Tax Report

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Income Tax

District Court Rules Texas Taxpayers Cannot Elect to Use Three-Factor MTC Apportionment in lieu of Texas's Single-Factor Apportionment

In a very closely watched case, a Texas District Court recently held that a taxpayer was not entitled to elect to use the Multistate Tax Compact's optional three-factor apportionment formula but rather was required to use the single-sales-factor formula prescribed by Texas law for purposes of the state's franchise, or margin, tax. Although the court did not provide the reasons for this decision, this article examines the arguments that were advanced by the parties, including as to the threshold issue of whether the Texas tax constitutes an income tax for purposes of the MTC election provision.

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Tax Legislation

State Nonresident Payroll Withholding Rules Present Complexity to Employers That Deploy a Mobile Workforce – Is It Time for a Federal Mandate?

The shift in recent years to a much more mobile U.S. workforce has made it increasingly important for both employers and employees to know the rules governing the taxation of income earned in a nonresident state and the payroll withholding and reporting requirements, which differ substantially among the various states. This article provides a general overview of the nonresident payroll withholding rules and highlights how the lack of uniformity creates complexity for employers that wish to be compliant. The article also discusses legislation under consideration by the current Congress which, if enacted, would limit a state's authority both to tax nonresident employees and to require employers to comply with the state's withholding and information reporting requirements.

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TAX LEGISLATION

State Nonresident Payroll Withholding Rules Present Complexity to Employers That Deploy a Mobile Workforce – Is It Time for a Federal Mandate?

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Introduction

As we move towards a service-based economy, many companies are expanding their multi-state and international footprint. This is often accompanied by the deployment of a mobile workforce. And while both in-house corporate tax professionals charged with state tax responsibilities and external State and Local Tax ("SALT") advisors are quick to note that deploying a mobile workforce into multiple states may create nexus for corporate income, franchise, sales & use, and other entity-level business taxes, many tax professionals are less likely to focus on a company's responsibility to withhold on the wages of employees who perform employment duties in nonresident states. However, as states continue to search for revenue sources and, some would argue, transfer their tax burden to out-of-state business and individual taxpayers, nonresident payroll withholding is an area that employers who wish to be compliant cannot ignore. Unfortunately, as is the case with state laws in general, there is a lack of uniformity regarding when an employer must withhold in nonresident states. While some states provide for either a day or dollar *de minimis* threshold, the majority of states require employers to withhold from the very first day or dollar earned in the state. This lack of uniformity requires employers that deploy a mobile workforce to comprehend and apply a patchwork of state rules. This is one reason federal legislation has been introduced in Congress, which would impose a uniform "days exceeded" threshold before a State could subject a nonresident employee to the state's personal income tax and his employer to the State's nonresident withholding and reporting requirements.

State Nonresident Withholding and the Lack of State Uniformity

When an employer deploys its workforce to states from which it is not based or of which it is not a resident, the employer is required to withhold and remit state income taxes on the wages earned in the nonresident state. This is based on the concept that states are permitted to tax income that has a source in their state.

In general, withholding on the wages of nonresidents is required of an out-of-state employer if the employer "*transacts business*" in the state. States typically define "transacting business" for payroll withholding purposes as "[h]aving or maintaining within the state, directly or indirectly, an office, distribution house, sales house, warehouse, or other place of business, or otherwise operating or engaging in business within this state by or through any agent or other representative under the authority of the employer."[1] Thus, operating or engaging in any activity which is in line with the business of the employer, even if those activities were not sufficient to create "nexus" for corporate income/franchise or other business taxes, would likely be viewed as "transacting business" for nonresident payroll withholding purposes.

