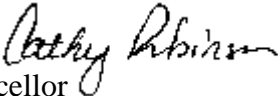


**The California State University  
Office of the Chancellor  
401 Golden Shore  
Long Beach, CA 90802-4210  
(562) 951-4411**

**Date:** December 1, 2005 **Code: TECHNICAL LETTER  
HR/Salary 2005-28**

**To:** Human Resource Directors **Supersedes: TECHNICAL LETTER  
HR/Salary 2000-09**  
Payroll Managers

**From:** Cathy Robinson   
Assistant Vice Chancellor  
Human Resources Administration

**Subject:** **Nonresident Alien Tax Withholding Changes Effective January 1, 2006**

Internal Revenue Notice 2005-76 provides new rules for determining the amount of income tax employers must withhold from wages paid for services performed by nonresident alien (NRA) employees within the United States. The new wage withholding rules, effective January 1, 2006, are designed to eliminate or reduce a general over withholding of federal income tax on NRA employee wages. The new rules are designed to provide for withholding that will more closely approximate actual federal income tax liability. This coded memorandum provides an overview of the new rules and an assessment of payroll administrative changes that will be required for the California State University (CSU) system.

**General Assessment**

The current Internal Revenue Service (IRS) withholding rules for NRA employees will change effective January 1, 2006. The current NRA withholding requirements (e.g., a filing status of Single-1 plus an additional \$33.10 per month for employees on a monthly pay period schedule) will not be mandatory for wages issued on or after January 1, 2006, in accordance with the rules announced in IRS Notice 2005-76 and further discussed in IRS Bulletin 2005-46. The IRS wants employers to withhold taxes differently and requires new and continuing NRA employees to complete and submit updated W-4 forms (for the CSU, Employee Action Request [EAR] forms, standard format or campus-modified) to their employers.

The requirement to withhold taxes differently requires the employer to add an “artificial” amount to the wages of the NRA employee solely for purposes of calculating the income tax withholding for each pay period, and to then determine the income tax to be withheld by applying the tables to the sum of the wages paid (e.g.,

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**Distribution:** CSU Presidents Vice Presidents, Student Affairs  
Vice Chancellor, Human Resources Associate Vice Presidents/Deans, Faculty Affairs  
Vice Presidents, Academic Affairs Director, SOSS  
Vice Presidents, Administration Manager, Tax Support Section, State Controller’s Office

“actual wages” plus the “artificial” amount) for the payroll period. It is our understanding that the added (artificial) amount is not income or wages to the employee, does not affect income, Federal Insurance Contributions Act (FICA) or Federal Unemployment Tax Act (FUTA) tax liability for the employer or the employee, and is not to be reported as income or wages.

IRS Notice 2005-76 provides a transitional relief for wages paid prior to January 1, 2007 to implement all of the changes. The transition period, however, should not preclude employers from implementing changes that can be made as soon as possible. With respect to wages paid prior to January 1, 2007, we understand that the IRS will not assert an employer’s liability for underpayment of income tax withholding and related interest and penalties resulting solely from the failure to apply the new withholding procedure to wage payments made to NRA employees, provided the employer has made a good faith effort to implement the withholding requirements as soon as possible. The transitional relief provided to employers does not affect the employee’s liability for federal income tax.

**Withholding Rules Effective for Wages Paid to Nonresident Alien Employees on or After January 1, 2006<sup>1</sup>**

For CSU employees, the Employee Action Request (EAR) document is a State of California form (Std. 686) used in lieu of IRS form W-4. The Student Payroll Action Request (SPAR) is a multi-purpose document also used for tax withholding purposes for student employees. Under the new rules with respect to withholding on wages to be paid on or after January 1, 2006, NRA employees are required to:

1. Not claim exemption from withholding;
2. Request withholding as if they are single, regardless of the actual marital status;
3. Claim only one (1) allowance (\*note: if the NRA is a resident of Canada, Mexico, or South Korea, he or she may claim more than one allowance); and
4. Write “Nonresident Alien” or “NRA” above the dotted line on line 6 of Form W-4. (**Note Modification for CSU Employees:** Indicate “Nonresident Alien” or “NRA” at the top of the EAR/SPAR document.)

Please note that like all other employees, NRAs may request additional withholding at their option.

