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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 31, and 301

[TD 9670]

RINs 1545-BJ06; 1545-BK38

Disregarded Entities; Religious and Family Member FICA and FUTA Exceptions; Indoor Tanning Services Excise Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to disregarded entities (including qualified subchapter S subsidiaries) and the indoor tanning services excise tax. These final regulations affect disregarded entities responsible for collecting the indoor tanning services excise tax and owners of those disregarded entities. The final regulations also relate to disregarded entities and certain exceptions from taxes under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, as well as backup withholding rules and related information reporting requirements. These final regulations affect individual owners of disregarded entities. These regulations also affect the owners of disregarded entities subject to backup withholding rules.

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

Applicability Dates: For dates of applicability, see §§1.1361-4(a)(8)(ii), 31.3121(b)(3)-1(e), 31.3127-1(c), 31.3306(c)(5)-1(e), 301.7701-2(e)(5), and 301.7701-2(e)(6)(iv).

FOR FURTHER INFORMATION CONTACT: Regarding excise tax-related provisions, Michael H. Beker (202) 317-6855; regarding employment tax-related provisions, Andrew Holubeck (202) 317-4770 (not toll free calls).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations amending the Income Tax Regulations (26 CFR part 1) under section 1361 of the Internal Revenue Code (Code), the Employment Tax Regulations (26 CFR part 31) under sections 3121, 3127, and 3306 of the Code, and the Procedure and Administration Regulations (26 CFR part 301) under section 7701 of the Code.

Indoor Tanning Services Excise Tax-Related Regulations

On June 25, 2012, final and temporary regulations (TD 9596) were published in the **Federal Register** (77 FR 37806). The regulations treat disregarded entities (including qualified subchapter S subsidiaries) as separate entities for purposes of the indoor tanning services excise tax imposed by section 5000B.

Also on June 25, 2012, a notice of proposed rulemaking (REG-125570-11) was published by cross-reference to the temporary regulations in the **Federal Register** (77 FR 37838). The preamble to TD 9596 includes background information and an explanation of provisions regarding the regulations.

Employment Tax-Related Regulations

On November 1, 2011, final and temporary regulations (TD 9554) were published in the **Federal Register** (76 FR 67363). The regulations extend the exceptions or exemptions from taxes under the Federal Insurance Contributions Act and the Federal Unemployment Tax Act under sections 3121(b)(3) (concerning individuals who work for certain family members), 3127 (concerning members of religious faiths), and 3306(c)(5) (concerning persons employed by children and spouses and children under 21 employed by their parents) to services performed in the employ of certain entities that are generally disregarded as separate from their owners for federal tax purposes under §301.7701-2(c). The regulations also clarify the existing rule that, in the case of an entity that is disregarded as an entity separate from its owner for any purpose under §301.7701-2(c), the owner is subject to the withholding requirements imposed under section 3406 (backup withholding).

Also on November 1, 2011, a notice of proposed rulemaking (REG-136565-09) was published by cross-reference to the temporary regulations in the **Federal Register** (76 FR 67384). The preamble to TD 9554 includes background information and an explanation of provisions regarding the regulations.

Combining the employment tax and excise tax provisions into this final regulation

The IRS did not receive any written or electronic comments responding to either notice of proposed rulemaking and a public hearing was neither requested nor held. Accordingly, both sets of proposed regulations are adopted as amended by this Treasury decision without substantive change and both sets of corresponding temporary regulations are removed. The nonsubstantive revisions are discussed in the next section.

Explanation of Revisions

These final regulations reorganize and revise §31.3121(b)(3)-1, §31.3127-1, §31.3306(c)(5)-1, and §301.7701-2(c)(2)(iv) for clarity, and no substantive changes are intended to these provisions. In §31.3121(b)(3)-1, concerning family employment, the general rule that applies to corporations was moved from §31.3121(b)(3)-1(c) to §31.3121(b)(3)-1(d), so that the rules for disregarded entities (which are treated as corporations for purposes of Subtitle C under §301.7701-2(c)(2)(iv)(B)) would follow after the general corporate rule. Similarly, in §31.3306(c)(5)-1, with respect to the provisions concerning family employment, the general rule that applies to corporations was moved from §31.3306(c)(5)-1(c) to §31.3306(c)(5)-1(d), so that the rules for disregarded entities would follow after the general corporate rule. For clarity, §31.3127-1(a) was reorganized into a list format and headings were added. In addition, §§31.3121(b)(3)-1(d), 31.3127-1(b), and 31.3306(c)(5)-1(d) were revised to provide that an entity that is treated as a corporation for purposes of Subtitle C under §301.7701-2(c)(2)(iv)(B) is not treated as the employer for purposes of

applying sections 3121(b)(3), 3127, and 3306(c)(5) and the regulations thereunder.

