Statement of

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Before the

U.S. House of Representatives
Committee on the Judiciary
Subcommittee on Commercial and Administrative Law

Hearing on H.R. 3359
The Mobile Workforce State Income Tax Fairness and Simplification Act of 2007

The Honorable Linda T. Sanchez, Chair

November 1, 2007

Chairwoman Sanchez, Ranking Member Cannon, Congressman Johnson and other Members of the Subcommittee, I am Doug Lindholm, President and Executive Director for the Council On State Taxation, which is more commonly known as COST.

COST is a non-profit trade association consisting of nearly 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and non-discriminatory state and local taxation of multi-jurisdictional business enterprises.

I very much appreciate the opportunity to share with you COST's views on the important issue of nonresident state and local personal income taxes imposed on employees who travel away from their resident states for temporary work periods and the withholding obligations of their employers.

I would like to thank Congressman Johnson and Ranking Member Cannon for being the initial cosponsors of HR 3359, The Mobile Workforce and State Income Tax Fairness Act of 2007, to allow Congressional, public sector and private sector dialogue to continue on this very important and widespread issue.

Widespread Problem—Simple Solution

The problem addressed by H.R. 3359 can be simply stated: every business day thousands of employees across the country are sent by their employers to work in nonresident states. The vast majority of these trips are temporary in nature, whereby the employee conducts business in the nonresident state for a short period of time and then returns to his/her resident state. Unfortunately, states that impose a personal income tax have diverse rules relating to the obligation of the nonresident employee to file a personal income tax return and to the commensurate employer withholding deductions. Some states impose a personal income tax filing requirement based upon a "first dollar" earned approach with

respect to the nonresident employee. Other states set a minimum threshold period of a specific number of days under which the employee is not subject to the nonresident state personal income tax. For example, Arizona and Hawaii have sixty day threshold periods. Some states utilize an earnings threshold, and yet other states utilize a combination of day and earnings threshold periods. In most cases, the commensurate withholding obligations on employers match the rules for determining the employee's liability, but in at least one state the burdens are disparate, with the employee responsible for paying nonresident tax on the first dollar earned, but the employer's responsibility for withholding triggered only after a fourteen day in-state period. The patchwork of inconsistent state laws and rules is shown by the map and chart attached as Exhibit A to my testimony. The challenges imposed upon employees to understand these widely divergent rules, track down the appropriate nonresident state forms and actually comply with this multiplicity of state tax rules is nearly insurmountable.

So too, employers are extremely hard pressed to comply with these varying and disparate rules and provide the appropriate nonresident state withholding. It is important to note that this is not only an issue affecting large corporations with thousands of employees travelling for work each year; small business, churches and other charitable entities, and even state and local governments severely struggle to attempt compliance with this regime. I must emphasize that there is no readily available technological solution to this problem. Very few large corporations have the capability to integrate payroll with business operating systems to allow tracking of employees' whereabouts on a daily basis in order to comply with the patchwork of nonresident state withholding obligations. The costs of creating such systems would be exorbitant in relation to any compliance gains to the various states. Small business would experience similar issues of undue expense for limited increases in compliance.

Simple Solution

The simple answer to this widespread problem is to legislate a federal threshold period of sixty days for temporary employee work assignments to nonresident states. Employees working in nonresident states for sixty or fewer days would remain fully taxable in their resident state for all earnings, to the extent the resident state chooses to have a state personal income tax system. The vast majority of employees who travel outside their resident state for employment purposes would fit within this threshold period. To the extent the employee has duties in the nonresident state for an extended period exceeding the sixty day annual threshold, then the employer would have adequate information to provide accurate withholding of wages to the nonresident state, and the employee would be on notice that the state filing rules must be complied with. This uniform rule would greatly enhance compliance for all businesses under the state withholding rules, and would provide much greater certainty for employees in fulfilling their personal nonresident state filing obligations.

Why is the Sixty Day Period Important? What about a Dollar Threshold?

I would like to respond to a concern raised by some state policymakers that the sixty day period is too long and that a dollar threshold period should be considered.