A link to the California Department of General Services website for STD. Form 686 is

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<sup>1</sup> Students and business apprentices from India are exempt from this general requirement if the NRA employee is or was a resident of the Republic of India immediately before visiting the United States and is present in the United States principally for the purpose of his or her education or training. This exception only applies for such period of time as may be reasonable or customarily required to complete the education or training undertaken. Refer to Article 21 of the Tax Convention with the Republic of India (generally effective January 1, 1991).

provided: <http://www.documents.dgs.ca.gov/osp/pdf/std686.pdf>

**Employer Calculation of Withholding on Wages of Nonresident Alien Employees**

For 2006, the amount that needs to be added to the NRA employee's wages for purposes of calculating income tax withholding for each length of payroll period is as follows:

<b>PAYROLL PERIOD</b>	<b>ADD ADDITIONAL</b>
Weekly	\$ 51
Biweekly	\$102
Semimonthly	\$110
Monthly	\$221
Quarterly	\$663
Semiannually	\$1,325
Annually	\$2,650
Daily or Miscellaneous (each day of the payroll period)	\$10.20

**Implementation of New IRS Requirements is a Shared Responsibility**

The CSU and the State Controller's Office (SCO) have a shared responsibility to implement the new IRS requirements due to the SCO's role as pay agent for the CSU.

*CSU Responsibilities:* Changes the CSU can implement readily include noticing affected NRA employees of the change in withholding requirements and processing EAR/SPAR form updates at the campus, as appropriate. The federal income tax wage withholding regulations under section 3402 of the Code require that an employer continue to use the tax withholding information currently on file for an employee for as long as that W-4 (EAR/SPAR) remains valid or until it is replaced by a new valid W-4 (EAR/SPAR.) If the employer does not obtain a new W-4 (EAR/SPAR) for affected NRA employees by the first payroll in 2006, the employer must continue to withhold under the old withholding rules for those employees until a new W-4 (EAR/SPAR) document is completed in accordance with the rules announced in Notice 2005-76.<sup>2</sup>

The December 2005 pay period marks the first (master payroll) pay period that wages are issued with an effective date on or after January 1, 2006. Campuses need to

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<sup>2</sup> Per Notice 2005-76, Forms W-4 (EAR/SPAR) furnished by employees in place of Forms W-4 (EAR/SPAR) in effect with an employer shall take effect at the beginning of the first payroll period (or the first payment of wages made without regard to a payroll period) on or after the 30<sup>th</sup> day after the day on which such Form W-4 (EAR/SPAR) is furnished. The employer may elect to make the replacement Form W-4 (EAR/SPAR) effective on or after the day the replacement Form W-4 (EAR/SPAR) is furnished by the employee and before the 30<sup>th</sup> day after the day on which the replacement Form W-4 (EAR/SPAR) is furnished.

consider the December pay period cutoff date (December 20, 2005) to accommodate this timeline for affected employees paid under master payroll. For “positive pay” employees paid on cycles outside of the master payroll schedule, campuses need to consider corresponding December payroll cutoff dates for affected wages that will be issued with an effective date on or after January 1, 2006.

It is anticipated that exceptions to the new rules for W-4 withholding and income tax calculation procedures, such as exemptions due to tax treaty benefits, will require special coordination with the SCO for affected NRA populations.

*SCO Responsibilities:* Per the SCO, because the Uniform State Payroll System is complex, the new procedure will require programming changes. At this time, the SCO will use the transitional relief period provided in IRS Notice 2005-76 before implementing the calculating of withholding taxes. Further information on this item will be released by the SCO at a later date. Campuses should **not** take action to implement methods that would apply an “artificial” amount to an affected employee’s wages that are paid through the uniform state payroll system independent of SCO coordination.

*Related Implementation Issues:* Please note that while the CSU can notice affected employees of the new withholding rules, the responsibility to implement payroll system changes to accomplish the “artificial” amount is that of the SCO. The SCO will advise us as additional information on the system change becomes available and we will notify the campuses accordingly.

In the meantime, should an NRA employee complete a new EAR/SPAR document based upon the new withholding rules prior to the payroll system change, the new procedure to calculate income tax withholding pursuant to section 3402 will **not** be synchronized with the NRA employee’s tax withholding change. This action may put the NRA employee at “risk” for potential under withholding for the 2006 tax year. It is important that this “risk factor” be communicated to affected employees at the time a revised EAR/SPAR is submitted. To preclude a potential under withholding, affected employees should consult their tax advisor and may also reference IRS Form 1040-ES (NR), “U.S. Estimated Tax for Nonresident Alien Individuals.” The link to this form can be accessed via: <http://www.irs.gov/pub/irs-pdf/f1040esn.pdf>.

