



# Multi-State Non-Resident Withholding

Myrtle Beach, November, 2016



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- The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.





Welcome

With you today



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# Multistate withholding

# Payroll issues with multistate nonresident withholding

- Payroll tax compliance is one of the primary concerns expressed when addressing multistate withholding requirements on regular wages, supplemental wages, and equity-based compensation.
  - Should we report?
  - Should we withhold?
  - Where should we report?
  - How much to report?
  - How much to withhold?
  - When to report?
  - Timeliness of tax remittance to authorities
  - Who is legally liable – employer, employee, or both?

## State unemployment taxes

### The basics

- State unemployment insurance (SUI) taxes assessed to all for-profit employers.
- Tax structure used to finance the unemployment claims system.
- Not-for-profit employers generally reimburse for SUI claims filed.
- Taxes are used to replenish employer accounts after benefits are paid to separating employees.
- Tax payments are generally based on three factors:
  - Employer's taxable wages (vary by state)
  - Health of the state's UI tax reserves, and
  - Employer's assigned SUI tax rate (varies by employer, dependent upon benefits paid, and other state factors)

## State unemployment

# Wage sourcing rules

### — General rules

- SUI wages should generally be reported in the state in which the employee primarily perform services.
- SUI wages are generally sourced to one state per calendar year unless there is a change in an employee's primary work location.

### — Sourcing rules (four prong test)

1. Localization of services – State in which a majority of services are performed, provided that services provided outside of that state are incidental.
2. Base of operations – If services are regularly performed in more than one state, wages should be sourced to the state where the **employee** maintains a base of operations if some services are performed in that state.
3. Direction and control – If an employee lacks a true base of operations, wages should be sourced to the state from which the employee receives direction and control if some services are performed in that state.
4. Residence – If none of the other factors apply, source SUI wages to the employee's state of residence.

## State income tax withholding

### The basics

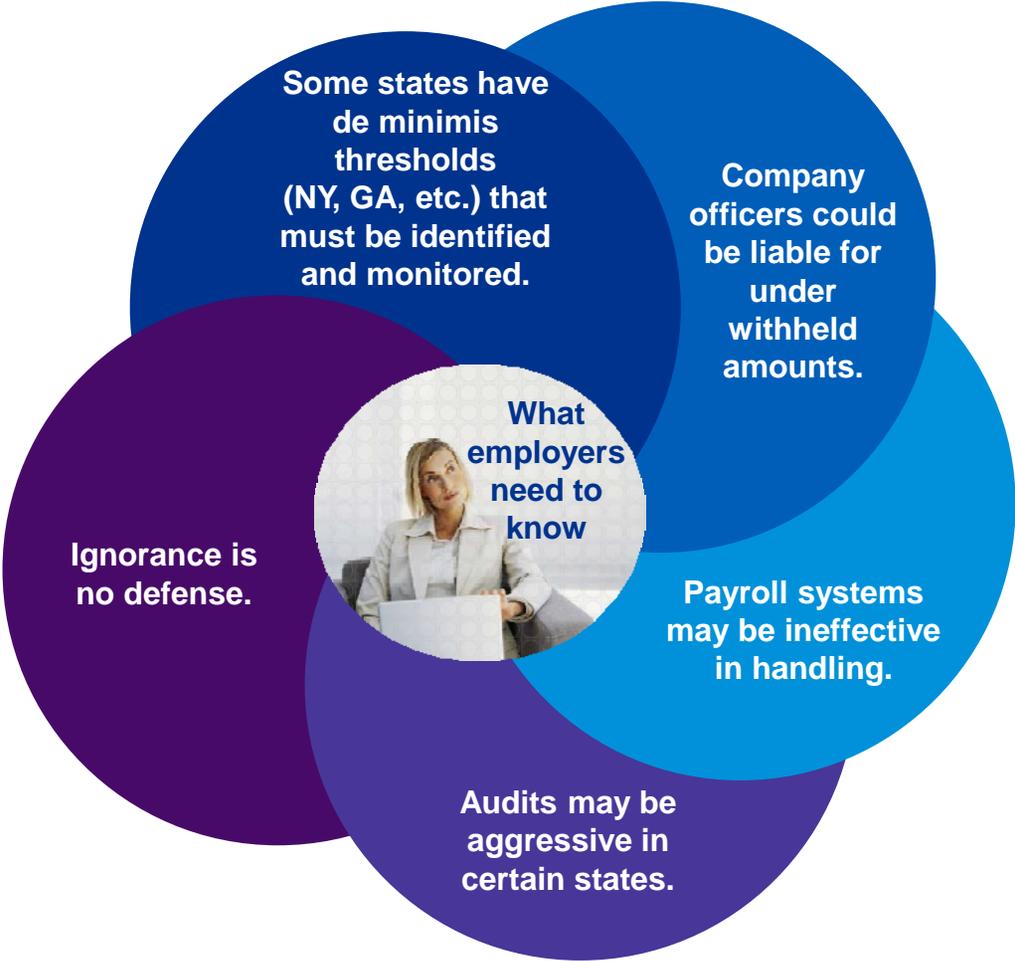
- Requirements and obligations of employer are well defined in most cases.
- The employer is ultimately responsible for proper withholding and reporting of their employee's state-sourced income.
- Sourcing rules (generally)
  - Income should be sourced to state or states where employee performs services.
  - Non-resident employees traveling to different states should have state income tax (SIT) withheld in those states.
  - Equity compensation is typically based on a look back period taking into account where the money was earned at a given point (e.g., upon vesting) rather than where it is paid out.



