Surgent cpe
EDUCATION FOR PROS

Remote Work – Employee Tax Issues

NCACPA

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Remote Work – Employee Tax Issues

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Remote Work – Employee Tax Issues

I. Multistate taxation of compensation

Many states, given their budget crises, are aggressively searching for new sources of revenue, and in many cases, companies stand out as easy targets. Finding delinquent tax filers is often as simple as matching payroll, sales, or property tax forms against required income tax filings. Most contractors who deny or ignore the existence of nexus within a state nonetheless file payroll, sales, or property tax returns, as applicable. If the state fails to make a match it will usually begin an investigation of the entity in order to discover whether a reason exists for the failure to file. As companies try to do more with fewer employees, such as cover more territory, including multiple states, many taxpayers find themselves scratching their heads as they try to determine how to comply with the laws of multiple states.

A complicating factor in our current times is the increased use of remote employees. While employees may physically be in one location, they may be working for an employer in another state. This increasingly common scenario generally raises two questions among employers: Which states do we need to withhold taxes in? And where do we need to pay unemployment taxes?

A. Taxation of compensation by multiple states

A state may generally tax the compensation of non-resident employees when income is earned in the state. There is a risk of double taxation: all employee compensation is taxed in the state of residence, while state-sourced compensation is taxed in the state of non-residence. Some states alleviate the problem by making credits available; however, they are generally not constitutionally required and are generally offered as a matter of legislative grace. States with an income tax generally permit residents to take a credit for taxes paid to other states. Some states provide credits to non-residents for taxes paid to other states. Some of the states that have credits include California, Indiana, Michigan, Minnesota, Oregon, Virginia, and West Virginia. These credits are fairly narrow in scope and are generally applicable only when the other taxing state does not allow a credit for tax paid.

1. Typical fact pattern for an employee

Suppose an individual lives in New Jersey, is assigned to the company's New York office, works from home one day each week, and travels to and works at the company's offices in various states, including Connecticut, California, Illinois, and Georgia. In this instance, the individual is subject to tax in New Jersey, his or her state of residence, and he or she is also subject to personal income tax in New York as a nonresident, and finally perhaps even subject to tax in other states as a nonresident. In most states, the individual allocates income to the nonresident state based on a "working days" ratio. A taxpayer is considered to have a domicile in New York State if they maintain a permanent place of abode in New York for more than 11 months of the year and spend 184 days or more in New York State during the taxable year. In New York, any part of a day spent at work in New York is considered to be a full day. Normally the working-days calculation is based on number of days worked in the state divided by total days worked.

2. Taxes that are required by the states

Forty-one states have a state income tax and nine states do not. However, an employee who works in a state that does not have state income tax, for example Nevada, does not avoid the problem. An employee that lives and works in a state that has a state income tax who works in a state without an income tax does not escape taxation. Quite often, the employer would be required to withhold tax for the employee's

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state of residence. In order to determine the proper taxation of multistate employees, the employer must determine the employee's state of residence and the state in which they work.

Most employers are not required to withhold state income tax from employee's wages from the following states – Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, Washington, and Wyoming, which have no individual state income tax. Tennessee does not require income tax withholding.

3. State Unemployment Insurance (SUI) or State Unemployment Tax Act (SUTA)

SUI/SUTA is dictated by FUTA (Federal Unemployment Tax Act). SUI/SUTA differs from FUTA because the tax structure is set at the state level. How the rates are determined, what the rates are, and the taxable wage base are all determined at the state level. There are some states that have an employee tax, for instance New Jersey has an employee SUI tax.

4. State Disability Insurance

State Disability Insurance is extremely rare. There are only five states that have state disability insurance (SDI) as it is known on the west coast. On the east coast it is known as temporary disability (TDI). If an employee is on the east coast the employer must cover the employee for temporary disability situations such as pregnancy or an accident such as a broken foot. Non-worker's compensation is a mandatory SDI/TDI type of program where the state requires the employer to cover an employee. Basically, it will require a percentage of a taxable wage base (funded by the employee to the tune of 1%) to be taken out of the employee's paycheck. Generally, the minimum wage base is $100,000. These programs allow the employer to be self-insured.

5. Paid family leave

While federal wage and hour laws requires employers to provide family leave it does not dictate family leave. There are states however, that do require paid family leave. The employer should be aware of states that require paid family leave. When an employee works in a state they are covered by that state's wage and hour law. If the employee is working in California, then they are covered by California wage and hour law, likewise if an employee is working in Nebraska they are covered by the law in Nebraska.

This issue became more in focus over the last year with the federal paid family leave credit. For a company with less than 500 employees, a federal payroll tax credit was allowed when an employee was unable to work due to reasons related to COVID-19. The credit was born out of the CARES Act and initially was only supposed to extend through the end of 2020. However, the credit was extended by the Consolidated Appropriations Act (CAA) through March 31, 2021. The American Rescue Plan then expanded and extended the credit through September 30, 2021. The initial credit was calculated at a maximum of $200 per day for up to 10 covered weeks. The actual period of coverage for the credit was 12 weeks, but the employer had the option of making the first two weeks of paid leave unpaid. Therefore, the maximum credit was $10,000 per employee ($200 x 5 days per week x 10 covered weeks = $10,000). However, for the period from April 1, 2021, to September 30, 2021, the American Rescue Plan eliminated the option of having the first two weeks being unpaid. Therefore, the credit period became 12 weeks, and the maximum credit became $12,000 for April 1, 2021, to September 30, 2021.

6. Obtaining SDI/TDI coverage in the states

Again, the state in which the work is performed governs the state wage and hour laws applicable to the employee. For example, in Hawaii the employer must generally purchase a private or self-insurance plan.

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New Jersey has a state plan that is employee- and employer-funded. It is a percentage of the taxable wage base, but paid family leave is incorporated into it.

In New York it is done through an insurance fund of the state. The employer can have private insurance, or they can self-insure. Normally it will be purchased through the state insurance fund and the employer can even deduct up to $.60 per week from the employee's paycheck to help pay for the premium.

Rhode Island also has a state plan. It is taken out of the employee's paycheck for a percentage of the taxable wage base. They also have paid family leave. Most of the time paid family leave will come under the SDI programs.

7. Examples of multistate employees relative to SDI/TDI

a. Issues:

Example 1: Employer does not have full-time employees in New York. They have an employee (not a full-timer) who goes over to New York every once in a while, and since they are in New Jersey and already covered, they might believe that they are not an employer in New York. Remember, the employee is subject to the wage and hour laws in the state in which they are working, therefore the employer would be considered to be an employer in New York.

Example 2: An employer located outside of New York has an employee that travels to New York and performs work for 40 days in any calendar year. New York employees are subject to the Disability Benefits Law after the 30th day therefore the employer must have TDI insurance for them. (Remember the employee is subject to the wage and hour laws in the state in which they are working.)

Example 3: A New Jersey employer has an employee who lives and works in New Jersey. She travels to New York once a week and she also worked in Connecticut for some one-off business cases.

She is subject to tax and TDI in New Jersey since she lives and works in New Jersey. She goes to New York 50 times per year (once a week…but she gets two weeks of vacation) so she is there for 50 weeks, therefore the employer should obtain TDI insurance for her in New York. The employer could contact New York and tell them that she is already covered under New Jersey. The state of New York may or may not apply the New York requirement for TDI.

b. Results:

Example 1: New Jersey — The employer will withhold state income tax in New Jersey, employer would withhold from employee's paycheck for TDI, and the employer will pay their portion of the tax.

If employee lives in Newark, they could also be subject to local tax.

Example 2: New York — Employer would be required to purchase insurance for employee in New York for TDI and employer could also be subject to income tax in New York (employee was working in New York more than 30 days, requiring TDI).

Example 3: Connecticut — Employer does not need to worry about TDI as Connecticut does not have that requirement, but the employee could be subject to Connecticut income tax.

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8. Local taxes

These taxes can be stealth taxes. Often, employers have employees working in another state and the employer is not aware that there are local taxes due until the employee receives a bill or the locality issues an arrest notice for the Chief Officer of the company for failure to remit local taxes. Employers need to make decisions on what the local tax is, whether they are subject to it, and whether they are going to deduct it from the employee's wages or is the employer going to pay the taxes.

With 7,000 taxing authorities in the United States there is a virtual array of taxes being asserted on employers and employees. These local taxes take many forms:

- Employee-paid taxes that may or may not be withheld from wages.
- Employer-paid taxes.
- Taxes that are levied on both the employee and employer and then deducted from the employee's wages.
- Taxes that are simply based on payroll in some manner.
- Employer may even need to know the county or school district where the employee lives.

Some of the local taxes are based on resident status or could be assessed if the employee performs services within the local jurisdiction Some of the states with local tax for resident or nonresidents performing services in the local area include:

- PA—Resident/work location.
- OH—Resident/work location.
- IN—Resident.
- MD—Resident.
- CO—Work location.
- MI—Resident.
- OR—Work location.
- NY—Work location.

9. Local tax examples

Chicago has an employer expense tax. For example, if an employee lives in Northwest Indiana and works in Chicago, the employer is now subject to the employer tax since they have an employee working in Chicago.

Wilmington, Delaware has an earned income tax. However, the biggest example of earned income tax is Pennsylvania's Act 32 and is assessed by county and school district. This is the only local tax that has its own W-4 equivalent and a certification requirement. Pennsylvania also has a Local Services Tax (formerly known as the emergency and municipal services tax or the Occupational and Privilege Tax for Pennsylvania and municipalities and school districts).

Counties in Maryland have a county income tax in addition to the state income tax. This requires the employer to determine the county that the employee lives in. Detroit and New York City treat a non-resident the same as a resident. However, if the New York resident lives in Yonkers, they are subject to a different tax chart. Additionally, New York City also has the MCTMT, the Metropolitan Commuter Transportation Mobility Tax which is paid by the employer related to commuting into New York. Ohio also assesses local taxes and provides a listing of the taxes as well as a website that explains each one.

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It is important for payroll that computer systems are set up with information for local and state income taxes. Computer systems should be programmed so that they classify and collect taxes correctly.

There are school district taxes. While many states use their property taxes to fund their schools, Ohio funds their schools through an employee paid tax that is withheld from their earnings. The tax is determined once a year based on the school district in which the employee resides. Therefore, the employer will need to know the employee's school district.

Portland, Oregon has a Metropolitan Transit District Tax (TriMet tax). For this tax, the employer is required to know where the employee lives and works and also if they work at any time within the boundaries of the TriMet as established in a map provided by the state of Oregon. If an employee works all over Oregon, or in the Portland area, and goes outside the boundaries of the TriMet they are not subject to the tax. If the employee works at any time within the boundaries, they are subject to the tax.

Workers Compensation could be based on payroll as it is in many states. The only state that does not require an employer to have workers compensation is Texas.

These taxes tend to sneak up on employers, since localities are inconsistent. Some places have local taxes and other states do not!

10. Adhering to the Internal Revenue Code

States generally conform to the Internal Revenue Code using three methods – automatic conformity, rolling conformity, or fixed date conformity. Automatic conformity is exactly what it sounds like. As soon as a law is passed at the federal level, it is automatically passed into law at the state level. Rolling conformity means that a conformity law is passed at a regular time interval (usually every year).

Example:
Every year, the Virginia General Assembly proposes a bill that says that Virginia tax law will conform to the Internal Revenue Code as of December 31st of the prior year. For instance, the VA General Assembly would meet in 2022 to address conformity to the Internal Revenue Code as of December 31, 2021. This would be an example of rolling conformity. It differs from automatic conformity in the sense that federal tax law changes between conformity passage dates may result in temporary differences between the IRC and VA tax law – until the next conformity bill is passed.

Fixed date conformity means that the state generally conforms to the Internal Revenue Code as of a specific date. The biggest difference between fixed date and rolling conformity is the expectation of when the bill will be proposed. With rolling conformity, there is an expectation that a new conformity bill will be proposed and passed each year. With fixed date conformity, there is no expectation of future conformity bills.

Additionally, it is rare for a state to completely conform to the Internal Revenue Code. More likely, a state will conform with the IRC as of a specific date, except for certain provisions.

While these various approaches to conformity may feel slight initially, the differences became more pronounced during the COVID-19 pandemic. In the case of rolling or fixed date conformity states, state legislatures generally have to meet for laws to be passed. With many people being confined to their homes during lockdown, many states were slower than normal in conforming.

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From the perspective of an employer paying employees, conformity is particularly relevant in the area of fringe benefits. For example, in some years transit passes and van pooling were treated differently for state and federal purposes with the state exceeding the federal allowance.

B. Sourcing issues—Which state gets the tax?

What happens if there are different sourcing rules for compensation in the resident and non-resident states? Take the well-known Sammy Sosa, who was a baseball player and, at the time, an Illinois resident. Sammy was subject to payroll tax withholding in every state that he played a game. He claimed a credit against taxes owed in Illinois for these "game days." However, Illinois used an all-or-nothing rule prior to 2005 and credits were allowed based on the base of operation. Since the base of operation was Chicago, Sammy received no credit. If the other states had a base-of-operation rule, then Illinois would have received nothing.

