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Multistate Workers and Their State Tax Liabilities

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ABSTRACT: The lack of uniformity of state laws applicable to employer withholding and their employees who work in multiple states has created a cumbersome compliance burden, not only for employers, but also for employees. This paper discusses the state tax ramifications associated with an employer having employees who work from a different state, and employers who have employees who perform services in multiple states. The paper also looks at proposed remedies for the mobile workforce issue, including proposed federal legislation and the Multistate Tax Commission's proposal addressing the issue. The paper considers whether Congress has authority under the Commerce Clause to regulate this issue. The paper concludes with alternative recommendations to consider as a workable solution.

Keywords: Commerce Clause; Dormant Commerce Clause; mobile work force; telecommuters; employer withholding; withholding thresholds; reciprocity agreements.

OVERVIEW: HOW MOBILE WORKERS TRIGGER TAX OBLIGATIONS

States that impose an income tax also require withholding on wages paid by an employer to its resident employees. This means that the employer is charged with the responsibility of withholding the income tax due from employee wages and remitting the amount withheld to the state and federal governments, or face significant penalties. Employers typically withhold income tax for the state in which an employee performs services, but if the employee is a resident of one state and performs services in a different state, then the employer must consider the laws of the state where the employee is a resident and the state where the employee performs services. Complying with nonresident state and local withholding requirements associated with traveling employees is complicated due to different withholding thresholds and withholding rates imposed by the states. In addition, the employee will probably be required to file an income tax return in the state where the service was performed. Unfortunately, the withholding requirements imposed on the employer and the return filing requirements imposed on the employee are not the same. Further, the presence of

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an employee in a state will probably create nexus for the employer in that state (with the result that the employer will be subject to that state's income and sales tax reporting requirements).

Employer experiences illustrate the dilemma. Take this response from ABC Corporation when asked to provide their opinion on the effect of existing state laws on the taxation of nonresidents:[1]

> We employ roughly 300 employees in 42 states. We have several customer service centers throughout the United States where most of our employees work. We also have some technicians who live in remote locations that work out of their homes. We have about 20 employees that travel out of their state on an occasional basis to work a job. We have a payroll administrator who spends about 8 hours every other week hand figuring the out of state/city taxes on certain employees as our payroll system is not designed to assess the tax for two different states or taxing authorities on the same paycheck. Some of the employees ended up owing the nonresident state about $30 or less and they resent having to file tax returns at year end for such a small amount owed to a different state/city. We were audited and we were penalized for under-withholding on certain employees (for whom our travel records were incorrect). The auditor claimed that we should have known about the travel because we reimbursed the expenses for the trips. In reality, the expense reporting system is not linked to the payroll system and the fact that travel expenses are reimbursed does not automatically mean that the payroll department is aware of the travel outside the state.

This article begins with a discussion of conflicting state law and regulations which govern withholding and other reporting requirements that apply to an out-of-state business that sends an employee into a state for even a few days a year. The article considers options under consideration to address these issues at both the national and state levels, and discusses constitutional restraints on Congressional power to legislate regarding state taxation of telecommuters. The article concludes with recommendations for employers to consider in managing the compliance burden currently imposed.

Telecommuters and Employer Withholding

State withholding tax laws are not consistent and require withholding using different thresholds, which might be based on days present in a state, dollars earned in a state, or some other measure. More than half of the states that have a personal income tax require employers to withhold tax from a nonresident employee's wages beginning with the first day the nonresident employee comes into the state for business purposes. Other states provide for a threshold before requiring income tax withholding for nonresident employees. Most of the states that have withholding thresholds use a different standard for imposing income tax return filing requirements on nonresidents—meaning that the employee may be required to file an income tax return even though the employer is not required to withhold.

For example, Arizona imposes employer withholding if a nonresident employee is in the state for 60 days or more.[2] Days spent in the state for job training or personal pursuits do not count. A

[1] Answer provided by client on 2010 Client Interview Questionnaire. Name of client has been withheld at client request. Each year, the international CPA firm, for whom the author did a Tax Professorship, asks their clients to complete a tax questionnaire to identify changes and issues related to the current tax year. In 2010, the firm asked their clients to comment on the specific facts of their mobile workforce and the impact of disparate tax laws on their business operations. Several clients provided varied responses, similar to the one cited here.

[2] Ariz. Rev. Stat. §43-403.

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nonresident income tax return must be filed if the taxpayer is single and the Arizona adjusted gross income is $5,500 or more. So if Jimmy, a nonresident, is in the state for 25 days and earns $30,000 of adjusted gross income sourced to Arizona, then Jimmy has to file a nonresident income tax return, although his employer will not be required to withhold any tax. Therefore, in this situation, it is up to Jimmy to understand the state personal income tax implications of performing work functions in states in which no withholding is required. Jimmy needs to be aware of the personal income tax filing requirements of all the states where he works over the course of the year. It is not likely that his employer will advise him of these filing requirements.

Equally as problematic are states that have no withholding threshold. For example, in Alabama, all wages earned in the state are subject to withholding. There is no *de minimis* threshold.[3] Therefore, if Jamie, a resident of New York, is sent to Alabama for five days, then Jamie's employer is required to withhold Alabama income tax on the portion of Jamie's wage earned in Alabama. Jamie will also have to file an Alabama personal income tax return if his gross income from Alabama sources exceeds the allowable prorated personal exemption.[4] Jamie should be able to claim a credit for the Alabama income tax paid against his New York tax liability on the same income, so there should not be a double tax on the income. But if Jamie's employer sends him to multiple states during the year, then the administrative burden on both the employer and employee is significant. The reality is that most payroll systems are not equipped to track and withhold taxes for employees who spend limited periods of time in multiple jurisdictions.

In order to properly comply with the applicable withholding statutes, the employer will need to know where the employee is a resident and (if different) the states where the employee worked. The state where the services were performed will almost always require withholding from nonresidents who come into the state to work. This obligation will be based on the wages paid for services performed in the state. Therefore, the employer will need to know how many days and how much income was earned in each state where the employee worked. In addition, the employer will need to become familiar with the law in each state where the employee works to determine if there is a threshold before withholding is required. These thresholds are usually based on number of days or income earned in the state.