With respect to a day threshold, COST members carefully analyzed various threshold periods and determined that the sixty day period enhanced and simplified compliance to the greatest extent. With a uniform sixty day threshold, the vast majority of employees who travel for business duties would not be subject to nonresident state taxation but would remain fully taxable in their resident states, with the employer fulfilling the normal withholding obligations on those resident state earnings. This time period further allows employers to focus compliance and education efforts on a small pool of employees who have easily identifiable extended duties at particular nonresident state locations. Shorter time periods

would enhance the probabilities that employees would "back into" the nonresident state rules unknowingly through intermittent trips of short duration, and would provide commensurately greater burdens on employers to identify those employees subject to nonresident state withholding and educate those employees on their filing obligations.

The sixty day threshold compares favorably with existing state reciprocity agreements. Under these agreements, some states provide for a full exemption for nonresidents traveling between neighboring states for work. In essence, these states have provided a "365 day threshold" for nonresidents from neighboring states. H.R. 3359 is conceptually similar to these existing agreements, albeit with a sixty day threshold rather than a full 365 day exemption, and it reflects the realities of our modern economy in which employees are as likely to travel across the country for temporary work assignments as they are to the state next door.

With respect to a dollar threshold, either as a substitute or in conjunction with a day period threshold, any such threshold nullifies the potential compliance gains and simplification from a uniform federal rule. Dollar limit thresholds would require even more onerous burdens than exist in most cases under the current patchwork of state laws: each employee would have to be tracked on a daily basis as to his or her whereabouts, and such information would have to be compared with personal and highly sensitive payroll data about salaries, and then allocations of salary and other remuneration would have to be made. Dollar thresholds would render the current state-by-state system even more complicated, and should not be considered a viable solution to the need for uniform rules to enhance compliance.

As a final point on the issues presented by state policymakers, I note that HR 3359 contains several provisions that are designed specifically to protect the legitimate

prerogatives of the states, such as exceptions from the uniform rule for professional athletes, entertainers and other public figures.

Why Uniform Rules are Needed Now

While states' laws addressing nonresident withholding and personal income tax liability have been on the books for many years, resolution of this issue has reached a critical stage for corporations for a number of reasons, most notably the enactment of the Sarbanes Oxley Act of 2002. Under Section 404 of the Act, company management is required to certify that processes and procedures are in place to comply with applicable laws and regulations, including state tax rules. This rule, along with a commensurate desire by corporations to be fully compliant with all rules and requirements as part of corporate governance responsibilities, has increased the interest of business in desiring uniformity and simplicity in matters of nonresident state income and withholding laws.

Furthermore, businesses have a significant interest in ensuring that employees comply with all state law taxation requirements. COST members are acutely aware of the burdens placed on their employees who travel outside their resident states for business. They have expressed a strong desire to meet their responsibilities as employers by assuring their employees comply with these burdens. Unfortunately, the current patchwork of state rules renders employees' abilities to comply with nonresident state law requirements extremely challenging.

Can the States Resolve These Issues Without a Federal Rule?

In a limited manner, some states have resolved the issue on a regional basis, typically with adjoining states through the bilateral reciprocal agreements noted previously. A list of existing reciprocal agreements is set forth in Exhibit B to my testimony. These existing

agreements are helpful in discrete regional situations, but fall well short of solving a problem that is nationwide in scope. We believe that it would be extremely difficult and take many years for each of the states that impose a personal income tax to pass a uniform set of laws governing both the income tax liability of the nonresident employee and the employer's commensurate withholding obligations. Although the states might as an administrative matter be in a better position to promulgate uniform withholding rules, such collaborative administrative relief on behalf of the states without creating companion symmetrical rules for employees' personal income tax liability through extremely time consuming state-by-state legislation would, in reality, provide no real benefit to either employees or employers. As a result, we believe the only way to secure a nationwide resolution of the issues is to provide a uniform and simple set of rules established under federal guidelines.

HR 3359 – Explanation of Provisions

First and foremost, HR 3359 provides that all wages and other remuneration paid to an employee would be subject to the income tax laws in the state or locality of the employee's residence. In addition, under the legislation wages and other remuneration are also subject to tax in the state or locality in which the employee is physically present performing duties for more than sixty days in a calendar year, and employers would be subject to commensurate withholding requirements of that nonresident state. The sixty day threshold does not apply to professional athletes, professional entertainers, or certain public figures who, because of their national prominence, are paid on a per-event basis to give speeches or similar-type presentations. For example, a professional football player would be subject to nonresident state personal income taxes for performance in an athletic event. As another example, a well-known author who is an employee of a speakers' organization would be subject to nonresident state income taxes for making a presentation in a state and receiving

compensation based on that event. In both of these cases, their respective employers would be subject to the nonresident state withholding requirements.

