Treasury Decision 9356

DATE: August 16, 2007

ACTION: Final regulations.

SUMMARY: This document contains final regulations under which qualified subchapter S subsidiaries and single-owner eligible entities that currently are disregarded as entities separate from their owners for Federal tax purposes will be treated as separate entities for employment tax and related reporting requirement purposes. This document also contains final regulations that treat such disregarded entities as separate entities for purposes of certain excise taxes reported on Forms 720, "Quarterly Federal Excise Tax Return;" 730, "Monthly Tax Return for Wagers;" 2290, "Heavy Highway Vehicle Use Tax Return;" and 11-C, "Occupation Tax and Registration Return for Wagering;" excise tax refunds or payments claimed on Form 8849, "Claim for Refund of Excise Taxes;" and excise tax registrations on Form 637, "Application for Registration (For Certain Excise Tax Activities)." These regulations affect disregarded entities and the owners and employees of disregarded entities with respect to the payment and reporting of Federal employment taxes and the reporting of wage payments. These regulations also affect disregarded entities and their owners in the payment and reporting of certain Federal excise taxes and in registration and claims related to certain Federal excise taxes.

EFFECTIVE DATE: Effective Date: These regulations are effective on August 16, 2007.

Applicability Dates: With respect to employment taxes, these regulations apply to wages paid on or after January 1, 2009. With respect to excise taxes, these regulations apply to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

FOR FURTHER INFORMATION CONTACT: John Richards at (202) 622-6040 (on the employment tax provisions) or Susan Athy at (202) 622-3130 (on the excise tax provisions) (not toll-free numbers).

SUPPLEMENTARY INFORMATION: This document contains amendments to 26 CFR parts 1 and 301. On October 18, 2005, a notice of proposed rulemaking (REG-114371-05) was published in the Federal Register (70 FR 60475) proposing to treat qualified subchapter S subsidiaries (QSubs) (under section 1361(b)(3)(B) of the Internal Revenue Code (Code)) and certain other single-owner eligible entities (under §§ 301.7701-1 through 301.7701-3 of the Procedure and Administrative Regulations) that currently are disregarded as entities separate from their owners (disregarded entities) as separate entities for purposes of employment tax and related reporting requirements and for purposes of certain excise taxes reported on Forms 720, 730, 2290, and 11-C; excise tax refunds or payments claimed on Form 8849; and excise tax registrations on Form 637. Comments addressing employment taxes were received from the public in response to the notice of proposed rulemaking. No comments were received regarding

the excise tax provisions of the proposed regulations. No public hearing was requested or held. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Summary of Comments and Changes Made

As provided in the proposed regulations, the final regulations provide that a disregarded entity is treated as a separate entity for purposes of employment taxes and related reporting requirements. The final regulations clarify that the separate entity is treated as a corporation for purposes of employment taxes and related reporting requirements. As provided in the proposed regulations, a disregarded entity continues to be disregarded for other Federal tax purposes. The final regulations clarify that an owner of a disregarded entity treated as a sole proprietorship is subject to taxes under the Self-Employment Contributions Act (SECA) (section 1401 et seq.). Additionally, the final regulations retain the example illustrating that an individual owner of a disregarded entity continues to be treated as self-employed for purposes of SECA taxes, and not as an employee of a disregarded entity for employment tax purposes.

Commentators suggested that the proposed regulations not be finalized, and that Notice 99-6 (1999-1 CB 321) be retained. Notice 99-6 provides that employment taxes and other employment tax obligations with respect to employees of a disregarded entity may be satisfied in one of two ways: (1) Calculation, reporting, and payment of all employment tax obligations with respect to employees of the disregarded entity by its owner (as though the employees of the disregarded entity are employed directly by the owner) and under the owner's name and taxpayer identification number; or (2) separate calculation, reporting, and payment of all employment tax obligations by each state law entity with respect to its employees under its own name and taxpayer identification number.

