



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 31, 301, and 602

[TD 9860]

RIN 1545-BN19

Certified Professional Employer Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document sets forth final regulations relating to certified professional employer organizations (CPEOs). The Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014, required the IRS to establish a voluntary certification program for professional employer organizations. These final regulations set forth the requirements a person must satisfy in order to become and remain a CPEO and the federal employment tax liabilities and other obligations of persons certified by the IRS as CPEOs. These final regulations will affect persons who apply to be treated as CPEOs and who are certified by the IRS as meeting the applicable requirements. In certain instances, the final regulations will also affect the federal employment tax liabilities and other obligations of customers of the CPEO.

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

Applicability date: For dates of applicability see §§31.3511-1(i), 301.7705-1(c), and 301.7705-2(o).

FOR FURTHER INFORMATION CONTACT: Nina Roca at (202) 317-6798 (this is not a toll-free number)

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2266.

The collection of information in these regulations is in §31.3511-1(g), which provides that the Secretary shall develop such reporting and recordkeeping rules, regulations, and procedures as the Secretary determines necessary or appropriate to ensure compliance by CPEOs with subtitle C of the Internal Revenue Code (Code), and in §301.7705-2, which relates to the requirements that a person must satisfy to become and remain certified as a CPEO.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and return information are confidential, as required by 26 U.S.C. 6103.

## **Background**

The Stephen Beck, Jr., Achieving a Better Life Experience Act of 2014 (the ABLE Act), enacted on December 19, 2014 (Pub. L. 113-295), added new sections 3511 and 7705 to the Code relating to the certification requirements for, and the federal employment tax consequences of, being a “certified professional employer organization” (CPEO). The ABLE Act required the Internal Revenue Service (IRS) to establish a voluntary certification program for persons to become CPEOs. Additionally, the ABLE Act made conforming amendments to sections 3302, 3303(a), 6053(c), 6652, and 7528 relating to the obligations, requirements, and penalties applicable to a CPEO.

Section 7705(a) defines a CPEO as a person who applies to be treated as a CPEO for purposes of section 3511 and has been certified by the Secretary as meeting the requirements of section 7705(b), which include requirements related to tax status and background, satisfying certain bond, financial review, and quarterly reporting requirements (as provided for in section 7705(c)), and notifying the IRS of any change that materially affects the continuing accuracy of information provided by the CPEO.

Section 7705(d) gives the Secretary the authority to suspend or revoke the certification of any person for purposes of section 3511 if the Secretary determines that the person is not satisfying the agreements or requirements of sections 7705(b) or (c), or fails to satisfy applicable accounting, reporting, payment, or deposit requirements.

Section 7705(f) provides that the Secretary shall make available to the public the name and address of each person certified as a CPEO and each person whose certification is suspended or revoked.

Under sections 3511(a)(1) and (c)(1), for purposes of federal employment taxes and other obligations under the federal employment tax rules, a CPEO is generally treated as the employer of any individual performing services for a customer of the CPEO and covered by a contract meeting the requirements of section 7705(e)(2) (CPEO contract) between the CPEO and the customer (covered employee), but only with respect to remuneration remitted to the covered employee by the CPEO. With respect to an individual covered by a CPEO contract who performs services for a customer at a work site that meets the coverage requirements of section 7705(e)(3) (a work site employee), section 3511(a)(1) specifies that no person other than the CPEO is treated as the employer for federal employment tax purposes with respect to remuneration remitted by the CPEO to such individual.

Under section 3511(g), the Secretary is directed to develop such reporting and recordkeeping rules, regulations, and procedures as the Secretary determines necessary or appropriate to ensure compliance with the applicable federal employment tax provisions by CPEOs. In addition, under section 3511(h), the Secretary is directed to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 3511.

On May 6, 2016, the Department of the Treasury (Treasury Department) and the IRS published final and temporary regulations under section 7705 (TD 9768) in the **Federal Register** (81 FR 27315, as corrected July 12, 2016 at 81 FR 45012) that describe the application process and certification requirements necessary for a person to become and remain a CPEO. On the same date, the Treasury Department and the IRS published a notice of proposed rulemaking (REG-127561-15) in the **Federal**

**Register** (81 FR 27360) cross-referencing the temporary regulations and proposing additional regulations under section 3511 that describe the federal employment tax consequences for CPEOs and their customers. On June 3, 2016, Revenue Procedure 2016-33 (2016-25 I.R.B. 1034) was also issued, which set forth the detailed procedures for applying to be certified as a CPEO. The IRS did not receive any requests for a public hearing on the regulations, and therefore no public hearing was held. Several comments responding to the proposed and temporary regulations and the revenue procedure were received. The Treasury Department and the IRS determined that it was important to respond promptly to some of these comments and issued Notice 2016-49 (2016-34 I.R.B. 265) on August 5, 2016 in response. Notice 2016-49 provided interim guidance and described modifications to certain certification requirements, which are reflected in these final regulations. Finally, the Treasury Department and the IRS also issued Revenue Procedure 2017-14 (2017-3 I.R.B. 426) on December 29, 2016, which addressed the requirements for a CPEO to remain certified and the procedures relating to suspension and revocation of CPEO certification. The written comments received 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 these final regulations.

### **Summary of Comments and Explanation of Revisions**

The IRS received seven written comments in response to the proposed and temporary regulations. Several of the points made in the comments related to items specifically addressed in the online application for certification, Rev. Proc. 2016-33, Notice 2016-49, Rev. Proc. 2017-14, Form 8973 “Certified Professional Employer

Organization/Customer Reporting Agreement”, Schedule R (Form 941) “Allocation Schedule for Aggregate Form 941 Filers”, and/or Form 14751 “Certified Professional Employer Organization Surety Bond”. Except to the extent that certain of these comments also relate to issues covered by the regulations, the comments are beyond the scope of the regulations and they are not otherwise addressed herein. They are under further consideration for future revisions of the revenue procedures and possible modifications to the application program and applicable forms.

#### 1. Annual Wage Base and Withholding Threshold for Covered Employees

Sections 3511(a) and (c), provide that, for federal employment tax purposes, a CPEO is treated as the employer of covered employees that are work site employees (section 3511(a)(1)) and covered employees that are not work site employees (non-work site covered employees) (section 3511(c)(1)) with regard to remuneration it pays to these covered employees. Remuneration paid by an employer to an employee within any calendar year is not subject to the social security portions of Federal Insurance Contributions Act (FICA) taxes, the equivalent portions of tier 1 Railroad Retirement Tax Act (RRTA) taxes, or Federal Unemployment Tax Act (FUTA) taxes to the extent it exceeds the applicable annual wage base for these taxes (collectively referred to in this Summary of Comments and Explanation of Revisions as the “annual wage base”). See sections 3121(a), 3231(e), and 3306(b) for FICA, RRTA, and FUTA taxes respectively. Under section 3102(f)(1), employers are required to withhold Additional Medicare Tax (AdMT) from an employee’s wages only to the extent that those wages exceed \$200,000 in a calendar year (referred to in this Summary of Comments and Explanation of Revisions as the “withholding threshold”). The annual wage base applies on an

employer-by-employer basis, unless the predecessor-successor employer rule discussed below applies; thus, only remuneration received during any calendar year by an employee from the same employer is considered in applying the annual wage base for purposes of the remuneration paid by that employer. See §§31.3121(a)(1)-1(a)(3) and 31.3306(b)(1)-1(a)(3) for FICA and FUTA taxes, respectively. Similarly, the AdMT withholding threshold applies only with regard to remuneration received during any calendar year by an employee from the same employer. See §31.3102-4(a).

By contrast, the annual wage base is not applied separately to successor and predecessor employers. See section 3121(a)(1). In accordance with section 3511(b), §31.3511-1(d) of the proposed regulations provides that, for purposes of the annual wage base: (1) a customer is considered a predecessor employer and a CPEO is considered a successor employer upon entering into a CPEO contract with respect to a work site employee who is performing services for the customer, and (2) a CPEO is considered a predecessor employer and a customer is considered a successor employer upon termination of the CPEO contract between the CPEO and the customer with respect to a work site employee who is performing services for the customer. The proposed regulations also provide that, except as provided with respect to successor and predecessor employers in §31.3511-1(d), remuneration received by a covered employee from a CPEO for performing services for a customer of the CPEO within any calendar year is subject to a separate annual wage base and withholding threshold that are each computed with respect to such remuneration, without regard to any remuneration received by the covered employee during the calendar year from any other employer (including, if applicable, remuneration received directly from the

customer receiving services from the employee). Thus, upon entering into a CPEO contract with a customer with respect to a covered employee, the CPEO starts a new annual wage base and withholding threshold with respect to the covered employee (unless the CPEO is treated as a successor employer under §31.3511-1(d)).

The proposed regulations also provide that if, during a calendar year, a covered employee receives remuneration from a CPEO for services performed by the covered employee for more than one customer of the CPEO, the annual wage base and withholding threshold do not apply to the aggregate remuneration received by the covered employee from the CPEO for services performed for all such customers. Rather, the annual wage base and withholding threshold apply separately to the remuneration received by the covered employee from the CPEO with respect to services performed for each customer.

The Treasury Department and the IRS received several comments on the annual wage base and withholding threshold rules for covered employees under the proposed regulations. One commenter recommended that current law, unaffected by section 3511 and the regulations thereunder, should apply for purposes of determining whether remuneration paid by a CPEO to a non-work site covered employee is subject to a separate annual wage base. The commenter asserted that the statutory distinction between the tax treatment of work site employees and the tax treatment of non-work site covered employees was intended to address CPEO and customer liability only in each case, and was not meant to otherwise change the federal employment tax treatment of wages paid to work site employees versus non-work site covered employees.

The Treasury Department and the IRS disagree with that assertion. Section 31.3121(a)(1)-1(a)(3) provides that if an employee receives remuneration from more than one employer in a calendar year, the annual wage base does not apply to the aggregate remuneration received from all of such employers, but instead applies to the remuneration received during that calendar year from each employer. Because section 3511 treats a CPEO as an employer separate and apart from the CPEO customer for whom the employees are performing services, employees receiving remuneration from both the CPEO and the CPEO customer in a calendar year must be treated as receiving remuneration from two different employers and the annual wage base therefore applies separately, unless the successor and predecessor rules under section 3511(b) apply.

The same commenter also suggested that, if an employee performs services for multiple customers of a CPEO, the annual wage base should apply to the aggregate remuneration received by the employee from the CPEO for services performed for all customers. The commenter argued that the customer-by-customer treatment of the annual wage base in the proposed regulations was contrary to the statutory language that treats the CPEO as the sole employer of work site employees.

A customer-by-customer treatment of the annual wage base is consistent with section 3511. Specifically, the maintenance of a separate annual wage base and withholding threshold with respect to each customer for which a covered employee performs services during a calendar year is consistent with the statutory language of section 3511(a)(1) which provides that the CPEO will “be treated as the employer (and no other person will be treated as the employer) of any work site employee performing services for any customer of such organization, *but only with respect to remuneration*

*remitted by such organization to such work site employee”* (emphasis added). This language contemplates that the CPEO will have a separate annual wage base under 3121(a), 3231(e), and 3306(b) (subject to the application of the predecessor-successor employer rules on a customer-by-customer basis). Furthermore, under section 3511(a)(2) (applicable to work site employees) and section 3511(c)(2) (applicable to non-work site covered employees), the exemptions, exclusions, definitions, and other rules, which are based on the type of employer in most cases will be based on the CPEO customer (assuming the typical situation in which the CPEO customer is the common law employer of the covered employees). In these instances, the attributes of the CPEO customer (e.g. tax-exempt or not) will be used to determine the taxes on the remuneration paid by the CPEO with respect to services performed for a customer. In addition, section 3511(d)(1)(A) provides that, for purposes of certain specified credits, with respect to services performed by a work site employee for a CPEO customer, the credits apply to the CPEO customer, not the CPEO. Thus, section 3511 requires, for both work site and non-work site covered employees, the separate treatment of amounts paid by the CPEO to one employee with respect to services performed by the employee for two or more different customers. A separate annual wage base and withholding threshold with respect to each customer for which a covered employee performs services is needed for purposes of applying some of the exemptions, exclusions, definitions, and other rules addressed in section 3511(a)(2) and (c)(2) and the treatment of some of the credits discussed in section 3511(d). Therefore, if a single employee receives remuneration from a CPEO pursuant to multiple CPEO contracts

with different customers, the CPEO must maintain a separate annual wage base and withholding threshold for the employee with respect to each customer.

For instance, wages paid to employees for services performed in the employ of a religious, charitable, educational, or other type of organization described under section 501(c)(3) are not subject to FUTA tax under section 3306(c)(8). Consequently, under sections 3511(a)(2) and (c)(2), wages paid by a CPEO to covered employees for services performed for a CPEO customer that is an organization described in section 501(c)(3) are not subject to FUTA tax. Wages paid by a CPEO to a covered employee for services performed for a CPEO customer that is a section 501(c)(3) organization cannot be used in determining FUTA tax liability for wages paid by the CPEO for services performed by that same employee for a CPEO customer that is subject to FUTA tax. The FUTA annual wage base must be applied separately to the remuneration paid by the CPEO for services performed for the non-section 501(c)(3) employer because under sections 3511(a)(2) and (c)(2) the exemption from FUTA tax applies only to the CPEO customer that is a 501(c)(3) organization.

For these reasons, the commenter's proposed changes are not adopted in these final regulations.

Finally, one commenter suggested that, because a CPEO that is treated as a successor employer will need to determine the amount of wages paid and applied toward the annual wage base by a customer that is treated as the predecessor employer and in some cases that information provided by a customer may be incorrect, the IRS should issue guidance stating that a CPEO may rely on the wage report provided by the customer. Whether, and to what extent, a CPEO relies on a wage

report from its customer is a business decision for the CPEO. The CPEO still has the obligation to report accurate information. General guidance on the procedures applicable to preparing and reporting wage information in predecessor and successor employer situations is addressed in the regulations under section 3121(a)(1) and in Revenue Procedure 2004-53, 2004-34 I.R.B. 320, (the revenue procedure specifically provides guidance on filing Forms 941, W-2, W-4, and W-5 in predecessor and successor employer situations). CPEOs that are treated as successor employers should refer to those provisions for guidance. For these reasons, the commenter's suggestion is not adopted in these final regulations.

## 2. Treatment of Credits

### a. Non-work site covered employees

Under section 3302(h), if a CPEO, or a customer of a CPEO, makes a contribution to a state's unemployment fund with respect to wages paid to a work site employee, the CPEO is eligible for the credits available under section 3302 for purposes of calculating FUTA tax with respect to that contribution. Similarly, under section 3303(a)(4), a CPEO is allowed an additional credit under section 3302(b) with respect to any reduced rate of contributions permitted by a state law if the Secretary of Labor finds that under that law the CPEO is permitted to collect and remit contributions during the taxable year to the state unemployment fund with respect to a work site employee. Because section 3302(h) and section 3303(a)(4) apply exclusively with respect to wages paid to work site employees, the Treasury Department and the IRS requested comments on the application of the credits in sections 3302(h) and 3303(a)(4) with respect to wages paid to non-work site covered employees.

