Non-Resident and Mobile Workers: State Tax Traps for Employers

THURSDAY, APRIL 23, 2015, 1:00-2:50 pm Eastern

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Non-Resident and Mobile Workers: State Tax Traps for Employers

April 23, 2015

Mary Jo Dolson
Skoda Minotti
mdolson@skodaminotti.com

Debra S. Herman
Hodgson Russ
dherman@hodgsonruss.com

Elizabeth Pascal, Esq.
Hodgson Russ
epascal@hodgsonruss.com
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Tax Traps Arising From Non-Resident and Mobile Workers Seminar

State Tax Nexus Rules
Withholding/Unemployment

Mary Jo Dolson, CPA – Partner Skoda Minotti
Nexus Requirements

- Fundamental requirement of both the Due Process and Commerce Clause of the US Constitution that there be “some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax.”
Nexus Requirements

• Some of the other items the states look to are:
  ➢ Acts of employees and independent contractors.
  ➢ Telecommuting employees
  ➢ Registration for sales tax.
  ➢ Utilization of intangibles in the state
Telecommuting Employees And Nexus

• Can create nexus for
  - Employer – employer taxes, SIT, franchise taxes and sales and use taxes
  - Employee – personal income tax
  - Employee nexus
    – Resident subject to tax on all income in resident state
    – Non-resident subject to tax only on income derived from sources in state
• 36 states and the District of Columbia say income tax nexus would result for an out-of-state corporation with employees who telecommute from homes within their jurisdiction
• 35 jurisdictions report nexus would arise from a single telecommuter who performed back-office administrative business functions
• Is the employee an in-state salesperson? The employee’s activity may still be protected by Public Law.
Once nexus is established an employer must comply with the state laws. What does this mean:

- Employer must
  - Resident withholding – on all resident employees, whether working in the state or not
  - Work site withholding – on earnings from services in the state by a non-resident employee
  - Abide by all state wage and hour laws
  - Pay unemployment
  - Worker’s compensation requirements determine if apply
Withholding Types

• Residency withholding:
  - Generally this is based on where an employee is domiciled. Where the employee lives.
  - Employers may voluntarily do resident withholding for employees even if the employer does not have nexus.
  - Keep in mind a business must have nexus with a state before residency based withholding is required.
  - AZ, DE and RI tax only work site earnings.
• Work site withholding:
  - Based on where the employee works.
  - Need to know where employees work
  - Major exception work site withholding is if you have a location in District of Columbia – withholding must only be done if the employee is a resident of DC. No withholding required for non-residents working in DC.
Withholding Issues

- Federal Statute can also impact state withholding requirements
  - Military personnel and spouses
  - Transportation employees – if in interstate commerce generally residency withholding
  - Ex-pats
  - Distribution from qualified pension plans, and certain deferred compensation plans are taxed where reside
  - Special rules for interstate applications of unemployment and worker’s compensation
Work Site Withholding Issues

• For work site withholding states can require withholding based on different factors
  ➢ De minims time in state working or limited dollars earned from state (sourced)
    – States that require withholding on first dollar and first day or portion thereof: AL, AR, CO, DE, IA, IL, IN, KY, KS, LA, MD, MA, MI, MN, MO, MS, MT, NE, NC, ND, OH, PA and VT
    – ID, NY, OK, OR, SC and WI have limits on dollars earned
    – AZ, CT, NY, GA, HI, ME and NM have various day limits
Employee's Residency

- Generally states look to place of employee’s domicile. States apply a test to determine residency:
  - If present in the state for “other than a temporary or transitory purpose” or if domiciled in the state, but only “outside the state for a temporary or transitory purpose”
  - Some states impose a fixed day count to determine residency
  - While others look to the employee’s intent while away.
  - Employer must rely on W-4 completed by the employee to determine residence.
Residency Exceptions to Withholding

• Some states allow offsetting of work site withholding, so resident withholding applies only if the rate is higher, and then only the excess rate. These states are CA, CT, KS, ME, MA, NE, NJ (but only if all services are outside NJ), NY (many complexities), OH, VT and VA.

