

PUBLICATION

Reminder: Disregarded Entities to Pay Their Own Employment and Most Excise Taxes

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Effective in 1997, the Internal Revenue Service published the famous "check the box" Treasury Regulations. One offshoot of such Regulations is that single-member limited liability companies are treated as "disregarded entities." Thus, the income and expenses of such entities are reported on the owner's tax return. This treatment was already in effect for electing Subchapter S subsidiaries.

In an attempt to alleviate some of the administrative difficulties encountered due to different reporting requirements for disregarded entities and the reporting rules for employment and excise taxes, the IRS issued final Treasury Regulations on August 17, 2007 pertaining to Sections 34, 361, and 7701 of the Internal Revenue Code. These Regulations take effect January 1, 2009 for employment taxes, but have been in effect since January 1, 2008 for federal excise taxes.

Under these Regulations, single-owner eligible entities that are disregarded entities, as well as qualified Subchapter S subsidiaries, will be treated as separate entities for purposes of employment tax liability and reporting requirements. IRS Notice 99-6 (January 6, 1999) is superseded in its entirety as of January 1, 2009 by these Regulations. Notice 99-6 was the IRS's answer to the many issues arising in the wake of authority that certain wholly-owned entities may be disregarded as separate entities by their owners. Notice 99-6 allowed for two methods of reporting and payment of employment taxes. Under Method #1, owners could choose to report and pay employment taxes incurred by the disregarded entity under their own name and identification number; whereas, under Method #2, the taxes were reported under the name and identification number of the entity. However, the owner was not allowed to switch from Method #1 to Method #2 after April 20, 1999.

As of January 1, 2009 with respect to employment taxes, the final Regulations provide that any entity disregarded as an entity separate for federal tax purposes will not be disregarded from its owner. Such entity is treated as a corporation for purposes of employment taxes and related reporting requirements; and, as a result, must report, collect and pay taxes for its own employees. Section 501(c)(3) tax-exempt organizations owning disregarded entities will continue to have an exception to these requirements. The final Regulations have also 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 Service has in certain circumstances asserted liability for unpaid employment taxes against the owners of single-member limited liability companies which have not elected to be taxed as corporations. Under the current language of the Internal Revenue Manual, whether or not an election is made, the owner will apparently no longer be liable unless Section 6672 is applicable or there is a state law remedy.

With respect to most excise taxes, the final Regulations provide that certain entities disregarded as separate from their owners will no longer be disregarded. Previously, state law was instrumental in determinations of various excise tax-related issues. The final Regulations 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.