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Nonresident and telecommuter payroll tax considerations

2 May 2014

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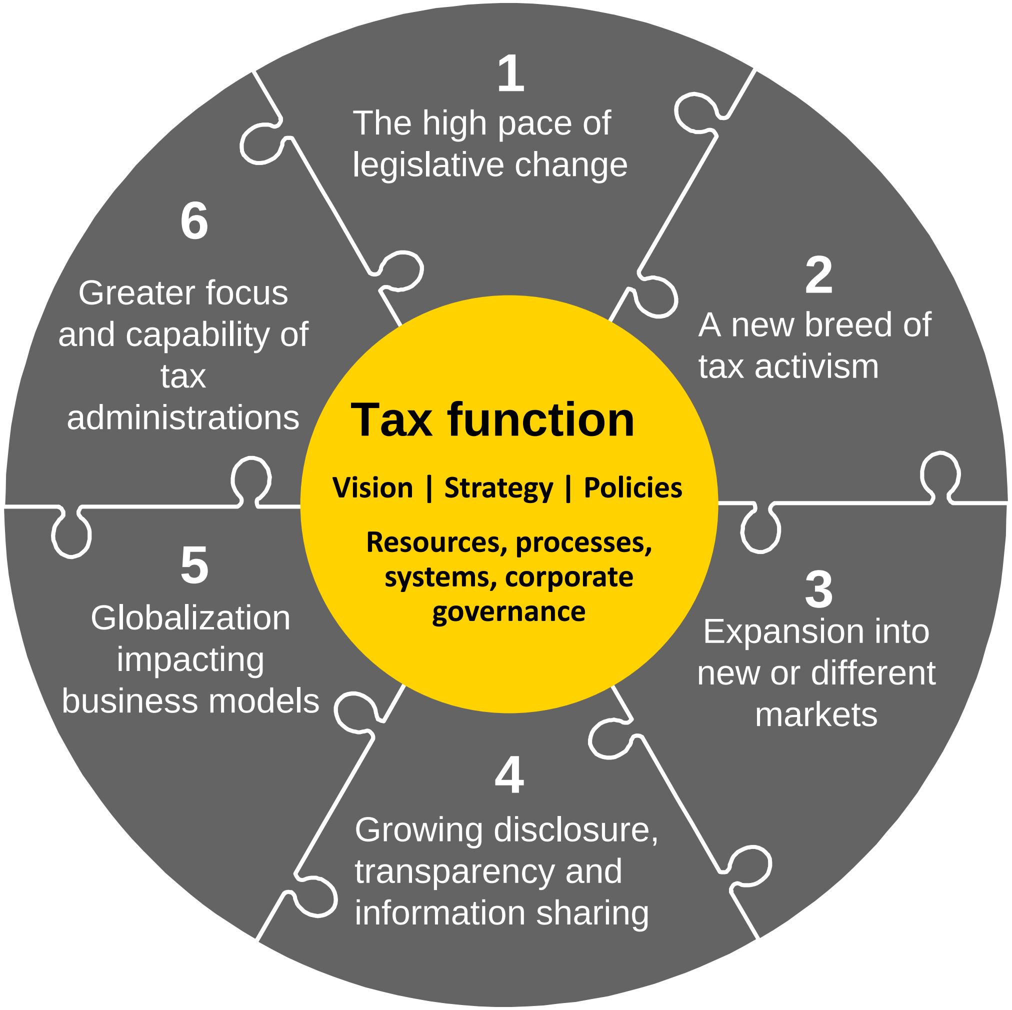
Today’s agenda

- What’s driving today’s compliance trends?
- Global withholding and employment tax basics
- US outbound payroll tax considerations
- US inbound payroll tax considerations
- Multi-state income tax considerations
- Jurisdictional enforcement and noncompliance risks
- Mobile workforce tax planning considerations
- Employee permanent transfers and refund opportunities
- Summing it up

“When business requirements result in travel across state or international borders, a series of tax compliance consequences are triggered.”

What's driving the new era of tax risk and uncertainty?

- Governments need revenue. They are raising the tax burden and policing the tax base in a far tougher manner.
- Companies are responding to the shifting global landscape and dramatically changing their business models.
- This convergence is driving a significant increase in tax controversy which can lead to financial, resource and reputational risk.
- Companies need to be "audit ready" in this new era of global risk and uncertainty.
- A number of key steps can help you reduce the threats posed to your business



