American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

April 7, 2016

The Honorable Tim Huelskamp
Chairman
Subcommittee on Economic Growth, Tax, and Capital Access
U.S. House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Judy Chu
Ranking Member
Subcommittee on Economic Growth, Tax, and Capital Access
U.S. House Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515

RE: AICPA Statement for the Record of the April 13, 2016 Hearing on "Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks"

Dear Chairman Huelskamp and Ranking Member Chu:

The American Institute of CPAs (AICPA) respectfully submits the attached statement for the record of the House Committee on Small Business Subcommittee on Economic Growth, Tax, and Capital Access hearing on April 13, 2016 on "Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks." Our testimony focuses on the importance of H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

We welcome the opportunity to discuss the mobile workforce legislation or to answer any questions that you may have. I can be reached at (801) 523-1051 or tlewis@sisna.com; or you may contact Eileen Sherr, Senior Technical Manager – AICPA Tax Policy & Advocacy, at (202) 434-9256, or esherr@aicpa.org.

Sincerely,

Troy K. Lewis, CPA, CGMA
Chair, AICPA Tax Executive Committee

American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

WRITTEN STATEMENT FOR THE RECORD

OF THE HEARING BEFORE

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON SMALL BUSINESS

SUBCOMMITTEE ON ECONOMIC GROWTH, TAX, AND CAPITAL ACCESS

On

Legislative Hearing on
"Keep It Simple: Small Business Tax Simplification and Reform, Main Street Speaks"

April 13, 2016

INTRODUCTION

The American Institute of CPAs (AICPA) commends Chairman Huelskamp, Ranking Member Chu, and Members of the Subcommittee for examining the need for, and potential benefits of, small business tax simplification and reform, including a bill that would assist small businesses, H.R. 2315, the Mobile Workforce State Income Tax Simplification Act of 2015. We applaud the leadership taken by the Committee to consider this important legislation.

The AICPA is the world's largest member association representing the accounting profession, with more than 412,000 members in 144 countries and a history of serving the public interest since 1877. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

The AICPA is also an active leader in the national Mobile Workforce Coalition, comprised of 295 businesses and organizations that support this legislation.

H.R. 2315

The AICPA commends the Subcommittee for their consideration of H.R. 2315, which limits the authority of states to tax certain income of employees for duties performed in other states. More specifically, the bill prohibits states from taxing most nonresident employees (there are exceptions for certain professions) unless the employee is present and performing employment duties for more than 30 days during the calendar year. Furthermore, employees would not be subject to state income tax withholding and reporting requirements unless their income is subject to taxation.

AICPA'S POSITION

The AICPA strongly supports H.R. 2315. We believe the bill provides relief, which is long-overdue, from the current web of inconsistent state income tax and withholding rules that impact employers and employees.

After taking into consideration the costs for processing nonresident tax returns with only a small amount of tax liability, we believe states receive only a minimal benefit (if any) from the tax revenue that results from an employee filing a return for just a few days of earnings in that state. If nonresident tax returns with minimal income reported were eliminated through a standard, reasonable threshold, such as in H.R. 2315, we think that most states would have an increase in resident income taxes to substantially offset any decrease in nonresident income tax revenue (assuming workers both travel to and out of the state for work). In other words, the current system as a whole unnecessarily creates complexity and costs for both employers and employees, without yielding a substantive benefit to most states. Sixteen states, such as Kansas, would either have no

or minimal revenue loss, and 18 states would, in fact, have a positive revenue gain from this legislation. Most importantly, according to estimates of the impact of the bill, the net change as a percentage of total state taxes for all states is only -0.01, a $42 million net change for all states.[1]

We believe Congressmen Bishop and Johnson have reached a reasonable balance between the states' rights to tax income from work performed within their borders, and the needs of individuals and businesses, and especially small businesses, to operate efficiently in this economic climate. Having a uniform national standard for nonresident income taxation, withholding and filing requirements will enhance compliance and reduce unnecessary administrative burdens on businesses and their employees. In addition to uniformity, H.R. 2315 provides a reasonable 30-day *de minimis* exemption before an employee is obligated to pay taxes to a state in which they do not reside.