Under section 3511(d), for purposes of various tax credits enumerated in section 3511(d)(2) under which the amount of the credit is determined by reference to the amount of federal employment taxes or the amount of wages subject to federal employment taxes, the credit with respect to a work site employee performing services for a customer applies to the customer, not to the CPEO. Consequently, in determining the amount of the credit, the customer, and not the CPEO, takes into account the federal employment taxes and wages paid by the CPEO with respect to the work site employee and for which the CPEO receives payment from the customer. Because the application of the specified tax credits to the customer under section 3511(d) applies exclusively with respect to work site employees, the Treasury Department and the IRS requested comments on the treatment of tax credits with respect to non-work site covered employees.

One commenter responded to these requests for comments. Concerning the application of the FUTA tax credits in sections 3302(h) and 3303(a)(4) to non-work site covered employees, the commenter stated that the application of the credits should be governed by current law without regard to the statutory provisions related to the CPEO program. But the commenter also suggested that “it is equitable, consistent with the intent of the law, and in the best interests of employment administration efficiency (without regard to the application of [section] 3511) to apply the application of the pass-through of the FUTA tax credit to a CPEO with respect to wages paid to ... individuals covered by a CPEO contract that are not Work Site Employees.” In addition, this commenter requested that the preamble to the final regulations note that “as a general

matter, the CPEO that is liable for the FUTA taxes on remuneration it pays would be eligible for the tax credits under sections 3302(h) and 3303(a)(4).”

The Treasury Department and the IRS have determined that, because amendments to regulations under section 3302(h) and section 3303(a)(4) were not included in the notice of proposed rulemaking, these final regulations will not address the general application of the credits in sections 3302(h) and 3303(a)(4) in connection with wages paid to non-work site covered employees. The Treasury Department and the IRS will continue to consider this issue.

Concerning the treatment of tax credits described in section 3511(d) with respect to non-work site covered employees, the commenter suggested that, just as with the credits under sections 3302(h) and 3303(a)(4), the application of these credits should be governed by current law. The commenter also added that there is “no basis or advantage” to treating work site employees and non-work site covered employees differently and therefore, as a general matter, the customer, and not the CPEO, should be eligible for the tax credits listed in section 3511(d). The Treasury Department and the IRS agree that current law should govern the eligibility for the tax credits listed in section 3511(d) with respect to wages paid to non-work site covered employees. For this reason, these final regulations do not include provisions regarding the application of the tax credits in section 3511(d) to non-work site covered employees. The Treasury Department and the IRS note that, in computing these credits under current law, generally the customer, and not the CPEO, will take into account wages and federal employment taxes paid by the CPEO with respect to the covered employee and for which the CPEO receives payment from the customer. This is the same treatment

accorded to tax credits listed in section 3511(d) for work site employees.

b. Additional credits

As discussed in the previous section, section 3511(d) governs the treatment of various tax credits under which the amount of the credit is determined by reference to the amount of wages or federal employment taxes and section 3511(d)(2) specifies these credits. Under section 3511(d)(2)(H), the Secretary may specify other credits subject to the treatment provided for under section 3511(d). Consistent with this section, the Treasury Department and the IRS requested comments on whether other credits should be specified in these regulations or in other guidance.

One commenter requested that the recently enacted employer credit for paid family and medical leave under section 45S be added to the list of specified credits in the regulations. Section 45S was added to the Code by the Tax Cuts and Jobs Act (Pub. L. 115-97) enacted December 22, 2017. Notice 2018-71, 2018-41 I.R.B. 548, published October 9, 2018, provides that, for wages paid by a CPEO to qualifying employees for services performed for an eligible employer, the eligible employer, not the CPEO, may take into account wages paid to qualifying employees for services performed for the eligible employer in determining the credit under section 45S. The notice also announces the IRS's intention to publish proposed regulations under section 45S. The Treasury Department and the IRS have determined that, although the credit under section 45S does not apply to wages paid in taxable years beginning after December 31, 2019 (unless extended), it is appropriate to add this credit to the list of specified credits. Therefore, these final regulations include the credit under section 45S in the list of specified credits under §31.3511-1(e)(2) (which provides a list of credits that

apply to the CPEO customer, and not the CPEO, with respect to services performed by a work site employee for a CPEO customer). In addition, §31.3511-1(e)(2)(ix) of these final regulations provides that the IRS may specify any other section as a specified credit in further guidance.

No other comments on the proposed regulations were received specifying additional credits to be included in the final regulations. However, subsequent to the issuance of the proposed regulations, the IRS did receive questions concerning whether wages paid by a CPEO to employees for services performed for a customer can be used by the customer in determining the employee retention credit in section 503 of the Disaster Tax Relief and Airport and Airway Extension Act of 2017 (The Disaster Relief Act (Pub. L. 115-63)) (assuming that the customer otherwise meets the requirements for the credit). In response to these inquiries, the IRS provided, in Publication 976 “Disaster Relief”, and on [irs.gov](https://www.irs.gov), that for purposes of the employee retention credit, qualified wages paid by a CPEO to eligible employees of an eligible employer are considered qualified wages incurred by the eligible employer. The employee retention credit for disaster relief found in The Disaster Relief Act is substantially similar to the credit provided for in section 1400R, which provides an employee retention credit for employers affected by Hurricane Katrina. In addition, several other disaster relief acts have provided employee retention credits modeled after the credit in section 1400R. Since future disaster relief acts may continue to include employee retention credits similar to those provided in section 1400R and in The Disaster Relief Act, these final regulations add statutory employee retention credits that are similar to the employee

retention credit in section 1400R and that provide disaster relief to employers in designated disaster areas to the list in §31.3511-1(e)(2).

### 3. Treatment of Self-Employed Individuals

Consistent with section 3511(f), which provides that a self-employed individual is not a work site employee with respect to remuneration paid by a CPEO, and with section 3511(c), which provides that a CPEO is not treated as an employer of a self-employed individual, the proposed regulations provide that section 3511 does not apply to any self-employed individual.

The proposed regulations define a “self-employed individual” as an individual with net earnings from self-employment (as defined in section 1402(a), without regard to the exceptions thereunder) derived from providing services covered by a CPEO contract, whether such net earnings are derived from providing services as a non-employee to a customer of a CPEO, from the individual’s own trade or business as a sole proprietor customer of the CPEO, or as a partner in a partnership that is a customer of the CPEO, but only with regard to such net earnings.

In addition, the preamble discussion of the definition of “work site employee” in the proposed regulations provides that a self-employed individual, whether an independent contractor to the customer, a sole proprietor customer of the CPEO, or a partner in a partnership customer of the CPEO, is not considered to be a work site employee under section 3511(f) with regard to those earnings, but also provides that in the limited case in which a self-employed individual who is an independent contractor of a customer is also paid wages by the CPEO under a CPEO contract with the customer, the individual may nevertheless be a work site employee with respect to those wages.

This latter language was intended to address the uncommon situation in which one individual is receiving payments from the CPEO for services provided to a customer in two separate capacities, i.e., for services performed for the CPEO customer as a common law employee of the customer and for completely separate and distinct services provided to the customer as an independent contractor. The CPEO is treated as the employer of the individual for federal employment tax purposes with respect to the payments the CPEO makes to the individual for the services the individual performs as a common law employee of the CPEO customer, and these payments are reported as wages by the CPEO. The payments for the services provided as an independent contractor are not wages and must be reported as payments to a self-employed individual.

Further, any payment made by a CPEO to a partner in a partnership under a contract between the partnership and the CPEO must always be treated as a payment to a self-employed individual and reported as such. Under Revenue Ruling 69-184 (1969-1 C.B. 256) “[b]ona fide members of a partnership are not employees of the partnership” for federal employment tax purposes. “Such a partner who devotes ... time and energies in the conduct of the trade or business of the partnership, or in providing services to the partnership as an independent contractor, is, in either event, a self-employed individual rather than an individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.” Thus, “[r]emuneration received by a partner from the partnership is not ‘wages’ with respect to ‘employment.’” Instead, under the statutory framework of Subchapter K of the Code, an allocation or distribution between a partnership and a

partner for the provision of services generally can be treated in one of three ways: (1) a distributive share under section 704(b) (reported as such by the partnership on Schedule K-1 (Form 1065), “Partner’s Share of Income, Deductions, Credits, etc.”); (2) a guaranteed payment under section 707(c) (reported as such by the partnership on Schedule K-1 (Form 1065)); or (3) as a transaction in which a partner has rendered services to the partnership in its capacity as other than a partner under section 707(a) (reported by the partnership like a payment to an independent contractor on Form 1099-MISC, “Miscellaneous Income”). It is irrelevant to the characterization of the payment whether a CPEO pays the partner or the partnership pays the partner directly.

One commenter requested that the IRS permit reporting of payments by CPEOs to self-employed individuals using Form W-2, “Wage and Tax Statement.” However, the reporting of amounts paid to self-employed individuals is outside of the scope of these regulations. For example, under the section 6041 regulations, certain payments to self-employed individuals are reported using information returns such as Form 1099-MISC, “Miscellaneous Income,” and not on Form W-2. Payments (within the meaning of section 6041 and the regulations thereunder) made to self-employed individuals should be reported in accordance with the rules under these and other applicable provisions.

#### 4. Reporting to the IRS by CPEOs

##### a. Reporting commencement or termination of CPEO contracts and service agreements

Section 3511(g) sets forth the reporting requirements and obligations that persons must satisfy in order to maintain certification as a CPEO. The proposed regulations provide that a CPEO must report information relating to the commencement or termination of (1) any CPEO contract with a customer and (2) any service agreement

described in §31.3504-2(b)(2) with a client and the name and EIN of such customer or client. The proposed regulations also provide that, with any Form 940, “Employer’s Annual Federal Unemployment (FUTA) Tax Return”, or Form 941, “Employer’s Quarterly Federal Tax Return”, that a CPEO files, the CPEO must attach the applicable Schedule R (or any successor form) including such information as the Commissioner may require about each of its customers under a CPEO contract and any clients under a service agreement described in §31.3504-2(b)(2). The only comment the IRS received related to these reporting requirements stated that they should be eliminated as they relate to clients under a service agreement described in §31.3504-2(b)(2) because they are unnecessarily burdensome, ineffective, and not supported by statute. The commenter also stated that reporting commencement or termination of CPEO contracts or service agreements should be required only quarterly.

Section 3511(g) provides that the “Secretary shall develop such reporting and recordkeeping rules, regulations, and procedures as the Secretary determines necessary or appropriate to ensure compliance with this title by certified professional employer organizations.” Because a CPEO contract potentially affects the liability of CPEO customers under such contracts, the proposed regulations provide that CPEOs must report service agreements described in §31.3504-2(b)(2) with clients so that the IRS has a record that explicitly provides which CPEO clients are *not* under a CPEO contract, in the event that disputes concerning liability arise. In addition, the instructions to Form 8973, which is the form used to report a CPEO contract with a customer and a service agreement described in §31.3504-2(b)(2) with a client, require that customers and clients sign Form 8973 and that a copy of this form be provided to the customers

and clients to ensure the customers and clients understand the nature of their relationship with the CPEO. This requirement is in line with the statutory requirement in section 7705(e)(2)(F) that a CPEO contract include a provision that the CPEO agrees to be treated as a CPEO for purposes of 3511 with respect to the CPEO customer's employees. Thus, requiring that CPEOs report service agreements described in §31.3504-2(b)(2) with clients not only facilitates the IRS's recordkeeping, but also provides a means for the IRS to verify that the CPEO has properly represented to clients and customers the nature of their contractual arrangement (i.e., whether they are covered by a CPEO contract or not).

Similarly, the proposed regulations provide that CPEOs must include information about clients under a service agreement described in §31.3504-2(b)(2) on Schedule R so that the IRS has a record of which amounts reported on Forms 941 and 940 are *not* subject to the liability provisions in sections 3511(a) and (c), in the event disputes concerning liability arise, and so that the IRS can better reconcile the total amounts of wages and taxes reported on Forms 940 and 941 with the amounts of wages and taxes reported on Schedule R.

Because the proposed regulations' reporting requirements relating to clients under a service agreement described in §31.3504-2(b)(2) assist the IRS in ensuring CPEO compliance with rules governing federal employment tax liability, consistent with section 3511(g), these final regulations retain the reporting requirements as they were in the proposed regulations.

The proposed regulations do not address the time and manner of reporting the commencement or termination of CPEO contracts and service agreements. Rather, this

information is provided in Rev. Proc. 2017-14 and in the instructions to the Form 8973. Requirements relating to the time and manner of reporting the commencement or termination of CPEO contracts and service agreements are criteria for tax administration that may need to be modified as processes or technology change or more knowledge about administrative challenges is acquired. Therefore, these requirements are more appropriately addressed in tax forms and publications or revenue procedures.

b. Form 943 – attaching Schedule R and reporting on magnetic media

The proposed regulations provide that, with every Form 940 and Form 941 it files, a CPEO must attach all required schedules, including, but not limited to, the applicable Schedule R (or any successor form). The proposed regulations also provide that a CPEO must file Forms 940 and 941, and all required accompanying schedules, on magnetic media unless the CPEO is provided a waiver by the Commissioner. The proposed regulations define magnetic media as electronic filing, as well as other media specifically permitted under the applicable regulations, revenue procedures, publications, forms, instructions, or other guidance.

For certain agricultural employer clients and customers, CPEOs must report federal employment taxes using Form 943, “Employer’s Annual Federal Tax Return for Agricultural Employees.” At the time the proposed regulations were promulgated, a Schedule R was not available for Form 943, and the form could not be filed electronically. However, Schedule R (Form 943) is now available, and electronic filing has since been made available for Form 943. For this reason, these final regulations provide that, just like Forms 940 and 941, Form 943 must be filed with all required

schedules, including Schedule R, attached and Form 943 must be filed on magnetic media unless the CPEO is provided a waiver by the Commissioner.

c. Waivers of the requirement to report on magnetic media

The proposed regulations provide that the requirement to file Forms 940 and 941 on magnetic media can be waived in cases of undue economic hardship. Since the promulgation of the proposed regulations, some CPEOs experienced difficulties in electronic filing due to temporary software and technological issues, and one commenter asked the IRS to clarify that undue economic hardship can include economic hardships resulting from software and technological issues. The IRS provided these clarifications on [irs.gov](http://irs.gov), and these final regulations also clarify that undue economic hardship includes economic hardships resulting from software and technological issues.

