STATE+LOCAL TAX INSIGHTS

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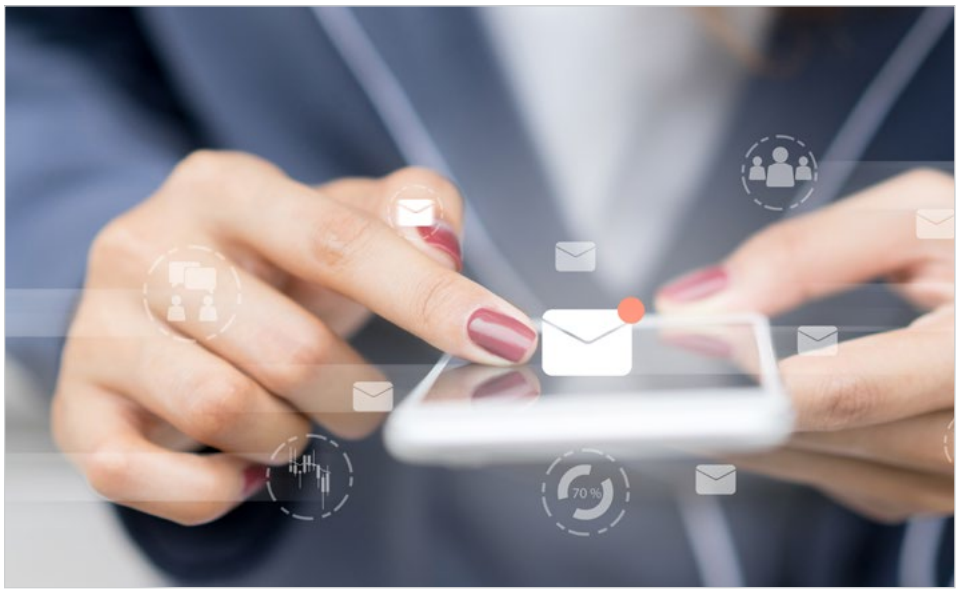

CHALLENGES OF A MOBILE WORKFORCE

By Nicole L. Johnson and William H. Gorrod

Gone are the days that employees worked from only one location from 9:00 a.m. to 5:00 p.m. With employees traveling throughout the U.S., and in many instances, having some employees telecommuting, a company must be diligent. These mobile employees can give rise to potential state and local tax obligations for the employers in unexpected jurisdictions and create tax compliance challenges for even the most diligent employers.

While tax requirements vary significantly among the states, mobile employees can result in tax filing obligations for corporate income taxes, sales and use taxes, payroll taxes and the myriad of other state and local taxes that are imposed in various jurisdictions. In this article, we discuss the potential state payroll tax filing requirements for mobile employees, the proposed federal legislation that could impact these requirements and best practices for remediating past exposures, managing prospective tax filing obligations and handling audits involving mobile employees.

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Upcoming Speaking Engagements

October 3, 2019

New Jersey State & Local Tax Day
New Brunswick, New Jersey

- "Handling State Tax Controversies"
  Mitchell A. Newmark

October 18, 2019

State + Local Tax Update: Boston
Boston, Massachusetts

- "State Impacts of Federal Tax Reform - One Year Later"
- "New England Updates"
- "SALT Litigation and Other Developments Around the Country"

October 22 – 25, 2019

Council on State Taxation's 50th Annual Meeting
Washington, D.C.

- "Combined/Unitary Reporting – States' Increasing but Varied Adoption"
  Craig B. Fields
- "International Tax Planning Post-TCJA: SALT Considerations"
  Mitchell A. Newmark
- "Market Based Sourcing"
  Nicole L. Johnson

October 28 – 30, 2019

Vanderbilt University Law School's 26th Annual Paul J. Hartman State and Local Tax Forum
Nashville, Tennessee

- "Top Ten Income Tax Cases"
  Hollis L. Hyans
- "To Be Or Not To Be – Judicial Deference in State Tax Controversies"
  Craig B. Fields
- "Local Taxes and Other Unwelcome and Unexpected Taxes"
  Mitchell A. Newmark

October 29, 2019

Tax Executives Institute Annual Conference
New Orleans, Louisiana

- "Limits on Taxation: PL 86-272, Economic Nexus, and Other Doctrines in a Post-*Wayfair* Age"
  Nicole L. Johnson

October 31, 2019

Multistate Tax Treatment of Multi-Tier Partnerships
Strafford Webinar

- "State Tax Issues for Nonresident Tiered Pass-Through Entities"
  William H. Gorrod

