

Questions for Department of Revenue on Nonresident Alien Taxation as it relates to the December 22, 2014 “Important Notice to Employers and Pension Payers That Withhold North Carolina Income Tax” and January 20, 2015 “Important Information About New Form NC-4 NRA”

### Basic questions:

1. What is NCDOR’s definition of Nonresident Alien (NRA)? Is it per IRS substantial presence test regulations outlined in IRS publication 519, or is it anyone who is in the United States on a USCIS issued VISA? (Example H-1B’s (once in the U.S. for 183 days in a year, they will become a Resident Alien), F-1’s (exempt from counting days for 5 years (NRA status), and J-1’s (most are exempt from counting days for 2 years (NRA Status))). If more examples of this are needed, OSC can provide more details.

*Answer: The definition of “nonresident alien” for North Carolina income tax purposes, including withholding of income tax from wages, is the same as defined for federal income tax purposes in IRS Publication 519.*

### Application of the New Regulations:

1. The new NC-4 NRA form states “If you do not provide a new NC-4 NRA to your employer before the first day of the first payroll period that ends on or after January 1, 2015, your employer is required to withhold as single with zero allowances.”

The new NC-30 publication (page 10) states “Because nonresident aliens are not allowed a standard deduction, nonresident alien employees must complete and sign a North Carolina Nonresident Alien Employee’s Withholding Allowance Certificate, Form NC-4 NRA. You must withhold tax using the “Single” filing status regardless of the employee’s actual marital status. If an employee does not give you a completed NC-4 NRA, you must withhold as single with zero allowances.”

However, the December 22 NCDOR notice ([http://www.dornrc.com/downloads/withholding\\_changes\\_2015.pdf](http://www.dornrc.com/downloads/withholding_changes_2015.pdf)) states “If a nonresident alien does not complete a Form NC-4 NRA, you must withhold North Carolina income tax from the employee’s wages based on a single filing status with no allowances and you must also withhold an additional amount per pay period.”

These notices contradict each other. Furthermore, does this mean that if we do not collect a new NC-4 NRA form do we simply withhold at single 0, and not withhold the additional amount listed on the form and notice?

*Answer: The information in the notice is not intended to contradict the information in the NC-30 or on the NC-4 NRA form. The requirement to withhold additional tax is mandatory (except for students and business apprentices subject to the treaty between the United States and India) so the employer must withhold that additional tax regardless of the taxpayer's number of allowances on line 1 of the NC-4 NRA or whether the employee submits a Form NC-4 NRA. The number of allowances is a variable to be claimed by the employee. If the employee does not provide the NC-4 NRA, then the employer must withhold using a filing status of single with no allowances.*

2. What is the expectation of the employers if a NRA completes the new NC-4NRA incorrectly? Are we expected to honor the signed form or continue to withhold at Single/0 with the additional withholding amount? Keep in mind, English is a second language for most foreign nationals, and the Payroll processor will need to explain the withholding details.

*Answer: Pursuant to section 14 of NC-30, the employer is not required to determine whether the number of allowances claimed by the employee is greater than the total amount to which the employee is entitled. However, the employer should immediately notify the Department if the employer believes that the number of allowances claimed by an employee is greater than the amount of allowances to which the employee is entitled. The employer should withhold based on the number of allowances claimed by the employee until the Department notifies the employer to do otherwise. The employer must withhold the additional withholding amount from the chart for line 2 unless the employee is a student or business apprentice and subject to the treaty between the United States and India.*

3. If employers are required to withhold all nonresident aliens at the 5.75% with the additional withholding, does this mean we are not to take into account actual yearly income in calculating taxes? Example: if a nonresident alien student earns \$150.00 each biweekly payroll the employer currently is instructed to withhold \$25.63 (5.75%+\$17 for biweekly payroll) in North Carolina withholding every payroll? By year end this student will only earn \$3900.00 but will have paid \$666.38 in North Carolina taxes. Is there not a de Minimis amount?

*Answer: On January 20, 2015, the Department published on its website a document titled "Important Information About New Form NC-4 NRA" that provides further guidance on the amount to withhold if the employee's pay for the payroll period does not exceed an amount that, if annualized, equals the North*

*Carolina standard deduction amount. In that case, the additional withholding amount for line 2 will be 5.75% of that payroll period's wages.*

4. What additional amount should be entered if an individual is paid on both monthly and biweekly payroll schedule on a regular basis?

