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MAKE SURE TO FILE ENTITY CLASSIFICATION ELECTION IF NON-DEFAULT TAX STATUS DESIRED

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The "check-the-box" regulations promulgated years ago by the U.S. Treasury Department allow an eligible business entity such as a limited liability company ("LLC") to elect its classification for Federal income tax purposes ("Entity Classification Election"). An LLC with a single owner may elect to be taxed either as a corporation or as a disregarded entity in which case its sole owner will be taxable on all income, loss and gains of the LLC. In the absence of such election, the single-member LLC by default will be treated as a disregarded entity for Federal income tax purposes. Thus, an Entity Classification Election is necessary only when the LLC chooses to be classified for tax purposes as something other than its default classification.

The Entity Classification Election is made by filing Form 8832 with the IRS. This election is effective on the date specified in the Form 8832 provided that the date specified is (i) not more than 75 days prior to the date the election is filed, and (ii) not more than 12 months after the election is filed. An Entity Classification Election will not be accepted unless all of the information required by Form 8832 and its instructions is provided.

In a recent Tax Court case, *Heber E. Costello, LLC, et. al. v. Commissioner*, TC Memo 2016-184 (September 29, 2016), a corporation ("Parent Corporation") wholly-owned by an individual ("Taxpayer") formed a wholly-owned limited liability company subsidiary ("Subsidiary"). During all years prior to the formation of the Subsidiary, the Parent Corporation filed Form 1120 (U.S. Corporation Income Tax Return) with the IRS. On the same day the Subsidiary was formed, the Parent Corporation merged with and into the Subsidiary with the Subsidiary being the surviving entity. Since the date of the merger, the Subsidiary has filed Forms 1120 using the Parent Corporation's employer identification number. The IRS accepted and processed the Forms 1120 filed by the Subsidiary; however, the Subsidiary never filed an Entity Classification Election affirmatively electing to be taxed as a corporation.

The issue for the Tax Court to decide was whether the Subsidiary should be treated as a corporation or as a disregarded entity for Federal income tax purposes. The Taxpayer argued that the filing of Form 1120 by the Subsidiary for the first year after its merger with the Parent Corporation constituted a valid election for the Subsidiary to be taxed as a corporation. The Taxpayer further argued that the doctrine of "equitable estoppel" prevented the IRS from contending that the Subsidiary was not a corporation for tax purposes because of the IRS's "tacit acquiescence" to the filings of Forms 1120 for the year of the merger and subsequent years.

The Tax Court noted that an eligible business entity like the Subsidiary may not elect its entity classification for tax purposes by filing any particular tax return it wishes; it must do so by filing Form 8832 and following the instructions for that form. Accordingly, the Tax Court held that the Subsidiary could not elect to be treated as a corporation for tax purposes merely by filing corporate income tax returns. The Tax Court further held that the doctrine of "equitable estoppel" did not bar the IRS from treating the Subsidiary as a disregarded entity. In so holding, the Tax Court noted that the IRS made no false statement to the Taxpayer and that the IRS's lack of rejection of the Subsidiary's Forms 1120 did not constitute a "wrongful misleading silence" on the part of the IRS.

This case illustrates the need to affirmatively and timely file an Entity Classification Election (Form 8288) with the IRS with respect to an eligible non-corporate entity in the event that entity wishes to be classified for tax purposes as something other than its default classification.

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