

NOTE: This handout is intended only for purposes of facilitating discussion at the interested parties meeting on August 3, 2016.

18 CCR 23038(b)-3 – Amendments – dft4a
(13 Jun 16)

§ 23038(b)-3. Classification of Certain Business Entities

(a) In general. A business entity that is not classified as a corporation under Reg. §23038(b)-2(b)(1), (3), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in Treas. Regs §301.7701-3. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under Reg. §23038(b)-2(b)(2)) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Paragraph (b) of Treas. Regs. §301.7701-3 provides a default classification for an eligible entity that does not make an election. Thus, federal elections are necessary only when an eligible entity chooses to be classified initially as other than the default classification or when an eligible entity chooses to change its classification. An entity whose classification is determined under the default classification retains that classification (regardless of any changes in the members' liability that occurs at any time during the time that the entity's classification is relevant as defined in subsection (d) of this regulation) until the entity makes an election to change that classification under paragraph (c)(1) of Treas. Regs. §301.7701-3. Paragraph (c) of Treas. Regs. §301.7701-3 provides rules for making express elections. Subsection (c) of this regulation provides that for purposes of the taxes imposed by Part 11 of the Revenue and Taxation Code (Corporation Tax Law, commencing with Revenue and Taxation Code section 23001), the classification of an eligible business entity shall be the same as the classification of the entity for federal purposes and that if the separate existence of a business entity is disregarded for federal tax purposes, the separate existence of that business entity shall be disregarded. No separate election is allowed. Subsection (d) of this regulation provides special rules for foreign eligible entities. Subsection (e) of this regulation provides special rules for classifying entities resulting from partnership terminations and divisions under Section 708(b) of the Internal Revenue Code. Subsection (f) (h) of this regulation sets forth the effective date of this regulation and a special rule relating to prior periods.

(b) Classification of eligible entities that do not file an election--(1) Domestic eligible entities. Except as provided in subsection (b)(3) of this regulation, unless the entity elects otherwise, a domestic eligible entity is--

(A) A partnership if it has two or more members; or

(B) Disregarded as an entity separate from its owner if it has a single owner.

(2) Foreign eligible entities--(A) In general. Except as provided in subsection (b)(3) of this regulation, unless the entity elects otherwise, a foreign eligible entity is--

1. A partnership if it has two or more members and at least one member does not have limited liability;

2. An association if all members have limited liability; or

3. Disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.

(B) Definition of limited liability. For purposes of subsection (b)(2)(A) of this regulation, a member of a foreign eligible entity has limited liability if the member has no personal liability for the debts

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of or claims against the entity by reason of being a member. This determination is based solely on the statute or law pursuant to which the entity is organized, except that if the underlying statute or law allows the entity to specify in its organizational documents whether the members will have limited liability, the organizational documents may also be relevant. For purposes of this regulation, a member has personal liability if the creditors of the entity may seek satisfaction of all or any portion of the debts or claims against the entity from the member as such. A member has personal liability for purposes of this subsection even if the member makes an agreement under which another person (whether or not a member of the entity) assumes such liability or agrees to indemnify that member for any such liability.

(3) Federal classification of existing eligible entities. (A) In general. Unless the entity elects otherwise, an eligible entity in existence prior to ~~the effective date of this regulation~~ January 9, 1998, will have the same classification for federal tax purposes that the entity claimed under repealed Treas. Reg. §301.7701-1 through 301.7701-3 as in effect on the date prior to ~~the effective date of this regulation~~ January 9, 1998; except that if an eligible entity with a single owner claimed to be a partnership under those regulations, the entity will be disregarded as an entity separate from its owner under this subsection (b)(3)(A) for federal tax purposes. For special rules regarding the classification of such entities for periods prior to ~~the effective date of this regulation~~ January 9, 1998, see subsection ~~(f)~~(h)(2) of Treas. Reg. §301.7701-3.

(B) Special rules. For purposes of subsection (b)(3)(A) of this regulation, a foreign eligible entity is treated as being in existence prior to ~~the effective date of this regulation~~ January 9, 1998, only if the entity's classification was relevant (as defined in subsection (d) of this regulation) at any time during the sixty months prior to ~~the effective date of this regulation~~ January 9, 1998. If an entity claimed different classifications prior to ~~the effective date of this regulation~~ January 9, 1998, the entity's classification for purposes of subsection (b)(3)(A) of this regulation is the last classification claimed by the entity. If a foreign eligible entity's classification is relevant prior to ~~the effective date of this regulation~~ January 9, 1998, but no California income tax, franchise tax, or information return is filed or the California income tax, franchise tax, or information return does not indicate the classification of the entity, the entity's classification for the period prior to ~~the effective date of this regulation~~ January 9, 1998, is determined under the regulations in effect on the date prior to ~~the effective date of this regulation~~ January 9, 1998.