C. Domicile

Some states don't define residence using a number of days; rather they just use the term 'domicile,' which means that a taxpayer could be a resident in more than one state. At that point it must be decided in which state the tax is paid and in which state the credit is paid. Taxpayers who own a home in New York City and work more than the requisite 183 days in the city have also been considered to be Connecticut residents under the "domicile" rule because the taxpayer owns an expensive home in the state. At first blush, one might say that this should not be an issue since the taxpayer would receive a credit for tax paid to Connecticut to offset tax liability in New York. However, Connecticut does not allow a credit for taxes paid to New York on earnings for work performed in Connecticut because it does not recognize New York's right to tax the income. Second, states generally do not give a credit for taxes on unearned income.

California and New York State are very aggressive in pursuing taxpayers by audit relative to domicile issues. In New York there are five primary factors that the auditors consider when evaluating the location of a taxpayer's domicile. The five factors are:

a. **Home** – This factor is analyzed in terms of size, value, purpose (primary home, vacation home, overnight stays, etc.). The surrender of a residence in one location that coincides with the acquisition of a residence in another location is only an "important indicator" of a change in domicile. Such an occurrence is not by itself determinative of the issue of a change in domicile.

b. **Time spent in various locations** – This factor is the most objective of the factors as it is simply a measure of time.

c. **Location of "near" and "dear" items** – This factor refers to property that is of special value to the taxpayer. Near and dear items need not be of great monetary value, e.g., report cards from school, pen pal letters, award certificates, diplomas, family pets. However, some near and dear items may possess great economic value, e.g., art collections, wine collections, cars, and boats, etc.

d. **Location of active business involvement** – The key to this factor is the word "active." Passive activity is not the main focus of this factor. An individual may be actively involved in a New York business even if they are not physically located in New York.

e. **Location of family** – This factor focuses on spouses and non-adult children. It is clear from the regulations that spouses may have different domiciles although the presumption is that they have the same domicile. The Guidelines instruct the auditors to refrain from

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examining the fifth factor if the taxpayer's domicile can be determined based on the first four factors.

In New York, the tax collectors look at the five factors. The location of favorite possessions or those near and dear items is often referred to as the "teddy bear" test. Taxpayers relocating from New York are finding that they can't just buy a one-bedroom condo in south Beach but leave behind a 20-room palace in Westchester County, or kids in a Manhattan private school.

The Guidelines also mention "other factors" that are considered if it is not possible to determine domicile based upon the five primary factors. The Guidelines indicate that in "virtually all" cases the "other factors" need not be reviewed by the auditor to determine domicile. These factors are:

- The address at which bank statements, bills, financial data, and correspondence concerning other family members is primarily received.
- The physical location of the safe deposit boxes used for family records and valuables.
- Location of auto, boat, and airplane registration as well as the individual's personal driver's or operator's license.
- The location of where the taxpayer is registered to vote and actually votes.
- Possession of a New York City parking tax exemption.
- Telephone service type and activity at various residences; and
- The citation in wills, testaments, and other legal documents that a particular location is to be considered the individual's place of domicile.

Similar criteria are used in most of the states to determine domicile.

1. Statutory residence in New York

A taxpayer who is not domiciled in New York State or City but maintains a permanent place of abode in New York State or City (an apartment) and spends more than 183 days in New York State or City will be a resident for New York State or City income tax purposes. The most important exception is time spent in New York City or State solely for transportation purposes, i.e., passing through New York City in a car or bus or utilizing airports and bus and train terminals.

2. Domicile in California

California's Residency Regulation (Title 18, Division 3, Chapter 2.5 Subchapter 1, (c)), offers the following definition of Domicile.

"Meaning of Domicile. Domicile has been defined as the place where **an individual has his true, fixed**, **permanent home and principal establishment, and to which place he has, whenever he is absent, the intention of returning.** It is the place in which a man has voluntarily fixed the habitation of himself and family, not for a mere special or limited purpose, but with the present intention of making a permanent home, until some unexpected event shall occur to induce him to adopt some other permanent home. Another definition of "domicile" consistent with the above is the place where an individual has fixed his habitation and has permanent residence without any present intention of permanently removing therefrom.

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An individual can at any one time have but one domicile. If an individual has acquired a domicile at one place, he retains that domicile until he acquires another elsewhere. Thus, if an individual, who has acquired a domicile in Illinois, for example, comes to California for a rest or vacation on business or for some other purpose, but intends to either return to Illinois or to go elsewhere as soon as his stay in California is completed, he retains his domicile in Illinois and does not acquire a domicile in California, even though he maintains a home here, has his family with him, and remains here a considerable period of time. Likewise, an individual who is domiciled in California and who leaves the State retains his California domicile as long as he has the definite intention of returning here regardless of the length of time or the reasons why he is absent from the State.

On the other hand, an individual, domiciled in Illinois, who comes to California with the intention of remaining here indefinitely, and who has no fixed intention of returning to Illinois, loses his Illinois domicile and acquired a California domicile the moment he enters the State. Similarly, an individual domiciled in California, who leaves the State, loses his California domicile the moment he abandons any intention of returning to California and locates elsewhere with the intention of remaining there indefinitely."

3. Statutory residence in California

California's Residency Regulation (Title 18, Division 3, Chapter 2.5, Subchapter 1) identifies taxpayers who are residents and nonresidents under Code Section 17014 of the California tax code. "The term 'resident' as defined in the law, includes (1) every individual who is in the State for other than a temporary or transitory purpose, and (2) every individual who is domiciled in the State who is outside the State for a temporary or transitory purpose. All other individuals are nonresidents."

a. **Couple failed to prove domicile in Arizona:** The State Board of Equalization (SBE) upheld the Franchise Tax Board's (FTB's) assessments against taxpayers who failed to substantiate their claim that they were nonresidents during the years in issue. The taxpayers lived and owned businesses in California and in 2004 began operating two businesses in Arizona. Their 2004 and 2005 returns reflected the proration of their income between Arizona and California. The taxpayers argued that this new investment was a substantial portion of their assets and liabilities and required them to spend a great deal of time in Arizona during the 2004 and 2005 tax years; therefore, they met the safe harbor provided by Cal. Rev. & Tax. Cd. §17014(d) for taxpayers who are not in the state for a substantial amount of time due to employment related absences. The taxpayers stated that their intent was to move to Arizona and that they had more significant contact with Arizona based on their exposure to risk, and thus should be considered part-year residents. The SBE found that the taxpayers failed to show that the absences were due to an employment-related contract and not for temporary or transitory purposes, or that they intended to permanently abandon their California domicile and establish one in Arizona. The evidence showed that for 2004 and 2005, the taxpayers had filed California resident income tax and Arizona nonresident income returns. In addition, the taxpayers retained their principal residence in California, registered two business entities in California using that home address, sent their children to school in California, and maintained their California drivers' licenses and vehicles. The taxpayers did not provide any evidence to support their presence in Arizona for the majority of the 2004 and 2005 tax years, and thus failed to qualify for the safe harbor.[1]

[1] Appeal of *Panhwar*, SBE, Dkt. No. 526808, 10/25/2011 (not to be cited as precedent).

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4. Maine issues Guidance

In 2015 the state of Maine introduced a Guidance document for determining residency in the state. In the guidance they define a resident taxpayer as a person who is domiciled in Maine ("a permanent legal resident") or a statutory resident. The state in which you are domiciled is the permanent legal residence. This is the place that the taxpayer intends to make their home for a permanent or indefinite period of time. It is generally the place where the taxpayer dwells and is the center of their domestic social and civic life.

The state emphasizes that no one single factor will determine the state of domicile. Rather, all relevant factors are evaluated together. Taxpayers should be reminded that "intent" is not enough. There are many factors that will be evaluated to determine evidence of domicile.

The Guidance further discusses the concept of "statutory residence." Taxpayers would be considered to be a statutory resident if:

- They spend more than 183 days (any portion of a day is considered to be a full day) in Maine during the tax year; and
- The taxpayer maintained a permanent place of abode in Maine for the entire tax year.

A permanent place of abode is a house, apartment, dwelling place, or other residence that an individual maintains as his or her household, whether or not he or she owns it.

The term does not include a seasonal camp or cottage that is used only for vacations, a hotel or motel room, or a dormitory room used by a student during the school year. A place of abode is not deemed permanent if it is maintained only during a temporary stay in Maine for the accomplishment of a particular purpose.

a. **Nonresident then Statutory resident** – Sarah is domiciled in New Jersey. She is transferred to her employer's Maine office for an assignment from June 1, 2015, to August 1, 2016. If Sarah resides in an apartment in Maine during this period, she will not be a statutory resident in Maine in 2015, even though she spends more than 183 days of the taxable year in Maine, because her apartment was not maintained for the entire year. Only income she receives (such as her salary) that is connected to or derived from sources in Maine will be subject to Maine's income tax in that year. If Sarah's assignment is extended in 2016 to last for the entire year and she maintains the apartment as a residence throughout 2016, she will be a statutory resident in 2016, and all her income will be subject to Maine income that year.

5. Domicile in Massachusetts

In Massachusetts, the legal status of a taxpayer's domicile depends upon all the facts and circumstances in each case, including the good faith of the individual. In the Q & As provided by the Massachusetts DOR, it states that an individual may have multiple residences at one time, but only one domicile. The legal residence or domicile is the one an individual regards as his true home or principal residence. An individual cannot choose to make his home one place for the general purposes of life and in another for tax purposes. One's legal residence is usually the place where an individual maintains the most important family, social, economic, political, and religious ties.

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In Massachusetts, the basic rules to be applied in determining the domicile or a change of domicile are:

- Each individual has a domicile. It may be a domicile of origin (birth), a domicile by operation of law, or a domicile of choice (accomplished by a change of residence).
- Each individual retains his or her present domicile until he or she establishes a new domicile at another place.
- A new domicile may be acquired only by: (i) abandoning the present domicile, or (ii) establishing residence at a new place and (intending to make the new residence one's home permanently or for an indefinite time, with no certain present intention to return to the previous home); and
- The burden of proving that a taxpayer has changed his or her domicile lies with the party asserting the change.

Factors to be considered in determining whether or not a taxpayer has changed his or her domicile to a new location outside of Massachusetts include whether the taxpayer:

- Purchased or leased a new home or apartment in the new location.
- Moved his personal property to the new location.
- Obtained permanent employment in the new location;
- Canceled Massachusetts bank accounts and opened new accounts in the new location;
- Sold real property in Massachusetts or canceled leases;
- Issued address change notices;
- Changed voter registration;
- Obtained a driver's license and automobile registration in the new location;
- Changed membership in churches and clubs; and
- In general, is involved in the new community.

6. Statutory residence in Massachusetts

Massachusetts also has a statutory residency status rule. A resident in Massachusetts is a taxpayer whose legal residence (domicile) is not in Massachusetts for the entire year but who: (i) maintains a permanent place of abode in Massachusetts; and (ii) spends in the aggregate more than 183 days of the taxable year in Massachusetts, including days spent partially in and partially out of Massachusetts. A day in Massachusetts while on active duty in the United States Air Force is not counted.

7. Domicile in New Mexico

Individuals who are physically present in New Mexico for a total of 185 days or more during the year, regardless of domicile, are considered residents. **In calculating presence in the state for 185 days or more, days when the taxpayer is in New Mexico for 24 hours are counted**. The 185 days do not have to be consecutive. Residents include individuals who are temporarily residing in New Mexico who plan to return to their out-of-state residence and who are physically present in New Mexico for 185 days or more. Residents could include students and individuals vacationing in or temporarily assigned to work in New Mexico, as long as they meet the 185-day rule.

8. Disabled veteran proved he was New Jersey resident

Taxpayer resided in New Jersey and considered his home there to be his permanent residence. In 2009 he purchased a home in Florida, which he contended was a vacation home. He rented the home out, which further substantiated that it was a vacation home. He obtained a Florida driver's license in 2004 prior to owning a home in New Jersey. His Florida license gave him some perks such as discounted entry into the state parks and other discounts offered to him as a veteran in the state. The taxpayer also

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registered to vote in Florida in order to vote in the 2008 and 2012 presidential elections; he claimed he was not aware he could have voted by absentee ballot in New Jersey.

Taxpayer reported his New Jersey address on all his federal income tax returns. All his mail was delivered to New Jersey, including credit card bills, bank statements, and correspondence with the Social Security Administration. The Court ultimately determined he was a New Jersey resident and entitled to the exemption for disabled veterans.[2]

9. Taxpayer claimed refund for New Mexico taxes since he was not a resident

One taxpayer moved out of state for part of the year while the other taxpayer remained in New Mexico with taxpayer's dependent. In this case the taxpayer failed to provide sufficient evidence that taxpayer had moved out of state and changed domicile. The Hearing Officer stated that everyone is deemed to be domiciled somewhere and once that domicile is established it does not change until the person moves "with the bonified intention" of making a new location that person's permanent home. Under New Mexico law domicile is what helps to establish a taxpayer's residence.

New Mexico uses 13 factors to determine a taxpayer's domicile. The Hearing Officer determined that eight of those factors weighed in favor of the Department, five were neutral, and zero weighed in favor of the taxpayer. The taxpayer failed to establish an entitlement to the refund that was the subject of the protest.[3]

10. Minnesota modified domicile test for resident individuals

Effective for tax years beginning after December 31, 2016, the definition of "resident" is modified so that the location of: the individual's attorney, certified public accountant, or financial adviser; and the place of business of a financial institution where the individual opened or maintains an account cannot be considered by the Department of Revenue or a court in determining where the individual intends his or her permanent home to be (i.e. the domicile test).[4]

11. Even days in jail count!

The days that an individual involuntarily spends in Minnesota due to incarceration for a criminal offense committed in Minnesota or as a result of a related court order to remain in the state count toward determining whether an individual qualifies as a non-domiciled resident.