# Non-resident state income tax withholding

- In general, employers are required to withhold SIT on non-residents of a state if services are or were performed by the employee in that state.
- Exceptions/limitations:
  - De minimis rules of certain states (not always applicable to equity compensation)
  - Reciprocal agreements between states
  - Exemption certificate allocation

# State income tax withholding



# General withholding exceptions/qualifiers

## — Reciprocity:

- Work state/resident state agreements
- Specific filing requirements

## — Exemption certificates:

- Many states allow for allocation of source income based on past history and future expectations.
- Can apply to equity compensation in many cases
- Must obtain and retain



## What is reciprocity?

- A reciprocal agreement allows residents of one state to request exemption from tax withholding in another (reciprocal) state.
- For example, New Jersey and Pennsylvania have a reciprocal agreement, also called reciprocity. This means that a New Jersey resident who works in Pennsylvania can ask their employer to stop withholding Pennsylvania taxes, saving them the trouble (and expense!) of having to file a PA return in addition to their NJ return.
- The reverse would also be true; that is, a Pennsylvania resident who works in New Jersey can elect to have their employer stop withholding for New Jersey, which means they'd only have to file a state return for Pennsylvania.

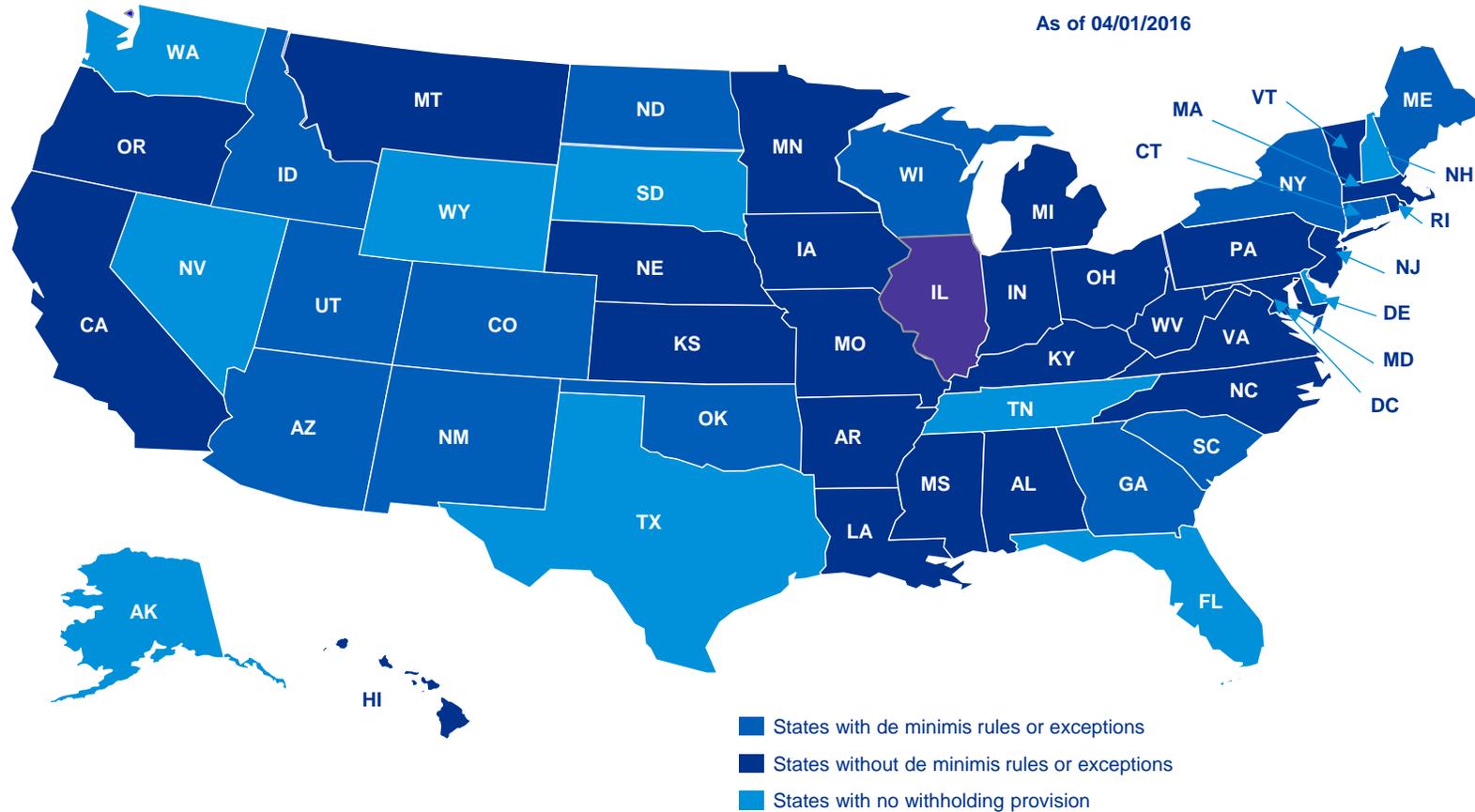