• Other states provide for withholding only where the work site state does not have an income tax FL or TX. States following this rule are: AL, AR, CO, GA, ID, LA, MS, MO, NC, ND, OR, PA and SC.

• Need to keep in mind if an employer has no business nexus in the state where the employee lives, resident-based withholding is not required, but work site withholding is required.
Reciprocity Agreements

- Reciprocity agreements between the different states can also impact the requirement for withholding in the different states.
  - Generally comes into play with work site withholding.
  - If employee is a resident of state that the work state has a reciprocity agreement, the employer is not required to do work site employing. Withholding would be done for the resident state.
Currently there are 27 states that do not have any reciprocity agreements in place. These states are the following:

- AL, AR, CA, CO, CT, DE, GA, HI, ID, KS, LA, ME, MA, MS, MO, NE, NH, NM, NY, NC, OK, OR, RI, SC, TN, UT and VT.
Reciprocity Agreements

• Audit Issues
  ➢ If no reciprocity, you still need to determine whether the employee is a resident or non-resident. If non-resident need to use state on-resident claim forms (if state has)
  ➢ If the state does have reciprocity with employees resident state need to make sure employee is completing the correct form.
  ➢ Make sure employee’s address agrees on all forms.
The state of Arizona does not have any reciprocity agreements with any other state but it does have a provision in its statute that can impact employers with non-residents working in Arizona. But only if these individuals are residents of the following states: CA, DC, IN, OR, and VA.

“The Department is authorized to relieve employers from withholding if the non-residents are allowed a tax credit for income taxes paid to their state of residence sufficient to offset the Arizona tax to be withheld”. A non-resident performing services for an employer in AZ may claim an exemption from withholding:

(1) – the employee is a resident of CA, DC, IN, OR or VA and
(2) – the employee is allowed a tax credit for income taxes paid to his state of residency.
What does the rule require?

- When non-resident employees commute to non-resident states to work for an employer, they must pay tax on income earned from these work days spent in the non-resident states.

- To limit a non-resident’s ability to reduce his or her tax liability by working from home, a handful of states have adopted a “convenience of the employer” rule.

- The terms of the convenience rule simply provide that days worked from home would be treated as work days in the non-resident states, unless the non-resident employee worked outside of the non-resident state by necessity.
“Convenience of The Employer” Rule

• Scope of Issue
  ➢ Only a handful of states apply such an aggressive rule.
  ➢ These states include NY, PA, DE, NJ and NE.
  ➢ The impact of the rule can lead to double taxation.
Federal Solution

- Federal legislation has been proposed to help ease the burden/confusion of employee withholding.
  - This will be discussed later in the presentation.
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Tax Traps Arising From Non-Resident and Mobile Workers Seminar

Latest developments and updates of Telecommuting Employees

Mary Jo Dolson, CPA – Partner Skoda Minotti
Telebright Corp. v. Director, Division of Taxation, 25 N.J. Tax 333 (Tax 2010)

- Maryland entity with an employee working out of her home in New Jersey
- Lower Court decided nexus existed because New Jersey employee was working on software code for employees
- Sufficient contact to require Telebright to be subject to New Jersey Corporate Business Tax
April 2012, The New Jersey Superior Court determined that Telebright was subject to New Jersey’s Corporate Business Tax.
Case decided in 2012 which involved a telecommuting employee.

Taxpayer was a Massachusetts corporation that did not have an office in California.

Warwick did have an employee living in California that did consulting and recruiting work from her home.

Franchise Tax Board argued that the maintenance of a single employee in-state provided substantial nexus to justify imposition of California Corporate Income tax.

Company argued they did not have any California employees and they activities of the in-state employee should be protected by P.L. 86-272.

State argued since employee was not soliciting sales but providing a service protection was not available.
Telecommuting Issues

Virginia – VA Public Document Ruling No. 13-203, 11/01/2013 – The Virginia Tax Commissioner ruled that a foreign corporation with one employee in Virginia who performed legal services from her home was required to pay withholding taxes and file a Virginia corporate income tax return. The Commissioner determined that the employee’s activities created nexus for the foreign corporation because the services were performed in Virginia, and legal services generally exceed any protection afforded under P.L. 86-272 unless considered de minimis.
Telecommuting

• Could require registering with the state as an employer, for purposes of income withholding, SUI, workers’ compensation, wage and hour laws.

