MULTISTATE TAX COMMISSION

MINUTES
Income & Franchise Tax Uniformity Subcommittee Meeting
Wednesday, September 9, 2009
2:00 – 3:30 Eastern Time
Via Teleconference

I. Welcome and Introductions

Chairman Wood Miller convened the meeting. The following persons were in attendance via conference call:

Name:	Organization:	Name:	Organization:
Andrew Glancy	West Virginia DOR	Eric Smith Janelle Lipscomb Deborah Buchanan	Oregon DOR
Scott Mezistrano	Am. Payroll Assoc.	Bob Montellione	Prudential Financial
Cotsukas (?)	CT DOR	Helen Hecht	Fed. Tax Admin.
Joe Crosby Todd Lard Jim Eads	COST	Wood Miller	Missouri DOR
Brian Meister	PWC	Shirley Sicilian Sheldon Laskin Bruce Fort Ken Beier	MTC
Jennifer Hays	Ky. Legislature	Reva Tisdale Ted Spangler	Idaho Tax. Comm.
Richard Cram	Kansas DOR	Dan Young	TEI
Donita Wald Miles ? Mary Loftsgard	North Dakota DOR	Stuart Binke	Michigan Treasury Dep't.
Dianne Smith Steve Krantz	Sutherland	Dan Armer	New Mexico TRD
Lili Crane	Wisconsin DOR	???	PCI
Tom Atchley	Arkansas DFA	Terri Frederick	Sprint
Valery Newsom Kim Ferrell	Utah State Tax Commission	Bruce Langston	CA FTB

Jamie Fenwick	**Time Warner Cable**	**Bruce Fatale**	**MA**

II. Public Comment Period

Todd Lard, noted that COST and the American Payroll Association (APA) have provided a "briefing book" that contains their comments and background information, and that Joe Crosby (COST) and Scott Mezistrano (APA) are available to make public comments and answer questions during the call.

III. <u>September 9, 2009</u>

A. Model Mobile Workforce Withholding Statute

1. Staff Review and Update

Shirley Sicilian noted that the MTC Executive Committee directed that this project was to be conducted on an expedited basis. The problem to be addressed by the project is that there are currently no uniform state laws that govern when an employer needs to withhold income tax from an employee for income earned in a state other then the employee's residence. The lack of uniform withholding rules creates tax compliance difficulties for the employer when an employee earns income in multiple states. Ms. Sicilian noted that information from the APA shows twenty-one states do not state a "safe harbor" minimum withholding threshold while sixteen states have established withholding thresholds. These thresholds are expressed either in terms of minimum days of employment in the state per year, a minimum amount of earned income per year or some combination of the two. Business groups have a strong interest in addressing the lack of uniformity through federal legislation which would preempt state authority to tax unless certain conditions were met, such as residence or presence in a state in excess of 30 days per year,. Under the proposed federal legislation, certain highly compensated individuals, such as athletes and entertainers would be excluded from the statutory safe harbors. As a response to the proposed federal preemption of state taxing authority, the MTC Executive Committee in July directed that this project prepare a state-level alternative to federal preemption, on an expedited basis. A work group was formed, consisting of Ted Spangler (ID), Phil Horowits (CO), Bruce Langston (CA), CA Daw (MT), and Rob Plattner (NY). As an initial project task, the Subcommittee asked the work group to prepare a policy checklist. The work group has prepared the checklist for consideration and guidance by this Subcommitte in preparing a first draft of a model statute. In addition, COST and APA submitted joint comments to the checklist questions for consideration by this Subcommitee, as well as additional information and data regarding current withholding practices..

2. Public Comment

3. Committee Discussion of Policy Checklist

Item I.A. (Employee's obligation to file)

Joe Crosby expressed COST's view that employees' income tax liability must be addressed simultaneously with the withholding issue. COST's members believe that addressing the withholding issue alone will not provide a solution to the problem of income earned in non-residence states. Furthermore, state reciprocity agreements for withholding provide a precedent for the underlying income tax liability determinations. The APA concurred in this view.