Section 301.7701-2(c)(2)(iv)(A) continues to provide that §301.7701-2(c)(2)(i) (relating to certain wholly owned entities) does not apply to taxes imposed under Subtitle C. Section 301.7701-2(c)(2)(iv)(B) also continues to provide that an entity that is disregarded as an entity separate from its owner for any purpose under §301.7701-2 is treated as a corporation for purposes of taxes imposed under Subtitle C. The cross references that were formerly in §301.7701-2(c)(2)(iv)(C) and were described as exceptions to §301.7701-2(c)(2)(iv)(B) are now described as special rules and are added to §301.7701-2(c)(2)(iv)(B). In addition, the language formerly of §301.7701-2(c)(2)(iv)(A) regarding backup withholding has been moved to new §301.7701-2(c)(2)(iv)(C)(1) to clarify that it is an exception to the general provisions of §301.7701-2(c)(2)(iv)(A) and (B). Finally, the last two sentences that were formerly in §301.7701-2(c)(2)(iv)(A) regarding taxes imposed under Subtitle A, including Chapter 2, Tax on Self Employment Income, have been moved to new §301.7701-2(c)(2)(iv)(C)(2) to put all the special clarifying rules and exceptions in one paragraph.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. 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 proposed regulations that preceded these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business and no comments were received.

Drafting Information

The principal authors of these regulations are Michael H. Beker, Office of the Associate Chief Counsel (Passthroughs and Special Industries), and Andrew Holubeck, Office of the Associate Chief Counsel (Tax Exempt & 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 31

Employment taxes, Income Taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

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, 31, and 301 are amended as follows:

PART 1--INCOME TAX

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

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

Par. 2. Section 1.1361-4 is amended as follows:

1. In paragraph (a)(8)(i)(A) the language “and 38” is removed and “38, and 49” is added in its place.

2. In paragraph (a)(8)(i)(B) the language “Chapter 33” is removed and “Chapters 33 and 49” is added in its place.

3. Paragraph (a)(8)(ii) is revised.

4. Paragraph (a)(8)(iii) is removed.

The revision reads as follows:

§1.1361-4 Effect of QSub election.

(a) * * *

(8) * * *

(ii) Effective/applicability date. (A) Except as provided in this paragraph (a)(8)(ii), paragraph (a)(8) of this section applies to liabilities imposed and actions first required or permitted in periods beginning on or after January 1, 2008.

(B) References to Chapter 49 in paragraph (a)(8) of this section apply to taxes imposed on amounts paid on or after July 1, 2012.

(C) Paragraph (a)(8)(i)(E) of this section applies for periods after December 31, 2014.

* * * * *

§1.1361-4T [Removed]

Par. 3. Section 1.1361-4T is removed.

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 4. The authority citation for part 31 continues to read in part as follows:

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

Par. 5. Section 31.3121(b)(3)-1 is amended by revising paragraphs (c), (d), and (e) to read as follows:

§31.3121(b)(3)-1 Family employment.

* * * * *

(c) Services performed in the employ of a partnership are within the exception described in paragraph (a) of this section only if the requisite family relationship exists between the employee and each of the partners comprising the partnership.

(d) Services performed in the employ of a corporation are not within the exception described in paragraph (a) of this section, except that services performed in the employ of an entity that is treated as a corporation under

§301.7701-2(c)(2)(iv)(B) of this chapter may qualify for the exception if the requirements of the exception are otherwise met. An entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter is not treated as the employer for purposes of applying section 3121(b)(3) and this section. For purposes of applying section 3121(b)(3) and this section, the owner of an entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter is treated as the employer.

(e) Paragraphs (c) and (d) of this section apply to wages paid on or after November 1, 2011. However, taxpayers may apply paragraphs (c) and (d) of this section to wages paid on or after January 1, 2009.

§31.3121(b)(3)-1T [Removed]

Par. 6. Section 31.3121(b)(3)-1T is removed.

Par. 7. Section 31.3127-1 is added to read as follows:

§31.3127-1 Exemption for employers and their employees if both are members of religious faiths opposed to participation in Social Security Act programs.

(a) Exemption--(1) Employer. Except as provided in paragraph (b) of this section, an employer is exempt from the taxes imposed by section 3111 on wages paid to an employee if--

(i) The employer (or if the employer is a partnership, each partner therein) and its employee are members of a recognized religious sect or division described in section 1402(g)(1);

(ii) Both the employer (or if the employer is a partnership, each partner therein) and the employee adhere to the tenets and teachings of that sect; and

(iii) Both the employer and the employee have filed and had approved applications under section 3127(b) for exemption from the taxes imposed by sections 3111 and 3101.

(2) Employee. If an employer is exempt from the taxes imposed by section 3111 under paragraph (a)(1) of this section, then each employee described in paragraph (a)(1) of this section is exempt from the taxes imposed by section 3101 on the wages received with respect to employment with that employer.

