An Update on State Wage Withholding and the Mobile Workforce Act
From the Payroll Department: Cut Us a Break!

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There is a constant struggle between the desire for federal legislation requiring uniformity in state tax laws and the need to respect state sovereignty. Under the concept of federally mandated uniformity among the states, uniform laws generally act to decrease administrative burdens faced by multistate businesses. Conversely, under the concept of state sovereignty, the states should be free to generate revenue and set tax policy without interference from the federal government. State sovereignty is sacred, especially to state tax administrators operating in this economy. Payroll withholding presents a unique intersection of these two concepts.

Federal legislation has been proposed for a number of years regarding the threshold at which nonresident individuals must file income tax returns and employers must withhold taxes from wages.\(^1\) Interestingly, in contravention of the goal of uniformity behind the federal legislation, the states have recently been enacting more divergent and varied laws, resulting in increased administrative burdens for employers. These new laws compound the difficulties facing multistate businesses, as well as their traveling employees, and increase the desire for passage of federal legislation. This article provides an update of the Mobile Workforce State Income Tax Fairness and Simplification Act ("H.R. 2110" or the "Bill") and analyzes some of the recently passed laws regarding state withholding.

**H.R. 2110**

The stated purpose of H.R. 2110, introduced in April 2009, is “[t]o limit the authority of States to tax certain income of employees for employment duties performed in other States.”\(^2\) More specifically, it intends to limit the scope of taxation on an employee who performs duties in more than one state to (1) the employee’s resident state, and (2) the state(s) in which the

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2. Id.
employee is physically present for more than 30 days performing employment duties. Currently, thresholds for levying income taxes on nonresidents vary by state from one to 60 days, and some states have dollar-amount thresholds. Pursuant to H.R. 2110, an employee is deemed to have worked within a state for a “day,” which will count towards the 30-day threshold, if the employee performs the preponderance of his or her employment duties within such state for that day. If the employee performs material employment duties in its resident state and in a nonresident state on the same day, the employee will be considered to have worked in the nonresident state for that day. Time spent in transit will not apply in determining where the performance of employment duties takes place. Finally, excluded from the definition of “employee,” and thus excluded from the protection of H.R. 2110, are professional athletes, entertainers, and certain public figures.

This most recent manifestation of the Bill appears to be the result of a compromise between those who support federally mandated uniformity and those who oppose federal preemption of state sovereignty. State lawmakers are reluctant to rely on Congress for a solution, if doing so means relinquishing sovereignty over state tax laws and the power to raise revenue.

Supporters of H.R. 2110, who agree that it would ease compliance burdens for both the business community and individual taxpayers, include the American Institute of Certified Public Accountants (“AICPA”), the American Payroll Association (“APA”), and the Council On State Taxation (“COST”). The day after it was introduced, AICPA’s president and chief executive officer, Barry Melancon, praised H.R. 2110. Melancon stated that it “is a good solution that fits today’s business environment” because it “sets a uniform, national standard” that still ensures states will receive taxes from nonresidents working within their borders. The APA has encouraged support of H.R. 2110, calling for letters asking state representatives to cosponsor the

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3 Id. at § 2(a).
4 Id. at § 2(d)(1)(A).
5 Id. at § 2(d)(1)(B).
6 Id. at § 2(d)(1)(C).
7 Id. at § 2(d)(2).
8 The Mobile Workforce State Income Tax Fairness and Simplification Act of 2007 (H.R. 3359) proposed a 60-day threshold. H.R. 3359, 110th Cong. (2007). This 2007 bill had been referred to the House Judiciary Subcommittee on Commercial and Administrative Law. Subcommittee hearings were held, and there were numerous discussions between opposing sides in an attempt to come up with an acceptable de minimis threshold. Many state tax administrators felt that the 2007 bill’s 60-day threshold was too high. State Tax Advisory Board Roundtable, State Tax Trends: A Roundtable Discussion, TAXES–THE TAX MAGAZINE, 32 (January 2009). The Council On State Taxation recommended a 40-day threshold, and the Federation of Tax Administrators recommended a 20-day threshold. Thus, as a compromise, a 30-day threshold was included in H.R. 2110. Buhl, John, U.S. Rep. Introduces Nonresident State Income Tax Legislation, TAX ANALYSTS, 2009 STT 83-1 (May 4, 2009).
Bill.\textsuperscript{10} The APA strongly believes that H.R. 2110 would spare employers the burdens associated with sending an employee into a new state for even one day, which can include registering with the state for a withholding account, updating payroll systems with new tax tables, depositing taxes, filing periodic tax returns, and submitting W-2 information to a new state. Additionally, Joseph R. Crosby, chief operating officer and senior director of policy for COST, feels that multistate taxation of nonresident employees is “one area where federal preemption is a positive,” because small employers do not have the resources to comply with widely divergent state income tax requirements for their mobile workers, and large employers cannot achieve full compliance.\textsuperscript{11}