(4) California classification of existing entities. (A) Notwithstanding subsection (c) of this regulation (related to requirement that an eligible business entity shall be classified or disregarded for tax purposes the same as the entity is classified or disregarded for federal tax purposes), an eligible business entity which, for any income year beginning within the sixty-month period preceding ~~the effective date of this regulation~~ January 9, 1998, was properly classified as an association taxable as a corporation for California income and franchise tax purposes under Revenue and Taxation Code section 23038 and the regulations thereunder, as in effect during such period, shall continue to be classified as an association taxable as a corporation until it irrevocably elects to be classified or disregarded for California income and franchise tax purposes the same as the entity is classified or disregarded for federal tax purposes.

(B) Election to be classified or disregarded the same as federal. 1. Election. An existing eligible business entity that, pursuant to subparagraph (A) of this subsection, is classified as an association taxable as a corporation for California income and franchise tax purposes for taxable or income years beginning on or after January 1, 1997, and, under Treas. Reg. §301.7701-3, is, without election, classified as a partnership or disregarded for federal tax purposes for taxable years beginning on or after January 1, 1997, may elect to be classified as a partnership or disregarded for California income and franchise tax purposes for taxable years beginning on or

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after ~~the effective date of this regulation~~ January 9, 1998, by filing an election to be classified or disregarded the same as the entity is classified or disregarded for federal tax purposes. An election under this subparagraph must be in writing, and will not be accepted unless all the information required by forms and instructions, including the taxpayer identification number of the entity and the information required by Revenue and Taxation Code sections 18633 or 18633.5, as applicable, is provided. See Treas. Reg. §301.6109-1 for rules on applying for and displaying Employer Identification Numbers.

2. Effective date of election. The election shall be effective on the date specified in the written election or on the date filed if no date is specified in the written election. Except with regard to an election filed within 90 days following the date this regulation is filed with the Secretary of State, the effective date specified in the written election can be no more than 90 days prior to the date on which the election is filed and no more than 12 months after the date on which the election is filed. An election filed within 90 days following the date this regulation is filed with the Secretary of State may specify an effective date of January 1, 1997.

3. Irrevocable election. If an eligible entity makes an election under subsection (b)(4)(B) of this regulation to be classified or disregarded the same for California income and franchise tax purposes as the eligible business entity is classified or disregarded for federal tax purposes, the election is irrevocable. However, the Franchise Tax Board, on a showing of fraud, mistake of fact, or other good cause, may permit the entity to rescind its election to be classified or disregarded for California income and franchise tax purposes the same as the entity is classified or disregarded for federal tax purposes.

4. Authorized signatures. An election made under subsection (b)(4)(B) of this regulation must be signed by each member of the electing entity who is an owner at the time the election is filed; or any officer, manager, or member of the electing entity who is authorized (under local law or the entity's organizational documents) to make the election and who represents to having such authorization under penalties of perjury. If an election under paragraph (b)(4)(B) of this regulation is to be effective for any period prior to the time that it is filed, each person who was an owner between the date the election is to be effective and the date the election is filed, and who is not an owner at the time the election is filed, must also sign the election.

(c) Federal tax classification binding for California income and franchise tax purposes. (1) In general. Except as provided in subsection (b)(4) of this regulation, the classification of an eligible business entity for California income and franchise tax purposes shall be the same as the classification of the eligible business entity for federal tax purposes under Treas. Regs. §301.7701-3. The election of an eligible business entity to be classified as an association or a partnership for federal tax purposes shall be binding for California income and franchise tax purposes. Except as provided in subsections (b)(4) and (c)(2) of this regulation, if the separate existence of an eligible business entity is disregarded for federal tax purposes, the separate existence of the eligible business entity shall be disregarded for purposes of Part 10 (Personal Income Tax Law commencing with Revenue and Taxation Code section 17001), Part 10.2 (Administration of Franchise and Income Tax Law commencing with Revenue and Taxation Code section 18401), and Part 11 (Corporation Tax Law commencing with Revenue and Taxation Code section 23001). An election to be disregarded for federal tax purposes shall be binding for purposes of Part 10 (Personal Income Tax Law commencing with Revenue and Taxation Code section 17001), Part 10.2 (Administration of Franchise and Income Tax Law commencing with Revenue and Taxation Code section 18401), and Part 11 (Corporation Tax Law commencing with Revenue and Taxation Code section 23001).