Commentators stated that the regulations would increase administrative burden for taxpayers that currently choose to pay and report employment taxes at the owner level as permitted by Notice 99-6. Commentators also suggested that if the regulations were finalized, complications could arise for states where state employment tax filings are required at the owner level. No written comments were received from any state. The IRS and the Treasury Department continue to believe that recognizing disregarded entities as employers for Federal employment taxes will improve administration of the Federal tax laws and simplify Federal tax compliance with respect to reporting, payment, and collection of employment taxes. In addition, because most states recognize disregarded entities as employers for reporting, payment, and collection of state employment taxes, these regulations will more closely align Federal and state reporting, payment and collection of employment taxes. Accordingly, this comment is not adopted.

One commentator requested clarification of the applicability of section 3306(c)(8) to services performed for a disregarded entity that is owned by an organization described in section 501(c)(3). Section 3306(c)(8) provides that services performed for an organization described in section 501(c)(3) are excepted from the definition of employment for Federal Unemployment Tax Act (FUTA) purposes. Even though a disregarded entity owned by a section 501(c)(3) organization will be regarded for employment tax purposes, the disregarded entity will continue to be considered an unincorporated branch or division of the section 501(c)(3) organization for other Federal tax purposes. For example, the disregarded entity will be considered an unincorporated branch or division of the section 501(c)(3) organization for purposes of the organization's annual information reporting requirements under section 6033. See

Announcement 99-102 (1999-2 CB 545). Because section 3306(c)(8) looks to the employer's status for income tax purposes to establish the basis for exemption from FUTA, a disregarded entity owned solely by a section 501(c)(3) organization is considered exempt from tax under section 501(c)(3) for purposes of section 3306(c)(8). Thus, a disregarded entity owned solely by a section 501(c)(3) organization will not be subject to FUTA tax on wages it pays its employees.

One commentator requested clarification of the applicability of the backup withholding provisions under section 3406 to disregarded entities. Section 3406 requires the payor of certain "reportable payments" to withhold from such payments a tax at the rate of 28 percent. For instance, if the payee where required to do so does not provide a valid taxpayer identification number (TIN) to the payor, the payor must backup withhold on reportable payments to the payee. Reportable payments are payments that must be reported to a payee on Form 1099, "U.S. Information Return for Calendar Year 1971," such as certain payments for services made in the course of a trade or business. Wage payments are not reportable payments however, and are not subject to backup withholding under section 3406. These regulations do not apply to reportable payments under section 3406. Because the owner of a disregarded entity other than a QSub is required to file and furnish information returns with respect to non-wage reportable payments and that requirement is not affected by these regulations, the disregarded entity is not subject to the backup withholding requirements. Rather, the owner of the disregarded entity is responsible for any backup withholding that is required with respect to reportable payments considered made by the owner. Under section 1361(b)(3)(E) disregarded entities that are QSubs are subject to information reporting requirements on non-wage payments, unless the Secretary provides otherwise. These regulations do not address the information reporting for QSubs.

Availability of IRS Documents

The IRS notice and announcement cited in this preamble are published in the Internal Revenue Bulletin or Cumulative Bulletin and are available at http://www.irs.gov.

Effective Date

The employment tax provisions of these regulations apply to wages paid on or after January 1, 2009. The notice of proposed rulemaking provided that these regulations would become effective with respect to wages paid on January 1 following the year of publication of these final regulations in the Federal Register, which would have been January 1, 2008. However, in order to ensure that taxpayers have sufficient time to make any necessary changes to their systems in response to these regulations, the IRS and the Treasury Department have determined that it is appropriate to delay the effective date of these regulations until January 1, 2009.

