

New withholding obligation

New Pennsylvania law puts more of a burden on Pennsylvania companies

“For all you businesses operating in Pennsylvania, effective January 1, 2018, Pennsylvania requires you to withhold Pennsylvania personal income tax, currently at the rate of 3.07 percent, from any payments made to: non-resident individuals; and disregarded entities that have a non-resident member.”

“Anybody who is concerned about the new law should contact their accountant or attorney to make sure they understand the parameters,” says Charles W. Ormsby, Jr., Managing Member at Semanoff Ormsby Greenberg & Torchia, LLC.

Smart Business spoke with Ormsby about the new tax law, how it will impact companies’ administrative burden and the risks costs associated with the provision.

How is the new law structured?

If you have an individual (not employee) who was doing work for your business as an independent contractor and they live out of state, you would be required to withhold the 3.07 percent on payments to them and remit it to the Commonwealth of Pennsylvania. Similarly, if you are doing business with a limited liability company (LLC) that is considered a disregarded entity and the owner is a non-resident, you would have to withhold. This holds true even if the company is a Pennsylvania business with a mailing address in Pennsylvania, but the owner lives in New Jersey.

Lease payments are treated a bit differently. If you have a non-resident landlord, you are only required to withhold for individuals, trusts and estates. It does not apply to disregarded entities. The policy behind the law is to capture tax from non-residents who

were not paying the Pennsylvania income tax. The withholding is mandatory if a business pays equal to or greater than \$5,000 to a vendor, other than a landlord.

How will the law affect a company’s administrative burden?

The law implicitly imposes due diligence requirements on Pennsylvania taxpayers to determine if a vendor is a disregarded entity (such as an LLC) with an out-of-state owner or an out-of-state individual. It is not enough just to send a check to a Pennsylvania address and assume the recipient is a Pennsylvania taxpayer. Failure to withhold can result in your business being required to pay the tax not withheld and remitted, plus penalties and interest. However, your business will not be subject to assessment for failure to withhold for a period ending prior to July 1, 2018. So there is still time to get prepared.

Businesses need to go through their accounts payable to identify whether they are making payments to either landlords or vendors who are out of state and determine whether they are paying \$5,000 or more to the vendors. Landlords are not subject to the \$5,000 limitation. From the standpoint of remitting, you need to check with your accountant to make sure you are filling out the right forms



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and making timely payments. There are a set of rules with regard to semi-weekly, semi-monthly and quarterly remittances. A Pennsylvania taxpayer may also want to apply for a 1099-Misc withholding account or use their existing account.

What are some best practices in terms of accounts payable files?

Do not be fooled by simply relying on someone’s street address. You may also want to rely on or use IRS Form W-9. Otherwise you might want to confirm the residence in writing or reach out to people in writing and have them provide written verification as to whether they are a resident or not. Some companies have thousands of vendors so they will need to dedicate a fair amount of resources to doing the due diligence necessary to determine the withholding situation.

How costly could the provision be?

The administrative costs, interest and penalties could swamp whatever the actual amount is that should have been withheld. In addition, if you have a claim that is made by the state for failure to withhold, then you will need to get your accountant or attorney involved and you will need to spend time and money to extricate yourself from the situation. Being prepared in advance is key! ●