# STRATEGIES FOR DEALING WITH A MOBILE WORKFORCE: STATE INCOME TAXATION AND WITHHOLDING REQUIREMENTS

*By Wayne D. Roberts*

On February 5, 2015, Senator John Thune (South Dakota) introduced Senate Bill 386,[1] which is a reintroduction of prior versions of the *Mobile Workforce State Income Tax Simplification Act*.[2] The reintroduction of this Mobile Workforce bill serves as a reminder of the need for uniformity and simplification in the area of state individual income taxation – and related state income tax withholding – in the context of a mobile workforce (i.e., a workforce comprised of employees that work in states other than their individual resident states). Each time mobile workforce legislation is introduced it has the same general stated purpose:

> [t]o limit the authority of states to tax certain income of employees for employment duties performed in other states.

The principal element in each mobile workforce bill is a uniform rule that prohibits the wages (or other remuneration) earned by an employee who performs employment duties in more than one state from being subject to income tax in any state other than:

> (1) the state of the employee's residence, and
>
> (2) the state within which the employee is present and performing employment duties for **more than 30 days** during the calendar year.

The mobile workforce bills also exempt employers from withholding of tax and information reporting requirements for employees that are not subject to state income tax under the relevant Act; and allow an employer, for purposes of determining penalties related to employer withholding or reporting requirements, to rely on an employee's annual determination of the time such employee will spend working in a state (in the absence of fraud or collusion by the employee).

Mobile workforce and nonresident employee issues increase in importance as businesses in the United States becomes more national – and global – in scope.[3] This article provides a survey of state individual income tax and related withholding issues that have created an environment in which there is a recognized need for federal legislation.[4]

## Multi-State Business Operations And A Mobile Workforce

Multi-state business operations often require that certain employees work, on either a temporary or permanent basis, in a state other than the employee's resident state. Without a uniform *de minimus* rule similar to the 30 day rule referenced above, a nonresident worker generally is subject to state income tax – and withholding – on work done in a nonresident state for as little as one day. As an example, consider a manufacturing company that might need engineers resident in California and Michigan to work in Indiana for either one day, or an extended period of time, to establish a new production facility in Indianapolis. This type of "mobile" employee situation creates complex issues for the business. Foremost among these complexities are state income tax and withholding requirements. In the example above, questions arise regarding which state individual income tax must be withheld by the employer when, for example, wages are paid to the Michigan resident for work being performed in Indiana. The corollary question becomes whether the Michigan resident's income is subject to state individual income tax in Michigan, Indiana, or in both states. The specific state income tax and withholding requirements, along with potential solutions for such "mobile" employee situations can vary greatly by state. And these variations create significant burdens and exposure to multi-state businesses. Key among these exposures is the typical state "penalty" provision that holds an employer 100% liable for state income taxes that were not withheld on employee wages for work done in the workplace state - but that the workplace state determines were required to be withheld.[5]

Until – and unless – a federal *Mobile Workforce Simplification*[6] law is enacted, multi-state businesses will be forced to address mobile workforce and non-resident employee issues on an ad hoc basis using a relatively dynamic approach. To successfully navigate the maze of state (and local)[7] income tax laws, it is necessary to adopt a strategy that is based on an appreciation of the general rules governing state income taxation, withholding, and nexus; state-specific legislation; and state income tax reciprocity agreements currently in existence.

## Nexus, State Income Taxation, And Withholding

Nexus in the individual income tax context represents the minimum connection that must exist between an individual and the taxing state before the state has jurisdiction to im-

pose its income tax on the individual's earnings. There typically are two types of state income tax jurisdiction, which can be analogized to standard *in personam* and *in rem* jurisdiction concepts. An *in personam* style jurisdiction applies to state residents, and allows a state to impose state income tax on all of the earnings of its residents. An *in rem* style jurisdiction applies to nonresidents, and generally allows a state to impose income tax on amounts earned in the state by nonresidents.

With regard to non-resident individuals, the jurisdictional, or nexus, threshold typically is satisfied because the nonresident employee is working – at least temporarily - within the jurisdiction that is seeking to impose its tax.[8] In addition, with regard to withholding, states normally require withholding on all wages for "work done" in the state.

To complicate matters, the employee's resident state typically imposes state income tax as broadly as possible on all income earned by its residents, and allows some form of credit for taxes paid to another state. The employee's resident state also typically requires state income tax withholding on all earnings of its residents.

