taxnotes®
state & local
Volume 85, Number 9 ■ August 28, 2017

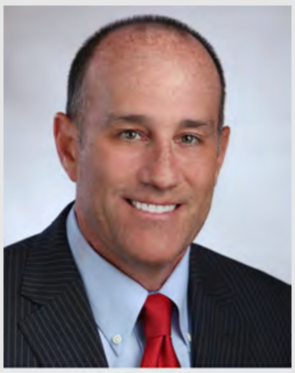
Passthrough Entities/Members Beware — Georgia Relief Is Not Absolute

by Richard C. Litwin

Reprinted from *State Tax Notes*, August 28, 2017, p. 887

Passthrough Entities/Members Beware — Georgia Relief Is Not Absolute

by Richard C. Litwin



Richard C. Litwin

Richard C. Litwin is an Atlanta attorney, who, since 1990, specializes in state and local taxation and tax disputes, including sales and use tax, multistate corporate income tax, personal income tax, and state residency and employment tax. He is a former chair of the tax sections of the Atlanta Bar Association and State Bar of Georgia and is a co-moderator of the Georgia Department of Revenue Attorney Liaison Committee. Before private practice, and from 1990-1995, Litwin was an assistant attorney general in the Tax Section of the Georgia Office of the Attorney General.

In this viewpoint, Litwin examines Georgia's alternative to withholding or to filing a composite return, and cautions passthrough entities that opt to use the alternative regarding unpaid taxes.

Like most states, Georgia requires that nonresidents with income from Georgia sources file and pay tax on that income.[1] Georgia's nonresident withholding laws ensure compliance by nonresidents who are partners, members, or shareholders (collectively, owners) of passthrough entities that conduct business in Georgia. The state provides alternatives to the nonresident withholding requirement. This article examines the Form NRW-Exemption, "Affidavit by Nonresident of Exemption," the alternative to withholding or to filing a composite return, and cautions passthrough entities that opt to use the alternative.

Georgia's Nonresident Withholding Requirement

Under Georgia law, a passthrough entity that conducts business in Georgia must withhold and remit 4 percent of the nonresident member's share of taxable income sourced to Georgia.[2] Alternatively, a passthrough entity can file a composite return to report and pay nonresidents' income taxes.[3]

Form NRW-Exemption

Since 2012 a passthrough entity has an easier alternative to paying withholding taxes or filing a composite return, Form NRW-Exemption, "Affidavit by Nonresident of Exemption." The entity can attach the affidavits, as signed by the nonresident owners, to its entity-level return.

Each nonresident owner completes a Form NRW-Exemption one time. Then, every year, the

[1] Ga. Code Ann. section 48-7-20(a) (Georgia imposes an annual income tax on every nonresident regarding income from services performed, property owned, or business conducted in Georgia); section 48-7-24(a) ("when one or more of the individual members of a partnership doing business in this state are nonresidents of this state, the nonresidents shall be taxable on their share of the net profits of the partnership"); and section 48-7-21(b)(7)(B) (subchapter S elections apply only if all stockholders agree to be subject to Georgia tax on their portion of the corporate income).

[2] Ga. Code Ann. section 48-7-129(a). Ga. Comp. R. & Regs. 560-7-8-.34(2).

[3] *See* Ga. Code Ann. section 48-7-129(b). Ga. Comp. R. & Regs. 560-7-8-.34(3). Entities with calendar year-ends must file the withholding return or the composite return and pay the associated taxes by April 15 of the following year. Entities with fiscal year-ends must file the return and pay the taxes by the 15th day of the fourth month after the fiscal year-end. Ga. Comp. R. & Regs. 560-7-8-.34(3)(e).

entity must attach to its entity-level return (whether the return is a Form 600S or Form 700) all signed Forms NRW-Exemption.[4] Attaching the Forms NRW-Exemption relieves the entity from having to withhold 4 percent of the nonresidents' taxable income (from the entity) that is sourced to Georgia.

By signing the Form NRW-Exemption, the nonresident owner assumes the responsibility for filing returns and paying taxes to Georgia for all Georgia-source income. The nonresident owner also promises to pay estimated taxes required by Georgia law.[5]

Relief to Passthrough Entity Is Not Absolute

The Form NRW-Exemption seems to offer a much-needed alternative to the administrative burdens tied to filing the annual nonresident withholdings or preparing a composite return. But the rules require careful review. In particular, Georgia law provides broad enforcement and collection powers to the Georgia Department of Revenue when the nonresident owner fails to comply with the original promise to file Georgia returns and pay Georgia taxes.