Despite this general requirement, some states provide a *de minimis* threshold that must be exceeded before an out-of-state employer is required to begin withholding. However, even in those states which have enacted or administratively provided for a *de minimis* threshold, there is lack of state uniformity as some states require that nonresident withholding begin once the nonresident has performed services in state for a certain number of days,[2] while in other states the threshold is based on a nonresident employee's earnings exceeding a certain dollar amount.[3] To add further complexity, some "threshold" states do not have a "set days" or "exact dollar" threshold that must be exceeded before an employer is required to withhold on the nonresident's wages, but instead base the threshold

[1] *See, e.g.*, Mass. 830 CMR 62B.2.1(2) (definitions).

[2] Although not an exhaustive list, states which permit a reprieve from withholding up until a certain number of days performing service in the state has been exceeded include: Arizona (60 days), Ariz. Rev. Stat. Ann § 43-403(A); Connecticut (14 days), Conn. Dept. of Rev. Services, AN 2010(3); Hawaii (60 days), Haw. Admin. Rules § 18-235-61-04 (b); Maine (10 days), Me. Rev. Stat. Ann. 36 § 5142(8-A); New Mexico (15 days), NMSA § 7-3-3(A)(2); and New York (14 days), NYS Dept. of Tax'n and Fin., TSB-M-12(5)I.

[3] Although not an exhaustive list, states which permit a reprieve from withholding up until a specific dollar amount of in-state wages have been earned include: Idaho ($1,000 in-state wages within a calendar year), Idaho Admin. Rules § 35.01.01.871; Oklahoma ($300 in-state wages in a calendar quarter), Okla. Stat. 68 § 2385.1(e); and Wisconsin ($1,500 in-state wages in a calendar quarter), Wis. Stat. § 71.64(6).

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on the nonresident employee's specific situation. For instance, New Jersey's nonresident withholding rule states that where it is expected that a nonresident employee will work only a short period of time within New Jersey and it is reasonably expected that the employee's total wages for personal services rendered in New Jersey will not exceed the employee's personal exemptions, the employer need not withhold or deduct any amount from the employee's wages until the aggregate amount paid equals or exceeds the exemptions.[4] Thus, an employer is required to have information specific to that employee in order to make a determination as to whether the employer must withhold New Jersey income tax.

Inconsistent Treatment Within a State as to Withholding, Information Reporting and Personal Income Tax Filing

However, even in those states that provide a *de minimis* threshold, the rules regarding when an employer must begin to withhold may not necessarily be consistent with the same state's information reporting requirements or the state's nonresident personal income tax filing threshold. This inconsistent intrastate result can occur for various reasons such as where a state imposes different thresholds for withholding, reporting and filing purposes.

Connecticut, for example, is a "days" threshold state with different rules for nonresident withholding, information reporting and personal income tax filing. According to Connecticut's guidance, articulated in a 2010 Department of Revenue Services ("DRS") Administrative Announcement, AN 2010(3), an employer is not required to withhold Connecticut income tax from the wages paid to a nonresident employee for services performed in Connecticut if the nonresident employee works in Connecticut 14 or fewer full or partial days during a calendar year and is assigned to a primary work location outside of Connecticut.[5]

However, regardless of this general rule, Connecticut AN 2010(3) adds that if an employer expects that a nonresident employee will work more than 14 days in Connecticut during a calendar year, the employer is required to withhold on all wages paid to the employee from the first day earned.[6] Alternatively, if a nonresident employee is *reasonably expected* to work 14 or fewer days in Connecticut during a calendar year, but inadvertently works more than 14 days in the state, an employer would not be penalized for failing to withhold immediately (assuming there was a reasonable expectation of 14 or fewer days in Connecticut). In this situation, the employer would not be required to make a catch-up withholding adjustment, but would be required to commence withholding on wages paid to the nonresident beginning with the 15th day of service in Connecticut.

However, Connecticut's "14-Day" withholding reprieve does not extend to an employer's information reporting requirements. Connecticut AN 2010(3) clarifies that even though an employer is not required to withhold Connecticut income tax from the wages paid to a nonresident employee who works 14 or fewer days in Connecticut during a calendar year, an employer is still *required to report the employee's pre-threshold wages* to Connecticut.[7]

Because an out-of-state employer is required to comply with Connecticut's wage information reporting requirement (even if there was no requirement to withhold under Connecticut's "14-Day" threshold) the reporting of the nonresident's Connecticut wages would likely subject the nonresident employee to Connecticut's personal income tax filing requirements. Furthermore, because the employer was not required to withhold Connecticut income tax, but was required to report those wages to the State, the nonresident could end up with a significant Connecticut tax liability.