November 5, 2019

San Francisco Tax Club
San Francisco, California

- William H. Gorrod

November 5, 2019

State and Local Tax Challenges in Mergers, Acquisitions, and Asset Sales
Strafford Webinar

- Mitchell A. Newmark and Eugene J. Gibilaro

November 8, 2019

California Tax Policy Conference
San Diego, California

- "*Certiorari* Granted: Essential SALT Litigation in 2019"
  Nicole L. Johnson

December 16 – 17, 2019

New York University's 38th Institute on State and Local Taxation
New York, New York

- "*Wayfair* Writ Large: The Spread of Economic Nexus"
  Craig B. Fields
- "Does *Wayfair* Affect P.L. 86-272?"
  Philip M. Tatarowicz
- "Combined Filing and the Resurgence of Worldwide Combined"
  Mitchell A. Newmark
- "Apportionment Issues: Recent Developments"
  Hollis L. Hyans

PAYROLL TAXES

In most states, payroll tax filing requirements generally include income tax withholding on employee earnings, unemployment insurance contributions and disability insurance contributions. Generally, for withholding purposes, residents are subject to withholding on all of their wages, while nonresidents are subject to withholding only on their wages earned within that state.

Thus, employers are left to determine where their employees earn their wages.

Moreover, if an employee receives compensation attributable to more than one year—such as stock options—employers can face significant challenges with determining how to allocate the compensation to each state.

If an employee receives compensation attributable to more than one year—such as stock options—employers can face significant challenges with determining how to allocate the compensation to each state.

Roughly 16 states have entered reciprocal agreements with other states to require withholding only in the resident state. For example, Pennsylvania has entered reciprocal agreements with Indiana, Maryland, New Jersey, Ohio, Virginia and West Virginia. Illinois has entered reciprocal agreements with Iowa, Kentucky, Michigan and Wisconsin. These contractual agreements between states can be particularly beneficial for employers that are located close to a border of a sister state. In addition, a limited number of states have adopted thresholds before an employer is required to withhold on a nonresident employee's wages. These thresholds can be based on days worked within the state, wages earned within the state or some combination of days worked and wages earned. For example, for New York withholding purposes, an employer is not required to withhold tax if it reasonably expects that the nonresident employee will work 14 days or less within New York during the year (although the employee may still have a nonresident personal income tax filing obligation).[1] Georgia is an example of a different type of threshold whereby the employer is not required to withhold if the nonresident employee works in the State for 23 days or less during the calendar quarter and the compensation paid to the employee does not exceed the lesser of $5,000 or 5% of the nonresident's compensation.[2]

Nevertheless, many states, such as California, do not have any minimum threshold (apart from the low income filing threshold) and can require withholding based on a single day worked within the state.[3] With the prevalence of the mobile workforce, complying with these rules can seem like a herculean task. However, there is proposed federal legislation that would limit that burden and ways to mitigate the risks involved.

PROPOSED FEDERAL LEGISLATION

Currently proposed federal legislation could change the state withholding landscape. The Mobile Workforce State Income Tax Simplification Act of 2019[4] is a pending federal bill that would limit the states' power to tax nonresidents and simplify withholding tax compliance for employers by establishing a 30-day threshold below which a state could not impose personal income tax on nonresidents. Thus, an employer would not have to withhold unless an employee's visits to a particular state exceeded 30 days.

Notably, the legislation does not apply to professional athletes, professional entertainers and certain public figures. In addition, the legislation does not provide protection against the imposition of corporate income taxes or sales and use taxes based on the presence of nonresident employees working within the state. Similar versions of the bill have been introduced in previous years but have not passed despite growing bipartisan support.[5] The bill is currently with the Senate Committee on Finance.

Not wanting to wait for federal legislation, Illinois recently enacted legislation based upon these same thresholds.[6] With any luck—and the work of many organizations, including the Council on State Taxation—other states will see the logic in not overburdening their corporate citizens and pass similar legislation.

BEST PRACTICES FOR MANAGING EXPOSURE

For many employers, it is difficult to maintain 100% compliance with state and local withholding requirements due to the variations in state thresholds and practical problems with tracking the travel for all employees and reporting it to their payroll departments. In order to reduce their exposure, employers should consider establishing policies for employees to report their travel.