Global employment and withholding tax basics

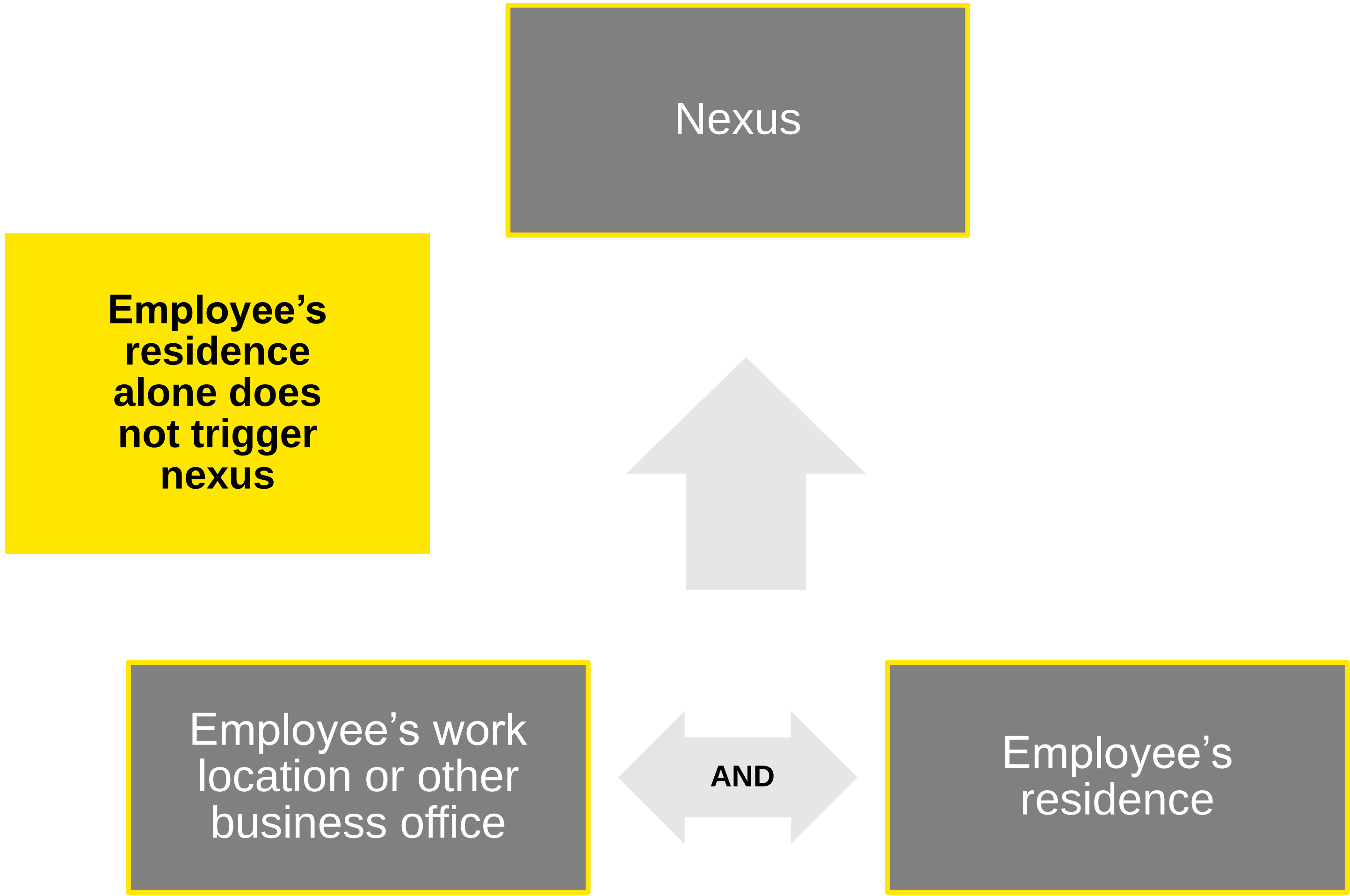
Global employment and withholding tax basics

- **Resident (domicile)**
  - Each jurisdiction defines the term "resident" and domicile
    - Generally, all income, regardless of where it was earned, is subject to resident income tax
    - Residency generally is based on the length of time a person has maintained a family home in the location
- **Nonresident (work location)**
  - Generally, income and employment tax apply in the location where the employee performs services
  - Exemptions from nonresident tax sometimes apply for certain activities (e.g., education) or de minimis periods

Global employment and withholding tax basics (cont.)

- **Nexus**
  - If a company conducts business or otherwise has a business connection to a location, nexus is generally triggered
  - Business tax and reporting requirements generally apply in those locations where a business has nexus
    - Business taxes may include
      - income tax withholding
      - social and unemployment insurance
      - corporate/franchise
      - sales and use
      - property

Employer nexus illustrated



Agreements that prevent dual taxation

Agreements to waive nonresident tax

- **Agreements to waive nonresident tax**
  - Jurisdictions may enter into agreements with each other to waive the nonresident withholding tax requirement

Type of jurisdiction	Nonresident tax waiver term
State income tax	Reciprocal agreement
International income tax	Tax treaty
International social insurance	Totalization agreement

Reciprocal agreements

- Some states have entered into reciprocal agreements (usually with bordering states) where nonresident income tax is not required
  - Example: Under Indiana’s reciprocal agreement, income tax withholding is not required for services performed in the state by residents of Kentucky, Michigan, Ohio, Pennsylvania and Wisconsin if employees have properly completed and filed Indiana Form WH-47 with the employer
- Generally, the exemption from nonresident income tax under a reciprocal agreement doesn’t apply unless the employee files the required certificate with the employer (generally, a certificate of nonresidency)

States with reciprocal agreements

District of Columbia	Montana
Illinois	New Jersey
Indiana	North Dakota
Iowa	Ohio
Kentucky	Pennsylvania
Maryland	Virginia
Michigan	West Virginia
Minnesota	Wisconsin

Social security totalization agreements

- Social security totalization agreements eliminate dual social tax when a worker is required to pay such tax on the same earnings in more than one country
- These agreements also fill gaps in benefit protection when workers have divided their careers between the US and another country
- The option to elect exemption under a totalization agreement applies for a limited period, generally, 5 years
- Employees must present certificate of coverage from foreign country to qualify for coverage under the agreement

Countries having Social Security totalization agreements with the US

Australia	Germany	Portugal
Austria	Greece	South Korea
Belgium	Ireland	Spain
Canada	Italy	Sweden
Chile	Japan	Switzerland
Czech Republic	Luxembourg	United Kingdom
Denmark	Netherlands	
Finland	Norway	
France	Poland	

International income tax treaties

- Taxes owed by a US citizen or resident to a foreign country on foreign source income may be reduced by a credit, reduction, deduction, exemption, or exclusion of income, under a treaty between the United States and the country in which the employee works
- The terms of the treaties vary
- Although most treaties benefit residents of the United States rather than expatriates, some treaty benefits extend to US citizens residing in the treaty country
- A table of tax treaties appears in IRS Pub. 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*. Also reference IRS Pub. 901, *U.S. Tax Treaties*

US outbound payroll tax considerations

US outbound payroll tax considerations

- **US/foreign jurisdiction – US income tax withholding (FITW)**
  - US citizens, but not US resident aliens may be exempt from FITW if (a) qualify for Sec. 911 exclusion or (b) foreign-sourced wages subject to mandatory foreign income tax withholding
    - If no mandatory foreign withholding, FITW applies but Form W-4 can be used to minimize in consideration of foreign tax credit
- **US totalization agreements (FICA)**
  - US citizens and US resident aliens may be exempt from foreign social taxes for up to five years
  - US certificate of coverage is necessary
- **FUTA and state unemployment insurance (SUI)**
  - Wages paid to US citizens (but not US resident aliens) for foreign employment are subject
  - SUI is determined by location of US employer (typically headquarter's state)

US outbound payroll tax considerations (cont.)

