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| EMPLOYMENT AND TRAINING ADMINISTRATION ADVISORY SYSTEM U.S. DEPARTMENT OF LABOR Washington, D.C. 20210 | CLASSIFICATION UI |
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| | DATE September 8, 2008 |

ADVISORY: UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 26-08

TO: STATE WORKFORCE AGENCIES

FROM: BRENT R. ORRELL /s/
Deputy Assistant Secretary

SUBJECT: Internal Revenue Service Bulletin 2007-39 - Changes to Treatment of Disregarded Entities That Affect the FUTA Certification Process

1. Purpose. To notify states of imminent changes by the Internal Revenue Service (IRS) that will affect reporting Federal Unemployment Tax Act (FUTA) payments by certain employers. The changes, which will become effective for wages paid on or after January 1, 2009, will affect single-member limited liability companies (SMLLC) or qualified subchapter S subsidiaries (QSub), who are “disregarded” by the IRS as entities separate from their owners for Federal tax purposes (disregarded entities).
2. References. [Internal Revenue Bulletin \(IRB\) No. 2007-39](#); [IRB 2005-45](#) (Notice of Proposed Rule Making); [IRB No. 1999-3](#) (Notice 99-6, which will expire on January 1, 2009); 26 CFR [Part 1](#) (Income Taxes); 26 CFR [1.1401](#) (Tax on Self-Employment Income); 26 CFR [Parts 31 through 39](#) (Employment Taxes and Collection of Income Tax at Source); 26 CFR [Part 301](#) (Procedure and Administration).
3. Background. Limited Liability Companies (LLCs) were created by state statute. When the states created LLCs, the IRS did not create a new tax classification, but instead applied the three tax entity classifications it had always used for business taxpayers: corporation, partnership, or sole proprietor. SMLLCs may presently elect treatment as a corporation for Federal employment tax purposes by filing [Form 8832](#), Entity Classification Election. Absent an election, the IRS currently regards an SMLLC as a sole proprietor for employment tax purposes.

IRS Notice 99-6, which expires January 1, 2009, provides SMLLCs and QSubs the option to report Federal employment taxes either at the owner level or at the entity (LLC or QSub) level. This allows an owner of multiple disregarded entities to consolidate employment tax

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reporting for his or her employees to the IRS under a single Employer Identification Number (EIN). The election applies only to the reporting of employment taxes for employees of the LLC or QSub. The IRS regards the LLC single-member owner as self-employed, and not as an employee for employment tax and FUTA purposes.

At the state level, Unemployment Compensation (UC) tax administrators have adopted various SMLLC coverage and reporting requirements. While some states require reporting at the entity level, other states require reporting at the owner level, and still others offer the LLC or QSub owner the option to report at either the owner or entity level, following the IRS guidance under IRS Notice 99-6. In addition, each state has policies and procedures in place to ensure that the employers make their UC tax payments in accordance with state and Federal UC law.

4. Policy Change. Effective with wages paid on or after January 1, 2009, the IRS will require SMLLCs and QSubs to file and pay employment taxes and excise taxes at the entity level, under the entity name and EIN. The IRS' guidance under IRB 2007-39 includes taxes collected under FUTA. The IRS believes that the rule change will improve the administration of the tax law(s) and simplify compliance by eliminating the filing option for owners of disregarded entities. Disregarded entities and owners of such entities may continue to use the procedures permitted by IRS Notice 99-6, for wages paid prior to January 1, 2009.
5. State Preparation for Changes. States need to review their procedures for certifying state UC payments for FUTA. States that currently require UC reporting and payment at the LLC and QSub level do not need to take any action. However, states that currently require consolidated UC reporting and payment under a single owner-member EIN, or provide employers the option to report and pay at either level, must prepare for the 2009 changes because their state reporting requirements would conflict with FUTA reporting requirements. Those states are encouraged to begin working on changes to their reporting requirements and tax accounting systems as soon as possible to ensure consistency with the IRS FUTA requirements that are effective for wages paid on or after January 1, 2009. States will need to develop a method to certify state UC payments to the IRS at the entity (SMLLC or QSub) level.
6. Examples. The following two examples are provided to explain the proper treatment for FUTA reporting for wages paid on or after January 1, 2009.
 - A. Example 1. Mr. Smith owns LLC I, an entity that has employees and pays wages. LLC I is subject to the provisions of subtitle C of the Internal Revenue Code (IRC) and its implementing provisions at 26 CFR subchapter C, Employment Taxes and Collection of Income Tax at Source, Parts 31 through 39. Accordingly, LLC I is liable for Federal income tax withholding, Federal Insurance Contributions Act (FICA) taxes and FUTA taxes. LLC I must file under its name and EIN Form 940 (Employer's Annual FUTA Return), Form 941 (Employer's Quarterly Employment Tax return), as well as W-2 (Wage and Tax Statement) and make timely employment tax deposits. Mr. Smith is self-employed for purposes of subtitle A, chapter 2 of the IRC, Tax on Self-Employment Income.

