



MULTISTATE TAX COMMISSION

Working Together Since 1967 to Preserve Federalism and Tax Fairness

**To: Robynn Wilson, Chair
Members of MTC Income & Franchise Tax Uniformity Subcommittee**

From: Shirley Sicilian, General Counsel

Date: November 5, 2010

Subject: Model Mobile Workforce Statute

I. Background

A. The Problem to be Addressed

As you know, a fundamental policy of both state and federal taxation is that income is taxable in the jurisdiction where it is earned. And standard administrative practice by both state and federal jurisdictions is to require businesses to withhold individual income tax if their employees earned income there. Most states require employees to report all income, wherever earned, to their state of residence; but then allow a credit for taxes paid to these other states where the income was earned. Federal legislation, H.R. 2110, has been proposed to address the perceived complexity and burden on employers that routinely send employees to multiple states for short periods. H.R. 2110 would eliminate filing, reporting and payment requirements to states where employees were present for short periods.

Many states have recognized that this standard practice poses some challenge for businesses and their employees when the employees earn income in multiple jurisdictions. At its May 2009 meeting, the Executive Committee asked the Uniformity Committee to develop a model that will address these challenges for states that wish to do so. The project is expedited because the model is intended as an alternative to H.R. 2110. The problem with H.R. 2110 is that it would work by creating a federal pre-emption of state taxing jurisdiction. The Uniformity Committee was charged with developing a model state-level solution to these challenges that does not involve federal preemption.

B. The Process to Date

At its July 2009 meeting, the Uniformity Committee formed a small drafting group of five states (Idaho, Colorado, Montana, New York, and California) to create a list of relevant policy questions. The drafting group held two teleconferences in August of 2009 and produced a policy question 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. Based on the

Subcommittee's policy choices, staff produced a draft model statute which was discussed and further amended by the Subcommittee at four in-person and teleconference meetings. On March 22, 2010, the Uniformity Committee recommended its model Mobile Workforce statute to the Executive Committee, and on April 7, 2010, the Executive Committee approved the model for public hearing. At the hearing, public comment was received from Council on State Taxation; the Massachusetts Department of Revenue; the Missouri Department of Revenue; and the Montana Department of Revenue; and Boerio & Company, CPAs. On May 18, 2010, the hearing officer submitted a report to the Executive Committee, with recommendations for changes. On May 21, the Montana Department of Revenue provided additional comments to the Executive Committee, expressing concern with the model and recommending that the model be sent back to the Uniformity Committee.

On May 24, 2010 the Executive Committee voted to:

- (1) Adopt the hearing officer's recommendations, and
- (2) Send the revised proposal to Uniformity Committee for further consideration in light of the Montana comments.

II. The Current Draft Model

The modified proposal as approved by Executive Committee is in attachment A. Its basic structure is:

- ***20-day de minimis threshold for withholding and non-resident individual income tax.*** Under the model, an employer is not required to withhold a non-resident employee's wage income for a state if the employee spent less than 20 work-days there and did not fall into one of the exceptions. Likewise, the employee is not 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.
- ***Jurisdiction retained.*** Both the individual income and the withholding provisions include an explicit statement that these exceptions have no application to the imposition of, or jurisdiction to impose, this or any other tax on any taxpayer.
- ***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, and (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 (in general, a "key employee" is a person who is one of the 50 highest paid officers and had a salary of at least \$160,000(indexed to inflation)).
- ***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.

- **Reciprocity.** The withholding and individual income exemptions are contingent on enactment of substantially similar exemptions in the non-resident employee's home state.

III. An Alternative Approach

On June 10, 2010, the Montana Department of Revenue provided an alternative proposal. The basic structure of the Montana Proposal is:

- **20-day de minimis threshold for withholding only; Information reporting required.** The 20-day work day threshold would apply for withholding – including the exceptions, safe harbor provision, and reciprocity requirement – but in addition:

- a provision for related party aggregation would be included.
- the benefits of that 20-day work day threshold would be reserved for those employers who annually apply for the exemption and file an annual report with the state detailing the number of days spent in the state by each employee, including those with less than 20 days in the state as well as those with more than 20 days in the state.

- **States would determine their own income tax filing thresholds but centralized electronic tools would be provided for non-residents.** Nonresidents would not have a separate, day-based threshold, but each state would retain its standard filing thresholds (most of which are applicable to residents and nonresidents alike). Centralized electronic tools (web site) would be developed to enable employees to easily determine whether they have a filing obligation in a state in which they worked during the year.

IV. Issues and Options for Uniformity Committee Consideration

The Income & Franchise Tax Uniformity Subcommittee asked that a Drafting Group be formed to develop a list of issues and options for the Subcommittee's consideration. The drafting group consists of Bruce Langston, CA-FTB; Phil Horwitz, CO; Brenda Gilmer, MT; and staff, Shirley Sicilian. The following are the Drafting Group's list of issues (which are primarily those that were raised by Montana or in response to those raised by Montana) and options.