- **Proper completion of forms is critical**
  - Form 673, *Statement for Claiming Exemption From Withholding on Foreign Earned Income Eligible for the Exclusion(s) Provided by Section 911*
  - Form W-4, *Employee's Withholding Allowance Certificate*

US inbound payroll tax considerations

US inbound payroll tax considerations

- **If assignee is present in US on nonimmigrant visa, employer visa sponsor is typically US company that has presence in US (e.g., H1B, E1, L1, TN, etc.)**
    - If work fails the dependent personal services article, wages are subject to US wage reporting/withholding even though paid from home country
- **Foreign nationals are typically subject to US Social Security/Medicare (FICA) and federal unemployment insurance (FUTA) tax**
  - FICA exemption may apply under totalization agreement if certificate of coverage in foreign country is provided to employer
  - Employees present under F1, J1, M1, Q1, or Q2 visas may be FICA and FUTA exempt
    - FICA /FUTA exemption period ranges from 2 to 6 calendar years
    - The F1,J1,Q1,Q2 exemption may not apply to state unemployment insurance (SUI)

US inbound payroll tax considerations

- **Short-term business visitors – foreign employer**
  - Sent by foreign employer to perform limited activities on behalf of foreign employer within US (meetings, training, etc.)
  - Statutory de minimis exemption (foreign employer, <90 days in US, <$3,000 in US sourced remuneration)

  - **Income tax treaty exemption**
    - Form 8233 with US taxpayer identification number is required
    - States and locals may not recognize income tax treaty

US inbound payroll tax considerations (cont.)

- **Foreign employer may need to obtain EIN to report applicable federal, state and local taxes**
    - Agent election – Appoint US affiliate as reporting agent tax payment purposes
    - Agent election not permitted for FUTA, SUI and in some states for income tax withholding
    - State and local registrations (e.g., income tax, SUI)
  - **Plan/use of current or existing US entity to house US employees**
    - SUI rate considerations/planning
    - Incentive opportunities
- **Multi-state income tax withholding**

Multi-state income tax considerations

Resident vs. nonresident withholding

- **Wages paid to a resident for services provided within and outside of the state are generally subject to resident income tax**

  Example:

  Employee Wayne, a resident of Oregon, works 3 months in California. All of his wages, including those earned for services in California are subject to Oregon resident income tax

- **Absent a reciprocal agreement, nonresident income tax is required on wages for services earned within the nonresident state**
- **When withholding state income tax, priority is generally given to the nonresident income tax**
- **The resident state generally considers nonresident income tax in the income tax withholding calculation**

Resident vs. nonresident withholding (cont.)

- **The withholding tax procedure when employees' wages are subject to resident and nonresident income vary by state, as follows:**
  1. Withholding tax reduction is specifically allowed for income tax withholding in another state (e.g., Indiana recently adopted this rule)
  2. Resident income tax withholding isn't required for services outside the state if nonresident income tax applies in that state (e.g., Alabama)
  3. Wages earned outside of the state are specifically exempt from income tax withholding (e.g., Arizona)
  4. Wisconsin excludes Minnesota nonresident wages from resident income tax withholding

Multistate withholding examples

- **Example 1:** Employee Martha is resident of Massachusetts and works in New Jersey. Massachusetts allows a reduction in resident income tax withholding for income tax withholding paid in another state
  - Assume that Massachusetts resident income tax is $60, and New Jersey nonresident income tax is $50. The employer withholds:

    New Jersey $50

    Massachusetts $10
- **Example 2:** Employee Bob is a New York resident and works in Texas for a payroll period. The employer withholds NY income tax from wages earned in Texas

The relevance of nexus

- **When a nonresident employee performs services in the state, those services generally create nexus within that state**
  - In addition to triggering an income tax withholding requirement, other business taxes, such as sales and use, may also be triggered
  - Keep in mind, that once there is a nonresident withholding obligation, a resident withholding obligation may also apply

Home offices and nexus

- If employees regularly work from home, most states consider the home office a place of business (creating nexus)
  - Businesses with home workers sometimes fail to pay and file for other business tax (e.g., sales and use) in those states where employees regularly work from home
- In a New Jersey Superior Court, Appellate Division, it was determined that a foreign corporation with a principal place of business in Maryland was subject to New Jersey's corporate income tax requirements because one of its employees was allowed to work on a full-time basis from her New Jersey home office (*Telebright Corporation v. Director, N.J. Super. Ct. App. Div., Dkt. No. A-5096-09T2, 03/02/2012*)

Nexus examples

- **Example 1:** Acme maintains one place of business in Illinois. Employee Alice lives in Wisconsin and works in the Illinois office

  Acme isn't required to withhold Wisconsin resident income tax because it has no place of business in Wisconsin

- **Example 2:** WidgCo has one business office in Illinois. It has 3 employees who are Wisconsin residents, one of whom works from her home office conducting sales and making services calls.

  WidgCo has nexus in Wisconsin because one employee regularly works from her Wisconsin residence. WidgCo is required to withhold Wisconsin resident income tax from all three employees. (It may also be subject to other Wisconsin business taxes.)

Deferred compensation considerations

- The deferred compensation of nonresidents (e.g., bonuses, stock options, restricted stock, nonqualified deferred compensation) are the focus of increased scrutiny by state taxing authorities
- Many states and localities will now seek to tax that portion of employee compensation that was earned (e.g., partially vested) in connection with services performed within the jurisdiction, but is ultimately exercised (NQSO), vested (restricted stock) or received (severance) when the employee is no longer a resident of that jurisdiction

Deferred compensation considerations (cont.)

- Noncompliance frequently arises in the context of employees retiring to states with no individual income tax (e.g., Florida, Nevada, Texas, etc.)
- May also arise in the context of employees who perform services in several states or offices throughout their career

Deferred compensation considerations (cont.)

