

QBI Deduction and Wages Through Professional Employer Organization

The citation for this article doesn't address QBI at but does address wages through a Professional Employer Organization (PEO). We feel the issue addressed can be important when it comes to QBI as well, thus we wrote this article.

The Qualified Business Income (QBI) deduction under Section 199A is generally 20% of the profit from the business with some adjustments. Taxpayers with income above the threshold have to apply an additional limitation connected to wages and property in the business.

In the case of a partnership or sole proprietorship, they are often little or no wages because the owners are the workers. One way often used to get around this "no wage" issue is to pay the owners through a Professional Employer Organization (PEO).

OUR QUESTION – Does this create "wages" paid by the business for purposes of the QBI deduction for higher taxable income taxpayers? Here are detail showing why we are asking the question and trying to make you think. (Yes, we know tax season has barely ended and you may not want to think yet.)

PEOs are legal separate entities and act as the HR department for various clients. PEOs handle tax matters, any fringe benefits, and other employer related items. PEOs often issue Forms W-2 for the clients using the PEOs' name and EIN as the employer. Some PEOs appear to be created only for one client while some PEOs have many clients.

Regulation 1.199A-2(b) states "In determining W-2 wages, an individual or RPE [relevant passthrough entity] may take into account any W-2 wages paid by another person and reported by the other person on Forms W-2 with the other person as the employer listed in Box c of the Forms W-2, provided that the W-2 wages were paid to common law employees or officers of the individual or RPE for employment by the individual or RPE. ... For purposes of this paragraph (b)(2)(ii), personal that pay and report W-2 wages on behalf of or with respect to others can include, but are not limited to, certified professional employer organizations under Section 7705, ...". "Certified professional employer organizations" (CPEO) were created through new code sections 7705 & 3511 as part of a 2014 Act effective January 1, 2015.

Recently IRS issued Chief Counsel Advice (CCA) Memorandum 201916004 dated March 1, 2019. This CCM addresses questions regarding a statement in the preamble to regulation 301.7705-1, which states, in part, that a self-employed individual including partners of a partnership are not "employees" for purposes of any services they are providing through the PEO to their own sole-proprietorship or partnership. As such monies paid to these individuals are not wages but

instead these individuals should be issued a Form 1099-MISC from the PEO instead of a Form W-2.

EXAMPLE INCLUDED IN THE CCA: 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 CPEO makes to the individual for these services the individual performs as a common law employee of the marketing firm, these payments are reported as wages by the CPEO.

SECOND EXAMPLE FROM THE CCA: In contrast to the situation described above...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.

This CCA memorandum does not mention "wages" for purposes of the QBI deduction, but the regulations for the QBI deduction do mention "wages" paid through a PEO. Therefore, if the "wages" paid by a PEO to a self-employed taxpayer or a partner should be reported on a Form 1099-MISC, are they considered "wages" for purposes of the QBI?

CCA 201916004, March 1, 2019. A copy of this CCA can be found by going to www.irs.gov/pub/ clicking on irs-wd and then on 201916004.

Upcoming seminars listed below.

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UPCOMING SEMINARS:

May 16 & 17, Michigan Chapter of NATP at Double Tree, 4747 28th St, SE, Grand Rapids, MI. Topics include Teens & Taxes (kiddie tax, scholarships, dependents, and more), Elections, HSAs, Schedule C, Medicaid, Social Security planning, and Ethics. For more information go to www.minatp.org.

May 21, Orange County Chapter of California Society of Enrolled Agents at the Phoenix Club in Anaheim, CA. David is presenting 1031 Exchanges and Nonresident Alien Issues. For more information go to eaoc.org.