5. Applicable Definitions

a. Certified public accountant (CPA)

In connection with the financial statement and quarterly assertion and attestation requirements in the temporary regulations, the CPEO applicant or CPEO must submit an opinion or an examination level attestation, as applicable, from a CPA. The temporary regulations define a CPA as an individual who is independent of the CPEO (as prescribed by the American Institute of Certified Public Accountants' (AICPA) Professional Standards, Code of Professional Conduct), and among other things, files with the IRS a written declaration that he or she is authorized to represent the CPEO applicant or CPEO before the IRS. The Treasury Department and the IRS requested comments regarding whether the CPA independence guidelines or requirements of

other governmental agencies or departments of industry self-regulatory bodies (such as the Department of Labor's guidelines on the independence of CPAs retained by employee benefit plans under 29 CFR 2509.75-9, the Securities and Exchange Commission's (SEC) independence guidelines for auditors reporting on financial statements included in SEC filings, and the Government Accountability Office's auditor independence requirements under Government Auditing Standards that cover federal entities and organizations receiving federal funds), as adapted for a CPA of a CPEO, would better ensure the impartiality of CPAs providing opinions on a CPEO's financial statements. One commenter responded that the AICPA's independence guidelines are the most appropriate for the CPEO program, and that most CPAs are more familiar with those guidelines than the other guidelines referenced in the preamble to the temporary regulations. The Treasury Department and the IRS agree that the AICPA's independence guidelines are the most appropriate for the CPEO program. Therefore, these final regulations retain the reference to the AICPA professional standards.

Several commenters also noted that the requirement that a CPA be authorized to represent the CPEO applicant or CPEO before the IRS could conflict with the CPA independence requirements of the AICPA. Consistent with Notice 2016-49, and to ensure that the CPA may be "independent" within the meaning of the AICPA guidelines, these final regulations omit the requirement that the CPA file with the IRS a written declaration of authorization to represent the CPEO applicant or CPEO before the IRS.

b. Responsible individual

Section 7705(b)(1) provides that the Secretary may establish requirements for certification that apply not only to the CPEO applicant or CPEO, but also to "any owner,

officer, and other persons as may be specified in regulations.” Accordingly, the temporary regulations include a number of requirements that apply to certain owners, officers, and other individuals (referred to in the regulations as “responsible individuals”). The temporary regulations generally define a responsible individual as an individual in any of the following categories with respect to the CPEO applicant or CPEO: (1) certain owners; (2) directors and officers; (3) individuals with ultimate responsibility for implementing the decisions of the organization’s governing body; (4) individuals with ultimate responsibility for the organization’s management and operations; (5) individuals with ultimate responsibility for managing the organization’s finances; (6) managing members or general partners; (7) the sole proprietor of a sole proprietorship; and (8) any other individuals with primary responsibility for federal employment tax compliance of the organization. With respect to determining whether an individual is a responsible individual by reason of ownership, the temporary regulations specify that a responsible individual includes any individual who owns 33 percent or more of the total combined voting power of all classes of stock of a corporation entitled to vote or the total value of shares of all classes of stock of a corporation, or any individual who owns 33 percent or more of the profits interest or capital interest in a partnership.

The Treasury Department and the IRS requested comments regarding the administrability of applying the definition of responsible individual with respect to ownership of profits interests in a partnership, the value of which may fluctuate over time. One commenter indicated that, although there would be situations where a partner’s capital interest or profits interest will fluctuate, similar fluctuations will likely

occur with respect to changes in corporate ownership. The commenter did not suggest revising the definition of responsible individual with respect to ownership percentages, but the commenter did suggest that the IRS require only annual reporting of responsible individuals unless there is significant turnover in the CPEO's responsible individuals. The temporary regulations require that a CPEO applicant or CPEO notify the IRS, in the time and manner prescribed by the Commissioner in further guidance (as defined in §301.7705-1(b)(8)), of any change that materially affects the continuing accuracy of any agreement or information that was previously made or provided to the IRS. A change in responsible individuals is an example of a material change, and the time and manner for reporting this information to the IRS is currently set forth in Rev. Proc. 2016-33 and Rev. Proc. 2017-14. Accordingly, the final regulations do not adopt this suggestion, but the Treasury Department and the IRS will consider this comment in any future updates to these two revenue procedures. Additionally, the final regulations adopt the definition of responsible individuals from the temporary regulations, with additional language regarding disregarded entities as described in paragraph 7(a) of this Summary of Comments and Explanation of Revisions.

The temporary regulations also require the CPEO, and each of its responsible individuals, to take such actions as are necessary to authorize the IRS to investigate the accuracy of statements and submissions made by the CPEO, including waiving confidentiality and privilege when necessary and submitting fingerprints to conduct comprehensive background checks, including, but not limited to, checks on tax compliance and criminal background. With respect to suitability requirements applicable to responsible individuals, the Treasury Department and the IRS requested

comments regarding the possible expansion of the category of individuals who must authorize the IRS to conduct comprehensive background checks and submit fingerprint cards to include certain directors, officers, and owners of a CPEO applicant's or CPEO's related entities. The Treasury Department and the IRS received one comment in response. The commenter requested that the category not be expanded because such an expansion would impose additional paperwork burdens on professional employer organizations (PEOs), responsible individuals, and the IRS without any meaningful improvements in the program. The Treasury Department and the IRS considered the likely impact on PEOs, responsible individuals, and the IRS of expanding this category and the likely value of this additional information to the IRS. As of the date of these final regulations, the IRS has certified 120 CPEOs, and the information provided regarding each CPEO applicant, its related entities, precursor entities, and responsible individuals, coupled with the ongoing certification requirements applicable to CPEOs and responsible individuals, has been sufficient for the IRS to make determinations regarding certification. Therefore, these final regulations do not expand the category of individuals who must authorize the IRS to conduct comprehensive background checks and submit fingerprint cards beyond what was included in the temporary regulations.

c. Provider of employment-related services

The temporary regulations define a provider of employment-related services as a person that provides employment tax administration, payroll services, or other employment-related compliance services to clients. One commenter suggested that the phrase "or other employment-related compliance services" in the definition of provider of employment-related services could be interpreted to include entities that only provide

(1) labor through a staffing service, or (2) employment background screening services. The commenter suggested revising the definition to refer to “other similar employment-related compliance services.” The Treasury Department and the IRS agree with the commenter that the phrase “or other employment-related compliance services” could be construed to apply more broadly than was intended. As noted in the preamble to the temporary regulations, the term is intended to capture entities that provide payroll or other federal employment tax administration and compliance services. Accordingly, these regulations replace the term “provider of employment-related services” with “provider of payroll services” and revise the definition of this term to clarify that the entity must provide payroll, federal employment tax administration, or other similar federal employment tax-related compliance services.

d. Work site

The proposed regulations define “work site” as a physical location at which an individual regularly performs services for a customer of a CPEO (except that a work site may not be the individual’s residence or a telework site unless the customer requires the individual to work at that site) and if there is no such location, the work site is the location from which the customer assigns work to the individual. The proposed regulations also provide that, in applying the term “work site,” contiguous locations are treated as a single physical location and thus a single work site, and noncontiguous locations that are not reasonably proximate are treated as separate physical locations and thus separate work sites. A CPEO may treat noncontiguous locations that are reasonably proximate as a single physical location and thus a single work site, but any two work sites that are separated by 35 or more miles or that operate in a different

industry or industries will not be treated as reasonably proximate. Because the physical location at which an individual regularly performs services can, at times, be difficult to ascertain, the Treasury Department and the IRS requested comments on the definition of work site and any additional clarifications that would facilitate a determination of an individual's work site.

One commenter responded to this request for comments. The commenter suggested that the definition focus on the physical location where an individual "primarily" performs services and that, when appropriate, various client locations should be considered one work site location rather than providing for separate work sites for each location at which the CPEO customer's workers perform services. The commenter also suggested that work sites in different industries and work sites that are maintained as a separate operation for bona fide business reasons (based on facts and circumstances) are factors that should be taken into account for purposes of determining whether two or more work sites should be treated as one work site.

The definition of work site in the proposed regulations, as a location where an individual *regularly* performs services, was intended to take into account CPEO customers whose workers provide services in multiple noncontiguous, non-proximate locations and/or locations that operate in a different industry or industries. Under the proposed regulations, the determination of whether a covered employee is a work site employee is made separately with regard to each work site at which the covered employee regularly provides services; under this standard, a covered employee may be determined to be a work site employee at more than one work site during a calendar quarter. Furthermore, the proposed regulations provide that a covered employee will be

considered a work site employee for the entirety of a calendar quarter if the employee qualifies as a work site employee at any time during that quarter. Therefore, a covered employee that regularly performs services for a customer at multiple sites need only qualify as a work site employee at one of the sites in a calendar quarter to be considered a work site employee for that entire quarter.

The use of the phrase “primarily performs services” instead of the phrase “regularly performs services” would not provide the customer this flexibility, but would instead require customers with covered employees at multiple sites either to identify the site at which covered employees “primarily” perform services or to make a determination (with appropriate substantiation) that it maintains separate work sites for a bona fide business reason such that these sites can be treated as one work site. To avoid that result, these final regulations do not adopt this suggested change.

However, the Treasury Department and the IRS recognize that certain employers have employees regularly working at the location of clients of varying industries, all doing work in the employer’s industry rather than the industry of the client. For example, an information technology business might have employees regularly performing services related to information technology at the locations of clients in a variety of unrelated industries (factory, restaurant, museum, etc.). To address this situation, these final regulations provide that the determination of the industry of a work site is based on the nature of the CPEO customer’s work at that work site, irrespective of work performed by other entities at the same site.

In addition, these final regulations provide that when treating noncontiguous locations as a single physical location and thus a single work site, one noncontiguous

location cannot be included in more than one work site. The final regulations contain an example illustrating this rule. Finally, for clarification, non-substantive changes were made to the language in the proposed regulations.

e. Work site employee

The proposed regulations, consistent with section 7705(a), provide that a work site employee means, with respect to a customer, a covered employee who performs services for the customer at a work site where at least 85 percent of the individuals performing services for the customer are covered employees of the customer. The proposed regulations also provide that a covered employee will be considered a work site employee for the entirety of a calendar quarter if he or she qualifies as a work site employee at any time during that quarter. Consequently, a covered employee can be a work site employee for one or more calendar quarters of the year and a non-work site covered employee for other calendar quarters during the same year. One commenter suggested a safe harbor rule providing that a covered employee who qualifies as a work site employee at any time during a calendar quarter is considered a work site employee for the entirety of that quarter *and* for the remainder of the calendar year. Since the CPEO program began in 2016, the IRS has not been made aware of any issues concerning the quarterly determination of work site employees. For this reason, and because a quarter-by-quarter work site employee determination coincides with a CPEO's quarterly federal employment tax reporting, these final regulations do not adopt this suggestion.

The same commenter also requested that the regulations clarify the rules regarding excluded employees under section 414(q)(5). In accordance with section

7705(e)(3), the proposed regulations provide that, in determining whether the 85 percent threshold is met, individuals who are excluded employees within the meaning of section 414(q)(5) (such as newly hired or part-time employees) are not taken into account as either covered employees or individuals performing services, although those individuals may otherwise be covered employees and work site employees under the proposed regulations. The commenter was concerned that this rule could be interpreted to mean that all employees of a startup company would be excluded employees for purposes of determining whether the 85 percent threshold is met. The commenter suggested that the regulations incorporate the flush language from section 414(q)(5), which provides that an employer may substitute a shorter period of service, smaller number of hours or months, or lower age for the period of service, number of hours or months, or age specified in section 414(q)(5), though the commenter also suggested that the regulations provide that any such modifications must be on a consistent and uniform basis with respect to individuals performing services at the work site.

Because the application of section 414(q)(5) is outside the scope of these regulations, these final regulations do not provide for any further explanation of the application of section 414(q)(5). Therefore, employers should look to the language of section 414(q)(5) in determining which employees should be excluded under section 7705(e)(3). However, the Treasury Department and the IRS agree that the flush language from section 414(q)(5) can be applied in the context of determining whether the 85 percent work site coverage requirement threshold is met under section 7705(e)(3), such that an employer may substitute a shorter period of service, smaller

number of hours or months, or lower age for the period of service, number of hours or months, or age specified in section 414(q)(5).

Finally, this commenter suggested that the regulations provide that reasonable good faith determinations concerning the application of the 85 percent coverage test in determining work site employees will be respected unless there is a pattern of abuse of this rule by the CPEO or its customer. The Treasury Department and the IRS agree that, because applying the 85 percent coverage rules for determining work site employees may be challenging in certain situations, a good faith standard is appropriate. For this reason, these final regulations provide that a CPEO's determination that a covered employee is a work site employee will be respected if the CPEO has made a good faith determination that the covered employee meets the requirements of section 7705(e), the regulations, and further guidance.

## 6. Application Process

The temporary regulations provide that a CPEO applicant will be notified by the IRS whether its application for certification has been approved or denied, as well as the effective date of certification or the reason(s) for the denial, each as applicable. One commenter noted that the temporary regulations do not address the reapplication process for CPEO applicants that are denied certification. The commenter requested that the final regulations clarify that a CPEO applicant may not reapply for certification for at least one year following a denial of certification, unless the CPEO applicant has resolved the issues identified by the IRS as the reason for the certification denial. The commenter also suggested that the final regulations clarify that a CPEO applicant that withdraws its application before the IRS makes a decision regarding certification may

reapply for certification at any time. Rev. Proc. 2016-33 sets forth the detailed procedures for applying to be certified, including the ability to withdraw an application, but it does not address reapplication following a denial of certification. The Treasury Department and the IRS agree that the final regulations should address the ability to reapply after a denial of certification or withdrawal. Accordingly, the final regulations provide that a CPEO applicant may reapply for certification in such time and manner, and must include such information, as the Commissioner may prescribe in further guidance. Because procedural requirements relating to the time and manner of applying for certification may need to be modified as processes or technology change or more knowledge about administrative challenges is acquired, the Treasury Department and the IRS intend to address these requirements in a future revision of Rev. Proc. 2016-33.

## 7. Suitability

### a. Disregarded entities and sole proprietorships

The temporary regulations provide that a CPEO may not be a business entity that is disregarded as an entity separate from its owner for federal tax purposes under §§301.7701-2 and 301.7701-3 (without regard to the special rule in §301.7701-2(c)(2)(iv) that provides that such entities are corporations for federal employment tax purposes). Several commenters expressed concerns regarding the prohibition against disregarded entities becoming CPEOs. The commenters indicated that the temporary regulations may unnecessarily limit the ability of persons to apply for certification. They explained that PEOs may be structured as disregarded entities for legitimate business reasons, such as to reduce the overall compliance burden associated with filing state

income tax returns. As a result of those comments, the Treasury Department and the IRS announced in Notice 2016-49 the expectation that the final regulations would not prohibit a business entity that is disregarded as separate from its owner under §§301.7701-2 and 301.7701-3 from becoming a CPEO, provided the disregarded entity is (1) wholly owned directly (including through one or more disregarded entities organized in the United States) by a United States person (as defined in section 7701(a)(30)), and (2) created or organized in the United States or under the law of the United States or of any state (collectively, a domestic disregarded entity). Consistent with Notice 2016-49, these final regulations allow domestic disregarded entities to apply for certification as CPEOs. The Treasury Department and the IRS requested comments on the appropriateness of allowing a disregarded entity that is domestically organized but not wholly owned directly by a United States person to apply for certification as a CPEO, but no comments were received on this issue. Accordingly, these final regulations require the disregarded entity to be both domestically organized and wholly owned directly by a United States person.