*Answer: A nonresident alien who works for two employers will complete a separate NC-4 NRA for each employer and will complete line 2 as instructed on page 2 of Form NC-4 NRA. Likewise, an employee who works two jobs with the same employer and has different payroll periods for the two jobs should submit separate Form NC-4 NRAs for each job and complete line 2 as instructed on page 2.*

5. If we are paying supplemental wages, will there be an additional amount or just tax at 5.75%?

*Answer: The tax rate is 5.75% regardless of the amount of income so supplemental wages are treated just like other wages.*

6. The way the new regulations are written makes it impossible for most software providers (ex: PeopleSoft and Banner) to write code to help automate the process. This will require payroll departments to manually review every nonresident to make sure they are processing the additional amount correctly. A recommendation is to review IRS publication 15 page 21 (<http://www.irs.gov/pub/irs-pdf/p15.pdf>) to see how the IRS manages not allowing the standard deduction for those who are in nonresident alien tax status. This procedure allows for the additional withholding but does so in a way that can be automated and takes into account yearly income.

*Answer: The Department believes that the additional withholding is simple and should not be difficult to program. The additional withholding amounts in the chart on page 2 of the NC-4 NRA are determined by multiplying the standard deduction of \$7,500 by the tax rate and then dividing by the number of payroll periods. The Department has discovered that this method results in overwithholding if the employee's wages for the pay period multiplied by the number of pay periods in the year are equal to or less than \$7,500. The January 20, 2015 document provides further guidance on the amount to withhold if the employee's pay for the payroll period is less than an amount that, if annualized, equals the North Carolina standard deduction amount. In that case, the additional withholding amount for line 2 will be 5.75% of that payroll period's wages.*

*Summary: The wage bracket tables, percentage, and annualized methods of computing income tax withheld included in NC-30, in conjunction with the*

*additional information provided in the Department's Important Notice to Employers and Pension Payers That Withhold North Carolina Income Tax dated December 22, 2014 and the January 20, 2015 Important Information About New Form NC-4 NRA work together to maintain the standard deduction in the calculation process and then use the additional withholding on line 2 to address the fact that most nonresident aliens do not qualify for the standard deduction.*

## Tax Treaty

1. Clarification is needed for tax treaty income. Are we only able to exempt 8233 tax treaty income, or are you recognizing other tax treaties? (Example: The India Student Treaty per Article 21-an Indian student is able to claim the standard deduction on his/her tax return).

*Answer: Pursuant to G.S. 105-163.1(13), the term "wages" has the same meaning as in section 3401 of the Code. Only wages excludable from withholding for federal purposes are excludable from withholding for State purposes. The January 20, 2015 document addresses the standard deduction for students and business apprentices that are residents of India by permitting those employees to enter \$0 as the amount of additional withholding on line 2 of the NC-4 NRA. All other nonresident aliens must enter the proper amount from the chart on page 2 of Form NC-4 NRA.*

2. Currently the IRS requires the 8233 (Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual) be filed annually for each individual foreign national. Is there any reporting that is necessary to the NC DOR to exempt any wages if DOR plans to continue to honor treaty benefits?

*Answer: No reporting is required. The employer should maintain the 8233 in its records for three years in case the Department reviews its withholding records.*

## Contractors or ITIN holders:

1. Could we please get clarification on what the proper rate to withhold for independent personal service income paid to those who are in nonresident alien tax status? 4% or 5.75%? Why is the rate 4% withholding when the NC flat rate is 5.75%?

*Answer: G.S. 105-163.3 **requires** a payer who pays more than \$1,500 during a calendar year to either a nonresident contractor or an ITIN contractor to withhold 4% of the compensation paid to the contractor. The law does not explain why the withholding rate is 4% instead of the income tax rate but our understanding is the withholding rate is based on the presumption that the contractor will incur business expenses in earning the contract income.*

2. Per the directive: “Effective January 1, 2010, a person who, in the course of a trade or business, pays compensation of \$1,500 or more for services performed in this State to a person who holds an ITIN and not a social security number and who is a contractor and not an employee must withhold North Carolina income tax equal to 4% of the compensation.” Question – If the contractor (foreign national) does not have an ITIN or SSN – should the 4% be withheld or is this only for the ITIN holders? What should be withheld if the foreign national who has a SSN receives contracted service payments?