Withholding Threshold Based on Number of Days

Arizona, Connecticut, Georgia, Hawaii, Maine, New Mexico, North Dakota, and Utah impose a withholding requirement using a number of days threshold. Determining how a day is calculated for purposes of determining the threshold is important to avoid double counting and to insure compliance. The rules adopted by states that use a number of days threshold are set forth in Table 1.

Connecticut

Certain states provide guidance on how to count days, and the results are not always consistent. A good example of the confusion that currently exists is the definition of a "day" used by Connecticut.

Connecticut recently adopted the same 14-day rule used to define employer withholding requirements that was formerly used by New York. Under this rule, if an employee is assigned to a primary work location outside of Connecticut and works in Connecticut 14 or fewer days, then no

[3] Ala. Admin Code r. §§810-3-71-.01(7) and (8).
[4] Ala. Admin Code r. §810-3-27-.01(2).

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TABLE 1
Number of Days Threshold

State	Withholding Threshold
Arizona	In the state for more than 60 days in a calendar year.[a]
Connecticut	In the state for more than 14 days in a calendar year.[b]
Hawaii	In the state for more than 60 days in a calendar year.[c]
Maine	In the state for more than 12 days during the tax year and earns more than $3,000 of gross income.[d]
New Mexico	In the state for more than 15 days in a calendar year.[e]
North Dakota	In the state for more than 20 days during the calendar year.[f] Effective for tax years beginning after December 31, 2012.
Utah	Withholding is only required if the *employe*r is doing business in Utah for over 60 days.[g]

[a] Ariz. Rev. Stat. §43-403.A.5(b).
[b] Announcement 2020(3), Conn. Dept. of Revenue Services, January 11, 2010.
[c] Haw. Admin. Rules §18-235-61-04(E); Hawaii Dept. of Taxation announcement No. 99-28 (Oct. 22, 1999).
[d] Me. Rev. Stat. Ann. Tit. 36, §5142.8-B.
[e] NM Stat. Ann. §7-3-3(A)(2).
[f] ND Cent. Code §57-38-59.
[g] Utah Code Ann. §59-10-402.

employer withholding is required. For purposes of this rule, any part of a day spent performing services in Connecticut will be considered a full day.[5] New York uses the same "one hour equals a day" rule, which means that entering the state for any part of the day to perform work on behalf of the employer will count as a full day.[6]

Example: Charlie lives in Connecticut and works more than 14 days in both New York and Connecticut. Frequently, Charlie works for part of the day in Connecticut and then goes in to the New York office and works for part of the day in that office. Under the withholding guidelines of both states, the one day counts as a "working day" by both states. Therefore, the employer will be required to keep track of Charlie's whereabouts and withhold New York personal income tax and Connecticut personal income tax on Charlie's wages for that one day. Since the income for the day where services are performed in Connecticut and New York is sourced to each state, it does not appear that Charlie will get a credit offset for the New York tax withheld by his employer on his personal income tax return filed in Connecticut. The withholding and personal income tax rules of New York and Connecticut might become the most important part of Charlie's daily scheduling process.

Not only does the employer have to keep track of where the employees work, but—at least in New York—the employer must also keep documentation to prove each employee's whereabouts. In the *Matter of Suburban Restoration Co., Inc.*,[7] a New Jersey corporation doing business in New York was liable for deficient New York State and New York City personal income tax withholding that it failed to deduct from wages of four nonresident employees who allegedly performed

[5] Announcement 2010(3), Connecticut Department of Revenue Services, January 11, 2010.
[6] NY Comp. Codes R. and Regs. Tit. 20, §105.20(c).
[7] NYS Tax App. Trib., DTA No. 816361, Feb. 8, 2001, aff'd 299 App Div. 2d 751, 750 NYS 2d 359 (3d Dept., 2002).

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services in New York City. The petitioner had asserted through the testimony of its bookkeeper that the four employees in question had not worked in New York, but had worked only in New Jersey and were, therefore, not subject to New York withholding tax. The bookkeeper was not able to produce evidence supporting her statements, as she testified that she had destroyed the only payroll records that would have documented the worksites of the four employees on the belief that such records were unnecessary. The Administrative Law Judge found the bookkeeper's testimony to be unreliable in light of the fact that her statements were not supported with any documentation. The Judge made clear that the taxpayer had an affirmative duty to prove where its employees worked (and where they did not work).

The result is that the employer has to split wages by state by keeping track of the number of hours worked for an hourly employee or days worked for a salaried employee. This recordkeeping requirement can represent an administrative nightmare for businesses with employees who are constantly traveling. The stakes are high, in that if the employer fails to adequately substantiate its employees' whereabouts, the employer could be required to withhold tax on all wages paid, plus interest and penalties.

Withholding Threshold Based on Wages Earned in State

Certain states use an earnings threshold as the base for requiring employer withholding. States that have established an earnings threshold (or an earnings/number of days threshold) are listed in Table 2.

Determining Income Attributable to a "Day"

In order for an employer to comply with the withholding thresholds specified above, it is necessary that the employer be able to determine the wage per day. The difficulty in making this determination is compounded when the states do not all source income using the same rules. States have developed different rules for sourcing wages paid to employees, and have never agreed on how to source deferred compensation.

Thirty-six of the states that assess an income tax on wages source wages based on physical presence. This means that if an employee works in multiple states, then the employee apportions his or her income based on the amount of time worked in each state. California is an example of a state that uses physical presence as the basis for sourcing wages of nonresidents. Nonresidents who are employed within and without California and who are paid on a daily, weekly, or monthly basis must allocate their compensation between California and out-of-state locations according to the number of working days spent within and without the state.[8] To comply with this requirement, the employer is required to track the employee's time and income earned in a particular jurisdiction.

Five states assess a tax on the nonresident's wage under the "convenience of employer" test. These states include Delaware,[9] Nebraska,[10] New Jersey,[11] New York,[12] and Pennsylvania.[13]

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[8] Cal. Code Reg. tit. 18, §17951-5.
[9] Del. Code Ann. Tit. 30, §1124(b).
[10] Neb. Rev. Stat. §77-2733(8); 316 Neb. Admin. Code §22-003.01C(1).
[11] Generally uses physical presence test, but informally states convenience of employer test could be applied in any given case. (Reported by Commerce Clearing House, telephone conversation with Division of Taxation, August 10, 2009).
[12] NY Comp. Code R. and Regs. Tit. 20, §132.18(a).
[13] 61 Pa. Code §109.8.