As a result of the change permitting certain disregarded entities to apply for certification as a CPEO, these final regulations also revise the definition of “responsible individual” to include: (1) in the case of a disregarded entity owned by a corporation or partnership, the responsible individuals of that corporation or partnership, and (2) in the case of a disregarded entity owned by an individual, the individual owner. These final regulations also clarify that CPEO applicants and CPEOs that, but for their status as disregarded entities, would separately be members of a controlled group, are treated as

members of a controlled group for purposes of sections 3511 and 7705 and the regulations thereunder.

One commenter noted that the requirement that a CPEO must be a business entity would preclude an individual operating a business through a sole proprietorship from becoming a CPEO. As stated in Notice 2016-49, to ensure parity between sole proprietorships and disregarded entities that are wholly owned by individuals, these final regulations also expressly allow sole proprietorships to apply for certification as CPEOs.

b. Fingerprint cards and background checks

The temporary regulations provide that each responsible individual must submit fingerprints in the time and manner and under the circumstances prescribed by the Commissioner in further guidance. Currently, the specific requirements regarding the time and manner of fingerprint submissions, including whether a responsible individual needs to submit multiple cards are included in Rev. Proc. 2016-33, the CPEO application for certification, and in the Responsible Individual Personal Attestation (RIPA) instructions. One commenter requested that the temporary regulations be revised to clarify that a responsible individual may submit a single fingerprint card that will be used for background check purposes for all CPEO applicants in a controlled group for which that person is a responsible individual. The final regulations do not adopt this suggestion because the Treasury Department and the IRS have determined that the regulations should continue to provide the IRS with the flexibility to include specific instructions regarding fingerprint cards in other guidance, such as revenue procedures and the application for certification, as the program develops and as changes in technology permit new procedures. The Treasury Department and the IRS

will consider this comment in any future updates to Rev. Proc. 2016-33. However, the Treasury Department and the IRS consider it appropriate to include a specific reference to Federal Bureau of Investigations (FBI) background checks in order to acknowledge the scope of the background check. Accordingly, these final regulations expressly state that a CPEO or CPEO applicant, and each of its responsible individuals must take such actions as are necessary to authorize the IRS to conduct comprehensive background checks, including, but not limited to, FBI or other similar criminal background checks.

One commenter requested that responsible individuals who are attorneys, CPAs, enrolled agents, and officers of publicly traded companies be allowed to provide professional status information (e.g., credential number, state of jurisdiction, and date of expiration) in lieu of submitting fingerprints. The commenter indicated that this would be consistent with the IRS's e-file program. Under sections 3511(a)(1) and (c)(1), with respect to remuneration remitted to an individual by a CPEO, for purposes of federal employment taxes and other obligations under the federal employment tax rules, the CPEO is treated as the employer of any individual performing services for a customer of the CPEO and covered by a CPEO contract. This treatment and the tax liability associated with it makes the CPEO program unlike other contractual arrangements, including a relationship with an e-file provider. The Treasury Department and the IRS continue to view the criminal background of a CPEO applicant and its responsible individuals as an important factor in determining whether the CPEO applicant's or the CPEO's certification presents a material risk to the IRS's collection of federal employment taxes. Accordingly, the final regulations do not adopt the suggestion to rely on professional status data in lieu of an FBI or other similar background check.

c. Waiving confidentiality and privilege

The temporary regulations require that CPEOs and responsible individuals take such actions as are necessary to authorize the IRS to investigate the accuracy of statements and submissions, including waiving confidentiality and privilege when necessary. One commenter noted that this requirement could be read to imply that responsible individuals and CPEOs are required to provide a blanket waiver of confidentiality and privilege on all issues. The temporary regulations were not intended to require responsible individuals and CPEOs to provide a blanket waiver. However, the Treasury Department and the IRS recognize that the language in the temporary regulations could be read more broadly than intended. Accordingly, and consistent with similar provisions in Rev. Proc. 2016-33, the final regulations clarify that the waiver will be required only in instances in which the IRS is otherwise unable to obtain or confirm the information it needs to evaluate a CPEO applicant's or CPEO's qualification for certification (e.g., from relevant third parties, such as former employers, because of the existence of confidentiality, non-disclosure, or similar agreements).

d. Financial institution

The temporary regulations require CPEO applicants and CPEOs to use only financial institutions described in section 265(b)(5) to hold cash and cash equivalents. One commenter stated that CPEOs may violate this requirement by keeping small amounts of cash and cash equivalents on their premises. The commenter noted that this is a common practice and that certain cash equivalents are not ordinarily deposited in financial institutions. To address this concern, the final regulations require CPEO applicants and CPEOs to hold substantially all of their cash and cash equivalents in

financial institutions described in section 265(b)(5). This change is intended to allow CPEO applicants and CPEOs to hold petty cash and cash equivalents (such as undeposited checks) on their premises.

#### 8. Working Capital Requirements

The temporary regulations provide that CPEO applicants and CPEOs must cause to be prepared and provided to the IRS, by the same date they must provide a copy of their annual audited financial statements, an opinion of an independent CPA that the financial statements reflect positive working capital for the fiscal year, unless an exception applies. In addition, the temporary regulations require this opinion to set forth in detail, a calculation of the CPEO applicant's or CPEO's working capital and state that the financial statements are presented fairly in accordance with generally accepted accounting principles (GAAP). Two commenters suggested that the final regulations eliminate the requirement that a CPEO applicant and CPEO have positive working capital. The commenters maintained that because the specific requirement of positive working capital is not included in the language of section 7705, the IRS should not impose this requirement on CPEOs. The commenters suggested that the IRS, instead, make its decision regarding whether to certify (or suspend) a CPEO applicant or CPEO, as applicable, based on the entity's financial situation, experience, and other factors in their entirety. Additionally, the commenters cautioned against the imposition of a rigid and difficult-to-monitor requirement.

The Treasury Department and the IRS consider a CPEO with annual audited financial statements that reflect positive working capital (as determined in accordance with GAAP) to present a materially lower risk to the IRS's collection of federal

employment taxes than a CPEO without positive working capital. Accordingly, pursuant to section 7705(b)(1) and consistent with several state PEO certification and registration laws, the final regulations have retained the positive working capital requirement. The Treasury Department and the IRS recognize that working capital may fluctuate over the course of a CPEO's fiscal year due to normal business operations. To allow for some fluctuation in working capital, the final regulations retain the exception to the positive working capital requirement set forth in the temporary regulations. This exception allows the CPEO applicant or CPEO to have negative working capital for no more than two consecutive quarters, provided the CPEO applicant or CPEO explains the reason it has negative working capital and demonstrates that the failure to have positive working capital does not present a material risk to the IRS's collection of federal employment taxes.

Several commenters indicated that CPAs may be prevented from including a statement on working capital in the CPA opinion due to certain AICPA limitations on what can be included in a CPA opinion. As stated in Notice 2016-49, to ensure consistency with the AICPA guidelines applicable to CPA opinion letters, these final regulations have been revised to require a CPEO applicant or CPEO to submit a copy of its annual audited financial statements and an opinion of a CPA that the annual audited financial statements are presented fairly in accordance with GAAP, provided that the audited annual financial statements covered by the opinion include a Note to the Financial Statements that states that the financial statements reflect positive working capital or that the CPEO applicant or CPEO satisfies the positive working capital exception included in these final regulations. The Treasury Department and the

IRS anticipate making similar changes in future revisions of Rev. Proc. 2016-33 and Rev. Proc. 2017-14.

The temporary regulations further require a responsible individual of a CPEO applicant or CPEO to provide, by the last day of the second month after the end of each calendar quarter and beginning with the most recently completed quarter as of the date of the application for certification, a statement verifying under penalties of perjury that the CPEO applicant or CPEO has positive working capital with respect to the most recently completed fiscal quarter. The temporary regulations further provide that although CPEO applicants and CPEOs that are members of a controlled group, within the meaning of sections 414(b) and (c), and the regulations thereunder, will be treated as a single CPEO applicant or CPEO for purposes of the annual audited financial statements, quarterly assertion and attestation, and bond requirements, the annual and quarterly requirements imposed with respect to positive working capital apply to each CPEO applicant or CPEO on a separate basis.

With respect to both the annual and quarterly requirements regarding positive working capital, two commenters suggested that these requirements should not apply on an individual CPEO basis. The commenters noted that many PEOs have multiple related PEO entities that maintain combined or consolidated financial statements, and these entities should be permitted to demonstrate compliance with any positive working capital requirement on an aggregate basis. The commenters suggested that the IRS could impose a requirement that each related entity guarantee the liabilities of its related CPEOs to the IRS.

Under the CPEO program, the decision regarding whether to certify, suspend, or revoke each CPEO applicant or CPEO (as applicable) is made on an entity-by-entity basis. Although the suitability of related and precursor entities is relevant when determining whether to certify a CPEO applicant, the IRS makes a separate certification determination with respect to each CPEO applicant. Accordingly, the final regulations adopt without change the provisions in the temporary regulations that the annual and quarterly requirements imposed with respect to positive working capital apply to each CPEO applicant or CPEO on a separate basis.

#### 9. Examination Level Attestation

In accordance with section 7705(c)(3)(B), §301.7705-2T(f)(1)(i) and (f)(3)(i) of the temporary regulations provide that CPEOs and CPEO applicants must provide, on a quarterly basis, an assertion, signed by a responsible individual under penalties of perjury, stating that the CPEO has withheld and made deposits of all federal employment taxes (other than taxes imposed by chapter 23 of the Code) as required by subtitle C for such calendar quarter, and an examination level attestation from a CPA stating that this assertion is fairly stated in all material respects. One commenter suggested that the final regulations provide the IRS with authority to provide an agreed-upon procedural alternative to the examination level attestation requirement because that option would provide uniformity, greater certainty, and potential cost savings. The Treasury Department and the IRS note that section 7705(c)(3)(B) specifically requires an examination level attestation on a quarterly basis and does not provide authority for other options. For this reason, these final regulations do not adopt this suggestion.

#### 10. Bond Requirements

Section 7705(c)(2) sets forth the bond requirements that a person must satisfy in order to become and remain a CPEO. The temporary regulations provide, among other things, that a CPEO must meet the bond requirements without posting collateral. Two commenters suggested that the final regulations remove the requirement that a CPEO meet the bond requirements without posting collateral. The commenters suggested that the “no collateral” requirement could limit access to CPEO certification for “small and medium sized PEOs,” but the commenters did not suggest what size entity would qualify as a small or medium sized PEO. As an alternative to removing the requirement in its entirety, one commenter suggested the IRS include the fact that a CPEO has obtained a bond with collateral as a factor in evaluating the application for certification. Alternatively, one commenter suggested that a surety be permitted to request collateral for small CPEO applicants (those with a required surety bond penal sum of under \$1,000,000). Finally, one commenter suggested that the IRS retain the discretion to not automatically revoke a CPEO’s certification merely because the surety has sought collateralization of its risk after the CPEO is certified. The commenter suggested that the request for collateral be treated as a material change that must be reported and explained to the IRS.

One commenter remarked that “[a]s a general matter, a surety prefers to provide bonds on an uncollateralized basis.” The commenter further noted that a surety may require collateral if a bond applicant is qualified, but the obligation being secured is “particularly risky.” The commenter noted that the potential duration of the CPEO bond (which is the time during which the IRS may make a claim and collect tax under

sections 6501 and 6502) may make the CPEO bond particularly risky, and indicated that this increased risk could conceivably be addressed by a collateral requirement.

As indicated in the preamble to the temporary regulations, one of the main benefits of the bond requirement in section 7705(c) is that a CPEO must submit to the bonding surety's financial underwriting process to obtain the bond. This underwriting process provides the IRS with a certain level of assurance concerning the financial condition of the CPEO. As of the date of these final regulations, the IRS has certified 120 CPEOs. Each CPEO (or controlled group, where applicable) has provided the IRS with a bond without posting collateral, including several with bond amounts below the \$1 million threshold. The Treasury Department and the IRS view the surety's financial underwriting process as a fundamental component of the bond requirement in section 7705(c), and have determined that the purpose of the bond requirement is substantially undermined if the CPEO obtains the bond by posting collateral in the amount of the bond. However, the Treasury Department and the IRS acknowledge that in certain limited circumstances, an exception to the prohibition on posting collateral may be appropriate. Accordingly, these final regulations state that the Commissioner may provide exceptions to this rule in further guidance. The Treasury Department and the IRS will continue to consider this issue in connection with anticipated revisions to Rev. Proc. 2017-14. In addition, the Treasury Department and the IRS recognize that in certain situations, a surety may want to retain the right to request collateral of a CPEO and that this right by itself does not violate the regulatory requirement that a CPEO must meet the bond requirements without posting collateral. For this reason, the final regulations provide that a surety's retention of the right to request collateral does not

violate the rule against posting collateral, as long as no collateral is actually required by the surety or posted by the CPEO. However, if a surety later exercises this right and seeks collateral for a CPEO's bond, this action qualifies as a material change that must be timely reported to the IRS and will result in the revocation of the CPEO's certification if the CPEO cannot obtain a bond from another surety that does not require the CPEO to post collateral, subject to any exceptions the Commissioner may provide, as described above.

The Treasury Department and the IRS also received comments requesting that the regulations clarify whether a CPEO must provide a separate bond for each year or adjust the penal sum of the bond based on its liability for the applicable bond period. One commenter also requested that the Treasury Department and the IRS define the terms strengthening bond and superseding bond. Consistent with guidance issued in Rev. Proc. 2017-14, these regulations clarify that the bond, any riders thereto, and any strengthening bonds are one continuous obligation from the effective date of the bond through the date the bond is superseded or cancelled. These regulations also provide definitions for riders, and for strengthening, superseding, and new bonds, and incorporate other guidance from Rev. Proc. 2017-14.

#### 11. Accrual Method of Accounting

Consistent with section 7705(b)(4) of the Code, the temporary regulations provide that a CPEO must compute its taxable income using an accrual method of accounting or, if applicable, another method that the Commissioner provides for in further guidance. One commenter requested that the IRS issue guidance approving the cash method of accounting as long as the entity provides audited financial statements

using the accrual method. The final regulations do not adopt this suggestion. Like the temporary regulations, however, the final regulations allow the Commissioner to provide for other accounting methods in further guidance, and the Treasury Department and the IRS will continue to consider the issue of whether to allow CPEOs to use the cash method of accounting.

## 12. Tip Reporting

The ABLE Act added section 6053(c)(8) to the Code regarding the application of the reporting requirements relating to certain large food or beverage establishments with respect to CPEOs and their customers. Section 6053(c)(8) provides that the CPEO customer with respect to whom a work site employee performs services is the employer for purposes of reporting under section 6053(c), and the CPEO is required to furnish to the customer and the IRS any information the IRS prescribes as necessary to complete this reporting. One commenter requested that these regulations clarify that the information required to be provided by section 6053(c)(8) is limited to information generated by the CPEO as a function of the services it performs as a CPEO and that is not already available to the customer. The Treasury Department and the IRS have determined that, because amendments to the regulations under section 6053 were not included in the notice of proposed rulemaking, these final regulations will not address information that must be provided under section 6053(c)(8). However, the Treasury Department and the IRS will continue to consider this issue.

