In July, 2009 the Multistate Tax Commission’s Uniformity Committee began developing a model state statute on withholding for multistate employees. The model is intended as a state level alternative to proposed federal legislation.\(^1\) The problem with the federal legislation is that it would work by pre-empting states’ jurisdiction to tax individual income based, in part, on the amount of time an individual is physically present in the state. This would set an unfavorable precedent that could be easily applied to any other state or local tax.

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

Following the November teleconference, MTC staff produced a **draft model statute (Attachment D)**, based on the Subcommittee’s preliminary policy choices, for the Subcommittee’s consideration at its December 2, 2009 in-person meeting. Once the Uniformity Committee approves a draft, it will then be considered by the Commission’s Executive Committee for public hearing, and possible further amendment. Our goal is to produce a draft for consideration by the full Commission in late July, 2010.

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I. Application of the Rule:

A. Should the rule address (1) the employee’s responsibility to file (i.e., the state’s exercise of jurisdiction), and thus obviate the employer’s responsibility to withhold, or (2) only the employer’s responsibility to withhold, and leave open the employee’s responsibility to file?

- The draft model should provide a filing exemption for multistate employees whose only connection to the state is employment related activity that falls below a certain de minimus threshold.

- Under the draft model, an employer would have no responsibility to withhold wage income for an employee whose employment related activity falls below the de minimus threshold.

B. Should the rule address local, as well as state, income tax withholding?

- The draft model should address state income tax withholding, showing optional language for states that wish to include local income tax withholding under the same rule.

C. Should the rule include a reciprocity provision to encourage enactment?

- The draft model should include a reciprocity provision.

- The draft model should explicitly preserve existing reciprocity agreements.

II. Specifics of the Rule – the threshold:

A. Should the threshold be stated in terms of:

   1. Time?

   - The draft model should be stated in terms of time.
a. The number of days the employee is present in the state – 10, 30, 60?

   ➢ The first draft model should reflect a threshold of 30 work days.

b. How should a “day” be calculated?

   i. Preponderance of a day or any part of a day?

      ➢ Any part of a day should count as a day, unless the employee is in more than one nonresident state, then the state where the most time is spent should be attributed the day. A nonresident state does not include the state where the employee “performs services” for purposes of state unemployment insurance law (see summary of typical state UI provision, attachment B)

   ii. Include travel time to, away from, and/or through, the state?

      ➢ An employee is not present in a state if his or her only activity in the state is travel.

2. Income?

   a. Only income subject to withholding or including income from other sources, such as intangibles and real property?

   b. Only such income as is attributable to the state or all such income?

      ➢ The draft model should not include a specific income threshold.

      ➢ There should be an exception to the de minimus threshold for a category or type of employee that could be expected to be a high-income employee (see Policy Question II.B.)

3. Some combination of both? (e.g., no requirement to withhold if employee is in the state for less than 10 days AND has/had wage income below $100,000/year)

      ➢ The de minimus threshold should be stated in terms of time only, with an exception that would generally include high-income employees. See Policy Question II.B.

B. Exceptions?

1. Professional entertainers?

      ➢ Yes, the draft model should include an exception to the de minimus time threshold for professional entertainers.

2. Professional athletes?

      ➢ Yes, the draft model should include an exception to the de minimus time threshold for professional athletes.
3. Certain public figures?

- Yes, the draft model should include an exception to the de minimus time threshold for certain public figures.

4. Others?

- Yes. An exception should be added to generally include categories or types of employees that could be expected to be high-income employees. Staff should provide some language for consideration. (Staff provided language that references the “key employee” reports required under IRC § 416 (i) for deferred compensation purposes, the definition of “high-income taxpayer” for COBRA purposes. See attachment C for background on these provisions. Staff also provided language for a dollar threshold based on past year’s compensation.)