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TABLE 2
Earnings Thresholds

State	Withholding Threshold
California	Withholding required if payment exceeds filing threshold or $1,500 in a calendar year.[a]
Georgia	Withholding required if taxpayer earns more than $5,000 or 5 percent of total income in Georgia.[b]
Idaho	Withholding required if wages exceed $1,000 in a calendar year.[c]
Minnesota	Withholding required if wages exceed nonresident personal income tax filing threshold.[d]
New Jersey	Withholding required if wages exceed the personal exemption.[e]
New York	Withholding required if wages exceed the personal exemptions.[f]
Oklahoma	Withholding required if wages exceed $300 in a calendar quarter.[g]
South Carolina	South Carolina withholding requirements do not apply to remuneration paid for personal services performed on occasional, sporadic, or casual visits to South Carolina by nonresident employees in connection with their regular employment outside the state. Remuneration for occasional visits is defined as equal to or less than the personal exemption amount provided in Internal Revenue Code Section 151(d). However, this item does not apply to employees performing construction, installation, engineering, or similar services where the *situs* of the job is in this state.[h]
Virginia	Every employer paying wages is required to deduct and withhold tax from such wages. The amount withheld should approximately equal the employee's Virginia income tax liability after allowing for the personal exemptions and either the standard deduction or the itemized deductions to which the employee is entitled.[i]
West Virginia	Withholding required if wages exceed the personal exemption amount.[j]
Wisconsin	Withholding required if wages exceed $1,500 in a calendar year.[k]

[a] Cal. Code Reg. Tit. 18 §18662-2.
[b] Ga. Code Ann. §48-7-1(11)(A).
[c] Rule 35.01.01.871.01.b.
[d] Minn. Stat. §290.92(19)(a)(2)(ii).
[e] NJ Stat. Ann. §54A:7-1(A) and Instructions Form NJ-WT.
[f] NY Comp. Codes R. and Regs. Tit. 20, §171.6(b)(4).
[g] Okla. Stat. Ann. Tit. 68, §2385.1(e).
[h] SC Code Ann. §12-8-520.
[i] Va. Code Ann. §58.1-460.
[j] W. Va. Code R. §110-21-71.4.2.4.
[k] Wis. Stat. §71.64(6); Publication W-166.

When a nonresident employee commutes to New York to work for a New York-based employer, the employee must pay tax on the earned income based on the employee's New York workdays. In order to limit a nonresident's ability to reduce the New York tax liability by working from home, New York has pioneered the development of the "convenience of the employer" rule. The terms of the convenience rule provide that days worked from home are treated as New York work days unless the nonresident employee worked outside of New York by necessity. The rule provides as follows:[14]

[14] NY Comp. Code R. and Regs. Tit. 20 §132.18[a].

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> [i]f a nonresident employee . . . performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State . . . However, any allowance claimed for days worked outside New York State must be based upon the performance of services that of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employer.

New York (like most states) taxes its own residents on all their income, while nonresidents are taxed on income derived from New York sources.[15] In order to limit a nonresident's ability to reduce the New York tax liability by working from home, New York maintains that an employee's out-of-state services are not performed for an employer's necessity where the services could have been performed at his employer's office. Therefore, if the work performed in another state could have been performed at the employer's office located in New York, then the work performed at home is for the employee's convenience and not the employer's convenience. In order to prove otherwise, the taxpayer must present evidence to show that the services that he or she performed out of state could not have been performed at the employer's New York office.

These same rules carry over to the employer withholding requirements. Generally, an employer must deduct the New York income tax on all wages paid to a nonresident employee for services performed in New York.[16] If a nonresident employee performs services partly within and partly outside New York, the employee should file Form IT-2104.1 Certificate of Nonresidence and Allocation of Withholding Tax, showing the employee's estimate of the percentage of services performed in New York and, therefore, subject to withholding. An employer is required to withhold tax from all wages paid to a nonresident employee unless the employee files Form IT-2104.1 or unless the *employer* keeps adequate current records to determine the amount of wages from New York sources.[17]

Withholding is also not required on wages paid to certain nonresident employees who perform services both within and outside New York and who work only a short period of time within New York State, and it is reasonably expected that the total wages of the nonresident employee for services rendered in New York will not exceed the amount of the employee's personal exemptions.[18]

Therefore, assume Jamie works for his New York employer for 220 days out of the year. On 145 days, he works at his office in New York City. On the remaining 75 days, he works from his home in Connecticut. His employer provides him with an office in New York City; therefore, he does not work at home at the convenience of his employer. Since Jamie works primarily in New York, his employer must withhold New York income tax from his wages. Since all of his wages are sourced to New York, withholding would be required on his entire wage. Jamie is also a resident of Connecticut, a state which requires employers to withhold the Connecticut income tax on compensation for services rendered within Connecticut. Therefore, Jamie's employer will be required to withhold income tax from Jamie's wage for two states. Jamie will probably also find that he will not get the money back from either state, as each state sources his wage to their state.

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[15] NY Tax Law §601(e).
[16] NY Comp. Code R. and Regs. Tit. 20 §171.6; Publication NYS-50.
[17] See the *Matter of Zelinsky v. Tax Appeals Trib. of State of NY*, 1 NY 3d 85 (2003), 769 NYS 2d 464, (2003), cert denied, 541 U.S. 1009 (2004) for discussion of the "convenience of the employer" test.
[18] NY Comp. Code R. and Regs. Tit. 20, §171.6(b)(4).

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RECIPROCITY AGREEMENTS

Some states have agreed to work together to resolve the administrative dilemma faced by traveling employees and their employers by entering into reciprocity agreements with neighboring states. Under these arrangements, if two states have a reciprocal agreement, only the state where the taxpayer resides will be entitled to the tax. For example, Illinois and Iowa have a reciprocity agreement. If Jamie lives in Illinois, but works in Iowa, then under the agreement, Illinois is allowed to assess tax on Jamie's income because Jamie lives there. Therefore, Jamie's employer should withhold tax and report wages only to Illinois. In most cases, the employee will be required to submit a certificate of nonresidence for the state in which he/she works before the employer can honor the reciprocal agreement.

