are objective in nature, an entity must demonstrate reasonable cause as to why a timely S election was not filed. This is a subjective inquiry.

Historically, the IRS has placed a low threshold on the reasonable cause requirement. Examples of situations where the IRS has found reasonable cause include: (1) the entity’s responsible person failed to file the S election; (2) the entity’s tax professional failed to file the S election; and (3) the entity did not know it needed to affirmatively file an S election.

Prior IRS Forms 1120S

If the corporation has filed all IRS Forms 1120S for tax years it intended to be an S Corporation, IRS Form 2553 requesting late filing relief can be attached to the current tax year’s IRS Form 1120S, provided the forms are filed within 3 years and 75 days from the intended effective date of the S election. An extension of time to file the current tax year’s IRS Form 1120S will not extend the 3 year and 75 day period.

No Prior IRS Forms 1120S Filed

If the corporation has not filed an IRS Form 1120S for the tax year it intended to be the effective date of the S election, then IRS Form 2553 requesting late filing relief may be attached to IRS Form 1120S for the first intended S Corporation tax year, provided:

1. IRS Form 1120S for the intended effective date of the S election must be filed less than 3 years and 75 days from the intended S election date; and
2. All other delinquent IRS Forms 1120S must be filed simultaneously and consistently with the requested relief.

Rev. Proc. 2013-30 greatly expands the situations where late filing relief may be available.

Conclusion

If you discover an S election was not filed or was not timely, there may be hope. If you don’t qualify for assistance under Rev. Proc. 2013-30, relief may still be available through a private letter ruling. This process, however, is time consuming and costly.

They are excellent tools to navigate through Rev. Proc. 2013-30.

The GSB Tax and Benefits Group has significant experience handling S corporation matters. For more information about taxation of S corporations, please contact:

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