As seen in the Connecticut example, even in threshold states that have issued adequate guidance, an employer must still understand how the "rule" works and how it impacts both the employer's withholding and information

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[4] N. J. Rev. Stat. §54A:7-1; N.J.A.C. §18:35-7.2(b); New Jersey Form NJ-WT, page 3.

[5] Connecticut Dept. of Rev. Services, Announcement - AN 2010(3), "14-Day" Withholding Rule for Nonresident Employees (1/11/2010).

[6] For instance, if a nonresident's anticipated annual work schedule is such that the nonresident will likely work in Connecticut three days each month, or 36 days in the calendar year, the "14-Day" rule would not apply and the employer would be required to begin withholding Connecticut tax from the nonresident's wages from the first day in which the employee performs services in Connecticut. Note that this requirement would apply even if the employee ultimately ends up working 14 or fewer full or partial days in Connecticut.

[7] Thus, even if no Connecticut income tax was withheld, employers must report *all* Connecticut wages on Form CT-941, Connecticut Quarterly Reconciliation of Withholding, and in the "state wages, tips, etc." box of federal Form W-2. *See also* Connecticut Form CT-W4NA - Employee's Withholding Certificate Nonresident Apportionment.

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reporting duties. Employees must also understand that their employer's reprieve from withholding does not necessarily translate to a reprieve from filing a nonresident return. Additionally, in other states, a withholding "rule" may be based on informal guidance which fails to address all of the requirements, leaving taxpayers and their advisors to make a determination as to how the state's "rule" should be applied.[8] Another nuance is where a State's withholding rules and personal income tax rules do not consistently conform to the Internal Revenue Code as of the same date, creating potential differences between what a state considers wages for withholding purposes and what it considers wages for personal income tax purposes.[9] One final complexity that employers must comprehend are the rules in certain states where withholding is not required due to a reciprocity agreement between neighboring states.

Finally, not only are state nonresident rules complex, employers that are required to deduct and withhold state income tax from the wages of nonresident employees will generally be liable for the payment of the required tax whether or not it is collected from the employees. State payroll taxes are considered "trustee taxes" whether withheld or not. Therefore, in general, for purposes of assessment and collection, amounts required to be withheld and remitted (and any penalties and interest) are the liability of the employer.[10] Further, for some companies, nonresident state withholding liabilities may represent a FAS 5[11] contingent reserve which must be recorded in accordance with Financial Accounting Standards.

Is a Federal Mandate Needed?

As illustrated in the discussion above, employers must currently deal with nonresident payroll withholding rules that are not uniform from state-to-state and which may also provide a different threshold as to whether and when an employer must withhold state income tax versus when the employer must report those wages. The current structure not only places an undue administrative burden on employers, but subjects employees to the filing requirement in nonresident states as well as to potential exposure for underpaid nonresident state income taxes in situations where an employer was not required to withhold. The lack of uniformity in the state nonresident payroll withholding rules has been the focus of proposed federal legislation that would impose a uniform nonresident payroll withholding threshold on all states.

Currently, there are two companion proposals under consideration by the U.S. Congress. The first of the two proposals, H.R. 1129, was introduced on March 13, 2013, by U.S. Representatives Howard Coble (R-NC) and Hank

[8] A prime example here deals with the New York State Department of Taxation and Finance Withholding Tax Field Audit Guidelines issued on April 5, 2005. In its audit guidelines, the Department directed that its audit division should not make an assessment where an employer failed to withhold on the wages of a nonresident employee who worked in New York 14 or fewer days. Although New York's guidance was not statutory or articulated in taxpayer administrative guidance, it became a common practice for many out-of-state employers to not withhold New York State income tax if they met the audit guidelines' "14-day" rule. However, the audit guidelines did not specifically address the employer's requirement to report the pre-14-day wages. More than seven years after the audit guidelines were issued, the Department finally issued administrative taxpayer guidance in TSM-M-12(5)I, Withholding on Wages Paid to Certain Nonresidents Who Work 14 Days or Fewer in New York (July 5, 2012), which addressed both the withholding and information reporting requirements.