B. Thus, under 26 CFR 1.1401, Mr. Smith is subject to tax on his net earnings from self-employment with respect to LLC I's activities. Mr. Smith is not an employee of LLC I for purposes of subtitle C of the Code (Employment Taxes). The following two examples describe situations where a state will/will not need to modify its systems.

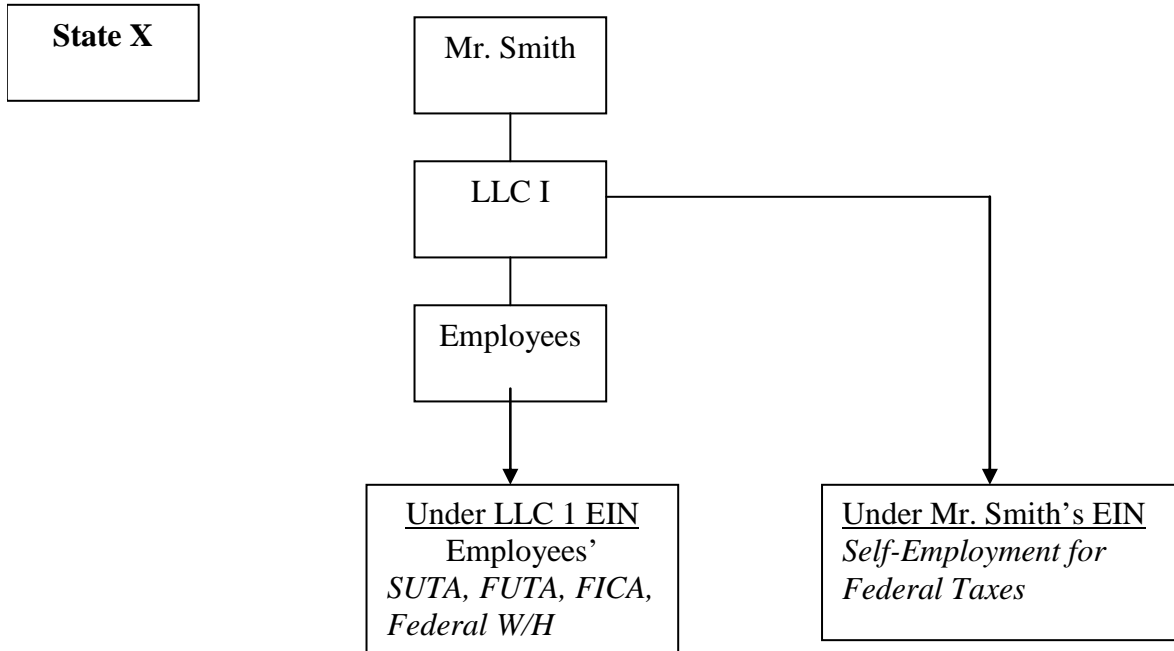
- i. State X requires SMLLCs to file and pay SUTA taxes at the entity (LLC I) level. Since state X's policy aligns with IRB 2007-39, the state FUTA certification process will not require changes.
- ii. State Z allows or requires SMLLCs to file and pay SUTA taxes under Mr. Smith's EIN. State Z will need to develop a method to certify the SUTA taxes under the SMLCC (LLC I) EIN for the annual FUTA certification.