An employer may rely on an employee's determination of the time spent in a nonresident state absent knowledge of employee fraud or collusion between the employer and employee. If an employer, however, at its discretion, maintains a time and attendance system tracking where employees perform their services, such system must be used instead of the employee's determination.

An employee is considered to be in a state or locality for a "day" if the employee performs more than fifty percent (50%) of his or her duties in such state or locality for such day.

The terms "employee" and "wages or other remuneration" are defined by the state or locality in which the employment duties are performed. These references to state law protect the prerogatives of the state, and we believe it is the overall intention of the legislation to make the least incursion practicable in current state withholding and personal income tax rules and regulations.

Impact on State Taxes

With respect to the impact of HR 3359 on state revenues, in some states, the nonresident taxes currently collected exceed the tax credits provided to residents. In other states, the converse is true. In the majority of states, the net impact is not significant as a percentage of the state's overall tax receipts. I have included a detailed explanation of the impact on state tax receipts and a state-by-state analysis as prepared by Ernst & Young, LLP as Exhibit C to my testimony. As noted in the fiscal impact analysis, twenty-nine states either gain revenue or have net reductions of less than two hundredths of one percent (0.02%). The impact of the legislation results in a redistribution of income taxes between resident and

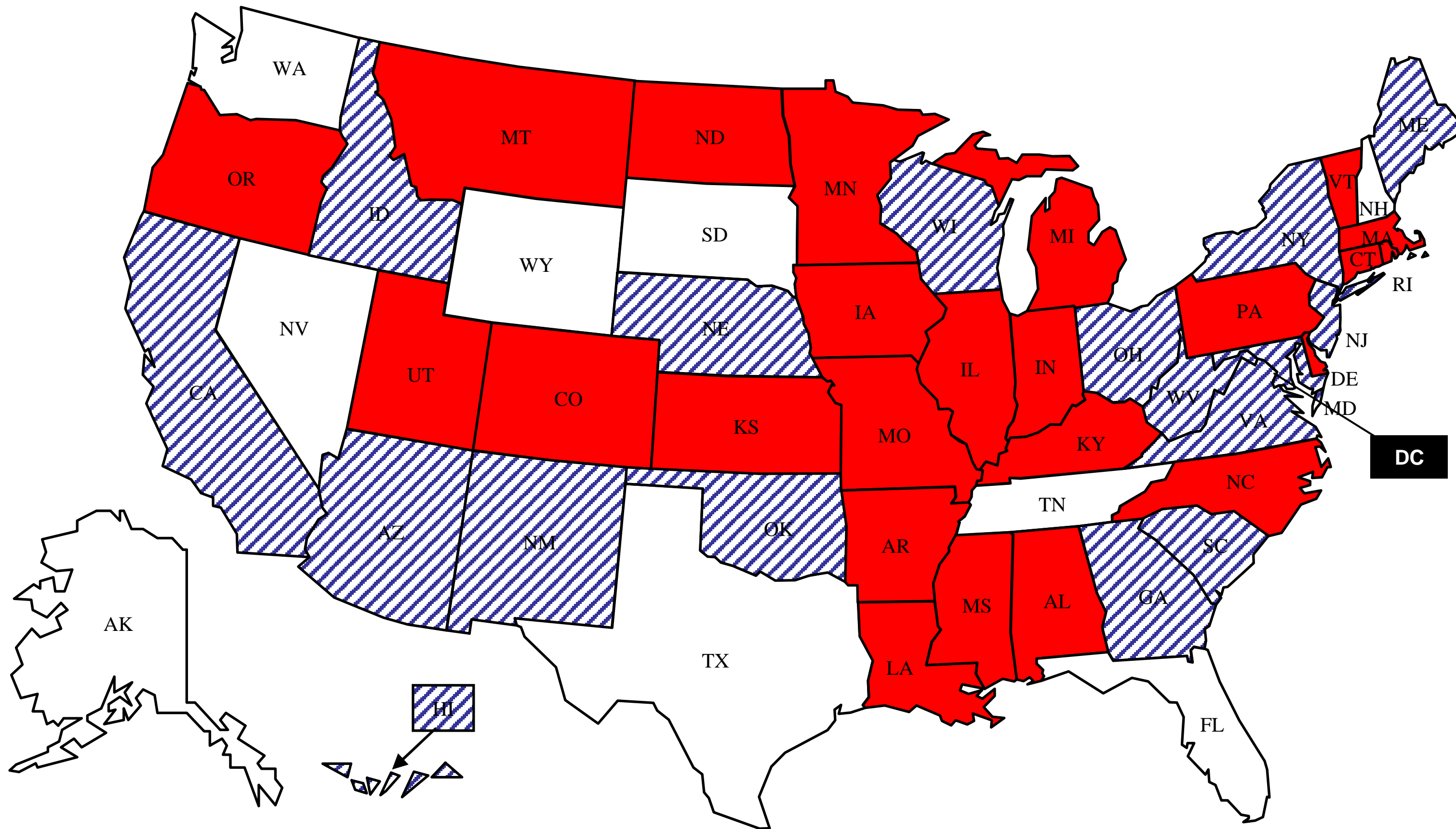
nonresident states with only a very slight reduction in total income taxes collected by the states. For all fifty states and the District of Columbia combined, the net change is only a reduction of one hundredth of one percent (.01%), which accrues as a net reduction in overall personal income taxes.