In this case the taxpayer filed his 2011, 2012, and 2013 Minnesota state tax returns as a nonresident. However, the Commissioner of Revenue found that he spent more than one half of 2011 and 2012 in the state and qualified as a non-domiciled resident, in other words he qualified under the 183-day rule. The taxpayer tried to argue he was in the state involuntarily and only voluntary days should count toward residency.

The Tax Court found that residence is residency regardless of intent. Non-domiciliary residency is based on an individual's physical presence in Minnesota, whether or not it was voluntary. While the taxpayer was under court order to remain in Minnesota while awaiting trial after his August 2011 arrest, the record indicates he could have sought permission from the court to leave Minnesota, but he apparently did not.

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[2] Taylor v. Township of Waterford, N.J. Tax Ct. Dkt. No. 000668-2017, 4/18/2018.

[3] Matter of the Protest of Joel W. and Jaqueline R. Draham, New Mexico Taxation and Revenue Department Decision and order no. 18-01, 1/9/2018.

[4] L. 2017, H1 (1st S.S.) (c. 1).

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The court concluded that when someone owning an abode in Minnesota drives under the influence and refuses to submit to a chemical test, a foreseeable consequence is that the individual will be charged and convicted requiring them to stay in Minnesota and potentially be subject to income tax.[5]

12. Recent case in New York

The following case was featured prominently in the news and has attracted a new focus on the residency rules in states, particularly in New York. A New York court ruled that all income earned by a New Canaan, Connecticut couple was subject to New York state taxes because they owned a summer home on Long Island, they used only a few times a year. Total additional tax assessed to the couple was in the neighborhood of $1.06 million.[6] Basically the court asserted that the taxpayers had a permanent residence or domicile in the state of New York. New York's definition of "permanent place of abode" specifically excludes "a mere camp or cottage, which is suitable only for vacations." The judge ruled that the couple's Long Island vacation home qualified under the law as a permanent abode because it was suitable for living year-round; whether or not the couple actually stayed in the home was not relevant. Under the ruling, if an owner does not spend a single day in a home, it could still count as a permanent residence. The Napeague, Long Island house was purchased by John and Laura Barker for $260,000 in 1997. Based on court records, the period of assessment, the Barkers said they spent only 17 days a year at the home, usually during the summer.

As previously established under judicial precedent, it is immaterial if the taxpayer decides to actually reside in the abode throughout the year. However, what does matter is that the abode has the amenities to make it suitable for year-round habitation. In order to be defined as a permanent place of abode it must be suitable for year-round living and the taxpayer must maintain dominion and control.

Since the husband had full time employment in NY the parties stipulated that they had met the 184-day rule, however, the argument centered on the Napeague cottage and its classification as a permanent place of abode.

The Department cited the following facts in determining if the cottage was a permanent place of abode:

i. Size of the abode at 1100+ square feet with three bedrooms and two baths, plus large deck.
ii. Home was heated and insulated allowing it to be inhabited during the winter. (While Napeague is a seasonal community and documentation was provided to prove such, the wife's parents (specifically her father) spent many weekends at the house between November and May).
iii. Based on credit card statements, utility, telephone, cable and oil delivery bills, the home was occupied during the winter (again by the wife's parents).
iv. The wife's father operated a fishing charter business (for hire) that used the Napeague house address as the address for the business, and the father operated charters between November and May.
v. While the wife's parents utilized the home on a regular basis (probably more than the taxpayers) the Department argued that they (taxpayers) maintained dominion and control over the home.

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5 (*Wersal v. Commissioner of Revenue*, Minn. Tax Ct. Dkt. No. 8957-R, 5=4/5/2017).
6 In re *Barker*, No. 822324 (NY Tax App. Jan 13, 2011).

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In another case, a taxpayer had a penthouse apartment and was employed in NYC and obviously spent more than 184 days in New York. However, this taxpayer also owned a weekend home in Connecticut. Connecticut asserted that taxpayer had "domicile" in Connecticut based on owning a multi-million-dollar home, even though taxpayer could document use of the home on the weekends. Again, the home could be inhabited year-round. Connecticut also has an exemption for a vacation home or camp—but in this case the Connecticut authorities pointed to the size and price of the house and said it could not be a "vacation property." Connecticut also states that the domicile is the place that the taxpayer intends to return to. Taxpayers can have multiple residences; however, the domicile does not necessarily mean the place where the taxpayer spends the most time. Once again, taxpayer found that it was paying tax on the same income in Connecticut, New York, and New York City.

As an aside—in 1996, the North Eastern States Tax Officials Association (NESTOA) provided a determination of domicile and residence. The states that signed this agreement were CT, DE, ME, MD, MA, NH, NJ, NY, PA, RI, UT, and DC. The idea behind this reciprocal agreement was to keep taxpayers from being taxed twice on the same income.

D. Credit for taxes paid to another state

In the Barker case above, one would think that the tax that they paid in Connecticut would be offset by the tax that they paid in New York. However, that is not always the case. Under New York Law §620, residents of New York are permitted to take a credit for “any income tax imposed for the taxable year by another state….upon income both derived therefrom and subject to tax under this article.” The regulations then define income derived from another state for purposes of Tax Law §620 as compensation for services performed in that jurisdiction, income from a trade or business carried on in that state, or from tangible personal property situated in the other jurisdiction. **The regulation specifically excludes the available credit for taxes paid to the other jurisdiction on income from intangibles.**[7] Connecticut has a similar rule.[8] So if a Connecticut domiciliary is subject to tax as a statutory resident of New York, Connecticut will provide a credit for New York tax paid on New York-source income and vice versa. The intangible income gets taxed twice.

If the credit provisions were fixed so that New York would give its statutory resident (taxpayer who spent 184 days in the state) a credit for all Connecticut tax paid on the intangible income it would fix the problem. Connecticut would get tax on the intangibles, which would be appropriate since the taxpayer’s home is in Connecticut, but the income would only get taxed once. The rule would be reciprocal so that if the situation were reversed Connecticut would offer a credit for the New York taxes paid on intangible income. This would not get rid of the dual residency issues, nor would it end difficult residency requirements. But it would get rid of double taxation.

Interestingly enough, the credit for income from intangibles idea has been around for quite some time. In 1996 the North Eastern States Tax Officials Association (NESTOA) provided a determination of domicile and residence. The states that signed this agreement (CT, DE, ME, MD, MA, NH, NJ, NY, PA, RI, UT, and DC) hoped to address many of the problems arising from multiple state residency rules. The idea behind this reciprocal agreement was to keep taxpayers from being taxed twice on the same income. The agreement called for the adoption of uniform criteria for determining a taxpayer’s domicile, a mechanism to resolve certain disputes when two or more states each claim domicile for the same year, and the adoption of uniform credits for taxes paid to other states.

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7 (20 NYCRR 120.4(d)).
8 (Conn. Agencies Regs. 12-704(a)-4(3)).

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The final provision of the NESTOA agreement is applicable in this situation. "The member states agree that the preferred method for the elimination of double taxation of the select classes of income is the utilization of a credit for taxes paid to the other jurisdiction. The state to which income is sourced shall be entitled to the tax on earned income and the states of domicile and statutory residence shall be required to give the individual a credit for taxes paid to another jurisdiction on such income. The state in which an individual is domiciled shall be entitled to the tax on income sourced to, but not taxes by, a state other than the state of statutory residence and "non-source" income such as from intangible assets with the state claiming statutory residence being required to give the individual a credit for taxes paid to the state of domicile on such income."

Seems easy—if a taxpayer is domiciled in one state and a statutory resident of another, the state of domicile gets the tax on the intangible income. The statutory resident state is required to give the resident a tax credit on non-sourceable income.

Implementing the changes under the NESTOA agreement would require legislation in some states. Following the agreement, Connecticut and Vermont enacted legislation to establish the tax credit mechanism envisioned by the cooperative agreement. However, Connecticut's rule said that the application of the credit provisions is contingent on the existence of similar legislation in the reciprocal state.[9] Other states (Delaware, Maine, Rhode Island, and Maryland) already provided for such a credit and New Jersey's credit provision was broad enough already to permit a credit for taxes paid regardless of the source of income.

That leaves us with New York. Unfortunately, no credit provision was ever enacted. Legislation was proposed in 1997 to amend the resident credit provisions to include language consistent with the NESTOA agreement. But it never went anywhere. Fifteen years later, there are still difficult residency audits and different states applying different tests and this could be fixed if New York State would follow through on the 1996 NESTOA agreement and enact a revised credit provision. However, unless New York City also adopted similar legislation, the same double taxation issues would be present.

Yet another issue that exists in many states is that many states restrict the amount of credit to be reflected based on the tax rate of the resident state. For example, if a taxpayer lives in a state that taxes at a five-percent rate and has income in a state with a seven-percent rate, and if the resident state restricts the allowed credit to the same tax rate in the resident state, then the taxpayer will not receive full credit for tax on income from the nonresident state. As discussed in more detail elsewhere, taxes paid at the entity level in some states are not considered to be creditable taxes for individuals.

E. New York strikes again at Statutory Residency Rules

Under the New York residency statutory test, a taxpayer who maintains a permanent place of abode and spends more than 183 days in New York can be taxed as a resident, regardless of where they "live" or where their home is located. The question of whether someone maintains a "permanent place of abode" becomes central in residency audits. This analysis was guided by the Tax Appeals Tribunal's decision in Matter of Evans, which required a fact-intensive analysis into the taxpayer's use and relationship to the particular dwelling in order to determine whether it was a "permanent" place of abode.

[9] Conn. Gen. Stat. §12-704(d).

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The Tax Appeals Tribunal reversed its own decision in a recent case.[10] In *Gaied* the issues concerned whether an apartment owned by a taxpayer but maintained for his sick, elderly parents constituted a "permanent place of abode." The taxpayer initially lost at the administrative law judge level, with the judge ruling that a New Jersey domiciliary's access to his parents' apartment – though limited – was enough to justify resident taxation in New York (coupled with his presence in the state of more than 183 days). On appeal, the Tax Appeals Tribunal reversed, holding that the taxpayer's restricted access to the apartment, lack of personal items there, and lack of usage of the apartment as a residence established that the abode lacked the "permanence" necessary to qualify as a "permanent place of abode."

This decision was consistent with prior Tribunal cases including Evans. However, the Tax Department took the unusual step of requesting re-argument. The new argument was that ownership (or property rights) transcends all other facts and circumstances. **If a taxpayer has a property right in an abode, the Division argued that the abode automatically qualified as a "permanent" place of abode**. In its new formulation of the permanent place of abode test, ownership or property rights are all that matter. Specifically, the Tribunal said: "[W]here a taxpayer has a property right to the subject premises, it is neither necessary nor appropriate to look beyond the physical aspects of the dwelling place to inquire into the taxpayer's subjective use of the premises." In a footnote, the Tribunal also found that the requirement for a dwelling place to have a bedroom or a bed is found nowhere in the case law or statute, stating that "the lack of a bedroom or bed would not preclude [a] premises from being deemed a permanent place of abode."

The Tribunal reversed itself and distanced itself from prior cases and even from current Tax Department policy**. It appears that under this decision, if a taxpayer has any property rights in a dwelling place in New York, it may not matter whether the taxpayer ever steps foot in the place, or that it even has a bed. And it certainly may not matter if the taxpayer never uses the place as a residence**.

F. Divided Appellate Division affirms the Tribunal's *Gaied* "Permanent Place of Abode" decision

A divided Appellate Division affirmed a controversial Tax Appeals Tribunal decision holding that Staten Island residential property owned by a New Jersey resident and occupied by his parents constituted his "permanent place of abode" and made him a "statutory resident" of New York.[11]

While the Appellate Division upheld the Tribunal decision, it did not adopt the Tribunal's conclusion that ownership and maintenance of a dwelling alone is determines a permanent place of abode. Falling back on Third Department precedent, the Appellate Division held that in determining whether a taxpayer maintains a permanent place of abode, a variety of factors and circumstances may be relevant, including, but not limited to, whether the taxpayer: (1) had free and continuous access to the dwelling; (2) received visitors there; (3) kept clothing and other personal belongings there; and (4) used the premises for convenient access to and from a place of employment. While the Appellate Division gave more weight to a number of factors than the Tribunal did, the Court still held that the Tribunal's findings of fact were supported by substantial evidence in the record.

Two of the five justices dissented, finding that "the record clearly establishe[d] that petitioner purchased the property…as both a place for his parents to live and as an investment" and therefore the Tribunal's

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10 *In the Matter of John Gaied, New York State Tax Appeals Tribunal*, DTA No. 821727 (2011).
11 *Matter of John Gaied v. Tax App. Trib.*, 2012 NY Slip Op. 9108 (3d Dep't, Dec 27, 2012.

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determination was “irrational and unreasonable.” The dissent observed that the case law makes clear that the purpose of the stator residence rule is to tax those, who for all intents and purposes, are residents of the State.