The IRS and the Treasury Department believe that the considerations that support a January 1, 2009, effective date for the employment tax provisions do not apply to the excise tax provisions. Thus, the excise tax provisions of these regulations apply to liabilities imposed and actions required or permitted in periods beginning on or after January 1, 2008. For periods beginning before that date, the IRS will treat payments made by a disregarded entity, or other actions taken by a disregarded entity, with respect to the excise taxes affected by these regulations as having been made or taken by the sole owner of that entity. Thus, for such periods, the owner of a disregarded entity will be treated as satisfying the owner's obligations with respect to the excise taxes affected by these regulations, provided that those obligations are satisfied either (1) By the owner itself or (2) by the disregarded entity on behalf of the owner.

Effect on Other Documents

Disregarded entities, and the owners of such entities may continue to use the procedures permitted by Notice 99-6 for wages paid prior to January 1, 2009. Notice 99-6 provides that if the owner calculates and pays all employment taxes and satisfies all other employment tax obligations with respect to employees of the disregarded entity under the owner's name and taxpayer identification number (as permitted under method (1) of Notice 99-6) for a return period that begins on or after April 20, 1999, then the owner must continue to use this method unless and until otherwise permitted by the Commissioner. However, Notice 99-6 is modified such that a taxpayer may switch to method (2) of Notice 99-6 with respect to wages paid on or after August 16, 2007 and before January 1, 2009, without seeking permission of the Commissioner. Taxpayers who switch from method (1) to method (2) with respect to wages paid prior to January 1, 2009, may consider wages paid by the owner to employees of the disregarded entity during the calendar year of the switch as having been paid by the disregarded entity for purposes of determining whether wages paid to the disregarded entity's employees have reached the contribution and benefit base as determined under section 230 of the Social Security Act and for purposes of the wage base under section 3306. However, as provided in Notice 99-6, regardless of whether the owner uses method (1) or method (2), the owner is ultimately responsible for employment tax liabilities and other employment tax responsibilities with respect to all wages paid prior to January 1, 2009, to employees of the disregarded entity.

Notice 99-6 is obsoleted as of January 1, 2009.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Susan Athy, Office of Associate Chief Counsel (Passthroughs and Special Industries), and John Richards, Office of Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.34-1 is revised to read as follows:

§ 1.34-1 Special rule for owners of certain business entities.

Amounts payable under sections 6420, 6421, and 6427 to a business entity that is treated as separate from its owner under § 1.1361-4(a)(8) (relating to certain qualified subchapter S subsidiaries) or § 301.7701-2(c)(2)(v) of this chapter (relating to certain wholly-owned entities) are, for purposes of section 34, treated as payable to the owner of that entity.

§§ 1.34-2, 1.34-3, 1.34-4, 1.34-5, and 1.34-6 [Removed]

Par. 3. Sections 1.34-2, 1.34-3, 1.34-4, 1.34-5, and 1.34-6 are removed.

Par. 4. Section 1.1361-4 is amended as follows:

1. In paragraph (a)(1) introductory text, the language "Except as otherwise provided in paragraphs (a)(3) and (a)(6)" is removed, and the language "Except as otherwise provided in paragraphs (a)(3), (a)(6), (a)(7), and (a)(8)" is added in its place.

2. Paragraphs (a)(7) and (a)(8) are added.

The additions read as follows:

§ 1.1361-4 Effect of QSub election.

(a) * * *

(7) Treatment of QSubs for purposes of employment taxes-- (i) In general. A QSub is treated as a separate corporation for purposes of Subtitle C--Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24, and 25 of the Internal Revenue Code).

(ii) Effective/applicability date. This paragraph (a)(7) applies with respect to wages paid on or after January 1, 2009.

(8) Treatment of QSubs for purposes of certain excise taxes-- (i) In general. A QSub is treated as a separate corporation for purposes of--

(A) Federal tax liabilities imposed by Chapters 31, 32 (other than section 4181), 33, 34, 35, 36 (other than section 4461), and 38 of the Internal Revenue Code, or any floor stocks tax imposed on articles subject to any of these taxes;

(B) Collection of tax imposed by Chapter 33 of the Internal Revenue Code;

(C) Registration under sections 4101, 4222, and 4412; and

(D) Claims of a credit (other than a credit under section 34), refund, or payment related to a tax described in paragraph (a)(8)(i)(A) of this section or under section 6426 or 6427.