[9] For example, see Mass. 830 CMR 62B.2.1 (3)(c), addressing the differences between withholding requirement and taxability, which states: "Massachusetts withholding law is based on the current [IRC], while taxation of income is generally based on the [IRC] as of a certain date. Because of these differences between withholding requirements and taxability, employers may meet their withholding obligation yet employees may still be reburied to pay estimated taxes or agree to additional withholding . . . ."

[10] For instance, Connecticut employers who fail to comply with the requirements to withhold Connecticut income tax are subject to the following:

- Tax Due – The amount that was withheld or should have been withheld from the wages of the nonresident who performed services in the state.
- Late Payment Penalty - The penalty for late payment or underpayment of tax due is 10% of the amount due on all returns including payments made with an electronically-filed Form CT-WH.
- Late Filing Penalty – Even if no tax is due, the Commissioner of Revenue Services may impose a $50 penalty for failure to file any return or report that is required by law to be filed.
- Interest – In the event a return is filed late, interest is computed on the underpayment at the rate of 1% per month or fraction of a month from the due date until the date of payment.
- Required Informational Returns - A penalty of $5 per statement (up to a total of $2,000 per calendar year) is imposed for failure to provide federal Form W-2 to each employee and a copy to DRS unless due to reasonable cause.

[11] Financial Accounting Standards Statement Number 5 (FAS 5).

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Johnson (D-GA).[12] On November 5, 2013, a second proposal, S. 1645, was introduced by Senators Sherrod Brown (D-OH), John Thume (R-SD), and six additional co-sponsors.[13] The companion proposals are similarly titled the "Mobile Workforce State Income Tax Simplification Act of 2013" and read identically. (They are referred to collectively hereinafter as the "Act.")

Before delving into the provisions of the Act, it should be noted that this is not the first time that this legislation has been introduced in Congress.[14] During the 112th Congress, an identical Mobile Workforce State Income Tax ("SIT") Simplification proposal, H.R. 1864, was introduced.[15] That proposal, which included the same provisions as the current companion proposals, was advanced by the former House of Representatives, which approved it on May 15, 2012 via voice vote. While it appeared that the prior session's Mobile Workforce SIT Simplification legislation could finally be enacted, the proposal failed to progress any further, thus necessitating the reintroduction of the current proposals.

The Provisions of the Mobile Workforce SIT Simplification Act of 2013

The Act would generally limit the authority of States to tax certain income of employees[16] who perform employment duties in states other than their state of residence or from which they are based. Specifically, section 2(a) of the legislation states:

> No part of the wages or other remuneration earned by an employee who performs employment duties in more than one State shall be subject to income tax in any State other than (1) the State of the employee's residence; and (2) the State within which the employee is present and performing duties for more than 30 days during the calendar year in which the wages or remuneration is earned.

Additionally, the legislation applies a coordinated threshold with regards to limiting a State's authority to impose nonresident payroll withholding and information reporting requirements on employers. On this point, section 2(b) of the Act states that "[w]ages or other remuneration earned in any calendar year shall not be subject to State income tax withholding and reporting requirements unless the employee is [also] subject to income tax" in states other than the employee's state of residence or states where the 30-day threshold is exceeded.