While there is strong support for H.R. 2110, the Bill is not without its opponents: the Federation of Tax Administrators (“FTA”), the Multistate Tax Commission (“MTC”) and, of course, the revenue departments of states that will potentially lose revenue upon passage of the Bill (e.g., New York\textsuperscript{12}). These organizations are largely concerned with creating a solution at the state level to avoid federal preemption, protecting the taxing authority of the states. They want to limit the exposure of the states to any losses caused by uniform legislation, especially in a weak economy. Still, opponents of H.R. 2110 seem willing to compromise. For example, to counteract the effects of a longer threshold, the FTA is in favor of an income threshold permitting states to impose income taxes on nonresidents who do not meet the day threshold but earn over a specified level of income.\textsuperscript{13} The FTA believes that relying on a day threshold alone would expose states to additional risk. The MTC is also in favor of an income threshold and has included one in its model statute.

As an alternative to federal legislation, the MTC has been working on a “Model Mobile Workforce Statute.” The MTC’s work is significantly different from H.R. 2110.\textsuperscript{14} The model statute provides for a \textit{de minimis} threshold of 20 days, as opposed to the 30-day threshold in H.R. 2110.\textsuperscript{15} The model statute requires the nonresident employee to have no other in-state income and requires the nonresident employee’s state of residence to provide a “substantially similar”

\textsuperscript{10} American Payroll Association, \textit{Ask Your Representative to Co-Sponsor H.R. 2110 to Ease Multi-State Withholding}, PAYROLL CURRENTLY (July 2009), http://legacy.americanpayroll.org/pdfs/pc2009/09JulyIDC.pdf (all web sites herein last visited February 24, 2010).


\textsuperscript{12} Robert Plattner, Deputy Commissioner for Tax Policy Analysis for the New York Department of Taxation and Finance, has estimated that the 30-day threshold proposed in H.R. 2110 would cost New York State $75 million to $95 million per year and that even a 14-day threshold for individuals would cost the state between $40 million and $45 million. Buhl, John, \textit{NCSL Panel Defers Vote on Nonresident Income Taxation Policy}, TAX ANALYSTS, 2009 STT 138-3 (July 22, 2009). In addition, Illinois may potentially lose approximately $7.4 million if H.R. 2110 makes it through Congress. \textit{Uniform Policy Would Help Address Multistate Payroll Tax Issues, Panel Says}, DAILY TAX REPORT, 235 DTR H-4 (December 10, 2009).


\textsuperscript{14} Staff Memo from Shirley Sicilian, MTC General Counsel, to Members of MTC Income & Franchise Tax Uniformity Subcommittee (January 12, 2010).

\textsuperscript{15} Draft MTC Model Mobile Workforce Withholding and Individual Income Tax Statutes (January 5, 2010).
exclusion from wage withholding (i.e., the statute would apply to other states’ residents on a reciprocal basis). In contrast to the more equitable “preponderance” standard proposed in H.R. 2110, the model statute provides that any portion of a day that a nonresident employee spends working in a state counts as one day toward the 20-day threshold, regardless of whether other states were visited for longer periods of time in the same day. In addition, the model statute excludes from its protection not only professional athletes and entertainers, but also “highly compensated employees” pursuant to Internal Revenue Code § 414(q); i.e., the model statute excludes individuals earning more than $110,000 annually.16 The MTC hopes to have a model proposal ready for public hearings as early as this March.17

Despite the noble efforts of the MTC, the private sector may continue to seek federal legislation on this issue.18 A significant concern with having the states resolve this issue without federal legislation is the likely difficulty in getting all, or even a majority, of the states to adopt a model statute.19 Moreover, even if the MTC encourages state legislatures to adopt its model statute, getting all of its members to cooperate could take years. An additional consideration is that the MTC’s membership does not include all of the states.