*Answer: The payer should withhold 4% from the compensation paid to the contractor if the contractor provides an ITIN or does not provide a taxpayer identification number that is a social security number. If the individual contractor provides a social security number, the 4% withholding is required only if the individual contractor is a nonresident and is providing personal services in connection with a performance, an entertainment, an athletic event, a speech, or the creation of a film, radio, or television program.*

## Scholarships:

1. The new regulation does not address scholarship income. IRS requires all scholarships paid to those in nonresident alien tax status to be taxed at the source and reported on form 1042-S annually. Should we be withholding any state taxes on non-qualified scholarships?

### IRS Guidance:

- a. Per IRS Publication 970:

**Qualified education expenses.** For purposes of tax-free scholarships and fellowships, these are expenses for:

- Tuition and fees required to enroll at or attend an eligible educational institution, and
- Course-related expenses, such as fees, books, supplies, and equipment that are required for the courses at the eligible educational institution. These items must be required of all students in your course of instruction.

**Expenses that do not qualify.** Qualified education expenses do not include the cost of:

- Room and board,
- Travel,
- Research,
- Clerical help, or

- Equipment and other expenses that are not required for enrollment in or attendance at an eligible educational institution.

*Answer: North Carolina law does not require withholding on scholarships.*

## Reporting:

1. The new regulations do not provide guidance on how to report 1042 income and the taxes collected for the state of North Carolina. There has never been a formal procedure for reporting this income and taxes. Most report 1042 income on the NC-3 form and hand write 1042 information on the form. Clarification on how to report this income would be appreciated.

*Answer: There is no separate reporting requirement for State tax purposes. An employer will report withholding on wages paid to nonresident aliens on the same forms and at the same time as reporting withholding on wages of other employees.*

2. Will the NC individual income tax return instructions (D-400) be updated to instruct NRAs who are in nonresident alien tax status for tax year 2015 that they are not allowed to take the standard deduction for 2015 or will there be a new NRA NC income tax return?

### **2014 D-400 clarification:**

- The current D-400 does not address those who file form 1040NR or form 1040NR-EZ. ([http://dornc.com/downloads/fillin/D400\\_webfill.pdf](http://dornc.com/downloads/fillin/D400_webfill.pdf)) Line 6 states filers must submit what is listed on form 1040 or 1040EZ to complete their North Carolina tax returns. Individuals who are in nonresident alien tax status are required to file form 1040NR or 1040NR-EZ. This may result in North Carolina tax reporting errors for those who are in nonresident alien tax status.

*Answer: The fact that a nonresident alien cannot take a North Carolina standard deduction is addressed on the 2014 individual income tax form and in the instructions for that form.*

*North Carolina has no current plans to publish a new tax return form for use by nonresident aliens.*

*The Department will consider the suggestion about adding more instructions to assist a nonresident alien with properly completing a North Carolina income tax return.*

## Specific Questions:

Can NCDOR give examples of how to complete the NC-4 NRA, especially Line 2, and the back side of the form?

*Answer: Nonresident alien employees should complete line 1 using the same instructions that other employees use to determine their allowances to claim on Form NC-4 or Form NC-4 EZ. The Department provided guidance on completing Form NC-4 and Form NC-4EZ in late 2013 in the form of a webinar. Please see <http://www.dor.state.nc.us/press/2013/nc4requirement.html>. Line 2 is easy to complete. The employee uses the payroll period used by the employer to determine the proper amount to enter on line 2 as additional withholding. For example, an employee paid on a weekly basis will enter \$9 on line 2.*

Another suggestion, can NCDOR include in the NC-30, for Foreign Nationals, the Percentage Method - Formula Tables for Percentage Method Withholding Computations as shown for regular employees on pages 14 - 17. That would be very helpful.

*Answer: The Department elected to maintain one set of withholding tables, percentage and annualized methods of computing the amount of tax to withhold for all taxpayers and to use the additional withholding on line 2 of Form NC-4 NRA to address the fact that most nonresident aliens do not qualify for the standard deduction.*

Income Tax Division  
Personal Taxes Section  
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