- **The State Taxation of Pension Income Act of 1995 (4 U.S.C. § 114) limits the state taxation of nonresident retirement income under the following arrangements:**
  - Income from any tax-qualified employer plans: 401(k), 403(b), SEPs, 457(b), and government retirement arrangements
  - Distributions from a NQDC arrangement paid in the form of an annuity over a period of 10 or more years
  - Distributions from an “excess benefit plan”

Case in point: Apportionment cannot be assumed

- In an Oregon tax court decision, it was held that nonresident income related to a stock option is subject to Oregon income tax if the individual was an Oregon resident when the stock options were earned.
- The decision rules out the possibility of using an income apportionment approach when Oregon residents perform services outside of the state during the period the stock options are earned. (*Domingo Garcia Jr. and Jenny H. Garcia v. Oregon Department of Revenue, April 30, 2012*)

Case in point: Apportionment may apply in the absence of regulations

- In a 2011 Rhode Island Administrative Hearing Decision (*2010-11, Rhode Island Department of Revenue, Division of Taxation, 10/28/2010, Case No.: 09-T-034*), it was held that despite the lack of Rhode Island regulations, the income derived from stock options granted and exercised by Rhode Island non-resident employees must be apportioned to Rhode Island
- Adding additional flavor to the proceedings was the fact that in the absence of its own regulations concerning the details that apply to the non-resident apportionment, deference was made to New York's regulations.

New York nonresident stock income allocation – *Case study*

- Employee works 50% of his time in New York in 2008 through 2010
- There are 720 total work days in this period, and 360 (720 x 50%) are attributable to services performed in New York as a nonresident
- In 2001 the employee is granted options to purchase 5,000 shares of stock valued at $30 per share
- The options vest on December 31, 2010 with a FMV of $35 per share
- From January 1, 2008 through December 31, 2012, the employee spends 100% of his time in Florida. There are 480 total work days in this period
- Total work days from date of grant to date of exercise is 1200 (480 + 720)
- On December 31, 2012 the employee exercises the stock options
- FMV at time of exercise is $40 per share

New York nonresident stock income allocation
Case study results

- Total income vs. NY taxable income
  - Exercise value: $40 per share
  - Grant value: $30 per share
  - Spread: $10 per share
- $10 per share x 5,000 shares = $50,000 total taxable spread
- Days from grant date and vesting date = 720 days
- 360 days in NY/720 total days = 50% of days spent in NY
- $50,000 x 50% = $25,000 NY taxable income

Deferred compensation audit considerations

- The IRS requires that income resulting from the exercise of nonqualified stock options be separately reported on IRS Form W-2, box 12, code V
- Nonqualified deferred compensation under certain circumstances is reported on Form W-2, box 11
- Although these Form W-2 codes are used by the IRS and the Social Security Administration, a state employment tax agent could conceivably identify the underreporting of nonqualified deferred compensation by performing a review of multiple years’ Forms W-2

Nonresident income tax myths and facts

- **All states have de minimis exceptions for meetings or infrequent trips in and out of the state**
  - Only a few states provide for de minimus exceptions from the nonresident income tax withholding requirements (e.g., Arizona and Hawaii treat as de minimis 60 days or less per calendar year)
- **The federal Form W-4 can be used for state income tax withholding purposes**
  - Numerous states require use of their own withholding allowance certificate—the Form W-4 cannot be used for state income tax withholding purposes

Nonresident income tax myths and facts (cont.)

- **Nonresident employees are exempt from income tax withholding if there is a reciprocal agreement**
  - A form must generally be signed and provided to the employer for the nonresident income tax withholding exemption to apply
- **Employees must tell us how much time they work in a nonresident state**
  - Employees should provide this information, but in many states, employers also have a responsibility to verify the accuracy of employee statements

Jurisdictional enforcement and compliance risks

"Audit targets are no longer limited to consultants, athletes and entertainers. The broad technology net cast by an electronic withholding tax audit (e.g., Connecticut and New York) is designed to catch almost any individual that crosses jurisdictional boundaries."

US global mobility business risks for short-term business travelers (STBT)

Employees in states can create nexus risks for the company

Non-compliance with complex state income tax withholding and other reporting requirements resulting in penalty assessment

Employees could pose additional liability or employment law exposure to company

Noncompliance by executives/company in a particular market can seriously harm business reputation

Tax laws in many states have penalties and interest including civil penalties for willful tax evasion

Employees subject to personal tax and multi state tax filing obligations

Failure to properly budget and allocate STBT costs

IRS international payroll tax audits

- IRS Large Business and International (LB&I) established International Training Course in June 2011 to train its employment tax specialists
  - Form 673 and review of citizenship (3401(a)(8)(A)(i) and (ii) exclusions
  - FICA tax assessment if certificate of coverage not on file
  - Comprehensive Information Document Requests (IDR)

IRS international payroll tax audits (cont.)

- **IRS international Information Document Requests contain some of the following questions:**
  - How many foreign nationals were living and working here in the US during the examination period?
  - Describe briefly the company's foreign assignment policies and intercompany operational and financial arrangements. Describe compensation including benefits, cost reimbursements and any other employer-provided or employer-subsidized items to employees who work in a foreign country. Identify the Totalization Agreements relative to any exemption from US Social Security and the appropriate sections/ articles of the particular income tax treaties if any, from US income tax for payments/benefits to these individuals

IRS international payroll tax audits (cont.)

- Provide a list of all foreign nationals, TINs, country of origin and the company/subsidiary that employed them
- Identify their residency status and employment tax agreement as Resident or Nonresident Alien
- Indicate total compensation paid and whether or not Form W-2, Form 1099 or Form 1042-S was issued for their personal services
  - If none, why not?

