State Payroll Tax Withholding for Traveling Employees

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Business Travel Is On The Rise

85% companies with employees working outside their resident jurisdiction[1]

$284B 2016 spend on U.S. business travel[2]

6.1% forecasted increase in U.S. business travel for 2018[3]

1. BloombergBNA and Ernst & Young Multistate Payroll Withholding survey of 506 companies, 2015.
2. GBTA BTI Outlook, Annual Global Report & Forecast.
3. Id.

Agenda

- Corporate Tax/Nexus Issues
- Withholding and Payroll Tax Issues
- Responses
  - Multistate Tax Commission
  - Proposed Federal Legislation
- Compliance Solutions

CORPORATE TAX/NEXUS ISSUES

Corporate Nexus Issues

- Mobile employees may create nexus with a state for numerous purposes, including:
  - Corporate income taxes;
  - Unemployment taxes; and
  - Sales and use taxes.
- Income tax moving towards economic nexus
  - So employee visits = income tax nexus

Possible Exceptions

- Public Law 86-272
  - Prohibits the imposition of a net income tax by a state if the only activities performed in the state relate to solicitation of sales of tangible personal property.
  - Does not affect an employer's responsibility to withhold income tax, pay unemployment tax and disability insurance, and cover workers' compensation. *See e.g.*, VA. Pub. Doc. 94-192 (1994).
  - Only applies to income taxes.
    - No impact on gross receipts taxes (*e.g.*, Ohio commercial activity tax and Washington B&O tax) or sales and use taxes
  - Limited to sales of tangible personal property
  - Limited to "mere solicitation." *Wisconsin Dept. of Revenue v. William Wrigley, Jr. Co.,* 505 U.S. 214 (1992)

Possible Exceptions

- TSB-A-13(6)C
  - Taxpayer was clothing retailer and remote seller
  - No NY stores; no real or tangible property; no sales visits
  - BUT: employees did come to NY occasionally (10x/yr) to meet with merchandise vendors, for "inspirational" shopping trips and to attend (but not participate in) trade shows
  - Due to limited purpose and duration = no nexus for corporate franchise tax
  - "Close question"

Sales Tax Nexus Issues

- Easy: Mobile workers in-state = physical presence
- *Quill (and legislation to circumvent it)*
- De minimis – Is a "cookie" property?
- New Developments
  - Use tax reporting obligation
  - Anti-*Quill* legislation and the *Wayfair* case
  - Marketplace provider nexus – new hot topic

Nexus and Telecommuting

- Telecommuting employees can create nexus for:
  - Employer (withholding taxes, income and franchise taxes, as well as sales and use taxes)
  - Employee (personal income tax)
- Employee withholding
  - Employee nexus
    - Resident: Subject to tax on all income in resident state
    - Nonresident: Taxable only on income "sourced" in state
  - Employer nexus
    - Statutory nexus triggered by "doing business" or "transacting business" in-state, maintaining an office, owning or leasing property, or having employees performing services for the employer in-state
    - Telecommuting employees can create an in-state presence for employers

Temporary Employee Presence

- New York
  - *Orvis* (N.Y. 1995)
    - New York Court of Appeals held that the State could require an out-of-state company to collect sales/use tax based on roughly 12 visits to the State by employees over a 3-year period.
- Kansas
  - *In re Intercard* (Kan. 2000)
    - Kansas Supreme Court held that the State could <u>not</u> require an out-of-state company to collect sales/use tax based on 11 visits to the State by employees over a 4-year period.

Temporary Employee Presence, cont.

- Florida
  - *Share Int'l, Inc.* (Fla. 1996)
    - Florida Supreme Court held that the State could <u>not</u> require an out-of-state company to collect sales/use tax based on an employee's and an officer's attendance at trade shows in the State.
- Washington
  - Wash. Tax Determination No. 14-0062 (Feb. 20, 2014)
    - Washington State Administrative Law Judge determined that an out-of-state company was subject to B&O tax and sales/use tax collection obligations based on its employees' attendance of trade shows in the State.

