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From: [REDACTED]
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Subject: Clarification concerning CPEOs and self-employed individuals

We have received some questions concerning language in the preamble to the proposed regulations for Certified Professional Employer Organizations (CPEOs) (proposed section 301.7705-1), specifically regarding the preamble discussion of the treatment of self-employed individuals who receive remuneration from a CPEO. Some tax practitioners have asked us to clarify language in the preamble addressing how payments from CPEOs to self-employed individuals should be treated for employment tax purposes.

The reporting of amounts paid to self-employed individuals is provided for in section 6041. CPEOs must report remuneration they pay to self-employed individuals (within the meaning of section 6041 and the regulations thereunder) in accordance with the rules under these and other applicable provisions. Section 3511(f) of the Code provides that a self-employed individual is not a work site employee with respect to remuneration paid by a CPEO to the self-employed individual. Section 3511(c) provides that a CPEO is not treated as an employer of a self-employed individual. Consistent with these two provisions, section 31.3511-1(f)(2) of the proposed regulations provides that section 3511 does not apply to any self-employed individual.

Section 301.7705-1(b)(14) of the proposed regulations defines a “self-employed individual” as an individual with net earnings from self-employment (as defined in section 1402(a) and 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. Accordingly, any remuneration from the CPEO to such self-employed individuals, in their capacity as a non-employee providing services to a customer of the CPEO, a sole proprietor customer of the CPEO, or a partner in partnership that is a customer of the CPEO, is not wages and must not be treated as such for reporting purposes. Under the section 6041 regulations, payments to self-employed individuals are reported on information returns such as Form 1099-MISC, Miscellaneous Income, and not on Form W-2.

The preamble discussion of the definition of “work site employee” under section 301.7705-1(b)(17) of 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 such earnings,” but also provides that “in the limited case in which such an individual also is paid wages by a CPEO under a CPEO contract with the customer, the individual may nevertheless be a work site employee *with respect to such wages*.” This latter language addresses the very uncommon situation in which one individual is receiving payments from the CPEO in two separate capacities. For instance, a common law employee of a marketing firm receives wages from a CPEO for services the employee performed for the marketing firm under a contract between the firm and a CPEO. This employee also owns a part-time cleaning business as a sole proprietor and this cleaning business is contracted by the marketing firm to clean its offices. Payments to the cleaning business for its cleaning services are also managed by the CPEO under its contract with the marketing firm. Payments made to the individual by the CPEO for the services the individual’s sole proprietor cleaning business performs for the marketing firm are not wages and must be reported as payments to a self-employed individual under section 6041. However, the CPEO is treated as the employer of the individual for 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 marketing firm, these payments are reported as wages by the CPEO.

In contrast to the situation described above, under the proposed regulations 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 section 6041. Under Revenue Ruling 69-184, “[b]ona fide members of a partnership are not employees of the partnership” for employment tax purposes. “Such a partner who devotes his 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.’” So whether an individual partner in a partnership is receiving payments from the CPEO for services performed in the conduct of the trade or business of the partnership, or receiving payments from the CPEO for services performed as an independent contractor of the partnership, the payments are payments to a self-employed individual and should be treated as such for reporting purposes as provided by section 6041.