## STATE SPECIFIC LEGISLATION

It is important to identify state-specific legislation that affects the state income taxation of resident and nonresident employees. For example, it is important to know that the states identified in the table below do not impose a state individual income tax:

| States Not Imposing An Individual Income Tax | | |
|---|---|---|
| Florida | Nevada | New Hampshire |
| South Dakota | Tennessee | Texas |
| Washington | Wyoming | |
| ***Note:*** Washington, DC imposes no income tax on nonresidents working in the District | | |

In addition, it is important to identify states that have specific statutory provisions that affect state income taxation or withholding. For example, New York has a "*de minimus*" threshold under which withholding is not required on wages of a non-resident employee who works in New York for 14 days or less during calendar year.[9] California, Hawaii, New Jersey and Oklahoma also have some form of *de minimus* threshold relative to withholding.

## STATE INCOME TAX RECIPROCITY AGREEMENTS

Over the years, many states have recognized the difficulties associated with the taxation of employees that live in contiguous states, but cross state lines to go to work every day (or regularly). For example, a factory in Northern Indiana might employ a large number of Michigan residents in its operations. In these types of situations, states have entered into state reciprocity agreements that address two principal issues: taxation of nonresidents by the state in which the work is done; and withholding by the employer on wages earned by such an employee.

Under a typical state income tax reciprocity agreement, two party States agree that (1) income earned by a resident of one of the states is taxable only in the employee's resident state, and is exempt from tax in the workplace non-resident state; and (2) income earned by such an employee is subject to income tax withholding only for the resident state and is exempt from withholding in the nonresident, workplace state.[10] One anomaly presented by state reciprocity agreements is that the employer typically must withhold and remit state income tax to a state that is different from the state in which the employer is located; this also typically requires that the employer apply the other state's income tax law, withholding guidelines and withholding tables. For example, the Northern Indiana employer referenced above may have no connection with Michigan, but under the applicable reciprocity agreement would be applying Michigan income tax law and withholding and remitting Michigan income tax for its Michigan resident employees.

There is little logic or predictability with regard to the existence of a particular reciprocity agreement. These agreements generally have been entered into on an ad hoc basis based on historical events. The states that have entered into reciprocity agreements are detailed in the table at the end of this article.

## DEALING WITH A MOBILE WORKFORCE IN PRACTICE

Based on a review of the complexities and potential state income tax withholding exposure associated with a mobile workforce and nonresident employees, global strategies for addressing the myriad issues often are not adopted. However, there are strategies, which are based on comprehensive research and best practices, that can be implemented to limit exposure. The author proposes the following structure as one type of "best practices" approach to a typical mobile workforce state income tax analysis.

Step 1. Identify the states involved. Identify the resident state, along with each state in which work is performed during the tax year.

Step 2. Determine whether there are state-specific statutes that provide for exemptions or *de minimus* types of thresholds. Apply any state-specific provisions.

Step 3. Determine whether a reciprocity agreement exists between each set of states at issue. In the example above, the states cited are California, Michigan, Illinois.

Step 4. If a reciprocity agreement exists, have all employees covered by the reciprocity agreement complete the proper "nonresident" forms to properly document exemption from state income tax withholding requirements. Even if a reciprocity agreement exists, the employer normally can claim exemption from state income tax withholding in the workplace state only if it obtains a valid "certification of nonresidence" form. These forms (see table *infra*) are provided by nearly all states and should be updated regularly and maintained in the employer's personnel files.

Step 5. If no state-specific provisions or reciprocity agreements exist, then employers must evaluate the applicable state withholding statutes and administrative guidelines, and should implement policies to record and track the employee's work schedule for the tax year. This may require the maintenance of a daily log to document daily work location for an entire year. And while this could be cumbersome, there is little doubt that having contemporaneous, written (or electronic) work location records is very helpful in addressing auditor questions regarding state income tax withholding.

In connection with the steps three and four from the above outline, which involve the evaluation of state income tax reciprocity agreements, the table that follows identifies the states that have entered into reciprocity agreements, the additional party states to each such agreement, and the form that is required in each state as a "certificate of residence" or "certificate of nonresidence." In addition readers should note that there currently are at least 26 states that have no reciprocity agreements,[11] and Arizona has a hybrid reciprocal arrangement that applies to residents of California, Washington DC, Indiana, Oregon and Virginia.

## Conclusion And Didactic Case Study Analysis

The current multi-state environment consists of hundreds of state and local taxing jurisdictions with unique laws governing individual income taxation and withholding requirements. To address these myriad issues, a business that employs nonresident employees or employees that work in multiple states needs to adopt a thoughtful, comprehensive strategy. The approach suggested above, along with the state-specific information contained in this article, should serve as a good starting point for the type of analysis that is required to create – or at least discuss creating - an effective strategy for most businesses.