IRS employment tax penalties for failure to report and remit withholding

- Employers are jointly and severally liable for income tax and FICA tax not withheld
- Employers generally will be assessed FUTA tax at the full 6% rate when the employer has not reported wages paid to foreign nationals working in the US

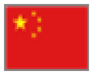
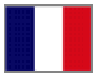
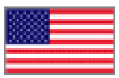
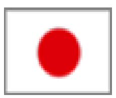
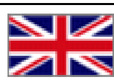
IRS employment tax penalties for failure to report and remit withholding

Potential penalty	Penalty rate	Description
Withholding tax assessment	25% in 2014	**The employer is liable for all the applicable withholding taxes, even though none was withheld from the employee.** This is the “trust fund penalty” which is 100% of the tax that should have been withheld. Tax, but not penalties may be abated by procuring Form 4669 from employee who states under penalties of perjury that s/he reported the income and paid the tax.
Social Security tax	6.2% EE share and 6.2% ER share on $117,000 in 2014– assessed for both employer and employee portion	The employer is liable for all the applicable taxes, even though none was withheld from the employee. This is the “trust fund penalty” which is 100% of the tax that should have been withheld.
Medicare	2.9% Assessed for both employer and employee portion	The employer is liable for all the applicable taxes, even though none was withheld from the employee. This is the “trust fund penalty” which is 100% of the tax that should have been withheld.
Failure to deposit under Code Sec. 6656(a) & (b)	Generally 10% (ranges from 2% to 15%)	On the employer portion of the Social Security/Medicare. (Revenue Ruling 75-191, 1975-1 C.B. 376.) This penalty does not carry interest if paid by the due date of the Notice & Demand. Otherwise, interest will begin accruing from the assessment date.

IRS employment tax penalties for failure to report and remit withholding (cont.)

Potential penalty	Penalty rate	Description
Negligence penalty under Code Sec. 6662	20%	On the total tax for disregard of rules or regulations. This penalty carries interest beginning with due date of Form 941 to which the penalty applies
Incorrect information penalty under Code Sec. 6721	Max. $100 (if intentional disregard, $250 or 10% of amount not reported instead of $100)	On each incorrect information return (e.g., Form W-2) to a maximum of $1.5 million
Incorrect payee statement penalty under Code Sec. 6722	Max. $100 (if intentional disregard, $250 or 10% of amount not reported instead of $100)	On each incorrect payee statement to a maximum of $1.5 million
Interest expense: If Code Sec. 6205 (interest free adjustment) does not apply.	Varies quarterly	On the unpaid tax as of the due date of the return

International income tax audits of US employers

Country		***Example***
China		Manufacturer subjected to largest payroll audit ever in China resulting in the requirement for payment of $25m in back taxes and $8m in penalties
France		Increasingly aggressive social security authorities led a raid and criminal investigation on multinational company resulting in $8m assessment of back social security tax and penalties, even though the company had an agreement with another EU country to protect its position in France
USA		Oil company fined $20m for falsifying work permit applications
Japan		Global financial services company had their entire foreign retirement plan retroactively disqualified for Japan tax purposes requiring payments of back tax of $8m and $1m in penalties
Germany		SEC enquiry into related matter uncovers internal control breakdown requiring multinational company to re-state financial statements by Euro 100m to correctly report employer paid tax expense
UK		Company pays £40m + in back taxes and penalties for failure to accurately report home paid income in the UK
Brazil		Company unable to collect $1m in employee debt by not being able to enforce loan agreements not written in local language
India		European multinational assessed Euro 5m in penalties for failing to report full home paid compensation for employees assigned to work in India. Indian authorities now opened full 3-year investigation resulting in additional professional fees of over Euro 1m to respond.
UK		Of 407 immigration investigations in the UK, 72% resulted in prosecution and criminal sanctions, of which 46% included jail sentences of 7-12 months

Recent state nonresident income tax audits

California

- $100,000 for courier company (executives and regional managers)
- $ 50,000 for real estate developer (architects and project managers)

New York

- $23 million for media and entertainment company (execs, expats, inpats, telecommuters)
- $2 million for media and entertainment company (execs, telecommuters and NJ residents)

Nonresident state income tax audit flags

- Officers and highly-paid employees travel to nonresident states (including board meetings and meetings with investors)
- State actively conducts employment tax audits (e.g., CA, CT, LA, MA, NJ, NY, and PA)
- Subsidiary entity operates in another state
- Unemployment insurance paid to state but no income tax withholding
- Expense reports show frequent travel to nonresident state(s)
- Corporate jet log shows travel to nonresident state(s)

Nonresident state income tax audit flags (cont.)

- Public records show nonresident presence in state (e.g., board meeting minutes) also known as "*the New York Times test*"
- Corporate-leased or owned property in nonresident state
- Employee leased/owned property or other investments in nonresident state
- Employee driver's license in nonresident state
- Employee registered to vote in nonresident state

Nonresident income tax audit exposures
Businesses

- Liability for income tax not withheld
- Penalty and interest (not abated even if employee paid income tax)
- Other sanctions (Maryland – loss of business license)
- Personal liability of officers
- Employee personal damages
- Financial audit (FAS 5)

Nonresident income tax audit exposures – *Individuals*

- Liability for tax not withheld or paid
- Estimated tax penalties
- Running of statute of limitations for claiming resident credit
- Penalty and interest

Nonresident income tax
Other concerns

- Lien on real property in state
- Levy on bank accounts

Payroll tax audits
Key records

- Returns/information statements
- Tax tables and formulas
- System taxability configurations
- Employee data concerning work state and percentage of allocation
- Laws/regulations supporting taxability

Payroll tax audits
Key records

- Employee v. Independent contractor – audit steps
  - Search Forms 1099-misc for payments to individuals
  - Search accounts payable records for payments to individuals
  - Purge against form 1099 file
  - Create file of payments not on 1099

Payroll tax audits
Key records

- Nonresident withholding – data requested
  - Federal Forms W-2
  - State codes for all employees
  - State(s) allocation percentages
  - Expense reimbursements
  - Withholding allowance certificates, nonresident certificates, exemption certificates

Payroll tax audits
Key records

- Nonresident withholding – data requested
  - Records indicating presence in state (newspaper, court records, minutes of meetings)
  - Records of all nonqualified deferred comp and stock records including work/resident states during period income earned

Payroll tax audits
Key records

- Nonresident withholding – gaps of interest
  - Where state code exists but no state W-2
  - Where expense reports, public records or minutes of meeting show presence in state
  - Where income from nonqualified deferred comp or stock was not allocated to state