Why is there a net reduction in overall personal income taxes? Under H.R. 3359, employees whose work responsibilities in nonresident states are under the sixty day threshold period would experience a reduction in personal income taxes under the following two circumstances: (1) to the extent the employee's resident state imposes tax at a lower rate than the nonresident state or (2) when a nonresident state tax is imposed on an employee whose resident state does not also impose a personal income tax.

Conclusion

The sixty day threshold period and other operating rules provided in H.R. 3359 respond to an immediate need for uniformity in the nonresident state taxation of employees. The uniform rules will greatly enhance compliance and provide simplicity in administration for employers and employees alike. The legislation is further structured to protect state taxation prerogatives to the greatest extent possible. Chairwoman Sanchez, I thank you again for the opportunity to present this testimony before the Subcommittee today. I welcome any questions that you or other Subcommittee Members would like to discuss.

Exhibit A – Nonresident Personal Income Taxes



Key

- Non-Resident Withholding Required — NO *de minimis* rule
- Non-Resident Withholding Required — *de minimis* rules / safe harbors
- Non-Resident Withholding NOT Required (only Washington, D.C.)
- No personal Income Tax (thus, no withholding and no credits for taxes paid to other states)

States currently have widely inconsistent standards regarding state income tax withholding requirements. In general terms, listed below are the various exemption threshold levels utilized by the states when determining whether an employer must withhold on a nonresident's wages. Exemption thresholds generally fall into two categories: a set number of days or a dollar threshold (a few states use both).

State Exemption for Nonresident Personal Income Tax Withholding Measured by Days:

Arizona: Withholding is not required if the nonresident is physically present in the state for less than 60 days in a calendar year.

Georgia: Withholding is not required if the nonresident has been employed in the state for 23 days or less in a calendar quarter and the remuneration for services performed in the state do not exceed the lesser of 5% of total income received by the nonresident in the taxable year or $5,000.

Hawaii: Withholding is not required if the nonresident employee is performing services in the state for no more than 60 days.

Maine: Withholding is not required if personal services are performed in the state for 10 days or less.

New Mexico: Withholding is not required if the employee is to perform services in state for 15 days or less.

New York: Withholding is not required for wages paid for services performed in state for 14 or fewer days or for wages that will not exceed the employee's personal exemption.

State Exemption for Nonresident Personal Income Tax Withholding Measured by Dollars:

California: Withholding is not required for wages below "Low Income Exemption Table" amounts (i.e., semi-monthly wage amount of $470 or less for 2007).

Idaho: Withholding is not required if the nonresident will be paid below $1,000 in a calendar year for services performed in Idaho.

Maryland: Withholding is not required for wages paid below $5,000.

Nebraska: Withholding is not required for payments for personal services below $5,000.

New Jersey: Withholding is not required for wages paid below an employee's personal exemption.

Ohio: Withholding not required for wages paid below $300 in any calendar quarter.

Oklahoma: Withholding not required for wages paid below $300 in any calendar quarter.

South Carolina: Withholding not required for wages paid below $1,000 for the year or for wages paid below the employee's Federal personal exemption.

Virginia: Withholding not required for wages paid below the employee's personal exemptions ($900 each) and standard deduction ($3,000 individual) or, if elected by the employee, the employee's filing threshold (single $7,000; married $14,000).