## 13. Maintain Employee Records

Under section 7705(e)(2)(E), a service contract must provide that a CPEO will maintain employee records, and the proposed regulations include the same requirement

with respect to a CPEO contract. One commenter asked for further guidance regarding this requirement to maintain employee records. Although the statutory and regulatory provisions regarding service agreements and CPEO contracts require that the contract or agreement include certain provisions, including that the CPEO maintain employee records, the CPEO and its customers and client may choose to include additional provisions in their contracts. To allow for some flexibility and business judgment in negotiating CPEO contracts, the final regulations do not adopt the suggestion to expand upon the statutory requirements concerning maintaining employee records, and retain without modification the requirements for CPEO contracts set forth in the proposed regulations.

#### 14. Marketing as CPEOs

One commenter asked the Treasury Department and the IRS to clarify that only CPEOs may market themselves as CPEOs. Section 7705(f) and §301.7705-2(a)(3) and (n)(4)(ii) provide that the IRS will make available the name and address of every person certified as a CPEO and every CPEO whose certification is suspended or revoked. These regulations impose rules and requirements on CPEO applicants and CPEOs, but they do not apply to those entities that do not apply for or obtain certification. Whether an entity other than a CPEO incorrectly represents its classification in its business materials is not a matter for IRS enforcement. Accordingly, the final regulations do not adopt this suggestion, but the Treasury Department and the IRS encourage customers and clients of entities claiming to be CPEOs to confirm that those entities are listed and remain listed as CPEOs on [www.irs.gov](http://www.irs.gov).

#### 15. Confidentiality of Information

One commenter requested guidance indicating that information submitted to the IRS will be kept confidential. This comment is beyond the scope of these regulations, so no changes were made in these final regulations. Generally, returns and return information, including CPEO applications, are confidential and may only be disclosed as authorized by the Internal Revenue Code. See section 6103. Section 7705(f) provides for the public disclosure of the name and address of CPEOs and whether a CPEO's certification was suspended or revoked.

#### 16. No Inference Language

One commenter requested that the regulations reiterate language in section 206(h) of the ABLE Act that nothing in section 206 of the ABLE Act (which includes sections 3511 and 7705) shall be construed to create any inference with respect to the determination of who is an employee or employer (1) for federal tax purposes (other than the purposes set forth in the amendments made by section 206), or (2) for purposes of any other provision of law. This suggested addition to the final regulations is not necessary. Section 7705(g) sufficiently addresses the implications of the no inference provisions with respect to the Code. It provides that except to the extent necessary for purposes of section 3511, nothing in section 7705 shall be construed to affect the determination of who is an employee or employer for purposes of Title 26. Comments related to other laws are beyond the scope of these regulations, and they are not addressed herein.

#### 17. Other Changes

In addition to the changes discussed above, these final regulations include non-substantive or clarifying changes to the text of the proposed and temporary regulations.

## Special Analyses

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 Treasury Department and the Office of Management and Budget regarding review of tax regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. The collection of information is in §§31.3511-1(g) and 301.7705-2. The certification is based on the following:

The Treasury Department and the IRS anticipate that the organizations that choose to apply for this voluntary certification program are likely to be entities that already have many of the systems and processes in place that are needed to comply with these regulations. For example, it is expected that CPEOs will generally maintain annual audited financial statements during the normal course of their business, rather than solely as a result of §301.7705-2(e). Moreover, the requirements in §301.7705-2(e) and (f) for demonstrating positive working capital on an annual basis and for the quarterly assertions regarding federal employment tax compliance build upon requirements already reflected in many state PEO certification and registration laws, thereby minimizing the economic impact on those CPEO applicants already subject to the similar state law requirements.

In addition, many of the requirements in §§31.3511-1(g) and 301.7705-2 that impose a collection of information on CPEOs constitute one-time notifications to the IRS, customers, or clients or notifications that relate to events in the life cycle of a CPEO that are less predictable and may be infrequent – such as transfers of existing

CPEO contracts, making material changes to agreements previously provided to the IRS, suspension or revocation of the CPEO's certification, or the reclassification of employees at a particular work site as non-work site covered employees – and thus will have a minimal economic impact on the CPEO. Moreover, the Treasury Department and the IRS expect that CPEOs participating in this voluntary program will be able to build upon pre-existing systems and processes through which they already communicate with their clients.

For these reasons, pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6) it is hereby certified that this rule will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, the NPRM preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### **Drafting Information**

The principal authors of these regulations are Melissa Duce, Andrew Holubeck, Nina Roca, and Neil Shepherd of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the Treasury Department and the IRS participated in the development of these regulations.

### **Statement of Availability of IRS Documents**

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 Printing Office, Washington, DC 20402, or by visiting the IRS website at <http://www.irs.gov>.

## List of Subjects

### 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.

### 26 CFR Part 602

Reporting and recordkeeping requirements.

## Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 31, 301, and 602 are amended as follows:

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

Paragraph 1. The authority citation for part 31 is amended by adding an entry for § 31.3511-1 in numerical order to read in part as follows:

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

Section 31.3511-1 is also issued under 26 U.S.C. 3511(h).

\* \* \* \* \*

Par. 2. Section 31.3511-1 is added to subpart F to read as follows:

#### §31.3511-1 Certified professional employer organization.

(a) Treatment as employer--(1) In general. For purposes of the federal employment taxes and other obligations imposed under chapters 21 through 25 of

subtitle C of the Internal Revenue Code (federal employment taxes), a certified professional employer organization (CPEO) (as defined in §301.7705-1(b)(1) of this chapter) is treated as the employer of any covered employee (as defined in §301.7705-1(b)(5) of this chapter), but only with respect to remuneration remitted by the CPEO to the covered employee.

(2) Work site employee. In the case of a covered employee who is a work site employee (as defined in §301.7705-1(b)(17) of this chapter) of the customer, no person other than the CPEO is treated as the employer of the work site employee with respect to the customer for purposes of federal employment taxes imposed on remuneration remitted by the CPEO to the work site employee.

(3) Non-work site covered employee. In the case of a covered employee who is not a work site employee, a person other than the CPEO is also treated as an employer of the employee for purposes of federal employment taxes imposed on remuneration remitted by the CPEO to the employee if such person is determined to be an employer of the employee without regard to the application of this paragraph (a) and section 3511.

(b) Exemptions, exclusions, definitions, and other rules--(1) In general. Solely for purposes of federal employment taxes imposed on remuneration remitted by a CPEO to a covered employee, the application of exemptions, exclusions, definitions, and other rules that are based on the type of employer is presumed to be based on the type of employer of the customer of the CPEO for whom the covered employee performs services. If a covered employee performs services for more than one customer of the CPEO during the calendar year, the presumption described in the previous sentence

applies separately to remuneration remitted by the CPEO to the covered employee for services performed with respect to each such customer.

(2) Presumption rebutted. The presumption set forth in paragraph (b)(1) of this section may be rebutted if either the Commissioner determines, or the CPEO demonstrates by clear and convincing evidence, that the relationship between the customer and the covered employee is not the legal relationship of employer and employee as set forth in §31.3401(c)-1. If such a determination or demonstration is made, then, with respect to remuneration remitted by a CPEO to a covered employee, the application of exemptions, exclusions, definitions, and other rules that are based on the type of employer will be based on the type of employer of the person determined by the Commissioner or demonstrated by the CPEO to be the common law employer of the covered employee in accordance with §31.3401(c)-1.

(3) No inference from presumption. The presumption set forth in paragraph (b)(1) of this section does not create any inference with respect to the determination of who is an employer or employee or whether the legal relationship of employer and employee exists for federal tax purposes or for purposes of any other provision of law (other than for paragraph (b)(1) of this section).

(c) Annual wage limitation, contribution base, and withholding threshold--(1)  
CPEO has separate taxable wage base, contribution base, and withholding threshold. For purposes of applying the annual wage limitations under sections 3121(a)(1) and 3306(b)(1) (relating to the Federal Insurance Contributions Act and the Federal Unemployment Tax Act, respectively), the contribution base under section 3231(e)(2) (relating to the Railroad Retirement Tax Act), and the withholding threshold under

section 3102(f)(1) (relating to the Additional Medicare Tax), remuneration received by a covered employee from a CPEO for performing services for a customer of the CPEO within any calendar year is subject to a separate annual wage limitation, contribution base, and withholding threshold that are each computed without regard to any remuneration received by the covered employee during the calendar year from any other employer (including, if applicable, remuneration received directly from the customer receiving services from the employee). Notwithstanding the preceding sentence, a CPEO is treated as a successor or predecessor employer for purposes of the annual wage limitations and contribution base upon entering into or terminating a CPEO contract (as defined in §301.7705-1(b)(3) of this chapter) with respect to a work site employee, as described in paragraph (d) of this section.

(2) Performance of services for more than one customer. If, during a calendar year, a covered employee receives remuneration from a CPEO for services performed by the covered employee for more than one customer of the CPEO, the annual wage limitation, contribution base, and withholding threshold do not apply to the aggregate remuneration received by the covered employee from the CPEO for services performed for all such customers. Rather, the annual wage limitation, contribution base, and withholding threshold apply separately to the remuneration received by the covered employee from the CPEO with respect to services performed for each customer.

(d) Successor employer status--(1) In general. For purposes of sections 3121(a)(1), 3231(e)(2)(C), and 3306(b)(1), a CPEO and its customer are treated as--

(i) A successor and predecessor employer, respectively, upon entering into a CPEO contract with respect to a work site employee who is performing services for the customer; and

(ii) A predecessor and successor employer, respectively, upon termination of the CPEO contract between the CPEO and the customer with respect to the work site employee who is performing services for the customer.

(2) Non-work site covered employee. A CPEO entering into a CPEO contract with a customer during a calendar quarter with respect to a covered employee who is not a work site employee at any time during that calendar quarter will not be treated as a successor employer (and the customer will not be treated as a predecessor employer) for purposes of paragraph (d)(1)(i) of this section regardless of whether, during the term of the CPEO contract, the covered employee subsequently becomes a work site employee. Similarly, a CPEO terminating a CPEO contract with a customer during a calendar quarter with respect to a covered employee who is not a work site employee at any time during that calendar quarter will not be treated as a predecessor employer (and the customer will not be treated as a successor employer) for purposes of paragraph (d)(1)(ii) of this section regardless of whether, during the term of the CPEO contract, the covered employee had previously been a work site employee.

(e) Treatment of credits--(1) In general. For purposes of the credits specified in paragraph (e)(2) of this section--

(i) The credit with respect to a work site employee performing services for a customer applies to the customer, not to the CPEO; and

(ii) In computing the credit, the customer, and not the CPEO, is to take into account wages and federal employment taxes paid by the CPEO with respect to the work site employee and for which the CPEO receives payment from the customer.

(2) Credits specified. A credit is specified in this paragraph (e) if such credit is allowed under--

(i) Section 41 (credit for increasing research activity);

(ii) Section 45A (Indian employment credit);

(iii) Section 45B (credit for portion of employer social security taxes paid with respect to employee cash tips);

(iv) Section 45C (clinical testing expenses for certain drugs for rare diseases or conditions);

(v) Section 45R (employee health insurance expenses for small employers);

(vi) Section 45S (employer credit for paid family and medical leave);

(vii) Section 51 (work opportunity credit);

(viii) Section 1396 (empowerment zone employment credit);

(ix) Statutory employee retention credits that are similar to the employee retention credit in section 1400R and that provide disaster relief to employers in designated disaster areas; and

(x) Any other section specified by the Commissioner in further guidance (as defined in §301.7705-1(b)(8) of this chapter).

(f) Section not applicable to related customers, self-employed individuals, and other circumstances. This section does not apply--

(1) In the case of any customer that--

(i) Has a relationship to a CPEO described in section 267(b) (including, by cross-reference, section 267(f)) or section 707(b), except that “10 percent” shall be substituted for “50 percent” wherever it appears in such sections; or

(ii) Has commenced a CPEO contract with the CPEO but such commencement has not been reported to the IRS as described in paragraph (g)(3)(i) of this section; or

(2) To remuneration paid by a CPEO to any self-employed individual (as defined in §301.7705-1(b)(14) of this chapter) in that capacity;

(3) To any CPEO contract that a CPEO enters into while its certification has been suspended by the IRS; or

(4) To any CPEO whose certification has been revoked or voluntarily terminated for periods after the effective date of revocation or voluntary termination.

(g) Reporting and recordkeeping--(1) Reporting and recordkeeping for employers. A CPEO that is treated as an employer of a covered employee pursuant to paragraph (a) of this section must meet all reporting and recordkeeping requirements described in subtitle F of the Code that are applicable to employers in a manner consistent with such treatment.

(2) Reporting on magnetic media--(i) In general. A CPEO must file on magnetic media any Form 940, “Employer’s Annual Federal Unemployment (FUTA) Tax Return,” Form 941, “Employer’s QUARTERLY Federal Tax Return,” and Form 943, “Employer’s Annual Federal Tax Return for Agricultural Employees,” and all required accompanying schedules, as well as such other returns, schedules, and other required forms and documents as is required by further guidance.

(ii) Waiver. The Commissioner may waive the requirements of this paragraph (g)(2) in case of undue economic hardship (including economic hardship resulting from temporary software and technological issues). The principal factor in determining hardship will be the amount, if any, by which the cost of filing the return, schedule, or other required form or document on magnetic media in accordance with this paragraph (g)(2) exceeds the cost of filing on or by other media. A request for a waiver must be made in accordance with applicable guidance. The waiver must specify the type of filing (that is, the name of the form or schedule) and the period to which it applies. In addition, the waiver will be subject to such terms and conditions regarding the method of filing as may be prescribed by the Commissioner in further guidance.

(iii) Magnetic media. The term magnetic media means any magnetic media permitted under applicable guidance. These generally include electronic filing, as well as other media specifically permitted under the applicable guidance.

(3) Reporting to the IRS by CPEOs. A CPEO must report the following to the IRS in such time and manner, and including such information, as the Commissioner may prescribe in further guidance:

(i) The commencement or termination of any CPEO contract (as defined in §301.7705-1(b)(3) of this chapter) with a customer, or any service agreement as described in §31.3504-2(b)(2) with a client, and the name and employer identification number (EIN) of such customer or client.

(ii) With any Form 940, Form 941, and Form 943 that it files, all required schedules, including, but not limited to, the applicable Schedule R (or any successor form), containing such information as the Commissioner may require about each of its

customers under a CPEO contract (as defined in §301.7705-1(b)(3) of this chapter) and each of its clients under a service agreement (as described in §31.3504-2(b)(2)). A CPEO must file Form 940, Form 941, and Form 943, along with all required schedules, on magnetic media, unless the CPEO is granted a waiver by the Commissioner in accordance with paragraph (g)(2)(ii) of this section.

