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North Carolina Adopts New Changes to Contractor Income Tax Withholding Rules

By Keith A. Wood

Senate Bill 523 (July 26, 2019) made significant amendments to N.C.G.S. 105-163.3, which requires that any payer paying more than \$1,500 in a calendar year to an ITIN contractor to withhold 4% of income tax on the compensation being paid to the ITIN contractor. Under the amended N.C.G.S 105-163.3, effective January 1, 2020, a payer must deduct and withhold 4% NC income tax from nonwage compensation paid to a "payee" if the payer expects to pay more than \$1,500 to the payee in that calendar year. Under N.C.G.S. 105-163.1(9a), a "payee" is defined as any of the following:

1. A non-resident contractor that provides a performance, entertainment, athletic event, speech or creation of film, radio or television program here in North Carolina.
2. An ITIN contractor, including someone who is applying for an ITIN and someone who has an expired ITIN.
3. Any person who performs services in NC who fails to provide the payer a taxpayer identification number.
4. A person who performs services in North Carolina that fails to provide the payer a valid taxpayer identification number. (And, for this purpose, the NCDOR must notify the payer that the ITIN is invalid and if that happens, then the withholding requirement only applies to compensation paid to that payee after that date).

The withholding requirement applies to any payer who expects to pay more than \$1,500 of nonwage compensation to the payee during that calendar year. However, tax is not required to be withheld from the payment of compensation to a payee if the payment is \$1,500.00 or less and at the time the payment is made, the payer does not believe that the total compensation to be paid to the payee during the year will exceed \$1,500.00. If additional compensation paid to the payee later in the year causes total compensation for the year to exceed \$1,500.00, the payer is only required to withhold tax from the additional compensation and does not have to make up from the compensation for which no tax was withheld.

On October 18, 2019, the North Carolina Department of Revenue issued Notice Directive TA-19-1 and provides a specific example of how these new rules will work. In the example provided in the Directive, the payer pays a payee \$900 in January 2020 and does not expect to make any further payments to the payee in 2020. Because the compensation is \$1,500.00 or less, no tax is required to be withheld. However, later in 2020, the same payee is paid an additional \$800.00. In this case, the payer must withhold \$32.00 from the \$800.00 compensation ($\$800 \times 4\%$) because the total compensation paid to the payee for the year now exceeds \$1,500.00. In contrast, if the payer makes regular payments to the payee during the year, the total which is expected to exceed \$1,500, 4% income tax must be withheld from these payments.

There are certain exceptions to the new withholding rules. For example, tax is not required to be withheld from compensation paid to a non-resident entity if the entity is a corporation or limited liability company that has obtained a certificate of authority from the North Carolina Secretary of State. However, the payer must obtain from the entity, and retain in its records, the entity's identification number issued by the North Carolina Secretary of State.

Could a Responsible Person Be Personally Liable for Failing to Do the 4% Withholding?

N.C.G.S. 105-242.2 (b)(4) imposes personal liability on responsible persons for unpaid income taxes required to be withheld by the business. Presumably therefore, a responsible person could be held personally liable for the failure to withhold the 4% income tax on compensation paid to the above-mentioned "payees" regardless of whether the corporate officer knew or should have known of the withholding obligation.

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