### **General Information**

1. To assist campuses in identifying and noticing affected employees of the change in tax withholding requirements, HR-ISA has developed a report request in the common library called **FOC5012**, which can be used to produce a list of employees who have values of “F,” “J,” “M,” or “Q,” in Item 825 of the PIMS employment history database. The list also includes students currently in the “Nonresident Alien Student” classification (code 1868.)
2. Attachment A is provided as a sample notice. Campuses may modify or adopt

- their own communication as appropriate.
3. The link to IRS Notice 2005-76 can be accessed via <http://www.irs.gov/pub/irs-drop/n-05-76.pdf>.
  4. The link to IRS Bulletin 46 dated November 14, 2005 can be accessed via: <http://www.irs.ustreas.gov/pub/irs-irbs/irb05-46.pdf>

Questions regarding this technical letter may be directed to Human Resources Administration at (562) 951-4411. This document is available on Human Resources Administration's Web site at: <http://www.calstate.edu/HRAdm/memos.shtml>.

CR/dth

**ATTACHMENT A  
SAMPLE NOTICE  
(December 2005)**

**Change in Internal Revenue Service 2006 Withholding Rules Affecting Employees  
(including student employees) in a Nonresident Alien Tax Status**

Internal Revenue Service (IRS) withholding rules for nonresident alien employees will change for wages issued on or after January 1, 2006. Because some nonresident alien employees had their income taxes over withheld on wages earned for services performed in the United States, the IRS has reconsidered the requirements for determining the amount of income tax to be withheld under section 3402 from their wages. The new rules are designed to provide withholding on nonresident alien employee wages that more closely approximates the income tax liability. The new rules apply to both the employee and the employer.

**Nonresident Alien Employee Requirements**

The IRS requires new and continuing employees in a nonresident alien tax status to complete and submit updated W-4 forms to their employers. For California State University (CSU) employees, the Employee Action Request [EAR] and Student Payroll Action Request (SPAR) documents are used in lieu of the W-4 form.

The current additional withholding requirement (e.g., filing status of Single-1 plus an additional \$33.10 per month for employees on a monthly pay period schedule) will no longer be mandatory for wages issued on or after January 1, 2006 in accordance with the rules announced in IRS Notice 2005-76. Under the new rules, nonresident alien employees are required to:

1. Not claim exemption from withholding;
2. Request withholding as if they are single, regardless of the actual marital status;
3. Claim only one (1) allowance (**\*note:** if the nonresident alien is a resident of Canada, Mexico, or South Korea, he or she may claim more than one allowance); and
4. Write "Nonresident Alien" or "NRA" above the dotted line on line 6 of Form W-4.  
(**Note Modification for CSU Employees:** Indicate "Nonresident Alien" or "NRA" at the top of the EAR/SPAR document.)

Please note that like all other employees, nonresident alien employees may request additional withholding at their option.

**Employer Requirements**

The IRS wants employers to withhold taxes differently. The new rules require an "artificial" amount to be added to the wages of a nonresident alien employee for purposes of calculating income tax withholding based upon the following payroll period schedule:

<b>PAYROLL PERIOD</b>	<b>ADD ADDITIONAL</b>
Weekly	\$ 51
Biweekly	\$102
Semimonthly	\$110
Monthly	\$221
Quarterly	\$663
Semiannually	\$1,325
Annually	\$2,650
Daily or Miscellaneous (each day of the payroll period)	\$10.20

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Please note that the responsibility for this payroll system change to recognize the “artificial” wages for purposes of tax withholding is that of the State Controller’s Office (SCO), the pay agent for California State University (CSU) employees, and the change has not yet been made. We will advise you when the SCO has made the change.

In the meantime, if a nonresident alien employee completes a new W-4 (EAR/SPAR) document based upon the new withholding rules prior to the payroll system change, taxes will be withheld based on the employee’s actual wages rather than the actual plus “artificial” wages. To prevent a potential under withholding, affected employees should reference IRS Form 1040-ES (NR), “U.S. Estimated Tax for Nonresident Alien Individuals,” and consult their tax advisor. This form can be accessed on the IRS website via: <http://www.irs.gov/pub/irs-pdf/f1040esn.pdf>.

Also please note that the federal income tax wage withholding regulations require that an employer continue to use the W-4 tax withholding information currently on file for an employee as long as that W-4 remains valid or until it is replaced by a new valid W-4. If the employer does not obtain a new W-4 for affected nonresident alien employees by the first payroll in 2006, the employer must continue to withhold under the old withholding rules for those employees until a new W-4 document is completed.

Please note that the changes discussed in this notice may not be applicable to all employees in a nonresident alien tax status and employees should consult their tax advisors to obtain additional information.

To inquire how to update your tax withholding information, please contact your campus Payroll or Personnel Services Department.