PROBLEMS WITH THE CHECK-THE-BOX REGULATIONS

Monte Jackel

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1. **Current Check the Box Regulations**
2. Eligible business entities, that is, those entities that are not per-se corporations or special corporations, that have one or more “members” or “owners” can make an election for entity classification-either association or partnership. The first step is to determine if you have an “entity” for tax although not necessarily for local law purposes. Then you test under per se or special corporation list. At the same time as you are doing this, you need to determine if you have members or owners. Then you make the election or you default into one.
3. Once the election is made, you are then a partnership or association.
4. At that point, it would seem impossible to test an entity for which you chose or that defaulted to a partnership under the *Culbertson i*ntent test and the *Castle Harbour* “you look like debt” case or the chances of making a profit cases. If you chose association, the only test would seem to be *Moline Properties*. But courts, particularly the Tax Court, have so far refused to accept this ordering under check the box and continue to test tax abusive transactions under *Culbertson* et al.
5. **Proposed Modifications/Options to current law**
6. Leave the regulations as is and do nothing. Regulations are drafted out of order but the courts don’t seem to care.
7. Amend the check the box regulations to apply in this order:
8. Do you have a tax entity and, if so, is it an eligible business entity?
9. Then….If you are going to choose or would default into partnership or may choose partnership but are not sure, test for who is a partner and what is a partnership under *Culbertson* et al. even if you end up choosing corporate status? If you would flunk under *Culbertson,* do the regulations then tell you that you are an association or perhaps just a sham to be disregarded and for which no election is possible?
10. If you are going to choose or would default into corporation status but could later possibly choose partnership, do you test under both *Moline Properties* and *Culbertson*? What if you flunk *Culbertson*-is corporate treatment or sham treatment then mandatory? What if you flunk *Moline Properties*-is it still possible to apply *Culbertson*?
11. **Repeal of former section 704(e)(1)**
12. It seems that the amendment as part of the TCJA confirms that if you own a capital interest that turns out to be a partnership interest, you are per se a partner but, that conclusion presupposes that you have a valid partnership. If you need to test whether one is a partner in a partnership under some test other than post-TCJA section 704(e) and 761(b), then since taxing income to the capital owner is common law, it seems all of the family partnership regulations could be either deleted or substantially shortened.
13. But merely owning a capital interest in something under post-TCJA law does not mean that you are automatically a partner in a partnership. Although it is not clear whether *Culbertson* still applies to test who is a partner and do you have a partnership (because a careful reading of the legislative history to the 1939 version of section 704(e) said the purpose was to eliminate *Culbertson i*nquiries), it is clear that you need to determine whether you have debt or equity under cases such as *Castle Harbour, Chemtech,* and so on. Whatever the answer was under former section 704(e)(1) (that is, were you automatically a partner regardless of intent or profitability or sharing of losses if you owned a capital interest in a business where capital was a material income producing factor?), that is clearly no longer the law.
14. The regulations under 1.704-1(e) need to be substantially rewritten or perhaps deleted ASAP. Other than a very limited donor-donee services allocation rule, the regulations focus on who is the true capital owner in a business where capital is a material income producing factor. That principle derives from the common law relating to assignment of income. It seemingly could be added to the grantor trust language in the section 671 regulations or perhaps a new regulation under section 61.