

Chicago Chapter APA

2023 employment tax year in review

November 10, 2023



**Building a better
working world**

Today's agenda

- Nexus and business tax
- Identifying work and resident locations
- Multistate tax implications of hybrid workers
- Payroll tax onboarding
- Teleworker tax legislation and legal challenges
- Evaluating and managing teleworker arrangements
- Form W-2 reporting considerations
- Claiming federal tax credits retroactively
- Year-end reporting considerations
- Resources
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Nexus and business tax



Nexus implications for state and local business and payroll taxes

- ▶ If an employer has nexus with a state, not only does the employer have an obligation to withhold income and other applicable taxes from an employee's wages, and perhaps, to pay unemployment insurance and employer taxes, but other business taxes may also apply
- ▶ Business taxes that may apply at the state level include:
 - ▶ Corporate income tax
 - ▶ Franchise tax (based on net worth or fixed minimum tax)
 - ▶ Sales and use tax
 - ▶ State-level gross receipts tax
- ▶ Local payroll and business taxes may also apply such as license/service fees, payroll expense taxes, transit taxes, net profit taxes, gross receipts taxes, etc.

Activities that do/don't trigger nexus

Some activities that generally create nexus

- ▶ Repairs and maintenance
- ▶ Technical assistance, consulting
- ▶ Resolving customer complaints
- ▶ Picking up or replacing damaged or returned property
- ▶ Installing or supervising of installation at or after shipment/delivery
- ▶ Hiring, training or supervising unless connected to sales
- ▶ Approving or accepting orders
- ▶ Collecting current or past due accounts
- ▶ Collecting deposits on sales
- ▶ Conducting training or making presentations to clients for other than sales
- ▶ Performing credit checks

Some activities that generally don't create nexus

- ▶ Passing along orders, inquiries and complaints to the home office
- ▶ Checking customer inventory without a charge thereafter
- ▶ Recruiting, evaluating or training sales staff including occasional use of homes, hotels and similar places for sales personnel meetings

Always check state and local law before assuming that nexus doesn't apply, and when in doubt, confer with your tax advisor



Resident

- ▶ Provided the employer is doing business in the state (i.e., established nexus), resident income tax withholding is generally required on all wages paid to the employee regardless of the state where the wages were earned
- ▶ Employers may [courtesy withhold](#) in the absence of nexus
- ▶ States have differing rules about whether a credit is allowed against resident income tax withholding for income taxes withheld in other states



Nonresident

- ▶ In general, nonresident income tax withholding applies to all wages that are earned for work performed in the nonresident state ([exceptions apply](#))
- ▶ There are [federal exceptions](#) which prohibit the withholding of nonresident income tax under certain circumstances

Courtesy resident income tax withholding

- ▶ Some employers withhold resident income tax even in the absence of nexus
- ▶ If you do courtesy withhold, you are responsible for making timely deposits with the taxing authorities and are liable for underpayments and subject to penalty for late payments
- ▶ Courtesy withholding helps employees avoid large, unexpected tax balances when they file their income tax returns
 - ▶ Employees take for granted that income tax is withheld from their wages, so if you will not courtesy withhold be sure to notify employees in writing at the time of hire or relocation

2017 EY/Bloomberg Multistate Payroll Tax Compliance Survey

Courtesy withholding

Do you provide state courtesy withholding for your employees?



Yes	46%
No	33%
For some	21%

Overall results were generally matched by employers large and small in all industries

- ▶ Because income tax withholding can send a false nexus flag to taxing authorities, businesses that courtesy withhold are sometimes erroneously assessed unemployment insurance and other business taxes
- ▶ Take action to reduce risk:
 - ✓ Consult your tax advisor when registering a new income tax withholding account
 - ✓ If not clear on the business registration form, call or write the taxing authority bringing to their attention that nexus does not apply
 - ✓ Monitor new tax accounts closely for incorrect business tax assessments and respond promptly to any agency notices
 - ✓ Confirm that you are paying unemployment insurance to the correct states and make a prompt claim for refund where overpayments are discovered



Identifying work and resident locations of employees



Why does the teleworker's physical location matter?