For these reasons, it is difficult to predict whether H.R. 2110 will be able to garner the support necessary to make real progress through Congress. However, the Bill does appear to have bipartisan support,20 as well as the support of the business community and the general workforce. (Though these constituencies generally tend to have divergent interests, their interests in the passage of the Bill appear to be aligned.)

As of this article’s publication date, H.R. 2110 was still in the first step of the legislative process, having been referred to the Subcommittee on Commercial and Administrative Law (“CAL”).21 The Bill has yet to be introduced in the Senate. The most recent activity on H.R. 2110 was a hearing on February 4, 2010, before CAL, entitled “State Taxation: The Role of

16 Internal Revenue Code § 414(q) provides that the term “highly compensated employee” means any employee who: (A) was a 5 percent owner at any time during the year or the preceding year, or (B) for the preceding year (i) had compensation from the employer in excess of $80,000, and (ii) if the employer elects the application of this clause for such preceding year, was in the top-paid group of employees for such preceding year. § 414(q)(1). The threshold of $80,000 listed in § 414(q)(B)(i) was increased to $110,000 for tax year 2009 and remains unchanged for tax year 2010. IR-2008-188 (October 16, 2009); IR-2009-94 (October 15, 2009). The “top-paid group” means the top 20 percent of employees when ranked on the basis of compensation for any given year. § 414(q)(3).

17 Uniform Policy Would Help Address Multistate Payroll Tax Issues, Panel Says, supra note 12.


19 Id.

20 H.R. 2110 is cosponsored by Representatives Shelley Berkley (D-Nevada), G.K. Butterfield (D-North Carolina), Jason Chaffetz (R-Utah), Michael Conaway (R-Texas), Joe Courtney (D-Connecticut), Virginia Foxx (R-North Carolina), Trent Franks (R-Arizona), Robert Goodlatte (R-Virginia), Dean Heller (R-Nevada), Walter Jones (R-North Carolina), Jim Jordan (R-Ohio), John Larson (D-Connecticut), Frank Pallone (D-New Jersey), Mark Souder (R-Indiana), Bennie Thompson (D-Mississippi), and Dina Titus (D-Nevada).

Congress in Defining Nexus.” At this hearing, testimony was presented on the issue of Congress’s role in defining nexus. Stay tuned for further updates regarding H.R. 2110.

Recent State Developments

While there is a wave of momentum in support of uniformity with respect to employers’ withholding responsibilities, some states have imposed, primarily for fiscal reasons, ever more divergent rules. Other states have simply changed their existing rules. These new and divergent rules are onerous, generally creating additional administrative burdens. Payroll departments struggle to keep apprised of the new rules and any associated compliance requirements. In the next section, we discuss some of these new rules.

California—Accelerated Withholding

In an effort to deal with declining revenue collections, a few states have accelerated or increased the amount of withholding required from employee wages. Accelerating or increasing the amount of withholding accomplishes two main goals: it places additional funds at the state’s disposal and avoids the stigma associated with an outright rate increase.

For example, California enacted legislation in 2009 requiring the Franchise Tax Board to change the employer wage withholding tables and increase the amount of withholding by 10 percent for wages paid on or after November 1, 2009. Because of this change, California receives the benefit of advanced availability of increased tax revenues. While those funds eventually return to taxpayers in the form of refunds, it provides a great fiscal advantage to California, a state currently facing significant budget challenges. However, the change in withholding does not account for the inevitable impact on employers. Because of the change, employers may face a number of administrative burdens, including the need to adjust withholding systems, field inquiries from employees as to why their paychecks are lighter, and deal with increased paperwork. (Paperwork would increase if employees submit new or revised withholding forms adjusting (i.e., increasing) the number of exemptions in an effort to offset the increased withholding rate.)

Arizona—Adjusted Withholding Percentages

Another example is Arizona. In 2009, Arizona made changes to its withholding rules. Formerly, the amount of Arizona withholding for an employee was calculated as a percentage of the amount of federal withholding. Thus, when the federal stimulus reduced wage withholding in 2009, Arizona changed its law in order to prevent a corresponding reduction in Arizona withholding at a most inopportune time. Beginning July 1, 2010, Arizona’s withholding will

22 Testimony was presented by Walter Hellerstein (Francis Shackelford Professor of Taxation, University of Georgia Law School), R. Bruce Johnson (chair, Utah State Tax Commission, appearing on behalf of the FTA), and Joseph R. Crosby (chief operating officer and senior director of policy, COST).


cease to be a percentage of federal withholding. While this change is prudent for the fiscal well-being of Arizona, what goes largely unnoticed is the burden imposed on employers.

