FREQUENTLY ASKED QUESTIONS

THE **MOBILE WORKFORCE**

STATE INCOME **TAX SIMPLIFICATION ACT**

What problem does this legislation address?

States currently have varying and inconsistent standards regarding the requirements: for *employees* to file personal income tax returns when traveling to a nonresident state for temporary work periods; and, for *employers* to withhold income tax on employees who travel outside of their state of residence for temporary work periods.

Employees who travel outside of their states of residence for business purposes are subject to onerous administrative burdens because, in addition to filing federal and resident state income tax returns, they may also be legally required to file an income tax return in every other state into which they traveled, even if they were there for only one day. According to the Federation of Tax Administrators, "Complying with the current system is…indeed difficult and probably impractical."

How does this legislation solve the problem?

The Mobile Workforce State Income Tax Simplification Act provides for a uniform, fair, and easily administered law and helps to ensure that the correct amount of tax is withheld and paid to the states without the undue burden that the current system places on employees and employers. The Act provides a uniform 30-day threshold before liability attaches and withholding is required. After 30 days, existing state laws will apply.

Consistent with current law, the legislation provides that an employee's earnings are subject to full tax in his/her state of residence. In addition, under the legislation, an employee's earnings would be subject to tax in the state(s) within which the employee is present and performing employment duties for more than 30 days during the calendar year.

As under current law, nonresident employees who visit a state for longer than 30 days (and are therefore subject to that state's nonresident filing and withholding rules) will still be able to take a credit against their resident state personal income tax liability for amounts paid to other states.

Why are athletes, entertainers, and certain public figures and production employees not protected under this legislation?

The purpose of exempting certain individuals from the protections generally afforded by prospective federal legislation is to minimize revenue dislocations among the states. Given their high profiles and public calendars, there is currently a relatively high degree of compliance for these individuals with state nonresident personal income tax laws.

Why does this legislation use a 30-day threshold?

Prior legislation addressing the taxation of nonresident employees set a threshold of 60 days below which nonresidents would not be subject to personal income tax in a state. After careful consideration and deliberation, the threshold was set at 60 days because it struck an appropriate balance between two goals: 1) to provide administrative simplification for employees and employers; and 2) to minimize disruptions to state revenue flows. The 60-day threshold is far shorter than any other law Congress has enacted in this area, most of which provide for full preemption.

Despite this careful balancing, representatives for state tax administrators opposed the 60-day threshold, arguing that it was too long. In response to those concerns this legislation is introduced with a 30-day threshold, just as has been since the 112th Congress (H.R. 1864 in the 112th; H.R. 1129 in the 113th; and H.R. 2315 in the 114th).

Based on a survey of employers conducted by the Council On State Taxation, the 30-day threshold more than doubles the number of employees that would be subject to nonresident taxation (when compared against the number that would be subject to tax under a 60-day threshold). That same survey shows that any further reductions in the threshold would dramatically increase the number of employees subject to nonresident taxation.

It is important to recognize that this legislation does not limit the definition of a “day” to a Monday through Friday schedule. Under this legislation, all work days, regardless of when they occur (weekdays, weekends, federal holidays, etc.) count against the threshold. Thus, the 30-day compromise is analogous to the “full month of work days” that the Federation of Tax Administrators has described as a reasonable threshold.

A threshold shorter than 30 days would require that the legislation be made more complex and difficult to comply with by carving out certain types of days (e.g., weekends) or types of activities (e.g., attendance at trade shows). A single, comprehensive 30-day threshold is far simpler and thus preferable as it will foster compliance and ease administration by employees, employers and states.

How is a “day” defined under this legislation?

In determining how a day should be calculated for the purposes of the threshold, it is helpful to keep in mind practical compliance issues. The definition of a day must be intuitive for the employee or it is unlikely to be adhered to fully. This legislation includes a simple rule for determining nonresident days.

