

GEORGIA NONRESIDENT
WITHHOLDING REQUIREMENTS
IMPOSED ON PASS-THROUGH ENTITIES

2009 GSCPA REAL ESTATE CONFERENCE

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RICHARD C. LITWIN, ESQ.
THE LITWIN LAW FIRM, P.C.
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1742 Mt. Vernon Road - Suite 300
Atlanta, Georgia 30338
(678) 990-0600
www.litwinlaw.net

Overview

- Background
- Highlights of the 2008 Revisions to Withholding Statutes and Withholding Regulation
- Rules for Composite Returns
- Tiered Situations
- Exceptions from Tiered Situations
- Withholding Procedures
- Undue Hardship

A. Background

Policing the activities of Georgia residents is a vast undertaking for the Georgia Department of Revenue. Monitoring nonresidents is equally difficult.

To ensure that nonresidents file returns and pay their share of Georgia income tax on income from Georgia businesses, the State of Georgia requires the business to withhold a portion of the distributions to nonresidents. The nonresident withholding tax is imposed on a partnership, Subchapter S corporation, or limited liability company (hereinafter singularly “Entity” and collectively “Entities”) that are doing business in Georgia and that have nonresident members/partners/shareholders. The nonresident withholding requirement is similar to the withholdings from wages requirement is placed on an employer. This withholding mandate gives some assurances that the nonresident member will file a Georgia income tax return and pay his/her share of Georgia taxes.

Any Entity that owns property or conducts business in Georgia is subject to a withholding tax. Official Code of Georgia Annotated (“O.C.G.A.”) § 48-7-129(a).¹ The Entity must withhold 4% of distributions to nonresident partners, shareholders or members. In lieu of withholding, the Entity may file a composite return and pay the nonresidents’ Georgia income tax. *See* O.C.G.A. § 48-7-129(b)(1).² These mandates ensure that the nonresidents pay income taxes on their income from the Entity.

The withholding statute and the corresponding regulation have dogged taxpayers and practitioners for several years. Frustration is rooted in (1) meeting the filing deadline for year-end returns and (2) computing the withholding tax base. Entities that do not comply (do not pay the

¹ Effective April 9, 1993 and with respect to any distribution paid or credited after January 1, 1994.

withholding tax) face a maximum 25% penalty (which used to be a 100% penalty). Further, the liability for the penalty is “joint and several.” This means that the members are also liable for the penalty. O.C.G.A. § 48-7-129(c)(1). Finally, the annual consent form required of S corporations creates additional paperwork for all parties.

During the 2008 legislative session, the Georgia General Assembly passed and Governor Perdue signed H.B. 1151. The bill resulted from input by leaders in the Georgia Society of CPA’s and the State Bar of Georgia, in conjunction with the Georgia Department of Revenue (the “Department”). The effort led to revisions to some arcane rules, a relaxing of the onerous penalty and changes for S corporations.

In late 2008, the Department updated its rules and guidelines for nonresident withholdings by revising GA. COMP. R. & REGS. r. 560-7-8-.34 (the “Withholding Regulation”), to reflect the revisions to the withholding statute made by H.B. 1151. In the changes, the Department also loosened the longstanding limitations imposed on using composite returns.

This presentation addresses the changes to the withholding statutes and the regulation, both of which are effective for tax years beginning on or after January 1, 2008. *See* H.B. 1151, section 13; GA. COMP. R. & REGS. r. 560-7-8-.34(9). In particular, this presentation addresses the General Assembly’s effort through H.B. 1151 (1) to clarify the amount on which the withholding is computed, (2) to provide more time for Entities to report and pay the withholding tax and (3) to reduce the harsh 100% penalty for failure to pay the withholding tax. This presentation also examines the Department’s 2008 revisions to the Withholding Regulation.

² The right to file a composite return is subject to various conditions provided by the Department’s regulation. *See* GA. COMP. R. & REGS. r. 560-7-8-.34(3). These conditions are discussed below in Part II.C.

Nonresident withholding is required on –

- Payment of periodic distributions;
- Payment of any special distribution;
- Crediting of a distribution in lieu of payment;
- Guaranteed payments
- Distributions credited but not paid – amount of “distributions credited” is reduced by distributions paid during the year, if withholding has occurred on such payments.³ This includes COD income.

Nonresident withholding is not required –

- On that portion of the income that is not reasonably attributable to property owned or business done in Georgia, as apportioned under O.C.G.A. § 48-7-31. *See* GA. COMP. R. & REGS. r. 560-7-8-.34(2)(b).
- Where the total annual distributions paid or credited to the nonresident member is less than \$1,000. *See* GA. COMP. R. & REGS. r. 560-7-8-.34(2)(c). *See also* O.C.G.A. § 48-7-129(e)(1)(B).
- Where the distributions paid or distributions credited to nonresident are subject to withholding under other provisions of Georgia law. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(d).
- If the distributions paid or distributions credited represent previously taxed income. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(d)
- On payments for rents or royalties made to the nonresident member. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(d).
- Where the distributions paid or distributions credited to nonresident is a return of capital or investment. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(d)
- Where the Entity files a composite return for the nonresident members. GA. COMP. R. & REGS. r. 560-7-8-.34(3)(d). *See also* O.C.G.A. § 48-7-129(e)(1)(A).
- On payments to a nonresident member by an Entity that holds marketable securities (not as broker) and which is not subject to tax under O.C.G.A. § 48-7-24(c)(does not apply where Entity is a FLP).

