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Steve Leimberg's Business Entities Email Newsletter - Archive Message #138

Date: 24-Jul-13
From: Steve Leimberg's Business Entities Newsletter
Subject: **Ken Crotty: Disregarded Entity Reporting Requirements**

"Typically disregarded entities are either single member LLCs or Grantor trusts, which are trusts that are treated as owned by the Grantor for income tax purposes. As a general rule, disregarded entities and Grantor trusts are not required to obtain employer identification numbers. However, many financial institutions require employer identification numbers for income reporting purposes and will not allow the social security number of the owner or Grantor to be used.

There are several ways to report disregarded entities based on the form of the entity as a single member LLC or a Grantor Trust. This commentary will discuss the different reporting requirements, as well as the reporting options available for a Grantor trust trustee."

Now, **Ken Crotty** provides members with practical insights regarding disregarded entity reporting options for single member LLCs and grantor trusts.

Kenneth J. Crotty, J.D., LL.M., is a partner at the Clearwater, Florida law firm of **Gassman Law Associates, P.A.**, where he practices in the areas of estate tax and trust planning, taxation, physician representation, and corporate and business law. Mr. Crotty has co-authored several handbooks that have been published in BNA Tax & Accounting, Estate Planning, Steve Leimberg's Estate Planning and Asset Protection Planning Newsletters, Estate Planning magazine, and Practical Tax Strategies. Mr. Crotty is also the author of the Limited Liability Company Chapter of the Florida Bar's Florida Small Business Practice, Seventh Edition. He, Alan Gassman and Christopher Denicolo are the co-authors of the BNA book Estate Tax Planning in 2011 & 2012. Mr. Crotty is board certified by the Florida Bar Association in Tax Law. His email address is Ken@gassmanpa.com.

Here is his commentary:

EXECUTIVE SUMMARY:

There are several ways to report disregarded entities based on the form of the entity as a single member LLC or a Grantor Trust. This commentary will discuss the different reporting requirements, as well as the reporting options available for a Grantor trust trustee.

FACTS:

Typically disregarded entities are either single member LLCs or Grantor trusts, which are trusts that are treated as owned by the Grantor for income tax purposes. As a general rule, disregarded entities and Grantor trusts are not required to obtain employer identification numbers. However, many financial institutions require employer identification numbers for income reporting purposes and will not allow the social security number of the owner or Grantor to be used.

Reporting Disregarded Entities

If a disregarded entity has an employer identification number and later the ownership of the disregarded entity changes so that it no longer qualifies as a disregarded entity, the disregarded entity should retain its old employer identification number when its classification changes. For example, if a disregarded LLC has an employer identification number, and then a second member buys into the LLC so that it is now treated as a partnership, the partnership should continue using the employer identification number that was assigned to the LLC when it was disregarded.

Generally disregarded entities do not need to file a separate tax return. The items of income, deduction and credit from the activities of the disregarded entity will be picked up on the owner's tax return on the following Schedules:

Schedule C – Profit or Loss from Business (sole proprietorship)

Schedule E – Supplemental Income or Loss

Schedule F – Profit or Loss from Farming

The disregarded entity is treated as separate from its owner for employment tax purposes for wages paid on or after January 1, 2009 and for excise taxes reported and paid on Forms 720, 730, 2290, 11-C, or 8849 after December 31, 2007. In these situations, the employment tax and excise tax return instructions should be reviewed to be certain that the disregarded entity is reporting the necessary information.

Reporting Grantor Trusts

If a trustee is not using one of the optional methods of filing, which are discussed below, and the entire trust is a Grantor trust, the trustee need only fill in the entity information on the Form 1041. The trustee should not show any dollar amounts on the Form 1041 itself. Instead, the trustee should show the dollar amounts on attachments to the Form 1041. The attachment should not be a Schedule K-1. The trustee must give the Grantor of the trust a copy of the attachment.

If the trust is only a partial Grantor trust, then the items of income, deduction and credit for the non-Grantor portion of the trust should be reported on the Form 1041 as normally would be done and the portion of the items treated as owned by a Grantor trust should be shown on an attachment.

The attachment must show the name, identifying number, and address of the persons to whom the income is taxable. The income must be reported in the same detail as it would be reported on the Grantor's return if it had been received directly by the Grantor. Any deductions or credits that apply to the income also need to be reported in the same detail as they would be if they had been received directly by the Grantor. That Grantor then reports the items of income, deductions and credits on the Grantor's personal return.

COMMENT:

For Grantor trusts, there are three optional methods of filing, which the trustee may choose instead of filing the Form 1041. If a trust is treated as owned by one person, then the trustee may select Option 1 or Option 2 described below. If a husband and wife are treated as the owners of a trust, they will be deemed to be one person and therefore the trustee may select either Option 1 or Option 2 below. If the trust is treated as owned by more than one person, then the trustee may select Option 3 below.