If an employee works from home on more than an occasional basis, the physical location of the telework must generally be treated just as any place of business of the employer. This has significant implications for employers if the requirements of the teleworker's state/locality are ignored.

State/local wage and employment considerations

- Minimum wage
- Frequency of pay
- Overtime pay
- Timing for final wages
- Payment of accrued vacation
- Requirement for unpaid leave
- Requirement for paid leave
- Limitations on deductions from pay
- Direct deposit/pay cards
- Employee notices/posters
- Workers' compensation
- Other employment considerations
- Workplace health and safety considerations
- Pay equity considerations

State/local payroll taxes and business taxes

- State income/withholding
- Local tax/withholding
- Local occupational license fees
- New hire reporting
- State unemployment insurance
- Disability insurance
- Paid family and medical leave insurance
- Other state/local payroll tax
- Corporate income tax
- Corporate franchise tax
- LLC/partnership income tax
- Sales and use tax

Potential risks

- Backpay awards, settlements and legal fees
- Tax penalty and interest
- Loss of employee morale
- Loss of business license
- Loss of business reputation

Home office state vs. employer's office state: Case study 2023

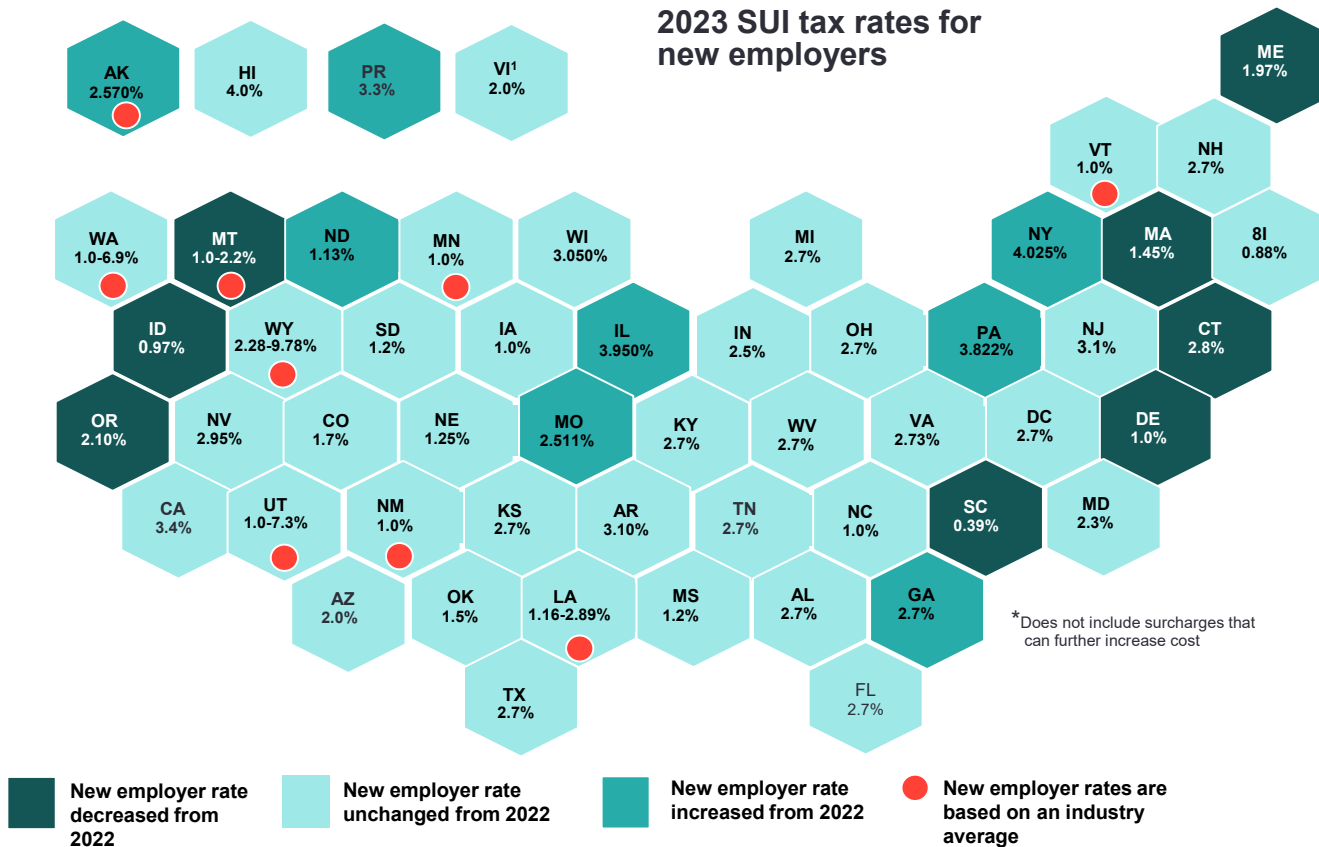


In this example, failure of the employer to recognize the physical location of the teleworker in Oregon would result in numerous risks, including the failure to withhold and pay various Oregon state and local taxes.

State/local requirements	Teleworker home Oregon	Employer office Texas
State minimum wage	\$14.20	\$7.25
SUI wage base	\$50,900	\$9,000
SUI tax rate	2.1% (new employer)	0.23% (experience rate)
State income tax	Yes	No
State transit tax	Yes	No
Local transit tax /income tax	Yes	No
Workers' compensation insurance tax	Yes	No
Paid family and medical leave insurance tax	Yes	No

Setting up a teleworker in a new state could mean higher SUI taxes*

Keep in mind that if a teleworker is operating in a state where the employer doesn't currently have employment, the employer is assigned the new employer rate for a few years, which may be higher than the employer's experience rate in those states where it currently operates



Multistate tax implications for hybrid teleworkers



Multistate payroll tax challenges for hybrid teleworkers



01 Sourcing wages to the correct jurisdictions

To which jurisdictions do income tax and unemployment insurance apply? Pursuant to state income tax, does a reciprocal agreement apply?