³ *See* GA. COMP. R. & REGS. r. 560-7-8-.34(2)(a).

- Where nonresident member is a corporation with nexus and that qualifies under the regulations. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(g)
- Entity is a publicly traded partnership as defined in I.R.C. § 7704. *See also* O.C.G.A. § 48-7-129(e)(1)(E).
- Entity is a subchapter S corporation for federal purposes but must file as a C corporation in Georgia due to failing to meet requirements in O.C.G.A. § 48-7-21(b)(7)(B)
- Department has granted Entity’s petition for undue hardship. *See* O.C.G.A. § 48-7-129(e)(1)(D).

B. Highlights of the 2008 Revisions to Withholding Statutes and Withholding Regulation

1. Clarification of the Amount on which Withholding Tax is Due

Each tax season, practitioners and in-house tax executives of Entities grapple with the withholding requirements. In particular, they struggle with trying to figure out the amount on which to withhold. Should the Entity withhold on distributions of “cash”? Or, must the Entity withhold on the nonresident’s “allocable share” of the Entity’s income? Defining “distributions paid or credited” has been the single source of much of the frustration with compliance.

At enactment, in 1993, and up to H.B. 1151, in 2008, the Withholding Statute defined “distributions paid or credited” as a “disbursement of funds or recognition or assignment of interest in proceeds or property of an Entity, which is passed through to the members and which may be subject to Georgia income tax.” *See* O.C.G.A. § 48-7-100(2.1) (as it existed prior to the 2008 amendment). Practitioners, even the Department (in its lengthy booklet prepared as a taxpayer guide), understood “distributions paid or credited” to mean only disbursements of cash or property or a credit in lieu of such payment. Indeed, under the original Withholding Regulation, the term did not mean “distributive share of income” (K-1 income). *See* GA. COMP. R. & REGS. r. 560-7-8-

.34(1)(a)(as it existed before January 1, 2006).

Over the years, in enforcing the nonresident withholding requirement, the Department insisted that “distributions paid or credited” meant the nonresident member’s “distributive share.”⁴ Thus, the Department expected Entities to withhold on the nonresident member’s K-1 income, even if the Entity did not pay out cash during the year. This stoked fury among practitioners and taxpayers, and the ardor increased especially due to the fact that having K-1 income did not necessarily mean that the Entity had funds to pay the 4% withholding tax.⁵

In late 2005, the Department adopted a new regulation to apply to tax years beginning on or after January 1, 2006. The new regulation required an Entity to “withhold” on the nonresident partner, member or shareholder’s *distributive share of income*, even where no distribution was actually made by the Entity to nonresident member. GA. COMP. R. & REGS. r. 560-7-8-.34(1)(a)(as it existed prior to December 2008). The statutory definition did not change. Thus, grasping the true intent of the statutory definition of “distributions paid or credited” continued, and the confusion caused by the contradictory regulation thwarted taxpayer efforts to comply with the rules.

The passage of H.B. 1151 brings an end to the drama. For tax years beginning on or after January 1, 2008, the Withholding Statute, as amended, requires that the tax must be withheld from *“any distributions paid or any distributions credited but not paid”* to the Entity’s nonresident

⁴ Prior to the amendments in H.B. 1151, the Withholding Statutes defined “distributions paid or credited,” and the phrase “distributive share” was not found in the definitions. See O.C.G.A. § 48-7-100(2.1) (as it existed prior to the 2008 amendments). In fact, the term “distributive share” appears in other provisions of the Georgia Revenue Code. *E.g.* O.C.G.A. § 48-7-24. Thus, the Georgia General Assembly is familiar with the term and opted not to include it in the definition of “distributions paid or credited.”

⁵ Entities may be cash-strapped during the back-end of a loan, where the bulk of the payment is nondeductible principal and not deductible interest payments. Relief from the withholding obligation was available for an Entity facing undue hardship. O.C.G.A. § 48-7-129(e)(1)(D). However, inability to pay was not a basis for obtaining undue hardship relief. See Ga. Comp. R. & Regs. r. 560-7-8-.34(5)(b)(as it existed before January 1, 2006) and Ga. Comp. R. & Regs. r. 560-7-8-.34(6)(b)(as it currently exists).

members. *See* H.B. 1151, section 12, which amends Code Section 48-7-129(a)(1).⁶ With this change comes revised definitions that, hopefully, should clarify the amounts on which withholding is required.

