[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 301

[TD 9869]

RIN 1545-BM77

Self-employment Tax Treatment of Partners in a Partnership that Owns a Disregarded Entity

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations that clarify the employment tax treatment of partners in a partnership that owns a disregarded entity. These regulations affect partners in a partnership that owns a disregarded entity.

DATES: Effective date: These regulations are effective on **[INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

Applicability date: For dates of applicability, see §301.7701-2(e)(8).

FOR FURTHER INFORMATION CONTACT: Andrew K. Holubeck at (202) 317-4774 or Danchai Mekadenaumporn at (202) 317-6798 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to 26 CFR part 301. Section 301.7701-2(c)(2)(i) of the regulations specifies that, except as otherwise provided, a business entity that has a single owner and is not a corporation under §301.7701-2(b) is disregarded as an entity separate from its owner (a disregarded entity). However,

§301.7701-2(c)(2)(iv)(B) treats a disregarded entity as a corporation for purposes of employment taxes imposed under Subtitle C of the Internal Revenue Code (Code). This exception to the treatment of disregarded entities does not apply to taxes imposed under Subtitle A of the Code, including self-employment taxes, and the regulations issued in TD 9670 on June 26, 2014 (79 FR 36204) explicitly provided that the owner of a disregarded entity who is treated as a sole proprietor for income tax purposes is subject to self-employment taxes.

On May 4, 2016, temporary regulations (TD 9766) clarifying the employment tax treatment of partners in a partnership that owns a disregarded entity were published in the **Federal Register** (81 FR 26693, as corrected July 5, 2016, at 81 FR 43488). Prior to the publication of the temporary regulations, the regulations did not explicitly address situations in which the owner of a disregarded entity is a partnership, and the Department of the Treasury (Treasury Department) and the IRS had been informed that some taxpayers were reading the regulations to permit the treatment of the individual partners in a partnership that owned a disregarded entity (either directly or through tiered partnerships) as employees of the disregarded entity. The Treasury Department and the IRS issued the temporary regulations to clarify that the rule that a disregarded entity is treated as a corporation for employment tax purposes does not apply to the self-employment tax treatment of any individuals who are partners in a partnership that owns a disregarded entity. The temporary regulations, like the final regulations they replaced, continued to explicitly provide that the owner of a disregarded entity who is treated as a sole proprietor for income tax purposes is subject to self-employment taxes. A notice of proposed rulemaking (REG-114307-15) cross-referencing the temporary

regulations was published in the **Federal Register** on the same day (81 FR 26763). No public hearing was requested or held. Comments responding to the notice of proposed rulemaking were received. All comments were considered and are available for public inspection and copying at http://www.regulations.gov or upon request. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision, and the corresponding temporary regulations are removed. The public comments are discussed in this preamble.

Explanation and Summary of Comments

The Treasury Department and the IRS received two comments in response to the proposed regulations. One commenter requested that the Treasury Department and the IRS consider addressing whether an eligible entity's election to be classified as an association (and thus a corporation under §301.7701–2(b)(2)) pursuant to the final entity classification regulations under section 7701 of the Code (also known as the "Check-the-Box" regulations) would change the result such that a partner of the upper tier entity could be an employee at the lower tier entity that is treated as a corporation. While the temporary regulations did not address tiered entities, the use of an entity classified as a corporation under the Check-the-Box regulations presents different issues, such as whether, under the facts and circumstances, the partner is an employee of the corporation. However, these issues are outside the scope of these final regulations, and for this reason, these regulations do not address this comment.

In the preamble of TD 9766, the Treasury Department and the IRS requested comments on the appropriate application of the principles of Rev. Rul. 69-184, 1969-1 C.B. 256, to tiered partnership situations, the circumstances in which it may be

appropriate to permit partners to also be employees of the partnership, and the impact on employee benefit plans (including, but not limited to, qualified retirement plans, health and welfare plans, and fringe benefit plans) and on employment taxes if Rev. Rul. 69-184 were to be modified to permit partners to also be employees in certain circumstances.

In response to this request, one commenter described the effects of the application of the principles of Rev. Rul. 69-184 in the context of publicly traded partnerships. This commenter noted that one particular concern in the publicly traded partnership context is that the publicly traded partnership may not know which service providers treated as employees (whether at the publicly traded partnership level or at any disregarded entity owned by the publicly traded partnership) hold units since individuals may purchase units on the open market without the knowledge of the publicly traded partnership. If an acquisition of units by the service provider occurs without the publicly traded partnership's knowledge, then improper tax withholding and benefit plan participation may occur until the publicly traded partnership discovers the error. This commenter also noted a number of negative effects on service providers receiving equity-based compensation from a publicly traded partnership and the ensuing burden required in administering any equity-based compensation plan in the publicly traded partnership context. This commenter requested that the IRS consider an exception to the principles of Rev. Rul. 69-184 for publicly traded partnerships.