(iii) A periodic verification that it continues to meet the requirements of §301.7705-2 of this chapter, as described in §301.7705-2(j).

(iv) Any change that materially affects the continuing accuracy of any agreement or information that was previously made or provided by the CPEO to the IRS, as described in §301.7705-2(k) of this chapter.

(v) A copy of its audited financial statements and an opinion of a certified public accountant regarding such financial statements, as described in §301.7705-2(e)(1) of this chapter.

(vi) The quarterly statements, assertions, and attestations regarding those assertions described in §301.7705-2(f)(1) of this chapter.

(vii) Any information the IRS determines is necessary to promote compliance with respect to the credits described in paragraph (e)(2) of this section and provided in section 3302.

(viii) Any other information the Commissioner may prescribe in further guidance.

(4) Reporting to customers by CPEOs. A CPEO must meet the following reporting requirements with respect to its customers in such time and manner, and including such information, as the Commissioner may prescribe in further guidance:

(i) Provide each of its customers with the information necessary for the customer to claim the credits described in paragraph (e)(2) of this section.

(ii) Notify any customer if its CPEO contract has been transferred to another person (or if another person will report, withhold, or pay, under such other person's EIN, any applicable federal employment taxes with respect to the wages of any individuals covered by its CPEO contract) and provide the customer with the name and EIN of such other person.

(iii) If the CPEO's certification is suspended or revoked as described in §301.7705-2(n) of this chapter, notify each of its current customers of such suspension or revocation.

(iv) If any covered employees are not, or cease to be, work site employees because they perform services at a location at which the 85 percent threshold described in §301.7705-1(b)(17) of this chapter is not met, notify the customer that it may also be liable for federal employment taxes imposed on remuneration remitted by the CPEO to such covered employees, as described in paragraph (a)(3) of this section.

(5) Information and agreements in any contract or agreement between a CPEO and a customer or client. Any CPEO contract (as defined in §301.7705-1(b)(3) of this chapter) between a CPEO and a customer or service agreement described in §31.3504-2(b)(2) between a CPEO and a client must--

(i) In the case of a contract that is a CPEO contract--

(A) Contain the name and EIN of the CPEO reporting, withholding, and paying any applicable federal employment taxes with respect to any remuneration paid to individuals covered by the contract or agreement;

(B) Require the CPEO to provide to the customer the notices and information required by paragraph (g)(4) of this section;

(C) Describe the information that the CPEO will provide that is necessary for the customer to claim the credits specified in paragraph (e)(2) of this section; and

(D) Require the CPEO to notify the customer that the customer may also be liable for federal employment taxes on remuneration remitted by the CPEO to covered employees if the work sites at which they perform services do not (or ever cease to) meet the 85 percent threshold described in §301.7705-1(b)(17) of this chapter; and

(ii) In the case of a service agreement described in §31.3504-2(b)(2) that is not a CPEO contract (and thus the individuals covered by that contract are not covered employees), or if this section does not apply to the contract under paragraph (f) of this section, notify, or be accompanied by a notification to, the client that the service agreement or contract is not covered by section 3511 and does not alter the client's liability for federal employment taxes on remuneration remitted by the CPEO to the employees covered by the service agreement or contract.

(h) Penalties and additions to tax--(1) In general. A CPEO that is treated as an employer of a covered employee under this section and that is required to meet the reporting requirements of an employer is subject to the same penalties and additions to tax as an employer with respect to such reporting requirements, including, but not limited to, penalties and additions to tax under sections 6651, 6656, 6672, 6721, 6722, and 6723.

(2) Failures to timely make reports required under section 3511. CPEOs are subject to penalty under section 6652(n) with respect to reports required to be made to

the IRS in paragraphs (g)(1) and (3) of this section and reports required to be made to customers in paragraph (g)(4) of this section.

(3) Failures to attach Schedule R. A CPEO is subject to penalty under section 6652(n) for failure to attach Schedule R (or successor form) to Forms 941, 940, or 943 as required by paragraph (g)(3)(ii) of this section. A CPEO is also subject to penalty under section 6723 for failure to include the EIN of each customer on Schedule R of Form 941, 940, or 943. See §301.6723-1 of this chapter for the application of the section 6723 penalty in the case of multiple failures on a single document.

(4) Failures to file on magnetic media. With respect to the requirement in paragraph (g)(3)(ii) of this section that a CPEO must file Forms 940, 941, and 943, along with all required schedules, on magnetic media, a failure to file on magnetic media does not constitute a failure to file for purposes of section 6651(a)(1) nor does it constitute a failure to make a report for purposes of section 6652(n). Rather, the requirement to file Forms 940, 941, and 943 on magnetic media is a condition of maintaining certification as a CPEO.

(i) Applicability date. The rules in this section apply on and after May 3, 2019.

#### PART 301--PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 is amended by removing entries for §§ 301.7705-1T and 301.7705-2T and adding entries for §§ 301.7705-1 and 301.7705-2 in numerical order to read in part as follows:

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

Section 301.7705-1 also issued under 26 U.S.C. 7705(h).

Section 301.7705-2 also issued under 26 U.S.C. 7705(h).

\* \* \* \* \*

Par. 4. Sections 301.7705-1 and 301.7705-2 are added to read as follows:

§301.7705-1 Certified professional employer organization.

(a) In general. The definitions set forth in this section apply for purposes of this section, §§31.3511-1 and 301.7705-2, and sections 3302(h), 3303(a)(4), 6053(c)(8), and 7528(b)(4).

(b) Definitions--(1) Certified professional employer organization (CPEO) means a person that applies to be certified as a CPEO in accordance with §301.7705-2(a) and has been certified by the Internal Revenue Service (IRS) as meeting the requirements of §301.7705-2. For purposes of §301.7705-2(g)(2), the term CPEO also includes the person before it applied for certification and while its application is pending with the IRS. For all other purposes, a person is a CPEO as of the effective date of its certification (as specified in the certification notice described in §301.7705-2(a)(2)) and until its certification is revoked by the IRS (as described in §301.7705-2(n)) or, if earlier and applicable, until the CPEO voluntarily terminates its certification in the time and manner prescribed by the Commissioner in further guidance.

(2) CPEO applicant means a person that has applied to be certified as a CPEO in accordance with §301.7705-2(a) and whose application is pending with the IRS.

(3) CPEO contract means a service contract between a CPEO and a customer that is in writing and provides that, with respect to an individual providing services to the customer, the CPEO will--

(i) Assume responsibility for payment of wages to the individual, without regard to the receipt or adequacy of payment from the customer for the services;

(ii) Assume responsibility for reporting, withholding, and paying any applicable federal employment taxes with respect to the individual's wages, without regard to the receipt or adequacy of payment from the customer for the services;

(iii) Assume responsibility for any employee benefits that the service contract may require the CPEO to provide to the individual, without regard to the receipt or adequacy of payment from the customer for such benefits;

(iv) Assume responsibility for recruiting, hiring, and firing the individual in addition to the customer's responsibility for recruiting, hiring, and firing the individual;

(v) Maintain employee records relating to the individual; and

(vi) Agree to be treated as a CPEO for purposes of section 3511 with respect to the individual.

(4) Certified public accountant (CPA) means a certified public accountant who--

(i) With respect to a CPEO applicant or CPEO, is independent of the CPEO applicant or CPEO (as prescribed by the American Institute of Certified Public Accountants' Professional Standards, Code of Professional Conduct, and its interpretations and rulings);

(ii) Is not currently under suspension or disbarment from practice before the IRS;

(iii) Is duly qualified to practice as a CPA in any state;

(iv) Files with the IRS a written declaration that he or she is currently qualified to practice as a CPA in any state; and

(v) Meets such other requirements as the Commissioner may prescribe in further guidance.

(5) Covered employee means, with respect to a customer, any individual (other than a self-employed individual, as defined in paragraph (b)(14) of this section) who performs services for the customer and who is covered by a CPEO contract between the CPEO and the customer.

(6) Customer--(i) In general. Except as provided in paragraph (b)(6)(ii) of this section, a customer is any person who enters into a CPEO contract with a CPEO.

(ii) Persons who are not customers. A provider of payroll services that uses its own EIN for filing federal employment tax returns on behalf of its clients (or that used its own EIN immediately prior to entering into a service contract with the CPEO) is not a customer, even if it has entered into a service contract with the CPEO that meets all of the requirements for a CPEO contract described in paragraph (b)(3) of this section other than being a contract between a CPEO and a customer.

(7) Federal employment taxes mean the taxes imposed by subtitle C of the Internal Revenue Code.

(8) Guidance includes guidance published in the Federal Register or Internal Revenue Bulletin, as well as administrative guidance such as forms, instructions, publications, or other guidance on the [irs.gov](http://irs.gov) Web site.

(9) Partnership means a business entity (as described in §301.7701-2(a)) that is classified as a partnership for federal tax purposes under §§301.7701-1, 301.7701-2, and 301.7701-3. Accordingly, any references to a managing member or general partner of a partnership mean a managing member or general partner of an entity that is classified as a partnership for federal tax purposes.

(10) Precursor entity--(i) In general. A precursor entity means, with respect to a CPEO applicant, any related entity of the CPEO applicant that is or was a provider of payroll services that--

(A) Has made a substantial asset transfer to the CPEO applicant during the calendar year in which the CPEO applicant applies for certification or any of the three preceding calendar years or plans to make such a substantial asset transfer while the application for certification is pending or in the 12-month period following the date of the CPEO applicant's application for certification; or

(B) Has ceased operations or dissolved during the calendar year in which the CPEO applicant applied for certification or any of the three preceding calendar years.

(ii) Related. For purposes of this paragraph (b)(10), a provider of payroll services is considered a related entity of a CPEO applicant if it is a related entity within the meaning of paragraph (b)(12) of this section or if it would be or would have been such a related entity based on the ownership and responsible individuals of the provider of payroll services at the time of its substantial asset transfer, ceasing of operations, or dissolution, as applicable, and the ownership and responsible individuals of the CPEO applicant at the time of its application.

(11) Provider of payroll services means a person that provides federal employment tax administration, payroll services, or other similar federal employment tax-related compliance services to clients, including, but not limited to, collecting, reporting, and paying federal employment taxes with respect to wages or compensation paid by the person to individuals performing services for the clients. A provider of payroll services includes, but is not limited to, a CPEO.

(12) Related entity means, with respect to a CPEO applicant or CPEO, any person that meets one or more of the following criteria:

(i) The person is a member of a controlled group of which the CPEO applicant or CPEO is also a member. Additionally, CPEO applicants and CPEOs that, but for their status as disregarded entities would separately be members of a controlled group, are treated as members of a controlled group for purposes of this paragraph (b)(12)(i). For purposes of this paragraph (b)(12)(i), controlled group has the meaning given to such term by sections 414(b) and (c) and §§1.414(b)-1 and 1.414(c)-1 through 1.414(c)-6 of this chapter, except that--

(A) With respect to a person that is not a provider of payroll services “more than 50 percent” will be substituted for “at least 80 percent” each place it appears in section 1563(a) (which is cross-referenced in section 414(b) and §1.414(c)-2 of this chapter); and

(B) With respect to a person that is a provider of payroll services, “more than 5 percent” will be substituted for “at least 80 percent” each place it appears in section 1563(a) and §1.414(c)-2 of this chapter; or

(ii) The person is a provider of payroll services and--

(A) A majority of the directors or a majority of the officers (as described in paragraph (b)(13)(ii) of this section) of the CPEO applicant or CPEO are directors or officers (as described in paragraph (b)(13)(ii) of this section), respectively, of the provider of payroll services; or

(B) An individual is a responsible individual of both the provider of payroll services and the CPEO applicant or CPEO by reason of paragraph (b)(13)(i) of this section.

(13) Responsible individual means, with respect to a CPEO applicant or CPEO, (or, for purposes of paragraph (b)(10)(ii) or (b)(12)(ii) of this section, a provider of payroll services), the following individuals:

(i) Any individual who owns, directly or indirectly, applying the constructive ownership rules of section 1563(e) with respect to stock ownership and substituting the term “interest” for the term “stock” and the term “partnership” for the term “corporation” used in that section, as appropriate for purposes of determining whether an interest in a partnership is indirectly owned by any person, 33 percent or more of--

(A) In the case of a corporation, the total combined voting power of all classes of stock entitled to vote of such corporation or the total value of shares of all classes of stock of such corporation; or

(B) In the case of a partnership, the capital interest or profits interest of such partnership.

(ii) Any individual who is a director or an officer. For purposes of this paragraph (b)(13)(ii), a director is a voting member of the governing body (that is, the board of directors or equivalent controlling body authorized under state law to make governance decisions on behalf of the organization), and the officers are determined by reference to the organizing document, bylaws, or resolutions of the governing body, or otherwise designated consistent with state law. Officers may include individuals such as a president, vice-president, secretary, and treasurer.

(iii) Any individual who, regardless of title, has ultimate responsibility for implementing the decisions of the organization's governing body. An individual who serves with the title of chief executive officer, executive director, and/or president has this ultimate responsibility. An individual with this ultimate responsibility may include an individual who is not treated as an employee of the organization. If this ultimate responsibility resides with two or more individuals (for example, co-presidents), who may exercise such responsibility in concert or individually, then each such individual is a responsible individual.

(iv) Any individual who, regardless of title, has ultimate responsibility for supervising the management, administration, or operation of the organization. An individual who serves with the title of chief operating officer has this ultimate responsibility. An individual with this ultimate responsibility may include an individual who is not treated as an employee of the organization. If this ultimate responsibility resides with two or more individuals, who may exercise such responsibility in concert or individually, then each such individual is a responsible individual.

(v) Any individual who, regardless of title, has ultimate responsibility for managing the organization's finances. An individual who serves with the title of chief financial officer or treasurer has this ultimate responsibility. An individual with this ultimate responsibility may include an individual who is not treated as an employee of the organization. If this ultimate responsibility resides with two or more individuals who may exercise the responsibility in concert or individually, then each such individual is a responsible individual.

(vi) In the case of a partnership, any individual who is a managing member or general partner.

(vii) In the case of a sole proprietorship, the sole proprietor.

(viii) In the case of a disregarded entity owned by a corporation or partnership, the responsible individuals of that corporation or partnership.

(ix) In the case of a disregarded entity owned by an individual, the individual owner.

(x) Any other individual with primary responsibility for the organization's federal employment tax compliance.

(14) Self-employed individual means an individual with net earnings from self-employment (as defined in section 1402(a) without regard to the exceptions thereunder) derived from providing services covered by a CPEO contract, whether such net earnings from self-employment are derived from providing services as a non-employee to a customer of the CPEO, from the individual's own trade or business as a sole proprietor customer of the CPEO, or as an individual who is a partner in a partnership that is a customer of the CPEO, but only with regard to such net earnings.

