MULTISTATE TAX COMMISSION
Working Together Since 1967 to Preserve Federalism and Tax Fairness

Report of the Hearing Officer
Model Mobile Workforce Withholding and Individual Income Tax Statute
May 18, 2010

I. Introduction and Summary

On April 7, 2010, the Commission Executive Committee approved proposed model Mobile Workforce statutes for public hearing. Under the proposal, an employer would not be required to withhold non-resident employee wage income for a state if the employee spent less than a de-minimus number of work days there and did not fall into one of the exception categories. Likewise, the employee would not be required to file and pay tax on that wage income to the non-resident state, as long as the employee has no other income attributable to the state. The employee would, of course, be subject to tax on that income in his or her home state.

On May 10, 2010, the hearing officer held the public hearing and received written comments from the Council on State Taxation, the Massachusetts Department of Revenue, the Missouri Department of Revenue, the Montana Department of Revenue, and the managing director of CPA firm Boerio and Company. (*See* Attachments B through F, Public Comments.) This Report summarizes the proposal's procedure and substance, reviews the public comment received, and explains the hearing officer's recommendation that the proposal be approved with modifications. (*See* Attachment A, Proposal with recommended modifications.)

The proposal is now before the Executive Committee to consider approval for a bylaw 7 survey. The Committee may approve the proposal, with or without modifications; remand the proposal to an earlier stage of the process for further development; or reject the proposal and end the project. If the proposal is approved, it will be submitted to a bylaw 7 survey of Compact member states. The bylaw 7 survey asks whether the state would consider adopting the proposal in its jurisdiction. If a majority of Compact member states respond in the affirmative, the proposal will be submitted to a vote of the Commission in July, 2010.

II. Procedural Background

A. Development of the Proposal

At its May 2009 meeting, the Executive Committee discussed the extent to which standard withholding requirements pose challenges for employers when employees earn wage income during short business visits to non-resident states. These challenges have prompted some in the business community to support federal legislation H.R. 3359 and H.R. 2110, which would pre-empt states from taxing this non-resident wage income. (*See* Attachment H, H.R. 2110.) The Executive Committee referred the issue to the Uniformity Committee and asked that it expedite development of a model state law to address these challenges for states that wish to do so.

The Uniformity Committee, at its July 2009 meeting, formed a small work group of five states (Idaho, Colorado, Montana, New York, and California) to create a list of relevant policy questions. The work group held two teleconferences in August of 2009 and produced a policy checklist. The Uniformity Income & Franchise Tax Subcommittee then met by teleconference in September, October, and November of 2009 to answer those questions. (*See* Attachment G, Policy checklist.) Each of the Subcommittee teleconferences was well attended by state and taxpayer representatives, including the Council on State Taxation, the American Payroll Association, and the Federation of Tax Administrators.

Based on the Subcommittee's policy choices, staff produced a draft model statute which was discussed and further amended by the Subcommittee at in-person and teleconference meetings held December 2, 2009; January 22, 2010; March 3, 2010 and March 22, 2010. During each discussion, the Subcommittee received valuable input from the Council on State Taxation, the American Payroll Association, and other individual business representatives. On March 22, 2010 the Subcommittee voted to approve the model and the Uniformity Committee then voted to recommend it favorably to the Executive Committee for approval for public hearing. On April 7, 2010, the Executive Committee approved the model for public hearing.