Mobile workforce tax planning

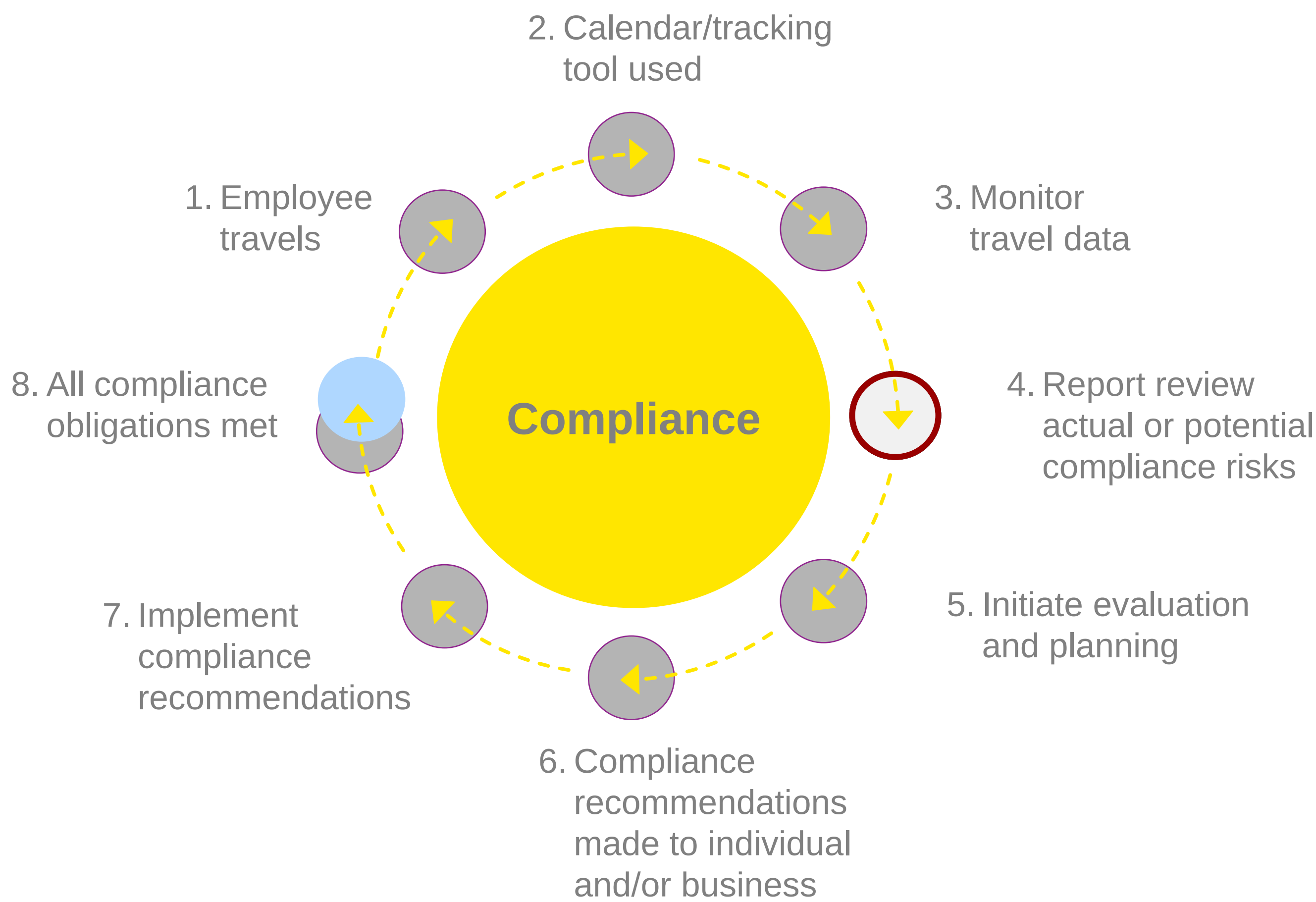
“Becoming compliant with the nonresident income tax requirements is a significant undertaking, but well worth the effort for those individuals and businesses with significant exposure.”

Voluntary disclosure

- Federal reporting errors
  - Some errors can be corrected on an interest and penalty free basis by filing a Form 941-X and paying the tax due
  - Errors that can't be disclosed using the Form 941-X process can be submitted as a voluntary disclosure
- State and local reporting errors
  - Penalties could be abated, but not interest
- Errors not disclosed are required to be quantified and booked to a reserve account under FAS 5

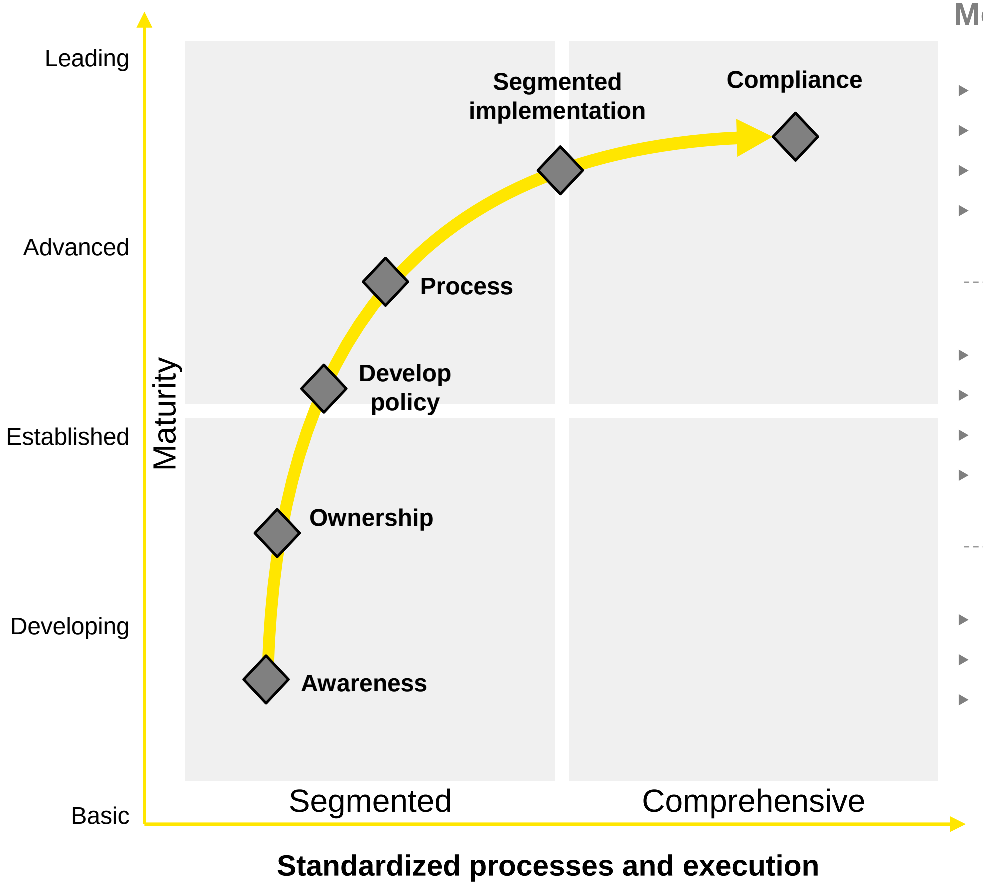
Global remediation process – business travelers and foreign nationals on assignment