• Other points to consider:
  ➢ Will employee in state create a corporate income tax liability with the state
  ➢ Is business nexus created which would require withholding on all resident employees – even if they do not work in the state.
Telecommuter issue

- As states start to move to more of an economic nexus the telecommuting employee creates more and more issues.
- These problems are not only from an income tax perspective but also from a sales and use tax perspective
Sales and Use Tax Issues

• During 2012 there were numerous court cases that can impact the nexus requirements of business that has a telecommuting employee located in the state.
• Some of the cases pertained to the utilization of third party agents and independent contractors
• Since sales tax nexus much lower standard easier to create nexus
Sales and Use Tax Issues

- Pending legislation
  - Main Street Fairness Act
  - Marketplace Fairness Act
  - Marketplace Equity Act
  - Business Activity Tax Simplification Act
Main Street Fairness Act

- Originally introduced July 29, 2011 in the Senate
- A companion bill was also introduced in the House
- Congressional hearings were held on July 24, 2012
- No action has been taken on either bill to date
- This legislation is tied to the Streamlined Sales and Use Tax Agreement
- The Main Street Fairness Act authorizes each state that is a party to the Agreement to require remote sellers to collect sales tax
Marketplace Fairness Act

- Was introduced on November 9, 2011
- No hearings have taken place to date
- This legislation is also tied to the Streamlined sales tax agreement
Business Activity Tax
Simplification Act

• Introduced on April 8, 2011
• No hearings to date
• This bill would set forth a minimum standard for imposing state and local income taxes and other business activities.
• 15 day safe harbor
Ohio City Taxation Issue

- Ohio is one of the many states that currently imposes city income tax on businesses doing business in the city.
- Currently very little guidance as to when a business must do employee withholding for individuals working in a city or if the business must file a corporate tax return.
- Legislation is currently pending to address this issue.
- Under current law if an employee works in a city for more than 12 days in a calendar year, the employer must do employee withholding.
- The requirement for withholding is retroactive to the beginning of the year.
- Under current law if an employee works in multiple cities during a day and have met the 12 day rule, the employer must withhold for the different cities where the employee worked that day.
- Ohio has been fighting to enact legislation to ease this burden on employers.
Ohio City Taxation Issue

• During 2014 Ohio finally enacted municipal reform.
• In some eyes the reform did not go far enough. Many feel that Ohio still has a long way to go for complete municipal reform.
• The legislation enacted eases the burden on employee withholding.
• The new legislation is effective 1/1/2016 and changes the 12 day rule to a 20 day rule. It is from the 20\textsuperscript{th} day on that the employer must do withholding.
• If an employee does not meet the 20 day rule, withholding will be done for the municipality where the employers principal place of business is located.
• The legislation also changes the impact once an employee meets the 20 day rule. Once the days requirement is met, withholding is required.
Ohio City Taxation Issue

- The legislation provides relief when an employee works in multiple municipalities during a day.
- The “occasional entrant rule” eliminates the need to withhold municipal income tax for multiple municipalities for the same day. A preponderance of a work day determining where withholding will be required. If an employee travels to eight different cities in a day and the majority of the day is spent in City A withholding will only have to be done for City A if the 20 days has been met.
Ohio City Taxation Issue

• If the employer is operating a construction site or a temporary worksite, and it is reasonably expected that the work at the site will last more than 20 days, the employer is expected to withhold on employee’s wages at these sites from day one. This is to prevent an employer from rotating out employees to avoid the 20 day rule.

• An exemption from the 20 day rule was put in place for small businesses. A small business is defined as business with annual gross receipts of less than $500,000. Any small business is not required to follow the 20 day rule and is only required to withhold municipal tax for their fixed location municipality.
Ohio City Taxation Issue

• When determining the amount of time an employee spends in a particular location, the following are deemed to be performed in the principal place of work municipality:
  - Traveling to the location at which the employee will first perform services or the employer on that day;
  - Traveling from a location at which the employee was performing services for the employer to any other location; Traveling from any location to another location in order to pick up or load, for the purpose of transportation or delivery, property that has been purchased, sold, assembled, fabricated, repaired, refurbished, processed, remanufactures, or improved by the employee’s employer.
Ohio City Taxation Issue

- Transporting or delivering property described above provided that, upon delivery of the property, the employee does not temporarily or permanently affix the property to the real estate owned, used or controlled by a person other than the employee’s employer.