B. Public Hearing

A public hearing was held after 30 days notice on May 10, 2010 in Washington, D.C. Oral public comments were received. In addition, five sets of written comments were received prior to the closure of the public comment period on May 10, 2010. A one day extension of time was granted in one case. The written comments are attached as Exhibits:

Exhibit B	Council On State Taxation (COST) – Joseph R. Crosby, COO & Senior Director, Policy
Exhibit C	Massachusetts Department of Revenue (MA DOR)– Michael T. Fatale, Chief, Rulings and Regulations Bureau
Exhibit D	Missouri Department of Revenue (MO DOR) – Wood Miller, Managing Counsel, General Counsel's Office
Exhibit E	Montana Department of Revenue (MT DOR) – Dan Bucks, Director of Revenue
Exhibit F	Boerio and Company CPAs – (Boerio) Dave Clark, Managing Director

III. Summary of Proposal

Basic Structure

- ***Covers Both Employer Withholding and Non-resident Employee Individual Income Tax.*** Under the model recommended by the Uniformity Committee, an employer would not be required to withhold a non-resident employee's wage income for a state if the employee spent less than a de-minimus number of work days there and did not fall into one of the exception categories. Likewise, the employee would not be required to file and pay tax on that income to the non-resident state, as long as the employee has no other income attributable to the state. The employee would, of course, be subject to tax on that income in his or her home state.
- ***Addresses Only State Tax.*** The model does not address local withholding or individual income taxes. The Subcommittee felt that should be an option for the states, but need not be included in our basic model.
- ***Reciprocity.*** The withholding and individual income exemptions are contingent on enactment of substantially similar exemptions in the non-resident employee's home state.
- ***Specific Statement on Jurisdiction to Tax.*** Both the individual income and the withholding provisions include a specific statement that the exceptions have no application to the imposition of, or jurisdiction to impose, this or any other tax on any taxpayer.

Important Details

- ***20 work-day threshold.*** The model sets 20 work days as the de-minimus threshold under which the state would not exercise its jurisdiction to require withholding or individual income tax filing. Any part of a day spent in a state counts as one day toward the threshold, even if multiple states are visited in a single 24 hours. Presence in a state purely for travel through it does not count toward the threshold.
- ***No Income Threshold.*** The model does not set an income threshold, although income level is a factor in one of the exceptions to the rule.
- ***Exceptions.*** The model provides exceptions from the exclusions for: (1) professional athletes and members of a professional athletic team, (2) professional entertainers, (3) "persons of prominence," (4) construction workers, (5) persons who are "key employees" under IRC 416(i) provisions related to deferred compensation, by virtue of the income test but not the ownership test, and whether working for a privately or publicly traded company. An employee would be considered a "key employee" for our purposes if that person is one of the 50 highest paid officers in a publicly or privately held company, and had a salary of at least $160,000 in 2010. (The income threshold under IRC 416(i) is indexed to inflation in $5,000 increments.)
- ***Employer Safe-Harbor from Withholding Penalties.*** A safe-harbor from penalties is provided for situations where the employer has miscalculated the number of days. The safe harbor is available where the employer has relied on (1) a time and attendance system, (2) or if no time and attendance system is available, then employees

travel records, or (3) if neither a time and attendance system nor employee travel records are available, then employee travel expense reimbursement requests.

IV. Public Comment and Hearing Officer Recommendations

Threshold Number of Days

COST provided written and oral comment in strong support of an amendment to lengthen the day threshold from 20 to 30. COST's comments point out that the original federal bill would have established a 60 day threshold, which COST estimates would have a net fiscal impact on all states together of less than $100 million annually. After negotiations at the federal level, the bill's sponsor introduced new legislation cutting the day threshold in half, to 30 days. COST estimates that moving from 60 to 30 days would double the number of employees that would be subject to nonresident taxation and reduces the net fiscal impact to $40 million annually. Information available to COST shows that moving from 30 to 20 days will again nearly double the number of employees subject to tax. No further estimate is provided for the net fiscal impact. But COST notes that there may be no fiscal impact at stake even at substantially higher threshold levels because of reciprocity agreements and because several states already provide thresholds for nonresidents in excess of 20 days.