State tax departments are well aware that it is difficult for employers to comply with the requirements discussed above. As such, they often audit employers to seek to identify liabilities for underwithheld taxes, plus impose penalties and interest. A cynic would say that auditing an employer is more efficient in bringing in tax dollars than

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MASSACHUSETTS INSIGHTS IN BRIEF

By Matthew F. Cammarata

Massachusetts Imposes Sales Tax Collection Obligations on Marketplace Facilitators and Remote Retailers

Governor Baker's fiscal year 2020 budget included significant amendments to the sales tax laws, requiring certain defined marketplace facilitators and remote retailers to collect sales tax if sales within Massachusetts exceed $100,000 in the prior or current taxable year.[A]

Massachusetts Responds to the Tax Cuts and Jobs Act ("TCJA")

Massachusetts has enacted legislation codifying the corporate excise tax treatment of certain international provisions of the TCJA.[B] Corporate excise taxpayers must include deferred foreign income under Internal Revenue Code ("I.R.C.") Section 965 ("deemed repatriated income") in their Massachusetts gross income for the same tax year that it is included in federal gross income. Massachusetts does not allow the deduction available under I.R.C. Section 965(c), which creates a preferential tax rate for the deemed repatriated income. Massachusetts also will not allow taxpayers to elect to pay tax liabilities attributable to deemed repatriated income over an eight year period as they are allowed to do federally. The law also requires Massachusetts corporate excise taxpayers to include in Massachusetts net income any global intangible low-taxed income ("GILTI") included in federal gross income. Massachusetts does not allow the federal deduction for 50% of the amount of GILTI included in income, nor does it allow the deduction for certain foreign-derived intangible income available under I.R.C. Section 250.

Both deemed repatriated income and GILTI will be treated as dividends subject to a 95% dividends received deduction. Amounts included in income as deemed repatriated income or GILTI are excluded from the sales factor.

The Massachusetts Department of Revenue ("Department") has issued a Technical Information Release explaining the legislation.[C]

Massachusetts Proposes Changes to Its Corporate Nexus Regulation

The Department has released a proposed amended corporate nexus regulation that incorporates nexus without physical presence principles in light of the U.S. Supreme Court's decision in *South Dakota v. Wayfair, Inc.*[D] According to the proposed regulation, a corporate excise taxpayer will have nexus with Massachusetts when it lacks other "contacts" with Massachusetts, "but has considerable in-state sales derived through either economic or virtual contacts."[E]

Senate President Announces Revenue Working Group

The President of the Massachusetts Senate has announced the formation of a Revenue Working Group that will conduct a comprehensive review of the entire Massachusetts tax code. The Revenue Working Group is composed of 21 members, including state senators, representatives from business associations and a law professor. Legislative recommendations are not expected until 2021.

A H. 4000, 191st Gen. Ct., 2019 Reg. Sess. (Mass. 2019).

B *See* Mass. Gen. Laws ch. 63, §§ 1, 2A, 30, 32B, 38.

C Mass. Dep't of Revenue, Tech. Info. Release 19-11, *Legislation Impacting the Massachusetts Tax Treatment of Selected International Provisions of the Federal Tax Cuts and Jobs Act* (Aug. 8, 2019).

D 138 S. Ct. 2080 (2018).

E Mass. Dep't of Revenue, 830 CMR 63.39.1: Corporate Nexus (Proposed Regulation) (May 3, 2019); 1390 Mass. Reg. 33 (May 3, 2019).

identifying and conducting personal income tax audits for individual employees—and the cynic would be right. Oftentimes if the employer has not withheld on an employee's income in nonresident states, the employee has not filed personal income tax returns in those states where the employee worked.

State tax departments . . . often audit employers to seek to identify liabilities for underwithheld taxes, plus impose penalties and interest.

Frequently, state withholding tax audits focus on highly compensated employees and audit a sample to extrapolate for other employees. In this instance, employers are well-advised to dispute the amount asserted for each employee in detail and to carefully review whether the sample of employees selected for audit is appropriate. A $100 underwithholding in the sample can be extrapolated into a much larger tax burden.

Employers should also proactively consider their historic state withholdings. To the extent that an exposure is identified prior to being contacted by a state, the employer may qualify for a voluntary disclosure agreement or an amnesty program, which may often be applied for on an anonymous basis. Most programs offer a limited lookback period (often between three and six years) and the waiver of penalties if the employer agrees to pay the tax and interest due. However, prior to submitting any underwithholding information to a state, employers should inform their employees.

CONCLUSION

As more workers telecommute and travel to various states for work, employers will continue to face significant challenges with complying with the myriad of tax filing requirements. It is prudent for employers to analyze their tax filing requirements based on the activity of their mobile employees on a regular basis, implement a compliance policy and consider opportunities for resolving historical exposures in advance of being contacted by a state. Employers should also continue to track the progress of—or even actively support—proposed federal (and state) legislation that could potentially change many of their multistate withholding obligations.

