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GMS Flash Alert

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United States - Proposal Would Limit State Tax and Withholding for Nonresident Employees

On July 27, 2020, Republicans in the U.S. Senate released several legislative proposals intended to serve as components of a broader Senate legislative response to the coronavirus (COVID-19) pandemic. One of the proposals, the "American Workers, Families and Employers Assistance Act," contains tax provisions that could significantly impact global mobility and business traveler programs if passed, as it imposes limitations on state and local taxing jurisdictions'[1] ability to withhold and tax nonresident employee income through 2024.

The "American Workers, Families and Employers Assistance Act," is just a proposal and the provisions contained therein may be deleted or significantly modified prior to enactment.

KPMG LLP (U.S.) is monitoring the legislation and will keep you updated of any significant developments.

WHY THIS MATTERS

The proposed legislation would be welcome news to global mobility and business traveler programs. It may help reduce the complexity and cost of compliance as programs would no longer have to account for the various laws and thresholds across U.S. states when mobilizing employees for inter-state travel. Potential explicit cost savings could also arise, as the implementation of a standard threshold would potentially reduce or eliminate the need for state and local tax gross-ups when an employee performs services in a nonresident state.

Background

Even though U.S. states do not follow a standardized income tax code and instead adhere to their own tax and withholding laws, they are united by the fact that the income tax and withholding treatment of individual employees depend on whether the employees are considered residents or nonresidents of a state.

While each state has its own criteria for determining residency, employees are generally subject to income tax and withholding on their entire income from employment, which includes wages and other remuneration, such as bonuses, allowances, and equity compensation, in their resident state.

Employees may also be subject to income tax and withholding in a state where they are deemed to be a nonresident if they perform services or employment duties in that state. Currently, each state utilizes its own rules and thresholds for determining when a nonresident is liable for income tax or subject to income tax withholding and reporting.

However, the proposed legislation would institute a standardized threshold for taxing and withholding nonresident employee income based on the number of days an employee was present and performing employment duties in a nonresident state.

Summary of Proposed Legislation

In its current form, the proposed bill provides that in order for a state to tax the employment income of an employee who is a resident of a different state, the nonresident employee must be present and performing employment duties in that nonresident state for more than 30 days during the calendar year in which the wages or other remuneration are earned.[2]

Specifically, the bill provides that no part of the wages earned by an employee would be subject to income tax in any state other than the employee's resident state and any other jurisdiction where the employee is present and performing services for more than 30 days during the calendar year in which the wages are earned. Likewise, the employee's wages would not be subject to income tax withholding unless the employee is subject to income tax because he or she has been working in that state for more than 30 days during the calendar year. Once the 30-day threshold is met, withholding and reporting would be required on wages and other remuneration earned as of the commencement date of employment duties in the state.

For any employee who performs employment duties in a state other than the employee's resident state during calendar year 2020 as a result of the COVID-19 public health emergency, the threshold would increase from 30 to 90 days.

KPMG NOTE

Working from a Different State and COVID-19

There is no guidance on what it means to be working from a different state as a result of the COVID-19 public health emergency; however, it appears that any employee working outside of his or her resident state in 2020 would be eligible for the 90-day threshold.

Application of the Threshold and Residency

It is important to note that for the threshold to apply, an employee must be considered a resident of a state. For purposes of the bill, the residency of an employee is determined under the laws of the state in which the employee maintains a dwelling which serves as the employee's permanent place of abode during the calendar year. Therefore, based on the language of the bill, the threshold may not be applicable to employees who are not residents of any state or to expatriate employees who do not maintain a dwelling which serves as their permanent place of abode in the United States during the calendar year.

If an employee is not eligible for relief under the bill and performs employment duties in a nonresident state and triggers an income tax liability or income tax withholding requirement, he or she may be able to exclude the employment income from being subject to taxation and withholding in the nonresident state if the state honors federal income tax treaties.

KPMG NOTE (cont'd)

Determining Where Duties Are Performed and Possible Penalties

For purposes of determining penalties related to an employer's income tax withholding and reporting requirements with respect to any state, an employer may rely on an employee's annual determination of where he or she expects to spend time performing duties absent collusion or actual knowledge by the employer of fraud by the employee. If an employer, at its sole discretion, maintains a time and attendance system that tracks where the employee performs duties on a daily basis, data from the time and attendance system would have to be used instead of the employee's determination.

Relief for Employees Working Remotely and COVID-19 Pandemic

Furthermore, in response to the increase in the number of remote workers as a result of the COVID-19 pandemic, the bill sets out specific protections for employees and employers during "covered periods." The term ''covered period'' means, with respect to any employee "working remotely," the period beginning on the date on which the employee began working remotely and ending on the earlier of: (1) the date on which the employer allows, at the same time, the employee to return to his or her primary work location and not less than 90 percent of the employer's permanent workforce to return to that primary work location; or (2) December 31, 2020.

''Working remotely'' in this context means the performance of duties by an employee at a location other than the employee's primary work location[3] at the direction of his or her employer due to conditions resulting from the public health emergency relating to COVID-19, including:

- To comply with any government order relating to COVID-19;
- To prevent the spread of COVID-19; and
- Due to the employee or a member of the employee's family contracting COVID-19.

During this covered period, any wages earned by an employee working remotely would be deemed to have been earned at the primary work location of the employee unless the employer maintains a daily time tracking system and the employer elects to treat the wages of the employee as earned at the remote performance location.

Will Workers in a "Remote" State Create Nexus in that State for the Business? Apportionment Issues?

For an out-of-state business that has employees working remotely in the state during the covered period, the duties performed by the employee would not create any nexus or establish any minimum contacts or level of presence that would otherwise subject the business to any registration, taxation, or other related requirements in that jurisdiction. Similarly, any duties performed by an employee in the remote state would not be used to apportion any income or gross receipts to the state. Rather, for apportionment purposes, the duties would be treated as if performed at the primary work location of the employee.

What's Next?

The U.S. House of Representatives on May 15, 2020, passed (on a largely party-line vote) the "Health and Economic Recovery Omnibus Emergency Solutions Act" (The HEROES Act),[4] which was then sent to the Senate. The Senate took no action on the bill. There are many significant differences between the HEROES bill and the Senate Republicans' recent proposals. In order for further COVID-19 response legislation to become law, the House, Senate, and White House all will ultimately have to agree to the same legislation.

FOOTNOTES:

1 The term "taxing jurisdiction" is defined in the proposed bill as "any of the several States, the District of Columbia, or any municipality, city, county, township, parish, transportation district, or assessment jurisdiction, or any other political subdivision of a State with the authority to impose a tax, charge, or fee." For ease of reference, we will refer to a "taxing jurisdiction" as "state" and taxing jurisdictions collectively as "states."

2 Certain types of individuals – professional athletes, entertainers, and public figures paid on a "per event" basis and qualified production employees – would be excluded from the definition of an employee for purposes of the threshold.

3 The term "primary work location" is defined in the proposed bill to mean, with respect to an employee, the address of the employer where the employee is regularly assigned to work when the employee is not working remotely during the covered period.

4 For the text and status of The HEROES Act (H.R. 6800), see: https://www.congress.gov/bill/116th-congress/house-bill/6800/all-info .

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