



GMS Flash Alert

2020-410 | September 25, 2020



United States – California: New Developments for Mobile Workers and Their Employers

On September 18, 2020, California passed a law simplifying state tax compliance for foreign employees.¹ The new law, effective from January 1, 2021 through January 1, 2026, permits electing nonresident aliens without identifying numbers such as a social security number (SSN) or individual taxpayer identification number (ITIN) to be included in group returns.²

Also, on March 19, 2020, California's governor issued Executive Order N-33-20 in response to the COVID-19 pandemic. California's public health directives require all residents to stay at home as a preventative measure against the spread of the virus.³ As a result, corporations that previously had no business connections with California may have employees performing services in the state for an indefinite period.⁴ Recently, the California Franchise Tax Board (FTB) announced that such out-of-state corporations will not be treated as "doing business" in the state, thus will not trigger state tax.⁵

WHY THIS MATTERS

COVID-19-related travel disruptions have created great uncertainty with respect to withholding and reporting requirements as they apply to mobile workforces and have created possible exposure to state corporate income tax where there might previously have been none. The California developments enable California employers to comply with state regulations more easily and to perform corporate tax planning with greater certainty.

Background

Nonresident Group Returns

On September 18, 2020, California passed legislation that permits employers to file group returns on behalf of electing foreign employees for tax years beginning January 1, 2021 until January 1, 2026.⁶ This law simplifies state tax compliance for both the employer and employees. Before the new law, companies found state tax compliance difficult because many of the foreign employees who traveled to California for business did not have or did not qualify to obtain identifying numbers. Due to the state's previous requirement of identifying numbers, the employers were at risk of exposure to under-withholding penalties because of their inability to operate payroll for foreign employees without an SSN or an ITIN.

For tax years from 2021 to 2025, if a foreign employee chooses to opt in to be included in a group return, the employer may file on the employee's behalf and pay the state taxes. The foreign employees may exclude tax payments made by their employer from their gross income.⁷ In the proposed bill, the applicable tax rate to each foreign employee's taxable income was at the highest marginal rate (12.3%) and, if applicable, the additional mental health tax.⁸ However, the new law does not reference applicable tax rates, deductions, or credits, and will require further guidance from California.⁹

KPMG NOTE

It is important to note that while tax payments made by the employer are excluded from state taxable income, they may not be excludable for federal tax purposes. To the extent that eligible business travelers from treaty countries may seek relief under dependent personal services/income from employment treaty articles, not all individuals may qualify for all conditions of the treaty. If income is borne by a U.S. permanent establishment, that portion of the income may not be excluded under the treaty.¹⁰ Thus, while the new state law would decrease employer's risk of exposure to under-withholding penalties due to the inability to operate payroll for certain foreign employees, it may increase reportable income for foreign employees who were previously able to exempt income under a treaty provision for federal tax purposes.

State Nexus for Out-of-State Companies with Employees Teleworking in California

The governor of California's stay-at-home order placed out-of-state corporations that were previously not considered to be "doing business" in the state at risk of triggering California corporate state income tax due to having employees teleworking in the state.¹¹ Generally, "doing business" means that a corporation has sufficient connections (i.e., state nexus) to California to be subject to taxation, and having employees in the state may rise to the level of "doing business."¹² However, in response to growing concerns over compliance, California announced that it will treat out-of-state corporations with employees teleworking in the state due to the governor's Executive Order as de minimis activity that does not create a state nexus requiring taxation.¹³

KPMG NOTE

The new guidance alleviates state compliance concerns for out-of-state corporations, at least until the expiration of the governor's Executive Order.¹⁴

FOOTNOTES:

- 1 See [AB-2660](#).
- 2 Id.
- 3 See California Franchise Tax Board [Website](#).
- 4 Id.
- 5 Id.
- 6 See [AB-2660](#).
- 7 Id.
- 8 Proposed bill.
- 9 Assemb. Prop. [A.B. 2660](#) (Cal. 2020).
- 10 2006 U.S. Model Income Tax Convention, Article 14(2).
- 11 See California Franchise Tax Board [Website](#).
- 12 Id.
- 13 Id.
- 14 Id.

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