The dissent of two Appellate Division justices is significant as it enables the taxpayer to appeal to the New York Court of Appeals as *of right*. If the decision is appealed, the Court of Appeals will have the opportunity to address some of the inequities of the permanent place of abode rule and possibly provide more clarity regarding this issue.

G. NY Tax Bulletin TB-IT-690 issued December 15, 2011

Subsequent to the *Gaied* case, the state of New York issued Tax Bulletin TB-IT-690, which provides guidance regarding a permanent place of abode. A permanent place of abode is defined as a building or structure where a person can live that the taxpayer maintains, whether they own it or not; and is suitable for year-round use. A taxpayer is considered to be maintaining a permanent place of abode if: the place of abode meets the physical characteristics previously described; and it is maintained for substantially all of the tax year (disregarding small portions of the year).

If the taxpayer does not own or lease the place where they live, they are considered to be maintaining it if they are making contributions to the household in the form of money, services, or other contributions. Examples in the Bulletin include a roommate who contributes to the rent even thought their name is not on the lease. The roommate would be considered to have a permanent place of abode in New York even though they do not own or lease the place where they live.

A taxpayer maintains a permanent place of abode for substantially all of the tax year if it is maintained for more than 11 months during the year. Therefore, if a taxpayer has a residence that would normally be considered to be a permanent place of abode in New York, but it is rented out 11 months during the year and the taxpayer only lives in it one month during the year, such taxpayer would not be considered to have a permanent place of abode in New York.

Instances when a permanent place of abode may not be maintained for 11 months would include when the place of abode is first leased or purchased during the tax year or when the taxpayer terminates the lease or sells the place of abode during the year.

H. Finally, the taxpayer wins in New York

The New York Department of Taxation and Finance concluded that taxpayers **did not maintain a permanent place of abode** in New York for 2010 and, thus, the taxpayers who spent in excess of 183 days in New York in 2010 should not be taxed as residents of New York in that year. The taxpayers moved out of their New York City apartment on May 14, 2010, and changed their domicile from New York to Connecticut. Taxpayers entered into a real estate listing contract under which they were legally bound to **turn over all the keys** to their apartment to the real estate agent, **remove all their personal possessions** from the apartment, and **agree not to live in the apartment during the period of the sales process**. Although the taxpayers did pay for maintenance, such as electric utilities as part of the common charges included in monthly assessments, until the property was sold, **they were contractually prohibited from entering the apartment during the period during which it was being shown to potential buyers**. As such, they did not maintain a permanent place of abode in New York., because **they did not have unfettered use of their apartment**. Therefore, the taxpayers were not resident

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individuals in that year for purposes of New York State personal income tax, because they did not maintain a permanent place of abode for substantially all of the taxable year.[12]

I. New York high court overturns tax tribunal's definition of statutory resident

On February 18, 2014, New York's highest court ruled that to qualify as a "statutory resident" for individual income tax purposes, **there must be a reason to believe that a residence maintained by a taxpayer is actually used by the taxpayer himself.**

In Gaied v. New York State Tax Appeals Tribunal, the New York court of appeals reversed a Tax Appeals Tribunal decision holding that a nonresident who maintains "a permanent place of abode….and spends in the aggregate more than 183 days of the taxable year in the state" is considered a statutory resident.

The court found "that in order for an individual to qualify as a statutory resident, **there must be some basis to conclude that the dwelling was utilized as the taxpayer's residence**."

In this case, Gaied contended that although he owned a business and a home in Staten Island, he was a resident of New Jersey. The residential property in question had been purchased in 1999 as an investment property and a place for his parents to live.

From 2001 to 2003, Gaied filed nonresident tax returns in New York and was subsequently audited. The state found that he owed $253,062 in New York State and local income taxes, plus interest as a statutory resident. Gaied appealed, claiming he was a full-time resident of New Jersey.

The Department of Taxation and Finance determined Gaied to be a resident for tax purposes partly because the bills for his parents' home were in his name and he had voted in New York general elections in 2000. Gaied challenged the department's determination and testified that the bills were in his name to better accommodate his parents.

His first appeal was initially struck down by an administrative law judge on the grounds that, by law, he was a statutory resident of New York. Gaied filed an exception to the Tax Appeals Tribunal, which reversed the administrative ruling but then reversed itself after a re-argument, calling its original decision an "improper departure" from the statute.

"There is no requirement that the petitioner actually dwell in the abode, but simply that he maintain it," the tribunal said, finding that Gaied's resident status was determined correctly because he spent more than 183 days in New York City and maintained "a permanent place of abode" determined by the residency test of New York State Tax Law.

The Court of Appeals' ruling focused on prior cases and legislative history regarding the statutory residency issue. The court determined that the tribunal's interpretation of the law had no rational basis.

"Notably, nowhere in the statute does it provide anything other than the 'permanent place of abode' must relate to the taxpayer," the ruling said. "The legislative history of the statue, to prevent tax evasion by New York residents, as well as the regulations**, support the view that in order for a taxpayer to have**

[12] New York Advisory Opinion TSB-A-11(9)I, 11/08/2011.

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maintained a permanent place of abode in New York, the taxpayer must, himself, have a residential interest in the property."

J. New York tax department revises nonresident audit guidelines

Following the decision of the state's highest court, the New York State Department of Taxation and Finance has published revised nonresident audit guidelines. This is the sixth set of revisions since they were first issued in 1992. The revisions were prompted by the New York Court of Appeals' ruling in February in ***Gaied v. New York State Tax Appeals Tribunal,*** which said that for a taxpayer to qualify as a "statutory resident" for individual income-tax purposes, there must be a reason to believe that a residence maintained by a taxpayer is actually used by the taxpayer himself.

The revised guidelines are particularly significant because of New York's high rate of audit activity – especially in New York City, where many taxpayers keep an apartment, such as high-net-worth individuals and top executives, who temporarily reside in the state on occasional business. Department officials have said that they issue approximately 2,400 nonresident audits annually and collect $150 million in revenue in the most recent fiscal year.

The majority of the changes in the 2014 Audit Guidelines reflect the department's view on the Court of Appeals' decision in *Gaied.* The department states that the *Gaied* decision "is consistent with current audit policy that the taxpayer must have a relationship to the dwelling for it to constitute a permanent place of abode."[13] In short, they seem to largely imply that nothing has really changed. This conclusion has to leave the practitioner shaking his/her head. If nothing has changed, then why didn't the court find for the Department? This would seem to imply that the department's new audit guidelines may still not reflect the court decision. A simple reading of the logic of the decision would seem to say that the "relationship" with the place of abode does not matter. It is whether or not the taxpayer actually lives there!

On February 18, 2014, New York's highest court ruled that to qualify as a "statutory resident" for individual income tax purposes, there must be a reason to believe that a residence maintained by a taxpayer is actually used by the taxpayer himself. From a practical standpoint that may differ with recent experiences of many practitioners and individuals involved in residency audits. Quite often they find that the Department auditors often assert that merely owning a dwelling in New York—regardless of the individual's actual, residential use of the apartment—is a sufficient basis on which to conclude that the dwelling constitutes the individual's permanent place of abode.

The department states in the guidelines that they will assess the place of abode under two sets of characteristics: (i) the physical aspects; and (ii) the nature of relationship that the taxpayer has with the residence. A permanent place of abode can be a house, co-op apartment condo, or other dwelling. New York State Income Tax Regulations §105.20(e) defines a permanent place of abode, in part, as a "dwelling place of a permanent nature maintained by the taxpayer, whether or not owned by him, and will generally include a dwelling place owned or leased by his or her spouse."

For a dwelling to be permanent, it must be suitable for year-round use. Thus "a mere camp or cottage that is suitable and used only for vacations is not a permanent place of abode" according to the regulations in 20 NYCRR 105.20(e)(1). Suitability for year-round use turns on the physical attributes of the dwelling, that

[13] (Audit guidelines p. 54) H. New York High Court Overturns Tax Tribunal's Definition of Statutory Resident.

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is, whether its construction and other features make it suitable for year-round use. The fact that the taxpayer/owner does not choose to live in the dwelling the entire year does not determine if it is suitable for year-round use. Therefore, the "subjective use of a dwelling by a taxpayer" does not determine whether it is a permanent place of abode. In recent cases, the courts have also noted the fact that the taxpayers who maintained "dominion and control over the dwelling" were sufficient, or that the Tribunal to conclude that the home was a permanent place of abode.

Generally, in addition to being suitable for year-round use, a place of abode must contain "facilities ordinarily found in a dwelling such as facilities for cooking, bathing, etc." in order for it to be permanent according to the regulations in NYCRR 105.20(e)(1). Despite the absence of cooking facilities, however, a hotel room and an apartment were both deemed to be permanent places of abode in an advisory opinion.[14] The opinion based its conclusion in both instances on the fact that the living arrangements will be maintained on a permanent basis.

One can maintain a residence by making monetary contributions to the household expenses in a variety of ways, either by sharing the costs of ownership such as the mortgage, or operating costs such as utilities or repairs, or by paying specific expenses. Or in lieu of money, one could make in kind contributions by providing services in the form of repairs, cleaning, or cooking.

The 2014 Audit Guidelines establish clear factors that auditors are to consider, namely, whether the individual:

- Has property rights to the dwelling;
- Maintains the dwelling either in money or in kind;
- Uses the dwelling or otherwise has access to it;
- Has a relationship to other occupants of the dwelling (and the nature of that relationship);
- Has separate living quarters or keeps personal items at the dwelling; and
- Uses the address of the dwelling for government or business purposes.

The guidelines now also make it clear that "[w]hile the possession of property rights and the making of contributions either in cash or in kind are two important aspects to be considered in evaluating a taxpayer's relationship to a residence, by themselves they would not necessarily make a dwelling a permanent place of abode, *without more*."[15]

The 2014 Audit Guidelines provide a number of examples to illustrate the department's view on Gaied. Example 4 closely tracks the fact pattern that was present in Gaied – a fact pattern that is common to many individuals who claim that they are not statutory residents of New York. This example provides that an individual who: (i) buys an apartment for his family member who uses the apartment; (ii) is the legal owner paying all the expenses; (iii) has a key to the apartment; and (iv) occasionally sleeps on the couch when visiting his family member does not have a residential interest in the property because the **"overriding point" is that the residence is primarily used by the family member and the individual's "occasional use" should not change its character**.[16]

Individuals, especially those who hold legal title to a residence in New York, but that residence is used by the individual's children or other family members, should point to this example when confronted by an

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14 Paul Gajkowski, TSB-A-02(7)I.
15 (2014 Audit Guidelines p. 56 (emphasis from original).
16 (Audit Guidelines p. 55).

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auditor who insists that "mere ownership" is enough to classify that residence as the individual's permanent place of abode.

Other examples provided by the department make clear its views on Gaied, that the individual must have the ability to use the dwelling as his or her residence; a demonstration of actual use in a residential manner may not be required. Example 2 of the 2014 Audit Guidelines illustrates this point. In it the department provides that a taxpayer in connection with her change of domicile to Florida, listed her New York home for sale. The home remained fully furnished, and the taxpayer had unfettered access to the dwelling although she no longer resided there. On those facts, the department concludes that the situation evidences a residential interest between the taxpayer and her New York home "because the taxpayer continues to have unfettered access to the home which had been her primary residence in the past and no one else is using it as a residence currently.[17] The Department then contrasts this situation with new facts in Example 3, where the individual demonstrated that the contents of the home were moved to her Florida residence and the New York home was vacant. On these new facts, the Department concludes that the individual would not have a residential interest in the property, as it "would not be reasonable to expect her to use a vacant home despite having unfettered access."[18]

The guidelines also provide some taxpayer friendly advice guidance on the 183-day count. Traditionally, auditors have taken the position that if the taxpayer could not prove where a part of a day or an entire day was spent it must have been spent in New York. Residency audits are extremely detail oriented due to taxpayers attempting to prove where they have been each day. The 2014 Audit Guidelines recognize that individuals "may not always leave a paper trail" to substantiate that they were outside of New York.[19] The department therefore advises auditors to "generally accept the taxpayer's allegations absent evidence to the contrary such as a clear pattern of regularly being in New York on weekends.[20] This advice will hopefully eliminate some of the needless efforts that had been expended in recent residency audits debating established patterns of behavior.

K. Where does NY stand with their decision in "*Gaied*"?

If a taxpayer uses a dwelling more regularly but there are other facts that indicate he did not maintain the dwelling as a residence for himself permanently, this also raises questions under the new *Gaied* standard. That conclusion gets back to the purpose of New York's statutory residency statute and the court's decision in *Gaied*, which was to tax people who really lived in New York. Does a taxpayer who spends 10 to 20 nights at an apartment in New York really liver here? What about the vacation-home owner who spends a few weekends in her place – and far away from where she works in New York regularly? Those are situations in which the question – Does the taxpayer really live here? – becomes so relevant. But the tax department does not appear willing to factor that question into the analysis. As stated earlier, the current audit guidelines being used by the department seem inconsistent with the Court's decision, which seemed to hinge on where the taxpayer actually lived – nothing more. When a case with primary dwelling comes up and *Gaied* is particularly relevant, the tax department auditors will respond in the same manner, "The facts in *Gaied* were different; his parents lived there."