A. Issues

Treating residents and nonresidents differently

A work-day income tax threshold could excuse some nonresident wage earners with no other income in the state from filing, even though the non-resident would have otherwise met the state's standard filing threshold that is applicable to all residents and to non-residents that do have other income in the state. Does this difference create unacceptable inequities?

Are there administrative considerations and benefits for either taxpayers or the state that would outweigh any real or perceived inequity concerns of providing a special rule for nonresident wage earners (see “complexity” discussion, below)?

To what extent are inequity concerns resolved by the fact that the non-resident individuals are not excused from tax entirely, but will pay it (if imposed) to their state of residence?

To what extent are inequity concerns addressed by the reciprocity provision?

Has this balance of competing policy concerns already been determined by many states, given that the same outcome results from the numerous border-state reciprocal agreements that exist today? Or, is the fact that border-state reciprocity agreements also typically provide for information exchange between the party states something that motivates, or at least tips the balance, in the case of border state reciprocity agreements?

Compliance

Do withholding thresholds in general create an incentive for employers to organize into multiple entities in order to allow the employer to avoid the threshold by shifting employees among the multiple entities, and making it easier for the non-resident employee to avoid complying with whatever the individual income tax filing threshold is? Should related employers be required to be aggregate employee information to address this incentive?

Would requiring aggregation of related employers reduce the ability for claims of “residency” in states that have no income tax?

Would requiring aggregation of related employers lead to fewer claims of residency in different states for different purposes (such as in-state tuition, hunting licenses, etc.)?

Does the model sufficiently address burden of proof? Is it clear that the employer has the burden of proving that withholding is not required because an employee has not spent the requisite time in the state? Given the difficulty of proving a negative, has the burden of proof essentially been shifted to the state to prove that an employee has exceeded the work-day threshold? Could an employer who maintains no records about where its employees are defeat a state’s effort to require withholding?

Complexity

Do either of the proposals effectively address the concerns that prompted the federal legislation? The federal law was proposed because of the perceived complexity and burden on employers that routinely send employees to multiple states for short period, and would eliminate filing, reporting and payment requirements to states where employees were present for short periods.

Does the 20 day rule for individual income tax introduce additional complexity into a state’s income tax system by requiring it to manage multiple income tax filing thresholds?

If so, is any such complexity for the state outweighed by the increased simplicity for the bulk of nonresident employees who will spend only a few work-days in the state and who would otherwise have to determine whether and how much of their income is properly sourced to each non-resident state that they visited on business? Does relying on employee income thresholds require more complex calculations and evaluations by the employee and/or employer – e.g., a higher income employee may have to file a return in the traveled-to state while colleagues on the same project might not? Whether income threshold are exceeded may not be known until the end of the tax year, after the work was performed and the decision was made whether or not to withhold for that state. Could employees thus be faced with a foreign state tax liability for which no prepayment has been made to that state?

Is any such complexity for the state outweighed by the avoidance of administrative or compliance problems that could result from a mismatch between withholding and non-resident individuals filing requirements?

Consistency with other MTC Proposals

Is the 20 day presence test inconsistent with the established position of the Multistate Tax Commission regarding physical presence filing thresholds for business activity taxes? The Commission has recommended that states adopt a filing threshold for business activity taxes based on the presence in the state of more than a *de minimis* amount of the standard apportionment factors: property, payroll (employees) and sales. The Commission has opposed *de minimis* tests that rely solely on physical presence in the state.

B. Options

1. Options regarding whether or not to include a work-day *de minimus* provision for individual income tax -
 - a. Retain the model work-day *de minimus* provisions for both individual income tax and withholding
 - b. Modify the model to delete the work-day *de minimis* exemption for individual income tax (and rewrite the current work-day *de minimis* exception for withholding as a stand-alone statute), OR
 - c. Modify the model to present states an option of either adopting both the work-day *de minimis* individual income tax and withholding provisions or just the *de minimis* withholding provision
 - i. Rewrite both the *de minimis* individual income tax and withholding provisions so that states could choose to either adopt both or to adopt just the withholding provision on a stand-alone basis, OR
 - ii. Leave the model as is for states that wish to adopt both the *de minimis* individual income tax and withholding provisions, but

add an additional model for states that wish to adopt a withholding provision on a stand-alone basis.

2. Other possible additions –
 - a. Require aggregated day count for related employers.
 - b. Require employers to annually apply for the exemption and file an annual report with the state detailing the number of days spent in the state by each employee, including those with less than 20 days in the state as well as those with more than 20 days in the state



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MTC Model Mobile Workforce Statute

**Showing Recommendations of the Hearing Officer
Adopted by the Executive Committee
May 24, 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.