

'ITIN Contractors' – What North Carolina Construction Companies Need to Know to Minimize Risk

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April 11, 2018



As explained in an earlier article, the North Carolina Department of Revenue (the "NCDOR") has aggressively audited North Carolina construction companies on the issue of whether they are properly withholding with respect to payments they make to their Individual Taxpayer Identification Number ("ITIN") contractors. We continue to see the NCDOR targeting North Carolina construction companies on this issue, so you continue to need to be aware of the issues involved, including how you and your human resources team should handle ITIN

contractors.

While we have been able to negotiate very favorable settlements in a number of these audits, the process is daunting and takes valuable time from your finance and human resources professionals. Pursuant to the old adage that "an ounce of prevention is worth a pound of cure," to limit your exposure, you should seek to identify your ITIN contractors and properly withhold with respect to payments you make to them.

What is an ITIN?

An ITIN is issued by the Internal Revenue Service ("IRS") to individuals who are required to file United States tax returns but who are not eligible to receive a Social Security number. For example, a legal immigrant who is in the United States pursuant to a valid "green card" and who operates a sole proprietorship in North Carolina would be required to pay federal and North Carolina taxes, but would not be entitled to a Social Security number. Therefore, this individual would be required to obtain an ITIN from the IRS.

All ITINs have the same numbering format as a Social Security number, but they all begin with the number "9," which makes it easier for your construction company to identify that it may have an ITIN contractor withholding obligation.

What is an ITIN Contractor?

An ITIN contractor is an individual, including a sole proprietor, who:

- Performs services for your construction company;
- Uses an ITIN for tax reporting purposes (instead of a Social Security number or an Employer Identification Number ("EIN")); and,
- Is treated by your company as an independent contractor and not an employee.

Any independent contractor who uses an ITIN number for tax reporting purposes and provides subcontracted labor to your construction company would be considered an ITIN contractor.

What Type of Special Withholding Requirement Applies to ITIN Contractors?

Although your company doesn't generally have any obligation to withhold from amounts you pay to independent contractors, it may have a withholding obligation for its ITIN contractors. All North Carolina businesses that pay more than \$1,500 in any year to an ITIN contractor are required to withhold 4% of the payments and forward the withheld amounts to the NCDOR. The policy rationale behind the withholding is to ensure that the state is collecting at least a portion of the income taxes due from the ITIN contractors, who are thought to often be transient workers who may not otherwise properly file tax returns and pay taxes to North Carolina.

What is the NCDOR Doing About ITIN Contractor Withholdings?

Starting in 2016, the NCDOR identified the ITIN contractor withholding issue as one of its top audit priorities because it was, and continues to be, concerned that businesses using ITIN contractors are not complying with the 4% withholding requirement. Because the construction industry is one of several industries using a significant number of ITIN contractors, the NCDOR has been especially aggressive in targeting construction companies for the ITIN contractor withholding audits. These audits can result in significant assessments of past due taxes, interest, and penalties.

Unfortunately, the NCDOR has not done a very good job of educating construction companies and their advisors about the ITIN contractor withholding requirement, so a lot of construction companies only learn about it as a result of an audit that results in unexpected and expensive consequences.

What Should Your Construction Company Do if It Becomes the Subject of an ITIN Contractor Withholding Audit?

First, your company must take all proper actions to comply with the ITIN contractor withholding rules before it becomes subject to any audit. But if you didn't timely comply with the withholding requirement and the NCDOR institutes an audit of your company, you need to consult with your tax and legal advisors immediately in order to develop a strategy to minimize your exposure to additional taxes, interest, and penalties.

There are a number of strategies you can employ as part of an audit defense, most of which relate to limiting the number of people covered by the scope of the audit and obtaining credit against your withholding obligation for those tax payments your ITIN contractors have actually made. Additionally, there are several nuances related to these audits and the ITIN contractor withholding requirement that, if properly applied, can limit your tax liability.

Ward and Smith's Construction and Tax Practice Groups have significant experience in helping large, medium, and small construction companies comply with the ITIN contractor withholding requirement and defending against ITIN contractor withholding audits.

While we hope that you never have to deal with the headaches involved with an ITIN contractor withholding audit, we stand ready to help you and your accounting team with your ITIN contractor withholding compliance or, if necessary, navigate the nuances related to an audit.

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