Gaied stands for the proposition that a dwelling cannot be a taxpayer's Primary Place of Abode (PPA) without proof that the taxpayer maintained the dwelling as a residence. As outlined above, the court in

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[17] 2014 Audit Guidelines, p.55.
[18] 2014 Audit Guidelines pg. 55.
[19] 2014 Audit Guidelines p.66.
[20] 2014 Audit Guidelines, p. 66.

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Gaied stopped short of deciding the case on its own merits; it merely set forth the law to be applied in primary dwelling cases. That standard must be applied in all cases, not just cases in which a taxpayer may be maintaining a place for someone else to use.

It appears that the *Gaied* court set forth a pretty simple standard for deciding PPA cases. The taxpayer has to use the place as a residence. But it appears the department is applying a different test. Under their view if: (1) a dwelling is available for the taxpayer to use – that is the taxpayer has unfettered access to the place, and (ii) if no one else is living there, the dwelling will be a PPA.

However, that standard misses the mark. It runs counter to the mandate that a taxpayer must maintain the dwelling as a residence; and it runs counter to the Chief Judge Lippman: "There's got to be some rhyme and reason to it. And what I'm saying to you – what makes sense is, if you really don't reside there that's the ultimate test, and no one who [ ] doesn't actually reside [should be subject to tax as a resident] – I can make sense of the statute if that's the test."[21]

There will be more cases coming and with *Gaied* in the same corner as the taxpayers, we think the taxpayers stand a great chance for another big win.[22]

L. Other withholding issues

What defines the obligation to withhold state income tax? One of the first things to determine, when looking for guidance, is whether there **is federal withholding required on the payment**. For instance, non-qualified stock options are considered compensation, while qualifying incentive stock options would normally not be determined to be compensation subject to withholding. It is also important to determine whether the payment or incentive is by definition "compensation."

One particular area that has come more into focus in recent times because of the pandemic is employee expense reimbursements. With more employees than ever working from home, companies are often reimbursing the employee for additional costs they incur when doing business from home, such as additional software costs, business internet usage, and even office supplies. The question is when an expense reimbursement would require withholding. As a general rule, if an expense reimbursement meets the requirements of an accountable plan, then no withholding is required because it is not considered compensation to the employee. If the expense reimbursement does not meet the requirements of an accountable plan, then it is automatically considered as part of a non-accountable plan. Payments that are part of a non-accountable plan are generally considered to be part of compensation and therefore require withholding. In either case, expense reimbursements are generally deductible by the company, as long as they meet the normal "ordinary, necessary, and reasonable" requirements. The differentiation between accountable and non-accountable plans is largely in whether they or not they are included in employee compensation.

In order for a payment to be treated as part of an accountable plan, it must meet three requirements:

1. Expenses to be reimbursed must have a business connection,[23]
2. Expenses must be substantiated in a reasonable time,[24] and

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[21] Transcript of oral argument at 13-14, *Gaied*, 22 N.Y. 3d 592.
[22] *Gaied v. New York: 3 Years Gone*, by Timothy P. Noonan and Daniel P. Kelly, Reprinted from State Tax Notes, March 6, 2017, p. 825.
[23] Reg 1.62-2(d)
[24] Reg 1.62-2(e)

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3. If the employee was given an advance, then any unused money must be returned to the employer in a reasonable time period.[25]

The "reasonable time" requirements are a facts and circumstances determination. However, the Regulations provide two safe harbor rules that provide more bright line guidance:[26]

Fixed Date Method - Expenses substantiated within 60 days of when they are paid or incurred are within "reasonable time." An advance given within 30 days of when the expenses are paid or incurred, as well as unspent funds returned within 120 days, are considered within reasonable time.

Periodic Statement Method - An employer must provide at least quarterly statements requesting reimbursement of excess funds or asking for additional substantiation of business deductions by the employee within 120 days to be considered reasonable time.

> ***Example:*** Joe's company reimburses him for home internet costs since he was working from home during the pandemic. Joe's company requires him to send them the invoice from his internet provider along with an approved expense reimbursement form within 60 days of the invoice date. This meets the reasonable time safe harbor (fixed date method), and therefore, the expense reimbursement would not be subject to payroll taxes or withholding. The payment would also be deductible by the company.

In some instances, **supplemental withholding** is required by the federal government; again, these rules vary by state.

How long does an employee need to work in a state before state income tax withholding is required? There is no good answer to this question. In some states a person working in the state for eight hours would technically require an employer to start withholding. With states looking for more money in their coffers, many more of them will be likely to enforce their withholding provisions. Refer to nonresident withholding chart on page 2-42.

II. From which state must you withhold?

A. Default rule

The starting point is that an employer is required to withhold income tax for the state in which services are performed. This is pretty easy to follow if the employee is a resident of the state that they live in, making the assumption that the employee does not live in one of the nine states that do not have income tax withholding (Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming).

B. Three withholding rules

First, determine the state in which the **employee is resident**; this would be applicable if an employee lives and works in one state but is still a resident of another state. If the employer has nexus and operations in that state, and meets other criteria, then they may be required to withhold for that state. **Second,** if an employee lives in one state and works in another, they may be covered by a **reciprocity agreement**. **Third, the resident/nonresident taxation policies** must be examined.

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[25] Reg 1.62-2(f)
[26] Reg 1.62-2(g)(2)

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In today's world where many employees are working from home, *where* an employee is "working" may cause confusion. As we will see, state departments generally look to where the employee is performing the work – not where the company is for withholding purposes. For example, a North Carolina resident who is working from home from a South Carolina company is generally considered to be both living and working in North Carolina – since that is where the work is generally being performed. More on this to come – but for our purposes, when we refer to the employee's work location, we mean where is work physically being done – not where the office is.

C. Nexus

In the withholding context if the employer has nexus (or any operations) in a state they may be subject to the withholding laws of that state. This will make a difference in whether an employer has to withhold income tax for an employee's state of residence even though he or she performed no services there.

If an employer does not have nexus with an employee's state of residence, but there is a reciprocal agreement between the two states, then the **employer must honor the reciprocity** agreement and not withhold income tax for the state where the employee works. However, if the **employer does not have nexus in the state where the employee lives, they are not obligated to withhold income tax for the state where the employee lives**. In this case the employee would be obligated to make estimated payments to the state.

If an employer **does not have nexus in a state for which one of its employees will have a personal income tax liability**, it can choose to **establish a withholding account in that state and** begin **withholding as a courtesy to the employees.** However, the payroll department should check with the corporate tax and legal departments of the company first because once a taxpayer has voluntarily registered for one tax, it can bring inquiries from the state regarding other taxes such as corporate and sales tax. Also, in some states the act of withholding and remitting taxes could establish nexus, now making the taxpayer open to being sued in the courts of that state.

D. Withholding rule no. 1 – Defining residency

First the taxpayer must establish the **state of residence of the employee**. This is primary because the employee is subject to the laws of that state, including the income tax laws. Because states have varying policies on withholding from employees who provide services in another state, as well as non-residents who perform services within the state, it is important to establish the state of residency. To sort out the policies correctly the taxpayer needs to know which state or states can claim the employee as a resident.

Employees often want to claim that they are a resident of their "home" state, particularly if their "home" state is one of the nine states that do not assess an individual income tax. However, if the employee has relocated to work for the taxpayer, he or she may want to continue to claim the former state as their tax home because their family and residence are there, and of course they don't want to file a personal income tax return in two states. An employee who works for the taxpayer only during the nine months of the school year might try to claim that they are a resident of the state in which they grew up, even though the employee now spends just three months a year there. Again, the "home" state is much more attractive if it happens to be a state that does not assess personal income tax.

It is up to the employer to locate and follow the rules of the appropriate state. Most states have a two-pronged definition of residency. An individual is considered to be a resident by either:

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- Being **domiciled** in the state, or
- Spending more than a **number of days** in the state

The term "**domicile"** usually means the place where an individual has **a true, fixed, permanent home and principal establishment**, and it usually means the **place to which the individual intends to return**. Common indicators that an individual is domiciled in a particular location include:

- Property ownership,
- Bank accounts,
- Driver's license and vehicle registration,
- Voting registration,
- Presence of family, and
- Club and church memberships.

1. Example of employee working remotely for Oklahoma employer

With a larger number of employees working remotely, employers need to make sure that they are familiar with their state's withholding rules. Two examples follow that illustrate.

Note that these factors are similar to the factors that the Internal Revenue Service considers when determining the "tax home" of an individual if they are working away from home.

a. The Oklahoma Tax Commission tax policy division explained in a letter ruling that an employer is not required to deduct and withhold Oklahoma withholding tax on the wages of an employee residing out of state but working remotely for the Oklahoma company.

Example: The taxpayer had moved out of Oklahoma in August of 2010 and filed as a nonresident for the 2010 tax year. He has been working remotely out of state since 2010, performing no services in Oklahoma. Taxpayer is now a resident of another state where he files and pays income tax. His employer, an Oklahoma resident entity, continues to withhold Oklahoma income tax from his paycheck.

In this letter ruling, the Oklahoma Tax Policy Division stated that as a nonresident whose salaries, wages, and commissions are for work performed outside of Oklahoma and who derives no income from sources within the state of Oklahoma, the employer is not required to deduct and withhold Oklahoma withholding tax from his wages.[27]

2. Nonresident employee not subject to Illinois state withholding

a. The Illinois Department of Revenue explained that a nonresident individual who works for an Illinois employer should not have Illinois tax withheld from his compensation because his base of operations – his home office – is located in another state.

Example: Taxpayer is an employee of a small private civil engineering consulting company located in Illinois. Employer is a resident Illinois entity paying income tax in the state. In 2013, taxpayer's employer allowed him to move to and reside permanently in another state while continuing to work for the Illinois employer as a "satellite" employee. Taxpayer said that the vast majority of his work was performed from his home office in another state, however he occasionally went to Illinois to meet with clients and inspect infrastructure improvements.

In response to questions posed in Illinois Publication -130, the taxpayer stated that he did not meet any of the localization tests that are used to determine if

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[27] LR-14-012 June 20, 2014.

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compensation has been paid in Illinois. None of the taxpayer's services were provided in Illinois; the services he provided while in Illinois were actually incidental to services provided in his resident state; and finally, he had established a base of operations with his home office in his resident state. While Illinois currently has reciprocal agreements with Iowa, Kentucky, Michigan, or Wisconsin they do not have a reciprocal agreement with the state where the taxpayer resides.

In a general information letter, the Illinois Tax Policy Division responded that based on the employee's stated fact pattern, the taxpayer had a "permanent job location" in another state, which he described as a "home office." Based on that description the "permanent job location" is the "base of operations," and none of the wages paid to the taxpayer would be "paid in this state." Accordingly, none of the wages paid to the taxpayer would be subject to Illinois income tax withholding under §701(a)(1).[28]

E. Withholding rule no. 2 – Reciprocity

If an employee performs services in a state other than the state of residence, you must find out whether the two states have a reciprocal agreement. A **reciprocal agreement allows the taxpayer to withhold only for the state of residence, as opposed to the state in which the services are performed**. The wages would be reported only to the state of residence when reporting "state wages" in boxes 16 and 17 of Form W-2. In most cases, the employee is required to submit a certificate of non-residence for the state in which he or she works before the employer is allowed to honor the reciprocal agreement.

The goal of reciprocity is to ease administration issues for the employer and the employee. The employee is required to file one personal income tax return and the employer is only required to withhold in the state where the employee lives. This is especially helpful in the case of an employee who performs services in multiple states that have a reciprocity agreement with the employee's home state. For example, an employee who lives in Kentucky works in Kentucky, Illinois, and Indiana and submits certificates of non-residence for Illinois and Indiana. The employer would only be required to withhold Kentucky income taxes since the three jurisdictions have reciprocal agreements with each other. On the flip side, if a reciprocal agreement is in place, it could require the employer to change the state of withholding and reporting if the employee moves his or her residence from one state to another, even though there has been no change in the state in which the services are performed. **A chart including the nonresident withholding policies of the states and also the states that currently have reciprocal agreements is located at the end of this chapter.**

F. Withholding rule no. 3 – Resident/non-resident taxation policies

If an employee is a **resident of one state but performs services in another, and there is no reciprocal agreement, then the laws of both states must be taken into consideration**. Again, the determination of the resident state of the employee is important since it indicates the laws that may need to be considered, in addition to those of the states in which the employee works.

The state in which the services are performed will almost always require withholding from nonresidents who come into the state to work (withholding only from the wages for services performed in that state). A few states have exceptions to this, usually based on whether the employee works in the state for less than a certain length of time or earns less than a certain amount of money. For example, if a California resident works in Arizona, Arizona withholding is required if the employee is physically present in the

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[28] IT 14-0011 GIL.

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state for 60 days or more. In general, an employer is always subject to the laws of a state in which it has an employee performing services, whether or not the employer has a facility (such as a factory, office, retail location) in the state.

The employee's state of residence may also need to be considered even if the employee doesn't work there. If the employer has nexus with the state in which the employee resides, then the employer is subject to the laws of that state and may be required to withhold that state's income tax, in addition to the tax for the state in which the employee is working. For example, if the California resident works exclusively in Arizona for six months, and if the employer has nexus in California:

i. Arizona withholding is required (employee has exceeded the 60-day threshold); and
ii. California withholding is required, with a credit for income tax withheld for the work-state (which in this case would be Arizona).