If an employee works in a nonresident state for any part of a day, then it is a “nonresident day.” If an employee workdays in two or more nonresident state during the same day, then it is a “nonresident day” in the nonresident state in which the employee has worked longer for that day. Time spent transiting through a state is disregarded in determining a “day.”

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Why doesn't this legislation include a dollar-based threshold?

The purpose in relying solely on a reasonable time-based (rather than dollar-based) threshold is to eliminate the need for most employees to keep track of their whereabouts for tax purposes. This same purpose holds for employers as well; a reasonable time-based threshold would allow employers to analyze their workforces and provide increased education and compliance tools only to the relatively small number of employees who travel to a nonresident state for a significant period of time.

A dollar threshold nullifies the potential compliance gains from a uniform rule. Dollar thresholds would create greater burdens than exist in most cases under the current patchwork of state laws. Several examples effectively illustrate this point:

- **Employees Don't Know the Exact Amount of Income They Will Earn in a Year.** In addition to salary, many employees will earn bonuses, commissions and other perquisites throughout the year. Most of these employees will not know the amount of these payments because they will be based on a variety of unknown factors, such as the economy, business performance and personal performance levels. In addition, employees frequently receive stock commissions, relocation benefits and other benefits (e.g., personal use of a company car) that generate income. These supplemental wage payments are based on factors not related to salary and cannot be estimated prior to the end of the year.

- **States Have Different Definitions of "Income."** While a "day" is the same everywhere, the concept of "income" is defined differently in every state. A dollar threshold would thus require either a model definition of "income"—which would significantly alter state tax statutes—or employees would be required to research each specific state statute where they expect to travel in order to calculate their earnings on a per day basis.

- **A Dollar Threshold Would Require Employers to Coordinate with Many Third Parties.** A dollar threshold will require employers to coordinate their payroll systems with payments made to employees by third parties. Third party payments may include sick or disability payments, supplemental retirement pay, and various types of stock compensation and relocation benefits, all of which may be considered wages to the employee. It will be extremely challenging for employers to track and incorporate these supplemental wages, which are generally paid outside an employer's payroll system, and add that information to the internal payroll information.

- **A Dual Threshold (Day and Dollar) Would Require Creation of Two Tracking Systems.** Under a proposal that would have an alternative of a day or dollar threshold, employers would be forced to run two separate systems: one to calculate days in a state, one to calculate dollars earned in a state. This would be extremely complex, costly and burdensome to employers.

When employees travel they do not think in terms of the "dollars" earned while they are away from home but the "days" they are on business travel. A dollar threshold is not simple, would not ease compliance for employees or employers (or state auditors), and it would not be a meaningful or positive change from the current patchwork system.

What information does this legislation allow employers to rely on in determining whether withholding is required?

One of the primary benefits of a uniform law governing short term work assignments of employees in nonresident states from an employer perspective is that it minimizes the undue expense that would be needed to create and implement tracking systems for all employee activities. Only a very small number of employers—primarily those that bill for work on an hourly basis—have systems in place that readily track an employee's daily whereabouts for purposes of monitoring short term nonresident employment duties.

This legislation allows employers to rely on the employees' records of these short term assignments. This is a standard and simple benchmark for compliance that employees and employers can implement and rely upon. Employers want their employees to be in full compliance with the law, including state tax laws, when they are traveling on company business, and this standard will facilitate compliance. The State of New York currently provides such a rule, with an accompanying form.

Importantly, the "reliance rule" in this legislation merely protects employers from the assessment of penalties upon audit for failure to withhold. Such a rule would in no way affect an employee's tax liability. If an employee represented to an employer that the employee would be in a jurisdiction for less than the threshold period, but in fact the employee exceeded that period, then the employee would be fully liable for any taxes due, just as is the case under current law.

Why does this legislation address both tax liability and withholding?

To solve the current problem, this legislation provides for a uniform threshold for both personal income tax liability and employer withholding. A bifurcated system under which personal income tax liability rules differ from employer withholding rules would essentially guarantee employee noncompliance with nonresident personal income tax laws. Without employer withholding, few employees would have the information or ability to comply.