The general purpose of reciprocity is to make the process of withholding administratively easier for the employer and employee. The employee will have to file only one state personal income tax return, and the employer will withhold only for the state in which the employee lives. Although the intent is to simplify the process, not all states have these types of agreements, so the employer has to keep up to date on the status of these various agreements. In addition, the employer will have to change the state of withholding and reporting if the employee moves his/her residence from one state to another, even though there has been no change where the services are performed. Although the numerous reciprocity agreements that various border states have with each other are an attempt to respond to the administrative complexity that has evolved, it is a patchwork solution at best.

A summary of the current reciprocity agreement is included as Appendix A. Most of the states that have entered into these agreements are in the Midwest. Notable omissions include most of the states on the West Coast and New York.

SIMPLIFICATION OF EMPLOYER WITHHOLDING REQUIREMENTS

At least three efforts are underway to implement consistent thresholds for employer withholding and employee tax filing requirements among all 50 states. Two bills have been introduced in Congress. One such effort is H.R. 1864, the Mobile Workforce State Income Tax Simplification Act of 2011, introduced into Congress on May 12, 2011. The second is S. 1811, the Telecommuter Tax Fairness Act of 2011, introduced into Congress on November 7, 2011. A third such effort is the development of a model statute by the Multistate Tax Commission (MTC), entitled the MTC Model Mobile Workforce Statute.[19]

Mobile Workforce State Income Tax Simplification Act of 2011

On May 12, 2011, U.S. Reps. Howard Coble (R-NC) and Hank Johnson (D-GA) introduced the Mobile Workforce State Income Tax Simplification Act of 2011 (H.R. 1864). The bill passed

[19] The Multistate Tax Commission (MTC) is an intergovernmental state tax agency working on behalf of states and taxpayers to administer, equitably and efficiently, tax laws that apply to multistate and multinational enterprises. Created by the Multistate Tax Compact, the Commission is charged with facilitating the proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes, promoting uniformity or compatibility in significant components of tax systems, facilitating taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration, and avoiding duplicative taxation. Any proposal of the MTC must still be enacted into law by each respective state.

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the House on May 15, 2012, and is on its way to the Senate. H.R. 1864 provides that all wages and other remuneration paid to an employee would, in general, be subject to the income tax laws in the state of the employee's residence. In addition, the bill sets forth a threshold of 30 days before an employee performing duties in a state during a calendar year would be subject to personal income tax, and employers would be subject to commensurate withholding requirements of the nonresident state. Therefore, the standard for assessment of the nonresident state's income tax and employer withholding requirements would be the same. This is a significant improvement over the existing situation, where most states either do not have a withholding threshold or the threshold is different from the personal income tax return filing requirement. The new federal rules would become effective on January 1 of the second year that begins after enactment of the bill.

Under this bill, the employer is not required to keep records of an employee's location, and may rely on the employee's determination of the time spent in a nonresident state, absent knowledge of employee fraud or collusion between the employer and employee. If the employer does maintain a "time and attendance" system, then that information will serve as the base for determining days spent in the state. A "time and attendance system" is a contemporaneous recordkeeping system which also serves as the base for allocating the employee's wage among the states. The option of allowing an employer to rely on an "employee's determination of time spent within a state" recognizes that not all businesses have a sophisticated time-tracking process. Reliance on employee records is an expedient remedy, but places the enhanced responsibility of accurate bookkeeping on the employee. Problems could arise upon audit if the employee's records are not as detailed or accurate as a state tax administrator might like.

An employee is considered to be performing duties in a state if the employee performs the preponderance of his or her employment duties in a state for a day. If an employee performs material employment duties in the employee's resident state and one nonresident state during a single day, then the bill provides a "tie breaker" provision, which states that the employee will be considered to have performed the preponderance of his or her duties in the nonresident state for that day. Days in transit do not count in this analysis. This provision attempts to eliminate the potential for double counting of a single day under the 30-day test by two states.

The 30-day threshold applies to both the employer wage withholding requirements and the employee income tax return filing requirements. There is no wage threshold included as part of the test. An exception is provided for professional athletes, entertainers, and certain public figures who are presumed to be the "high income" wage earners that the states want to be sure that they tax. Professional athletes, entertainers, and public figures are generally defined as performing services on a per-event basis, but there is no *de minimis* amount payable per event to help determine if the individual falls into one of these categories. The "per event" distinction is meant to identify taxpayers who can more easily determine how much income was earned in the state, as they know where they were and how much they earned for the event.

The new rules apply only to employers and their employees. Independent contractors are not covered by the legislation, and would remain subject to the varied rules that cover personal income tax filing requirements imposed by the states. There are certainly as many independent contractors in the mobile workforce as there are employees. These workers are likely to be small businesses with little access to state filing requirements, with the result that these taxpayers often fail to file personal income tax returns in states where they work for only short periods of time.

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Telecommuter Tax Fairness Act

On November 7, 2011, U.S. Sens. Joseph I. Liebermann (I-CT) and Richard Blumenthal (D-CT) introduced the Telecommuter Tax Fairness Act (S. 1811), which would prohibit states from taxing income earned by nonresident telecommuters.[20] Specifically, the bill would prohibit states from taxing the income nonresidents earn when they are physically present in another state. The result would be that New York (and other states) would no longer be able to apply the "convenience of the employer" test, which requires nonresident telecommuters to pay tax to New York as though they were physically present in the state. Further, the bill makes clear that for purposes of determining the period of time with respect to which compensation is paid, no state may deem a period of time during which a nonresident individual is physically present in another state to be time that is not normal work time unless the individual's employer also agrees. There is no *de minimis* threshold included in S. 1811.