02 Convenience of the employer rule

Does the state/locality where the employee reports impose the convenience of the employer rule?

03 De minimis exceptions

When the employee works in the state or locality for short periods, does nonresident income tax apply?

04 Apportionment

For #03, how is the portion of taxable wages that is sourced to the nonresident state apportioned for income tax and withholding purposes?

05 Trailing compensation

Does the state require income tax based on where wages were earned for compensation that accrues over more than one payroll period?

06 Resident and nonresident income tax withholding

Does the resident state allow for reduction of income tax withholding for income tax withheld in the nonresident state? What employee withholding certificates are required?

Sourcing for unemployment insurance and similar taxes

Employer

- Where wages are paid
and
- There is a covered employee

Covered employee

- Applies only in one state at a time
- Temporary work incidental to the main job location is not considered

The SUI state is where the employee performs some work, and (in this order):

- Where the work is localized
- The employee's base of operations
- or**
- The employee's place of control
- _____
- If none of the above:
 - The employee's residence

(US Department of Labor, [Program Letter 20-04](#))



Sourcing for unemployment insurance and similar taxes, *example*

Employer

- Headquarters office is in New York
- Employment and employees are SUI covered in all states

Employee

- Works across two states, Texas and Louisiana
- Home office is in Texas
- General manager is in New Mexico

The SUI state is where the employee performs some work, and (in this order):

- Where the work is localized (N/A)
- The employee's base of operations (Texas)
or
- The employee's place of control (New Mexico)

- If none of the above:
 - The employee's residence (Texas)

Since work is not localized in one state, and Texas (rather than New York) is the base where the employee normally receives instructions, mail, etc., Texas is the unemployment insurance state.

State income tax reciprocal agreements

- ▶ Some states have entered into reciprocal agreements (usually with bordering states) where nonresident state income tax is not required. Instead, income tax and income tax withholding are required only in the resident state
 - ▶ **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 (usually, a certificate of nonresidence)

States (and District of Columbia) that have entered into reciprocal agreements with some other states

