Multi State Taxation Issues

Dee Byrd CPP PHR SHRM-CP
Sr. Project Manager
PayTech Inc

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Agenda

- Withholding and Payroll Tax Issues
- Personal Income Tax Issues
- Responses
  - Multistate Tax Commission
  - Proposed Federal Legislation
- Practical Considerations
  - Obstacles
  - Exposure

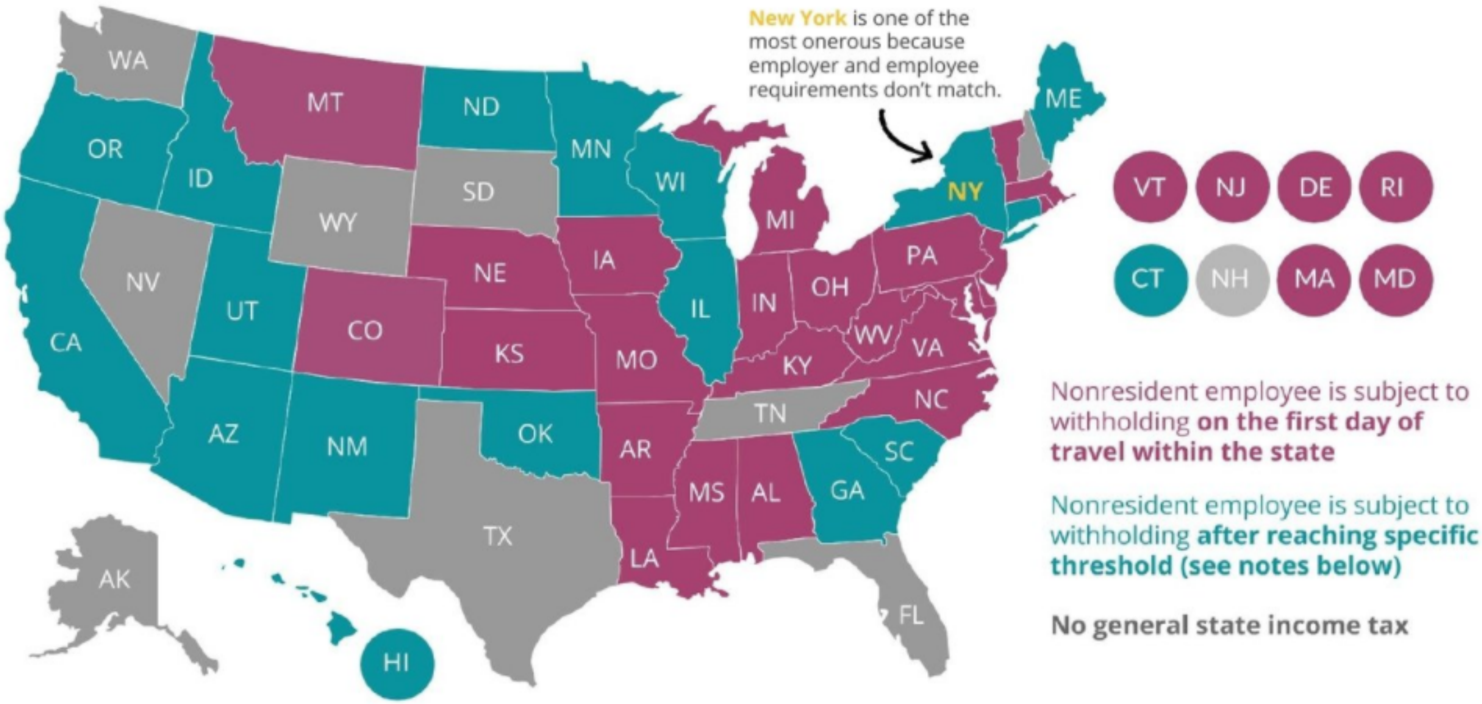
WITHHOLDING AND PAYROLL TAX ISSUES

Employer Withholding

- Generally, states require employers to withhold personal income taxes on behalf of their employees.
- Employer withholding requirements differ widely among the states. According to the Mobile Workforce Coalition:
  - Thresholds based on days
    - Arizona, Hawaii (60 days); Connecticut (15 days); New York (14 days); Maine (12 days)
  - Thresholds based on in-state wages
    - Wisconsin ($1,500); Idaho ($1,000); South Carolina ($800); Oklahoma ($300)
    - California (above low-income exemption); Oregon (equal/above employee's standard deduction)
  - Many states have no thresholds (*e.g.*, require withholding on first dollar earned or first day worked in State)
    - Examples: Colorado, Indiana, Massachusetts, Maryland, Michigan, North Carolina, Ohio, Pennsylvania, Virginia

Withholding Rules

When is a nonresident employer subject to withholding?