# States with reciprocity agreements

<b>Illinois</b> <ul style="list-style-type: none"> <li>— Iowa, Kentucky, Michigan, Wisconsin</li> </ul>	<b>Indiana</b> <ul style="list-style-type: none"> <li>— Kentucky, Michigan, Ohio, Pennsylvania, Wisconsin</li> </ul>	<b>Iowa</b> <ul style="list-style-type: none"> <li>— Illinois</li> </ul>	<b>Kentucky</b> <ul style="list-style-type: none"> <li>— Illinois, Indiana, Michigan, Ohio, Virginia, West Virginia, Wisconsin</li> </ul>	<b>Maryland</b> <ul style="list-style-type: none"> <li>— Washington DC, Pennsylvania, Virginia, West Virginia</li> </ul>
<b>Michigan</b> <ul style="list-style-type: none"> <li>— Illinois, Indiana, Kentucky, Minnesota, Ohio, Wisconsin</li> </ul>	<b>Minnesota</b> <ul style="list-style-type: none"> <li>— Michigan, North Dakota</li> </ul>	<b>Montana</b> <ul style="list-style-type: none"> <li>— North Dakota</li> </ul>	<b>New Jersey</b> <ul style="list-style-type: none"> <li>— Pennsylvania</li> </ul>	<b>North Dakota</b> <ul style="list-style-type: none"> <li>— Minnesota, Montana</li> </ul>
<b>Ohio</b> <ul style="list-style-type: none"> <li>— Indiana, Kentucky, Michigan, Pennsylvania, West Virginia</li> </ul>	<b>Pennsylvania</b> <ul style="list-style-type: none"> <li>— Indiana, Maryland, New Jersey, Ohio, Virginia, West Virginia</li> </ul>	<b>Virginia</b> <ul style="list-style-type: none"> <li>— Washington DC, Kentucky, Maryland, Pennsylvania, West Virginia</li> </ul>	<b>West Virginia</b> <ul style="list-style-type: none"> <li>— Kentucky, Maryland, Ohio, Pennsylvania, Virginia</li> </ul>	<b>Wisconsin</b> <ul style="list-style-type: none"> <li>— Illinois, Indiana, Kentucky, Michigan</li> </ul>

