

HR and tax alert



United States

Guidance released on new withholding rules for nonresident aliens working in US

The Internal Revenue Service (IRS) has issued Notice 2009-91 (<http://www.irs.gov/pub/irs-drop/n-09-91.pdf>) to modify withholding rules to more closely approximate the income tax liability of nonresident aliens working in the United States. An adjustment is necessary because nonresident aliens are not eligible for the Making Work Pay Credit used in withholding table calculations resulting in an under withholding of tax. The new rules are effective 1 January 2010.

Background

Employers are required to withhold income tax on wages paid to employees according to tables and computations provided by the IRS. For employees who are US citizens or residents, the calculations assume use of the standard deduction. However, use of the standard deduction is not allowed for nonresident aliens. In the past, employers were instructed to add an amount to the wages of nonresident alien employees to reflect their ineligibility for the standard deduction when calculating withholding.

The American Recovery and Reinvestment Act of 2009 (Public Law No. 111-5) (ARRA) created the Making Work Pay Credit (the Credit). The Credit is equal to the lesser of 6.2% of earned income or US\$400 per individual. The IRS modified withholding

tables to reflect availability of the Credit. Nonresident aliens are not eligible for the Credit. Calculating withholding for nonresident aliens using the modified withholding tables would result in an under withholding of tax.

New withholding rules

Beginning for wages paid on or after 1 January 2010, employers must make two adjustments to calculate withholding for nonresident alien employees. Employers must make the adjustment for the standard deduction and must now also add an amount from a separate table to offset the effect of the Credit. Specific steps to make those adjustments will be provided in Publication 15 and other IRS forms and publications.

Implications

Employers need to adopt these new procedures when calculating withholding on wages paid to nonresident aliens working in the US. It is important to note that tax withholding is generally required on US source wages of nonresident aliens, even when the employer is a non-US entity.

Earlier this year, the IRS announced it would be conducting detailed employment tax examinations as part of a national research program. In addition, the IRS updated

its Servicewide Approach to International Tax Administration to support its Strategic Plan for 2009-2013, which includes a focus on international tax issues. We have recently seen requests from the IRS for very detailed information regarding nonresident alien and expatriate employee compensation, withholding and reporting issues.

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For further information on the new nonresident alien withholding rules or other matters related to withholding and reporting for nonresident aliens, please contact your local Ernst & Young Human Capital professional.