A bifurcated threshold also fails to provide employers with true relief because states would have more incentive than exists today to audit employee payroll due to the fact that, absent withholding, noncompliance is a given. Although a withholding threshold would protect employers from penalties for failure to withhold, employers would still face costly audits by states determined to impose tax on employees who failed to file.

A bifurcated system solves nothing. It does not help employees in any conceivable way. It does not help employers; they would remain subject to the exact same costly audit burdens they face today with the only difference being that penalties for failure to withhold would be diminished. Finally, many employers would choose to ignore the withholding threshold so as to ensure that employees were in compliance with the law; in other words, the employers would feel obligated to their employees to begin withholding as of the first day of travel.

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Will this legislation impact current state reciprocity agreements?

No. Many states have entered into reciprocity agreements with neighboring states that provide that personal income taxes are paid in (and withheld for) the resident state only. For example, a resident of Virginia who works in Maryland is subject to tax only in Virginia, and a Maryland resident working in Virginia is only subject to Maryland tax. This legislation provides a 30-day safe harbor from liability and withholding *before* state laws apply. Thus, because such reciprocity agreements are, in effect, a 365-day safe harbor, they are unaffected by the provisions of this legislation. Similarly, statutes in states such as Hawaii and Arizona which apply a threshold greater than the 30 days provided by this legislation would not be affected (Hawaii and Arizona offer a 60-day safe harbor for nonresidents).

Will this legislation have an impact on state tax revenues?

COST retained the Quantitative Economics and Statistics Group at Ernst & Young LLP (E&Y) to estimate the state tax revenue impact of a federal law addressing nonresident taxation. E&Y's revenue impact estimates are based on information collected from a survey of state tax agencies, publicly reported state and local income tax collection information from state tax agencies and the U.S. Census *Governmental Finances*, U.S. Census data on state-by-state journey-to-work patterns, and Bureau of Economic Analysis estimates of the components of state personal income.

COST and Ernst & Young worked with staff at the Federation of Tax Administrators and the Multistate Tax Commission to survey state tax agencies for personal income tax information to be used in the estimating process. Detailed information was received from seventeen states, including California, Connecticut, New Jersey and New York.

The net fiscal impact to each state is the difference between the reduction in taxes on nonresident workers and the higher taxes paid by residents through lower credits for taxes paid to other states. As a result, some states will experience slightly higher revenues, and others slightly lower. In most states, this legislation would result in a change in state tax revenues of less than one-hundredth of one percent (0.01%). In no state would revenues be reduced more than seven-hundredths of one percent (0.07%). The total net fiscal impact on all states is estimated to be less than $50 million.

Have the proponents of this legislation sought input from state and local government officials?

Yes. The proponents of this legislation first approached state and local tax officials about this issue in 2005 and have been involved in dialogue with them since that time. This legislation includes numerous provisions that have been crafted to address concerns raised by state and local tax officials. For example:

- The legislation was altered to protect wages "earned" rather than "paid" to address states' concerns regarding deferred compensation;
- The legislation was altered to remove "physically" before "present" to address states' concerns with nexus rules for other taxes;
- At the states' request, the operating rules in the legislation were changed to require employers using a time and attendance system to rely on such system for nonresident tax withholding;
- The definition of "day" was changed to address the states' position that any time in a nonresident state should constitute a day for the purposes of the threshold;
- The definition of "certain public figures" was expanded in response to the states' concern that the initial definition was too narrow;
- The definition of "State" was changed to address concerns expressed by local government officials; and
- The effective date was changed to allow states and employers sufficient time to implement new systems and to ensure that there would be no impact on state revenues during the current fiscal downturn.

The proponents recognize the states' extreme care in evaluating federal legislation that in any manner restricts states' taxing authority. However, compliance with existing nonresident personal income tax laws is at best extremely difficult and is in many cases impossible. Such a tax regime benefits no one and clearly inhibits the commerce essential to expand our national economy.