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## Proprietors and Partners Mistakenly Pay Themselves Illegal W-2 Wages

Sole proprietors and partners who are above the Section 199A thresholds look for W-2 wages as a means to salvage the 20 percent deduction allowed by Section 199A.

They also often look enviously at the fringe benefits that are available to employees and not to them as sole proprietors or partners.

To overcome getting shorted on the Section 199A deduction or being denied fringe benefits, some sole proprietors and partners instruct their payroll services to make them W-2 employees.

When the payroll services do this, the proprietors and partners believe they are now legitimate employees of their proprietorships and partnerships. Wrong.

Totally wrong.

The sole proprietor may not be a W-2 employee of his or her sole proprietorship.<sup>1</sup>

A partner may not be a W-2 employee of a partnership.<sup>2</sup>

Some sole proprietors and partners have had their Certified Professional Employer Organization (CPEO) treat them as employees. Also, wrong!

Using a CPEO does not create the possibility of paying a W-2 wage to a partner or a sole proprietor.<sup>3</sup>

### ***Takeaways***

The sole proprietor is not a W-2 employee of the proprietorship. He or she is self-employed and operates under the rules for the self-employed.

The partner is not a W-2 employee of the partnership. He or she is a partner and is treated as a partner under the tax rules. Partners receive remuneration for services as guaranteed payments, which are subject to self-employment taxes.

The single-member LLC is a proprietorship unless the member elects treatment as an S or a C corporation. Similarly, a multimember LLC is a partnership unless it elects treatment as an S or a C corporation.

[Client Letter on This Article for Use by Tax Pros. Click Here.](#)

- 1 Est. of Bertha V. Nottingham, T.C. Memo 1956-281; IRS Publication 334, Tax Guide for Small Business (2018), Dated Dec. 18, 2018, p. 34.
  - 2 Rev. Rul. 69-184; Temp. Reg. Section 301.7701-2T(c)(2)(iv)(C)(2); TD 9766.
  - 3 CCA 201916004.
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