H.R. 2315 is an important step towards tax simplification for state income tax purposes for small businesses. Therefore, the AICPA urges Congress to establish (1) a uniform standard for nonresident income tax withholding and (2) a *de minimis* exception from the assessment of state income tax as provided in H.R. 2315. This legislation should be passed as soon as possible.

BACKGROUND

The state personal income tax treatment of nonresidents is inconsistent and often bewildering to small businesses and their employees. Currently, 41 states plus the District of Columbia impose a personal income tax on wages, and there are many different requirements for withholding income tax for nonresidents among those states. There are seven states that currently do not assess a personal income tax, and two states that do not tax wages and only tax interest and dividends of individuals.[2] Employees traveling into all the other states are subject to the confusing myriad of withholding and tax rules for nonresident taxpayers. These rules on a state to state basis vary so much that it is impossible to predict or to even guess what one state may hold as its own rules.

Some of the states have a *de minimis* number of days or *de minimis* earnings amount before employers must withhold tax on nonresidents, or nonresidents are subject to tax. These *de minimis* rules are not administered in a uniform manner. For example, for 2015, a nonresident is subject to income tax withholding in certain states based upon an entirely different threshold, such as, after working 59 days in Arizona, 15 days in New Mexico, or 14 days in Connecticut.[3]

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[1] See Statement of Statement of Douglas L. Lindholm, President & Executive Director, Council On State Taxation (COST), Before the U.S. House of Representatives Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial and Antitrust Law, Hearing on H.R. 2315, The Mobile Workforce State Income Tax Simplification Act of 2015, June 2, 2015, Exhibit C, pp. 1-2.

[2] These seven states have no personal income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. New Hampshire and Tennessee are the two states that do not tax wages and only subject to tax interest and dividends earned by individuals.

[3] See *Payroll Issues for Multi-State Employers*, 2015 ed., American Payroll Association, pp. 4-1 et seq.

Other states have a *de minimis* exemption based on the amount of the wages earned, either in dollars or as a percent of total income, while in the state. For example, for 2015, employers generally are required to withhold in a nonresident state once an employee earns, or is expected to earn, taxable wages of $1,500 in Wisconsin, $1,000 in Idaho, $800 in South Carolina, and $300 a quarter in Oklahoma.[4] Other states that have thresholds before nonresident withholding is required are Georgia, Hawaii, Maine, New Jersey, New York, North Dakota, Oregon, Utah, Virginia, and West Virginia.[5] Some of these states' thresholds are set at the state's personal exemption, standard deduction, or filing threshold, which often change each year. The remainder of the states tax income earned within their borders by nonresidents, even if the employee only works in that state for one day.

Some states exempt, and some do not exempt, from the withholding requirement, the income earned from certain activities, such as training, professional development, or attending meetings. Note that some of the states only cover exemptions from state withholding, and as a result, they do not address the nonresident taxpayer's potential filing requirement and tax liability in a state or local jurisdiction. Furthermore, only a minority of states use day or income thresholds — and without any uniform standard.

It is also important to note that approximately one-third of the states (mostly bordering each other in the Midwest or East) have entered into reciprocity agreements under which one border state agrees not to tax another border state's residents' wages, and vice versa. Accordingly, the in-state resident does not need to file a non-resident border state return, and the employer does not have to withhold non-resident income taxes with respect to the in-state resident, even if the in-state resident primarily works in the nonresident state. Some type of an "exemption form" is often required to be filed in each nonresident border state.

However, not all border states have reciprocity agreements. For example, no reciprocity agreement exists between Maryland and Delaware. Therefore, both Maryland and Delaware require withholding, the payment of taxes and the submission or a tax return for a car salesman who lives and primarily works in Ocean City, Maryland but occasionally has to drive to another dealer in Rehoboth Beach, Delaware.