Distributions Credited - means a recognition or assignment of interest in proceeds or property of a partnership, Subchapter “S” corporation or limited liability company, including a net distributive share of income which is passed through to members and which may be subject to Georgia income tax. O.C.G.A. § 48-7-100(2.1).

Distribution Paid – means any disbursement of funds of a partnership, Subchapter “S” corporation or limited liability company that is made to a member with respect to that member’s interest in the Entity and which may be subject to Georgia income tax. O.C.G.A. § 48-7-100(2.2).

Ordering of distributions paid or distributions credited - Distributions are first considered to be distributed from distributions credited. Any distributions for the year that exceed the member’s distributions credited are not subject to withholding. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(d). Further, as noted above, previously taxed income is not subject to withholding requirements. GA. COMP. R. & REGS. r. 560-7-8-.34(2)(d).

⁶ Of course, if the nonresident member of the Entity is not subject to tax, the withholding is not applicable. O.C.G.A. 48-7-129(a)(1); *see also* O.C.G.A. § 48-7-129(e)(1) (exceptions to requirement); GA. COMP. R. & REGS. r. 560-7-8-.34(2)(e)(exempt organizations) and (2)(f) (insurance companies). Under Georgia law, the nonresident members of a Georgia limited partnership whose income comes exclusively from buying, selling and holding securities on its own behalf and not as a broker and not a family limited partnership are not subject to Georgia tax. O.C.G.A. 48-7-24(c).

2. Due Date for filing
Withholding Return on Year-End (K-1) Income

Under the prior version of the statute and regulation, the withholding return and the payment of the withholding tax on K-1 income was due within 30 days of the close of the tax year.⁷ Thus, an Entity (or its outside tax advisor) had to compute annual income and allocable shares, prepare the applicable returns and pay the tax by January 30 of the next year. This placed a palpable burden on Entities and their outside tax advisors. Indeed, the January 30 due date was the single source of absolute disdain and led to pleas for extensions (from the January 30 due date) because of the difficulties tied to complying with the 30-day rule. The January 30 due date also created tumult for Department officials who had to endure the wrath of the administrative salvos within public accounting firms across Georgia. Practitioners' begged for an extended due date.

For tax years beginning on or after January 1, 2008, the Withholding Statute (as revised by H.B. 1151, section 12), now provides a more reasonable due date for the "year-end" withholding tax. The deadlines are different depending upon whether the withholding tax is due on "distributions paid" or "distributions credited but not paid." *See* HB 1151, section 12, which amends Code Section 48-7-129(d)(1).⁸

⁷ Under the prior version of O.C.G.A. § 48-7-129(d)(1), an Entity must pay withholding tax on or before last day of calendar month following calendar month within which distribution was paid or credited. Under GA. COMP. R. & REGS. r. 560-7-8-.34(5)(b), withholding is due within 30 days of the close of the calendar month in which the distribution is paid or credited to the nonresident member. In late 2005, the Department revised the regulation to require that the Entity withhold on "distributive shares." Computing the withholding tax on cash distributions was not hard. An Entity could comply with the rule requiring that the withholding be filed and the tax paid within 30 days of the end of the month of the cash distribution. However, for many years prior to 2008, the Department believed that withholdings were also due on "distributive share" (Schedule K-1) income. Under this interpretation, the Department required an Entity to withhold 4% of the nonresident partner/shareholder/member's allocable share of the Entity's income, a task that is typically undertaken after January 30.

⁸ Of course, if the nonresident member of the Entity is not subject to tax, the withholding is not applicable. O.C.G.A. 48-7-129(a)(1); see also O.C.G.A. § 48-7-129(e)(1) (exceptions to requirement); GA. COMP. R. & REGS. r. 560-7-8-.34(2)(e)(exempt organizations) and (2)(f) (insurance companies). Under Georgia law, the nonresident members of a Georgia limited partnership whose income comes exclusively from buying, selling and holding securities on its own behalf and not as a broker and not a family limited partnership are not subject to Georgia tax. O.C.G.A. 48-7-24(c).

Distributions Paid - the deadline has not changed; taxes deducted and withheld on distributions paid by an Entity to nonresidents are due by the last day of the calendar month following the month of the distribution. O.C.G.A. § 48-7-129(d)(1)(A). Under the regulation, the payment must include a Form GA-V (voucher) and the Entity must file a Form G-7 (return). GA. COMP. R. & REGS. r. 560-7-8-.34(6)(b)1. Thus, the withholding tax payment and the return for a distribution paid on July 20, 2009 are due by August 31, 2009.⁹

Distributions Credited but not Paid – taxes deducted and withheld on distributions credited but not paid to nonresidents are due by the due date for filing the Entity’s income tax return, subject to various conditions, which are provided in O.C.G.A. § 48-7-129(d)(1)(B) --

Calendar Year Entity – withholding return and payment due by April 15. O.C.G.A. § 48-7-56(a).

Fiscal Year Entity – withholding return and payment due by fifteenth day of fourth month after close of fiscal year.

