MULTISTATE PAYROLL WITHHOLDING TAX ISSUES

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Agenda

I. Corporate Nexus Issues

II. Withholding and Payroll Tax Issues

III. Personal Income Tax Issues

IV. Responses

V. Managing Compliance and Practical Solutions

Business Travel is on the Rise

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

$355B Expected annual spending on U.S. business travel by 2022[2]

462M U.S. domestic business trips forecasted for 2020[3]

1. BloombergBNA and Ernst & Young Multistate Payroll Withholding survey of 506 companies (2015).
2. GBTA BTI Outlook, Annual Global Report & Forecast (Aug. 2018).
3. GBTA BTI Outlook, Annual Global Report & Forecast (Aug. 2018).

Polling Question #1

Does your company track employee travel for tax purposes?

a. Yes
b. No
c. Our employees don’t travel
d. Something else

CORPORATE NEXUS ISSUES

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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

- The rise of economic nexus for income tax purposes
  - Result: Employee visits can result in income tax nexus

Temporary Employee Presence

- **New York:** *Orvis Co. v. Tax Tribunal* (86 N.Y. 2d 165 [1995])

  NY's highest court held that the State could require an out-of-state company to collect sales/use tax based its employees' 12 visits to the State over a 3-year period only to discuss problems such as concerning shipping and to check on how Orvis products were displayed

- **Kansas:** *In re Appeal of Intercard* (270 Kan. 346 [2000])

  Kansas Supreme Court held that the State could not require an out-of-state company to collect sales/use tax based on 11 visits to the State by employees over a 3-month period (totaling 44 hours) to install card readers

Temporary Employee Presence - *continued*

- **Florida:** *Share Int'l, Inc.* (667 So.2d 226 [Fla. 1996]), *cert. denied* 519 U.S. 1056 (1997)

  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 <u>attendance at in-state trade shows</u>

- **Washington:** Wash. Tax Determination No. 14-0062 (Feb. 20, 2014)

  Washington State ALJ determined that an out-of-state company <u>was</u> subject to B&O tax and sales/use tax collection obligations based on its employees' <u>attendance of trade shows in the State</u>

Nexus and Telecommuting

- Telecommuting employees can create nexus for:
  - Employer (withholding taxes, income/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

Telecommuting

As of 2019:

- **In 41 states**, having between 1 and 6 telecommuting employees conducting **non-solicitation activities** is enough to create nexus
- **In 39 states**, a single telecommuting employee can create nexus if they're performing **product development functions**
- **In 38 states**, a single telecommuting employee can create nexus if they're performing **back-office functions**

Source: BNA 2019 Survey of State Tax Departments

Telecommuting - *continued*

As of 2019, the following States stated that holding one-day seminars in their state would <u>not</u> establish nexus for sales and use tax purposes as long as not soliciting sales or servicing customers while in the State:

- Arkansas
- Massachusetts
- Mississippi
- Tennessee
- Vermont
- Virginia

Source: BNA 2019 Survey of State Tax Departments

Telecommuting - *continued*

- New Jersey – *Telebright v. Div. of Taxation* (25 N.J. Tax 333 [2010]), *aff'd* 424 N.J. Super. 384 (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 NJ

- Ohio - Ohio Department of Taxation website (FAQ #264)

  Question: *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 - *continued*

- Virginia – Va. Dep't Tax, Pub. Doc. No. 16-15 (Mar. 3, 2016)

  VA Department of Taxation ruled that a single employee working from home in VA creates corporate income tax nexus for an out of state corporation. The employer was an S-corporation headquartered out-of-state that provided internet-based templates for use by customers on their websites.

- California - *Appeal of Warwick McKinley*, Cal. State Bd. Equal. No. 489090 (2012)

  CA Board of Equalization held that a foreign corporation (MA-based marketing/consulting service provider) has nexus with CA solely by having one employing working from home in CA

Potential Federal Exception

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.

- Doesn't impact employer's withholding tax obligations, nor does it impact gross receipts taxes 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)

Polling Question #2

True or False: Public Law 86-272 prohibits states from imposing withholding tax on certain activities.

a. True
b. False

WITHHOLDING AND PAYROLL TAX ISSUES

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Employer Withholding

- Generally, states require employers to withhold personal income taxes on behalf of their employees
- Employer withholding requirements differ widely among the states
- States generally adopt 1 of 3 types of thresholds:
  1. <u>Number of days in-state</u> (*E.g.*, 60 days/year for AZ and HI; 15 days/year for CT; 14 days/year for NY)
  2. <u>In-State Wages</u> (*E.g.*, WI is $1,500/year; ID and SC are both $1,000/year)
  3. <u>No Threshold</u> (*E.g.*, CO, IN, MD, MI, NC)
- Some states adopt hybrid thresholds, *for example*:
  - Maine's threshold is 12 days/year <u>and</u> gross income of $3,000
  - Georgia's threshold is 23 days/quarter <u>and</u> the GA wages can't exceed 5% of total income

Withholding Rules

Which states are the most friendly to mobile workers and their employers?