- Traveling from the location at which the employee makes the employee’s final delivery or pick-up for the day to either the employee’s principal place of work or a location at which employee will not perform services for the employer.
Principal Place of Work is defined using a cascading test:

1. The Fixed Location to which an employee is required to report for employment duties on a regular and ordinary basis.
   - Fixed Location means a permanent place of doing business in Ohio, such as an office, warehouse, storefront or similar location owned or controlled by an employer.
   - Cannot be a non-Ohio location.
   - Cannot be a location owned by a customer.
Ohio City Taxation Issue

2. If no Fixed Location exists, then Principal Place of Work means the Worksite Location to which the employee is required to report for employment duties on a regular and ordinary basis. R.C. 718.011(A)(7).

- A “worksite location” is a construction site or other temporary worksite in Ohio at which the employer provides services on more than 20 days during the calendar year.
  - But, a worksite location cannot include the employee’s residence.
  - A worksite location cannot include a location outside
If no Fixed Location or Worksite Location applies, then Principal Place of Work means the location in Ohio at which the employee spends the greatest number of days in the calendar year performing services for or on behalf of the employer.

- Ties: If the greatest number of days spent performing services is the same for two or more municipalities, then the employer must allocate any of the employee’s qualifying wages among those two or more municipalities for withholding tax purposes.
  - Allocations must be made using any fair and reasonable method, including, but not limited to:
    - An equal allocation among the two or more cities; and
    - An allocation based upon time spent or sales made by the employee in each such municipality
Ohio City Taxation Issue

- Withholding would be required for a municipality if the employee seeks a refund from the “principal place of business” municipality for the days worked outside the municipality in other municipalities. There is a requirement to bypass the 20 day rule and municipal withholding is required.

- The 20 day rule does not apply to professional athletes, professional entertainers or public figures.
Non-Resident and Mobile Workers: State Tax Traps for Employers

Potential Federal and Multi-State Solutions

Presented by
Elizabeth Pascal, Esq.
April 23, 2015
Employee Filing and Employer Withholding

The Problem:

- Everyday hundreds of thousands of employees across the country are sent by their employers to work outside their home states.

- Inconsistent standards governing when an employee has to file personal income tax returns and when an employer has to withhold.

- Inconsistent rules for withholding on different types of compensation.

- Practical technological solutions can be costly and may not resolve the problem.

- Pervasive: the problem applies to everyone (large and small businesses, charities, other non-profits, and even governmental agencies).
Employee Filing and Employer Withholding

Why is the Problem Becoming a Crisis?

- Increased enforcement activities by state taxing authorities
- Section 404 of the Sarbanes Oxley Act of 2002
- The internet and the globalization of business
- Ease and increase of business travel
- Difficult economic environment
Federal Legislation:

A potentially uniform solution to state tax withholding, reporting and telecommuting issues
MTC Model Law

- Model Mobile Workforce Withholding and Individual Income Tax Statute (Multistate Tax Commission Uniformity Project)

- Creates threshold of 20 working days in a state before a withholding obligation and a nonresident personal income tax filing obligation arises

- Would not apply to professional athletes, entertainers, “a person of prominence,” construction workers or key employees defined under IRC §416(i)

- Would not affect existing reciprocal agreements between states
The Mobile Workforce and State Income Tax Simplification Act of 2015

Possible Federal Solution—the 30 day rule:

- Employees working in nonresident states for thirty days or fewer remain fully taxable in their resident state for all earnings

- If the employee works more than 30 days in a nonresident state then they have to file income tax returns there

- If the employee works more than 30 days in a nonresident state then the employer must withhold
The Mobile Workforce and State Income Tax Simplification Act of 2015

The Details:

- The 30 day requirement would not apply to professional athletes, professional entertainers, or certain national figures who are paid on a per-event basis to give speeches or similar presentations.