## What is withholding de minimis?

- In terms of State income tax, de minimis refers to the point at which withholdings should be initiated for a nonresident working in a state which taxes personal income.
- Not all U.S. states levy income taxes, and there's little consistency among nonresident de minimis standards for those that do.
- Some states base de minimis on the number of days worked (although the definition of what counts as a workday has been controversial, others on the dollars earned or a percentage of total income derived from work in the state, still others using a combination of methods.

# Non-resident withholding de minimis jurisdictions



Source: KPMG LLP Global Mobility Services



# Equity awards and compensation

- Basis for equity-based compensation typically spans multiple years
- Employers required to allocate gain based upon time an employee performs services in a particular jurisdiction.
- Many employers have not instituted procedures necessary to track employee movements for equity-based compensation withholding purposes.
- Highly compensated individuals, such as C-suite executives, travel to numerous states while executing their responsibilities.
- States are aware of such employee movements and are becoming more aggressive in their enforcement efforts with respect to employer withholding.
- Public corporations, private equity firms, financial institutions and non-U.S. based companies with U.S. presence are key audit targets.

# Legislative action has been slow



## Non-resident withholding

### Current legislation introduced

- H.R. 2315, ***Mobile Workforce State Income Tax Simplification Act of 2015***
- S. 386, ***Mobile Workforce State Income Tax Simplification Act of 2015.***
- Senate and House bills are identical
- Statutory framework
  - No state personal income tax on
    - “Wages or other remuneration,” earned by
    - “Employee” performing “employment duties,” except by:
      - Employee’s state of residence, or
      - **State in which employee is “present” for more than 30 days**
  - No state withholding or reporting rules apply unless taxable
    - If taxable, rules apply as of commencement of employment duties
- **UPDATE: on September 21 the House passed the latest version of the bill**
- **It has not gone to the Senate yet and will likely not make it out of committee (4% chance)**

## Some common internal tracking

- Time and attendance application
- Third party travel provider
- Travel reimbursements (AP system)
- What about you payroll system?

# State withholding audits

## — What might they ask for?

- Review of company expense reimbursement and travel policy
- Review of payroll manual for company policy on taxation of mobile workforce
- Review of payroll manual for company policy on taxation and reporting of stock and equity compensation
- Review of employee expense records – specifically hotel and flight reimbursements
- Review of any publicly available information as to major projects/events taking place in the state
- Review of executive calendars
- Review of corporate jet logs/itineraries
- Review of stock grant, vest, and exercise data relating to mobile workforce

# State withholding audit activity (samples)



## — New York

- Aggressive enforcement for almost a decade
- Potential significant assessments especially on allocation of equity compensation

## — California

- Aggressive since the mid-90s
- San Francisco Payroll Expense Tax (being phased out)
- New initiative for auditor hiring/training

## — Minnesota – Canceled WI reciprocity (effective: January 1, 2010)

## — Connecticut

- Enacted New York's de minimis regulations as their own
- Uptick in Connecticut audits

## — Increase in audit activity in states that border a state with no personal income taxes

- Massachusetts, Georgia, etc.