C. Example 2. Mr. Smith entirely owns LLC I, LLC II, and LLC III. Each LLC has employees and pays wages. LLC I, LLC II, and LLC III are subject to the provisions previously cited in Example 1. Accordingly, each LLC is separately liable for Federal income tax withholding, FICA and FUTA taxes. Each LLC must file separately, Forms 940, 941, W-2, and make timely employment tax deposits under the individual LLC name and EIN. Mr. Smith is self-employed for purposes of subtitle A, chapter 2 of the IRC, Tax on Self-Employment Income. Thus, under 26 CFR 1.1401, Mr. Smith is subject to tax on his net earnings from self-employment with respect to the combined activities of all three LLCs. Mr. Smith is not an employee of any of the LLCs for purposes of subtitle C of the Code (Employment Taxes).

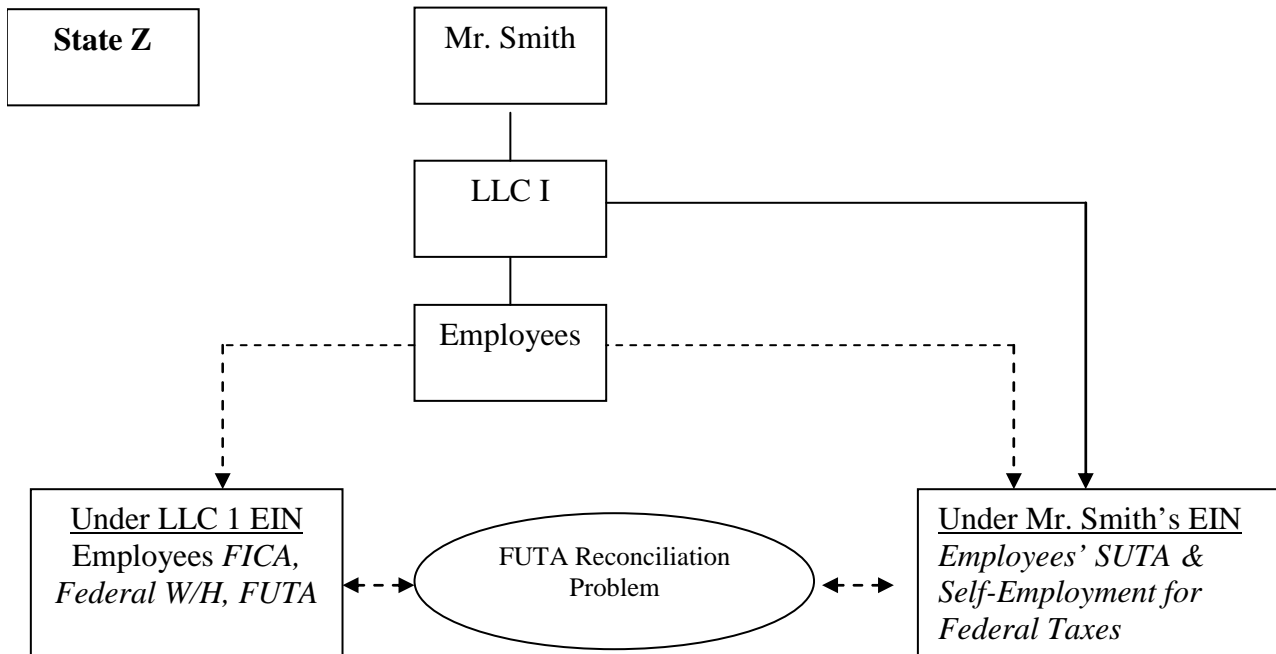
- i. State X requires SMLLCs to file and pay SUTA taxes at the entity, individual LLC level. Since state X's policy aligns with IRB 2007-39, the state FUTA certification process will not require changes.
- ii. State Z allows or requires SMLLCs to file and pay SUTA taxes under Mr. Smith's EIN. State Z will need to develop a method to certify the SUTA taxes under each SMLLC EIN for the annual FUTA certification.