Extensions do not Apply – an extension given to the Entity for filing its income tax return does not extend the due date for the withholding return and payment.

The 2008 regulation mirrors the statute. *See* GA. COMP. R. & REGS. r. 560-7-8-.34(6)(b)2.

Extension of Time for Income Transmittal Statement – the legislation also provides new due dates for the transmittal report (Form G-2-A) that must be sent to the nonresident member to notify the nonresident member of the distributions paid and withheld during the tax year. O.C.G.A. § 48-7-129(d)(2).

The rules for the withholding returns and payments apply to the income transmittal

⁹ The Withholding Regulation requires that the withheld tax be paid within 30 days of the close of the calendar month that the distribution was made. *See* GA. COMP. R. & REGS. r. 560-7-8-.34(6)(b). This rule, however, is inconsistent with the statutory language of H.B. 1151 and may be simply an administrative oversight by the Department.

statement. Now, the statements must be sent to the nonresidents on or before the earlier of (1) the date that the Entity's income tax return is filed or (2) the due date for filing the return, without regard to any extension of time for filing the Entity's return.

3. Penalty Reduced

Prior to January 1, 2008, an Entity that failed to pay the withholding tax faced a severe penalty. Under the prior statutory language, the penalty was the amount of the tax not paid over. Thus, if the Entity owed \$50,000 in withholding taxes, then the Department imposed a penalty of \$50,000, *in addition to* the tax and interest.

Litigation ensued. Taxpayers argued that if the payment was made, albeit late, the penalty should not apply. Taxpayers reasoned that the language of the statute called for a penalty equal to the amount *not paid over* and not for a penalty equal to the amount not paid over timely. In essence, Taxpayers believed that the missing "timeliness" requirement seen in other penalty provisions meant that the penalty did not apply if the tax was eventually paid.

H.B. 1151 revised the penalty in O.C.G.A. § 48-7-129(a)(3). H.B. 1151's revisions changed the amount of the penalty only.

Under the revised statute, the penalty is "equal to 25 percent of the amount not withheld and paid over." Thus, an Entity that fails to pay \$50,000 of withholding taxes may also owe a penalty of \$12,500, in addition to the tax and the interest.¹⁰

H.B. 1151 did not fix the penalty provision in its entirety. Still left unresolved is the Department's right to impose penalty where the tax is paid albeit late. For example, if an Entity paid the tax 30 days (or even three months) late, would the penalty still apply? The penalty

¹⁰ Most state tax penalties are 5% per month after the due date, with a maximum of 25%. The 25% penalty on the nonresident withholding accrues the first day after the due date.

imposed on an employer who fails to pay withholding tax is imposed for failing to pay within the time prescribed. *See* O.C.G.A. § 48-7-126(c) (“If an employer fails to file within the prescribed time a return required under this article or fails to pay when due the tax required under this article, or both, unless it is shown that the failure is due to reasonable cause and not to willful neglect, there shall be assessed a penalty.”). The penalty imposed on corporations regarding estimated tax payments is for failing to pay timely. *See* O.C.G.A. § 48-7-126(f) (If a corporation fails to timely pay estimated tax, a penalty shall be assessed against the corporation in an amount equal to 5 percent of the Georgia income tax imposed on the corporation for the taxable year”). *See also* O.C.G.A. § 48-7-86(a)(1)(A) (“The amount shown as tax on a return on or before the date prescribed for payment of the tax, such date to be determined with regard to any extension of time for payment, there shall be added to the amount of tax required to be shown on the return one-half of 1 percent of the amount of the tax if the failure is for not more than one month and with an additional one-half of 1 percent for each additional month or fraction of a month during which the failure continues”); O.C.G.A. 48-2-44(a) (“In any instance in which any person willfully fails to file a report, return, or other information required by law or willfully fails to pay the commissioner any revenue held in trust for the state, he shall pay, in the absence of a specific statutory civil penalty for the failure, a penalty of 10 percent of the amount of revenue held in trust and not paid on or before the time prescribed by law”). The confusion surrounding the application of the 25% penalty will remains an open issue.

4. Lifting of Restrictions for Composite Returns

As an alternative to withholding, the Entity can file a composite income tax return for one or all of the Entity’s nonresident members. O.C.G.A. § 48-7-129(b)(1). Filing a composite return relieves the Entity from the withholding requirements. Also, nonresident members that

are included on the composite return computation are not subject to withholding provisions and are not required to file a Georgia income tax return. GA. COMP. R. & REGS. r. 560-7-8-.34(3)(d).

Under the prior regulation, nonresident members with other Georgia-source income (such as income from other Entities) could not be included in an Entity's composite return. The Department feared that allowing nonresident members to appear on multiple composite returns would give an unfair advantage to such members due to the prescribed method for computing income tax on a composite return.¹¹

The Department's new regulation allows *all* nonresident partners/shareholders/members to be included in the composite return. However, the nonresident member with income from sources other than the Entity must pay a 6% tax rate on his/her share of the income from the Entity's business in Georgia. *See* GA. COMP. R. & REGS. r. 560-7-8-.34(3)(c)1(iii).