As noted in the preamble to TD 9766, these regulations do not address the application of Rev. Rul. 69-184 in tiered partnership situations, but rather clarify that a disregarded entity owned by a partnership is not treated as a corporation for purposes of

employing any partner of the partnership. Similarly, these regulations also do not address the application of Rev. Rul. 69-184 to publicly traded partnerships. Accordingly, the final regulations do not provide an exception to the principles of Rev. Rul. 69-184 for publicly traded partnerships. However, the Treasury Department and the IRS will continue to consider the application of Rev. Rul. 69-184, including the specific issue noted by the commenter, and welcome further comments.

The temporary regulations provided that their applicability date would be the later of August 1, 2016, or the first day of the latest-starting plan year following May 4, 2016 of an affected plan (based on the plans adopted before, and the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under §301.7701-2. It has come to the attention of the Treasury Department and the IRS that some taxpayers may have read the applicability date to begin on the first day of the last plan year prior to the termination of an affected plan (as defined in §301.7701-2(e)(8)), which may have been a date after May 4, 2017 . This is not a proper reading of the applicability date.

In the case of an entity with several affected plans that may have different plan years, the applicability date was the first day of the plan year of the affected plan that had the latest plan year beginning after May 4, 2016, and on or before May 4, 2017 (assuming that date is after August 1, 2016). For example, an entity may have had two affected plans, with one plan year that began on September 1, 2016, and another plan year that began on January 1, 2017. In this case, the applicability date for this entity would have been January 1, 2017. The applicability date for any entity affected by these regulations should not have been delayed beyond May 4, 2017 in any case. For

this reason, the final regulations clarify in §301.7701-2(e)(8) that the applicability date of §301.7701-2(c)(2)(iv)(C)(2) is the later of August 1, 2016, or the first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan (based on the plans adopted before, and the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under §301.7701-2.

Special Analysis

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Department of the Treasury and the Office of Management and Budget regarding review of tax regulations. It has also 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 NPRM preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Andrew Holubeck of the Office of the Associate Chief Counsel (Employee Benefits, Exempt Organizations and Employment Taxes). However, other personnel from the IRS and the Treasury Department participated in their development.

Statement of Availability

IRS Revenue Procedures, Revenue Rulings, Notices, and other guidance cited in this document are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at http://www.irs.gov.

List of Subjects in 26 CFR Part 301

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

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7701-2 is amended by:

1. Revising paragraph (c)(2)(iv)(C)(2).

2. Removing the “(e)” from the “(e)(8)” paragraph designation and revising paragraph (e)(8).

The revisions read as follows:

§301.7701-2 Business entities; definitions.

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(c) * * *

(2) * * *

(iv) * * *

(C) * * *

(2) Paragraph (c)(2)(i) of this section applies to taxes imposed under subtitle A of the Code, including Chapter 2—Tax on Self-Employment Income. Thus, an entity that is treated in the same manner as a sole proprietorship under paragraph (a) of this section is not treated as a corporation for purposes of employing its owner; instead, the entity is disregarded as an entity separate from its owner for this purpose and is not the employer of its owner. The owner will be subject to self-employment tax on self-employment income with respect to the entity's activities. Also, if a partnership is the owner of an entity that is disregarded as an entity separate from its owner for any purpose under this section, the entity is not treated as a corporation for purposes of employing a partner of the partnership that owns the entity; instead, the entity is disregarded as an entity separate from the partnership for this purpose and is not the employer of any partner of the partnership that owns the entity. A partner of a partnership that owns an entity that is disregarded as an entity separate from its owner for any purpose under this section is subject to the same self-employment tax rules as a partner of a partnership that does not own an entity that is disregarded as an entity separate from its owner for any purpose under this section.

* * * * *

(e) ***

(8) Paragraph (c)(2)(iv)(C)(2) of this section applies on the later of–

(i) August 1, 2016; or

(ii) The first day of the latest-starting plan year beginning after May 4, 2016, and on or before May 4, 2017, of an affected plan (based on the plans adopted before, and

the plan years in effect as of, May 4, 2016) sponsored by an entity that is disregarded as an entity separate from its owner for any purpose under this section. For rules that apply before the applicability date of paragraph (c)(2)(iv)(C)(2) of this section, see 26 CFR part 301 revised as of April 1, 2016. For the purposes of this paragraph (e)(8)--

(A) An affected plan includes any qualified plan, health plan, or section 125 cafeteria plan if the plan benefits participants whose employment status is affected by paragraph (c)(2)(iv)(C)(2) of this section;

(B) A qualified plan means a plan, contract, pension, or trust described in paragraph (A) or (B) of section 219(g)(5) (other than paragraph (A)(iii)); and

(C) A health plan means an arrangement described under §1.105-5 of this chapter.

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§301.7701-2T [Removed]

Par. 3. Section 301.7701-2T is removed.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

Approved: May 15, 2019.

David J Kautter,

Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2019-14121 Filed: 6/28/2019 4:15 pm; Publication Date: 7/2/2019]