Telecommuting

- New Jersey
  - *Telebright* (N.J. Tax 2010), *aff'd* 2012
    - The Appellate Division of the New Jersey Superior Court held that a company was subject to corporate income tax based on one telecommuting employee who resided in the State.
- Ohio
  - Ohio Department of Taxation website:
    - "Our company has an employee that works out of their home in Ohio. Are we required to withhold Ohio income tax on the employee's compensation?"
    - Answer: "Yes, you must withhold Ohio income tax. Your company is transacting business in Ohio since you have an employee working in Ohio."

Telecommuting, cont.

- The following States have stated that having one to six employees telecommuting from their home and conducting non-solicitation activities would not establish nexus for corporate income tax purposes:
  - Indiana
  - Kentucky
  - Maryland
    - Depends on the activities conducted in the State
  - Mississippi
  - Oklahoma

- Source: BNA 2017 Survey of State Tax Departments

Telecommuting, cont.

- The following States have stated that holding two or more seminars in the State and having employees visit the State five times would <u>not</u> establish nexus for sales and use tax purposes:
  - Indiana
  - Mississippi
    - As long as not soliciting sales or servicing customers while in the State

- Source: BNA 2017 Survey of State Tax Departments

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

WITHHOLDING AND PAYROLL TAX ISSUES

Employer Withholding – Tax On Employees

- Importance of Residency Status
  - Residents: Taxable on one thing (everything)
  - Nonresidents: Taxable on "source" income only
- Basic Residency Tests
  - Domicile Test: Permanent/Primary Home
  - "Statutory" Tests: 183 days and living quarters
  - Other Tests: Non-Temporary/Transitory Purpose
- Employer's Obligation to Know: Where Do You Live?

Employer Withholding – Tax On Employees

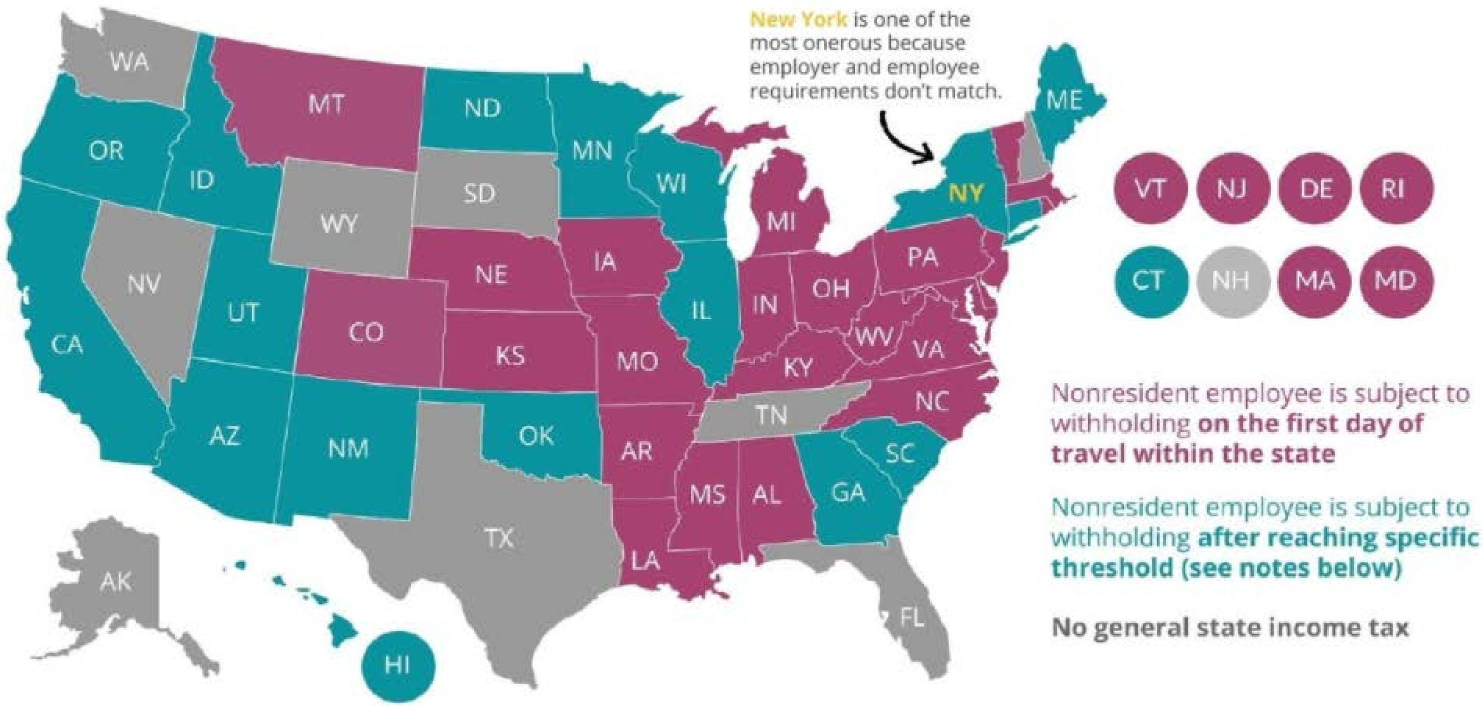
- <u>Basics of Nonresident Taxation</u>
  - Where is the income "earned?"
  - The concept of "sourcing:" Is the income "derived from" sources in the state?
- <u>Typical Executive Comp Subject to Sourcing</u>
  - Wages/Bonuses
  - Stock Options and Restricted Stock
  - Deferred Compensation/Retirement Income
- <u>Working in Multiple States</u>
  - 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