West Virginia: Withholding not required for wages paid below employee's personal exemption amount (one exemption equals $2,000).

Wisconsin: Withholding not required for wages paid below $1,500.

PRICEWATERHOUSECOOPERS

EXHIBIT B

STATE RECIPROCITY AGREEMENTS
UPDATED as of 10/10/07

The table below summarizes the state "reciprocity agreements" that exist for non-resident withholding tax purposes. Generally, under such agreements, each signatory state agrees not to require withholding from the wages of residents of the other signatory state, regardless of the amount of work performed in the state of non-residence.

State	Agreements	Citations
Alabama	None	N/A
Arizona[1]	California, Indiana, Oregon, Virginia	Arizona Withholding Tax Ruling No. 92-3 (10/1/02); Form WEC "Withholding Exemption Certificate"
Arkansas	None	N/A
California	None	N/A
Colorado	None	N/A
Connecticut	None	N/A
Delaware	None	N/A
District of Columbia[2]	N/A -- Taxation of nonresidents prohibited by Federal law	Pub. L. No. 93-198
Florida	No Personal Income Tax	N/A
Georgia	None	N/A
Hawaii	None	N/A
Idaho	None	N/A
Illinois	Iowa, Kentucky, Michigan, Wisconsin	Form IL-1040 Instructions; Form IL-W-5-NR
Indiana[3]	Kentucky, Michigan, Ohio, Pennsylvania, Wisconsin	Ind. Admin. Code tit. 45, r. 3.1-1-115; Form WH-47; Publication WH-13
Iowa	Illinois	Iowa Admin. Code r. 701-38.13(422)
Kansas	None	N/A
Kentucky[4]	Illinois, Indiana, Michigan, Ohio, Virginia, West Virginia, Wisconsin	103 Ky. Admin. Regs. Sec. 17:010
Louisiana	None	N/A
Maine	None	N/A
Maryland	District of Columbia, Pennsylvania, Virginia, West Virginia	Form MW507 "Employee Exemption Certificate"
Massachusetts	None	N/A
Michigan	Illinois, Indiana, Kentucky, Minnesota, Ohio, Wisconsin	Michigan Form 1040 Instructions
Minnesota	Michigan, North Dakota, Wisconsin	Minnesota Form M-1 Instructions; Income Tax Fact Sheet 4 (Revised December 2006)
Mississippi	None	N/A
Missouri	None	N/A
Montana	North Dakota	Mont. Admin. R. 42.17.134; Montana Form NR-2 "Employee Certificate of

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		North Dakota Residence"
Nebraska	None	N/A
Nevada	No Personal Income Tax	N/A
New Hampshire	None	N/A
New Jersey	Pennsylvania	Form NJ-165 "Employee's Certificate of Non-Residence in New Jersey"
New Mexico	None	N/A
New York	None	N/A
North Carolina	None	N/A
North Dakota	Minnesota, Montana	Form ND-1 Instructions
Ohio	Indiana, Kentucky, Michigan, Pennsylvania, West Virginia	Form IT-4 NR "Employee's Statement of Residency in a Reciprocity State"
Oklahoma	None	N/A
Oregon	None	N/A
Pennsylvania	Indiana, Maryland, New Jersey, Ohio, Virginia, West Virginia	Form REV-420
Rhode Island	None	N/A
South Carolina	None	N/A
South Dakota	No Personal Income Tax	N/A
Tennessee	None	N/A
Texas	No Personal Income Tax	N/A
Utah	None	N/A
Vermont	None	N/A
Virginia[5]	District of Columbia, Kentucky, Maryland, Pennsylvania, West Virginia	Va. Admin. Code 10-110-250; Form 763 Instructions
Washington	No Personal Income Tax	N/A
West Virginia	Kentucky, Maryland, Ohio, Pennsylvania, Virginia	Form WV/IT-104
Wisconsin	Illinois, Indiana, Kentucky, Michigan, Minnesota	Wis. Admin. Code Sec. Tax 2.02
Wyoming	No Personal Income Tax	N/A

[1]Arizona: Arizona has no reciprocal agreements. However, due to credits it grants to nonresidents for income tax paid to certain states of residence or domicile, Arizona does not require withholding for such nonresidents.

