



DIRECTIVE

Subject: Withholding from Nonresident Contractors and ITIN Holders

Tax: Withholding Tax

Law: G. S. 105-163.1 and G.S. 105-163.3

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The law that requires North Carolina income tax to be withheld from payments made to nonresidents for personal services has been amended to also require withholding on payments to ITIN contractors beginning January 1, 2010. The changes were enacted by Senate Bill 1006, Chapter 476 of the 2009 Session Laws. Effective January 1, 2010, this directive amends and supersedes PD-98-3 and PD-07-1.

Definitions:

Compensation- Consideration a payer pays to any of the following:

- a) A nonresident individual or nonresident entity for personal services performed in this State.
- b) An ITIN holder who is a contractor and not an employee for services performed in this State.

ITIN Contractor- An ITIN holder who performs services in this State for compensation other than wages.

ITIN Holder- A person whose taxpayer identification number is an Individual Taxpayer Identification Number (ITIN). (An ITIN is issued by the Internal Revenue Service to a person who is required to have a taxpayer identification number but does not have and is not eligible to obtain a social security number.)

Nonresident Contractor- Either of the following:

- a) A nonresident individual who performs in this State for compensation other than wages any personal services in connection with a performance, an entertainment or athletic event, a speech, or the creation of a film, radio, or television program.

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- b) A nonresident entity that provides for the performance in this State for compensation of any personal services in connection with a performance, an entertainment or athletic event, a speech, or the creation of a film, radio, or television program.

Nonresident Entity- Either of the following:

- a) A foreign limited liability company, as defined in G.S. 57C-1-03, that has not obtained a certificate of authority from the Secretary of State pursuant to Article 7 of Chapter 57C of the General Statutes.
- b) A foreign limited partnership as defined in G.S. 59-102 or a general partnership formed under the laws of any jurisdiction other than this State, unless the partnership maintains a permanent place of business in this State.
- c) A foreign corporation, as defined in G.S. 55-1-40, that has not obtained a certificate of authority from the Secretary of State pursuant to Article 15 of Chapter 55 of the General Statutes.

Payer- A person who, in the course of a trade or business, pays compensation to any of the following:

- a) A nonresident individual or nonresident entity for personal services performed in this State.
- b) An ITIN holder who is a contractor and not an employee for services performed in this State.

General Requirements

Effective January 1, 2010, North Carolina income tax of 4 percent is required to be withheld from non-wage compensation paid to either:

- a) A nonresident contractor or,
- b) An ITIN contractor.

The requirement to withhold applies to payers who, in the course of a trade or business expect to pay more than \$1,500 of non-wage compensation to nonresident or ITIN contractors.

Exceptions to Withholding

Tax is not required to be withheld from compensation paid to a nonresident entity if the entity meets certain requirements. No tax is required to be withheld if the entity is a corporation or a limited liability company that has obtained a certificate of authority from the Secretary of State. The payer must obtain from the entity and retain in its records the entity's identification number issued by the Secretary of State.

No tax is required to be withheld from an entity that is exempt from North Carolina corporate income tax under G.S.105-130.11. This includes any organization that is exempt from federal income tax under the Internal Revenue Code. The entity must provide verification of this tax exemption to the payer, such as a copy of the

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organization's federal determination letter of tax exemption or a copy of a letter of tax exemption from the Department of Revenue.

If an entity is a partnership, no tax is required to be withheld if the partnership has a permanent place of business in this State. The payer must obtain from the partnership and retain in its records the partnership's address and taxpayer identification number.

Tax is not required to be withheld from personal services paid to an individual who is an ordained or licensed member of the clergy or who is a resident of North Carolina. If the payer does not withhold income tax because the individual is a resident of this State, the payer must retain the individual's address and social security number in its records.

Threshold

Withholding is required if the nonresident or ITIN contractor is expected to be paid more than \$1,500 during the calendar year. Tax is not required to be withheld from a payment of compensation to a nonresident or ITIN contractor if the payment is \$1,500 or less and, at the time the payment is made, the payer does not believe that the total compensation to be paid to the nonresident or ITIN contractor during the year will exceed \$1,500. If additional compensation paid to the nonresident or ITIN contractor later in the year causes total compensation for the year to exceed \$1,500, the payer is not required to withhold tax from the additional compensation to make up for the compensation from which no tax was withheld. *For example*, the payer pays a nonresident or ITIN contractor \$900 in January 2010, and does not expect to make any further payments to the nonresident or ITIN contractor in 2010. Because the compensation is \$1,500 or less, no tax is required to be withheld. Later in 2010, the same nonresident or ITIN contractor is paid an additional \$800. The payer must withhold \$32 from the \$800 compensation ($\$800 \times 4\%$) because the total compensation paid to the nonresident or ITIN contractor for the year now exceeds \$1,500. In contrast, if the payer makes regular payments to the nonresident or ITIN contractor during the year, the total of which is expected to exceed \$1,500, tax must be withheld from each payment.