The Act also contains certain operating rules, which include permitting an employer to avoid failure to withhold penalties by relying on an employee's annual determination of the time expected to be spent in a nonresident state.[17] The Act's operating rules also provide that the employer may still rely on an employee's determination even if the employer maintains, in the regular course of business, records of an employee's location.[18] However, if an employer maintains a "time and attendance" system that tracks where the employee performs duties on a daily basis, the employer must use the data from the time and attendance system[19] instead

[12] H.R. 1129, 113th Cong. (2013). The House Bill was referred to the Subcommittee on Regulatory Reform, Commercial And Antitrust Law on April 15, 2013. Since the bill's introduction on March 13, 2013, twenty-eight additional Representatives have signed on as co-sponsors.

[13] S. 1645, 113th Cong. (2013). The Senate Bill was read twice and referred to the Committee on Finance on November 5, 2013. Since the bill's introduction on the same date, four additional Senators have signed on as co-sponsors.

[14] Prior Mobile Workforce SIT Simplification legislation has been introduced in at least the three prior Congressional sessions. These proposals include, H.R. 1864, introduced May 12, 2011, 112th Congress; H.R. 2110, introduced on April 27, 2009, 111th Congress; and H.R. 3359, introduced August 3, 2007, 110th Congress.

[15] H.R. 1864, 112th Congress.

[16] S. 1645, § 2(d)(2). The term "employee" has the same meaning given to it by the State in which the employment duties are performed, except that the term "employee" shall not include a professional athlete, professional entertainer, or certain public figures.

[17] *Id.* § 2(c)(1)(A),(B). Although the Act provides that an employer may rely on an employee's annual determination of time expected to be spent in a nonresident state for purposes of determining penalties related to an employer's State income tax withholding and reporting requirements, this provision does not apply if the employer has actual knowledge that the employee is committing fraud or the employer and employee collude to evade tax.

[18] *Id.* § 2(c)(2).

[19] *Id.* § 2(d)(8)(A), (B). The Act defines a "time and attendance" system as one where the employee is required to contemporaneously record his work location for every day worked outside of the State in which the employee's duties are primarily performed; and, which is designed to allow the employer to allocate the employee's wages for income tax purposes among all States in which the employee performs his employment duties.

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of the employee's determination.[20] Additionally, where an employee performs duties in more than one state on the same day, the employee is considered to have been "present and performing duties" in the state in which he performs most of his duties during that day.[21] However, if an employee performs duties in both his resident state and only one nonresident State on the same day, the employee is considered to have been "present and performing duties" in the nonresident state.[22]

If the Act becomes law, it would be effective on January 1st of the second year that begins after the date of the Act's enactment.[23] Any tax obligation that accrues before the Act's effective date would not be alleviated or impacted by the Act.[24]

Will Mobile Workforce SIT Simplification Legislation be Enacted?

As noted previously, Mobile Workforce SIT Simplification legislation has been introduced during each of the last three Congressional sessions. In 2012, legislation introduced by the 112th Congress was advanced by the former House of Representatives via voice vote, but failed to progress further.

What is the likelihood that the Act will be enacted by the end of 2014? And what efforts are underway to see the legislation pass?

One of the Act's most ardent supporters is the Council on State Taxation ("COST").[25] On November 4, 2013, COST submitted a letter to the two leading sponsors of S. 1645, Senator Sherrod Brown and Senator John Thune. In its letter, COST emphasized that "*The Mobile Workforce Issues is COST's number one federal legislative priority.*" Recognizing that state tax administrators are concerned with the impact on state tax revenue if a uniform 30-day threshold is imposed, COST, along with public accounting firm Ernst & Young, worked with the Federation of Tax Administrators and Multistate Tax Commission, to survey state tax agencies for personal income tax information used in the estimating process. Other efforts include working with officials at some of more resistant states, such as New York, as well as continuing to grow the number of "Letter of Support" backers to well over 250 organizations. Additionally, in an effort to educate businesses, taxpayers, the media and other interested parties, COST has produced a highly informative FAQ document which further explains the Mobile Workforce SIT Simplification legislation, and the rationale as to why the legislation make sense.[26]

Like COST, the American Institute of Certified Public Accountants ("AICPA") is championing the passage of the current Mobile Workforce legislation, as it has with prior proposals. In an AICPA position paper, the organization noted that having a uniform national standard would eliminate the burden of having to research multiple state laws when employees work on an interstate basis only for short periods of time. The position paper added that in today's uncertain economic times, businesses should not be expending their resources on the administrative burden that multiple, inconsistent state tax laws impose. Rather, they should focus on operating their business, job creation and retaining employees.