[2]District of Columbia: Pursuant to Federal law, the District of Columbia is barred from taxing the income of nonresidents. Nonresidents who work in D.C. must file Form D-4A with their employers to confirm their exempt status. Note that Maryland and Virginia each treat D.C. as a reciprocating state.

[3]Indiana: While Indiana regulations (Ind. Admin. Code tit. 45, r. 3.1-1-115) list Illinois as a reciprocal state, this agreement was halted effective January 1, 1998.

[4]Kentucky: The agreement with Virginia only applies to taxpayers who commute daily to their employment in the nonresident state.

[5]Virginia: Pursuant to Virginia Form 763 Instructions, Virginia's agreements with D.C. and Kentucky only apply to taxpayers who commute daily to their employment in Virginia. 23 Va. Admin. Code 10-110-250 indicates that this restriction applies more broadly to other reciprocal states (the regulation was last updated in 1985).

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Exhibit C

October 11, 2007

Preliminary Estimates of State-by-State
Impacts of H.R. 3359

Table 1 presents state-by-state estimates of the net change in personal income taxes projected from the impact of H.R. 3359 at fiscal year 2007 levels. The estimates for each state include two components: 1) the reduction in tax collections due to the increase in the number of in-state days required before a nonresident employee is subject to taxation, and 2) the increase in tax collections due to reduced credits on resident tax returns for taxes paid in other states. Table 1 provides the change in personal income taxes in dollar terms and in terms of the net change in state personal income taxes divided by total estimated state taxes in fiscal year 2006.[1]

Thirty of the forty-four states (including the District of Columbia) with a personal income tax either gain revenue, have no change, or have net reductions less than 0.02% (two-hundreds of a percent or two-tenths of a mill) as a result of H.R. 3359. As the table illustrates, the bill redistributes income taxes between resident and nonresident states with only a very slight reduction in total income taxes collected by the states. For all fifty states and the District of Columbia combined, the net change in total state taxes is only a reduction of -.01% which accrues as a reduction in overall personal income taxes.

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[1] The estimates were prepared by Ernst & Young LLP based on survey data provided by seventeen states through the Federation of Tax Administrators, as well as state tax collection data for other states from the U.S. Census *Governmental Finances* and journey-to-work data from the U.S. Census. More detailed estimates, as well as a description of the estimating methodology, are available upon request. The bill will also have a small net impact on local personal income taxes in several states. The local tax impact is not included in Table 1. FY 2006 is the latest available year for state-by-state total state tax collections.

Table 1: Preliminary Estimates of Impact of H.R. 3359		
State	**Net Change as a Percent of Total State Taxes**	**Net Change in Millions of Dollars**
Alabama	0.01%	$1
Alaska	0.00%	0
Arizona	0.02%	3
Arkansas	-0.01%	-1
California	-0.01%	-15
Colorado	-0.03%	-3
Connecticut	0.07%	9
Delaware	0.11%	3
District of Columbia	0.01%	1
Florida	0.00%	0
Georgia	-0.02%	-4
Hawaii	0.01%	0
Idaho	0.01%	0
Illinois	-0.05%	-14
Indiana	0.05%	7
Iowa	0.04%	2
Kansas	0.02%	1
Kentucky	-0.03%	-3
Louisiana	-0.04%	-4
Maine	0.00%	0
Maryland	-0.02%	-3
Massachusetts	-0.07%	-13
Michigan	-0.01%	-3
Minnesota	-0.03%	-6
Mississippi	0.03%	2
Missouri	0.03%	3
Montana	-0.01%	0
Nebraska	-0.01%	0
Nevada	0.00%	0
New Hampshire	0.00%	0
New Jersey	0.23%	57
New Mexico	0.00%	0
New York	-0.19%	-104
North Carolina	-0.01%	-3
North Dakota	-0.01%	0
Ohio	-0.02%	-5
Oklahoma	-0.02%	-1
Oregon	-0.08%	-6
Pennsylvania	0.00%	0
Rhode Island	0.24%	6
South Carolina	0.06%	5
South Dakota	0.00%	0
Tennessee	0.00%	0
Texas	0.00%	0
Utah	-0.02%	-1
Vermont	0.03%	1
Virginia	-0.01%	-3
Washington	0.00%	0
West Virginia	-0.02%	-1
Wisconsin	-0.01%	-1
Wyoming	0.00%	0
Total for All States	**-0.01%**	**-$93**