5. Annual Consent Requirement Imposed on Subchapter S Corporations

Before the changes provided by H.B. 1151, O.C.G.A. § 48-7-27(d)(2) required nonresident shareholders of Georgia Subchapter "S" corporations to sign a consent to jurisdiction (a consent to pay tax on his portion of the corporation's income for the year). Every year, the Subchapter "S" corporation had to gather the consent forms from all the nonresident shareholders. An Entity was not recognized as a Subchapter "S" corporation, unless each nonresident shareholder signed the annual consent form. This rule created unnecessary paperwork for the S corporations, their advisors and shareholders. The requirement also hindered the Department's effort to reduce the clogs at the processing center in south Atlanta.

¹¹ Under the Withholding Regulation, in computing Georgia taxable income for the nonresident member, the Entity can reduce the member's income from the Entity by the standard deduction and the personal exemptions. GA. COMP. R. & REGS. r. 560-7-8-.34(3)(c)1(ii). Presumably, a nonresident member with several Georgia sources could benefit unfairly by getting a standard deduction and personal exemptions for every composite return, whereas all other taxpayers get only one standard deduction and personal exemption.

H.B. 1151 dispenses with the annual inconvenience. Nonresident shareholder consents are still required, but under H.B. 1151 the requirement is a one-time consent by each shareholder.

Under H.B. 1151, the consent is filed in the first year that the S corporation is required to file a Georgia return. If the S corporation existed before January 1, 2008, then the consent agreement is due at the time of the first return after January 1, 2008. A consent agreement must be filed for any new nonresident who becomes a shareholder of the S corporation. *See* O.C.G.A. § 48-7-27(d)(2).

C. Rules for Composite Returns

1. Electing to File a Composite Return

- a. Filing the composite return, Form IT-CR, constitutes the election.
- b. Election is irrevocable.
- c. When to make the election
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(a)
 - (1) Election must be made by the due date of the composite return (including approved extensions).
 - (2) Due Dates for filing
 - (a) Calendar Year Entity – same as for individual; extensions and estimated tax payments for filing are the same as for an individual.
 - (b) Fiscal Year Entity – within 3½ months of fiscal year end.
- d. No Changes - After the due date has passed, the return cannot be amended to include or exclude nonresident members. The return can be amended to exclude a nonresident who should never have been included in the first place. This would include a nonresident member with other Georgia source income who does not want his income taxed at the flat 6%. *See* r. 560-7-8-.34(3)(c)1.

2. Nonresident Members Included on the Composite Return

GA. COMP. R. & REGS. r. 560-7-8-.34(3)(a)

- a. Types of nonresident members allowed on Form IT-CR
 - Individuals
 - Corporations
 - Partnerships
 - LLCs
 - Estates
 - Trusts
 - Qualified Sub S Trusts and
 - Electing Small Business Trusts
 - **NEW REG**: Nonresident members whose aggregate annual distributions paid or distributions credited are less than \$1,000.

- b. Corporations included in the composite return must still file a separate net worth tax return for net worth tax that is due.
- c. Any nonresident member included on the composite return is not subject to the withholding tax and is not required to file a Georgia return. GA. COMP. R. & REGS. r. 560-7-8-.34(3)(d)

Estimated Tax Payments What happens where the nonresident member makes estimated tax payments during the year and then is included on a composite return for that year, the election for which is not made until the composite return is actually filed. Does the nonresident get credit on the composite return for the estimated taxes paid during the year? What if the nonresident is included on more than one composite return – which entity takes the credit?

First, none of the options for composite return tax computations mentions the right of the Entity to take a credit for estimated taxes paid by the nonresident during the year.

Second, if the nonresident member is making estimated payments, then such member should probably opt to file his/her own Georgia return to ensure that the credits for estimated taxes are applied to the tax liability. Otherwise, the nonresident would likely have to file a claim for refund (to recoup the estimated taxes paid during the year).

3. **Members Excluded from Composite Return**
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(d)
 - a. Nonresident members that have income within Georgia from sources other than the Entity and who do not want to be taxed under Option 3 (no deductions or exemptions – 6% on member’s income from Entity’s business done in Ga.).
 - b. Requirements for nonresident members excluded from composite return
 - (1) Subject to withholding provisions
 - (2) Must file a Georgia income tax return (unless exempt)

4. **Composite Return Schedule**
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(b)
 - a. Entity must create its own schedule.
 - b. Schedule must include information for nonresident members included and NOT included on composite return.
 - c. Nonresident members not included on composite return
 - (1) Name, address and identification number
 - (2) Distributions paid and distributions credited but not paid
 - d. Nonresident members included on composite return
 - (1) Name, address and identification number
 - (2) **2008 Reg:** Amount of income from Entity’s business done in Georgia
 - Nonresident’s net distributive share of income +
 - Guaranteed payments received by nonresident member (which are to be apportioned to Ga. under § 48-7-31)
 - Income may not be reduced by items subject to limitations, including
 - Charitable contributions
 - Investment interest expense
 - IRC § 179 expense