Some states do already provide thresholds for nonresidents in excess of 20 days. But according to data provided by COST and the American Payroll Association, there are not very many. More than half the states that have an individual income tax allow no exemption – based on either day or dollars – and presumably would currently require employers to withhold for nonresidents beginning with the first day of employment duties in the state. Of the remaining states that allow an exemption, only four have a day threshold set higher than 20 days (AZ, HI, GA, and UT).[1]

This means that for the large majority of states, a day threshold of 20 days is a significant increase compared to current provisions. COST estimates the net fiscal impact for all states together would be something less than $40 million. On average, that impact would be less than $1 million per state. Even this figure would present a difficulty for states in the current fiscal situation. But the proposal does not tend to impact states uniformly. Instead, there are extreme variances. At least one state is estimated to have a negative $45 million impact itself, while others would actually experience a positive impact.[2] These are significant impacts for states. A threshold of 20 days is also likely to have a significant impact for some states, but 20 days is 33% less than a 30 day threshold, and the volatility of the result should decrease accordingly.

Although fewer employees will come under a 20 day exception, the reduction in fiscal variance will enable more states to adopt the proposal, and allow greater

---

[1] *See* Mobile Workforce Briefing Book, p. 8; Prepared by COST and submitted as testimony to the Uniformity Committee on September 9, 2009.

[2] *Id.,* p. 63.

administrative cost savings for both states and employers through increased uniformity. In addition, many states provide reciprocal agreements – with no day or dollar threshold - and the proposed statutory language explicitly preserves those agreements with their resulting administrative benefits to individuals and employers.

The MO DOR's comments further remind us that moving the threshold in either direction creates offsetting administrative and revenue impacts. For example, moving the threshold downward reduces the proposal's administrative benefits for states, employers, and employees; but also reduces state revenue loss. On the other hand, moving the threshold upward increases administrative benefits, but also increases revenue loss.

The Commission states, after receiving significant helpful input from COST and the American Payroll Association, have chosen to set the balance at 20 days and the hearing officer does not recommend a change to that delicate balance.

Income Threshold vs. Day Threshold

The MT DOR commented that the proposal's provisions on individual income tax should be revised to reference the income threshold filing level in any state that has an income threshold for individual income tax. Alternatively, the MT DOR suggests the proposal be returned to the Uniformity Committee for further consideration. The MT DOR is concerned that the 20 day threshold creates a "dual test" that adds unnecessary complexity, creates inequities between non-resident and resident individual income taxpayers, creates inequities among non-resident individual income taxpayers, and is inconsistent with the established position of the MTC concerning filing thresholds for business activity taxes.

- ***Consistency with other Commission recommendations on physical presence***

The MT DOR's last concern raises an especially important point and bears careful consideration. The proposal is in no way intended to signal an endorsement of a physical presence nexus standard for individual income or any other tax. Rather, the proposal is intended as an exercise of state authority to allow a de minimus exception within the clear scope of state taxing jurisdiction. The existence of the de minimus exception itself indicates a presumption of state taxing authority, which would be exercised absent the explicit exemption. The proposal is intended to be consistent with Commission's position on business activity tax nexus. That position acknowledges the desirability of state-authorized de minimus exceptions for non-domiciliary corporations, and proposes a standard based on de minimus amounts of physical property, employees, or sales in a state. Likewise, this proposal would establish a state de minimus exception for non-resident individuals, applicable to only wage income; and sets a standard based on, among other things, de minimus employee presence (IIT 1(a)) or income (IIT 2(e)) in the state. This de minimus exception does not apply if there is *any other* income sourced to the state, whether or not the employee is physically present. (*See* IIT section 1(a) and (b).) If other types of income are sourced to the state, or if the employee falls within one of the enumerated exceptions, the provision retains full authority for the state to exercise its jurisdiction to tax, regardless of physical presence.

Indeed, the withholding provision includes explicit language on this point:

> (3) This section establishes an exception to withholding and deduction requirements and has no application to the imposition of, or jurisdiction to impose, this or any other tax on any taxpayer.