CONSTITUTIONAL RESTRAINTS ON CONGRESSIONAL POWER TO LEGISLATE REGARDING STATE TAXATION OF TELECOMMUTERS

The Commerce Clause provides Congress with the authority to regulate commerce between the states.[21] Its power to act pursuant to this affirmative grant of authority is sometimes referred to as the "positive" Commerce Clause.[22] The "negative" or Dormant Commerce Clause is differentiated from the "positive" Commerce Clause in that it has been used by the U.S. Supreme Court to restrict the states from taxing or regulating activities so as to exert an unjustifiably greater burden on interstate commerce than on intrastate commerce.[23] The Dormant Commerce Clause seeks to strike a balance between the Constitution's broad grant of power to Congress to regulate the national economy and the retention by the states of their police and taxing powers. As a result, the Commerce Clause operates by its own force to prevent the states from regulating interstate commerce as such, and allows the states to regulate commerce only as an incident of their local police powers, and then only to the extent that the state has a legitimate interest in the subject matter that justifies whatever burden that it places on interstate commerce.[24]

The power of Congress to exercise its authority to regulate interstate commerce has been interpreted broadly by the U.S. Supreme Court. In *Houston E&W Tex. Ry. v. United States*,[25] the Court stated, "It is unnecessary to repeat what has frequently been said by this court with respect to the complete and paramount character of the power confided to Congress to regulate commerce among the several States. It is of the essence of this power that, where it exists, it dominates . . . By virtue of the comprehensive terms of the grant, the authority of Congress is at all times adequate to meet the varying exigencies that arise and to protect the national interest by securing the freedom of interstate commercial intercourse from local control."[26]

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[20] As of May 12, 2012, the bill has been introduced, but has not yet been referred to Committee.
[21] Art. I, §8. Cl. 3.
[22] *West Lynn Creamery, Inc. v. Healy*, 114 S. Ct. 2005, 512 U.S. 186, 193(1994).
[23] *Oregon Waste Sys., Inc. v. Dep't of Envtl. Quality*, 114 S. Ct. 1345, 511 U.S. 93, 98–99 (1994).
[24] *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 521 (1935) (holding that a New York regulation fixing the price of milk imported from other states was not a legitimate exercise of New York's police powers).
[25] 234 U.S. 342 (1914).
[26] *Houston E&W Tex. Ry. v. United States*, 234 U.S. 342, 350–351 (1914).

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Under this broad authority to regulate any activity that exerts an influence on interstate commerce, the U.S. Supreme Court has sustained legislation that defined interstate commerce to include the amount of wheat a farmer can grow for his own consumption,[27] discrimination by a local motel,[28] and discrimination in the operation of a local restaurant.[29]

Despite what appears to be a broad authority granted to Congress under the Commerce Clause, the Court has, from time to time, struck down federal legislation which does not affect interstate commerce, with the result that it invades the realm of state sovereignty. Specifically, in *United States v. Lopez*,[30] the Court held that under the Commerce Clause, Congress lacked the power to prohibit possession of firearms in school zones because possession of a gun in a local school zone does not affect interstate commerce. In *Lopez*, the Court concluded that there are three broad categories of activity that Congress may regulate under its commerce power. First, Congress may regulate the use of the channels of interstate commerce. Second, Congress is empowered to regulate and protect the instrumentalities of interstate commerce, or persons or things in interstate commerce, even though the threat may come from intrastate activities. Finally, Congress's commerce authority includes the power to regulate those activities having a substantial relation to interstate commerce; i.e., those activities that substantially affect interstate commerce.[31] The Court found that the Gun Free School Zone Act of 1990 had nothing to do with "commerce" or any sort of economic enterprise. The Court stated, "the possession of a gun in a local school zone is in no sense an economic activity that might . . . substantially affect any sort of interstate commerce."[32]

When Congress attempts to regulate the states directly, the U.S. Supreme Court imposes the highest level of scrutiny. The Court has stated that the Commerce Clause authorizes Congress to regulate individuals, and not states, who are separate sovereigns.[33] The Court went on to explain this comment by stating, "the Federal Government may neither issue directives requiring the States to address particular problems, nor command the States' officers . . . to administer or enforce a federal regulatory program. It matters not whether policymaking is involved, and no case-by-case weighing of the burdens or benefits is necessary; such commands are fundamentally incompatible with our constitutional system of dual sovereignty."[34]

If a federal regulation involves interstate commerce and does not require state and local personnel to implement a federal regulatory program, then the statute must still survive a balancing test wherein the Court will focus on the federal benefit to be derived from a regulation, as opposed to the burden that the federal regulation imposes on the states. Federal regulation of state taxation would be subject to the highest scrutiny, as it is integral to the functioning of a state as a state (or as a separate sovereign).

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[27] *Wickard v. Filburn*, 317 U.S. 111(1942).
[28] *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964).
[29] *Katzenbach v. McClung*, 379 U.S. 294 (1964).
[30] 514 U.S. 549 (1995).
[31] *Id*. at 558.
[32] *Id*. at 567.
[33] *Printz v. United States*, 521 U.S. 898, 920 (1997). *Printz* involved certain provisions of the Brady Handgun Violence Prevention Act, which requires state and local law enforcement officers to conduct background checks on prospective handgun purchasers. The issue in this case was not whether the activity fell within the scope of interstate commerce, but rather whether state and local law enforcement could be required to implement a federal regulatory program.
[34] *Id*. at 935.

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The issue of federal regulation of telecommuters raises the first concern, and that is whether telecommuting involves interstate commerce. In *City of New York v. State*,[35] the New York Court of Appeals struck down New York City's commuter tax as a violation of both the Privileges and Immunities Clause and the Dormant Commerce Clause. In 1999, the New York Legislature repealed the city's commuter tax as it applied to New York residents, but kept the tax on out-of-state residents. Residents of New Jersey and Connecticut commenced an attack on the constitutionality of the new law, arguing that the partial repeal of the commuter tax as applied only to New York residents discriminated against out-of-state commuters and violated the Dormant Commerce Clause (and the Privileges and Immunities Clause). The Court of Appeals held that the statute was invalid, and based its decision in the U.S. Supreme Court's decision in *Camps Newfound/Owatonna, Inc. v. Town of Harrison*.[36] *Camps Newfound* involved a challenge under the Dormant Commerce Clause to Maine's real property tax exemption awarded to charitable institutions incorporated in Maine. The exemption was available only where the charitable institution provided its services to Maine residents. The challenge was brought by a Maine nonprofit corporation that operated a summer camp for children of the Christian Science faith. The camp marketed its service aggressively, with the result that most of its campers came from out of state. As a result, Maine determined that Camp Newfound was ineligible for the property tax exemption, and Camp Newfound challenged the denial of the exclusion. The U.S. Supreme Court struck down the exemption on the basis that it functionally served as an "export tariff" that targeted out-of-state consumers by taxing the businesses that serve them. One of the Commerce Clause cases that *Camps Newfound* relied on is *Heart of Atlanta Motel, Inc. v. United States*.[37] In that case, the U.S. Supreme Court upheld Title II of the Civil Rights Act of 1964[38] as a proper exercise of Congress's power under the commerce clause, because "the movement of persons through more States than one" has been understood to constitute interstate commerce since as early as 1849.[39]

The New York Court of Appeals used *Camps Newfound* to support the fact that "the movement of persons across State lines is a form of commerce . . . Nonresident campers who cross State lines to attend a camp in Maine affect interstate commerce."[40] Based on this reasoning, the New York Court of Appeals held that the Commerce Clause was "clearly implicated" because tens of thousands of nonresidents traveled to the city daily to earn their income and spend part of it.