- The employer can rely on an employee’s annual determination of the time spent in a nonresident state absent knowledge of employee fraud or collusion between the employer and employee.

- If, however, an employer maintains a time and attendance system at its discretion, tracking where employees perform their services, then such system must be used instead of an employee’s determination.
The Details (cont’d):

- An employee will be considered present performing duties in a state if the employee performs the preponderance of his or her duties in such state for such day.

- If the employee performs material employment duties in only the employee’s resident state and one nonresident state during a single day, such employee will be considered to have performed the preponderance of his or her duties in the nonresident state for such day.

- The terms “employee” and “wages or other remuneration” are defined by the state in which the employment duties are performed.
A previous Ernst & Young, LLP Analysis of the effect of identical legislation shows a minimal reduction in state tax revenue.

Why such a minimal reduction? The states lose revenue only when the employee works in a nonresident state for less than 30 days and:

1. the employee’s resident state imposes tax at a lower rate than the nonresident state, or

2. a nonresident state tax is imposed on an employee whose resident state does not impose a personal income tax

NY tends to oppose this approach!
The Mobile Workforce and State Income Tax Simplification Act of 2015

Likelihood this Legislation Will Become Law?

- The Mobile Workforce State Income Tax Simplification Act was reintroduced to the U.S. Senate by Sherrod Brown (D-OH) and John Thune (R-SD) on Feb. 24, 2015;
- Identical to the legislation that had been introduced but died in previous Congressional sessions;
- Passed by voice vote in the House in 2012;
- First introduced in 2007 with a 60-day threshold;
Multi-State Worker Tax Fairness Act of 2014

Possible Solution:

- The proposed legislation would require a nonresident individual to be physically present in a state in order for that state to tax the compensation of the nonresident.

- For purposes of determining physical presence in a state, the legislation provides that a state would not be allowed to deem a nonresident individual to be present in or working in a state on the grounds that the individual is present at or working from home for convenience, or the individual’s work at home or office at home fails a “convenience of the employer” test or similar test.

- Moreover, the power to determine whether part of an employee’s time could be characterized as “not normal work time,” “nonworking time,” or “unpaid time” would be left up to the employer, and not the state.
Multi-State Worker Tax Fairness Act of 2014

Limitations of the Law

- If enacted, this legislation would only apply to nonresident individuals in the capacity as employees or independent contractors and only for income tax purposes with respect to earned income.

- The law would not apply to the income taxation of dividends, interest, annuities, rents, royalties, or other forms of unearned income.

- Finally, the legislation would not apply to corporations or other business entities, or to individuals in the capacity of partners, shareholders or beneficiaries.
Multi-State Worker Tax Fairness Act of 2014

Likelihood this Legislation Will Become Law?

- Despite the fact that some version of it has been introduced five times in the past eight years, it has failed to move through the legislative process;

- Last introduced into the 113th Congress in February, 2014;

- Is this legislation even necessary if the Mobile Workforce and State Income Tax Simplification Act of 2015 becomes law?
Possible State Solutions?

Could the States create a workable solution?

- The limitations of bilateral reciprocal agreements;

- Political realities in 50 different states (and some local jurisdictions) seemingly preclude a uniform state solution
Tax Traps Arising From Non-Resident and Mobile Workers Seminar

Unemployment – Workers’ Compensation Issues

Mary Jo Dolson, CPA – Partner Skoda Minotti
Unemployment Tax Issues

- For Telecommuting employees where is the unemployment tax due
  - Resident state
  - Location of entity
  - Non-resident state where performing services
The state where taxes are being remitted to will not have issues – it is the states where you are not remitting unemployment for an employee that will be an issue.

Issues arise when an employee maybe working in multiple states.
• Generally four prong step must go through to determine the proper state for unemployment taxes
• Are the employee’s services localized within a state
  ➢ If it cannot be determined in which state the employee’s services are localized
• Where is the employee’s base of operations located
  ➢ If the employee routinely returns to a location to receive further instructions, contact clients, obtain supplies, and so on, then the employee’s base of operation is in that state.
Unemployment Taxes

• From what location does the employee’s employer exercise basic direction of and control over the employee
  ➢ If the location from which the employer exercises direction of and control over the employee is a state, then that state will have jurisdiction for coverage over the employee’s services.