7. Action. State Administrators are to provide this advisory to appropriate staff so they may determine whether they need to modify state reporting requirements to coordinate with the revised FUTA reporting requirements, which become effective January 1, 2009.
8. Inquiries. States should contact the appropriate Regional Office for additional information.
9. Attachment. Flowcharts to describe examples of compliant and non-compliant situations for both single and multiple SMLLCs

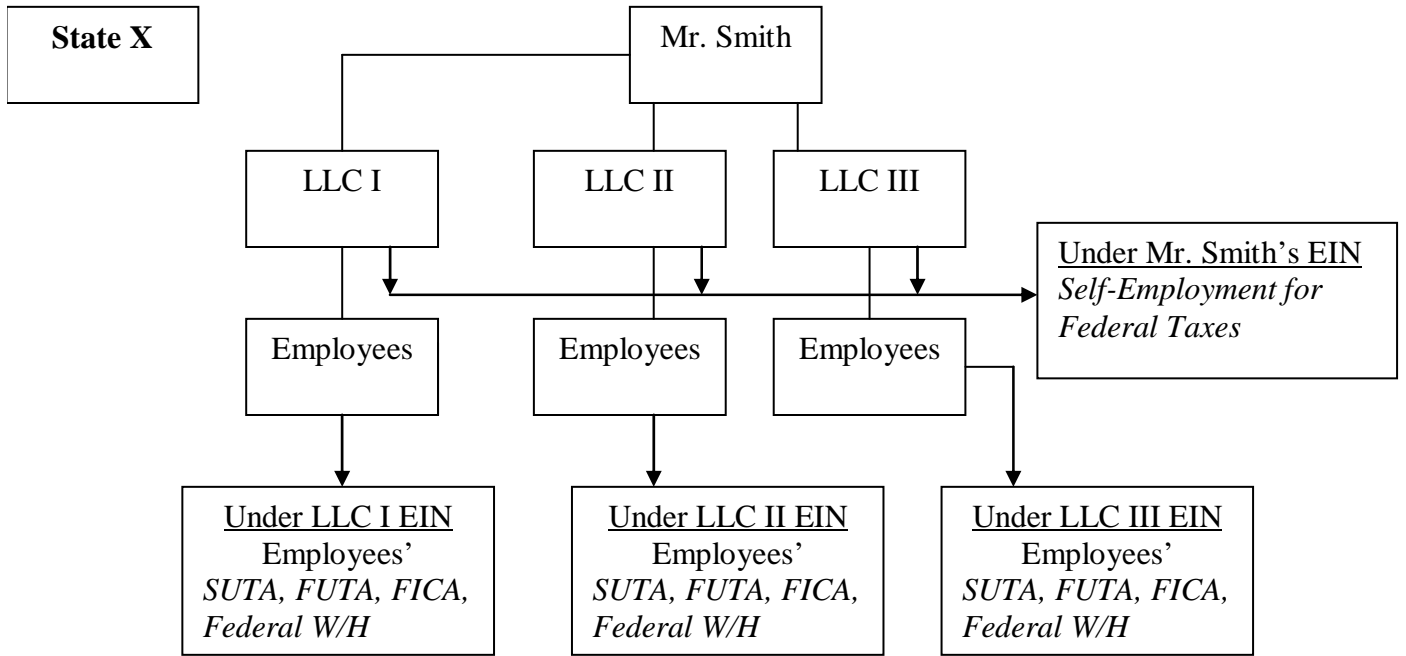
Example 1 i - One SMLCC – FUTA Compliant



Example 1 ii - One SMLCC – NOT FUTA Compliant



Example 2 i- Three SMLCCs – FUTA Compliant



Example 2 ii- Three SMLCCs – NOT FUTA Compliant

