
STATE CONTROLLER'S OFFICE
PERSONNEL/PAYROLL SERVICES DIVISION
P.O. Box 942850
Sacramento, CA 94250-5878

DATE: March 8, 2002

PAYROLL LETTER # 02-011

TO: All Agencies/Campuses in the Uniform State Payroll System

FROM: RALPH ZENTNER, Acting Chief
Personnel/Payroll Services DivisionRE: **NONRESIDENT ALIENS WITH TAX TREATY EXEMPTIONS**

This payroll letter provides instructions for requesting reductions of eligible nonresident alien employees' federal taxable wages as provided by a tax treaty exemption.

BACKGROUND

Under federal law, employers (agencies and campuses) are responsible for various nonresident alien program requirements. These responsibilities can be referenced via the Internal Revenue Service (IRS) Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Entities. These responsibilities include specialized reporting directly to the IRS using the agency's/campus's Federal Employer Identification Number (FEIN) and adhering to applicable tax treaty provisions, etc. One provision of the federal requirements, federal income tax withholding exemption, is administered through the Payroll System when initiated by employers on behalf of their nonresident alien employees.

Per the Internal Revenue Code Section 1441, federal income tax withholding is not required from compensation earned by a nonresident alien employee if 1) the services for which compensation is paid were performed in the United States and, 2) the compensation is exempt from federal withholding based on a tax treaty to which the United States is a party. As provided by a tax treaty exemption, a specific amount of a nonresident alien's annual wages can be exempt from federal income tax withholding. NOTE: Wages exempt from federal withholding may still be subject to State tax withholding.

SCO REPORTING PROCESS

The Uniform State Payroll System was recently modified to allow the State Controller's Office to report different federal and state taxable wage amounts on the Form W-2, thereby accommodating the tax treaty exemption provisions. To accurately report the taxable wage amounts on the Form W-2 for an eligible nonresident alien, the total amount to be subtracted from the employee's federal taxable wages must be reported via STD. Form 674, Payroll Adjustment Notice, as indicated below.

DOCUMENT COMPLETION INSTRUCTIONS

STD. Form 674 must be completed as follows:

Top of document – Attention: Nancy Jang, W-2/Non-USPS Unit

Item (1) - Check the W-2/NonUSPS box

Item (2) - Complete

Item (3) - Complete

Item (4) - Complete - Enter the employee's primary position number with the following exception:

Class Code - Complete using CLASS CODE 1000 this class code has been assigned for reporting purposes)

Item (5) - Complete Remarks section only with the following statement:

Reduction of Federal Taxable Gross Wages for Nonresident Alien Claiming a Tax Treaty Exemption

\$ _____ of the employee's wages are exempt from federal withholdings for the _____ tax year as provided by the tax treaty with the U.S. and (enter the employee's country of residence). I certify that the employee has a valid Form 8233, Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual, on file for the current tax year.

Item (7) – Complete

To report multiple employees, a listing may be submitted along with a cover STD. Form 674. The cover 674 must be completed as previously instructed except that the statement "Various - See Attached Listing" may be used where appropriate. The listing must be typed using a font size of 14, the rows should be double-spaced, and the column headings/information must in the following order from left to right:

SSN, First Name Initial, Last Name, Position Number, Gross Exempt Wages

DOCUMENT SUBMISSION DATE

To ensure accurate wage reporting on eligible employees' Forms W-2, the State Controller's Office must receive STD. Form 674 documents no later than December 16 of each year. Documents received after this date may require the issuance of corrected Form W-2s. Please note that the processing of the STD. Form 674 documents will generate zero amount warrants for affected employees.

EXEMPTION FROM WITHHOLDING

It is the employee's and agency's/campus's responsibility to file/process the appropriate withholding allowance documents (EAR/SPAR) to exempt wages from federal withholding based on a tax treaty. The amount of wages exempt from federal withholdings should be monitored and once the threshold is met, a new EAR/SPAR should be filed to resume federal withholdings. To claim an exemption from federal withholdings only, employees should be instructed to complete their EAR/SPAR indicating an 'S' in E/H I.01, and '95' in Section E/H I. 02. Employees should also complete Section E/H II. to ensure applicable state taxes are withheld. NOTE: Nonresident aliens should only be instructed to complete the Nontaxable Wages section of the EAR/SPAR if their wages are exempt from BOTH federal and state withholdings based on their tax treaty.

IRS REPORTING REQUIREMENTS

The IRS regulations regarding nonresident aliens include reporting requirements for withholding agents. SCO is the State's withholding agent for wages NOT EXEMPT by a tax treaty and reports these wages on Form W-2. For other types of compensation, including wages EXEMPT by a tax treaty, the employing agency/campus is the withholding agent and is responsible for IRS reporting outlined in IRS Publication 515. NOTE: Agencies and campuses must use their own FEIN and NOT this office's FEIN.

A revision to the PPM is forthcoming.

Please use the following contacts for assistance.

IRS Reporting Requirements
Internal Revenue Service 1-800-829-1040

Form STD. 674 Completion Instructions
Payroll Operations (916) 322-8100
W-2 Unit