• If all else fails, where is the employee’s place of residence located
Unemployment Taxes

• If the primary UI state, most states subscribe to the Interstate Reciprocal Coverage Arrangement to resolve where claim lies

• A written request to report wages based on this election. It applies where:
  ➢ Services are performed
  ➢ Employee has residence
  ➢ Employer maintains a place of business if the employee also performs some services in the state
Workers’ Compensation

- Do you need separate coverage in a state for an employee traveling to state for temporary work?
- Many states have reciprocity for workers’ compensation.
  - To apply extra-territorial provisions must be met
  - Generally reciprocity does not apply to the construction industry
Mary Jo Dolson, CPA
Partner, State and Local Tax
MDolson@SkodaMinotti.com

Skoda Minotti Tampa Office
201 E. Kennedy Blvd. Suite 1500
Tampa, FL 33602
813-386-3881
TAX TRAPS ARISING FROM NON-RESIDENT AND MOBILE WORKERS

PARTicular Issues with Withholding Taxes

Debra S. Herman, Esq.
Hodgson Russ LLP
1540 Broadway, 24th Floor
New York, NY 10036
Phone: (646) 218-7532
Fax: (646) 218-7694
dherman@hodgsonruss.com
ISSUES WITH WITHHOLDING TAXES: PUBLIC LAW (P.L.) 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.

- Does not affect an employer’s responsibility to withhold income tax, pay unemployment tax and disability insurance, and cover workers’ compensation. See e.g. VA Public Document 94-192.
EMPLOYEE WITHHOLDING

How do states identify potential audit candidates?

- Withholding tax audits – Focus on travel and entertainment
- Related audits
- Newspapers
- Clever use of databases
WITHHOLDING RULES

Nonresident Personal Income Tax Withholding

Key:
- Red: Nonresident employees subject to tax withholding on first day of travel
- Yellow: Nonresident employees subject to tax withholding after reaching threshold (see Appendix A for details)
- Green: No general personal income tax (or, in the case of Washington, DC, no tax on nonresidents)
TRICKY PROBLEMS

- How do you count a “day”?
- What is the proper denominator?
- Bonuses
- Severance (for past or future services?)
- Stock options
  - New York: Grant to vest
  - California: Grant to exercise
  - Connecticut: Grant to exercise
  - Credits for taxes paid to other states may not sync

- Retirement income – Public Law 104-95
- Special rules for professional athletes, entertainers, public figures & employers involved in the business of interstate transportation
- Rewards for whistle blowers
- IRS information sharing
How do you count a “day”? Any part of a day?

- CT: For purposes of the “14 Day Rule:” Any part of day spent performing services in CT will be considered a full day. CT DOR, AN 2010(3).

Does traveling through the state count?

Exemptions/Safe harbors – applicability to professional athletes, entertainers, public figures, others?

- Speeches? North Carolina: What constitutes a speech for purposes of the 4% withholding? Any speech that amuses, entertains, or informs is subject to the withholding requirement. This includes instructors at seminars that are open to the public for an admission fee or are for continuing education. See N.C. Withholding Tax FAQs, [www.dornc.com/wh_tax/faq.html](http://www.dornc.com/wh_tax/faq.html)

Documentation issues
WHAT IS THE PROPER NUMERATOR & DENOMINATOR?

- Nonresidents: States typically do not require withholding for all of a corporation’s nonresident employees
  - Focus is on “source income”

- What is the numerator?
  - Percentage of services during year performed within the state
    - Days, miles, time or similar criteria
    - Volume of business
  - Certification of Nonresidence and Allocation of Withholding Tax

- What is the denominator?
  - Bonuses, severance
SPECIAL TREATMENT OF STOCK OPTIONS