(ii) Effective/applicability date. This paragraph (a)(8) applies to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

§ 1.1361-6 [Amended]

Par 5. Section 1.1361-6 is amended by removing the language "Except as provided in §§ 1.1361-4(a)(3)(iii), 1.1361-4(a)(5)(i), and 1.1361-5(c)(2)" and by adding the language "Except as provided in §§ 1.1361-4(a)(3)(iii), 1.1361-4(a)(5)(i), 1.1361-4(a)(6)(iii), 1.1361-4(a)(7)(ii), 1.1361-4(a)(8)(ii), and 1.1361-5(c)(2)" in its place.

PART 301--PROCEDURE AND ADMINISTRATION

Par. 6. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 7. Section 301.7701-2 is amended as follows:

1. A sentence is added at the end of paragraph (a).

2. Paragraph (c)(2)(i) is revised.

3. Paragraphs (c)(2)(iv), (c)(2)(v), (e)(5), and (e)(6) are added.

The additions read as follows:

§ 301.7701-2 Business entities; definitions.

(a) * * * But see paragraphs (c)(2)(iv) and (v) of this section for special employment and excise tax rules that apply to an eligible entity that is otherwise disregarded as an entity separate from its owner.

* * * * *

(c) * * *

(2) Wholly owned entities-- (i) In general. Except as otherwise provided in this paragraph (c), a business entity that has a single owner and is not a corporation under paragraph (b) of this section is disregarded as an entity separate from its owner.

* * * * *

(iv) Special rule for employment tax purposes --(A) In general. Paragraph (c)(2)(i) of this section (relating to certain wholly owned entities) does not apply to taxes imposed under Subtitle C--Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24, and 25 of the Internal Revenue Code). Paragraph (c)(2)(i) of this section does apply to taxes imposed under Subtitle A, including Chapter 2--Tax on Self-Employment Income. The owner of an entity that is treated in the same manner as a sole proprietorship under paragraph (a) of this section will be subject to the tax on self-employment income.

(B) Treatment of entity. An entity that is otherwise disregarded as an entity separate from its owner but for paragraph (c)(2)(iv)(A) of this section is treated as a corporation with respect to taxes imposed under Subtitle C--Employment Taxes and Collection of Income Tax (Chapters 21, 22, 23, 23A, 24, and 25 of the Internal Revenue Code).

(C) Example. The following example illustrates the application of paragraph (c)(2)(iv) of this section:

Example.

(i) LLCA is an eligible entity owned by individual A and is generally disregarded as an entity separate from its owner for Federal tax purposes. However, LLCA is treated as an entity separate from its owner for purposes of subtitle C of the Internal Revenue Code. LLCA has employees and pays wages as defined in sections 3121(a), 3306(b), and 3401(a).

(ii) LLCA is subject to the provisions of subtitle C of the Internal Revenue Code and related provisions under 26 CFR subchapter C, Employment Taxes and Collection of Income Tax at Source, parts 31 through 39. Accordingly, LLCA is required to perform such acts as are required of an employer under those provisions of the Internal Revenue Code and regulations thereunder that apply. All provisions of law (including penalties) and the regulations prescribed in pursuance of law applicable to employers in respect of such acts are applicable to LLCA. Thus, for example, LLCA is liable for income tax withholding, Federal Insurance Contributions Act (FICA) taxes, and Federal Unemployment Tax Act (FUTA) taxes. See sections 3402 and 3403 (relating to income tax withholding); 3102(b) and 3111 (relating to FICA taxes), and 3301 (relating to FUTA taxes). In addition, LLCA must file under its name and EIN the applicable Forms in the 94X series, for example, Form 941, "Employer's Quarterly Employment Tax Return," Form 940, "Employer's Annual Federal Unemployment Tax Return;" file with the Social Security Administration and furnish to LLCA's employees statements on Forms W-2, "Wage and Tax Statement;" and make timely employment tax deposits. See §§ 31.6011(a)-1, 31.6011(a)-3, 31.6051-1, 31.6051-2, and 31.6302-1 of this chapter.

