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## **TAX INFORMATION RELEASE NO. 97-4**

RE: Application of the business entity classification rules under the “check-the-box” regulations to the Hawaii income tax and other taxes.

The purpose of this Tax Information Release is to provide guidance to taxpayers regarding the application of the “check-the-box” regulations pending adoption by the Department of Taxation (“Department”) of its own rules on this subject.

- I. Introduction.
- II. The Department Will Follow IRC Section 7701 Check-The-Box Regulations For Purposes of the Hawaii Income Tax Law (Chapter 235, Hawaii Revised Statutes, (“HRS”)).
  - A. General Rule.
  - B. Attach Copy of Federal Form 8832.
- III. The IRC Section 7701 Check-The-Box Regulations are Applicable to the General Excise Tax Law (Chapter 237, HRS) and Other Gross Receipts and Transaction-Type Hawaii Taxes, But With Modifications for Single-Member Limited Liability Company (“LLC”) Treatment.
  - A. General Rule.
  - B. Treatment of Distributions.
  - C. License and Registration Requirements Applicable at the Entity Level.

### **I. Introduction.**

Final regulations under section 7701 of the Internal Revenue Code of 1986, as amended (“IRC”), implementing an elective regime for classifying business entities, called “check-the-box” regulations, became effective January 1, 1997 (T.D. 8697). A business entity is any entity recognized for federal income tax purposes that is not properly classified as a trust or otherwise subject to special treatment. Treas. Reg. §§ 301.7701-2, 301.7701-3. An eligible entity is any business entity that is not required to be treated as a corporation. Treas. Reg. § 301.7701-3(a). These regulations allow an eligible entity with at least two members to elect its classification for federal income tax purposes either as an association taxable as a corporation or as a partnership. *Id.*

The regulations further provide that a business entity with only a single owner can elect to be classified as a corporation or disregarded as an entity separate from its owner. *Id.* If the business entity does not elect to be treated as a corporation and is disregarded, its activities are treated in the same manner as a sole proprietorship or a branch for federal income tax purposes. Treas. Reg. §§ 301.7701-1(a)(4), 301.7701-2, and 301.7701-3.

Default classification rules provide most eligible entities with the entity classification they would choose without filing an election. An eligible entity coming into existence on January 1, 1997, or later, may affirmatively elect its classification or change its classification by filing federal Form 8832 (Entity Classification Election) with the Internal Revenue Service. Treas. Reg. § 301.7701-3(a). Unless the entity elects otherwise, an eligible entity in existence before January 1, 1997, will continue the same classification claimed before January 1, 1997, except for entities subject to existing entity-special classification rules. Treas. Reg. §§ 301.7701-3(b)(3), and 301.7701-3(f)(2).

## **II. The Department Will Follow IRC Section 7701 Check-The-Box Regulations For Purposes of the Hawaii Income Tax Law (Chapter 235, HRS).**

### **A. General Rule.**

The Department will follow the check-the-box regulations for purposes of the Hawaii income tax law under Chapter 235, HRS. Each entity, entity owner, or other appropriate person specified under the check-the-box regulations that is responsible for filing a return is required to file a Hawaii return consistent with the federal classification effective as of January 1, 1997. If an entity is classified either as a partnership or as a corporation for federal income tax purposes, the same classification applies for Hawaii income tax purposes, regardless of whether the classification is by default or election. If a single-member entity is disregarded as an entity separate from its owner for federal income tax purposes, the entity is also disregarded for Hawaii income tax purposes.

### **B. Attach Copy of Federal Form 8832.**

An entity that elects its classification by filing Form 8832 with the IRS shall attach a copy of that Form to the entity's Hawaii income tax or information return covering the first taxable year in which the entity carries on business in Hawaii, derives income from sources in Hawaii, or makes distributions that are received by a pass-through entity owner who is either a resident of Hawaii or carries on business in Hawaii and is subject to taxation under chapter 235, HRS. Haw. Admin. Rules ("HAR") § 18-235-95. If an entity elects its classification but is not required to file a Hawaii return for the taxable year, the appropriate person specified under the check-the-box regulations shall attach a copy of Form 8832 to that person's Hawaii income tax or information return for the taxable year which includes the date in which the election was effective.