- Statutory Stock Options
  - Incentive stock options (ISOs)
  - Employee stock purchase plans (ESPPs)
  - Compare state tax rules:
    - NY: Income realization: Conforms to federal (when sold)
      - Allocation formula: Date of grant to date of vest
    - GA: Income realization: Conforms to federal (when sold)
      - Allocation formula: Date of grant to date of vest, but only on or after January 1, 2011
Assume the following: Individual, currently a resident of another state, was granted 1,000 ISOs on July 1, 2010, which are exercisable on June 30, 2012 at a price of $25 per share. Individual vested on June 30, 2012. The fair market value on June 30, 2012 was $35 per share. Individual sold the stock on December 31, 2013 for $50 per share. Individual was a resident of STATE A during the period July 1, 2010 until December 31, 2011, and had 200 total work days for the employer in STATE A during 2010 and 75 total work days in STATE A for the employer during 2011, and had 375 total work days for the employer doing this period. Individual was a nonresident of STATE A during the period January 1, 2012 until June 30, 2012. Individual worked in STATE A for the employer during this period for 25 days and had 125 total work days for the employer during this period.
EXAMPLE CONT’D

- Assume STATE A is New York: Individual must include $6,000 of the ISO income as New York source income. $10,000 (difference between FMV on exercise date and the amount paid on exercise, $35 less $25 x 1000 shares) x 60% (ratio of New York days from grant to vest (200 + 75+25)/500 = 60%

- Assume STATE A is Georgia: Individual must include $2,000 of the ISO income as Georgia source income. $10,000 (difference between FMV on exercise date and the amount paid on exercise, $35 less $25 x 1000 shares) x 20% (ratio of Georgia days from grant to vest, but excluding days prior to Jan. 1, 2011 in numerator of the fraction (75+25)/500 = 20%
STOCK OPTIONS – NONSTATUTORY STOCK OPTIONS

- Generally not receive same favorable timing and character of income treatment as SSOs
- In general, an employee recognizes gain on the grant of non-statutory stock options if the options have a readily ascertainable fair market value.
- More commonly, employees recognize ordinary income upon the exercise of the stock options measured by the excess of the fair market value of the optioned shares over the option exercise price (Compensation Income). Thereafter, the appreciation recognized on the sale of the stock is treated as gain derived from the sale of the stock (Investment Income) and is typically of no concern to the employer.
- States rules for determining the portion of a non-resident’s source income related to non-statutory stock options vary. Below is a sampling of rules involving the allocation of income upon the exercise of non-statutory stock options.

  • Grant to exercise: AZ, CA, CT
  • Grant to exercise, but on or after 1/1/2011: GA
  • Grant to vest: NYS and NYC, ID
  • Compare with “Ohio related appreciation”
Assume on July 1, 2009, while a resident of Texas, Company grants individual NQSOs with no readily ascertainable fair market value. On July 1, 2010, Company permanently relocates Individual to STATE A. On July 1, 2011, the stock options become exercisable. On July 1, 2012, Individual leaves the Company and permanently moves to Florida. From July 1, 2009 through July 1, 2012, Individual worked for the Company a total of 500 days in STATE A and 250 days in other states. The number of days in STATE A from January 1, 2011 through July 1, 2011 is 100 days. The number of days from July 1, 2009 through July 1, 2011 in STATE A is 240 days and in other states 260 days. On August 1, 2012, the Individual exercises the options.
EXAMPLE:

- Assume STATE A is California: The income allocation percentage to CA would be 66.67% (500 CA work days from 7/1/09-7/1/12/750 total work days from 7/1/09-7/1/12)

- Assume STATE A is Georgia: The income allocation percentage to GA would be 20% (100 GA work days from 1/1/11-7/1/11/500 total work days from 7/1/09-7/1/11)

- Assume STATE A is New York: The income allocation percentage is 48% (240 NY work days from 7/1/09-7/1/11/500 total work days from 7/1/09-7/1/11)
SPECIAL RULES

➢ Retirement Income: Public Law 104-95
  • Pensions and annuities
  • Determining residence

➢ Rules for professional athletes, entertainers, public figures & employers involved in the business of intrastate transportation.
  • *See* Nathaniel Moore, NYS Department of Taxation and Finance, TSB-A-89(2)I
EMPLOYER PENALTIES

- Uncollected withholding taxes can trigger personal liability on all responsible persons/officers.