Under Arizona law, employees may elect the withholding percentage from a schedule of statutory rates. Pursuant to the law passed in 2009, the Arizona Department of Revenue is required to prescribe new withholding tables effective for July 1, 2010. All employees will need to file a new election form for wages paid after June 30, 2010. The law imposes an administrative burden on Arizona employers, providing that “[e]ach employer shall notify the employees of the election made available under this subsection and shall have election forms available at all times.” Further, “[e]ach form shall be completed in triplicate, with one copy each for the department, the employer and the employee. The employer shall file a copy of each completed form with the department.” For large Arizona employers, the administrative burden will not be insignificant, requiring dedicated resources to ensure full compliance.

Connecticut Passes a 14-Day Rule

The Connecticut Department of Revenue Services (“Connecticut DRS”) recently announced a new 14-day withholding rule applicable to nonresident employees. Under this new rule, employers are not required to withhold Connecticut income tax from wages paid to nonresident employees if such employees work in Connecticut for 14 or fewer days during a calendar year. If an employer expects a nonresident employee to work more than 14 days in a calendar year, the employer must withhold on all wages paid to the employee. However, if a nonresident employee who was expected to work fewer than 14 days actually works more than 14 days, the employer must begin withholding after the 14th day. Of course, this rule does not excuse nonresident employees from their responsibility to pay Connecticut income tax on any wages earned in Connecticut. Notably, the Connecticut DRS has provided that any part of a day spent performing services in Connecticut will count as a full day towards the 14-day threshold.

Connecticut’s new 14-day withholding rule provides welcome guidance to the business community and is similar to the rule imposed by New York State in 2005. Previously, there was an utter lack of guidance regarding when employers should withhold from nonresident employees’ wages. Connecticut’s DRS provided only that “wages of a nonresident are subject to Connecticut income tax withholding if the wages are paid for services rendered in Connecticut.” Such nondescript language caused employers considerable frustration, especially on audit and in light of New York’s 14-day rule.

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27 Form A-4, Employee’s Arizona Withholding Percentage Election.
29 Id.
30 Conn. Dept. of Rev. Svcs., AN 2010(3) (January 11, 2010).
31 Id.
The timing of the announcement of Connecticut’s new rule is interesting. While there may be no connection, the passage of the rule may be perceived as an attempt to influence the pending federal legislation.

Minnesota & Wisconsin—No More Reciprocity

The income tax reciprocity agreement between Minnesota and Wisconsin terminated on September 18, 2009, and such termination was effective for wages earned beginning January 1, 2010. The majority of the blame for the termination falls on the current economic environment.

According to a press release by the Minnesota Department of Revenue, the number of Wisconsin residents working in Minnesota is more than double the number of Minnesota residents working in Wisconsin. As a result, Wisconsin reimburses Minnesota for the tax collected from Minnesota workers. However, there was a 17-month delay before Minnesota received reimbursement. Because of its strained fiscal situation, Minnesota sought to revisit the agreement in order to accelerate the reimbursement payment. The states terminated the existing agreement when they were unable to settle on the new terms for a revised agreement.

As a result, the withholding requirements on employees in Minnesota and Wisconsin have changed dramatically. The states now have to collect and process withholding allowance certificates, as well as adjust their withholding processes to account for employees formerly not subject to withholding. Thus, payroll departments for employers in Minnesota and Wisconsin will have more paperwork to process and will field more inquiries from employees who have never filed a tax return outside their state of residency. Unfortunately, the termination of the reciprocity agreement is another casualty of the current economic crisis.

Conclusion

While the overall economy may be showing signs of recovery, individual states will likely face fiscal difficulties into the future. Therefore, we will likely see states continue to revise and tweak their existing withholding rules in an effort to maximize the amount of available funds at their disposal. As for uniformity in the area of nonresident withholding, passage of federal legislation appears promising—if not now, then in the near future. What is certain is that employers and their payroll departments will need to be diligent to keep up with state law changes and the associated administrative burdens that result from any new rules.

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33 Minnesota Terminates Income Tax Reciprocity with Wisconsin (September 18, 2009),
http://www.taxes.state.mn.us/publications/press_releases/content/mn terminates_reciprocity.shtml.