Later, however, in *Zelinsky v. Tax Appeals Tribunal*,[41] the New York Court of Appeals balked at applying the Dormant Commerce Clause to encompass personal commuting from one state to another. The Court stated, "The critical distinction between *City of New York* and the instant case, is that in *City of New York*, the tax at issue was imposed on the activity of commuting, not on the individual as a commuter. Here, the tax is imposed on income derived from the activity of teaching, not on the individual who is reading in his study in Connecticut."[42] In this case, a law school professor commuted from his home in Connecticut to New York three days a week to teach. The other two days he worked at home. For tax purposes, he apportioned to New York the percentage

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[35] 94 NY 2d 577 (2000).
[36] 520 U.S. 564, 117 S. Ct. 1590 (1997).
[37] 379 U.S. 241 (1964).
[38] 42 U.S.C. §2000a *et seq*.
[39] 379 U.S. 241, at 255–256.
[40] *City of New York v. State*, 94 NY 2d 577, at 597 (2000).
[41] 1 NY 3d 85, 801 N.W. 2d 840, 769 NYS 2d 464, (2003), cert. den. 541 U.S. 1009 (2004).
[42] *Id*. at 93.

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of his total salary that reflected the number of days he commuted to the law school, and allocated the remainder to Connecticut. The New York Department of Taxation and Finance applied the convenience of the employer test and determined that because Zelinsky was not obligated by his employer to work outside New York, the days he was at home should be counted as New York workdays. The taxpayer challenged the constitutionality of the test under the Commerce Clause and the Due Process Clause.

The New York Court of Appeals decided the *Zelinsky* case primarily on the basis that the crossing of state lines to voluntarily do work at home did not transform the taxpayer into an interstate actor. Taking work home did not impact interstate markets so as to implicate the Commerce Clause. The court justified their conclusion by explaining that allowing nonresidents to manipulate the New York tax liability by electing to work at an alternative work location is unfair to resident employees who do not have the same option. The taxpayer in this case was paid by the law school to teach a certain number of classes. As long as he completed this assignment, he is paid his full salary regardless of where he may perform other activities related to his position. The state does not have to subsidize personal convenience, while at the same time discouraging commuting into New York City and facilitating erosion of the tax base. The Court of Appeals found that where the work was performed out of state for the employee's convenience, it was intrastate commerce, and it was only when the work was performed out of state for the employer's convenience that interstate commerce was implicated. This was because the employer in that circumstance has a presence in the state where the work was performed. The case was appealed to the U.S. Supreme Court, which denied *certiorari*.[43]

Zelinsky was followed by *Huckaby v. Tax Appeals Tribunal*,[44] wherein the New York Court of Appeals again upheld the convenience of the employer test; however, this time, the decision was reached with a four-to-three vote which included a vigorous dissent. The majority's opinion drew heavily from the *Zelinsky* case in holding that the convenience of the employer test only implicates interstate commerce if a nonresident employee must perform work out of state for the employer's necessity, in which case, a nexus is created between the employer and the foreign state.

The foregoing suggests that the convenience of the employer test does not implicate interstate commerce under the Dormant Commerce Clause. This result raises the question whether the definition of "commerce" is the same under the positive Commerce Clause, which would impact the power to Congress to regulate the area (such as what is proposed in the Telecommuter Tax Fairness Act). In *Camps Newfound/Owatonna, Inc., v. Town of Harrison, Maine, et al*.,[45] the U.S. Supreme Court stated that the definition of "commerce" is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation.[46] Despite the language in *Camps Newfound*, the Dormant Commerce Clause has the limited purpose of protecting interstate business from state regulation that results in a discriminatory burden on interstate markets. Congress has the right to extend the scope of its legislation not merely to "commerce" as such, but also to activities which exert a substantial effect on interstate commerce.[47] The U.S. Supreme Court has not yet provided any guidance to protect

[43] 541 U.S. 1009 (2004).
[44] 4 NY 3d 427, 829 N.E. 2d 276, 796 NYS 2d 312, cert. denied 126 S. Ct. 546 (2005).
[45] 520 U.S. 564, 117 S. Ct. 1590 (1997).
[46] *Camps Newfound/Owatonna, Inc*. rested upon the Court's reasoning in *Philadelphia v. New Jersey*, 437 U.S. 617 (1978), where the Court rejected a two-tiered definition of commerce.
[47] An example is the national debate currently in the news (and in the courts) involving the constitutionality of the federal health care bill. The Patient Protection and Affordable Care Act of 2010; P.L. 111-148, 124 Stat. 119.

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the states from federal legislation in the state tax area. The lack of judicial standards in this area has resulted in uncertainty regarding the scope of federal preemptive authority.

The argument does continue to exist that under the U.S. Constitution, the states are sovereigns, separate and distinct from the federal government.[48] The power to tax is a fundamental aspect of sovereignty: "The power to tax is basic to the power of the state to exist."[49] The power of Congress to regulate interstate commerce needs to be reconciled with the power of the states to tax as independent sovereigns. The Tenth Amendment to the Constitution expressly reserves to the state the powers that are not reserved to Congress, and it should be implicated in such a challenge.

Beginning with P.L. 86-272, enacted in the late 1950s, Congress has been enacting restrictions, or limitations, on the state's ability to tax under the authority granted by the Commerce Clause.[50] The Commerce Clause arguably provides justification for congressional action with respect to commercial activities. But when Congress uses the Commerce Clause as authority for imposing restrictions on the states' taxation of individuals, the conflict between the sovereign powers of the states and taxation and the delegated authority to Congress to regulate interstate commerce becomes more acute. The enactment of P.L. 104-95, which limits the ability of the state to tax the retirement income of former residents, is an example of congressional action where this issue could be raised.[51] Both the Mobile Workforce State Income Tax Simplification Act of 2011 (H.R. 1864) and the Telecommuter Tax Fairness Act (S. 1811) also raise these issues.