- Several states impose penalties on employers for failing to timely and properly withhold and remit tax:
  - **Civil Penalties**
    - New York: 25% late filing penalty on employers that non-willfully fail to withhold and pay taxes, and 25% late payment penalty; N.Y. Tax Law 685(f)
  - **Criminal Penalties**
    - California: Willful failure to withhold and remit tax is a felony ($2,000 penalty or imprisonment).

- Payment of all personal income tax due by employee is not typically a defense to the assertion of employer penalties.
Unpaid withholding taxes can attach to responsible persons

- **Ohio**: Personal liability for unpaid withholding taxes on employees of corporations having “control or supervision” over withholding and corporate officers who are responsible for the “execution of the corporation’s fiscal responsibilities.” Ohio Rev. Code Ann 5747.07(G)

- **New York**: A responsible person may be an officer, an employee, a director or shareholder of a corporation; a member or employee of a partnership; or some other person with sufficient control over funds to direct disbursement of such funds.

1) New York imposes an additional penalty equal to the tax owed and interest accrued on the non-withheld and/or non-remitted funds. N.Y. Tax Law 685(g).
TAX TRAPS ARISING FROM NON-RESIDENT AND MOBILE WORKERS

ADMINISTRATIVE CHALLENGES AND SOLUTIONS

Debra S. Herman, Esq.
Trends in audit

- States actively auditing employer withholding
  1) New York
  2) Connecticut
  3) Ohio

- States actively auditing employee personal income tax
  1) California
Trends in audit (Cont.)

• What will the auditor look at?

  1) Is withholding performed in the correct state?
     – Review of accounts payable documents
     • Travel records
     – Review of accounts receivable
     • Tracks contracts, and hence employees
Trends in audit (Cont.)

• Are the withholding rates correct?
  1) Some states are actually looking at calculations to determine if they are correct.
     – New York and California
  2) Should supplemental rates have been used?
  3) Do you have the state-equivalent to a W-4?
Trends in audit (Cont.)

- Local taxes
  1) Localities are now looking for revenue.
     - Activity on San Francisco business tax, Ohio, Pennsylvania, New York
     - City of Wilmington, Del., imposes steep penalties and interest.
     - Employee- or employer-based tax
WORKER MISCLASSIFICATION – THE NEW YORK EXAMPLE

• 11/18/13: US Department of Labor Signs Agreements with NY Department of Labor and NY Attorney General’s Office to reduce misclassification of employees.

• New York Joint Enforcement Task Force

  1) Consists of the Department of Labor, Workers’ Compensation Board and Fraud Inspector General, Department of Taxation and Finance, Attorney General, Comptroller of the City of New York

  2) 2013 Task Force Report – up to 10% of workers covered by New York employment audits were misclassified as independent contractors
TAX WHISTLEBLOWERS

- State False Claims Acts/Qui Tam lawsuits
- IRS Whistleblower Program
EMPLOYEE – RELATED CONCERNS

- Failure to file a return may be a crime. See *New York Tax Department Press Release*, June 28, 2012
- Might be a “zero sum game” for many employees
- Statute of limitations concerns
- Recordkeeping: Diaries, travel logs, expense reimbursements
State specific documentation requirements

- NY: An employer cannot rely on withholding tax forms received from employees unless it has a system in place to verify the accuracy of such forms. See N.Y. Audit Guidelines, p. 40.

Implement documentation system
- Obtain and retain state-specific forms
- Audit the documentation system

Implement employee-tracking system
- Audit the tracking system (review expense reimbursements)
- Review accounts payable and receivables

Compliance worksheet (Matrix)
- How many employees in state?
- How often?
- Is there a de minimis rule?
- Are there reciprocal agreements
OTHER PRACTICAL CONSIDERATIONS

- Credit for employee – paid taxes
- Always get state version of W-4
- Structure post-employment relationship
- Voluntary Disclosure or Amnesty
  - Use of MTC or
  - State-by-state filings
- Federal solutions
Thank You.

Debra S. Herman, Esq.
**Hodgson Russ LLP**
1540 Broadway, 24th Floor
New York, NY 10036
Phone: (646)218-7532
Fax: (646)218-7694
dherman@hodgsonruss.com