In this case the employer must first calculate and withhold Arizona income tax. Then the employer must calculate California income tax on the same wages and, if the California tax is greater, withhold an amount equal to the difference between the California income tax and the Arizona income tax. If the California tax is less than the Arizona tax, no California tax need be withheld.

If the employer does not have nexus in California, then the employer is not subject to the laws of that state and is not required to withhold that state's income tax. However, the employee may have personal income tax liability on these and all other earned wages by virtue of being a resident in the state.

G. What about COVID restrictions that change employee location?

Looking at the rules above, one can see that many of the withholding requirements depend on where the company has nexus. If an employee is physically working in a particular state, this nearly always creates nexus for the company – because the company has a physical presence in the state itself. This issue becomes more complicated due to COVID though. If an employee is forced to work from home due to state lockdown requirements, can this situation create nexus for a company where it did not exist before?

States generally fell into three categories related to this issue:

1. Nexus did not create merely as a result of COVID restrictions.
2. Nexus did create as a result of COVID restrictions (in other words, the state follows the normal rules around nexus making no exceptions for COVID restrictions)
3. The state gave the taxpayer a choice of where to withhold.

Many states included safe harbor rules stating that temporary work locations (that is, working from home due to the pandemic) did not create nexus (category 1 above), if one did not already exist. In short, the company would do nothing different. If a withholding requirement did not exist before the pandemic, then one did not exist due to a temporary change in location. These states included: Massachusetts, Maine, Maryland, Nebraska, Pennsylvania, Rhode Island, and South Carolina.

However, at the time of this writing, these same states had this safe harbor expiring. For example, in Pennsylvania, the safe harbor had expired as of June 30, 2021. Similarly, the guidance in Massachusetts expired on September 13, 2021. Unless this guidance is extended, presumably states will go back to the default rules which are based on where the services are performed. For companies that continue to offer

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hybrid or remote work environments even after the guidance expires, this would once again create nexus for them.

New York provided a bit of a twist on this idea by expanding its convenience of the employer rule.[29] If a nonresident normally worked inside of the state of New York, then the employer still has a withholding requirement – even on days the employee was telecommuting from a location outside the state.

A lesser number of states chose not to provide a safe harbor for nonresidents working in their state. For example, North Carolina had not issued guidance as of this writing. Therefore, if one were working inside North Carolina and met the normal rules for establishing nexus in a temporary work location, he/she would be subject to North Carolina withholding (assuming there was no reciprocal agreement between North Carolina and the employee's resident state).

A lesser number of states provided an option of where to withhold. Kansas and Missouri provided employers with an option of which state to withhold in. That is, an employer could choose to withhold for an employee temporarily located within these states or not. Again though, these elections have begun to expire. In Missouri, this election expired in July 2021. In Kansas, the election is set to expire in December 2022.

For employers, the choice of whether or not to continue to let employees telecommute is wrought with tax issues. At some point, safe harbor provisions that have effectively delayed the decision for employers will expire. Eventually, states presumably will go back to normal rules concerning nexus.

H. Employees that work in multiple states without reciprocity

If an employee works in multiple states that do not have reciprocity with the employee's state of residence, then the amount of wages earned in each state must be separately examined under withholding rule no. 3.

The first step is to split the wages by state. This could be done based on the number of hours for an hourly employee, days worked for a salaried employee, or by the sales volume for a commissioned employee. The employer will have nexus in the state in which services are performed and will most likely (depending on the state's law) need to withhold the work-state's tax from the wages earned within the state. If the employer has nexus in the resident state, then withholding for that state may need to be made as well.

Exceptions to this process are made under the Amtrak Reauthorization and Improvement Act of 1990 (Pub. L. 101-322). Railroad and motor carrier employees (for instance operators of a commercial motor vehicle, like a tractor trailer or semi-trailer) who work in more than one state are subject only to the state and local income tax laws of the state of their residence, regardless of where they work. Employees in the air transportation business are subject to withholding for their state of residence and any other state in which they earn more than half their wages.

Under Pub. L 106-489, merchant mariners employed in interstate commerce are subject to the state and local income taxes of their state of residence.

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[29] New York State Department of Taxation & Finance, Frequently Asked Questions about Filing Requirements, Residency, and Telecommuting for New York State Personal Income Tax, October 19, 2020.

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An Illinois corporation was not required to withhold Illinois income tax from wages paid to nonresident truck drivers who worked outside Illinois. The determination of the employee's base of operations was not controlled by the employer's base of operations. Additionally, federal law limited Illinois from taxing certain nonresident employees of motor carriers. However, if the federal law limitations did not apply and the employee performed services in Illinois that were more than merely incidental to services performed elsewhere, Illinois tax withholding would be proper if the employee's base of operations was Illinois.[30]

1. Examples of employee working in multiple states

Example 1: In this case the employee, a traveling salesman, makes $100,000 per year and works in two or more states. If total income is based on the volume of business, then the wages should be allocated to each state based on the ratio of that business to the whole.

In the example at hand the salesperson, an Arizona resident, makes $1,500 in commissions each month and works an equal amount of time in Arizona, New Mexico, and Nevada. Each month he has $500 income in Arizona, $500 income in New Mexico, and $500 income in Nevada (which has no individual income tax).

As a resident of Arizona, the salesperson will be taxed on the entirety of his income in the state unless there is another state involved. He will be taxable in New Mexico because he has passed the income threshold and number of days.

- He is taxed $1,000 each month in Arizona because since Nevada has no individual income tax, Arizona, the resident state taxes that $500.
- $500 of the income per month will be taxed in New Mexico.

This will require reporting income from multiple states on the Form W-2.

Example 2: ***Reporting employee wages earned in multiple states (reporting on Form W-2)***

The employee lives in New Jersey and works in New York and Connecticut, making $100,000 per year.

In Connecticut if the employee is not a resident, then only the money they earned in CT is to be reported on the Form W-2 as attributable to the state. If the employee earned $20,000 in CT and was taxed on this amount, the CT wages of $20,000 would be reported on the Form W-2.

The full $100,000 of wages will be reported as New Jersey wages as the employee is a resident of the state.

New York requires that if a non-resident employee performs total or part of their services in NY, the state wages on the federal Form W-2 should be the same as federal wages in Box 1.

The employee should report to the employer the amount of income they earned in New York and the employer will withhold on that amount earned in NY.

Because NY requires the NY wages to equal the amount reported in Box 1 the employer could include the amount that was actually earned in Box 14. If the employee worked in New York City, the employer should be notified of that amount so that proper reporting and withholding can be made.

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[30] Illinois Dept. of Rev. General Information Letter No. IT 14-0001-GIL, 1/24/2014 (released 9/23/2014.

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Finally, in New Jersey if the employee is a resident of a city that imposes local tax, for example Newark, there could be reporting and withholding required. As discussed earlier, there is SDI for New Jersey that would also be reported on the Form W-2.

Example 3: ***Reporting on multiple Forms W-2***

Facts are same as **Example 2**. The Form W-2 for the employee's resident state of New Jersey would include $100,000 in Box 1 and $100,000 indicated as wages taxable in New Jersey.

The Form W-2 for New York would have no Federal Income in Box 1 and then the amount actually earned in New York would be reported as state wages.

The Form W-2 for Connecticut would have no Federal Income in Box 1 and then the wages attributed to Connecticut would be reported as state wages.

Note that all the state wages added together may exceed Federal Box 1 wages; in the case above the employer is reporting $220,000 of state earnings and Box 1 federal wages are $100,000. Remember the employee may get a credit to apply against their New Jersey tax for taxes paid in another state.

2. Telecommuting employee example

A Wisconsin resident who commutes daily to a job in another state is subject to Wisconsin tax on the income earned in the other state. A **resident of Minnesota**, who received $60,000 for services performed for a Wisconsin corporation, **telecommuted from his home office** located in Minnesota for **230 business days, and worked at the employer's Wisconsin site for 10 business** days during the calendar year, would be subject to **Wisconsin income tax on $2,500** (compensation of $250 per day ($60,000/240 = $250; 10 days X$250 = $2,500). Note that this answer would not apply to an individual who is a resident of a state with which Wisconsin has a reciprocity agreement. A **Wisconsin resident who normally works in Wisconsin earning $5,000** per month, who is **temporarily assigned to work in Minnesota for four months**, is **taxable on the total $60,000 in Wisconsin** and **must file a return in Minnesota to report the $20,000 sourced to Minnesota**. A **Minnesota resident who works for a Minnesota company**, but **telecommutes on Fridays from a second home in Wisconsin**, would be **taxable in Wisconsin on $10,000** of his or her total annual salary of $50,000. A **Wisconsin resident who works for a Wisconsin company, but telecommutes on Fridays from a second home in Minnesota**, is **taxable in Wisconsin on the entire $50,000 annual salary** and would **also be subject to Minnesota tax on $10,000**. The previous examples are based on the assumption that the income was earned evenly throughout the year, but if income is not evenly earned, the amount of income taxable to a state may have to be determined on a monthly, weekly, or hourly basis.[31]

3. Special rules for athletes and entertainers

Athletes and entertainers who make large sums of money and perform or play in multiple cities and states are subject to **special withholding rules, based on sourcing their income to the locations in which they perform or play**. In order to source the income, the practitioner needs to know **how the state defines total income that should be apportioned,** the definition of duty days in the state, and how the apportionment should be accomplished. Since many sports teams play in large cities, not only are athletes concerned about state tax when they play in different venues, they are also concerned with the same issues for local tax purposes. Due to perceived amount of large wages and availability of their playing schedule, athletes and entertainers are targeted when it comes to state revenue departments.

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[31] Wisconsin Dept. Rev. Tax Bulletin 171, 4/1/2011.

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The state of Indiana recently revised its information bulletins in regard to this type of income. These bulletins provide good examples of the calculation of the income and the method of apportionment, in this case to the state of Indiana.

Nonresident professional athletes playing or on contract with a team will apportion their income to Indiana based on duty day performed in Indiana compared to total duty days in a taxable year. The following information is included in Information Bulletin #88 dated November 2011.

a. **Applicable teams** include nonresident members of a professional baseball, basketball, football, hockey, or soccer team that played games or had services rendered by a team member in Indiana.
b. The provision applies to employees who are **active players, players on the disabled list,** and other individuals required to travel with and perform services on behalf of the team on a regular basis, including **coaches, managers, and trainers.**
c. **"Income"** means total compensation received during the taxable year for services started from the beginning of the official preseason training through the last game the team competes as well as income received from participation in instructional leagues, in an all-star or pro-bowl game or with a promotional caravan (bonuses do not include signing bonuses).
d. **Income includes** salaries, wages, bonuses, and any other type of compensation paid to a team member for services rendered in that year. It does not include strike benefits, severance pay, termination pay, contract or option year buyout payments, expansion or relocation benefits or any other payments not related to services rendered to the team.
e. **Total Duty Days** means all days during the taxable year that a team member renders a service for the team, starting with preseason and ending with the last game for which the team competes or is scheduled to compete.
    i. Game days, practice days, days spent at team meetings, days spent with a promotional caravan and at preseason training camps, and days served with the team through all postseason games in which the team competes or is scheduled to compete.
    ii. Days spent conducting training and rehabilitation activities, but only if the service is conducted at the facilities of the team.
    iii. Travel days that do not involve a game, practice, team meeting, promotional caravan, or other similar team event.
    iv. Days for which a member is on the disabled list.
f. **"Indiana duty days"** means the number of total duty days spent by a team member within Indiana rendering a service for the team in any manner during the taxable year, except:
    i. Travel days spent in Indiana that do not involve a game, practice, team meeting promotional caravan or other similar team event; and
    ii. Those days spent in Indiana for which a team member is on the disabled list.
g. **Calculation of Indiana Income** (for this purpose) is the individual's total income during the taxable year multiplied by the following fraction:
    i. The numerator of the fraction is the individual's Indiana duty days for the taxable year.
    ii. The denominator of the fraction is the individual's total duty days for the taxable year.

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iii. **For Example:** a nonresident team member plays one game in Indiana with a practice day before the game (2 Indiana duty days). The total duty days during the tax year totaled 150. The fraction will be 2/150 of 1.33 percent. This percentage is then multiplied by the total income to arrive at the Indiana income.

h. **Simplified Reporting** for Teams not located in Indiana. The Department may establish simplified reporting for members of a team if the team is not based in Indiana. The Department will establish a withholding system that requires the team to withhold adjusted gross income tax for each member and to remit the withheld taxes to Indiana on an annual basis. The Department may require each team to submit the withheld taxes to Indiana on an annual basis. Remittance of the withholding tax and submission of the required information satisfies the team member's tax liability and return filing responsibilities. A Form W-2 will be issued to each team member.

A team member may file an individual income tax return to claim a refund if the amount remitted exceeds the amount otherwise owed using the methodology in 7(c) above.

i. **Reciprocity agreements** that are in place with other states will be honored with nonresident team members if they play for a nonresident team or live in a reciprocity state and play for an Indiana team.

There are often multiple issues involved in enforcing the income tax liability that results from athletic and entertainment appearances in multiple states. The flow of revenue from ticket purchasers to performers varies, and different performers work under different types of contracts. In determining the tax liability that results from entertainment and certain athletic performances, there are very often three different scenarios:

- Employees of a promoter or an organizer.
- Independent contractors.
- Employees of a production company.