The Compliance Cycle



The path to compliance

It's not just about an IT solution



Models/characteristics

- Corporate ownership and global reporting
- Integrated and standardized approach to risk mitigation
- Optimal use of technology
- KPIs and SLAs established

- Increased corporate ownership
- Partial visibility and control over workflow and processes
- Single or few service providers
- Some standardization of data formats and processes

- Minimal corporate ownership
- Limited or no standardized policy and process
- Variety of service providers

Issues, considerations and leading practices

Issue	Considerations	Leading practice
How do we get our arms around the traveling population?	▸ HRIS and payroll system capabilities ▸ Travel documentation (expense reports, calendars, airline reservations, etc.) ▸ Telecommuters ▸ Foreign jurisdiction travel	▸ Focus on travel to most aggressive states ▸ Quarterly travel projections/true-up ▸ Repercussions/rewards aligned with corporate culture (reimbursement, performance, etc.)
How and what should be communicated to employees?	▸ Communication vehicle ▸ Explanation of the issue and risks associated with non-compliance ▸ Tax equalization and return preparation assistance	▸ Setting the tone/risk tolerance from the top ▸ Communicate employer/employee issues and risks associated with non-compliance ▸ Implement an accountability framework to drive compliance (i.e., tracking participation and completion of trainings) ▸ Communicate differences between employer and employee requirements (e.g., NY 14 day rule)
What type of company policy is best?	▸ Ease of implementation ▸ System constraints ▸ Employee perception ▸ Reputational risk	▸ Single policy for tax equalization ▸ Reimbursement policy for assistance with tax return preparation
How are companies creating and/or adapting their policies?	▸ Threshold baseline for withholding ▸ Definition of workday ▸ Definition of compensation ▸ Prior year exposure ▸ Which states to focus on	▸ Ten day threshold except for New York and Connecticut ▸ Four hours = workday ▸ Includes all "wage" types ▸ Deal with prior year issues when and if they arise, versus retroactively dealing with prior years ▸ Implement in most aggressive states first then follow with other states; focus on states where business travel to the state is highest; apply 80/20 approach to implementation ▸ Management audit verification with compliance

Employee permanent transfers and refund opportunities

Mergers, acquisitions and transfers

- **Positive and negative cost fluctuations can occur as the result of changes in the business, such as acquisitions, mergers or the transfer of employees to new job locations**
  - Under certain conditions, the successor employer is required to consider the wages paid by the predecessor employer in determining if the FICA and FUTA wage base is met for the year
  - Whenever all or part of another business is acquired, there are state rules governing the transfer of the wages and experience from the predecessor to the successor
  - Some states mandate the transfer of experience and wages when all of a business is acquired
  - Many states make transfer of experience optional in the case of a partial acquisition (unless there is common ownership)

Mergers, acquisitions and transfers (cont.)

- **What is the benefit of transferring UI wages from the predecessor to the successor employer?**
  - Double payment of SUI taxes is avoided on those wages up to the state UI wage limit.

Example

You purchased all of the assets and hired all four employees of WidgeCo, a Kansas employer, in October 2014. The Kansas wage base is $8,000 and your UI rate is 1.4%. You pay $10,000 to each of these employees through December 2014. By how much have you potentially overpaid your Kansas UI tax?

Answer

$8,000 x 4 employees x 1.4% = $448

Mergers, acquisitions and transfers (cont.)

- What is the potential impact on cost when transferring the experience of the predecessor employer?
  - The successor employer's UI rate is adjusted by taking into account the experience of the predecessor employer.

Example

WidgeCo's 2913 UI rate was the highest rate for Kansas employers at 9.4%. You have had no claims against your UI account and you paid at the lowest rate of 0.11%. What is the likely result of having acquired WidgeCo with a higher UI rate than yours?

Answer

Your Kansas UI rate was adjusted in an upward direction, with the rate falling between 0.11% and WidgeCo's higher rate of 9.4%.

Mergers, acquisitions and transfers (cont.)

- What is the benefit of having the option of transferring the predecessor employer's experience rate?
  - A business can reject an experience transfer that has an adverse cost impact.

Mergers, acquisitions and transfers (cont.)

- When an employer transfers employees from one state to another within the same calendar year and under the same FEIN, most states allow a credit for wages paid in the previous state up to that state's wage limit.
  - **Example:** Assume an employee earned $12,000 in Kansas through June 2014. Wages up to the Kansas wage base of $8,000 are credited against the wage base in the state of transfer. Therefore, if the employee moved to Arizona in July 2014 with a wage base of $7,000, no UI tax would be owed in Arizona for this employee for the remainder of the year.

Did you know?

Minnesota doesn't allow for the transfer of wages under these circumstances. Therefore, if the Kansas employee moved to Minnesota in 2014, UI tax is due on the first $29,000 of covered wages paid in Minnesota.

Mergers, acquisitions and transfers (cont.)