Unintended Consequences

What happens if a nonresident owner does not file a Georgia return and pay taxes on his portion of taxable income sourced to Georgia? What action can the Georgia DOR take against the entity? What action can the DOR take against the entity's other owners?

If the nonresident fails to comply, the DOR can seek from the passthrough entity payment of the 4 percent nonresident withholding taxes, as well as accrued interest and a 25 percent penalty. That rule applies to all years for which the nonresident does not file a return or pay Georgia income taxes on his share of the taxable income sourced to Georgia.[6] Thus, the entity becomes the de facto enforcer for the DOR.

Each year, the entity must ensure that nonresident owners file returns and pay Georgia taxes. Three or four filing cycles may pass before the DOR realizes that the nonresidents have failed to file returns and pay taxes. Indeed, several years could pass before the DOR seeks from the entity payment of the 4 percent tax, plus interest and penalty. But the grim consequences of the noncomplying nonresidents do not end with the entity. Indeed, all owners face exposure, individually.

Unintended Consequences Become Personal

If the entity cannot pay the nonresident withholding taxes, interest, and penalties, the Georgia DOR can seek payment from every owner. All members are jointly and severally liable[7] for 100 percent of the unpaid withholding taxes.[8] Thus, if the tax, interest, and penalty total $50,000, the Georgia DOR can turn to every member for the $50,000. In fact, when the DOR assesses the entity, the DOR includes an additional page titled "Responsible Partners."

Georgia law does not limit the exposure to general partners or responsible persons (who may otherwise may be liable as a responsible person under Georgia's responsible person liability statute[9]).

No 3-Year Statute of Limitations

As indicated above, several years could pass before the Georgia DOR realizes that a nonresident owner has not paid taxes on income from the passthrough entity. The possible delay in the Georgia DOR's detection that a nonresident owner has not paid taxes on income from a passthrough raises questions about whether the entity and the other members are protected by the statute of limitations.

By law, the Georgia DOR can assess any tax at any time.[10] The three-year limitation is an exception to the rule and applies only when the taxpayer files a return (and assuming no fraud).[11] Here, the passthrough entity does not file a

[4] Ga. Comp. R. & Regs. 560-7-8-.34(2)(g)1.

[5] Ga. Comp. R. & Regs. 560-7-8-.34(2)(g)1(i).

[6] Ga. Comp. R. & Regs. 560-7-8-.34(2)(g)2.

[7] Ga. Code Ann. section 48-7-129(a)(3) (authorizes the penalty).

[8] Ga. Code Ann. section 48-7-129(a)(4) ("the partnership, Subchapter 'S' corporation, or limited liability company and its members shall be jointly and severally liable for the withholding tax . . . and shall be assessed accordingly").

[9] Ga. Code Ann. section 48-2-52.

[10] Ga. Code Ann. section 48-2-49(a).

[11] Ga. Code Ann. section 48-2-49(b).

nonresident withholding return; the purpose of the Form NRW-Exemption is to relieve the entity from having to file the withholding return. Because the entity never filed a withholding return to pay the nonresident withholdings, the statute of limitations does not apply. Thus, on receiving an assessment (based on personal liability for the withholding taxes), the individual owner may not be able to argue that the Georgia DOR is limited by the three-year statute of limitations.[12]

Conclusion

Form NRW-Exemption provides much-needed relief to passthrough entities that do not have the resources to prepare nonresident withholding returns or composite returns. But such entities and their members (including limited partners, general partners, residents, and nonresidents) must monitor nonresident members to ensure that the nonresidents are filing returns and paying taxes on their share of the entity's taxable income sourced to Georgia. Otherwise, the comfort from not having to file a nonresident withholding return could quickly turn into panic when the nonresidents' failure to comply results in the DOR turning to the other members to pay the tax, interest, and penalties. ■

[12]Although some authority exists to support a seven-year statute of limitation when no return is filed. *See Leroy Parker*, 2014-8 Ga. Tax Tribunal (June 3, 2014).