Likewise, the individual income tax "returns and payment" portion of the proposal includes explicit language on the same point:

> (2) This section is applicable to the determination of an individual income taxpayer's filing requirement and has no application to the imposition of, or jurisdiction to impose, this or any other tax on any taxpayer.

However, there is no such language currently included in the individual income tax "non-resident compensation exclusion" portion of the proposal. In light of the MT DOR's concerns on this important point, the hearing officer recommends similar language be added to that section, as follows:

> (4) This section creates an exclusion from non-resident compensation under certain de minimus circumstances and has no application to jurisdiction to impose this or any other tax on any taxpayer.

- ***Potential for inequities***

MT DOR also suggests the proposal creates inequities among and between residents and non-residents in the application of income taxes. Individual income taxpayers are generally excused from filing if income falls below a certain threshold. Under the proposal, it will be possible for non-residents to earn income in the state above that threshold, yet not be subject to tax there. The MT DOR recommends that the individual income tax day and income thresholds be eliminated and states rely instead on their standard filing thresholds (this could be specific in the model, but need not be). The hearing officer does not believe the non-resident "safe harbor" based on number of days creates an inconsistency among residents and non-residents that supports elimination of the threshold. Many states currently provide reciprocity agreements that create the same sorts of inconsistency for their respective residents. That is, non-residents may be completely excused from filing, regardless of the amount of income earned in the state. The existence of these agreements seems to indicate that states view the administrative gains for themselves, their residents, and employers, to be worth the level of inconsistency created. The non-residents are not excused from state income tax, rather they simply pay to their state of residence rather than the source state. The proposal explicitly preserves these existing reciprocity agreements. The proposal also retains consistent treatment of residents among the states by establishing a reciprocity requirement for application of the statute – that is, the "safe harbor" applies only to employees from states that reciprocate for the home state's residents. (*See* Individual income tax section 1(c)). For these reasons, the hearing officer does not recommend a change.

- ***Added complexity***

The MT DOR also expresses concern that the proposal creates added complexity by establishing a 20 day threshold in addition to states' standard "income based" filing requirement threshold. Complexity is an important consideration and the concern is well taken. However, the hearing officer believes that, without the 20 day threshold for individual income tax, the administrative burden that we are trying to rectify for employers would simply fall to employees. Employees who spend only small amounts of time in the state would become responsible for determining the state's filing requirements and, if necessary, filing in the state, all without the benefit of having his or her income withheld for the state by the employer. Under the proposal, both the non-resident employee and the employer can rely on the 20 day threshold. If the employee spends less than 20 days in the state, the employee knows he or she need not file there, and the employer will withhold for the employee's home. This should reduce administrative burden for employees who might otherwise face non-uniform filing thresholds and exceptions in multiple states. For this reason, the hearing officer does not recommend a change.

"Key Employee" Clarifications

Two commenters recommend clarifications to the "key employee" exception in the Individual Income Tax provision 2(e). First, the MA DOR suggests deleting "identified as," because there is technically no "identification" of such persons pursuant to the Code. The MA DOR also recommends language be added, based on its understanding that the Uniformity Subcommittee members "were seeking a dollar limitation like that set forth in [IRC Section] 416(i) that has general applicability, and that therefore would not be limited to circumstances in which a company happened to have in place a specific type of benefit plan." The hearing officer believes this understanding is correct and recommends the proposed changes be adopted as follows:

> (e) a person who is ~~identified as~~ a key employee, without regard to ownership or the existence of a benefit plan, for the year immediately preceding the current tax year pursuant to Section 416(i) of the Internal Revenue Code.

Second, Mr. Clark of Boerio and Company expressed concern in his written comments that the "key employee" exception (to the filing exemption) may sweep in certain self-employed persons – officers of LLCs, LLPs, partnerships, etc. But during the hearing, Mr. Clark suggested an amendment was not necessary, since the exemption is for wage income only and would not apply to self-employed persons at all. The hearing officer agrees with Mr. Clark's understanding and no amendment is necessary.