- Casualty losses
- Capital losses

- Income may not be reduced by items tied to self-employment that are normally above-the-line deductions (to compute AGI), including
 - Self-employment health insurance
 - Keogh or SEP contributions

- (3) distributions paid or credited for each included nonresident member
- (4) for nonresident members included in composite return and for nonresident members not included in composite return

5. Computing the Tax - Individual Nonresident Members
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(c)1

- a. Three options – with conditions
- b. Options may be used on member-by-member basis; Entity not required to use same option for every member
- c. Important Points on Electing an Option
 - (1) Member can change the option used from year-to-year
 - (2) Option selected cannot be changed after return is filed
 - (3) Option 1 and 2 – available only for nonresident members whose Georgia income is from the Entity only and not from other sources in Georgia
 - (4) Option 1 and 2 – Each year, the member must sign and provide to Entity an affidavit using Form CR-AFF verifying that the member does not have income from sources in Georgia other than the Entity and verifying the individual member's filing status.
 - (5) Option 3 must be used for nonresident members with multiple sources of Georgia income (*i.e.*, more than one Entity)

Option 1 – Filing Status

- Entity pays tax on nonresident's income from Georgia operations, using tax rate schedules
- simple – no exemptions/deductions – more tax paid

Option 2 – Standard Deduction and Dependents

- pay tax on nonresident's income from Georgia operations less a percentage of standard deduction and personal exemptions
- percentage: ratio of nonresident's share of Entity's Georgia income to nonresident's share of Entity total income
- net taxable income is the nonresident's share of Georgia income less the applicable Ga. percentage of the standard deduction/exemption and credit for dependents
- does not permit adjustments to income based on self-employment, self-employed health insurance, Keogh or SEP or other adjustments normally permitted in computing AGI.
- more complicated – allows nonresident to take advantage of standard deduction and personal exemptions

Option 3 – 6% Rate

- used for member who has income within Georgia from sources other than the Entity
- Entity may also elect to use this option
- the member's income from the Entity's operations in Georgia is multiplied by 6%
- if the member is otherwise required to file a Georgia return, then the income that was included in computing the tax under this option is excluded from the individual member's return

6. Computing the Tax – Non-Individual Nonresident Members

GA. COMP. R. & REGS. r. 560-7-8-.34(3)(c)2

- a. Corporations and partnerships
- b. List Ga. income and multiply it by 6% (Ga. income tax rate)

7. Composite Return Due Dates
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(e)
 - a. Calendar year Entity
 - (1) April 15 - same as due date for calendar year individual
 - (2) Extensions and estimated tax payments for filing are the same as for individuals
 - (3) Fiscal year entity - due within 3 ½ months of close of fiscal year
 - b. Requesting an extension
 - (1) File on Form IT-303
 - (2) Only extends time to file
 - (3) Any tax that is due should be remitted on the composite estimated tax return (Form CR-ES, Composite Return Estimated Tax).

8. Amended Composite Returns
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(f)
 - a. Cannot be used to include/exclude members if filed after due date.
 - b. May be filed during same period as individual returns (*i.e.*, where extension is requested, extended due date, regardless of date actually filed).
 - c. File on Form IT-CR and mark in large letters “Amended Return”

9. Consent Agreements Not Required
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(g)
 - a. Entity is not required to include with the composite return the consent agreement that an “S” corporation shareholder is required to provide under O.C.G.A. § 48-7-27(d)(2).
 - b. Consent agreement must, however, still be attached to the S Corp. return in order to maintain the S-election in Georgia.

10. Composite Return NOL's
GA. COMP. R. & REGS. r. 560-7-8-.34(3)(h)
- a. Composite to Composite
- (1) NOL computed on a composite return can be carried forward to another composite return year.
- (2) **2008 Reg:** For individual member, income that loss is carried to must be computed using the option that was used when computing the loss. Thus, if Option 1 is used in 2009 and generates a loss to carry-forward to 2010, then Option 1 must be used in 2010.
- b. Non-composite to Composite
- (1) NOL cannot be carried from a year in which member was excluded on the composite return to year in which member is included on the composite return.
- (2) **2008 Reg:** If NOL is carried back from year that member is included on composite return to year (years) that member is not included on composite return and the NOL is not fully absorbed in the specific carryback years, then any remaining NOL can be carried to a year to which member is included on composite return.
- c. Composite to Non-Composite - NOL must be carried from year in which member was included on the composite return to year in which member files member's own tax return.
- d. Entity's Waiver of Use of NOL
- (1) On behalf of a member, an Entity may elect to waive the carry back period of a NOL on a composite return.
- (2) Such election shall be made using the same provisions that would apply to the member as if they were excluded on the composite return.