▶ Common errors in UI rate calculations

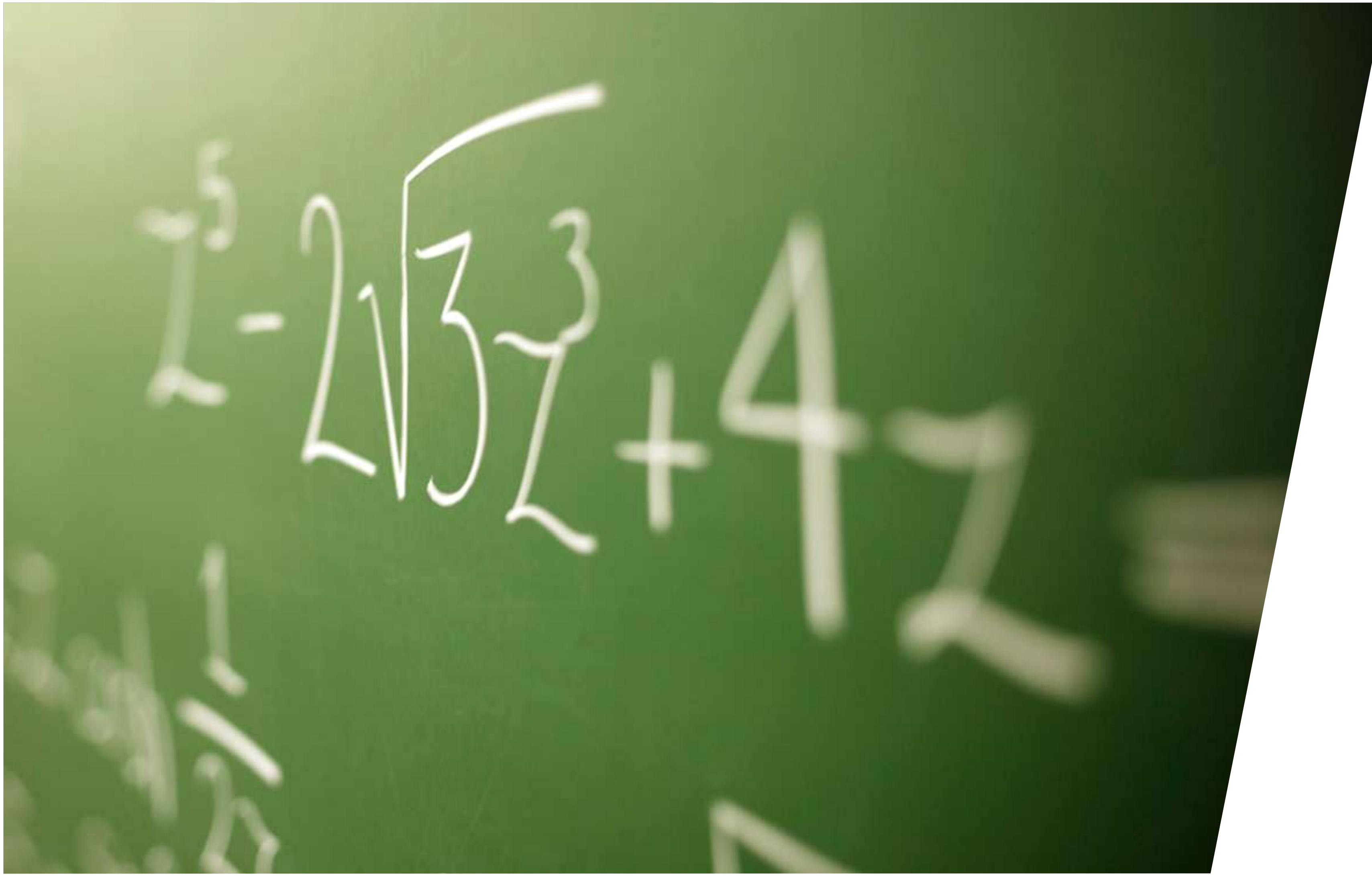
State error	Employer error
Assignment of penalty rate in error	Failure to transfer previous state wages when employee moves to another state
All employer contributions not posted	Failure of successor to take into account wages paid by predecessor
Benefits charged incorrectly to account	Failure to notify state of a total or partial acquisition
Taxable payroll and reserve balances not timely or correctly transferred	Not taking advantage of statutory elections
Incorrect or untimely posting of statutory elections	Not timely dissolving joint accounts that are no longer advantageous

Payroll tax refund case studies

- **$1 million**
    - Retailer
    - Corporate reorganization
    - Failed to apply for SUI experience transfers
- **$3.5 million**
  - Manufacturer
    - Acquisition
    - FICA/SUI transfers
    - Saved $10 million in SUI expense

    - **$1.2 million**
      - Financial services
      - Internal reorganization
      - SUI rate and wage transfers

Summing it up



Summing it up

- Determine the rules that govern payroll taxes in the jurisdictions where employees conduct business
- Develop a policy that takes into account your business and compliance needs
- Acquire or test technology to ensure it is adequate in meeting your business and compliance needs
- Identify gaps in your process (e.g., mock audits) and take corrective action
- Keep in mind that some gaps may result in tax overpayments
  - Refunds could partially offset compliance costs

Where are you now?

		Needs attention	In process	Highly satisfied
Ownership	▸ Who owns STBT initiative? ▸ What drives compliance? ▸ Do STBT objectives align with business strategy? ▸ Which functional units participate in STBT initiative?			
Policies and process	▸ Do you have policies which cover STBTs? ▸ Do you have processes which cover STBTs? ▸ To what extent is compliance with the above tracked? ▸ When were the above last updated?			
Data	▸ How much STBT data is available (travel, payroll, calendars, equity etc.)? ▸ Who owns the data and to what extent is it available? ▸ How do you know when someone arrives or departs to/from a jurisdiction? ▸ How do you track telecommuters?			
Issues and challenges	▸ Are your STBTs currently under audit by local authorities? ▸ Do you have sufficient resources to manage your risk? ▸ Are STBTs covered by your internal audit and due diligence protocols?			

Comments? Questions?

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