(b) Corporation. Services performed in the employ of a corporation are not within the exemption described in paragraph (a) of this section, except that services performed in the employ of an entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter may qualify for the exemption if the requirements of the exemption are otherwise met. An entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter is not treated as the employer for purposes of applying section 3127 and this section. For purposes of applying section 3127 and paragraph (a) of this section, the owner of an entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter is treated as the employer.

(c) Effective/applicability date. This section applies to wages paid on or after November 1, 2011. However, taxpayers may apply this section to wages paid on or after January 1, 2009.

§31.3127-1T [Removed]

Par. 8. Section 31.3127-1T is removed.

Par. 9. Section 31.3306(c)(5)-1 is amended by revising paragraphs (c), (d), and (e) to read as follows:

§31.3306(c)(5)-1 Family employment.

* * * * *

(c) Services performed in the employ of a partnership are within the exception described in paragraph (a) of this section only if the requisite family relationship exists between the employee and each of the partners comprising the partnership.

(d) Services performed in the employ of a corporation are not within the exception described in paragraph (a) of this section, except that services performed in the employ of an entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter may qualify for the exception if the requirements of the exception are otherwise met. An entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter is not treated as the employer for purposes of applying section 3306(c)(5) and this section. For purposes of applying section 3306(c)(5) and this section, the owner of an entity that is treated as a corporation under §301.7701-2(c)(2)(iv)(B) of this chapter is treated as the employer.

(e) Paragraphs (c) and (d) of this section apply to wages paid on or after November 1, 2011. However, taxpayers may apply paragraphs (c) and (d) of this section to wages paid on or after January 1, 2009.

§31.3306(c)(5)-1T [Removed]

Par. 10. Section 3306(c)(5)-1T is removed.

PART 301--PROCEDURE AND ADMINISTRATION

Par. 11. The authority citation for part 301 continues to read in part as follows:

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

Par. 12. Section 301.7701-2 is amended as follows:

1. Paragraphs (c)(2)(iv)(A), (B), and (C) are revised.
2. Paragraph (c)(2)(v)(A)(1) is amended by removing the language “and 38” and adding “38, and 49” in its place.
3. Paragraph (c)(2)(v)(A)(2) is amended by removing the language “Chapter 33” and adding “Chapters 33 and 49” in its place.
4. Paragraph (c)(2)(vi) is removed.
5. Paragraph (e)(5) is revised.
6. Paragraph (e)(6)(iv) is added.
7. Paragraphs (e)(8) and (e)(9) are removed.

The revisions and addition read as follows:

§301.7701-2 Business entities; definitions.

* * * * *

(c) * * *

(2) * * *

(iv) * * *

(A) In general. Except as provided in paragraph (c)(2)(iv)(C) of this section, 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).

(B) Treatment of entity. Except as provided in paragraph (c)(2)(iv)(C) of this section, an entity that is disregarded as an entity separate from its owner for any purpose under 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). For special rules regarding the application of certain employment tax exceptions, see §§31.3121(b)(3)-1(d), 31.3127-1(b), and 31.3306(c)(5)-1(d) of this chapter.

(C) Special rules. (1) Paragraphs (c)(2)(iv)(A) and (B) of this section do not apply to withholding requirements imposed by section 3406 (backup withholding). Thus, in the case of an entity that is disregarded as an entity separate from its owner for any purpose under this section, the owner is subject to the withholding requirements imposed by section 3406 (backup withholding).

(2) Paragraph (c)(2)(i) of this section applies to taxes imposed under Subtitle A, including Chapter 2—Tax on Self Employment Income. Thus, the owner of an entity that is treated in the same manner as a sole proprietorship under paragraph (a) of this section is subject to tax on self-employment income.

* * * * *

(e) * * *

(5)(i) Except as provided in this paragraph (e)(5), paragraph (c)(2)(iv) of this section applies with respect to wages paid on or after January 1, 2009.

(ii) Paragraph (c)(2)(iv)(B) applies with respect to wages paid on or after September 14, 2009. For rules that apply before September 14, 2009, see 26 CFR part 301 revised as of April 1, 2009.

(iii) Paragraph (c)(2)(iv)(C)(1) of this section applies with respect to wages paid on or after November 1, 2011. For rules that apply before November 1, 2011, see 26 CFR part 301, revised as of April 1, 2011. However, taxpayers may apply paragraph (c)(2)(iv)(C)(1) of this section with respect to wages paid on or after January 1, 2009.

(6) * * *

(iv) References to Chapter 49 in paragraph (c)(2)(v) of this section apply to taxes imposed on amounts paid on or after July 1, 2012.

* * * * *

§301.7701-2T [Removed]

Par. 13. Section 301.7701-2T is removed.

John Dalrymple
Deputy Commissioner for Services and Enforcement.

Approved: February 7, 2014

Mark J. Mazur
Assistant Secretary of the Treasury (Tax Policy).

Editorial Note: This document was received for publication by the Office of the Federal Register on June 23, 2014.

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