Multistate Tax Commission (MTC) Mobile Workforce Statute

Another alternative solution that avoids the above debate is the MTC Mobile Workforce Statute. At the July 2011 Annual Meeting of the Multistate Tax Commission, the MTC adopted the Model Mobile Workforce Statute (Model Act) as a uniformity recommendation to the states. The Model Act settles on a 20-day threshold, which was criticized by some as too long (state tax administrators) and others as too short (employers and employees). The Model Act does address several issues left open under the proposal set forth in H.R. 1864.

Under the Model Act, a nonresident employee would not be required to file a personal income tax return, and the employer would not be subject to withholding if the employee were in the state solely to perform employment duties for not more than 20 days during a calendar year. The way that the Model Act accomplishes this result is by providing an exclusion from income sourced to the state if all of the following requirements are met:

- The nonresident has no other income from sources within the state for the tax year in which the compensation was received;
- The nonresident is present in the state to perform employment duties for not more than 20 days during the tax year in which the compensation is received, where presence in the state for any part of a day constitutes presence for the day unless such presence is purely for purposes of transit through the state; and

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[48] See *Federal Maritime Commission v. South Carolina Port Authority*, 531 U.S. 743, 122 S. Ct. 1864 (2002).
[49] *Arkansas v. Farm Credit Services of Central Arkansas*, 520 U.S. 821, 117 S. Ct. 1776 (1997).
[50] 15 U.S.C. §§381–384. P.L. 86-272 prohibits the states from imposing a net income-based tax on a business when that business limits its contacts with the state to the solicitation of sales of tangible personal property, where this property is delivered from outside the state.
[51] 4 U.S.C. §114.

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- The nonresident state of residence provides a substantially similar exclusion or does not impose an individual income tax.

The Model Act clarifies that the employee does not have to file income tax returns and the employer does not have to withhold income or state employment taxes. The number of days includes all days the nonresident employee is performing employment duties in the state for the employer or "related person." The income related to this time period would be subject to tax in his or her home state.

"Related person" is defined by reference to various sections of the Internal Revenue Code (IRC), which is meant to pick up parent-subsidiary and brother-sister relationships as defined under IRC Section 1563, various parties referenced under IRC Section 1563(e), and IRC Section 318 under provisions related to constructive ownership and the attribution rules.

Presence in the state for any part of a day constitutes one day under the 20-day threshold unless the employee is in transit. This means that a single day could be counted under the 20-day threshold for more than one state if the employee visits multiple states in a 24-hour period. Related employers must aggregate the day count for an employee who works for more than one of them during the year. There is no income threshold under the Model Act that looks solely to time spent within the state.

To qualify under the exception, the nonresident cannot have income from other sources within the state for the tax year in question. In this case, the exception would not apply and the nonresident would be required to file in the state.

The Model Act also requires reciprocity, in that the exception will not apply unless a similar exclusion is provided by the nonresident's state of residence, or the state of residence does not impose an income tax. Thus, the Model Act benefits only those employees who reside in a state that has enacted the law and who are traveling to a state that has also enacted the same law. Therefore, for employees who travel and their employers, there is no simplification unless and until all states imposing a personal income tax have adopted the Model Act.

The Model Act provides exceptions from the exclusion for the following:

- professional athletes and members of a professional athletic team;
- professional entertainers;
- persons of prominence;
- construction workers;
- persons who are "key employees" under IRC §416(i), related to the definition of a "key employee" for purposes of the definition of a top-heavy plan (or qualified plans which are subject to additional requirements) by virtue of the income test, but not the ownership test, and whether the employer is a publicly or privately held company.[52]

Similar to H.R. 1864, no dollar threshold or other definition is included to define what is meant by "persons of prominence."

The Model Act includes a safe harbor from penalties for situations where the employer has miscalculated the number of days. The safe harbor is available where:

- the employer has relied on a time and attendance system; or
- if no time and attendance system is available, then employee's travel records; or

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[52] An employee is considered a "key employee" under IRC §416(i) if that person is one of the 50 highest paid officers in a publicly or privately owned company and had a salary of at least $160,000 in 2010 and 2011. In addition, the definition of "key employee" is extended to cover employees of non-corporate employers.

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- if neither a time and attendance system nor employee travel records are available, then employee travel expense reimbursement requests are acceptable.

This is a very flexible provision, which recognizes that not all employers track the time and location of each employee.

The Model Act applies only to employers and employees, providing no relief to independent contractors whose work responsibilities might also require travel. The Model Act also does not provide much guidance on how to allocate income to the work days spent in the nonresident state. Additionally, the Model Act does not address bonuses, commissions, and deferred compensation.

CONCLUSION

"Solutions" devised to date, such as reciprocity agreements and *de minimis* rules of administrative convenience, are less than satisfactory, with the result of growing noncompliance caused by the expanding mobile workforce. With continuing fiscal difficulties facing states into the future, multistate withholding is poised to become the next big issue in state tax practice. Solutions for consideration include a single state sourcing rule and/or a significantly increased withholding threshold applied on a nationwide basis (Commerce Clause issues notwithstanding).

Proposal #1: Single State Sourcing Rule

Requiring withholding for only a single state, the state of residence, would be consistent with unemployment insurance taxes (which are assessed by only a single state) regardless of the number of states where an employee might work. Using the rules already in place for assessing unemployment insurance taxes alleviates the burden on the employer to keep up with the changing compliance landscape of over 40 states.

Proposal #2: Increased Withholding Threshold

Perhaps a more politically feasible alternative would be to substantially increase the withholding threshold. This could mean establishing a threshold for employer withholding of $50,000 of income sourced to the state or (in the alternative) presence in the state in excess of 60 days. States might not be as politically opposed to such recommendations as one might think. Although precise numbers are not available for California, it is estimated that the number of nonresidents who come into California and work for brief periods (and are subject to California income tax and withholding) are partly, if not wholly, offset by California residents who work outside the state and claim a credit against their California taxes for payments made to other states.