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 place on employees to document travel
  - No uniformity across states and cities

Audit Risks – Facts and Figures

New York withholding audit risk is growing.

395

New York payroll withholding audits open/closed in 2015

150%

Audit $ collected in 2015 vs. 2014

47%

Companies subjected to withholding audit by New York

Source: NYS FOIL; EY+BNA survey

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)

RESPONSES/FIXES?

- 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 (<u>e.g.</u>, 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.

MANAGING COMPLIANCE AND PRACTICAL SOLUTIONS

Managing Compliance and Practical Solutions

<u>Cleaning Up the Past</u>

- Status Quo?
  - Section 404 of Sarbanes-Oxley
- Prospective Compliance
  - Use of software (e.g., Monaeo)
- Voluntary Disclosure
- Responsible Person concerns

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Doing a Multistate Compliance Review

- How many employees visit?
- How many total visits?
- Total compensation paid to visiting employees?
- Existence of thresholds?
- Active in withholding area?

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Sample Compliance Chart

STATE	NO. OF EMPLOYEES VISITING STATE	TOTAL NO. OF VISITS	DE MINIMIS THRESHOLD FOR NONRESIDENTS?	RECIPROCAL AGREEMENTS IN EFFECT?	COMPLIANCE ACTION
LA	25	563	No	No	High activity state, with many employees over 25 days. State doesn't appear to have active criminal enforcement outside the sales tax area, but the high number of visits is problematic. Voluntary disclosure may be the best option.
NY	14	195	14 day rule	No	5 employees surpass 14 day threshold. NYS has been aggressive both on the withholding tax side and with respect to criminal enforcement. Thus, voluntary disclosure is also the best option. Going forward, put measures in place to track 14 day rule.
IL	10	88	Maybe	IA, KY, MI and WI	Employees' services could be considered localized elsewhere and services in IL incidental if they are temporary, transitory, or isolated; at the very least this could give us an argument for no withholding. Consider future compliance options.
SC	16	35	$1,000	No	Low number of visits; some could fall below threshold; status quo for now

Managing Compliance and Practical Solutions

Special Considerations for Voluntary Disclosures

- Do employees disclose also?
- Is payment on behalf of employee = taxable income?
- Resident credits for employee in home state?

Special Considerations for Audits

- What to do?
- Practical guidance from the front lines

Thank You

Contact Information

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