

## Pa. Renter With Out-Of-State Landlord? Add Tax To Your Rent

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Nonemployer payors operating in Pennsylvania that pay certain Pennsylvania-sourced income<sup>[1]</sup> to nonresident nonemployees,<sup>[2]</sup> or that pay rent on Pennsylvania property to nonresident landlords, must carefully consider new Pennsylvania withholding rules that will be enforced beginning on July 1, 2018.

In October 2017, Pennsylvania enacted a statute<sup>[3]</sup> substantially expanding the income tax withholding beyond employee wages to require withholding of Pennsylvania income tax — at the applicable income tax rate, currently 3.07 percent — from certain Pennsylvania-sourced income totaling \$5,000 or more during a calendar year to a nonresident nonemployee. The new withholding rules also apply to “disregarded entities”<sup>[4]</sup> with a nonresident owner who perform services in Pennsylvania (which apparently will require payors to obtain information from such payees as to whether their owners are nonresidents). Finally, the new rules apply to rent payments of at least \$5,000, paid annually to nonresident landlords for the lease of Pennsylvania property.

These requirements became effective on Jan. 1, 2018. However, the Pennsylvania Department of Revenue announced that any income subject to these new withholding provisions would not be subject to an under-withholding assessment if a payor fails to withhold for a period ending prior to July 1, 2018<sup>[5]</sup> — effectively delaying the enforcement date until July 1, 2018.<sup>[6]</sup>

### Confusion, Potential for Invalidation, Further Delay

Both taxpayers and the Pennsylvania DOR have expressed concerns regarding interpreting, complying with and enforcing the new withholding law. Consequently, several efforts are underway to either repeal or simplify the law.

Currently, there is a constitutional challenge to Pennsylvania’s Act 43 of 2017 in commonwealth court that has the potential to invalidate the new withholding requirements, change the effective date of the new withholding rules or further delay their enforcement date.<sup>[7]</sup>

In addition, the Pennsylvania Institute of Certified Accountants has requested that the



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DOR delay the withholding obligations' effective date until Jan. 1, 2019.

The General Assembly is also pushing to amend, if not completely repeal these changes to the withholding requirements. On May 7, Rep. Keith J. Greiner (R) introduced a bill in the Pennsylvania General Assembly, H.B. 2413, that aims to streamline and clarify many issues with the new requirements, including how to determine nonemployer withholding on payments to payees that relate to business engaged within and outside of the commonwealth. This bill was immediately referred to the House Committee on Finance and currently resides there as of the date of this article. As the legislature is rapidly approaching the deadline for passing a fiscal budget, it is unclear whether this bill will gain the attention and support needed for enactment in the near term.

If the enforcement date is not delayed, this expansion of Pennsylvania income tax withholding requirements to nonemployee compensation and leases of Pennsylvania real estate from nonresident landlords will create further administrative burdens on businesses and nonprofits by subjecting them to substantial additional withholding and reporting requirements.

### **How to Comply**

To comply, nonemployer payors operating in Pennsylvania must:

- Determine which of their payees fall under the new withholding rules;
- Apply for a Form 1099-MISC withholding account with the DOR (complete PA-100 electronically [here](#)); and
- File quarterly withholding tax returns (and annual Form REV-1667R) remitting the applicable withholding payments to the DOR.

Going forward, the DOR requires nonemployer payors to file Form 1099-MISC annually for each payee receiving certain Pennsylvania-sourced compensation payments, as long as the Form 1099-MISC is required at the federal level. Note that, unlike employee compensation, state reciprocity agreements do not apply to payments made to nonresidents for nonemployee compensation under this new withholding law. Therefore, withholding is still required for payees who are residents of Indiana, Maryland, New Jersey, Ohio, Virginia and West Virginia.[8]

### **Takeaways**

Nonemployer payors operating in Pennsylvania that make payments of certain income from sources within the commonwealth to nonresident nonemployees at or above the \$5,000 threshold, or that pay rent for Pennsylvania property that meet the \$5,000 annual payment threshold to any nonresident landlords, should comply with the withholding requirements beginning on July 1, 2018, or risk liability (imposable on any payor that has failed to withhold) for the Pennsylvania taxes, penalties and interest due on these payments.

Nonresident nonemployees who fail to properly pay their Pennsylvania income taxes in one or more prior years should consider participating in Pennsylvania's Voluntary Disclosure Program to mitigate any past due tax liability, as the DOR will likely look to reconcile the 1099-MISC company filings against the tax filings of nonresident nonemployees to guard against income tax that was not paid.

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[1] 61 Pa. Code Section 101.8 provides guidance on Pennsylvania-sourced income and generally, it includes (1) income earned for the rendition of personal services in the commonwealth; and (2) income from ownership of an interest in real property, including rental income from real property in the commonwealth.

[2] E.g., independent contractors and corporate directors. Note, the determination of whether one is a “nonemployee” or “nonemployer” turns on the Federal income tax withholding requirements and the definitions of “employee” and “employer” under the Internal Revenue Code. See 72 P.S. Sections 7301(g); 7301(h).

[3] See Section 316.2 of the Tax Reform Act of 1971, as amended by Act 43 of 2017.

[4] Pursuant to Section 316.2(a)(1) of the Tax Reform Act of 1971, as amended by Act 43 of 2017, a disregarded entity is “[a]n entity that is disregarded under section 307.21 that has a nonresident member.” Note, this is a direct reference to a specific provision under 72 P.S. Section 7307.21, which states “an unincorporated entity that has a single owner shall be disregarded as an entity separate from its owner.”

[5] However, if tax is withheld before July 1, 2018, then it must be filed and remitted as required by Act 43. Also, a nonemployee’s income for all of 2018 would be required to be reported on 1099-MISC for 2018, even if it was not subjected to withholding of Pennsylvania income taxes.

[6] See Pennsylvania Fact Sheet on New 1099-MISC Withholding Tax Requirements, Feb. 15, 2018.

[7] In a petition filed with the state’s Commonwealth Court, a coalition of fireworks retailers argue that Act 43 of 2017 is invalid because the General Assembly failed to adhere to certain constitutional requirements for enacting legislation, including the single subject rule and the repealer rules. See Phantom Fireworks et al. v. Wolf et al., 21 M.D. 2018 (filed January 19, 2018).

[8] Note, H.B. 2413 would respect the state’s reciprocal agreements and not require payors to withhold on payees who are residents of Indiana, Maryland, New Jersey, Ohio, Virginia and West Virginia.