**III. The IRC Section 7701 Check-The-Box Regulations are Applicable to the General Excise Tax Law (Chapter 237, HRS), and Other Gross Receipts and Transaction-Type Hawaii Taxes, But With Modifications for Single-Member LLC Treatment.**

**A. General Rule.**

The entity classification elected for income tax purposes under the check-the-box regulations will control the classification of the entity for purposes of the general excise tax (“GET”), (chapter 237, HRS), transient accommodations tax, (chapter 237D, HRS), public service company tax, (chapter 239, HRS), fuel tax, (chapter 243, HRS), liquor tax, (chapter 244D, HRS), cigarette and tobacco tax, (chapter 245, HRS), conveyance tax, (chapter 247, HRS), rental motor vehicle and tour vehicle surcharge tax, (chapter 251, HRS), and nursing facility tax laws (chapter 346E, HRS). All business entities, including a single-member LLC, are taxable at the entity level for purposes of the GET and the other gross receipts and transaction-type Hawaii tax laws. *See generally, In re Island Holidays, Ltd.*, 59 Haw. 307, 582 P.2d 703 (1978). For example, if an entity is classified as a partnership for income tax purposes, the GET and other gross receipts and transaction-type taxes are imposed at the entity level. In like fashion, a single-member LLC is treated as a taxable entity for these taxes notwithstanding that the LLC is disregarded under the check-the-box regulations.

Any business entity having shareholders, partners, or members remains taxable upon its business with them, and they are taxable upon their business with it. As a taxable business entity, a single-member LLC is taxable upon its business with its member, and the member is taxable upon its business with the LLC, unless specifically exempted under applicable law (e.g., HRS § 237-23.5).

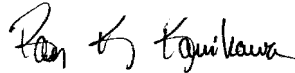
**B. Treatment of Distributions.**

Under the Department’s long-standing interpretation of the law, partners are not subject to the GET on distributive shares of income or distributions from a partnership, provided that such shares or distributions represent a return on the partners’ investment in and not from their business with the partnership. *See Island Holidays, supra*. This same treatment shall apply to distributive shares of income or distributions from an LLC to its members.

**C. License and Registration Requirements Applicable at the Entity Level.**

License and registration requirements are applicable at the entity level. All entities, including a single-member LLC, must have a GET license and, if appropriate, licenses and certificates of registration required by the transient accommodations tax, fuel tax, liquor tax, cigarette and tobacco tax, rental motor vehicle and tour vehicle surcharge tax, and nursing facility tax laws. Thus, a single-member LLC that is disregarded as an entity separate from the owner for income tax purposes must be licensed and registered in the LLC’s name.

The Department will follow IRS regulations and rulings relating to the need for a new federal employer identification number (“FEIN”) in determining whether a new GET license, and other new licenses or registrations, if applicable, are necessary. Thus, if a new FEIN is required as is the case when the business of a sole proprietorship is transferred to a partnership or to a corporation then a new GET license, and other new licenses or registrations, if applicable, are required. On the other hand, a new FEIN, a new GET license, and other new licenses or registrations are not required when an entity elects, under the check-the-box regulations, to change its federal and Hawaii income tax classification or when a domestic partnership converts into an LLC classified as a partnership (or vice versa). When a change of name occurs but a new license is not required, taxpayers must provide the Department with the name change information. Form GEW-TA-RV-5 Application Changes which is included in the general excise/use tax booklet is available for this purpose.



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HRS Chapters and Sections Explained: Sections 235-1, 235-2.3, 235-4, 235-21 to 235-39, 235-95, 235-98, 235-110.7, 235-121 to 235-130 HRS; Chapters 237, 237D, 239, 241, 243, 244D, 245, 247, 251, and 346E.