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Mr. Spangler asked what the rule should be if a non-resident employee has earned income in a state below the withholding threshold, but non-wage income brings that employee above the state filing requirement. Mr. Lard indicated that COST's members have no strong feelings on the issue and that it is probably not a big issue. Perhaps there should be no withholding obligation in that situation. Mr. Mezistrano expressed the view that wages should be considered without regard to other income. Mr. Crosby concurred. Mr. Spangler asked what if an individual has multiple employers in a non-residence state, no one of whom pays more than the threshold?[1] Mr. Lard is not sure this needs to be addressed in the model rule. In addition, he thinks most such people would be independent contractors, not statutory employees. Mr. Spangler asked whether COST agrees that in such multiple-employer cases, the employee should be liable even if the employer withholding threshold has not been exceeded. Mr. Lard agreed. Ms. Gilmer stated that she is opposed to limiting the states' jurisdiction. At least one state requires a non-resident employee declaration to the employer that states how much time the employee anticipates working in the state. She is of the view that the employer can rely on this. Ms. Gilmer asked whether business would consider this to be a good solution. She also suggested centralized reporting of such a declaration, perhaps through the FTA. Mr. Crosby thinks this would raise political concerns among business groups. Mr. Mezistrano feels that this is a minor problem and business may not want to report to yet another body. Ms. Sicilian stated that if the states adopt a model threshold limit, it would be a de minimis rule reflecting a choice not to exercise jurisdiction, not a concession that there is no jurisdiction. She also notedd that Ms. Gilmer's suggestion makes a threshold unnecessary – the employer can rely on the employee declaration.

Mr. Spangler asked what do the states think of question I.A.? Mr. Cram stated that Kansas is flexible on the issue. Mr. Spangler asked whether the residence state would be able to tax if the non-resident state were preempted? Mr. Crosby replied in the affirmative. Mr. Langston felt there would be large compliance problems if the rule were limited to withholding and did not include provisions for income tax liability. Ms. Wald (ND) felt that the rule should address both issues. Colorado, Oregon and Kansas agree.

I.B (local income tax withholding): Mr. Crosby stated that local jurisdictions should follow the state rule, but this could be optional. Mr. Spangler asked if business would still have a problem if the local jurisdictions were not required to follow the state rule. Mr. Crosby said that the local issues are not significant since not many local jurisdictions tax non-residents. Ms. Wald asked how many local jurisdictions impose an income tax. Mr. Mezistrano stated that there are many in PA, OH, KY and Indiana. Mr. Miller asked if an interstate employee should be treated differently under the rule than an intrastate employee. Mr. Crosby would limit the rult to interstate employees**.** Ms. Wald stated that the rule should be limited to state-level withholding. Colorado concurred.

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[1] This is not uncommon in the construction industry, for example.

I.C. (reciprocity): Mr. Crosby stated that ideally, the rule should apply to all non-residents. But reciprocity agreements can supply political cover and should be included as an option. Mr.Mezistrano said that the rule would not supersede existing reciprocity agreements. (example, IL and Wisc.) Ms. Gilmer would couple a reciprocity provision with centralized reporting. Mr. Horowitz would leave the issue of whether the rule supersedes existing reciprocity agreements to state legislative draftsmen. Ms. Sicilian expressed the view that a reciprocity provision could be included, simply by making clear that any optional reciprocity provision adopted by a state under the rule applies "notwithstanding" existing reciprocity provisions. Mr. Mezistrano agrees. Ms. Sicilian thinks the committee could draft optional reciprocity provision with "notwithstanding" or "not superseding" language. Phil – clarifies that it is ok with him that committee try to draft "notwithstanding" or "not superseding" language. Colorado indicates this is acceptable.