1 N.Y.S. Dep't of Taxation & Fin., TSB-M-12(5)I, *Withholding on Wages Paid to Certain Nonresidents Who Work 14 Days or Fewer in New York State* (July 5, 2012).

2 Ga. Code Ann. §§ 48-7-1(11), 48-7-100(10)(K).

3 *See* Cal. Emp't Dev. Dep't, DE 231D Rev. 12, *Multistate Employment* (Dec. 2017).

4 S. 604, 116th Cong.

5 The House of Representatives passed comparable bills in 2012 (H.R. 1864, 112th Cong.) and 2016 (H.R. 2315, 114th Cong.) but both bills stalled in the Senate.

6 S. 1515, 101st Gen. Assemb. (Ill. 2019).

CALIFORNIA INSIGHTS IN BRIEF

By William H. Gorrod

U.S. Supreme Court Denies Private Suits in Other States' Courts

In *California Franchise Tax Board v. Hyatt*, the U.S. Supreme Court reviewed a Nevada Supreme Court decision and addressed the question of whether *Nevada v. Hall*, which permits a sovereign state to be hauled into another state's courts without its consent, should be overruled.[A] The Court overruled *Hall* and held that states retain sovereign immunity against private suits in other states' courts.

Arizona Requests to File U.S. Supreme Court Action Against California

On February 28, 2019, the State of Arizona filed a motion for leave to file a bill of complaint against the State of California in the U.S. Supreme Court.[B] In its motion, Arizona asserts that California's imposition of tax on Arizona members of limited liability companies ("LLCs") that are doing business in California is an unconstitutional extraterritorial assessment. This case is an additional development regarding the issue of flow-through nexus based on a membership interest in an LLC, which in recent years has been addressed by the California Court of Appeal and Office of Tax Appeals in decisions that held that a 0.2% and a 25% passive, non-managing membership interest, respectively, in LLCs doing business in California were insufficient to create California nexus.[C] In addition, Arizona asserts that California's procedures for seizing Arizona taxpayers' property held in Arizona bank accounts, without judicial

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approval, in order to collect the alleged extraterritorial assessments is unconstitutional. Both States have filed briefs regarding the motion and the motion was distributed for conference. Most recently, on June 24, 2019, the Court invited the Solicitor General to file a brief expressing the views of the U.S. Out-of-state members of LLCs doing business in California should continue to monitor the progress of this case, as well as California developments regarding flow-through nexus.

California Enacts Limited Conformity with the Tax Cuts and Jobs Act ("TCJA")

On July 1, 2019, California enacted selective conformity with certain provisions of the TCJA, including the repeal of net operating loss carrybacks, limitation of like-kind exchanges to real property, elimination of separate Internal Revenue Code ("I.R.C.") Section 338 elections, repeal of technical terminations of partnerships, limitations on banks' deductions for Federal Deposit Insurance Corporation ("FDIC") premiums and limitations on deductions of excess employee compensation.[D] The legislation does not conform to the global intangible low-taxed income ("GILTI"), foreign-derived intangible income ("FDII"), base erosion and anti-abuse tax ("BEAT"), I.R.C. Section 163(j) interest expense limitations or full expensing.

California Penalty Relief for Marketplace Sellers

The California Department of Tax and Fee Administration ("DTFA") established a sales and use tax amnesty program with a penalty waiver and limited look back period to April 1, 2016 for out-of-state retailers with nexus based solely on being a marketplace facilitator with inventory stored in California. An out-of-state retailer is eligible for the program even if it has been contacted by the DTFA, as long as the retailer: (1) was not registered prior to December 1, 2018; (2) did not file sales and use tax returns prior to contact by the DTFA; and (3) voluntarily registers, files and pays or sets up a payment plan by September 25, 2019.

California Superior Court Validates Homelessness Gross Receipts Tax

During the 2018 elections, the City and County of San Francisco ("SF") enacted the Homelessness Gross Receipts Tax ("Homelessness GRT") and Early Care and Education Commercial Rents Tax ("CRT").[E] These taxes were proposed on the ballot through a citizen ballot initiative and were passed by a simple majority exceeding 50% of the vote, but did not obtain a supermajority exceeding two-thirds of the vote. In separate litigations addressing the same substantive issue for each tax, taxpayer associations argued that the taxes were invalid because they failed to comply with Propositions 13 and 218 of the California Constitution, which require a supermajority for special taxes imposed at the local level.[F] SF argued that the taxes were validly enacted based on *California Cannabis Coalition v. City of Upland*,[G] which stated in dicta that local ballot initiatives with the requisite number of signatures are subject to a simple majority, rather than a supermajority, of voter approval.