III. Scope of the Rule – beyond the threshold?

A. Should the rule address wage income sourcing? If so,
   1. should the wage income sourcing rule apply only for determining whether the threshold is met, OR
   2. for determining both whether the threshold is met and where the income is attributable for withholding and personal income tax purposes? If the latter,
      a. If an employee is present in a state, but the threshold is not met, should the income that would otherwise be attributed to the state of presence be attributed instead to the state of residence or to the state that is the base of employment?
      b. Other issues?

- No.

B. Should the rule address issues of evidence?
   1. Should the rule specify which records will (or may) be relied upon (employee, employer, or both)?
   2. Other?

- Yes. A safe harbor from penalties should be provided. The safe harbor should allow the employer to rely on (1) a time and attendance system, (2) employees travel records, or (3) employee travel expense reimbursement requests – in that order.

C. Should the rule address (or explicitly state that it does not address) issues of employer nexus for either withholding or any other business tax?

- Yes.
Attachment B – Definition of state where services performed if other than state of residence.

Most states unemployment insurance law determines where services are performed using the following hierarchy:

1) Localization. This refers to where the services are performed. The services are localized within the state and reportable to the state when:
   - The services are performed entirely within the state.
   - Most of the services are performed in state and individuals work outside the state only at minor or temporary tasks. Some factors to consider when determining if the services of the worker are minor or temporary are:
     - The employment relationship between the employer and employee, particularly the intention of the employer with respect to the individual’s present and future employment status.
     - Whether it is intended by the employer and the employee that those services performed in another state are isolated transactions or a regular part of the employee’s work.
     - Whether the agreement provides that the employee will return to the original state or will continue to work in other states.
     - Whether the assignment is temporary and of predetermined short duration with no change of residence. If a temporary assignment extends over a considerable period of time to the point it appears to be a permanent assignment, the state the wages are reported to should be re-evaluated.

2) Base of Operations. If an individual’s service is not localized in any state, it is necessary to apply a second test to determine the state where wages should be reported.
   - Does the individual perform some services in the state where he or she has a base of operation? The base of operation is a fixed center, of a more or less permanent nature, from where the employee starts work and to where the employee customarily returns to receive instructions from the employer, or communications from customers or other persons, or to replenish stock and materials, to repair equipment or to perform any other functions necessary to his or her trade or profession.
   - If the employee performs services in the state where the employee has a base of operation, all wages, including wages earned in other states, is reportable to the state with the base of operations.

3) Place of Direction and Control. If the employee has no base of operations, or has a base but does not perform any service in the state where the base is located, or if the base of operations moves from state to state, it is necessary to determine if any of the individual’s services are performed in the state where the employee’s services are directed or controlled.
   - The place where an individual’s services are directed or controlled is the place where basic authority resides and where general control originates, rather than the place where a manager or foreman may directly supervises the services. If services are performed in the state where general control is held, the services are reportable to that state.

4) Residence of Employee. If none of the other tests apply, all of the individual’s services are reportable to the state where the employee lives, provided some of the employee’s services are performed in that state.
Attachment C – Definition of High Income Individuals

Based on Deferred Compensation.

All publicly traded companies calculate a list of the top 50 employees in order to comply with the deferred compensation rules under Sec. 409A of the Internal Revenue Code. The top 50 specified employees must be identified as of December 31 of each year.

The specific rules for identifying the top 50 key employees are set forth in Section 416 (i) of the Internal Revenue Code. These rules are complex, but basically an employee would be considered a key employee if:

1. The employee is an officer of the employer with compensation in excess of $130,000 (adjusted for inflation, this limit is $150,000 in 2008),
2. The employee is a five-percent owner of the employer, or
3. The employee is a one-percent owner of the employer with compensation in excess of $150,000, and
4. no more than 50 employees would be considered key employees.

Note: under the existing law's aggregation rules, commonly controlled groups of corporations are considered to be a single taxpayer.

Based on COBRA.

The American Recovery and Reinvestment Act of 2009 makes changes to COBRA continuation premium payment requirements, effective for most plans March 1, 2009.