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(2) Disregarded entities. Except as provided in subsection (b)(4) of this regulation, if the separate existence of an eligible business entity is disregarded for federal tax purposes, the separate existence of the eligible business entity will be disregarded for purposes of Part 10 (Personal Income Tax commencing with Revenue and Taxation Code section 17001), Part 10.2 (Administration of Franchise and Income Tax Law commencing with Revenue and Taxation Code section 18401), and Part 11 (Corporation Tax Law commencing with Revenue and Taxation Code section 23001), subject to certain statutory provisions which recognize the existence of otherwise disregarded entities for certain purposes including the tax and fee of a limited liability company under Revenue and Taxation Code sections 17941 and 17942, the return filing requirements of a limited liability company under Revenue and Taxation Code section 18633.5, and the credit limitations of a disregarded entity under Revenue and Taxation Code sections 17039 and 23036.

(3) Notification of federal election. An eligible entity required to file a California income tax, franchise tax, or information return for the taxable year for which an election is made under paragraph (c)(1)(i) of Treas. Reg. §301.7701-3 must attach a copy of its federal Form 8832 (or any successor form) to its California income tax, franchise tax, or information return for that year. If the entity is not required to file a California income tax, franchise tax, or information return for that year, a copy of its federal Form 8832 must be attached to the California income tax, franchise tax, or information return of any direct or indirect owner of the entity for the taxable year of the owner that includes the date on which the election was effective. An indirect owner of the entity does not have to attach a copy of the federal Form 8832 to its return if an entity in which it has an interest is already filing a copy of the federal Form 8832 with its return. If an entity, or one of its direct or indirect owners, fails to attach a copy of a federal Form 8832 to its return as directed in this subsection, an otherwise valid election under paragraph (c)(1)(i) of Treas. Reg. §301.7701-3 will not be invalidated, but the non-filing party may be subject to penalties, including any applicable penalties if the California franchise tax or income tax or information returns are inconsistent with the entity's election under paragraph (c)(1)(i) of Treas. Reg. §301.7701-3.

(d) Special rules for foreign eligible entities--(1) Definition of relevance -- (i) (A) General rule. Definition of relevance. For purposes of this regulation, a foreign eligible entity's classification is relevant when its classification affects the liability of any person for California income tax, franchise tax, or information purposes. For example, a foreign entity's classification would be relevant if California source income was paid to the entity and the determination by the withholding agent of the amount to be withheld under the Revenue and Taxation Code (if any) would vary depending upon whether the entity is classified as a partnership or as an association. Thus, the classification might affect the documentation that the withholding agent must receive from the entity, the type of tax or information return to file, or how the return must be prepared. The date that the classification of a foreign eligible entity is relevant is the date an event occurs that creates an obligation to file a California income tax, franchise tax, or information return, or statement for which the classification of the entity must be determined. Thus, the classification of a foreign entity is relevant, for example, on the date that an interest in the entity is acquired which will require a California person to file an information return.

(ii) (B) Deemed relevance -- (A) (i) General rule. For purposes of this section regulation, except as provided in paragraph subsection (d)(1)(ii)(B)(B)(ii) of this section regulation, the classification for Federal tax California income tax or franchise tax purposes of a foreign eligible entity that files Form 8832, "Entity Classification Election", shall be deemed to be relevant only on the date the entity classification election is effective.