Option 3 has the same reporting requirements as Option 2 but only applies in situations where there is more than one Grantor, and the Grantors are not husband and wife. In this situation the trustee would need to determine which portion of the trust assets were payable to Grantor 1 and which portion of the trust assets were payable to Grantor 2. The trustee would then provide each of Grantor 1 and Grantor 2 with the same information as shown under Option 2.

Option 1: The trustee must give all of the payers of income during the year to the trust the social security number of the individual treated as the owner of the trust and the trust's address. To use this method, the owner of the trust must provide the trustee with a signed W-9. If the owner of the trust is not the trustee or co-trustee, then the trustee must (1) give the owner a statement showing all of the items of income, deduction, and credit of the trust; (2) identify the payer of each item of income; (3) explain how the owner takes such items into account when preparing the owner's tax return; and (4) inform the owner that these items must be included on his or her tax return. If the trustee reports under Option 1 and the trust does not have an employer identification number, the trust does not need to obtain an employer identification number to satisfy Option 1.

Option 2: The trustee must give all of the payers of income during the year to the trust the full name of the trust, the trust's address and the trust's tax identification number. The trustee also must file with the IRS the appropriate Forms 1099 to report the income paid to the trust during the tax year. These forms show the trust as the payer and the individual treated as the owner of the trust as the payee. If the owner of the trust is not the trustee or co-trustee, then the trustee must (1) give the owner a statement showing all of the items of income, deduction, and credit of the trust; (2) explain how the owner takes such items into account when preparing the owner's tax return; and (3) inform the owner that these items must be included on his or her tax return. If the trustee reports under Option 2 and the trust does not have an employer identification number, the trust needs to obtain an employer identification number to satisfy Option 2.

Option 3: The trustee must give all of the payers of income during the year to the trust the full name of the trust, the trust's address and the trust's tax identification number. The trustee also needs to file with the IRS the appropriate Forms 1099 to report the income paid to the trust during the tax year. These forms would show the trust as the payer and the owners as the payees. The trustee must (1) give each owner a statement showing all of the items of income, deduction, and credit of the trust attributable to such owner; (2) explain how each owner takes such items into account when preparing his or her tax return; and (3) inform each owner that these items must be included on his or her tax return. If the trustee reports under Option 3 and the trust does not have an employer identification number, the trust needs to obtain an employer identification number to satisfy Option 3.

If a trustee has been filing a Form 1041, the trustee can change to one of the three optional methods listed above at any time. The trustee can do this by filing a final Form 1041 for the tax year immediately preceding the first tax year that the trustee elects to use one of the optional methods of filing. On the front of the final Form 1041, the Final return box in item F must be checked and the

words “Pursuant to section 1.671-4(g), this is the final Form 1041 for this grantor trust” should be written on the first page of the Form 1041.

The filing of the relevant 1099s by the trustee, in relation to Options 2 and 3 above depends on the type of income for the Trust. For example the trustee may be required to file a 1099-DIV for dividend income and file a 1099-INT for relevant interest income.

In relation to the reporting of income from long-term gain or loss from a partnership, S Corporation, or trust, Treasury Regulation 1.671-4(b)(5) provides that in the case of a trust that owns an interest, the distributive share belonging to the trust as a partner, shareholder, or beneficiary will not be includable by the trustee on any Form 1099 because the distributive share is reportable by the partnership, S corporation, or trust on the Schedule K-1.

Certain trusts are not allowed to use the optional filing methods. These include the following:

1. The common trust fund;
2. A foreign trust or trust that has any of its assets located outside of the United States;
3. A qualified Subchapter S trust;
4. A trust which is treated as owned by one or more individuals who have a tax year other than a calendar year;
5. A trust which is owned by one or more persons who are not U.S. persons; and
6. A trust which is owned by one or more persons if at least one person is an exempt recipient for informational reporting purposes unless at least one other person is not an exempt recipient and the trustee reports the information without treating any of the owners as exempt recipients.

Conclusion:

For disregarded entities such as single member LLCs it is important to remember that although a separate income tax return does not need to be filed and all the items of income, deduction and credit are picked up on the personal return of the owner, there may be additional informational returns which need to be reported related to employment tax and excise taxes. For Grantor Trusts, even though the items of income, deduction, and credit are reported on the return of the Grantor, trustees have a duty to be certain that the necessary income tax returns and/or reporting statements are being filed with the Internal Revenue Service. If the trustee is not filing a Form 1041 with the necessary information of the trust, then the trustee must be certain that the trustee is complying with one of the optional methods of reporting the income, deduction and credit associated with the trust.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Ken Crotty

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