D. Tiered Situations - GA. COMP. R. & REGS. r. 560-7-8-.34(4)

1. With some exceptions, the rules apply to scenarios in which distributions are paid or distributions are credited (and not paid) from an Entity to a nonresident member that, too, is an Entity and to any other Entities.
2. Objective is for withholding to occur on distribution paid or the distribution credited (and not paid) to the last member in the chain.
3. Withholding is required where Entity
 - a. does business in Georgia on its own and not because it is a member of an Entity OR
 - b. owns property in Georgia on its own and not because it is a member of an Entity
4. Passing through the withholding - r. 560-7-8-.34(4)(b)
 - a. Withholding can be passed through, as long as all Entities in the chain must provide the following
 - G-2-A withholding statement
 - schedule that allocates the withholding tax between members at each tier based upon profit-loss percentage
 - b. No withholding credit allowed if the above 2 items are not provided
5. Composite return allowed at any level
 - a. However, if composite return is not filed by an Entity that owns property or conducts business in Georgia based on its own and not because of being a member and thus must withhold, then withholding is still required by the Entity unless otherwise exempt.
 - b. Tax withheld at one level can be claimed on a composite return at another level.

6. Member that is an Entity or Corporation - r. 560-7-8-.34(4)(c)
 - a. Must include its pro rata share of the Entity's property, payroll, and gross receipts in its own three-factor apportionment formula in computing its Georgia income.
 - b. In computing its income, the member includes its share of the Entity's income before Entity apportions and allocates its income.

Note – for tax years beginning on/after January 1, 2008, only gross receipts are included in apportionment formula.

7. In determining whether withholding is required, the Entity may consider only the members that directly own an interest in the Entity.

Ex. Entity is subject to withholding. Entity has several nonresident members. One nonresident member is also a member in several other Entities that are subject to withholding.

- Each Entity must withhold from payments to the nonresident member.
- It's irrelevant that the total income/loss from all Entities would result in a net loss for the member.
- Loss from one Entity cannot be used to offset the member's income from another Entity

Ex. Company A is subject to withholding requirements. Company B is a nonresident member of Company A. Company B has nonresident members, one of which is exempt from withholding (Company C). Company A must still withhold on 100% of the distribution to Company B (even though Company B has a member that is exempt).

E. Exceptions in Tiered Situations (2008 Reg)
GA. COMP. R. & REGS. r. 560-7-8-.34(5)

1. Withholding not required for distributions paid or distributions credited but not paid to a member that is also an Entity as long as the downstream Entity (the “Subsequent Entity”) does the following ***in writing***:
 - a. Elects to withhold
 - (1) At rate of 4% on any distributions paid or distributions credited but not paid to the Subsequent Entity’s nonresident members
 - (2) Withholding must be done in same manner as if the Subsequent Entity itself were subject to withholding rules

Note – Subsequent Entity must withhold on annual distributions less than \$1,000;
 - b. Agrees to be subject to personal jurisdiction of Georgia for purposes of collecting income taxes and withholding requirements; and
 - c. Before the date that withholding is first required to be paid for the taxable year, provides the election and the agreement to the Main Entity in which it is a member.
2. If the Subsequent Entity fails to make the election (as provided for above) and/or if the Subsequent Entity does not withhold at rate of 4% (where required to do so), then the exception does not apply and withholding is required on distributions to the Subsequent Entity.
3. Other downstream Entities in the chain may make election
 - a. The Entity in which the other (downstream) Entity is a member must also make the election.
 - b. Also, if any Entity in any tier in the electing chain fails to withhold at the 4% rate and is required to do so, then withholding is due as if no election had been made by any Entity in any tier.

F. Withholding Procedures - GA. COMP. R. & REGS. r. 560-7-8-.34(6)

1. Registration – Form CRF-002 – r. 560-7-8-.34(6)(a)
 - a. All entities must register with the Department on Form CRF-002
 - b. Registration for withholding is separate from registration and payment of payroll taxes
2. Paying the Withholding Taxes – r. 560-7-8-.34(6)(b)
 - a. Due on cash and property distributions
 - b. When to remit depends upon the type of distribution
 - c. Distributions Paid (actual payments of cash or property)
 - Payment due by last day of month following the month in which the distribution is paid to nonresident member, per O.C.G.A. § 48-7-129(d)(1)(A)
 - Remit payment with Form GA-V (withholding payment voucher)
 - Entity must also file a Form G-7 return (quarterly withholding return for monthly payer)
 - d. Distributions credited but not paid (distributive share distributions)
 - Taxes withheld are due on/before due date for filing the income tax return of the Entity
 - If the Entity gets an extension of time to file its income tax return, such does NOT extend the deadline for paying the withholding taxes.
 - Remit payment with Form GA-V
 - Entity must file Form G-7 return.