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~~(B) (ii) Exception. If the classification of a foreign eligible entity is relevant within the meaning of paragraph subsection (d)(1)(i)(A) of this section regulation, then the rule in paragraph subsection (d)(1)(i)(A)(B)(i) of this section regulation shall not apply.~~

~~(2) Entities the classification of which has never been relevant. If the classification of a foreign eligible entity has never been relevant (as defined in paragraph subsection (d)(1) of this section regulation), then the entity's classification will initially be determined pursuant to the provisions of paragraph subsection (b)(2) of this section regulation when the classification of the entity first becomes relevant (as defined in paragraph subsection (d)(1)(i)(A) of this section regulation).~~

~~(2) (3) Special rule when classification is no longer relevant. [---] [delete dashes] If the classification of a foreign eligible entity which was previously relevant for California income and franchise tax purposes ceases to be relevant for sixty consecutive months, is not relevant (as defined in paragraph subsection (d)(1) of this section regulation) for 60 consecutive months, then the entity's classification will initially be determined under the default classification pursuant to the provisions of paragraph subsection (b)(2) of this section regulation when the classification of the foreign eligible entity again becomes relevant (as defined in paragraph subsection (d)(1)(i)(A) of this section regulation). The date that the classification of a foreign entity ceases to be is not relevant is the date an event occurs that causes the classification to no longer be relevant, or, if no event occurs in a taxable year that causes the classification to be relevant, then the date is the first day of that taxable year.~~

~~(4) Effective date. Paragraphs Subsections (d)(1)(i)(B), (d)(2), and (d)(3) of this section regulation apply on or after October 22, 2003.~~

~~(e) Coordination with Section 708(b) of the Internal Revenue Code. Except as provided in Reg. §23038(b)-2(d)(3) (regarding termination of grandfather status for certain foreign business entities), an entity resulting from a transaction described in section 708(b)(1)(B) of the Internal Revenue Code (partnership termination due to sales or exchanges) or Section 708(b)(2)(B) of the Internal Revenue Code (partnership division) is a partnership.~~

~~(f) Changes in number of members of an entity -- (1) Associations. The classification of an eligible entity as an association is not affected by any change in the number of members of the entity.~~

~~(2) Partnerships and single member entities. An eligible entity classified as a partnership becomes disregarded as an entity separate from its owner when the entity's membership is reduced to one member.~~

~~A single member entity disregarded as an entity separate from its owner is classified as a partnership when the entity has more than one member. If an elective classification change under paragraph (c) of this section Treas. Regs. § 301.7701-3 is effective at the same time as a membership change described in this paragraph subsection (f)(2), the deemed transactions in paragraph subsection (g) of this section regulation resulting from the elective change preempt the transactions that would result from the change in membership.~~

~~(3) Effect on sixty month limitation. A change in the number of members of an entity does not result in the creation of a new entity for purposes of the sixty month limitation on elections under paragraph (c)(1)(iv) of this section Treas. Regs. § 301.7701-3.~~

~~(4) Examples. The following examples illustrate the application of this paragraph subsection (f):~~

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Example 1. A, a U.S. person, owns a domestic eligible entity that is disregarded as an entity separate from its owner. On January 1, 1998, B, a U.S. person, buys a 50 percent interest in the entity from A. Under this ~~paragraph~~ subsection (f), the entity is classified as a partnership when B acquires an interest in the entity. However, A and B elect to have the entity classified as an association effective on January 1, 1998. Thus, B is treated as buying shares of stock on January 1, 1998. (Under paragraph (c)(1)(iv) of ~~this section~~ Treas. Regs. § 301.7701-3, this election is treated as a change in classification so that the entity generally cannot change its classification by election again during the sixty months succeeding the effective date of the election.) Under ~~paragraph~~ subsection (g)(1) of ~~this section~~ regulation, A is treated as contributing the assets and liabilities of the entity to the newly formed association immediately before the close of December 31, 1997. Because A does not retain control of the association as required by section 351 ~~[26 USCS § 351]~~ of the Internal Revenue Code, A's contribution will be a taxable event. Therefore, under section 1012 ~~[26 USCS § 1012]~~ of the Internal Revenue Code, the association will take a fair market value basis in the assets contributed by A, and A will have a fair market value basis in the stock received. A will have no additional gain upon the sale of stock to B, and B will have a cost basis in the stock purchased from A.

Example 2. (i) On April 1, 1998, A and B, U.S. persons, form X, a foreign eligible entity. X is treated as an association under the default provisions of ~~paragraph~~ subsection (b)(2)(i) of ~~this section~~ regulation, and X does not make an election to be classified as a partnership. A subsequently purchases all of B's interest in X.

(ii) Under ~~paragraph~~ subsection (f)(1) of ~~this section~~ regulation, X continues to be classified as an association. X, however, can subsequently elect to be disregarded as an entity separate from A. The sixty month limitation of paragraph (c)(1)(iv) of ~~this section~~ Treas. Regs. § 301.7701-3 does not prevent X from making an election because X has not made a prior election under paragraph (c)(1)(i) of ~~this section~~ Treas. Regs. § 301.7701-3.