# Multistate withholding risks and control obstacles

- Potential risk associated with noncompliance
  - Audit risk
  - Public relations
  - Tax principal/penalty/interest assessments
- Barriers to compliance
  - Time and expense system limitations
  - Third-party vendors unable to comply
  - Corporate culture
  - Employee impact
  - Employers cannot track employee movement on a daily basis
  - Inconsistent policies and procedures for monitoring a mobile workforce

# Taking action

- Identify stakeholders and discuss concerns
- Identify and quantify exposure
- Define plan to address

action



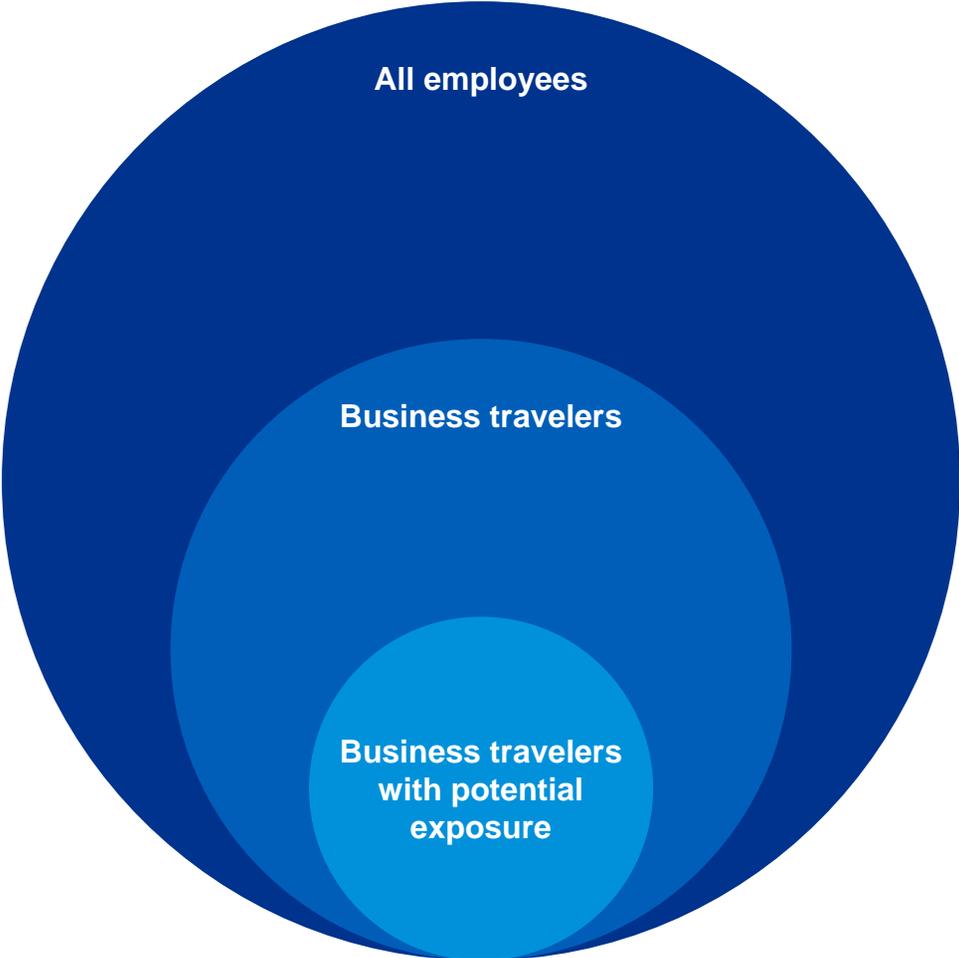
## Key challenges

# Project ownership and stakeholders



**Narrowing the field**

How to filter?



## Closing thoughts on short term business visitor issues

### Potential next steps

- Evaluation/assessment
  - Identify states/countries and employees likely to have material mobile activity
  - Identify records/sources that provide indicators of activity
- Compliance policy design
  - Determine processes
  - Methodology of data capture (travel records, employee data entry, etc.)
  - Real-time compliance
  - Communication and training to/for employees
  - Internal audit procedures
- Practical issues/concerns
  - Phased roll-outs
  - IT/technology/security issues
  - Deployment timeframes
- Legislative outlook (U.S.) – unclear