District of
Columbia

Montana

Illinois

New Jersey

Indiana

North Dakota

Iowa

Ohio

Kentucky

Pennsylvania

Maryland

Virginia

Michigan

West Virginia

Minnesota

Wisconsin

Convenience of the employer rule



- In most states, the default rule is that employees who are residents of one state (State A) but work for an employer in another state (State B), are taxed by State B only on wages earned for days the employee is physically present in State B.
- However, if State B has a convenience of the employer rule, a State A resident working from home for his/her own convenience within State A for an employer in State B is subject to State B nonresident income tax for all wages earned in State A and State B despite not being physically present to work in State B.
- Generally, the convenience of the employer rule applies if, for their own convenience, and not the necessity of the employer, employees are performing services from their homes within their resident states, rather than the locations of their employers in nonresident states.
 - New York has a more elaborate “test” as set forth in [TCB-M-06\(5\)I](#).
 - Alabama applies the rule if an employee is working from home outside of Alabama for an Alabama employer (no reference to convenience of employee or necessity of employer).

States that impose the convenience of the employer rule

Arkansas (reversed effective April 30, 2021)
Legal Opinion No. 20200203

Alabama
Alabama Tax Tribunal ruling, March 8, 2023, and May 19, 2023

Connecticut*
Conn. Gen. Stat. Section 12-711(b)(2)(C)

Delaware
Del. Code. Tit. 30, Section 1124(b)(1)(b)

Nebraska
316 Neb. Admin. Code Section 22-003.01C(1)

New York
20 NYCRR Section 132.18(a); Technical Memorandum TSB-M-06(5)I

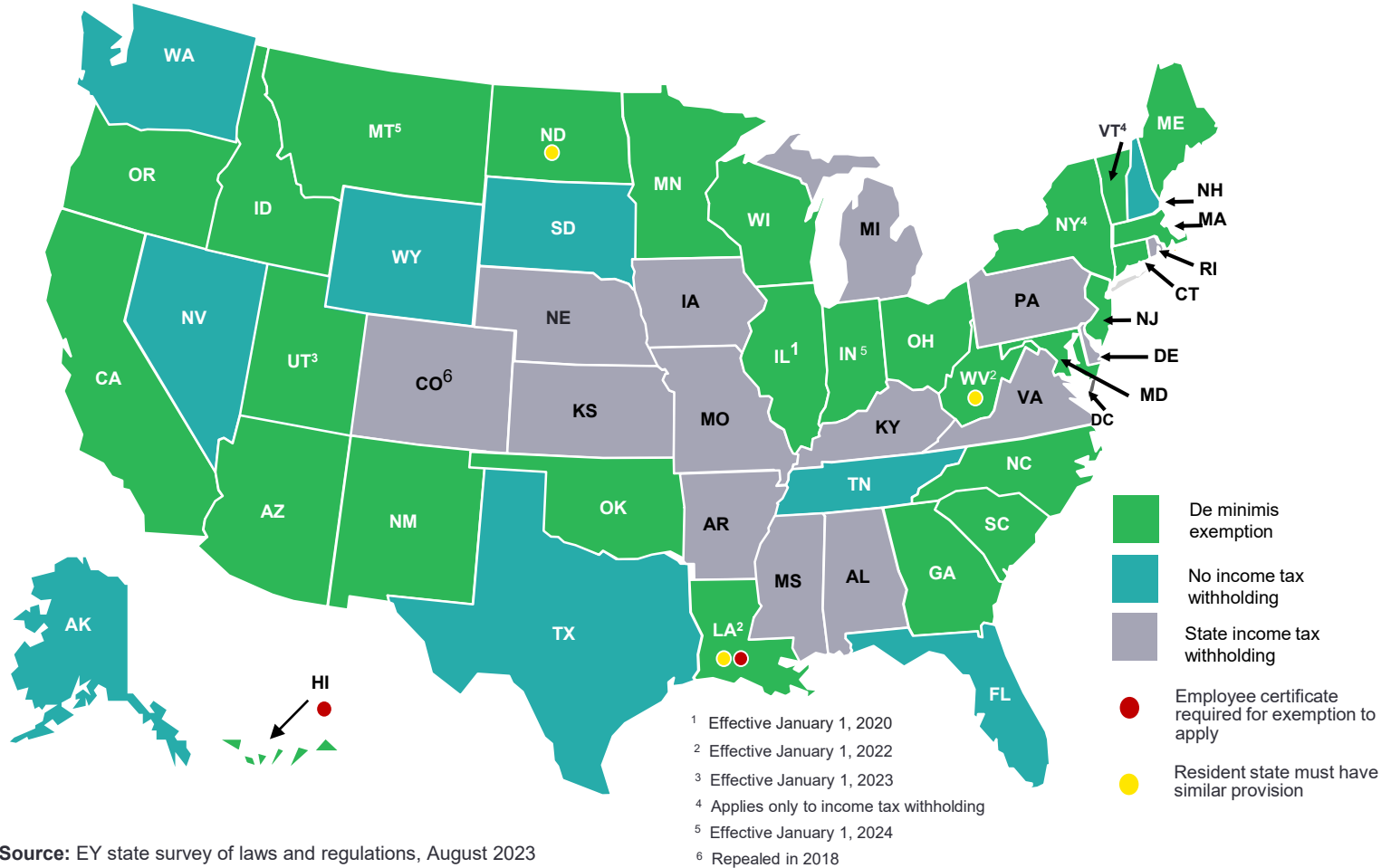
New Jersey*
A.4694 (enacted in 2023, effective 1-1-2023)