(15) Substantial asset transfer means any transfer of 35 percent or more of the value of the operating assets of the person making the transfer, whether through one or a series of transactions and whether accomplished through sale, lease, gift, assignment, succession, merger, consolidation, corporate separation, or any other means. For purposes of this paragraph (b)(15), operating assets include both tangible and intangible resources related to the conduct of the person's trade or business, including, but not limited to, such intangible assets as contracts, agreements,

receivables, employees, and goodwill (which includes the value of a trade or business based on expected continued customer patronage due to its name, reputation, or any other factors). In the case of a contract described in section 7705(e)(2) or a service agreement described in §31.3504-2(b)(2) of this chapter entered into by a provider of payroll services, even if the contract or agreement is not sold, gifted, assigned, or otherwise formally transferred to a CPEO applicant, it will be considered transferred from the provider of payroll services to the CPEO applicant if the CPEO applicant reports, withholds, or pays, under its employer identification number (EIN), any applicable federal employment taxes with respect to the wages of any individuals covered by the contract or agreement.

(16) Work site means a physical location at which an individual regularly performs services for a customer of a CPEO or, if there is no such location, the location from which the customer assigns work to the individual. A work site may not be the individual's residence or a telework site unless the customer requires the individual to work at that site. For purposes of this paragraph (b)(16), work sites that are contiguous locations will be treated as a single physical location and thus a single work site, and noncontiguous locations will be treated as separate physical locations and thus separate work sites, except as provided in the next sentence. A CPEO customer may treat noncontiguous locations as a single physical location and thus a single work site if each of the locations is separated by less than 35 miles from every other location in the single work site and all locations in the single work site operate in the same industry. For purposes of the preceding sentence, the determination of the industry of a work site is based on the nature of the CPEO customer's work at that work site, irrespective of

work performed by other entities at the same site. When treating noncontiguous locations as a single physical location and thus a single work site, one noncontiguous location cannot be included in more than one work site. For example, assume there are three noncontiguous locations, A, B, and C, operating in the same industry and that B is 20 miles east from A and C is 20 miles east from B. A CPEO customer would not be permitted to treat these three locations as a single work site but would be permitted to treat either A and B as a single work site or B and C as a single work site.

(17) Work site employee--(i) In general. A work site employee means, with respect to a customer, a covered employee who performs services for such customer at a work site where at least 85 percent of the individuals performing services for the customer are covered employees of the customer.

(ii) Self-employed individuals. Solely for purposes of determining whether the 85 percent threshold described in paragraph (b)(17)(i) of this section is met, a self-employed individual described in paragraph (b)(14) of this section is treated as a covered employee if such individual would be a covered employee but for the exclusion of self-employed individuals from the definition of covered employee in paragraph (b)(5) of this section.

(iii) Excluded employees. In determining whether the 85 percent threshold described in paragraph (b)(17)(i) of this section is met, an individual who is an excluded employee described in section 414(q)(5) is not treated as either an individual providing services or a covered employee.

(iv) Treatment for calendar quarter. A covered employee will be considered a work site employee for the entirety of a calendar quarter if the employee qualifies as a work site employee at any time during that quarter.

(v) Separate determination for each work site. The determination of whether a covered employee is a work site employee is made separately with regard to each work site at which the covered employee regularly provides services and for each customer for which the covered employee is providing services. A covered employee may be determined to be a work site employee of more than one work site during a calendar quarter.

(vi) Good faith determination respected. A CPEO's determination that a covered employee is a work site employee will be respected if the CPEO has made a good faith determination that the covered employee meets the requirements of section 7705(e), this paragraph (b)(17), and any further guidance related to work site employee determinations.

(c) Applicability date. The rules in this section apply on and after May 3, 2019.  
§301.7705-2 CPEO certification process.

(a) Application requirement and certification--(1) Application. To be certified as a certified professional employer organization (CPEO), a person must submit a properly completed and executed application for certification as a CPEO in the time and manner prescribed by, and providing such information as required by, this section and any further guidance issued by the Commissioner. In addition, the applicant's responsible individuals must submit such information as is specified in this section and further guidance.

(2) Notice. A CPEO applicant will be notified by the Internal Revenue Service (IRS) whether its application for certification has been approved or denied, and, if approved, the effective date of certification. If the IRS denies the application, the IRS will inform the CPEO applicant of the reason(s) for denial. If the IRS denies an application for certification, or if the CPEO applicant withdraws an application for certification, the CPEO applicant may reapply for certification in such time and manner, and must include such information, as the Commissioner may prescribe in further guidance.

(3) Public disclosure of certification. If the IRS approves a CPEO applicant's application for certification, the IRS will make available to the public the name and address of the CPEO, as well as the effective date of its certification, in the time and manner described in further guidance.

(4) Effective date of certification. A CPEO's certification will be effective as of the effective date of certification specified in the notice described in paragraph (a)(2) of this section and in the public disclosure described in paragraph (a)(3) of this section and will continue in effect until the effective date of the revocation of the CPEO's certification, if any, as described in paragraph (n) of this section or, if earlier, the date that the CPEO voluntarily terminates its certification in the time and manner prescribed by the Commissioner in further guidance.

(b) Requirements for certification. To receive and maintain certification, a CPEO applicant or CPEO must meet the requirements described in this section, as well as any additional requirements the Commissioner may prescribe in further guidance. In addition, any precursor entities, related entities, and responsible individuals of the

CPEO applicant or CPEO must meet any requirements applicable to them described in this section and in further guidance. The IRS may deny an application for certification or revoke or suspend a CPEO's certification if a CPEO applicant or CPEO, or one or more of its precursor entities, related entities, or responsible individuals, fails to meet any applicable requirement described in this section or other applicable guidance, and the IRS will do so if the IRS determines, in its sole discretion, that such failure presents a material risk to the IRS's collection of federal employment taxes. In determining whether one or more failures to meet the requirements described in this section presents a material risk to the IRS's collection of federal employment taxes, the IRS generally will consider all relevant facts and circumstances, including the size, scope, nature, significance, recurrence, and timing of and reason for the failure and, in the case of a CPEO, any prior failures of the CPEO to meet the requirements of this section.

(c) Suitability--(1) In general. The IRS may deny an application for certification or revoke or suspend a CPEO's certification for any of the following reasons:

(i) The CPEO applicant or CPEO, or any of its precursor entities, related entities, or responsible individuals, has failed to pay any applicable federal, state, or local taxes or file any required federal, state, or local tax or information returns in a timely and accurate manner, unless the failure is determined to be due to reasonable cause and not due to willful neglect.

(ii) The CPEO applicant or CPEO, or any of its precursor entities, related entities, or responsible individuals, has been charged with or convicted of any criminal offense under the laws of the United States or of a state or political subdivision thereof, or is the subject of an active IRS criminal investigation.

(iii) The CPEO applicant or CPEO, or any of its precursor entities, related entities, or responsible individuals, has been sanctioned, or had a license, registration, or accreditation (including a license, registration, or accreditation relating to its status or ability to operate as a professional employer organization) denied, suspended, or revoked, by a court of competent jurisdiction, licensing board, assurance or other professional organization, or federal or state agency, court, body, board, or other authority for any misconduct that involves dishonesty, fraud, or breach of trust or that otherwise bears upon the suitability of the CPEO applicant or CPEO to perform its professional functions (including, but not limited to, any civil or criminal penalty described in 42 U.S.C. 503(k)(1)(D) imposed by state law).

(iv) The CPEO applicant or CPEO, or any of its precursor entities, related entities, or responsible individuals, is listed on any sanctions list compiled by the Office of Foreign Assets Control (OFAC) within the Department of Treasury, including, but not limited to, the OFAC Consolidated Sanctions List and the OFAC Specially Designated Nationals List.

(v) The CPEO applicant or CPEO, or any of its precursor entities, related entities, or responsible individuals, fails to demonstrate a history of financial responsibility, which the IRS may assess by checks on credit history and other similar indicators.

(vi) The CPEO applicant or CPEO and the responsible individuals of the CPEO applicant or CPEO fail to demonstrate adequate collective knowledge or experience with respect to:

(A) Federal or state employment tax reporting, depositing, and withholding requirements;

(B) Handling of and accounting for payroll, tax payments, and other funds on behalf of others;

(C) Effective recordkeeping systems;

(D) Retention of qualified personnel and legal advisors as needed; and

(E) General business and risk management.

(vii) The CPEO applicant or CPEO, or any of its responsible individuals, gives false or misleading information (including by intentionally omitting relevant information), or participates in any way in the giving of false or misleading information, to the IRS, knowing, or having reason to know, that the information is false or misleading. For the purpose of this paragraph (c)(1)(vii), "information" includes (but is not limited to) facts or other matters contained in testimony, federal tax returns, and financial statements and opinions regarding such statements; applications for certification (and all accompanying documentation); affidavits, declarations, assertions, attestations, statements, and agreements; and periodic verifications that the requirements of this section continue to be met; and any other information that is required to be provided by this section, section 3511(g), §31.3511-1 of this chapter, or further guidance.

(2) Must be a business entity or sole proprietorship--(i) In general. A CPEO must be a business entity described in §301.7701-2(a) or a sole proprietorship. Accordingly, a CPEO may not be an entity classified as a trust under §301.7701-4.

(ii) Ownership by a United States person. In addition, a sole proprietorship or a business entity that is disregarded as an entity separate from its owner for federal tax purposes under §§301.7701-2 and 301.7701-3 (without regard to the special rule in §301.7701-2(c)(2)(iv) that provides that such entities are corporations for federal

employment tax purposes) must be wholly owned directly (including through one or more disregarded entities organized in the United States, in the case of a business entity) by a United States person (as defined in section 7701(a)(30)).

(iii) Treatment as separate member of a controlled group. Except as provided in paragraph (h) of this section, a CPEO applicant or CPEO that otherwise qualifies as a member of a controlled group (within the meaning of sections 414(b) and (c) and §§1.414(b)-1 and 1.414(c)-1 through 1.414(c)-6 of this chapter) but for its status as an entity disregarded as separate from its owner for federal tax purposes under §§301.7701-2 and 301.7701-3, is treated as a separate member of a controlled group for purposes of this section, §301.7705-1, section 3511, §31.3511-1 of this chapter, and section 7705.

(3) Authorization to investigate suitability. A CPEO applicant or CPEO, and each of its responsible individuals, must take such actions as are necessary to authorize the IRS to investigate the accuracy of statements and submissions, including waiving confidentiality and privilege when necessary (i.e., in situations in which the IRS is otherwise unable to obtain or confirm information necessary to evaluate a CPEO applicant's or CPEO's qualification for certification), and to conduct comprehensive background checks, including, but not limited to, Federal Bureau of Investigation or other similar criminal background checks, checks on tax compliance, professional experience (including through the contact of third-party references), credit history, and professional sanctions. In addition, a CPEO applicant or CPEO, and any of its responsible individuals, must provide the IRS with such additional information as the IRS may request to facilitate such background investigations. Each responsible

individual of a CPEO applicant or CPEO must also submit fingerprints in the time and manner and under the circumstances prescribed by the Commissioner in further guidance.

(d) Business location--(1) State of organization. A CPEO applicant or CPEO must be created or organized in the United States or under the law of the United States or of any state.

(2) Business location in the United States. A CPEO applicant or CPEO must have one or more established, physical business locations in the United States at which regular operations of an activity that constitutes a trade or business within the United States (within the meaning of section 864(b)) take place and at which a significant portion of its CPEO-related functions are carried on and administrative records are kept.

(3) United States responsible individuals. A majority of the CPEO applicant's or CPEO's responsible individuals must be citizens or residents of the United States.

(4) Use of financial institution. A CPEO applicant or CPEO must use only financial institutions described in section 265(b)(5) to hold substantially all of its cash and cash equivalents, receive payments from customers, and pay wages and federal employment taxes.

(e) Financial statements--(1) CPEOs. By the last day of the sixth month after the end of each fiscal year, and beginning with the first fiscal year that ends after the CPEO's effective date of certification, a CPEO must cause to be prepared and provided to the IRS--

(i) A copy of its annual audited financial statements for the fiscal year;

(ii) An opinion of a certified public accountant (CPA) that such financial statements are presented fairly and in accordance with generally accepted accounting principles (GAAP); and

(iii) A statement in the Note to the Financial Statements covered by the CPA opinion that the CPEO's annual audited financial statements reflect positive working capital or, only if the CPEO satisfies the requirements of paragraph (e)(3) of this section, reflect negative working capital, with such statement in either case setting forth in detail a calculation of the CPEO's working capital as reflected in the annual audited financial statements (a working capital statement).

(2) CPEO applicants--(i) In general. A CPEO applicant must cause to be prepared and provided to the IRS, with its application, a copy of its annual audited financial statements, an opinion with respect to such financial statements, and a working capital statement (each as described in paragraph (e)(1) of this section) for the most recently completed fiscal year as of the date it applies for certification.

Notwithstanding the preceding sentence, if a CPEO applicant applies for certification before the last day of the sixth month following its most recently completed fiscal year, and the audit of the financial statements for that fiscal year has not yet been completed at the time of application, a CPEO applicant must provide to the IRS, with its application, the financial statements, opinion, and working capital statement described in paragraph (e)(1) of this section for the immediately preceding fiscal year, if any, and must subsequently provide to the IRS the financial statements, opinion, and working capital statement for the most recently completed fiscal year by the last day of the sixth month after such fiscal year ends. In addition, for any fiscal year that ends after the

CPEO applicant applies for certification and on or before the effective date of certification, if applicable, the CPEO applicant must provide the audited financial statements, opinion, and working capital statement by the last day of the sixth month after such fiscal year ends. The obligation to provide the annual audited financial statements described in the preceding sentence continues to apply even if the CPEO applicant is certified as a CPEO prior to the date the annual audited financial statements are provided.

(ii) Newly established CPEO applicants. In addition to the requirements in paragraph (e)(2)(i) of this section, a CPEO applicant that was not operating as a provider of payroll services for all or part of its most recently completed fiscal year as of the date it applies for certification must provide a copy of the annual audited financial statements of any precursor entity, if one exists, an opinion with respect to such financial statements, and a working capital statement (each as described in paragraph (e)(1) of this section) for the precursor entity's most recently completed fiscal year as of the date of the application for certification in such time and manner as the Commissioner may prescribe in further guidance, as well as such additional information as the Commissioner may prescribe in further guidance.

(3) Exception to positive working capital requirement. A CPEO applicant or CPEO with annual audited financial statements for a fiscal year that do not reflect positive working capital will not fail to meet the requirements of paragraph (e)(1)(iii) of this section if--

(i) The CPEO applicant or CPEO has negative working capital for no more than two consecutive fiscal quarters of that fiscal year, as demonstrated by the financial

statements (for the final fiscal quarter in the fiscal year) and the statements described in paragraph (f)(1)(ii) of this section (for any other fiscal quarter), as applicable;

(ii) The CPEO applicant or CPEO, or its CPA, provides, in such time and manner as the Commissioner may prescribe in further guidance, an explanation to the IRS describing the reason for the failure; and

(iii) The IRS determines, in its sole discretion, that the failure does not present a material risk to the IRS's collection of federal employment taxes.