Reporting and Paying the Tax Withheld

A payer who withholds tax from compensation paid to nonresident or ITIN contractors but is not already registered with the Department of Revenue for wage withholding must register by completing Form NC/BR, **Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery, Equipment, and Manufacturing Fuel Tax**. The payer may complete the registration online at www.dorn.com by using the Department's Online Business Registration located under the Electronic Services section or by mailing the completed Form NC/BR to Post Office Box 25000, Raleigh, North Carolina 27640. The payer will be assigned an account identification number and will receive forms for paying the tax withheld.

A payer who withholds tax from compensation paid to nonresident or ITIN contractors and who also withholds tax from wages must file a return and pay the withholding from

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the nonresident or ITIN contractors with the wage withholding. The payment of the tax withheld is due at the same time the withholding from wages is due and the payer will be subject to penalties and interest on both types of withholding based on that due date.

(Prior law permitted tax withheld from compensation paid for personal services to be filed and paid on a quarterly basis.)

Annual Statement and Report

A payer must give each nonresident or ITIN contractor from whom tax was withheld a written statement which includes the following information:

- a) The payer's name, address, and taxpayer identification number.
- b) The nonresident or ITIN contractor's name, address, and taxpayer identification number.
- c) The total compensation paid during the calendar year.
- d) The total amount withheld from the amount paid to the nonresident or ITIN contractor.

For nonresident contractors, payers must report the compensation paid and the income tax withheld on Form NC-1099-PS. For nonresident contractors who are individuals, the payer may complete federal Form 1099-MISC in lieu of Form NC-1099-PS. For ITIN contractors, the payer may report the compensation paid and the income tax withheld on either Form NC-1099-ITIN or federal Form 1099-MISC. The statement must be given to the nonresident or ITIN contractor on or before January 31 following the calendar year in which the compensation is paid. If the services are completed before the end of the year, the statement must be given within 45 days of the last payment of compensation only if the nonresident or ITIN contractor requests the statement at that time. The payer must file an annual report with the Department of Revenue reconciling the amounts withheld from all employees and nonresident or ITIN contractors. The annual reconciliation (Form NC-3 or NC-3M) is due on or before February 28. Payers who have previously established separate withholding accounts for nonresident contractor withholding and wage withholding prior to January 1, 2010, must file separate annual reconciliations for tax year 2009.

The annual reconciliation for tax year 2009 should be mailed to: North Carolina Department of Revenue, Post Office Box 25000, Raleigh, North Carolina 27640. However, beginning with tax year 2010, there will be changes regarding the submission of the annual reconciliation. See our website (www.dornc.com) or contact the Department at 1-877-252-3052 after January 1, 2011, for new electronic submission requirements for filing the annual withholding reconciliation.

Beginning January 1, 2010, payers must begin filing and paying income tax withheld from wages, personal services, and ITIN contractors under one withholding account number. Payers who have previously withheld and paid income tax for personal services and wages under separate withholding account numbers must close the personal services withholding account and begin filing and paying all income tax withheld under the wage withholding account number. The withholding account number established for a

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personal services withholding account is nine digits beginning with the number three (3). The account may be closed by completing the Form NC-BN Out-of-Business Notification, and mailing the completed form to: North Carolina Department of Revenue, Documents and Payments Processing Division, Post Office Box 25000, Raleigh, North Carolina 27640.

Claiming Credit for Tax Withheld

Individuals having tax withheld should claim credit for the tax withheld on the same line on the individual income tax return, Form D-400, as credit is claimed for wage withholding. The C corporation franchise and income tax return, Form CD-405 has a specific line to claim the tax withheld. Partnerships, including limited liability companies filing as partnerships, may claim credit on the partnership income tax return, Form D-403, for the portion of the tax withheld that is attributable to nonresident partners on whose behalf the managing partner is required to pay tax. The portion of the tax withheld that is attributable to resident partners must be allocated to those partners on Schedule NC K-1. S corporations may claim credit on the S corporation franchise and income tax return, Form CD-401S, for the portion of the tax withheld that is attributable to shareholders on whose behalf the corporation files a composite income tax return. The portion of the tax withheld that is attributable to shareholders who are not part of a composite return must be allocated to those shareholders on Schedule K of the S corporation return.

Refund of Tax Withheld in Error

A payer who improperly withholds tax may refund the amount withheld in error to the nonresident or ITIN contractor, if the refund is made before the end of the calendar year and before the payer furnishes the person the annual statement of tax withheld. A payer who makes a refund should not report the amount refunded on the annual statement nor remit the amount refunded to the Department. If the amount refunded has already been remitted, the payer must reduce the next payment of tax withheld from compensation paid to that person by the amount refunded. If no additional compensation is due to be paid to that person, and the amount withheld in error has already been remitted, the payer may not refund the tax withheld in error. The nonresident or ITIN contractor must file an income tax return and claim credit for the tax withheld.