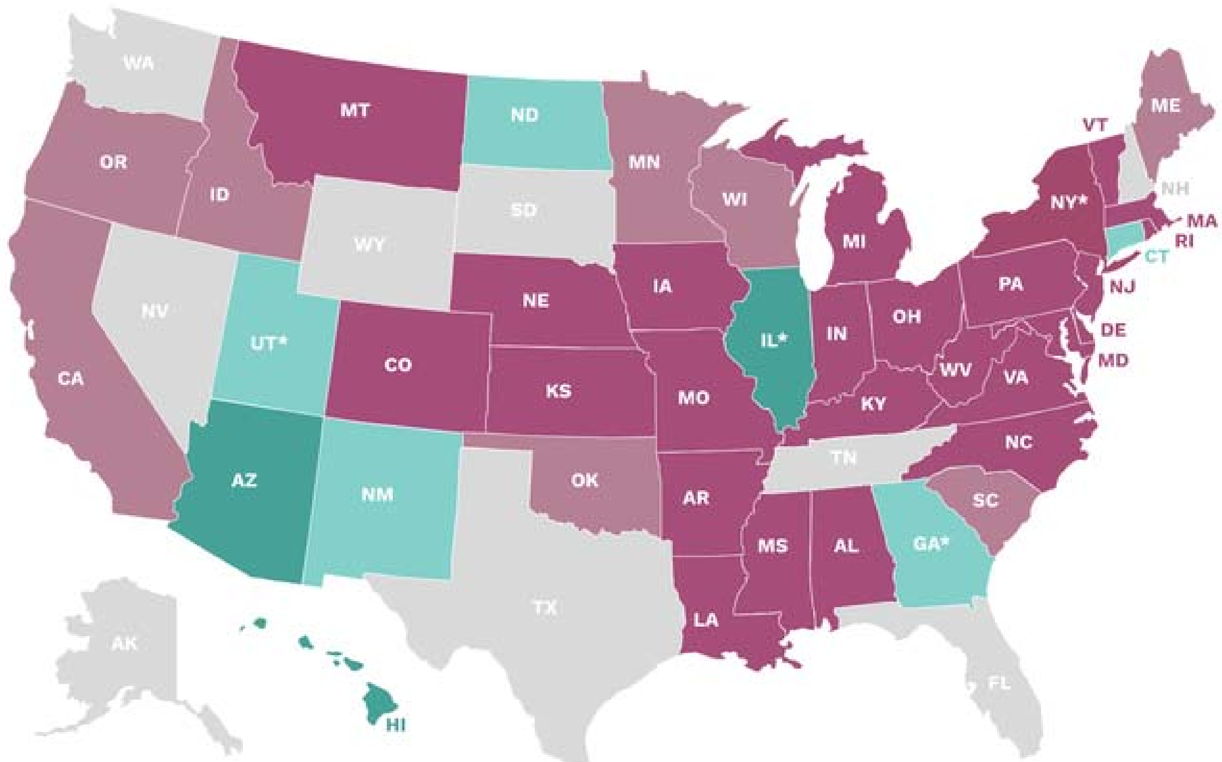
Very Friendly. State allows employees to work within the state for 30 or more days before employer is subject to withholding (AZ, HI, IL).

Moderately Friendly. State allows employees to work in the state between 15 and 29 days before employer is subject to withholding (CT, GA*, NM, ND), or has other accommodating provisions (UT*).

Unfriendly. State only allows employees to work in the state between 2 and 14 days before employer is subject to withholding (ME), or has a wage-based threshold (CA, ID, MN, OK, OR, WI).

Very Unfriendly. State requires employer withholding on first day an employee works within the state (24 states), or requires an individual to file on first day even if employer isn't required to withhold on first day (NY).

Not applicable. No state income tax.



Notes: In **Georgia**, employer must withhold if the employee is in the state for more than 23 days in a calendar year, or if $5,000 or more or 5% or more of total income is attributable to Georgia. In **Illinois**, the 30-day threshold applies for tax years beginning after December 31, 2020 (this is the result of legislation enacted in 2019). In **Utah**, employer must withhold if the employer (not the employee) does business in the state for more than 60 days in a calendar year.