Unfortunately, the existing reciprocity collaboration between some border states provides only patchwork relief with two-thirds of the country not covered by such agreements. Furthermore, the current agreements are primarily geared toward nonresident employees who ordinarily commute a few miles a day to particular adjoining states in which their employer is located. For example, while Virginia provides reciprocal withholding agreements with the District of Columbia, Kentucky, Maryland, Pennsylvania, and West Virginia, others states, such as California, Kansas, Mississippi, and New York do not provide any reciprocity agreements with neighboring states. The reciprocity rules generally do not apply to individuals who regularly travel greater distances.

[4] Ibid.
[5] Ibid.

However, in today's economic environment, it has become quite common for employees to travel for short periods of time to other states.

TYPES OF INDUSTRIES AND TAXPAYERS IMPACTED

These complicated rules impact everyone who travels for work. All types and sizes of businesses are impacted. Large, medium, and small businesses all have to understand each of the states' treatment of nonresident employee withholding and assessment of taxes and the unique *de minimis* rules and definitions. This issue also affects all industries – retail, manufacturing, real estate, technology, food, services, etc.

Some everyday examples include a real estate developer's employee who travels to 20 states to visit prospective sites and spends less than a day in each state, or a store manager who attends a half-day regional meeting in an adjoining state, with some of these meetings occurring only twice a year. Since there are states in which there currently is no minimum threshold, an employee's presence in that state for just one day could subject the employee to state tax withholding.

In addition, accounting firms, including small firms, conduct business across state lines. Many clients have facilities in nearby states that require on-site inspections during an audit. Additionally, consulting, tax or other non-audit services that CPAs deliver are frequently provided to clients in other states, or to facilities of local clients that are located in other states. In essence, all of these entities (small businesses, accounting firms and their clients) are affected by nonresident income tax withholding laws.

HYPOTHETICAL EXAMPLE

For example, assume an employee earns $75,000 per year, resides in Maryland, and travels to work in Indiana, Kansas, Massachusetts, and Ohio for 5 days each in a given tax year. Assume further that the taxpayer earns a pro rata amount of salary in each of the states of $1,500 ($75,000 * 5 days / 250 total workdays = $1,500).

Without the Mobile Workforce legislation, the employer currently must withhold on all of the employee's income in Maryland (the resident state) and the source income from different jurisdictions (which for all practical purposes, will only occur if the employer has a sophisticated time reporting system in place and the employee correctly reports the number of days worked in each state.)

Despite the relatively small amount of income in each of the nonresident states, some amount of tax is likely due in each of the states. The employer must withhold in all five states, and the employee then must file in addition to the federal tax return, income tax returns in Maryland (as a resident), and as a nonresident in Indiana, Kansas, Massachusetts, and Ohio, all of which require nonresident withholding on the first day of work in that state. Depending on the tax withheld, the nonresident state income tax returns may yield a small refund or a small additional tax payment.

While the Maryland return yields a refund, it becomes particularly complex because the employee is required to file forms showing the credit for taxes paid to each nonresident state, and Maryland does not always provide the employee with a dollar-for-dollar credit when factoring in the Maryland county-level tax required to be paid. The federal tax return also becomes more difficult because of the numerous state tax payments and refunds that impact deductions and adjustments for the state tax deduction (for alternative minimum tax purposes, for example).

The administrative burden of filing in five nonresident states, along with the complexity of the withholding rules for each state, would probably require utilization of a third-party service provider that assists with processing payroll for businesses (resulting in additional costs to the employee). The Mobile Workforce legislation makes it significantly easier for the employer and the employee from a compliance perspective. The taxpayer files one state income tax return in Maryland, and it is a more straightforward return (without calculations and credits for nonresident state taxes paid).

CHALLENGES FOR EMPLOYERS

Employers currently face unnecessary administrative burdens to understand and comply with the variations from state to state. For example, employers are responsible for determining whether to subject an employee to withholding in a state if the employee attends out-of-state training for a couple of days, or how to account for an employee responding to business calls and e-mails on a layover in an airport. Employers also need to consider whether to withhold taxes in a state for when an employee is working on a train that travels into multiple states and jurisdictions in the Northeast Corridor, or what happens when an employee working at a business located close to a state border must cross the state line for a quick mundane task.

