

PUBLICATION

Disregarded Entities To Pay Their Own Employment And Certain Excise Taxes Under Final Regulations

December 11, 2007

In an attempt to alleviate some of the administrative difficulties encountered due to different reporting requirements for disregarded entities and the employment tax reporting rules, the IRS issued final Treasury Regulations pertaining to Internal Revenue Code Sections 34, 361 and 7701. These Regulations take effect as of January 1, 2009 for employment taxes, and as of January 1, 2008 for the applicable federal excise taxes.

Single-owner eligible entities that are disregarded entities, as well as qualified subchapter S subsidiaries, will be treated as separate entities under these Regulations for purposes of employment tax liability and reporting requirements. The final Regulations, which were adopted on August 17, 2007, supersede IRS Notice 99-6 (Jan. 6, 1999) in its entirety as of January 1, 2009. Notice 99-6 was the IRS' answer to the many issues that arose in the wake of legislation which provided that certain wholly owned entities may be disregarded as separate entities by their owners. Under Notice 99-6, there were two methods of reporting and payment of employment taxes. Owners could choose to report and pay employment taxes incurred by the disregarded entity either under their own name and identification number (Method #1), or under the name and identification number of the entity (Method #2); however, the taxpayer was not allowed to switch from Method #1 to Method #2 after April 20, 1999.

As of January 1, 2009, the Final Regulations provide that any entity disregarded as an entity separate for federal tax purposes will not be disregarded from its owner with respect to employment taxes and must report, collect and pay taxes for its own employees. The final Regulations clarify that such entity is treated as a corporation for purposes of employment taxes and related reporting requirements. The exception currently in place for disregarded entities owned by Section 501(c)(3) tax exempt organizations will continue to be applicable. The IRS, acknowledging the administrative burden that will be placed upon certain entities, chose a January 1, 2009 date to ensure that taxpayers have sufficient time to make any necessary changes to their payroll systems and all other adjustments needed to comply with the Regulations. In the same vein, the final Regulations have modified Notice 99-6 to allow taxpayers using Method #1 under Notice 99-6 to switch to Method #2 without first seeking permission from the IRS with respect to wages paid on or after August 16, 2007.

The final Regulations also provide that certain entities disregarded as separate from their owners will no longer be disregarded for the purpose of certain excise taxes. The Regulations further address the difficulties that had arisen from the interaction of the disregarded entity rules and certain federal excise tax provisions. Currently, determinations for excise tax, as well as allowances of a credit, refund or payment of excise taxes could be determined in accordance with state law. The new Regulations attempt to clarify those issues by imposing liability upon the disregarded entity for those federal excise taxes which are reported on Forms 720, 730, 2290 and 11-C.