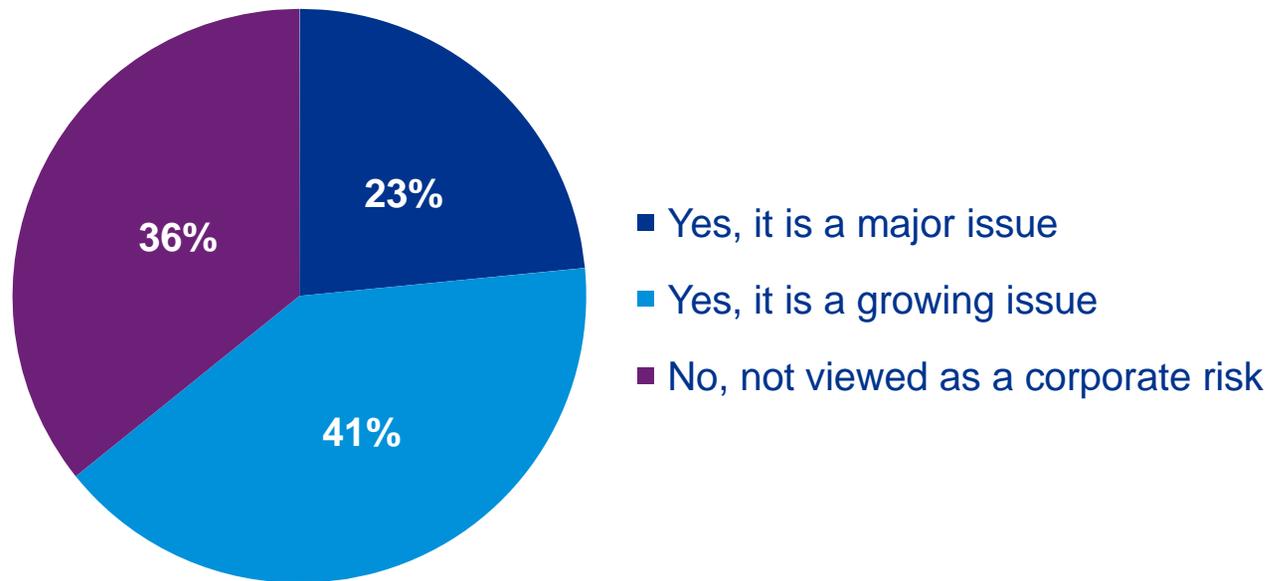
## Non-resident workforce survey

- Joint survey conducted by the American Payroll Association and KPMG
- Survey results collected in November 2014
- Over 1,100 respondents amongst 20 different industries



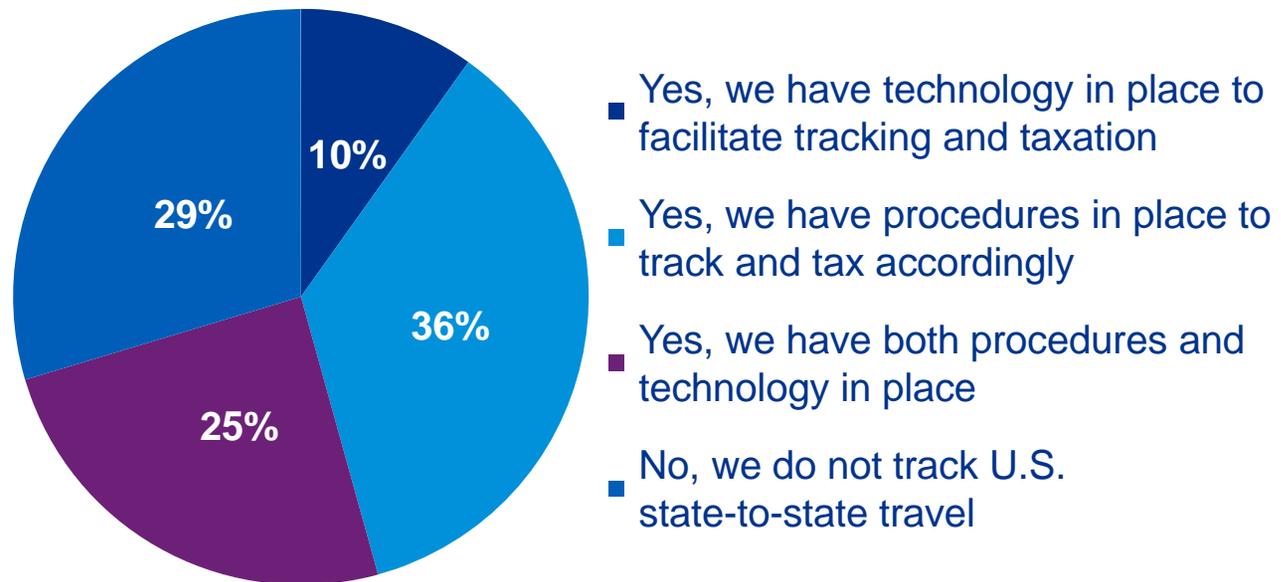
# Question 1

— Is U.S. non-resident state withholding/reporting a major or growing issue for your organization with respect to compliance and/or risk?