To illustrate they normal type of analysis that is required in this type of case, consider the following application of the suggested approach from above to the example referenced previously:[12]

1. *Identify the states involved.* California, Michigan (the resident states) and Indiana (the workplace state).
2. *Determine if there are controlling state-specific statutes.* N/A
3. *Determine whether there is a state tax reciprocity agreement between the relevant states.* In this case, there is a reciprocity agreement between Michigan and Indiana, but not between California and Indiana.
4. *Apply Reciprocity.* Exposure to Indiana income tax withholding on the a Michigan resident employee's wages can be eliminated by having the Michigan resident employee complete and sign a ***Certificate of Residence, Form WH-47***, and keeping this form on file in the company's records. With a properly completed Form WH-47, the employer will be required to withhold only Michigan income tax on the Michigan resident's earnings.

   However, there is no reciprocity protection for California – i.e., for the employer's withholding of Indiana state income tax on amounts paid to the California resident employee for work done in Indiana.

5. *Address non-reciprocity state issues:* In general, the employer that has a location in Indiana would be an Indiana withholding agent and would be required to withhold Indiana state income tax on wages paid to the California resident employee for work done in Indiana.[13] The employer should have some method for tracking and documenting work done in Indiana. The employee would be required to file an Indiana income tax return to claim the benefit of the withholding, and typically would be entitled to a credit for Indiana taxes paid in her home state (CA) individual income tax return.

Although the application of the proposed strategy in the simple example above may appear to be relatively straightforward, the ability to apply a strategy like this to "answer" these types of questions becomes very complicated and nuanced as the facts change, as employer and employee locations change or increase, and as additional variables are added to the fact pattern. Nevertheless, employers are well served to take action, and strategy outlined above is one method that an employer might use to begin to address the multiple, diverse, and complicated state income tax and withholding requirements that are imposed across the country.

### Multi-State Reciprocity Table

| STATE | RECIPROCITY WITH STATE(S) | NON-RESIDENT FORM |
|---|---|---|
| Arkansas[14] | Texas | Arkansas Form AR4EC(TX) – Texarkana Employee's Withholding Exemption Certificate |
| District of Columbia[15] | Maryland and Virginia (also see comments) | D.C. Form D-4A – Certificate of Nonresident in the District of Columbia |
| Illinois | Iowa, Kentucky, Michigan, Wisconsin | Illinois Form IL-W-5-NR – Employee's Statement of Nonresidence in Illinois |
| Indiana | Kentucky, Michigan, Ohio, Pennsylvania, Wisconsin | Indiana Form WH-47– Certificate of Residence |
| Iowa | Illinois | Iowa Form 44-016 – Employee's Statement of Nonresidence in Iowa |
| Kentucky | Illinois, Indiana, Michigan, Ohio, West Virginia, Wisconsin, Virginia | Kentucky Form 42A809 – Certificate of Nonresidence |
| Maryland | District of Columbia, Pennsylvania, Virginia, West Virginia | Maryland Form MW 507 – Employee's Maryland Withholding Exemption Certificate |
| Michigan[16] | Illinois, Indiana, Kentucky, Minnesota, Ohio, Wisconsin | Statement of Non-residence in Michigan |
| Minnesota | Michigan, North Dakota | Minnesota Form MWR - Reciprocity<br>Exemption/Affidavit of Residency for Tax Year 2014 |
| Montana | North Dakota | Montana Form NR-2 -Employee Certificate of North Dakota Residence |
| New Jersey | Pennsylvania | New Jersey Form NJ-165 - Employee's Certificate of Nonresidence in New Jersey |
| North Dakota | Minnesota, Montana | North Dakota Form NDW-R - Reciprocity exemption from withholding for qualifying Minnesota and Montana residents working in North Dakota |
| Ohio | Indiana, Kentucky, Michigan, Pennsylvania, West Virginia | Ohio Form IT 4NR - Employee's Statement of Residency in a Reciprocity State |
| Pennsylvania | Indiana, Maryland, New Jersey, Ohio, Virginia, West Virginia | Pennsylvania Rev-419 - Employee's Nonwithholding Application Certificate |
| Texas[17] | Arkansas | See Arkansas summary above |
| Virginia | District of Columbia, Kentucky, Maryland, Pennsylvania, West Virginia | Virginia Form VA-4 - Personal Exemption Worksheet |
| West Virginia | Kentucky, Maryland, Ohio, Pennsylvania, Virginia | West Virginia Form WV/IT-104 - Employee's Withholding Exemption Certificate |
| Wisconsin[18] | Illinois, Indiana, Kentucky, Michigan | Form W-220 - Nonresident Employee's Withholding Reciprocity Declaration (residents of Illinois, Indiana, Kentucky) |

