

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING 97-41**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether a foreign or a domestic limited liability company classified by the Internal Revenue Service under Treas. Reg. § 301.7701-3 (1997), better known as the “check-the-box” provisions, will be allowed the same classification for Tennessee franchise, excise tax purposes and for Tennessee income tax purposes.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

Under certain circumstances and conditions, the so-called “check-the-box” provisions of Treas. Reg. § 301.7701-3 (1997) permit a limited liability company to elect to be classified and taxed by the Internal Revenue Service as a corporation or as a partnership, or to be disregarded as an entity separate from its owner.

QUESTIONS PRESENTED

1. If a limited liability company makes a valid check-the-box election permitted by Treas. Reg. § 301.7701-3 (1997), will the Tennessee Department of Revenue recognize such election for purposes of the Tennessee franchise, excise tax?

2. If a limited liability company makes a valid check-the-box election permitted by Treas. Reg. § 301.7701-3 (1997), will the Tennessee Department of Revenue recognize such election for purposes of the Tennessee income tax, also known as the Hall income tax?

RULINGS

1. Yes.
2. Yes.

ANALYSIS

Treas. Reg. § 301.7701-3(a) and (b) (1997), set forth in part below, provides as follows with regard to the classification of certain business entities for federal tax purposes:

(a) In general. A business entity that is not classified as a corporation under § 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) (an eligible entity) can elect its classification for federal tax purposes as provided in this section. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under § 301.7701-2(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 this section provides a default classification for an eligible entity that does not make an election.

(b) Classification of eligible entities that do not file an election--

(1) Domestic eligible entities. Except as provided in paragraph (b)(3) of this section, unless the entity elects otherwise, a domestic eligible entity is--

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- (i) A partnership if it has two or more members; or
- (ii) Disregarded as an entity separate from its owner if it has a single owner.

(2) Foreign eligible entities--

(i) In general. Except as provided in paragraph (b)(3) of this section, unless the entity elects otherwise, a foreign eligible entity is--

- (A) A partnership if it has two or more members and at least one member does not have limited liability;
- (B) An association if all members have limited liability; or
- (C) Disregarded as an entity separate from its owner if it has a single owner that does not have limited liability.

T.C.A. § 48-211-101, enacted by the Tennessee legislature in 1994, makes the following provisions concerning the classification of a Limited Liability for Tennessee tax purposes:

For purposes of all state and local Tennessee taxes, a foreign or domestic LLC shall be treated as a partnership or an association taxable as a corporation as such classification is determined for federal income tax purposes. The members of a foreign LLC treated as a partnership are

subject to all state and local Tennessee taxes in the same manner and extent as partners in a foreign partnership. The members of a domestic LLC are subject to all state and local Tennessee taxes in the same manner and extent as partners in a domestic partnership.

Questions involving statutory construction must be answered in the light of reason, keeping in mind the object of the statute. *State v. Williams*, 854 S.W.2d 904 at 908 (Tenn. Cr. App. 1993) citing *State v. Netto*, 486 S.W.2d 725 at 728 (Tenn. 1972). It is an accepted rule of statutory interpretation to presume that, in enacting a provision, the legislature did not intend an absurdity, and that such a result must be avoided, if possible, by reasonable construction of the statute. *State v. Harrison*, 692 S.W.2d 29 at 31 (Tenn. Cr. App. 1985), citing *Epstein v. State*, 366 S.W.2d 914 (Tenn. 1963).

No statutory interpretation will be adopted that defeats the purpose of the law, provided the language of the statute will admit, fairly and rationally, an interpretation which sustains that purpose. 23 Tenn. Juris., *Statutes*, § 36 (1985). In the event a statute is capable of more than one construction, it should be construed so as to effect, rather than defeat, its purpose. *Knox County, ex rel. Kessel v. Personnel Board*, 753 S.W.2d 357 (Tenn. App. 1988) citing *State v. Netto*, 486 S.W.2d 725 (Tenn. 1972).

The obligation to pay taxes arises only by force of legislative action and the nature and extent of that is determined by the legislative meaning. Therefore, all rules of statutory construction are relevant in the interpretation of revenue measures. C. Sands, *Sutherland Statutory Construction* § 66.03 (4th ed. vol. 3 1974). However, the rule of statutory construction to which all others must yield is that the intent of the legislature must prevail. *Southern v. Beeler et al.*, 195 S.W.2d. 857 at 864 (Tenn. 1946).

T.C.A. § 48-211-101 was enacted in 1994 prior to the adoption of Treas. Reg. § 301.7701-3 (1997) and does not specifically address federal income tax classification elections by eligible limited liability companies under the check-the-box provisions nor does it address an election by a limited liability company to be disregarded as an entity separate from its owner. However, a statute need not expressly state what is necessarily implied in order to render it effectual. *Clanton v. Cain-Sloan Co.*, 677 S.W.2d 441 (Tenn. 1984) citing *Firestone Textile Co. v. Meadows*, 666 S.W.2d 730 at 732 (Ky. 1985); Cf. *State ex rel. Branch & Co. v Sinking Fund Com'rs*, 1 Tenn. Cas. (Shannon) 490, 502 (Tenn. 1875).

The apparent legislative intent of T.C.A. § 48-211-101 is to classify limited liability companies for Tennessee state and local tax purposes in the same way that they are classified for federal income tax purposes. To interpret the statute in any other manner would lead to inconsistencies and difficult, if not impossible, compliance problems for both the taxpayer and the Department.

Accordingly, for Tennessee franchise, excise tax purposes and for Tennessee Hall income tax purposes, the Tennessee Department of Revenue will treat a limited liability company

in the same manner as it is classified for federal income tax purposes including federal income tax classifications resulting from elections under the check-the-box provisions of Treas. Reg. § 301.7701-3 (1997).

T.C.A. § 48-203-103 requires limited liability companies formed under Tennessee law to have at least two members. However, in the event a foreign single member limited liability company doing business in Tennessee has made a valid election to be disregarded as an entity separate from its owner under Treas. Reg. § 301.7701-3 (1997) or is so classified by the default provisions, it will be disregarded as an entity separate from its owner for Tennessee franchise, excise tax purposes and for Tennessee Hall income tax purposes. In cases where the single member is a corporation and the limited liability company doing business in Tennessee has been disregarded as an entity separate from its owner, it will be treated as a division of its single corporate member and the corporation will be subject to Tennessee franchise, excise taxes.

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APPROVED: Ruth E. Johnson, Commissioner

DATE: 10-14-97