Source: Mobile Workforce Coalition

Reciprocal Tax Agreements

- If an employee works in State A but lives in State B, a reciprocal tax agreement between States A and B may provide that the employer need only withhold for, and the employee need only file in, State B.
- However, reciprocal tax agreements typically exist only between neighboring states, and not all neighboring states have them (e.g., New York and New Jersey).
- Do not apply to local taxing jurisdictions.
- Recent Developments
  - Minnesota/Wisconsin
  - New Jersey

Employer Withholding Audits

- States are becoming increasingly aggressive in enforcing withholding requirements – viewed as a new revenue source.
- There are multiple difficulties associated with withholding for a mobile workforce
  - Insufficient payroll system capabilities
  - Burdens placed on employees to document travel
  - No uniformity across states and cities

Employer Withholding Audits, cont.

- How do states identify potential audit candidates?
  - Travel and entertainment
  - Related audits
  - Newspapers
  - Clever use of databases
  - Trigger audits of executives (even if below threshold)

PERSONAL TAX ISSUES

Employee's Tax Responsibilities

- General Rule of Personal Income Taxation
  - A state will tax all of the income of its residents, and the income of nonresidents that is earned within the state.
  - If an individual lives in State A and works in State B, State A will generally provide a credit for income taxes paid to State B.
- An employee's income from a single day's work in a state is taxable in that state (or locality) unless an exemption or reciprocity agreement exists.
- Working in Multiple States
  - If an employee works in multiple states, she will likely need to apportion her income among the states in which she worked, based on a formula.
- Application of Resident Credits

Convenience of the Employer

- New York's "Convenience of the Employer" Test
  - If a nonresident is employed in New York, days worked outside the State are considered non-New York workdays only if the nonresident worked outside the State out of necessity rather than convenience.
    - Similar rules in Pennsylvania and Nebraska.
- New York's "Bona Fide Office" Safe Harbor
  - Home office can qualify as a "bona fide employer office" if certain factor-based tests are met.
    - Primary Factor: "special facilities" nearby
    - Secondary/Other Factors: requires significant cooperation between employer/employee to meet

RESPONSES

Multitate Tax Commission

- Model Mobile Workforce Statute
  - A nonresident employee's compensation is excluded from personal income tax if:
    1. The employee has no other state-source income;
    2. The employee is present in the state not more than 20 days to perform work-related duties; and
    3. The employee's state of residence provides a similar exclusion or has no income tax.
  - Partial days = full days. Traveling through state does not count.
  - Notwithstanding the exclusion, state may require the employee to file an informational return.

Multistate Tax Commission, cont.

- Exceptions:
  - Professional athletes and entertainers
  - “Persons of prominence” paid on a “per-event basis”
  - Construction workers
  - “Key employees” under I.R.C. Section 416
- An employer need not withhold personal income tax from an employee’s wages if:
  1. The employee is present in the state not more than 20 days to perform work-related duties; and
  2. The employee’s state of residence provides a similar exclusion or has no income tax.
     - It doesn’t matter if employee had other state-source income.

Multistate Tax Commission, cont.

- If an employer erroneously applies the Model Statute, a safe harbor from penalties is provided if the employer relied on:
  - A regularly maintained time and attendance system;
  - Employee travel records; or
  - Travel expense reimbursement records.
- Local taxes are not covered by the Model Statute.
- To date, only North Dakota has enacted the Model Statute.

Proposed Federal Legislation

- The Mobile Workforce State Income Tax Simplification Act of 2017 (H.B. 1393 and S. 540)
  - Only the following states may tax an employee's "wages or other remuneration":
    - The state in which the employee resides; and
    - Any state(s) in which the employee performs employment duties for more than 30 days.
      - Two or more states in one day? The day goes to the state in which the most employment duties were performed.
        - Exception: Nonresident state always defeats resident state if employee works in resident state and <u>one</u> nonresident state on the same day.
      - In-transit days do not count.

Proposed Federal Legislation, cont.

- The employer must comply with a state's withholding and reporting requirements only if the employee's wages are subject to tax in that state.
- A safe harbor from penalties is provided if the employer relied on a time and attendance system that tracks an employee's location on a daily basis.
- If the employer does not maintain such a system, it may rely on the determinations of its employees.
  - Exceptions: Knowledge of fraud or collusion to evade taxes
- The Act's limits on state taxation do not apply to:
  - Professional athletes and entertainers
  - Qualified production employees (e.g., movies, TV)
  - "Persons of prominence" paid on a "per-event basis"
- H.B. 1393 passed the House on June 20, 2017. Now pending in the Senate Finance Committee with S. 540.
- Effective Date: January 1 of the second calendar year that begins after the enactment of either Bill.

PRACTICAL CONSIDERATIONS

Obstacles

- Administrative
  - Where are your workers
  - HRIS/Payroll system
- Human Resources
  - Multiple Forms W-2
  - Contain a traveling workforce
- Tax
  - Potential nexus creating activity
  - Filing obligations
- Future Compliance

Exposure

- Quantification of the issue
  - Identify traveling population
  - Address any HR or strategic obstacles to compliance
  - Determine withholding obligation
    - Application of deminimis rules
  - Ascertain level of compliance
- Potential voluntary disclosures

Questions

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