The state of Indiana released Commissioner's Directive #5 in November 2011 that illustrates the treatment for withholding purposes in the state of this type of income.

a. **In the first scenario (employees of a promoter or an organizer),** the entertainers are performing on a salaried basis. They are under contract as part of an employer-employee relationship and paid a fixed amount not related to the location of a performance. Based on this understanding they incur no tax liability on their salary. No apportionment of income is required for performances in Indiana because the entertainer's compensation is a predetermined amount unaffected by performances in Indiana. Indiana resident entertainers would be required to file a return and report their earnings. Also, an Indiana resident entertainer under contract to an out-of-state employer must file an Indiana income tax return and might be eligible to receive a credit for taxes paid in another state.

b. **Independent Contractors** are entertainers and athletes who are not team members receiving payments for Indiana performances. This situation includes some performers in tennis and golf tournaments, nightclubs, and concerts. These "independent contractors" are paid on a per-performance basis or are parties to contracts that do not include any employer-employee relationship. Generally, ticket revenue is the property of the promoter and is used to pay expenses, including the performer's compensation for services.

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In this relationship, the independent contractor incurs a tax liability in Indiana by performing here. Because these performers are not employees, the compensation they receive does not constitute wages or salary. Therefore, reciprocity does not apply in this situation. The independent contractor's income earned for performances in Indiana should be allocated entirely to Indiana. Again, an Indiana resident independent contractor with similar contracts in other states must file an Indiana income tax return and report the independent contractor's income; however, a credit may be claimed for taxes paid in another state.

c. The third situation is the most complex. This situation involves **entertainers and athletes who are not team members and who have organized an intermediate "production company"** to receive payment for their performances. Typically, ticket revenue is collected by a promoter and paid to the production company. The production company then pays the performer. In this situation, the production company, its employees, or both, might incur a tax liability. Whether an employee of a production company incurs an Indiana tax liability must be determined by examining the terms of the employment contract, as follows:
    i. If the employee is paid a fixed amount periodically, regardless of whether the employee performs at all of the engagements, the employee will incur a tax liability in Indiana if the employee is an Indiana resident, or if the production company has a business situs here. This situation is similar of employees of a promoter or an organizer.
    ii. If the employee is paid on a per-performance basis or if the employee is paid a percentage of the production company's receipts, the employee will incur a tax liability by performing in Indiana. Income should be allocated to the state where it was earned. If allocation is unattainable, income should be apportioned in the same proportion that the production company's income was apportioned.

The production company's own tax liability is distinct from that of its employees. Whenever a production company is compensated for an Indiana performance, it incurs a tax liability. The actual liability depends on whether the company is organized as a sole proprietorship, a partnership, or a corporation.

The proprietor of a sole proprietorship and the partners in a partnership will be subject to the adjusted gross income tax on their Indiana income. A corporation will be subject to the adjusted gross income tax on its Indiana income. Indiana income is determined by using the single sales factor apportionment formula found in IC 6-3-2-2.[32]

I. State Unemployment Insurance

State Unemployment Insurance (SUI) and State Unemployment Tax (SUTA) is dictated by the Federal Unemployment Tax Act (FUTA). SUI /SUTA is paid by the employer.

SUI/SUTA is determined by the states. They determine the tax structure, the tax rates and how to calculate the taxable wage base. In most states the definition of employment provides that the employment by a single employer of an employee performing services in multiple states is not to be fragmented. The employer should be paying unemployment insurance in the state where the employee is

[32] Indiana Department of Revenue Commissioner's Directive #5, November 11, 2011.

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most likely to become unemployed and seek work. As a practical matter, many employers will pay unemployment insurance based on the "headquarters" of the business or the residence of the employee.

Example:
Kat is living and working in North Carolina for a company that is located in California. Unemployment should not be paid to both states. If Kat were to lose her job, it is reasonable to assume that she would look for work in North Carolina, since she lives there. Therefore, unemployment should be paid to North Carolina – not California.

There may be special cases where the employer is required to remit SUI in more than one state for a particular employee. But generally, the states will apply the following successive tests to determine the state of coverage:

- Localization of employee's services;
- Employee's base of operations;
- Place of employer's directions and control of employee; and
- Residence.

1. Example of paying SUI based on localization of services

Payroll clerk normally works in Georgia, which is the corporate Headquarters. Every time the company acquires a firm, she sets up the payroll department. The employee goes to Alabama for three months to set up their payroll department and then returns to corporate headquarters in Georgia.

Under the localization of services rule she normally works in Georgia so the employer would pay SUI in Georgia. Of course, this does not apply to income tax. Unless Georgia and Alabama have a reciprocal agreement, she will have to pay income tax in Alabama for the three months that she worked there.

2. Example of paying SUI based on base of operations

If the employee normally works in two or more states, they can't be localized so the employer should move to the next test, base of operations.

A New York based company has a regional sales manager that covers Pennsylvania, new Jersey, and Maryland. The employee works out of the office in PA and divides his time equally among the three states.

Even though activities are directed from New York the employer would pay SUI to PA because their services are not localized but their base of operations is in PA.

3. Example of paying SUI based on the place of direction and control

If the first two tests don't apply, localization of services and base of operations, then the employer moves to test number 3, the place of direction or control.

A salesperson covers D.C., Virginia, and Maryland. The employee does not have a base of operations but is required to call in to the company in D.C. once a day. In this case, the SUI should be paid to D.C. because direction and control is coming from the D.C. office, and they don't meet the first two qualifications.

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4. Example of paying SUI based on the residence of the employee

If the employer can't use any of the first three qualifications, then they move to the remaining test which is the residence of the employee. As long as the employee performs some services in the state and lives in the state, the employer can use that state.

An equipment manufacturer in Detroit employs an employee who supervises installations and handles complaints for Indiana and Ohio. The employee lives in Ohio but there is no base of operations in the state and there is no one to call for base of control purposes. The employer would then pay SUI to the state of residence of the employee, Ohio.

5. Interstate reciprocal coverage agreement

Multistate employers are covered under one state. Generally, there is an agreement between the states that says it is desirable to be covered by a single state. Therefore, the Employer can elect the state if the employee can't pick in cases where they don't have a place of residence.

A construction engineer works for a Texas firm. The Engineer works in New Mexico for four months, California six months, Colorado for two months, and Nebraska for seven months.

The Texas firm could elect to cover everything under Texas law. The employee will still apply for unemployment in their state of residence, they would not have to apply to Texas based on reciprocity rules.

III. Taxation of pension income

On January 10, 1996, President Clinton signed into law, H.R. 394, which became federal statute 4 U.S.C. section 114(a) providing that "**no State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State)**." **Applicable to amounts received after December 31, 1995**, 4 U.S.C. section 114(a) was a response to the source tax levied by New York and California (and some other states) on the pension income of former residents now living in other low or no-tax states, specifically New York residents who moved to Florida and California residents who moved to Nevada after retirement. A prime example would be a former California resident who retires to Nevada and receives a pension from his California employer. Prior to this law, California would tax the pension income of the former employee, even though they had now moved to Nevada, a state that levies no personal income tax. Originally, one of the prime movers behind this law was the Nevada Congressional Delegation. In general, pension income is now taxed in whatever state the retiree currently resides – not where the pension was generated.

The **types of pension income covered by the law** include all payments from Internal Revenue Code 401(a) qualified plans, including 401(k) plans, profit-sharing plans, employee stock ownership plans, money purchase plans, and defined benefit pension plans; Section 408(k) simplified employee pensions; Section 403(a) annuity plans; Section 403(b) annuity contracts; Section 408 individual retirement accounts; Section 457(a) eligible deferred compensation plans; Section 457 (b) governmental plans; Section 414(d) governmental plans; military retired or retainer pay plans; and Section 501(c)(18) employee contribution trusts.

The law only covers certain payments from nonqualified deferred compensation plans described in Internal Revenue Code section 3121(v)(2)(C) and does not cover any payments from other types

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of employment-related compensation plans not described in section 3121(v)(2)(C). This code section defines “nonqualified deferred compensation plan” for purposes of the special timing rule applicable to the FICA taxes associated with nonqualified deferred compensation plans. Generally, a plan is treated as providing for a deferral of compensation if, under the terms of the plan and the relevant facts and circumstances, an employee has a legally binding right during a calendar year to compensation that has not been actually or constructively received and that under the terms of the plan is payable to the employee in a later year. **Plans not covered by this section include stock options, stock appreciation rights, restricted stock, severance, sick leave, compensatory time, and vacation pay.** For example, if an executive retires from a New York employer and chooses to exercise his stock options after moving to Florida, the income from the stock options would still be considered to be New York income.

However, if a plan constitutes a nonqualified deferred compensation plan described in code section 3121(v)(2)(C), the next step is to determine whether payment is made in the form of an annuity or from an excess benefit plan following termination of employment. **Payments made in the form of an annuity fall under the nonresident exemption of 4 U.S.C. §114(a).** To qualify for the annuity exemption the income must be part of substantially equal periodic payments (payable not less frequently than annually) over the life or life expectancy of the employee (or the joint lives or joint life expectancies of the employee and employee’s beneficiary), or over a period of at least 10 years.[33] The payments will not fail to be considered to be substantially equal when they are adjusted under a plan’s predetermined formula, or a cost of living adjustment is provided. These payments could be included in exemption from being taxed by a state where the beneficiary is not a resident.

A. “Convenience of the employer” rule

The “convenience of the employer” rule is a part of New York’s individual allocation scheme. When a taxpayer earns wages or salary, or has income potentially in more than one state, various rules determine which states may tax part of the income. While the rules vary among the states, New York is unique in its zealous application of their convenience of the employer rule.

A 1960 New York Appellate Division case involving a nonresident commuter who allocated income from his New Jersey home provided the debut of their “convenience of the employer” rule.[34] Generally it is imposed only on nonresidents who work both inside and outside of New York during a tax period.

Under New York’s general rule, a nonresident worker’s total earnings are apportioned based on the number of days worked in each state.[35] The relatively straightforward rule is then qualified by the convenience of the employer rule, which states**: “However, any allowance claimed for days worked outside New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employer.”**[36]

Most states have conceded that they need to find a physical presence in the state before enforcing the obligation to collect and remit sales or use taxes. However, the presence or activity of any employee in a state, even for a short time, may prompt demand for collection and remittance of sales/use taxes on all

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33 U.S.C. §114(b)(1)(I)(i).
34 *Burke v. Bragalini*, 10 App Div 2d 654, 196 NYS2d 391 (3d Dept., 1960).
35 20 N.Y. Comp. Codes, Rules & Regs. Sec 132.18(a) (first sentence).
36 20 N.Y. Comp. Codes, Rules & regs. Sec 132.18(a) (third sentence).

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sales related to that state, even if there is no relationship between the employee's presence and the sales. Due to improved computer matching capabilities by states, an employer that registers for withholding tax purposes is likely to receive a nexus inquiry if the employer is not filing sales tax or business type tax returns.

Because of these issues, prior to allowing an employee to telecommute, an organization should ensure that it will not subject itself to either income tax or sales tax nexus based on the presence of the employee in the state.

IV. Federal legislation

H.R. 1393, the *Mobile Workforce State Income Tax Simplification Act of 2017*, was introduced in the House of Representatives on March 7, 2017. This bill would prohibit wages or other remuneration earned by an employee in more than one state from being subject to income tax by any other state other than the state of residence unless the employee is present and performing employment duties for more than 30 days in a calendar year. Employers could rely on the employee's reporting in regard to presence in a state. This legislation would effectively eliminate the convenience of the employer rule as enforced in New York. It does not apply to entertainers, professional athletes, and certain public figures. This bill passed the house on June 20, 2017, and has stalled. The bill failed to get through the Senate.

On February 28, 2019, U.S. Sens. John Thune (R-S.D.) and Sherrod Brown (D-Ohio) reintroduced the *Mobile Workforce State Income Tax Simplification Act* (S. 604). Senator Thune's press release stated the following: "While some states require state income tax filing for as little as one day of work in the state, this legislation would establish a common-sense 30-day threshold to help ensure that an equitable tax is paid to the state and local jurisdiction where the work is being performed while alleviating burdensome tax requirements on employees and employers."

In the same press release Senator Brown said: "We should be making it easier, not harder, for workers to support themselves and their families. We live in a highly mobile society. People travel across state lines for work. We should be cutting red tape and simplifying the state income tax filing process to help the worker get ahead.

S.1549, is known as the New Economy Works to Guarantee Independence and Growth (the NEW GIG) Act of 2017.

This bill was introduced in the fall of 2017 by U.S. Senator John Thune (R-SD) in response to what many are referring to as the GIG economy; this would include drivers for LYFT and UBER, among others.
If an internet platform or app facilitates the transaction and payments, then the third party is not the employer. If a taxpayer meets the objective standards set out in the bill, they meet the safe harbor.

The safe harbor focuses on three areas that are intended to demonstrate the independence of the service provider from the service recipient and/or the payer based on objective criteria, rather than a subjective facts-and-circumstances analysis:

1. The relationship between the parties (e.g., job-by-job arrangement, the service provider incurs his own business expenses, the service provider is not tied to a single service recipient);

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2. The location of the services or the means by which the services are provided (e.g., the service provider has his own place of business, does not work exclusively at the service provider's location, provides his own tools and supplies); and
3. A written contract (e.g., stating the independent-contractor relationship, acknowledging that the service provider is responsible for his own taxes, providing the service recipient's reporting and withholding obligations).

