

EXPLANATION OF DIFFERENT WITHHOLDING CLASSES

As shown in the chart at <http://www.nd.gov/spo/connectnd/manual/1099-irs-handout.xls>, payments are reported under different withholding classes depending upon the type of payment. Vendors must be set up for reporting under the various classes before the voucher can be used to report under that class. The following list is meant to be for guidance only, not to be the final word on IRS reporting.

Class 01

This class is for rent or lease payments made to reportable vendors. Common payment types under this category are:

- Building rent
- Leasing of office equipment
- Motel rooms and conference rooms
- Land rent

What surprises most people about this category is: (1) a lot of buildings and motels are owned by partnerships and not corporations, which makes them reportable; and (2) paying motels for a room IS reportable. Most office equipment is leased from a corporation, but if your rent or lease payment shows up on a voucher with a blue [withholding](#) link, consider the voucher reportable. The Vendor Registry has most likely determined that this vendor is not a corporation.

Class 02

This class is for royalties. Agencies need to be aware of the following items concerning this withholding class:

1. **The reporting minimum is \$10.00**, not \$600.00
2. Royalties include:
 - Literary rights
 - Copyrights
 - Publishing
 - **Licensing fees – including software licenses**

NOTE: However, software licenses for “canned software” such as Microsoft Office or other off-the-shelf programs are not reportable. The only type of software licenses that needs to be reported is when the program is developed specifically for the agency, or one that has been modified for your agency’s use.

3. Standard exemptions from reporting apply to domestic corporations and nonprofits.
4. Software licenses paid to foreign vendors are not automatically exempt.

Class 03

This class is called “Other Income.” Some items are classified here because they do not fit the definition of the other withholding classes. Class 03 and 07 are often confused with each other. Class 03 cannot be used for services of any sort. Rather, the income reported here is **unearned**, and the vendor will not have to pay self-employment taxes on it. Examples of Other Income are:

- Awards and prizes and raffle winnings – see [chart](#) for more details
- Payments Job Service makes to employers for certain programs
- Legal damages – [more information](#) available
- Federal disaster payments/reimbursements
- Federal, state, or local taxable grants
 - The IRS website states “A federal grant is ordinarily taxable unless stated otherwise in the legislation authorizing the grant. Do not report scholarship or fellowship grants” (<http://www.irs.gov/instructions/i1099g/ar01.html>).

Class 04 – BACKUP WITHHOLDING

Example: You need to pay John Smith \$10,000 as an independent contractor, but he fails to provide his TIN. You must backup withhold 28% (\$2800).

- Report payment of \$10,000 in box 7, **even though the check was issued for \$7200.**
- Report \$2800 in box 4.

Class 06

Payment for medical services provided (not consultation) is reportable under this class **even if the organization is a corporation**. Many hospitals and clinics within North Dakota are incorporated non-profit organizations, however. Agencies will need to determine whether their payment falls under the classification of non-employee compensation (consulting, witness fees) or medical services (eye examinations, inoculations). If the voucher does not show up with a [withholding](#) link, Vendor Registry has probably received paperwork from the vendor stating that it is a non-profit.

“Think broadly”:

- X-rays, MRIs, lab tests, physicals, optometrists, dentists, chiropractors, drug screenings, massage therapy, occupational or physical therapy, psychological counseling, veterinary services, etc. all fall under this class.

Special Medical Issues:

1. Reimbursing Medical payments: An individual pays for something. Your agency receives Medicare or Medicaid payments, then reimburses the individual. According to Marianne Couch at Cokala Tax Information Reporting Solutions, Inc., **these payments are reportable under Box 6!** They may not be taxable for the individual, but that is a separate issue.
2. Payments for renting or leasing hospital beds, shower chairs, other large medical items are reported under Box 1 for Rent, not Box 6. Corporations would be exempt under Box 1.

3. Medical testimony from doctors – all expert witness fees are reported under Box 7, not Box 6. That means corporations – but not individual doctors – would be exempt.

Class 07

Most payments for services will be reported under the withholding class of 07, “Non-employee Compensation.” This basically means payment for services to individuals who are not a state employee. Examples are:

- Consultants
- Accountants
- Repairs made
- Printers
- Janitorial
- Lawn Care

Vendors receiving a 1099 under this withholding class will be liable for self-employment taxes. Therefore, employees cannot receive payments for services unless they qualify as an Independent Contractor status. See this web site for more information on that determination: [Employees vs Independent Contractors](#).

Class 14

Agencies must make a distinction between Box 7 vs Box 14 when paying attorneys. Rule of thumb:

- ✓ If attorney/law firm performed services **for your organization**, report these payments in Box 7.
- ✓ If attorney/law firm performed services **for someone else (third party)**, report these payments in Box 14.

Furthermore:

1. If attorney’s/law firm’s name is on the check, report the total amount of the check in Box 14.
2. If the legal damages payment to the claimant is taxable (e.g., property damage), you must also report this amount to the claimant in Box 3 – even if the claimant’s name is not on the check.
 - This means you may be issuing two or more Forms 1099-MISC for a single check, one to the attorney in Box 14, and one to the claimant using Box 3.

For more details on this subject, please read the section titled “Payments to attorneys” in the Instructions for Form 1099-MISC (<http://www.irs.gov/pub/irs-pdf/i1099misc.pdf>).