(4) Completed fiscal year. For purposes of this paragraph (e), a fiscal year will be considered completed once the last day of that fiscal year has ended, regardless of whether the CPEO applicant or CPEO was in operation or certified for all 12 months of the fiscal year or the fiscal year consisted of fewer than 12 months.

(f) Quarterly assertions and attestations--(1) CPEOs. By the last day of the second month after the end of each calendar quarter, and beginning with the first calendar quarter that ends after the CPEO's effective date of certification, a CPEO must provide the following to the IRS:

(i) An assertion, signed by a responsible individual under penalties of perjury, stating that the CPEO has withheld and made deposits of all federal employment taxes (other than taxes imposed by chapter 23 of the Code) as required by subtitle C for such calendar quarter and an examination level attestation from a CPA stating that such assertion is fairly stated in all material respects.

(ii) A statement signed by a responsible individual under penalties of perjury verifying that the CPEO has positive working capital (as determined in accordance with

GAAP) at the end of the most recently completed fiscal quarter, as well as such additional financial information that the Commissioner may specify in further guidance.

(2) Exceptions--(i) Immaterial failures. A CPEO will not fail to meet the requirements of paragraph (f)(1)(i) of this section if the CPA examination level attestation indicates that the CPEO has failed to withhold or make deposits in certain immaterial respects, provided that--

(A) The attestation provides a summary of the immaterial failures that were found;

(B) The attestation states that the failures were immaterial and isolated and do not reflect a meaningful lapse in compliance with federal employment tax withholding and deposit requirements; and

(C) The IRS determines, in its sole discretion, that the isolated and immaterial failures identified by the CPA do not present a material risk to the IRS's collection of federal employment taxes.

(ii) Negative working capital. A CPEO with negative working capital at the end of a fiscal quarter will not fail to meet the requirements of paragraph (f)(1)(ii) of this section if--

(A) The CPEO does not have negative working capital at the end of the two fiscal quarters immediately preceding such fiscal quarter, as demonstrated by the annual audited financial statements described in paragraph (e)(1) of this section, if available, or the statements described in paragraph (f)(1)(ii) of this section;

(B) The CPEO provides an explanation to the IRS describing the reason for such negative working capital in such time and manner as the Commissioner may prescribe in further guidance; and

(C) The IRS determines, in its sole discretion, that the negative working capital does not present a material risk to the IRS's collection of federal employment taxes.

(3) CPEO applicants--(i) In general. By the last day of the second month after the end of each calendar quarter, beginning with the most recently completed calendar quarter as of the date of a CPEO applicant's application for certification and ending with the most recently completed calendar quarter as of the effective date of certification (if applicable), a CPEO applicant must provide to the IRS the assertion, examination level attestation, and working capital statement described in paragraph (f)(1) of this section, subject to the exceptions described in paragraph (f)(2) of this section (though substituting "CPEO applicant" for "CPEO").

(ii) Newly established CPEO applicants. A CPEO applicant that was not operating as a provider of payroll services during the most recently completed calendar quarter as of the date of its application for certification or during any calendar quarter that ends while its application for certification is pending must provide to the IRS the assertion, examination level attestation, and working capital statement described in paragraph (f)(1) of this section with respect to any precursor entity, if applicable, in such time and manner as the Commissioner may prescribe in further guidance, as well as such additional information as the Commissioner may prescribe in further guidance.

(g) Bond--(1) In general. A CPEO must post a bond (or bonds, as described in paragraph (g)(3) of this section) from a qualified surety (as described in paragraph

(g)(6) of this section) for the payment of federal employment taxes, issued in the form and containing the terms prescribed by the Commissioner in this paragraph (g) and in further guidance and in an amount described in paragraph (g)(2) of this section.

(2) Bond amount--(i) In general. The amount of the bond (or bonds, as described in paragraph (g)(3) of this section) must be, for each period beginning on April 1 of any calendar year and ending on March 31 of the following calendar year (or, in the case of a newly certified CPEO, beginning with the effective date of certification and ending on the subsequent March 31) (the bond period), at least equal to the greater of--

(A) Five percent of the CPEO's liability under section 3511 (or, if applicable, the liability described in paragraph (g)(2)(ii) of this section) during the calendar year preceding the beginning of the bond period, but not more than \$1,000,000; or

(B) \$50,000.

(ii) Amount of bond in first and second year as a CPEO. If a CPEO does not have any liability under section 3511 for all or a portion of a preceding calendar year because the CPEO was not certified as a CPEO for all or a portion of that preceding calendar year, the liability applied for purposes of paragraph (g)(2)(i)(A) of this section for the entirety or portion of the preceding calendar year during which the CPEO was not certified will be the federal employment tax liability of the CPEO, and of any precursor entity of the CPEO described in §301.7705-1(b)(10)(i)(A), that results from one or more service agreements described in §31.3504-2(b)(2) of this chapter. With respect to the federal employment tax liability of such precursor entity during a preceding calendar year, for purposes of paragraph (g)(2)(i)(A) of this section, the liability will be applied only to the extent it results from service agreements that have

been transferred or are intended to be transferred by the precursor entity to the CPEO at the time the bond amount is determined. For purposes of this paragraph (g)(2)(ii), an entity is considered a precursor entity of a CPEO described in §301.7705-1(b)(10)(i)(A) if it was determined to be its precursor entity under that section at the time it was a CPEO applicant.

(iii) One continuous obligation. The bond, any riders thereto, and any strengthening bonds posted to satisfy the requirements of this section are considered one continuous obligation of the surety for unpaid tax liabilities accrued by the CPEO under subtitle C from the effective date of the bond until the bond is superseded or cancelled.

(3) Increase in bond amount--(i) In general. A CPEO must determine if an increase in the bond amount is necessary for each new bond period. If a CPEO's liability under section 3511 (or, if applicable, the liability described in paragraph (g)(2)(ii) of this section) for the preceding calendar year results in a minimum required bond amount specified in paragraph (g)(2) of this section that exceeds the current amount of the bond, the CPEO must increase the amount of its bond with respect to the new bond period in order to meet the minimum required bond amount specified in paragraph (g)(2) of this section. To increase the bond amount, a CPEO may amend an existing bond through the use of a rider, or post a strengthening, superseding, or new bond, where applicable, and in such time and manner as the Commissioner may prescribe in further guidance.

(ii) To reflect adjustment or assessment. Subject to the limit in paragraph (g)(2)(i)(A) of this section, if, during the bond period, the CPEO or the IRS determines

that the applicable federal employment tax liability for the preceding calendar year was higher than the amount reported and paid and on which the bond amount for the bond period was based (and the applicable party makes an adjustment or assessment reflecting such determination), a CPEO must increase the amount of its bond to meet the minimum required bond amount specified in paragraph (g)(2) of this section through the use of a rider, or by posting a strengthening, superseding, or new bond in such time and manner as the Commissioner may prescribe in further guidance.

(4) Cancellation--(i) Notice. A bond required under this paragraph (g) must provide that it may be cancelled by the surety only after the surety gives written notice of such cancellation to the IRS and the CPEO in such time and manner as the Commissioner may prescribe in further guidance.

(ii) New or superseding bond required. If a CPEO either receives notice of cancellation from the surety provider of its bond, or gives notice to the IRS of the CPEO's intent to cancel the bond, the CPEO must post a new or superseding bond for the minimum required bond amount specified in paragraph (g)(2) of this section in such time and manner as the Commissioner may prescribe in further guidance.

(iii) Ongoing liability. A bond required under this paragraph (g) must provide that, if a surety cancels the bond without issuing a superseding bond to the CPEO, the surety will, notwithstanding the cancellation, remain liable for all federal employment tax liability accrued by the CPEO during the period beginning with the effective date of the first bond issued by the surety to the CPEO in any consecutive series of bonds issued by that surety prior to cancellation and ending with the cancellation of the bond (the total bond period), up to the penal amount of the bond at the time of the cancellation. A

cancelling surety will remain liable as described in this paragraph (g)(4)(iii) for federal employment tax liability accrued during the total bond period up to the penal amount of the bond for as long as the Commissioner may assess and collect taxes for such period under sections 6501 and 6502.

(5) No posting of collateral--(i) In general. Except as provided in paragraph (g)(5)(iii) of this section, a CPEO must meet the bond requirements of this paragraph (g) without posting collateral.

(ii) Surety's retention of the right to seek collateral by itself not a violation of paragraph (g)(5)(i) of this section. A surety's retention of the right to seek collateral, as long as no collateral is actually required by the surety or posted by the CPEO, does not violate the rule in paragraph (g)(5)(i).

(iii) Exceptions to no collateral requirement. The Commissioner may provide exceptions to the rule in paragraph (g)(5)(i) of this section in further guidance published in the Internal Revenue Bulletin.

(6) Requirements for surety. Any surety that issues a bond required by this paragraph (g) to a CPEO must be a surety company that holds a certificate of authority from the Secretary as an acceptable surety on federal bonds and meets such other requirements as the Commissioner may prescribe in further guidance.

(7) Bond definitions--(i) Rider. A rider is an amendment to an existing bond that increases the bond amount. The rider must apply to liabilities that arise on or after the effective date of the bond that the rider amends. The surety remains liable under the existing bond, as amended by the rider, for the assessment and collection periods applicable to the CPEO under sections 6501 and 6502, respectively, with respect to any

taxable period that occurs during the term of the bond unless and until the bond is superseded.

(ii) Strengthening bond. A strengthening bond is an additional bond posted in the incremental amount of the increase so that the strengthening bond together with the existing bond equal the total minimum required bond amount specified in paragraph (g)(2) of this section. The strengthening bond must apply to liabilities that arise on or after the effective date of the bond it strengthens. Both the strengthening bond and the bond it strengthens must remain in effect, and the surety remains liable under both bonds for the assessment and collection periods applicable to the CPEO under sections 6501 and 6502, respectively, with respect to any taxable period that occurs during the term of the bonds, unless and until the bonds are superseded.

(iii) New bond. A new bond is a bond posted for the total required bond amount, and a new bond may only be posted upon the CPEO's initial certification or immediately following cancellation of an existing bond. In the case of a cancellation of an existing bond, the effective date of the new bond must be no later than the effective date of the cancellation of the existing bond, and the surety providing the existing (now cancelled) bond remains liable for liabilities that accrued during the term of the cancelled bond for the assessment and collection periods applicable to the CPEO under sections 6501 and 6502, respectively, with respect to any taxable period that occurred during the term of that bond.

(iv) Superseding bond. A superseding bond is a bond posted for the total minimum required bond amount specified in paragraph (g)(2) of this section, not just for an incremental increase. Upon execution of the superseding bond, the superseded

bond is no longer in effect, and the surety that provided the superseded bond is no longer liable under the superseded bond. The superseding bond must apply to liabilities that arise on or after the effective date of the superseded bond.

(h) Controlled group. All CPEO applicants and CPEOs that are members of a controlled group within the meaning of sections 414(b) and (c), and §§1.414(b)-1 and 1.414(c)-1 through 1.414(c)-6 of this chapter, will be treated as a single CPEO applicant or CPEO for purposes of paragraphs (e) (other than (e)(1)(iii)), (f) (other than (f)(1)(ii)), and (g) of this section.

(i) Consents to disclose. To receive and maintain certification, a CPEO applicant or CPEO must provide such consents for the IRS to disclose confidential tax information to its customers, and to other persons as necessary to carry out the purposes of these regulations, that relates to its certification and obligations to report, deposit, and pay federal employment taxes as the Commissioner may require in further guidance.

(j) Periodic verification. A CPEO must periodically verify that it continues to meet the requirements of this section in the time and manner prescribed by the Commissioner in further guidance.

(k) Notification of material changes. A CPEO applicant or CPEO must notify the IRS, in the time and manner prescribed by the Commissioner in further guidance, of any change that materially affects the continuing accuracy of any agreement or information that was previously made or provided to the IRS.

(l) Accrual method of accounting. A CPEO must compute its taxable income using an accrual method of accounting or, if applicable, another method that the Commissioner provides for in further guidance.

(m) Compliance with reporting obligations--(1) In general. A CPEO must agree to make reports to the IRS and to its clients as provided in section 3511(g) and §31.3511-1 of this chapter, including filing all federal employment tax returns and information returns as required.

(2) Filing on magnetic media. A CPEO must file all returns, schedules, reports, and other forms and documents on magnetic media when required by section 3511(g) and §31.3511-1 of this chapter, other Treasury regulations, or other guidance.

(n) Suspension and revocation--(1) In general. The IRS may suspend or revoke the certification of any CPEO, in the time and manner and under the circumstances prescribed by the Commissioner in this section and in further guidance, as a result of one or more failures to meet any of the requirements for CPEOs described in this section, section 3511(g), §31.3511-1 of this chapter, and any further guidance and will suspend or revoke certification if the IRS determines, in its sole discretion, that such failure(s) present a material risk to the IRS's collection of federal employment taxes. See paragraph (b) of this section for the factors the IRS will consider in determining whether one or more failures to meet any of the requirements described in this section presents a material risk to the IRS's collection of federal employment taxes.

(2) Suspension. Section 3511 will not apply to any contract described in section 7705(e)(2) into which the CPEO enters while its certification is suspended.

(3) Revocation. If an organization's certification as a CPEO is revoked, the organization will not be considered a CPEO for purposes of section 3511 unless and until it again applies to be certified as a CPEO in accordance with paragraph (a) of this section and is again certified by the IRS as meeting the requirements of this section. An

organization whose certification as a CPEO has been revoked may not reapply to be certified as a CPEO until one year has passed after the effective date of its revocation.

(4) Disclosure of suspension and revocation--(i) Notification by the CPEO. An organization whose certification as a CPEO has been suspended or revoked must notify its customers of such suspension or revocation in the time and manner prescribed by the Commissioner in further guidance.

(ii) Disclosure by the IRS. If the IRS suspends or revokes an organization's certification as a CPEO, the IRS will make available to the public the fact of such suspension or revocation in the time and manner described in further guidance. The IRS may also separately notify the organization's customers of such suspension or revocation.

(o) Applicability date. The rules in this section apply on and after May 3, 2019.

§301.7705-1T [Removed]

Par. 5. Section 301.7705-1T is removed.

§301.7705-2T [Removed]

Par. 6. Section 301.7705-2T is removed.

PART 602 – OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 7. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 8. In §602.101, paragraph (b) is amended by adding entries in numerical order for “31.3511-1,” “301.7705-1,” and “301.7705-2” and removing the entries for “301.7705-1T” and “301.7705-2T” to read as follows:

§ 602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
* * * * *	
31.3511-1	1545-2266
* * * * *	
301.7705-1	1545-2266
301.7705-2	1545-2266
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Kirsten Wielobob,

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Deputy Commissioner for Services and Enforcement.

Approved: May 7, 2019.

David J. Kautter,

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Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 2019-10856 Filed: 5/23/2019 11:15 am; Publication Date: 5/28/2019]