**About the Author**

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**Endnotes**

1 S 386 (introduced to the 114th Congress in the United States Senate on February 5, 2015).

2 *See* prior mobile workforce introductions, including: H.R. 1129, Mobile Workforce Income Tax Simplification Act of 2013; H.R. 1864, Mobile Workforce Income Tax Simplification Act of 2012; H.R. 2110, Mobile Workforce Income Tax Simplification Act of 2009; H.R. 3359, Mobile Workforce Simplification Act of 2007.

3 The significance of these issues is reinforced by the fact that the Council of State Taxation ("COST"), the premier state tax organization representing business, has advocated for mobile workforce simplification for years. *See, e.g.,* COST Legislative Alert, ISSUE 15-06 (February 10, 2015).

4 The focus of this article is limited to state income taxation and withholding issues; future articles will be required to address additional issues relative to matters such as business tax nexus and international tax issues raised by the use of a mobile workforce.

5 And this 100% penalty in the workplace, nonresident state typically applies regardless of whether the employer withheld state income tax on 100% of the employee's wages and remitted the withholding to the employee's resident state.

6 *Supra*.

7 Although this article is limited to state individual income tax, the reader should note that there also are multiple local jurisdictions that impose income taxes and require withholding for work done in the locality.

8 There are related business tax nexus implications for a business that employs a nonresident employee. In such a case, the employer could be found to have business tax nexus in the employee's resident state due to the fact that the employee is performing work for the employer in such state. *See e.g., Telebright Corporation, Inc. v. Director, New Jersey Division of Taxation*, 2012 WL 669964; NJ Superior Ct, Appellate Div., Docket No. A-5096-09T2 (March 2, 2012) (Maryland-based software business that had no other contacts with New Jersey was held to have business tax nexus in New Jersey due to the employment of one software design employee working on software code writing out of her house in New Jersey). These business tax nexus questions generally are beyond the scope of this article. However, readers should note that, while state court and agency decisions may be inconsistent, nexus in a state is created by having an employee in such state only if the employee's activities are "significantly associated with the taxpayer's ability to establish or maintain a market in [the taxing] state for its sales." *Tyler Pipe Industrial v Dept of Revenue*, 483 US 232 (1987)(Washington B&O Tax). A similar legal test is applied to the activities of independent contractors acting on behalf of a taxpayer. *See Scripto v Carson*, 362 US 207 (1960)(Florida use tax nexus established by independent contractor salespersons).

9 For an explanation of the New York 14 day rule, *see* Technical Memorandum TCB-M-12(5)I (Income Tax, July 5, 2012) (New York State Department of Taxation and Finance – Taxpayer Guidance Division).

10 Although reciprocity agreement terms generally are consistent, the author recommends that tax counsel obtain and carefully review a copy of any potentially applicable reciprocity agreement as the agreements often were entered into in the 1970's or before, and editorials (including this one) summarizing a specific reciprocity agreement could not adequately address a particular situation.

11 Alabama, Arkansas (except Texarkana), California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Kansas, Louisiana, Maine, Massachusetts, Missouri, Nebraska, New Hampshire, New Mexico, New York, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Utah, and Vermont.

12 This example of the type of analysis required is somewhat simplistic. It is not intended to be, and cannot be relied on, as legal advice; it is included solely for didactic purposes.

13 This simplistic example assumes that the employer has no nexus, and is not an employer or withholding agent,

in California. Additional review may be required with respect to a California employer's withholding obligations in California.

14 Employees claiming exemption from Arkansas withholding must be residents of either Texarkana, TX, and Texarkana, AR. Texas has no individual income tax.

15 Form D-4A must be filed by "non-resident" to be exempt from D.C. withholding. To qualify as a non-resident an employee must have a permanent residence outside DC during the entire tax year and not "reside" in DC for 183 days or more during the tax year.

16 Michigan does not have a specific form. An employer generally must develop a form or obtain a signed and dated letter from the employee. Form or letter must contain employee's name, legal address, and SSN. The employer must retain this document in his files. A sample form is attached.

17 Texas does not impose an individual income tax. Reciprocity with Arkansas applies to residents of Texarkana, AR and Texarkana, TX - Arkansas withholding.

18 Reciprocity between WI and MN existed prior to 2010, but was not renewed.