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
- Not applicable to local taxing jurisdictions

Employer Withholding Tax 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, *for example*:
  - Insufficient payroll system capabilities
  - Burdens placed on employees to document travel
  - Lack of uniformity across states and cities

Employer Withholding Tax Audits - *continued*

- 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)

Audit Risks

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

Federal Withholding Exceptions

Military Spouses Residency Relief Act (P.L. 111-97; 50 App. U.S.C. § 571)

- Tax relief for military spouses who are present in a state solely to be with the servicemember when the servicemember is in that state in compliance with his or her military orders
- Allows spouses of military personnel to withhold state & local tax based on an address other than their duty station
- Effective 2010

Federal Withholding Exceptions- *continued*

- Merchant mariners (46 U.S.C. § 11108)
  - "Wages due or accruing to a master or seaman on a vessel in the foreign, coastwise, intercoastal, interstate, or noncontiguous trade or an individual employed on a fishing vessel or any fish processing vessel may not be withheld under the tax laws of a State or a political subdivision of a State" except (1) the resident state or (2) by voluntary agreement
- Railroad employees (46 U.S.C. § 11502)
  - No compensation paid by a rail carrier providing interstate transportation to an employee who performs regularly assigned duties in more than one state will be subject to state or local tax except for the employee's state/locality of residence
  - Withholding information returns and other reports are only due to such state/locality of residence

Federal Withholding Exceptions- *continued*

- Air carrier employees (49 U.S.C. § 40116)
  - The pay of an air carrier employee having regularly assigned duties on aircraft in at least two states is subject to the income tax laws of only: 1) the employee's state and locality of residence, and 2) the state and locality in which the employee earns more than 50% of his pay received from the air carrier
- Motor carrier employees (49 U.S.C. § 14503)
  - No compensation paid by

    (1) a motor carrier providing interstate transportation or

    (2) a motor private carrier who performs regularly assigned duties in two or more states

    will be subject to the income tax laws of any state or locality, other than the state or locality of the employee's residence.
  - Also applies to water carrier employee withholding

PERSONAL INCOME TAX ISSUES

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Employee’s Tax Responsibilities

Overview 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.
- General rule – workday allocation (determined annually)
- Deferred compensation – typically multi-year allocation
- Specialized occupations – *e.g.*, athletes, entertainers, salesmen, security and commodity brokers

Begins on Day 1

- 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

Employee's Tax Responsibilities - *continued*

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

- 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
- Not dollar-for-dollar
- Credit for local tax?

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 CT (**as of 1/1/2019**), DE, NE, NJ, and PA

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

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Multistate 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.

MTC - *continued*

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.

MTC - *continued*

- 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 2020 (H.R. 5674)

- Introduced 1/24/2020
- Prohibits states from taxing wages earned by an employee who performs employment duties in more than one state unless :
  1. The state is the employee's residence and/or
  2. The employee is present and performing employment duties for more than 30 days per calendar year in that state
- The term “employee” excludes professional athletes and entertainers; production employees working on a movie, TV show, or other commercial video production; and public figures who are “persons of prominence” who and paid on a per-event basis
- Similar bills introduced in nearly every Congress for the last decade or so

Polling Question #3

Have you gone through a state withholding tax audit?

a. Yes
b. No
c. That’s not my department
d. Something else

MANAGING COMPLIANCE
AND
PRACTICAL SOLUTIONS

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Addressing the Past

- Voluntary Disclosure
- Register with the state (DOL, tax, secretary of state, etc.)

Ensuring Future Compliance

- Multistate compliance review
    - Initial
    - Ongoing
- Register with the state (DOL, tax, secretary of state, etc.)

Managing Compliance and Practical Solutions - *continued*

Multistate Compliance Review

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

Managing Compliance and Practical Solutions - *continued*

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 - *continued*

Special Considerations for Voluntary Disclosures

- Should employees disclose also?
- Is payment made on behalf of the employee (*i.e.*, taxable income)?
- Resident credits for employee in home state?

Special Considerations for Audits

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

Managing Compliance and Practical Solutions - *continued*

<u>Considerations for Employers</u>

- Timely notification of location changes
- Establish system to track employees across state lines
- Offer courtesy withholding for nonresident employees (in states with no nexus)
- Gross-ups for short-term assignments

Questions

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Thank You for Joining Today

If you have further questions or if you need additional assistance, please contact me:

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