If the taxpayer meets the safe harbor, which means that the provider of services would be considered an independent contractor then payments in excess of $1,000 per year would be reported on a Form 1099-K. This form would be issued in lieu of the current 1099-Misc form that would be issued to service providers. The payer or service provider would be required to withhold a portion of the payment and remit to the IRS as a deposit (estimated payments) if the taxpayer qualifies for the safe harbor.

March 8, 2019, Congressman Tom Rice (R-S.C.) re-introduced the New Economy Works to Guarantee Independence and Growth (NEW GIG) Act, legislation that clarifies provisions in the tax code that classify workers as either independent contractors or employees. Senator John Thune (R-S.D.) introduced companion legislation in the Senate.

V. Independent contractors

In the last few years, states have started to focus on "misclassified" workers, or people who are compensated as independent contractors when they should be paid as employees. In order to try and stem the tide of taxpayers who pay people as independent contractors to avoid income-tax withholding, states have been enforcing rules to require withholding from amounts paid to independent contractors. In some cases, these are amounts paid to construction workers and in some cases, it is simply a way to try and tax undocumented workers. By placing the requirements on taxpayers to withhold from the amounts paid to independent contractors they are in essence now making them "employers" and they are subject to the rules and penalties that are involved with the withholding of tax from employee's wages.

The U.S. Department of Labor (DOL) has been vigorously enforcing the issue of employees who have been misclassified and paid as independent contractors.

A. Recent DOL announcements illustrate the vigorous enforcement

i. **Jan. 29, 2015** – Specialty Painting & Wall Covering Inc. and M&S Enterprise in Texas paid more than $108,000 in overtime back wages after a DOL investigation found that some workers were misclassified as independent contractors.
ii. **May 19, 2014** – Paul Johnson Drywall Inc. in Prescott, Arizona, agreed to pay $600,000 in back wages, damages, and penalties following the misclassification of works as independent contractors.
iii. **May 9, 2013** – The DOL recovered more than $1 million in back wages and damages for 196 workers of a Kentucky-based cable installer, Bowlin Group LLC and Bowlin Services LLC, who were misclassified as independent contractors.
iv. **Feb. 12, 2013** – A federal judge with the U.S. District Court for the Eastern District of Pennsylvania ordered KGB USA Inc., the world's largest independent provider of directory assistance, headquartered in Bethlehem, PA to pay $1.3 million in minimum-wage compensation to 14,568 workers following the company's misclassification of the employees as independent contractors.

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v. **April 26, 2012** – Hawkins Tree and Landscaping in Minnesota entered a consent judgment of back pay and liquidated damages for $478,000 to 57 current and former laborers, drivers, crew leaders, and foremen who were misclassified as independent contractors and were not paid overtime. The company and its owners also agreed to pay $22,000 in civil penalties.

B. Warning signs that an independent contractor is an employee

i. The individual is compensated any way other than on a per-project basis. Payment by the hour is particularly suspect.
ii. The employer grants the individual paid vacation or sick leave.
iii. The employer reimburses business expenses incurred by the individual.
iv. The type of work performed by the individual is typically paid by the employer on a W-2 basis.
v. A noncompete agreement is in place; such agreements are not used for independent contractors.

It should be noted that in a world of flexible work schedules and remote workers, the traditional 20-factor test traditionally employed by the IRS may lose some relevance. In more recent times, more focus has been given to exclusivity. In other words, contractors generally have more than one client, whereas employees normally have one employer (with some exceptions).

C. The "ABC Test" for employee status

In April 2018, the California Supreme Court established the ABC test in *Dynamex Operations West, Inc. v. Superior Court*, although a subsequent appellate court ruling in *Garcia v. Border Transportation Group, LLC* determined that the ABC test applies only to wage order claims. Currently state lawmakers are debating legislation (CA AB 5) that would codify the Dynamex decision. Two ABC test bills (WA HB 1515 and WA SB 5513) are also currently pending in the Washington Legislature. Massachusetts and New Jersey use the ABC test to restrict the number of workers classified as independent contractors. Other states use the ABC test for specific situations, such as determining unemployment compensation. Although the ABC test isn't law in every state, it is being used in some capacity in nearly every state. In 2018 Bernie Sanders, Senator from Vermont introduced a bill that would have made the ABC test the federal standard.

This test provides a narrower definition of who is an "independent contractor" than the more commonly known "20 Factor Test" included in IRC Rev Rule 87-41.

In the California lawsuit, Dynamex Operations West classified its delivery drivers as independent contractors. The drivers claimed they should have been employees. The Court ruled against Dynamex, saying that the delivery drivers were misclassified.

Employers must be able to answer yes to all three parts of the ABC test if they want to classify workers as independent contractors:

i. The worker is free from the control and direction of the hirer in relation to the performance of the work, both under the contract and in fact;
ii. The worker performs work that is outside the usual course of the hirer's business; and
iii. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hirer.

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If the worker can't answer yes to all three parts of the ABC test, then he/she must be classified as a W-2 employee.

The second prong of the ABC test is the one that changes the game for many contractors. If the employer hires a worker to do anything that is central to their business's offerings, they must classify the worker as an employee. For example, a taxpayer owns a car repair shop. If the repair shop has a worker who does any work on nearly any aspect of the car, then the owner must classify them as an employee because car repair is central to their business.

On March 4, 2019, a previous ruling that found that three New York Uber drivers and all similarly situated drivers are considered employees for the purposes of unemployment insurance became the law of the land in New York State, following a recent withdrawal of an appeal by Uber. Uber is now expected to begin making unemployment contributions for drivers.

The ruling that now stands is a final decision by New York State Unemployment Insurance Appeal Board, a state board that independently decides issues of unemployment insurance benefit eligibility and unemployment insurance contribution liability. In July 2018, the Board held that three former Uber drivers named in a suit for unemployment insurance benefits, and all similarly situated drivers who quit because they can't make ends meet or who are "deactivated" through no fault of their own, are considered employees in New York State for the purposes of unemployment insurance benefits.

In their decision, the Board found that Uber exerted control over drivers and acted as an employer based on the following criteria:

- Uber assigns work by dispatching drivers through the App.
- Uber sets the fare rates and collects the fares from passengers; and sets the pay rates for drivers and pays drivers.
- Uber maintains a 5-star rating system for drivers and deactivates drivers who fall below 4.5 stars.
- Uber monitors drivers' performance and fields complaints.
- Uber monitors drivers' acceleration, breaking, speed, and routes driven while on the app.

The landmark decision is now the official position of the New York State government and sets a precedent for all Uber drivers who apply for unemployment insurance in the future.

D. Memorandums of understanding

State agencies continue to enter into memorandums of understanding (MOU) with the Department of Labor (DOL) to identify misclassification. The MOUs facilitate information sharing among the DOL and state agencies to identify all types of misclassification of independent contractors and step-up wage and hour enforcement among private employers. For example, if a state agency finds that an employer is misclassifying workers as independent contractors for purposes of evading state unemployment taxes, that information will be shared with the DOL, which then can investigate whether the employer also has misclassified workers to evade federal wage and hour laws.

The Wisconsin Department of Workforce Development signed an MOU with the DOL on January 20, 2015. The Florida Department of Revenue also signed an MOU with the DOL on January 13, 2015. In addition, the DOL has MOUs with state agencies in Alabama, California, Colorado, Connecticut, Hawaii,

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Illinois, Iowa, Louisiana, Maryland, Massachusetts, Minnesota, Missouri, Montana, New Hampshire, New York, Utah, and Washington.

Misclassification causes issues in multiple areas because it results in employers not withholding the workers' federal taxes, not filling out I-9s for immigration purposes, not paying workers' compensation, and failing to pay overtime. It also results in individuals not being eligible to participate in the Employee Retirement Income Security Act (ERISA) benefits plans.

Since 2008, the DOL has hired 2,000 investigators, doubling its total number. Investigators look at whether individuals have been misclassified as independent contractors as a routine matter.

VI. Nonresident personal income-tax withholding and reciprocity agreements

Alabama	Nonresident employees subject to tax withholding on first day of travel
Alaska	No general personal income tax
Arizona	No withholding required if nonresident is in the state for 60 or fewer days in a calendar year Reciprocal with CA, IN, OR, VA
Arkansas	Nonresident employees subject to tax withholding on first day of travel
California	No withholding required if nonresident earns in-state wages equal to or below "Low-income exemption table"
Colorado	Nonresident employees subject to tax withholding on first day of travel
Connecticut	No withholding required if nonresident is in the state for 14 or fewer days in a calendar year (eff. 1/11/2010)
Delaware	Nonresident employees subject to tax withholding on first day of travel
District of Columbia	No general personal income tax on nonresidents Reciprocal with all states
Florida	No general personal income tax
Georgia	No withholding required if nonresident is in the state for 23 or fewer days in a calendar year or if less than $5,000 or 5% of total income is attributable to Georgia
Hawaii	No withholding required if nonresident is in the state for 60 or fewer days in a calendar year
Idaho	No withholding required if nonresident earns less than $1,000 in a calendar year
Illinois	Nonresident employees subject to tax withholding on first day of travel No withholding if base of operations is outside Illinois and some services in state Reciprocal with IA, KY, MI, WI
Indiana	Nonresident employees subject to tax withholding on first day of travel Reciprocal with KY, MI, OH, PA, WI

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Iowa	Nonresident employees subject to tax withholding on first day of travel Reciprocal with IL
Kansas	Nonresident employees subject to tax withholding on first day of travel
Kentucky	Nonresident employees subject to tax withholding on first day of travel Reciprocal with IL, IN, MI, OH, VA (certain conditions), WV, WI
Louisiana	Nonresident employees subject to tax withholding on first day of travel
Maine	No withholding required if nonresident is in the state for 12 or fewer days in a calendar year
Maryland	Nonresident employees subject to tax withholding on first day of travel Reciprocal with DC, PA, VA, WV
Massachusetts	Nonresident employees subject to tax withholding on first day of travel
Michigan	Nonresident employees subject to tax withholding on first day of travel Reciprocal with IL, IN, KY, MN, OH, and WI
Minnesota	Earning less than minimum amount required to file a state tax return (2018) $10,850 Reciprocal with MI and ND
Mississippi	Nonresident employees subject to tax withholding on first day of travel
Missouri	Nonresident employees subject to tax withholding on first day of travel
Montana	Nonresident employees subject to tax withholding on first day of travel Reciprocal with ND
Nebraska	Nonresident employees subject to tax withholding on first day of travel
Nevada	No general personal income tax
New Hampshire	No general personal income tax
New Jersey	No withholding required if nonresident earns in-state wages less than the employee's personal exemption in a calendar year Reciprocal with PA
New Mexico	No withholding required if nonresident is in the state for 15 or fewer days in a calendar year
New York	No withholding required if nonresident is in the state for 14 or fewer days in a calendar year
North Carolina	Nonresident employees subject to tax withholding on first day of travel
North Dakota	Nonresident mobile workforce not taxable if in state less than 20 days And resident of state with similar protections (reciprocity) Reciprocal with MN and MT
Ohio	Is in the state for more than 20 days in a calendar year Reciprocal with IN, KY, MI, PA, WV
Oklahoma	No withholding required if nonresident earns in-state wages less than $300 in calendar quarter

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Oregon	No withholding required if nonresident earns in-state wages less than the employee's standard deduction
Pennsylvania	Nonresident employees subject to tax withholding on first day of travel Reciprocal with IN, MD, NJ, OH, VA, WV
Rhode Island	Nonresident employees subject to tax withholding on first day of travel
South Carolina	No withholding required if nonresident earns in-state wages less than $800 in a calendar year
South Dakota	No general personal income tax
Tennessee	No general personal income tax
Texas	No general personal income tax
Utah	No withholding required for nonresident if **employer** does business in the state for 60 or fewer days in a calendar year
Vermont	Nonresident employees subject to tax withholding on first day of travel
Virginia	No withholding required if nonresident earns in-state wages less than the employee's personal exemptions and standard deduction or, if elected by the employee, the employee's filing threshold Reciprocal with DC, KY, MD, PA, WV
Washington	No general personal income tax
West Virginia	No withholding required if nonresident earns in-state wages less than the employee's personal exemptions Reciprocal with KY, MD, OH, PA, VA
Wisconsin	No withholding required if nonresident earns in-state wages less than $1,500 in a calendar year Reciprocal with IL, IN, KY, MI
Wyoming	No general personal income tax

VII. Summing It Up

In a world where crossing state lines is becoming more commonplace, it is important for practitioners to know where filing obligations can arise when it comes to employees. In terms of withholding, one must consider where an employee lives and works. If an employee lives in one state and works in another, taxes should be withheld in the state of residence – unless the company does not have nexus with that state. If no nexus exists, taxes may be withheld in the state where the company is located, but one should be mindful of reciprocity agreements that may exist. Unemployment taxes should generally be withheld in whatever state the employee would look for work should they become unemployed. While there are several exceptions to these rules, they provide the practitioner a starting point for navigating state laws.

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