II.A. (How should threshold be stated – time, income or combo): Mr. Crosby stated that COST clearly prefers a time-based withholding threshold, because that is what all income tax liability thresholds are based on. A dollar based withholding threshold would dramatically increase complexity. The residence states always retains authority to tax, so any revenue loss should be a wash. Mr. Horowitz noted that there are revenue implications if the threshold were based on time in-state. He suggests an exclusion from the time-based threshold for highly compensated employees. Mr. Crosby replied that industry strongly prefers a shorter time-based threshold to an exclusion from any time-based threshold for highly compensated employees. He reiterated that the residence state would pick up those high wage employees who fall below a time-based threshold out-of-state. Mr. Mezistrano indicated that payroll systems work best when employees are all subject to the same rules. Ms. Wald asked whether non-wage, employment related guaranteed payments would be subject to withholding. Mr. Crosby replied that under the proposed federal legislation, preemption would be limited to wages. For example, partnership income would not be covered by the statute. Mr. Horowitz stated that guaranteed payments are usually made to individuals who are both partners and employees. He thinks they are treated as wages for federal purposes and are therefore so treated in CO. Ms. Wald (?) said that is not the case in ND. Mr. Mezistrano asked how would an employer know in advance whether any annual threshold will be reached during the course of the year. The employer would be required to make an educated guess at the beginning of the year. Adjustments would be required later in the year, whether the threshold were time- or income-based.. Mr. Horowitz asked how are year-end bonuses treated for an employee who provides services in multiple states. Mr. Mezistrano said that if any of the bonus is attributable to work in a state whose threshold was exceeded, it should be apportioned. The same would be true for taxable moving expense payments. Mr. Langston expressed the view that a time-based threshold is preferable to do an income-based threshold. He would also allow for a grace period – i.e., first 30 days in-state would count for computing the threshold but withholding would only be triggered for in-state employment after the threshold was reached. Mr. Crosby indicated that a grace period doesn't work if the employee works out-of-state every day during the year. Mr. Horowitz Suggested a safe harbor could be allowed if the employee reasonably believes at the beginning of year that the threshold will not be exceeded. Ms. Gilmer inquired what do other states think about the lack of a dollar threshold for highly-paid professional service providers. She said that MT would never find these employees based on time-based thresholds alone. Oregon has not thought this through and felt the issue should be further discussed. Oregon would define "day" as any part of a day. Mr. Spangler commented that could result in a year exceeding 365 days. Mr. Crosby stated that COST prefers a day to be

defined as the preponderance of a day, but would accept any part of a day. He reiterated that this is just to determine the threshold for withholding, not for sourcing the income. Mr. Cram stated that he finds the industry arguments for time-based thresholds compelling, but the issue of highly compensated employees should be further considered. Mr. Spangler noted that the proposed federal law does exclude highly-paid athletes, entertainers, etc., from time-based thresholds and wondered why this is. Mr. Crosby said this is mainly because the states already have a good handle on this issue. He also noted that athletic and entertainment schedules are determined well in advance, which eliminates the necessity to speculate as to future employment out-of-state. Ms. Sicilian noted that the rules for entertainers, athletes, etc are not "exemptions" but "exceptions" because the starting point is that states can tax income where earned, so it is the threshold that is the "exemption." The entertainers, athletes, etc. are an "exception" to the "exemption" – they are held to the general rule that liability exists where income is earned. High income earners could be included in these exceptions, and thus could continue to be held to the general rule. Mr. Smith noted that there are federal restrictions on withholding and Oregon currently has filing thresholds. He asked how the current project l relates to existing restrictions? Mr. Crosby said that most of the existing state requirements are based on filing thresholds, which tend to be very low. Mr. Mezistrano said that the typical state filing threshold is so low that as a practical matter, there really isn't a threshold at all because they are so easy to exceed. Mr. Crosby expressed the opinion that the vast majority of employers don't currently comply because it is essentially impossible to do so. He and Mr. Mezistrano stressed the importance of ease of ease of compliance with any uniform rule.

B. New Business - Directives from Executive Committee

1. (a) Project - Compact Article IV Amendments

Ms. Sicilian reported that the UCL has dropped its UDITPA project. The MTC Executive Committee has now directed the Uniformity Committee to move ahead with its Article IV project. Staff will be putting materials together by the next committee teleconference. The Committee will begin to work on the materials at its December meeting.

(b) Consideration – Model Combined Reporting Amendment

The Organization for International Investment has asked the MTC to look at waters-edge apportionment again. The Committee will consider the request at its December meeting..

2. Public Comment

Ms. Smith stated that it would be useful for the public to see a draft Article IV proposal before the October teleconference..
Ms. Sicilian said that staff is just going to walk the Committee through the materials during the October teleconference in preparation for the December meeting. She does not anticipate any extended discussion or decisions in October. The committee discussion will take place in December in Alabama.