(iii) A is self-employed for purposes of subtitle A, chapter 2, Tax on Self-Employment Income, of the Internal Revenue Code. Thus, A is subject to tax under section 1401 on A's net earnings from self-employment with respect to LLCA's activities. A is not an employee of LLCA for

purposes of subtitle C of the Internal Revenue Code. Because LLCA is treated as a sole proprietorship of A for income tax purposes, A is entitled to deduct trade or business expenses paid or incurred with respect to activities carried on through LLCA, including the employer's share of employment taxes imposed under sections 3111 and 3301, on A's Form 1040, Schedule C, "Profit or Loss for Business (Sole Proprietorship)."

(v) Special rule for certain excise tax purposes-- (A) In general. Paragraph (c)(2)(i) of this section (relating to certain wholly owned entities) does not apply for purposes of--

(1) Federal tax liabilities imposed by Chapters 31, 32 (other than section 4181), 33, 34, 35, 36 (other than section 4461), and 38 of the Internal Revenue Code, or any floor stocks tax imposed on articles subject to any of these taxes;

(2) Collection of tax imposed by Chapter 33 of the Internal Revenue Code;

(3) Registration under sections 4101, 4222, and 4412; and

(4) Claims of a credit (other than a credit under section 34), refund, or payment related to a tax described in paragraph (c)(2)(v)(A)(1) of this section or under section 6426 or 6427.

(B) Example. The following example illustrates the provisions of this paragraph (c)(2)(v):

Example.

(i) LLCB is an eligible entity that has a single owner, B. LLCB is generally disregarded as an entity separate from its owner. However, under paragraph (c)(2)(v) of this section, LLCB is treated as an entity separate from its owner for certain purposes relating to excise taxes.

(ii) LLCB mines coal from a coal mine located in the United States. Section 4121 of chapter 32 of the Internal Revenue Code imposes a tax on the producer's sale of such coal. Section 48.4121-1(a) of this chapter defines a "producer" generally as the person in whom is vested ownership of the coal under state law immediately after the coal is severed from the ground. LLCB is the person that owns the coal under state law immediately after it is severed from the ground. Under paragraph (c)(2)(v)(A)(1) of this section, LLCB is the producer of the coal and is liable for tax on its sale of such coal under chapter 32 of the Internal Revenue Code. LLCB must report and pay tax on Form 720, "Quarterly Federal Excise Tax Return," under its own name and taxpayer identification number.

(iii) LLCB uses undyed diesel fuel in an earthmover that is not registered or required to be registered for highway use. Such use is an off-highway business use of the fuel. Under section 6427(l), the ultimate purchaser is allowed to claim an income tax credit or payment related to the tax imposed on diesel fuel used in an off-highway business use. Under paragraph (c)(2)(v) of this section, for purposes of the credit or payment allowed under section 6427(l), LLCB is the person that could claim the amount on its Form 720 or on a Form 8849, "Claim for Refund of Excise Taxes." Alternatively, if LLCB did not claim a payment during the time prescribed in section 6427(i)(2) for making a claim under section 6427, § 1.34-1 of this chapter provides that B, the owner of LLCB, could claim the income tax credit allowed under section 34 for the nontaxable use of diesel fuel by LLCB.

* * * * *

(e) * * *

(5) Paragraph (c)(2)(iv) of this section applies with respect to wages paid on or after January 1, 2009.

(6) Paragraph (c)(2)(v) of this section applies to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

Approved: July 25, 2007.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

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