However, despite this effort, Congress has been presented with several federal proposals which also focus, to some degree, on limiting or expanding state authority, such as the Marketplace Fairness Act of 2013 (S. 743/H.R. 684), the Business Activity Tax Simplification Act (H.R. 2992), the Digital Goods & Services Tax Fairness Act (S. 1364) and the Permanent Internet Tax Freedom Act of 2013 (H.R. 434 / S. 31). Thus, it will be interesting to see where Congress turns its efforts.

Conclusion

More and more employers are deploying a mobile workforce as they expand their multistate footprint. At the same time, states are stepping up their efforts to

[20] *Id.* § 2(c)(3).

[21] *Id.* § 2(d)(1)(A).

[22] *Id.* § 2(d)(1)(B). *See also id.* § 2(d)(1)(C) (clarifying that time spent in transit is not considered in determining the location of an employee's performance of employment duties).

[23] *Id.* § 3(a). As an example, if the Act were enacted by June 30, 2014, it would have an effective date of January 1, 2016.

[24] *Id.* § 3(b).

[25] COST is a non-profit trade association consisting of more than 600 multi-state corporations engaged in interstate and international business and is the premier state tax organization representing taxpayers.

[26] The FAQ can found at http://www.cost.org/uploadedFiles/Featured_News/HR%201129%20S%201645%20Mobile%20Workforce%20FAQ%2011-2013.pdf. Some of the questions and answers addressed in the FAQ include why the proposals use a 30-day threshold, why the proposals do not include a dollar-based threshold, what impact the proposal will have on state revenues and current state reciprocity agreements, and why the proposals address both tax liability and withholding.

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aggressively enforce their nonresident payroll withholding laws in an effort to capture more revenue from out-of-state taxpayers who perform services in their state. Thus, employers who wish to be compliant find that they must comprehend and apply a patchwork of state rules – some of which require nonresident withholding from the first day or dollar earned in the state, and others which allow a reprieve from withholding until a certain number of days or a dollar threshold is exceeded. And while both in-house and external SALT advisors recognize that performing services in multiple states may create nexus for a variety of entity-level business taxes, many tax professionals are less likely to focus on a company's responsibility to withhold on the wages of employees who perform employment duties in nonresident states, thereby creating potential exposure for employers. This is one of the important issues that federal legislation would address, by imposing a uniform "days exceeded" threshold before a State could subject a nonresident employee to the state's personal income tax and his employer to the State's nonresident withholding and reporting requirements. Despite the bi-partisan support of both the House and Senate bills, support from a growing number of organizations and the significant efforts by COST, the AICPA and other leading professional organizations, it remains to be seen whether this support will finally be enough to achieve passage of this legislation.

Property Tax Calendar ~April 2014

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Appeals Due

AZ* DE* HI* IA* KY* NC* ND* OK* SD* VA*

GA 4/1 (or 30 days after notice)

KS 4/1

MN 4/30 Tax Court (Prior Year)

NJ 4/1

NY Corning, Nassau County

ND Townships - 1st Monday;
Cities - 2nd Monday

DC By 4/1

VA Alexandria

Personal Property Filing Dates

4/1	4/15	4/20**	4/30
AZ	CO	AK*	SC*
CA	MD	VT	VA*
FL	TX		WA
GA			
LA			
ME			
MS			

Assessment Dates:

ME 4/1
VT 4/1

* Dates vary, check jurisdiction

** Date falls on weekend, should be next business day, Check Jurisdiction.

Confirm all information with local taxing jurisdictions.