The issue of employer tracking and complying with all the differing state and local laws is quite complicated. The employer and employee need to be aware of the individual income tax and withholding rules of each state to which that the employee travels, including whether the state has, and if the employee has exceeded, a *de minimis* threshold of days or earnings, and if there is a state reciprocity agreement that applies. Some states have extremely complicated rules for determining when to withhold for a nonresident. For example, Georgia requires withholding when a nonresident employee works more than 23 days in a calendar quarter in Georgia, or if five percent of total earned income is attributable to Georgia, or if the remuneration for services in Georgia is more than $5,000. The employer must determine and calculate each of the three thresholds to determine when to withhold for each employee working occasionally in that state.

The recordkeeping, especially if business travel to multiple states occurs, is voluminous. The recordkeeping and withholding a state requires can trigger for as little as a few moments of work in another state. The research to determine any given state's individual requirement is expensive and time-consuming, especially for a small firm or small business that does not have a significant amount of resources. Taxpayers need to update the research, at least annually, to make sure the state law has not changed. Of course, a small firm or business may choose to engage

outside assistance to research the laws of the other states; however, the business will incur an additional cost.

Many small firms and businesses use third-party payroll services rather than performing the function in-house. However, we understand that many third-party payroll service providers cannot handle multi-state reporting. For example, third-party payroll service providers generally report on a pay period basis (e.g., twice per month, bi-weekly) as opposed to a daily basis, which is necessary to properly report the performance of interstate work. Due to the software limitations, employers must track and manually adjust various employees' state income and withholding amounts to comply with different state requirements. The alternative is to pay for a more expensive payroll service.

CHALLENGES FOR EMPLOYEES

Employees face many challenges with complying with the multitude of state tax laws and requirements. When an employee travels for work to many states, even for short periods of time, each nonresident state tax return that is required is usually for a minimal amount of income and tax liability. Often, the employee is below the filing threshold, but since withholding is required, a nonresident state tax return is required, even if only to claim a refund of the taxes withheld.

UNIFORMITY AND *DE MINIMIS* EXCEPTION NEEDED

In addition to uniformity, there needs to be a *de minimis* exemption. AICPA has supported the 60-day limit contained in previous versions of similar legislation, but believes that the 30-day limit contained in H.R. 2315 is fair and workable. The 30-day limit in the bill ensures that the interstate work for which an exemption from withholding is granted does not become a means of avoiding tax or shifting income to a state with a lower tax rate. Instead, it ensures that the primary place(s) of business for an employee are where that employee pays state income taxes. For example, employees of many small businesses often travel to other states as part of their training, research, or operations. A prime example is a business located in South Carolina, which is on the border of North Carolina and Georgia, where no reciprocity agreements exist. It is easy for an employee to travel into three states within a few hours timeframe. For example: a small bike shop that has to occasionally cross state borders to buy a part, a catering company that delivers, and a roofing company that drives to the nearest home-improvement store (which is located across the state line).

CONCLUDING REMARKS

The current situation of having to withhold and file many state nonresident tax returns for just a few days of work in various states is too complicated for both employers and employees. The small business employers' costs to comply with the current system have become too burdensome and are not worth the lost economic productivity for those small businesses to justify the states in assessing and then trying to collect the tax. Employees are overwhelmed with the many states to

which they may have a nonresident filing and tax obligation and the different filing criteria for each state. The AICPA urges Congress to pass H.R. 2315 to ease our country's nonresident state income tax withholding and compliance burdens. The bill provides national uniformity and a reasonable 30 day *de minimis* threshold. Therefore, the AICPA strongly supports H.R. 2315 and respectfully commends the co-sponsors of this legislation for the development of this reasonable and much needed bi-partisan bill.

The AICPA appreciates the opportunity to submit this written statement in support of H.R. 2315.