

Uniform 30-Day Safe Harbor for Nonresident Employees and Related Employer Withholding Obligations

Position: *States with individual income taxes should provide a uniform 30-day safe harbor (threshold) before nonresident workers are required to file state income tax returns and their employers are subject to withholding obligations.¹ The current patchwork of state laws governing this area is outdated, burdensome, and inequitably subjects employees and employers to selective tax compliance and enforcement.*

Explanation: Forty-one states currently impose individual income taxes on income earned by state residents and on the income of nonresidents traveling to the state for work-related activity within the state. In most cases, employers are liable for related withholding obligations in states where employee income is subject to tax. States impose individual income taxes based on residence and source. Typically, all income of state residents is taxed by the resident state regardless of where it is earned, and income of nonresidents is taxed if earned from activity sourced within the state. To avoid double taxation, a credit is allowed against a resident's income tax for income tax paid to a nonresident state.

Under current state statutes in nearly half the states, employees are subject to a filing obligation if they set foot in the state on a work-related matter for a single day, and employers are subject to related withholding obligations on income earned in the state.² In some other states, traveling employees are not subject to tax until a dollar threshold is reached, which varies from state to state. In most states, the employer's withholding obligation mirrors the employee's personal income tax liability, but there are notable exceptions.³ Because of the frequency of employee travel and the cost of preparing, filing, and processing of small dollar returns on short trips across state lines, effective compliance is prohibitively difficult and costly, and noncompliance is widespread. Indeed, the states themselves have indicated a lack of enforcement activity on much income earned on interstate travel.⁴ As a result, when enforcement does occur it is typically imposed selectively on employers for retroactive withholding obligations, or on employees brought to the attention of revenue departments through unrelated circumstances. The patchwork of state laws and the uncertainty and costs surrounding compliance and enforcement hinder one of the greatest assets of our economy – the mobility of our nation's workforce.

Solution: To address this issue, states should provide a uniform and reasonable 30-day safe harbor (or threshold)⁵ on nonresident workers before imposing an individual income tax liability and concomitant withholding obligations on their employers. Until the threshold is reached, employees and employers would continue to pay and withhold in the state of residence. If the threshold is breached, liability and withholding would attach as of the first day in the nonresident state. Exceptions to the safe harbor are appropriate for professional athletes, entertainers, and persons of prominence who visit the state for discrete events, and for state programs (such as film tax credits) that are funded by nonresident employee

¹ Legislation that addresses cross-border issues among the states must be uniform to be effective. Ideally, Congress will address this issue under its plenary commerce clause authority, but absent Congressional action, the states should undertake uniform action themselves. The policy goals in this statement may also be met through federal legislation.

² See Mobile Workforce Coalition website at www.mobileworkforcecoalition.org.

³ New York imposes personal liability as of day one but does not impose a withholding liability until after 14 days in the State. Arizona and Vermont allow 60 days and 30 days, respectively, before withholding is required but still impose a filing obligation as of the first day in the state.

⁴ See statement of Alabama Commissioner of Revenue Julie Magee, testifying as Chair of the Multistate Tax Commission before the House Judiciary Committee on H.R. 2315, June 2, 2015: “*State tax administrators are not interested in asserting liabilities against nonresident employees or employers for income taxes on wages earned where the employee is present in the state for only a few days during the year.*” See <https://republicans-judiciary.house.gov/wp-content/uploads/2016/02/Magee-Testimony.pdf>.

⁵ COST recommends a 30-day calendar year safe harbor without any wage threshold limitations as the most effective balance between minimizing revenue dislocations between states and bringing into immediate compliance the greatest number of traveling employees, the majority of whose out-of-state work travel is less than 30 days in a calendar year. Any safe harbor less than 30 days increases in scope the number of traveling employees required to file nonresident income tax returns and the number of returns required to be processed by states.

withholding. Employers who incorrectly withhold on employee wages should be allowed to correct such withholding without triggering retroactive penalties and interest. Finally, each state should include a reciprocity provision in its safe harbor statute specifying that the state will only grant a safe harbor from withholding and liability to employees traveling from states with a similar safe harbor. The reciprocity provision is essential to ensure uniform adoption and operation of a safe harbor among the states and will encourage state adoption of a uniform safe harbor.

