

IRS Extends Relief for Late “Check-the-Box” Elections

By: **Claire Ollinger, CPA**

A recent Internal Revenue Service (IRS) ruling aims to provide relief to taxpayers who missed check-the-box elections.

On September 3, 2009 the IRS issued Rev. Proc. 2009-41 which provides guidance for an eligible entity that requests relief for a late-filed entity classification election (commonly referred to as a “check-the-box election”) within three years and 75 days of the requested effective date of such election.

The Rev. Proc. supersedes and significantly liberalizes the relief for late-filed entity classification elections that was allowed under Revenue Procedure 2002-59.

Background

IRS regulations provide rules for when a business organization will be treated as a corporation or a pass-through entity for U.S. tax purposes (the so-called default classification rules). An eligible entity may elect to change (or confirm) its classification for tax purposes by filing IRS Form 8832 within 75 days of the desired effective date of the classification.

This election is commonly used, for example, in the structuring of private equity funds and hedge funds where it is desirable that an entity be treated as a corporation under local corporate and tax law but as a pass-through entity for U.S. tax purposes. In many cases, taxpayers who failed to file check-the-box elections for the structure they had implemented faced very negative U.S. tax consequences for their investors.

Old Rules

Under the old rules (Rev. Proc. 2002-59), if a taxpayer realized it had not made a check-the-box election within the 75-day period, it could request relief under a relatively simple procedure by filing the form and attaching a statement explaining that the taxpayer had reasonable cause for not making the election on time. While relief was not automatic, it was generally granted by the IRS. However, in order to be eligible for this simple procedure,

- (a) the election had to be for an entity which was newly formed under local law, and
- (b) the due date for the first federal tax return (excluding extensions) of the entity’s desired classification for the year of the entity’s formation could not have passed.

However, if discovery of the missed filing was made beyond that point, the only available recourse was to file a request for a letter ruling with the IRS. This is a far more complex process which involves an IRS user fee, as well as necessary professional advice and fees. Also, if the corporation was not newly formed, but acquired (as a dormant shell), the only recourse for failing to file within the 75-day period was to file a request for a letter ruling with the IRS.

New Rules

Rev. Proc. 2009-41 supersedes Rev. Proc. 2002-59 by extending late-entity classification relief to both initial classification elections and changes in classification elections. It also extends the time for filing late elections to within three years and 75 days of the requested effective date of the eligible entity’s classification. To be eligible for this relief:

- 1) The entity must have failed to obtain its requested classification solely because Form 8832 was not filed timely under 301.7701-3(c)(1)(iii);
- 2) The entity seeking an extension of time to make the election must have timely filed (within 6 months of its due date excluding extensions) all required U.S. tax and information returns consistent with its requested classification for all of the years the entity intended the requested classification to be effective and no inconsistent returns have been filed by, or with respect to, the entity during any of the tax years;
- 3) The entity has reasonable cause for its failure to timely make the entity classification election; and
- 4) Three years and 75 days from the requested effective date of the entity’s election have not passed.

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Procedural Requirements

Rev. Proc. 2009-41, Section 4.02 contains detailed procedural specifications for requesting relief.

Granting Relief

Upon receiving a completed Form 8832 requesting relief under Rev. Proc. 2009-41, Section 4.01, the IRS will determine whether the requirements for granting the late entity classification election have been satisfied and will notify the entity of the result of its determination. An entity receiving relief under Rev. Proc. 2009-41 is treated as having made a timely election as of the requested effective date of the election.

General Effective Date

Generally, the Rev. Proc. was effective as of September 28, 2009. If an entity had filed a letter ruling request seeking relief for a late filed entity classification election and that letter ruling was pending on September 28, 2009, the entity could have withdrawn the request, and relied on the Rev. Proc. (assuming it meets the requirements). Such entities will receive a refund of the user fee for the letter ruling.



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