MEGA-TRENDS IN STATE TAXATION

Nonresident Withholding on Executive Compensation and Mobile Employees

Gregory A. Bergmann
Deloitte Tax LLP

Timothy P. Noonan
Hodgson Russ LLP

Frank A. Yanover
General Electric Company

Agenda

Part One: Understanding State Taxation of Executive Compensation

Part Two: Multistate Withholding: Obligations on the Employer

Part Three: Practical Solutions for Compliance (or whether they exist at all)

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 1: Nonresident Taxation of Executive Compensation

Importance of Residency Status

- Residents: Taxable on one thing (everything)
- Nonresidents: Taxable on "source" income only

Basic Residency Tests

- Domicile Test: Permanent/Primary Home
- "Statutory" Tests: 183 days and living quarters
- Other Tests: Non-Temporary/Transitory Purpose

Employer's Obligation to Know: Where Do You Live?

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 1: Nonresident Taxation of Executive Compensation

Basics of Nonresident Taxation

- Where is the income “earned?”
- The concept of “sourcing:” Is the income “derived from” sources in the state?

Typical Executive Comp Subject to Sourcing

- Wages/Bonuses
- Stock Options and Restricted Stock
- Deferred Compensation/Retirement Income

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 1: Nonresident Taxation of Executive Compensation

Wages/Bonuses

- General Rule: subject to allocation based on days in/days out method in year of receipt
  - Exception: Bonuses sourced based on year earned

- Example:
  - Frank works in NY 20 days out of a total of 200 work days in 2013. In 2012, he worked 90% in New York. Comp includes $100k salary for 2013 and $50,000 bonus, paid in 2013 but based on 2012 performance
  - Frank allocates 10% of his salary to NY in 2013 and 90% of his bonus

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 1: Nonresident Taxation of Executive Compensation

Stock Options/Restricted Stock

- General Rules
  - Recognition event = exercise of options or vesting of restricted stock
  - Treated as wage compensation, reportable on W-2
  - Restricted Stock rules are generally the same; employee has option to make IRC § 83(b) election, compensation is recognized in year of grant

- Significant Option Events:

  Grant ⟹ Vest/Exercise ⟹ Sale of Stock

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 1: Nonresident Taxation of Executive Compensation

<u>Stock Options/Restricted Stock</u>

- Nonresident Allocation varies on a state-by-state basis
  - Generally based on workdays between grant-vest or grant-exercise
  - Based on appreciation while resident?
  - No tax at all?

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 1: Nonresident Taxation of Executive Compensation

Deferred Compensation

- Most forms of deferred compensation allocated based on year (or years) earned
- NY Rule = year of retirement + 3 prior years

Pensions and Other Retirement Income

- 4 U.S.C. 114: states can't tax "retirement income"
  - Includes qualified plans (401k, ESUPs, annuities, etc.)
  - Also includes certain nonqualified deferred compensation plan if:
    - Paid in substantial equal payments over at least 10 years; or
    - Part of "excess benefit plan"

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 2: Multistate Withholding: Employer Obligations

Employer Withholding: Nexus

- Starting point for all multistate issues
- “Doing Business” or “Transacting Business” is the standard
- Presence of employees in-state usually = nexus
- Circular analysis: withholding is only an issue if employee is working in the state

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 2: Multistate Withholding: Employer Obligations

<u>Nexus and Telecommuting?</u>

- Home office employee = nexus?
- *Telebright* Case (N.J. Super. Ct. App. Div., 2010): software engineer working at home creates nexus for employer
- *Matter of Appeal of Warwick McKinley, Inc., Cal. SBE No. 489090*: marketing company with home office employee (and no other CA activities) had a "regular, systematic and substantial connection" with the state.
- A few states, though, take the position that a telecommuter does <u>not</u> = nexus

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 2: Multistate Withholding: Employer Obligations

<u>Thresholds for Withholding</u>

- No Threshold: About half of the states with an income tax have no threshold at all; withholding is required on day #1

- Income Thresholds: A few states only require withholding after a (low) income threshold is reached

- Time Thresholds: Withholding only required after an employee works a certain number of days
  - But, at least in NY, the 14-day threshold does not apply to certain executive compensation such as options
  - And check to make sure the “exemption” applies to employees too

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 2: Multistate Withholding: Employer Obligations

Thresholds for Withholding (con't.)