The Model Statute endorsed by the COST Board of Directors for uniform adoption by states is attached as Appendix A.

Appendix A

Nonresident Withholding and Reporting Threshold Draft Legislation

[Section 1]

(A) *As used in this section:*

(1) *“Professional athlete” means an athlete who performs services in a professional athletic event for compensation.*

(2) *“Professional entertainer” means a person who performs services in the professional performing arts for compensation on a per-event basis.*

(3) *“Public figure” means a person of prominence who performs services at discrete events, such as speeches, public appearances, or similar events, for compensation on a per-event basis.*

(4) *“Qualified Production employee” means a person who performs production services of any nature directly in connection with a state qualified [film, television, or other commercial video production] for compensation, provided that the compensation paid to such person are qualified expenditures under [state’s incentive program], and that such compensation is subject to withholding as a condition to treating the compensation as a qualified production expenditure.⁶*

(5) *“Time and attendance system” means a system through which an employee is required, on a contemporaneous basis, to record the employee’s work location for every day worked outside the state where the employee’s employment duties are primarily performed and which is designed to allow the employer to allocate the employee’s compensation for income tax purposes among all states in which the employee performs employment duties for the employer.*

(B)(1) *Compensation, as defined under [state statute cross-reference], paid to a nonresident individual is exempt from the tax levied under [state statute cross-reference] if all of the following conditions apply:*

(a) *The compensation is paid for employment duties performed by the individual in this state for thirty or fewer days in the calendar year;*

(b) *The individual performed employment duties in more than one state during the calendar year;*

(c) *The compensation is not paid for employment duties performed by the individual in the individual’s capacity as a professional athlete, professional entertainer, public figure, or qualified production employee; and*

(d) *The nonresident individual’s state of residence: i) provides a substantially similar exclusion, or ii) does not impose an individual income tax, or iii) the individual’s income is exempt from taxation by this state under the United States Constitution or federal statute.*

(2) *Except as otherwise provided in this division, an employer is not required to withhold taxes under [state statute cross-reference] from compensation that is paid to an employee described in*

⁶ A “production employee” exception is optional, based on whether it is needed to avoid undercutting a state’s film, television, or other commercial video production incentive program.

division (B)(1) of this section. If, during the calendar year, the number of days an employee spends performing employment duties in this state exceeds the thirty-day threshold described in division (B)(1)(a) of this section, an employer shall withhold and remit tax to this state for every day in that calendar year, including the first thirty days on which the employee performs employment duties in this state.

(C) The [revenue department] shall not require the payment of any penalties or interest otherwise applicable for failing to deduct and withhold income taxes as required under [state statute cross-reference] if, when determining whether withholding was required, the employer met either of the following conditions:

(1) The employer at its sole discretion maintains a time and attendance system specifically designed to allocate employee wages for income tax purposes among all taxing jurisdictions in which the employee performs employment duties for such employer, and the employer relied on data from that system.

(2) An employer maintaining records under subsection (1) shall not preclude an employer's ability to rely on an employee's determination under subsection (3).

(3) The employer does not maintain a time and attendance system, and the employer relied on the employee's annual determination of the time the employee expected to spend performing employment duties in this state, provided, however, that the employer did not have (a) actual knowledge of fraud on the part of the employee in making the determination and (b) provided that the employer and the employee did not collude to evade taxation in making the determination.

(D) For purposes of this section, an employee shall be considered present and performing employment duties within this state for a day if the employee performs more of the employee's employment duties in this state than in any other state during that day. Any portion of the day during which the employee is in transit shall not be considered in determining the location of an employee's performance of employment duties. However, if an employee performs employment duties in a resident state and in only one nonresident state during one day, such employee shall be considered to have performed more of the employee's employment duties in the nonresident state than in the resident state for such day.

[Section 2]

The enactment by this act of [state code section] applies to taxable years beginning on and after January 1, 202X.

[Section 3]

If any provision of this act, or the application of such provision to any person or circumstance, is held to be unconstitutional, then the remainder of this act, and the application of the provisions of such to any person or circumstance, shall not be affected thereby.