The California Superior Court upheld both taxes based on *Upland* and determined that while the California Constitution requires a supermajority vote for a local government to impose or increase a special tax, only a simple majority is required for voter initiatives that impose or increase local taxes. The Court's decisions in the both the CRT case and the Homelessness GRT case have been appealed. SF is currently offering a 10% credit to taxpayers that pay the Homelessness GRT and either waive their rights to refunds or make an irrevocable gift in the amount of the tax owed.[H]

A *See Franchise Tax Bd. v. Hyatt*, 139 S. Ct. 1485 (2019).

B *Arizona v. California*, No. 22O150 (U.S. filed Feb. 28, 2019).

C *See Swart Enters., Inc. v. Franchise Tax Bd.*, 212 Cal. Rptr. 3d 670 (Ct. App. 2017); *In the Matter of the Appeal of Satview Broadband, Ltd.*, OTA Case No. 18010756 (Cal. Office of Tax App. Sept. 25, 2018); *see also In the Matter of the Appeal of Jali, LLC*, OTA Case No. 18073414 (Cal. Office of Tax App. July 8, 2019) (determining that an interest of less than 5% in a manager-managed LLC doing business in California did not create nexus).

D *See* Assemb. 91, 2019-20 Leg., Reg. Sess. (Cal. 2019).

E *See* S.F., Cal., Bus. & Tax Regs. Code art. 28, § 2804; S.F., Cal., Bus. & Tax Regs. Code art. 21, § 2104.

F *See City & County of San Francisco v. All Pers. Interested in the Matter of Proposition C*, No. CGC-19-573230 (Cal. Super. Ct. S.F. Cty. July 5, 2019); *Howard Jarvis Taxpayers Ass'n v. City & County of San Francisco*, No. CGC-18-568657 (Cal. Super. Ct. S.F. Cty. July 5, 2019).

G 401 P.3d 49 (Cal. 2017).

H S.F., Cal., Bus. & Tax Regs. Code art. 28, §§ 2805.1, 2805.2.

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Agilent Technologies, Inc. v. Colorado (CO Sup. Ct. 2019)

Archer Daniels Midland Co. v. Pennsylvania (PA Bd. of Fin. & Rev. 2018)

Astoria Financial Corp. v. New York City (NYC Tax App. Trib. 2016)

Clorox Products Manufacturing, Co. v. New Jersey (NJ App. Div. 2008)

Crestron Electronics, Inc. v. New Jersey (NJ Tax Ct. 2011)

Daimler Investments US Corp. v. New Jersey (NJ Tax Ct. 2019)

Dollar Tree Stores Inc. v. Pennsylvania (PA Bd. of Fin. & Rev. 2015)

Duke Energy Corp. v. New Jersey (NJ Tax Ct. 2014)

E.I. du Pont de Nemours & Co. v. Michigan (MI Ct. of App. 2012)

E.I. du Pont de Nemours & Co. v. Indiana (IN Tax Ct. 2017)

EchoStar Satellite Corp. v. New York (NY Ct. of App. 2012)

Former CFO of Fortune 500 Co. v. New York (NYS Div. of Tax App. 2017)

frog design, inc. v. New York (NYS Tax App. Trib. 2015)

Hallmark Marketing Corp. v. New York (NYS Tax App. Trib. 2007)

Kohl's Department Stores, Inc. v. Virginia (VA Sup. Ct. 2018)

Lorillard Licensing Co. v. New Jersey (NJ App. Div. 2015)

Lorillard Tobacco Co. v. New Jersey (NJ Tax Ct. 2019)

MeadWestvaco Corp. v. Illinois (U.S. 2008)

Meredith Corp. v. New York (NY App. Div. 2012)

Nerac, Inc. v. New York (NYS Div. of Tax App. 2010)

Rent-A-Center, Inc. & Subsidiaries v. Oregon (OR Tax Ct. 2015)

Reynolds Innovations Inc. v. Massachusetts (MA App. Tax Bd. 2016)

Reynolds Metals Co. v. Michigan (MI Ct. of App. 2012)

Scioto Insurance Co. v. Oklahoma (OK Sup. Ct. 2012)

Thomson Reuters Inc. v. Michigan (MI Ct. of App. 2014)

United Parcel Service General Svcs. v. New Jersey (NJ Sup. Ct. 2014)

Wendy's International, Inc. v. Illinois (IL App. Ct. 2013)

Wendy's International, Inc. v. Virginia (VA Cir. Ct. 2012)

Whirlpool Properties, Inc. v. New Jersey (NJ Sup. Ct. 2011)

W.R. Grace & Co.-Conn. v. Massachusetts (MA App. Tax Bd. 2009)

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