3. Withholding Statement to Each Nonresident Member r. 560-7-8-.34(6)(c)
 - a. Form G-2-A is prepared for each nonresident partner/member/shareholder.
 - b. It shows the amount of distributions paid or distributions credited but not paid and the amount of tax withheld.
 - c. Form G-2-A's are required to be provided to the recipients and filed with the Department on or before the earlier of:
 - Date the income tax return is filed *or*
 - The due date for filing the income tax return for the Entity and extensions do not apply.
 - d. G-2-A is filed with Form G-1003 (transmittal form).
4. Form G-1003 – Income Statement Transmittal
 - a. Used to transmit to the Department a copy of the Form G-2-A's.
 - b. A copy of Form G-2-A should be attached to G-1003.
5. Credit for Withholding – r. 560-7-8-.34(6)(d)
 - a. The withholding tax may be claimed by each member as a credit against Georgia income tax on Georgia Form 500.
 - b. Member must submit Form G-2-A with the Georgia Form 500 Income Tax Return to receive credit.
 - c. The withheld tax is a credit (and must be claimed as a credit) for the member's tax year in which the withholding tax year of the Entity ends.

Ex. Calendar Year Entity – makes its only 2008 distribution paid to shareholders in December 2008 and remits 2008 withholding in January 2009. Individual nonresident shareholder gets a credit for such withholding on his/her 2008 Form 500.

Ex. Other than Calendar Year Member – calendar year partnership remits 2008 withholding taxes in 2008 and has a corporate partner with March 31 year end. The corporate partner may claim the credit for the withholding taxes on its corporate return due for year ending March 31, 2009 for the 2008 taxes withheld by the partnership.

Ex. Other than Calendar Year Entity – Entity has January 31, 2008 year end and remits withholding taxes on behalf of the nonresident members each month during the fiscal year. A calendar year end member can claim a credit on its 2008 Georgia Form 500 for taxes withheld by the Entity during the 2008 year.

G. Undue Hardship

GA. COMP. R. & REGS. r. 560-7-8-.34(7) and O.C.G.A. § 48-7-129(e)

1. Statute Exempts Entity from Withholding where Undue Hardship Exists
 - a. Written petition must be submitted to Commissioner.
 - b. Commissioner must approve petition in writing.
 - c. Commissioner may prescribe form for petition.
 - d. Commissioner may specify standards for when an Entity is not required to comply with withholding requirements.
2. Regulation Provisions for Undue Hardship
 - a. To qualify, entity must be experiencing significant hardship.
 - b. Written petition
 - (1) Must be filed with the Department requesting exemption from withholding.
 - (2) Must be filed at least 60 days prior to day on which withholding tax is due.
 - (3) Must include explanation for hardship incurred.
 - (4) Accepted petition is good for one year.
 - (5) Petitions must be filed on an annual basis.
 - (6) Failure to receive Department's notice of acceptance of undue hardship does not relieve Entity from withholding.

- c. Circumstances that do not Constitute Undue Hardship
 - (1) Inability to pay
 - (2) Additional record keeping costs
 - (3) Paperwork too cumbersome
 - (4) Missing K-1 data (social security number, address)
 - (5) Unfamiliar with filing requirements
 - (6) Inadequate records

Note: This begs the question of what circumstances result in “undue hardship.”

**H. Practice Tip
Don’t “Fund” the Withholding for the Partner – Withhold It**

Entities should strongly consider filing a composite return for all nonresident partners. However, for those nonresident partners that opt out of composite filing, the Entity should “withhold” a portion of the distribution.

For example, if the Entity decides to pay the nonresident partner a distribution of \$20,000.00, then the distribution is really \$19,231. The Entity should pay \$769 to the Department as a withholding tax payment. This payment will, in turn, be a credit on the nonresident partner’s 2009 nonresident income tax return. The Entity will note that the nonresident partner received a \$19,231 distribution, 4% of which was sent to the Department instead of the nonresident partner.

The gross-up computation can be tricky, because the withholding tax is due only on the Georgia percentage. Assuming that the income is 100% Georgia, if Entity declares that the nonresident partner gets a \$20,000 distribution, then, technically, the nonresident partner is getting MORE than a \$20,000 distribution. Because the Entity must withhold (by paying 4% to

the Department), the nonresident partner is actually getting cash of \$20,000 and a credit on his 2008 tax return of \$800. Thus, the nonresident partner really gets a distribution of \$20,800, which was not the Entity's original intent.

When an Entity declares a \$20,000 distribution for a nonresident partner, the Entity should make a special notation to the nonresident partner that his/her distribution is \$20,000 but a piece of it (\$769) has been withheld and sent to the Department. Otherwise, the Entity could be "funding" the withholding tax payment and not "withholding" it.

I. Composition of the "Distributive Share"

Per the Department, the "distributive share" comprises Schedule K-1, Lines 1-11 (on the 2008 Schedule K-1). Separately-stated items, such as Section 179 expense items, cannot be used to reduce the distributive share, because it may be limited at the partner level. (See Department's Frequently- Asked-Questions section – www.etax.dor.ga.gov/inctax/webfaq/faq-corp.aspx - Withholding on Distributions and Composite Returns for Nonresident Shareholders, Partners, and Members of S-Corporations, Partnerships and Limited Liability Companies).