Example 3. (i) On April 1, 1998, A and B, U.S. persons, form X, a foreign eligible entity. X is treated as an association under the default provisions of ~~paragraph~~ subsection (b)(2)(i) of ~~this section~~ regulation, and X does not make an election to be classified as a partnership. On January 1, 1999, X elects to be classified as a partnership effective on that date. Under the sixty month limitation of paragraph (c)(1)(iv) of ~~this section~~ Treas. Regs. § 301.7701-3, X cannot elect to be classified as an association until January 1, 2004 (i.e., sixty months after the effective date of the election to be classified as a partnership).

(ii) On June 1, 2000, A purchases all of B's interest in X. After A's purchase of B's interest, X can no longer be classified as a partnership because X has only one member. Under ~~paragraph~~ subsection (f)(2) of ~~this section~~ regulation, X is disregarded as an entity separate from A when A becomes the only member of X. X, however, is not treated as a new entity for purposes of paragraph (c)(1)(iv) of ~~this section~~ Treas. Regs. § 301.7701-3. As a result, the sixty month limitation of paragraph (c)(1)(iv) of ~~this section~~ Treas. Regs. § 301.7701-3 continues to apply to X, and X cannot elect to be classified as an association until January 1, 2004 (i.e., sixty months after January 1, 1999, the effective date of the election by X to be classified as a partnership).

(5) Effective date. This ~~paragraph~~ subsection (f) applies as of November 29, 1999.

(g) Elective changes in classification -- (1) Deemed treatment of elective change -- (i) (A) Partnership to association. If an eligible entity classified as a partnership elects under paragraph (c)(1)(i) of ~~this section~~ Treas. Regs. § 301.7701-3 to be classified as an association, the following is deemed to occur: The partnership contributes all of its assets and liabilities to the association

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in exchange for stock in the association, and immediately thereafter, the partnership liquidates by distributing the stock of the association to its partners.

(ii) (B) Association to partnership. If an eligible entity classified as an association elects under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 to be classified as a partnership, the following is deemed to occur: The association distributes all of its assets and liabilities to its shareholders in liquidation of the association, and immediately thereafter, the shareholders contribute all of the distributed assets and liabilities to a newly formed partnership.

(iii) (C) Association to disregarded entity. If an eligible entity classified as an association elects under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 to be disregarded as an entity separate from its owner, the following is deemed to occur: The association distributes all of its assets and liabilities to its single owner in liquidation of the association.

(iv) (D) Disregarded entity to an association. If an eligible entity that is disregarded as an entity separate from its owner elects under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 to be classified as an association, the following is deemed to occur: The owner of the eligible entity contributes all of the assets and liabilities of the entity to the association in exchange for stock of the association.

(2) Effect of elective changes -- (i) (A) In general. The tax treatment of a change in the classification of an entity for federal tax purposes by election under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 is determined under all relevant and applicable provisions of the Internal Revenue Code, the California Revenue & Taxation Code, and general principles of tax law, including the step transaction doctrine.

(ii) (B) Adoption of plan of liquidation. For purposes of satisfying the requirement of adoption of a plan of liquidation under section 332 [26 USCS § 332] of the Internal Revenue Code, unless a formal plan of liquidation that contemplates the election to be classified as a partnership or to be disregarded as an entity separate from its owner is adopted on an earlier date, the making, by an association, of an election under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 to be classified as a partnership or to be disregarded as an entity separate from its owner is considered to be the adoption of a plan of liquidation immediately before the deemed liquidation described in paragraph subsection (g)(1)(ii)(B) or (iii) (C) of this section regulation. This paragraph subsection (g)(2)(ii)(B) applies to elections filed on or after December 17, 2001. Taxpayers may apply this paragraph subsection (g)(2)(ii)(B) retroactively to elections filed before December 17, 2001, if the corporate owner claiming treatment under Internal Revenue Code section 332 [26 USCS § 332] and its subsidiary making the election take consistent positions with respect to the federal tax and the California franchise and income tax consequences of the election.

(3) Timing of election -- (i) (A) In general. An election under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 that changes the classification of an eligible entity for federal tax and California franchise and income 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 this paragraph subsection (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 paragraph subsection (g)(1)(ii)(B) of this section regulation (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

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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.

