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TAX BULLETIN

NEW EMPLOYMENT TAX RULES FOR DISREGARDED ENTITIES

The IRS has issued final regulations which provide new rules on how disregarded entities, including single member LLC's and Qualified Subchapter S Subsidiaries, report payroll and certain excise taxes. The regulations were issued in August 2007 but will only apply to wages paid on or after January 1, 2009 with the old rules still in effect for any wages paid prior to that date. Previously the IRS provided two options for the reporting and payment of employment taxes with respect to disregarded entities. One option was to report all the employment tax obligations of the employees of the disregarded entity as paid by the owner of the disregarded entity using the owner's name and employer identification number. The second option was to report the employment taxes as paid by the disregarded entity itself using the disregarded entity's name and employer identification number.

The new regulations eliminate the disregarded entity status for employment tax obligations and treat the disregarded entity as a separate entity for employment tax reporting purposes. The disregarded entity now must have its own taxpayer identification number and, if it has employees, it must comply with all payroll-related obligations including quarterly employment tax returns, annual unemployment tax returns, W-2s, etc. separate from its owner. Note that an individual owner of a disregarded entity that is treated in the same manner as a sole proprietorship will be subject to the tax on self-employment income and is not treated as an employee of the disregarded entity for employment tax purposes. The new regulations also stipulate these same rules apply for reporting and payment of excise taxes but do not change the entity's classification as a disregarded entity for other Federal tax purposes.

With the passing of these new regulations, the IRS has eliminated the option of using the owner's name and taxpayer identification number for employment tax obligations and now mandates that disregarded entities use their own names and employer identification numbers. Taxpayers classified as disregarded entities should pay careful attention to these new rules as the aggregation at the owner level of multiple disregarded entities for employment tax purposes is no longer allowed. Each disregarded entity will need its own name and employer identification number to report its individual employment tax obligations effective January 1, 2009 and businesses should be sure to acquire EINs and adjust their state registrations and payroll systems if necessary.

As always, if you have any questions about these provisions, please don't hesitate to contact us.