Respectfully Submitted,

____

Shirley K. Sicilian
Hearing Officer

Attachment A

MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

MTC Model Mobile Workforce Act

As Approved for Public Hearing - Showing Recommendations of the Hearing Officer
May 18, 2010

INDIVIDUAL INCOME TAX

- **Computation of Taxable Income**
  - **Adjusted Gross Income from Sources Within This State.**
    - **Nonresident Compensation, Exclusion**

(1) Compensation subject to withholding pursuant to [cite to state withholding tax], without regard to [cite to withholding tax exception (below)], that is received by a nonresident for employment duties performed in this state, shall be excluded from state source income if:

(a) the nonresident has no other income from sources within this state for the tax year in which the compensation was received;

(b) the nonresident is present in this state to perform employment duties for not more than 20 days during the tax year in which the compensation is received, where presence in this state for any part of a day constitutes presence for that day unless such presence is purely for purposes of transit through the state; and

(c) the nonresident's state of residence provides a substantially similar exclusion or does not impose an individual income tax.

(2) This section shall not apply to compensation received by:

(a) a person who is a professional athlete or member of a professional athletic team;

(b) a professional entertainer who performs services in the professional performing arts;

(c) a person of prominence who performs services for compensation on a per-event basis;

(d) a person who performs construction services to improve real property, predominantly on construction sites, as a laborer; or

(e) a person who is ~~identified as~~ a key employee, without regard to ownership or the existence of a benefit plan, for the year immediately preceding the current tax year pursuant to Section 416(i) of the Internal Revenue Code.

(3) This section shall not prevent the operation, renewal or initiation of any agreement with another state authorized pursuant to [cite to Code section that allows reciprocity agreements].

(4) This section creates an exclusion from non-resident compensation under certain de minimus circumstances and has no application to jurisdiction to impose this or any other tax on any taxpayer.

INDIVIDUAL INCOME TAX

- **Returns and Payment**
    - **Persons required to file returns, exception**

(1) A nonresident whose only state source income is compensation that is excluded pursuant to [Cite to Nonresident Compensation, Exclusion] has no tax liability under this Act and need not file a return. Provided that when, in the judgment of the Department, such nonresident should be required to file an informational return, nothing in this section shall preclude the Department from requiring such nonresident to do so.

(2) This section is applicable to the determination of an individual income taxpayer's filing requirement and has no application to the imposition of, or jurisdiction to impose, this or any other tax on any taxpayer.

WITHHOLDING TAX

- **Withholding from Compensation, Exception**

(1) No amount is required to be deducted or retained from compensation paid to a nonresident for employment duties performed in this state if such compensation is excluded from state source income pursuant to [cite to Nonresident Compensation, Exclusion], without regard to [cite to Nonresident Compensation, Exclusion, § (1)(a)].

(2) An employer that has erroneously applied the exception provided by this section solely as a result of miscalculating the number of days a nonresident employee is present in this state to perform employment duties shall not be subject to penalty imposed under [cite to withholding penalty provisions] if:

(a) the employer relied on a regularly maintained time and attendance system that (i) requires the employee to record, on a contemporaneous basis, his or her work location each day the employee is present in a state other than (A) the state of residence, or (B) where services are considered performed for purposes of [cite to state unemployment insurance statute], and (ii) is used by the employer to allocate the employee's wages between all taxing jurisdictions in which the employee performs duties;

(b) the employer does not maintain a time and attendance system described in subsection (a) and relied on employee travel records that the employer requires the employee to maintain and record on a regular and contemporaneous basis; or

(c) the employer does not maintain a time and attendance system described in subsection (a), or require the maintenance of employee records described in subsection (b), and relied on travel expense reimbursement records that the employer requires the employee to submit on a regular and contemporaneous basis.

(3) This section establishes an exception to withholding and deduction requirements and has no application to the imposition of, or jurisdiction to impose, this or any other tax on any taxpayer.