(ii) (B) Coordination with Internal Revenue Code section 338 [26 USCS § 338] election. A purchasing corporation that makes a qualified stock purchase of an eligible entity taxed as a corporation may make an election under section 338 [26 USCS § 338] of the Internal Revenue Code regarding the acquisition if it satisfies the requirements for the election, and may also make an election to change the classification of the target corporation. If a taxpayer makes an election under section Internal Revenue Code 338 [26 USCS § 338] regarding its acquisition of another entity taxable as a corporation and makes an election under paragraph (c) of this section Treas. Regs. § 301.7701-3 for the acquired corporation (effective at the earliest possible date as provided by paragraph (c)(1)(iii) of this section Treas. Regs. § 301.7701-3), the transactions under paragraph subsection (g) of this section regulation are deemed to occur immediately after the deemed asset purchase by the new target corporation under section 338 [26 USCS § 338] of the Internal Revenue Code.

(iii) (C) Application to successive elections in tiered situations. When elections under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 for a series of tiered entities are effective on the same date, the eligible entities may specify the order of the elections on Form 8832. If no order is specified for the elections, any transactions that are deemed to occur in this paragraph subsection (g) as a result of the classification change will be treated as occurring first for the highest tier entity's classification change, then for the next highest tier entity's classification change, and so forth down the chain of entities until all the transactions under this paragraph subsection (g) have occurred. For example, Parent, a corporation, wholly owns all of the interest of an eligible entity classified as an association (S1), which wholly owns another eligible entity classified as an association (S2), which wholly owns another eligible entity classified as an association (S3). Elections under paragraph (c)(1)(i) of this section Treas. Regs. § 301.7701-3 are filed to classify S1, S2, and S3 each as disregarded as an entity separate from its owner effective on the same day. If no order is specified for the elections, the following transactions are deemed to occur under this paragraph subsection (g) as a result of the elections, with each successive transaction occurring on the same day immediately after the preceding transaction S1 is treated as liquidating into Parent, then S2 is treated as liquidating into Parent, and finally S3 is treated as liquidating into Parent.

(4) S corporations. An eligible entity that timely elects to be an S corporation under Internal Revenue Code section 1362(a)(1) [26 USCS § 1362(a)(1)] is treated as having made an election under this section regulation to be classified as an association, provided that (as of the effective date of the election under Internal Revenue Code section 1362(a)(1)) [26 USCS § 1362(a)(1)] the entity meets all other requirements to qualify as a small business corporation under Internal Revenue Code section 1361(b) [26 USCS § 1361(b)]. Subject to Treas. Regs. § 301.7701-3(c)(1)(iv), the deemed election to be classified as an association will apply as of the effective date of the S corporation election and will remain in effect until the entity makes a valid election, under Treas. Regs. § 301.7701-3(c)(1)(i), to be classified as other than an association.

(4) (5) Effective date. Except as otherwise provided in paragraph subsection (g)(2)(ii) of this section regulation, this paragraph subsection (g) applies to elections that are filed on or after November 29, 1999. Taxpayers may apply this paragraph subsection (g) retroactively to elections filed before November 29, 1999 if all taxpayers affected by the deemed transactions file consistently with this paragraph subsection (g).

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~~(f)~~ (h) Effective date--(1) In general. Except as otherwise provided in this section, the rules of this regulation are effective for taxable or income years commencing on or after January 1, 1997.

(2) Prior treatment of existing entities. In the case of a business entity that is not described in Reg. §23038(b)-2(b)(1), (3), (4), (5), (6), or (7), and that was in existence prior to January 1, 1997, the entity's claimed classification(s) will be respected for all periods prior to January 1, 1997, if--

(A) The entity had a reasonable basis (within the meaning of Section 6662 of the Internal Revenue Code) for its claimed classification;

(B) The entity and all members of the entity recognized the California income and franchise tax consequences of any change in the entity's classification within the sixty months prior to January 1, 1997; and

(C) Neither the entity nor any member was notified in writing on or before May 8, 1996, that the classification of the entity was under examination (in which case the entity's classification will be determined in the examination).

(3) Deemed elections for S corporations. Paragraph (c)(1)(v)(C) of this section Treas. Regs. 301.7701-3 Section (g)(4) of this regulation applies to timely S corporation elections under section 1362(a) [26 USCS § 1362(a)] of the Internal Revenue Code filed on or after July 20, 2004. Eligible entities that filed timely S elections before July 20, 2004 may also rely on the provisions of the regulation.