The Act provides a federal government subsidy of COBRA continuation premiums for a maximum of 9 months for certain individuals who are COBRA qualified beneficiaries because of a covered employee’s involuntary termination of employment. The federal government will subsidize 65% of the COBRA premium actually charged to an “assistance eligible individual” (AEI) for up to 9 months. But any AEI who is a “high-income individual” or the spouse or dependent of a high-income individual will be required to repay the subsidy as an additional tax (“recapture tax”) on the high-income individual’s individual tax return for the year in which the subsidy was provided.

A “high-income individual” is defined for purposes of the Act as a single taxpayer with modified adjusted gross income in excess of $145,000 or a married taxpayer filing jointly with federal modified adjusted gross income in excess of $290,000. The modified adjusted gross income for this purpose is adjusted gross income determined without regard to Code §911 (relating to U.S. citizens or residents living abroad), Code §931 (income from sources in Guam, American Samoa, or the Northern Mariana Islands), or Code §933 (income from sources in Puerto Rico).
Attachment D – Draft Model

INDIVIDUAL INCOME TAX

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

(1) Compensation 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, and
   (b) the nonresident was present in this state to perform employment duties for not more than [30] days during the tax year in which the compensation was received.

(2) This section shall not apply to compensation received by:
   (a) a professional athlete, who performs services in a professional athletic event, provided that the compensation is received for performing services in his or her capacity as a professional athlete;
   (b) a professional entertainer, who performs services in the professional performing arts for compensation received on a per-event basis, provided that the compensation is received for performing services in his or her capacity as a professional entertainer.
   (c) a person of prominence who performs services for compensation on a per-event basis, provided that the compensation is received for services provided at a discrete event in the form of a speech, similar presentation or personal appearance,
   (d) a person who was identified as a key employee on any report filed prior to the current tax year pursuant to Section 416 (i) of the Internal Revenue Code, for purposes of deferred compensation under Section 409A of the Internal Revenue Code,
   (e) a person who received compensation of $100,000 or more from any one employer for each of the two preceding tax years, or
   (f) a single taxpayer with modified adjusted gross income in excess of $145,000 or a married taxpayer filing jointly with federal modified adjusted gross income in excess of $290,000, determined in accordance with the federal Consolidated Omnibus Budget Reconciliation Act (COBRA) ), Pub. L. No. 99-272.

(3) For purposes of this section, a nonresident who is present in this state for any part of a day shall be considered present for that day. A nonresident who is present in this state and one or more other states for any part of a single day shall be considered present in this state for that day if the time spent in this state is greater than the time spent in each of the other states. Provided:
   (a) a nonresident shall not be considered present in a state, including this state, if such presence is purely for purposes of transit through the state.
   (b) a nonresident shall not be considered present in another state if that state is (i) the state of residence, or (ii) where services are considered performed for purposes of [cite to state unemployment insurance statute].
(4) This section shall not supersede, or prevent the renewal of, any agreement with another state authorized pursuant to [cite to Code section that allows reciprocity agreements], which was originally entered into prior to [effective date of this section].

- **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 a 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 this or any other taxpayer.

**WITHHOLDING TAX**

- **Withholding from Compensation, Exception**

(1) No amount is required to be deducted or retained from compensation paid to a nonresident of 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) and (1) (f)]. For purposes of [cite to Nonresident Compensation, Exclusion § (1) (e)], an employer need only take into account the compensation it paid to its nonresident employee.

(2) For purposes of this section, an employer shall not be subject to penalty imposed under [cite to withholding penalty provisions] if:
   - (a) the employer has 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) if the employer does not maintain a time and attendance system described in subsection (a), the employer may rely on employee travel records that the employer requires the employee to maintain and record on a regular and contemporaneous basis;
   - (c) and if the employer does not maintains either a time and attendance system described in subsection (a) or require the maintenance of employee records described in subsection (b), the employer may rely 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 this or any other taxpayer.