- Reciprocity: Designed to set certain conventions for withholding on nonresident employees living in border states
- Obviously varies on state-by-state basis
- Example: PA resident works in NJ; states agree to allow withholding in state of residence only

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 2: Multistate Withholding: Employer Obligations

Low/No Thresholds: Practical Problems

- Frequently-travelling employees
  - Examples: travelling sales people; consultants
- Rules vary state-by-state
  - Withholding thresholds different; so hard to have overall company policy
  - Allocation rules vary: amount to be withhold on certain forms of income (options, for example) varies state-to-state
- Audits are increasing
- Trust Fund Tax = Personal Liability!

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 3: Managing Compliance and Practical Solutions

A Federal Solution?

- H.R. 1129 and S. 1645 Mobile Workforce State Income Tax Simplification Act of 2013
  - 30-day threshold for income/withholding responsibility
  - N/A to athletes, entertainers
- Similar legislation has been tabled for over five years

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 3: Managing Compliance and Practical Solutions

Cleaning Up the Past

- Status Quo?
  - Section 404 of Sarbanes-Oxley
- Prospective Compliance
- Voluntary Disclosures

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 3: Managing Compliance and Practical Solutions

<u>Doing a Multistate Compliance Review</u>

- How many employees visit?
- How many total visits?
- Total compensation paid to visiting employees?
- Existence of thresholds?
- Active in withholding area?

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 3: Managing Compliance and Practical Solutions

Sample Compliance Chart

STATE	NO. OF EMPLOYEES VISITING STATE	TOTAL NO. OF VISITS	DE MINIMIS THRESHOLD FOR NONRESIDENTS?	RECIPROCAL AGREEMENTS IN EFFECT?	COMPLIANCE ACTION
LA	25	563	No	No	High activity state, with many employees over 25 days. State doesn't appear to have active criminal enforcement outside the sales tax area, but the high number of visits is problematic. Voluntary disclosure may be the best option.
NY	14	195	14 day rule	No	5 employees surpass 14 day threshold. NYS has been aggressive both on the withholding tax side and with respect to criminal enforcement. Thus, voluntary disclosure is also the best option. Going forward, put measures in place to track 14 day rule.
IL	10	88	Maybe	IA, KY, MI and WI	Employees' services could be considered localized elsewhere and services in IL incidental if they are temporary, transitory, or isolated; at the very least this could give us an argument for no withholding. Consider future compliance options.
SC	16	35	$1,000	No	Low number of visits; some could fall below threshold; status quo for now

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 3: Managing Compliance and Practical Solutions

Special Considerations for Voluntary Disclosures

- Do employees disclose also?
- Is payment on behalf of employee = taxable income?
- Resident credits for employee in home state?

Special Considerations for Audits

- What to do?
- Practical guidance from the front lines

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Part 3: Managing Compliance and Practical Solutions

Going-Forward Compliance

- Require employee reporting of work days
  - IT-2104
  - Company Forms/Disclosures
    - Coordinate with expense reporting requirements

- Can Technology Track Movement?
  - e.g., the MONAEO option: real-time view of employee location by detecting location via mobile device

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014

Contact Information

Gregory A. Bergmann, Partner, Deloitte Tax LLP
PHONE
gbergmann@deloitte.com

Timothy P. Noonan, Partner, Hodgson Russ LLP
716.848.1265
tnoonan@hodgsonruss.com

Frank A. Yanover, Senior Tax Counsel, General Electric Company
PHONE
Frank.Yanover@ge.com

Copyright © 2014 The National Multistate Tax Symposium: February 5-7, 2014