In the interim, the problem does not appear to be one that will disappear anytime in the near future, meaning that employers and their payroll departments need to address the issue of proper recordkeeping (of employee whereabouts), coupled with diligent monitoring of state law developments, to insure compliance on a multistate basis.

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APPENDIX A

STATE RECIPROCAL WITHHOLDING AGREEMENTS

Illinois

Illinois has reciprocal agreements with Iowa, Kentucky, Michigan, and Wisconsin. Reciprocal agreements with Iowa, Kentucky, and Michigan provide for the employer to withhold tax for the state in which the taxpayer is domiciled. For example, Illinois employers withhold the Kentucky income tax at the Kentucky rate from Kentucky residents, and Kentucky employers withhold the Illinois income tax at the Illinois rate from Illinois residents. The agreement with Wisconsin provides that (1) Wisconsin employers are not required to withhold the Wisconsin income tax on compensation paid to Illinois residents for services performed in Wisconsin, and (2) Illinois employers are not required to withhold the Illinois income tax on compensation paid to Wisconsin residents for services performed in Illinois.[53]

[53] 35 Ill. Comp. Stat. 5/701(d); Ill. Adm. Code tit. 86 §100.7120.

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Indiana

Residents of Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin are not subject to Indiana income tax withholding for wages earned in Indiana if Form WH-47, Certificate of Residence, is filed with the employer. In addition, Indiana employees working in any of those states will not be taxed there.[54]

Iowa

Residents of Illinois are not subject to Iowa income tax withholding for wages earned in Iowa. These workers have only Illinois state tax withheld if they file Form 44-016, Employee's Statement of Nonresidence, in Iowa, with their employer.[55]

Kentucky

Residents of Illinois, Indiana, Michigan, Ohio, Virginia, West Virginia, and Wisconsin have only their resident state tax withheld if Form 42A809, Certificate of Nonresidence, is filed with the employer.[56]

Maryland

No Maryland tax is withheld from employees who commute daily to Maryland and reside in the District of Columbia, Pennsylvania, Virginia, and West Virginia. A certificate of nonresidence (Form MW 507, Employee Exemption Certificate) must be filed with the employer.[57]

Michigan

Michigan employers do not withhold Michigan state income tax from residents of Illinois, Indiana, Kentucky, Minnesota, Ohio, and Wisconsin. Michigan employees must file certificates of nonresidence to be exempt from withholding. No express form is provided.[58]

Minnesota

Residents of Michigan and North Dakota are exempt from Minnesota withholding. A Form MW-R, Reciprocity Exemption from Minnesota Withholding, Affidavit of Residency, must be filed with the employer. Individual income tax reciprocity with Wisconsin ended January 1, 2010. As a result, Minnesota and Wisconsin residents who work across the border must file returns in both states for 2010 and beyond if they meet minimum filing requirements.[59]

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[54] Ind. Code §6-3-5-1, Information Bulletin #28, Department of Revenue, September 2007; Information Bulletin #33, Department of Revenue.
[55] Iowa Admin. Code R. 701-38.13(1).
[56] Ky. Rev. Stat. Ann. §141.070(2); 103 Ky. Admin. Regs.17:010; 103 Ky. Admin. Regs. 17:140.
[57] Administrative Release No. 3, Comptroller of Maryland. (September 1, 2011).
[58] Mich. Comp. Laws §206.156, Revenue Administrative Bulletin # 88-17, Department of the Treasury.
[59] Income Tax Fact Sheet No. 4, Reciprocity, Minnesota Department of Revenue; Withholding Tax Fact Sheet No. 20, Reciprocity-Employee Withholding, Minnesota Department of Revenue.

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Montana

Montana employers are not required to withhold Montana income tax from residents of North Dakota. A certificate of North Dakota residency is required to be filed with the employer.[60]

New Jersey

New Jersey employers are not required to withhold New Jersey income tax for Pennsylvania residents if they file a certificate of nonresidence with their employers.[61]

North Dakota

Residents of Minnesota and Montana working in North Dakota are not required to have North Dakota tax withheld. Form NDW-R, Affidavit of Residency, must be filed with the employer annually.[62]

Ohio

Ohio has reciprocal agreements with Indiana, Kentucky, Michigan, Pennsylvania, and West Virginia. Form IT-4 NR, Employee's Statement of Residency in a Reciprocity State, must be filed with the employer to claim the exemption.[63]

Pennsylvania

Pennsylvania has reciprocal agreements with Indiana, Maryland, New Jersey, Ohio, Virginia, and West Virginia. Form REV-420, Employee's Statement of Nonresidence in Pennsylvania and Authorization to Withhold Other State's Income Tax, must be filed with the employer.[64]

Virginia

Currently, residents of Maryland, the District of Columbia, West Virginia, Kentucky, and Pennsylvania who earn salaries and wages in Virginia are not required to file Virginia income tax returns (and the employer is not subject to withholding) if certain conditions are met.[65]

West Virginia

Reciprocal agreements are in place with Kentucky, Maryland, Ohio, Pennsylvania, and Virginia. A West Virginia Certificate of Nonresidence (Form WV/IT-104) must be filed with the employer.[66]

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[60] Form NR-2, Employee Certificate of North Dakota Residence; Mont. Code Ann. §15-30-2621; Mont. Admin. R. 42.17.134, Instructions, Form 2, Montana Individual Income Tax Return.
[61] Form NJ-165 Employee's Certificate of Non-Residence in New Jersey; Employer's Instructions for Withholding, Payment and Reporting the New Jersey Gross Income Tax.
[62] ND Cent. Code §57-38-59.1.
[63] Ohio Rev. Code Ann. §5747.05, Ohio Tax Information Release IT 2001-01 (Aug. 31, 2001).
[64] 72 Pa. Stat. Ann. §7356(b).
[65] Va. Code Ann. §58 1-3, Va. Admin. Code 10-140-230.
[66] W. Va. Code Ann. §11-21-71(c); W. Va. Code R. 110-21-71.3.1.

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Wisconsin

Reciprocal agreements are in place with Illinois, Indiana, Kentucky, Michigan, and for taxable years beginning before January 1, 2010, Minnesota.[67] Employees from these states must fill out Form W-220, Nonresident Employee's Withholding Reciprocity Declaration, and file with their employer.

[67] Wisc. Admin. Code Tax 2.02, Wisconsin Department of Revenue Tax Publication 121 (December 1, 2011).

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