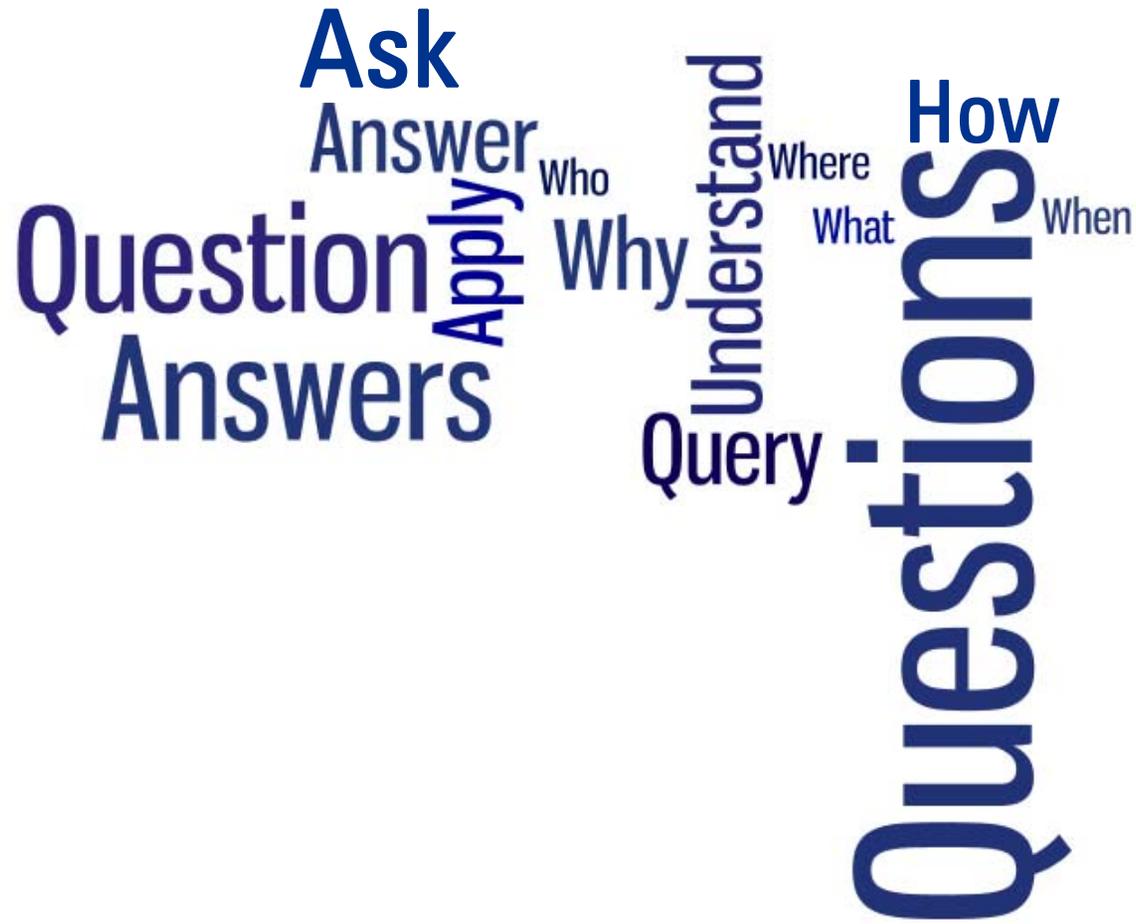


## Question 2

— Do you currently have procedures and/or technology in place to monitor U.S. employee work travel and remit/report taxes accordingly?



What questions do you have?





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