Pennsylvania
61 Pa. Code Section 109.8

*Applies only if resident state also imposes the rule.

De minimis exceptions from nonresident income tax requirements

Only 28 states have a de minimis exemption based on days or earnings



Source: EY state survey of laws and regulations, August 2023

Trailing compensation

Sourcing delayed wage payments to the jurisdiction earned

Scenario 1



Result: New York nonresident income tax on bonus. There is no income tax in Nevada.

Scenario 2



Result: New York nonresident income tax and New Jersey resident income tax applies to the bonus.

- In many US states and localities, lump sum payments such as accrued paid time off, severance, equity compensation, and nonqualified deferred compensation must be sourced to the jurisdiction(s) where the compensation was earned for income tax withholding purposes.
- For US state income tax purposes, an exception applies to qualified retirement and to top-heavy plans (Supplemental Executive Retirement Plan (SERP) or nonqualified deferred compensation) that are paid in substantially equal periodic payments over a period of not less than 10 years ([P.L. 104-95](#)).

Payroll tax onboarding



Step 1a: Find employee tax jurisdictions and rates with geocoding

? Why geocoding?

- ▶ Once hired, employees generally must provide certain documents (e.g., federal Form W-4) to substantiate their resident address (state, city, ZIP code)
- ▶ Except for remote workers and those who frequently travel, the address of the work location is generally well documented based on the employee's job position
- ▶ State employment tax and withholding obligations can be easily identified based on the employee's resident address and work location; however, the same is not true of county or city payroll taxes

? What is geocoding?

- ▶ Geocoding is based on a map of tax boundaries, which usually follow the city or county boundaries, but can be more complex than that
- ▶ The taxing authorities and tax rates are then associated with the tax boundary, and all addresses within that boundary
- ▶ Some taxing authorities give employers free access to their geocoding software in the form of an address lookup tool



Example

The Pennsylvania Department of Community and Economic Development (DCED) provides an [Address Search Application](#) to lookup an employee's Political Subdivision (PSD), Earned Income Tax (EIT) rates and Local Services Tax Rates (LST)

The employer enters the employee's resident and work address, and the tax type, tax rate and local tax administrator information is provided

Find Your Withholding Rates by Address

HOME ADDRESS: Copy From Work	WORK ADDRESS: Copy From Home
Street Address: <input type="text"/>	Street Address: <input type="text"/>
City: <input type="text"/>	City: <input type="text"/>
State: PA	State: PA
Zip: <input type="text"/> - <input type="text"/>	Zip: <input type="text"/> - <input type="text"/>



Issues

- ▶ Not efficient for high-volume of new hires in multiple jurisdictions
- ▶ Not efficient for audits of entire workforce
- ▶ Supporting documents can be cumbersome to extract and retain

Step 1b: Batch geocoding software

? What is batch geocoding?

- ▶ Batch geocoding stores all US state and local payroll tax boundary information in a central database which provides users with various capabilities including:
 - ▶ Queries of the data
 - ▶ One-off lookups for new hires
 - ▶ Upload capability for address information for entire workforce, or a segment, and receive back all state and local payroll tax types and rates by employee

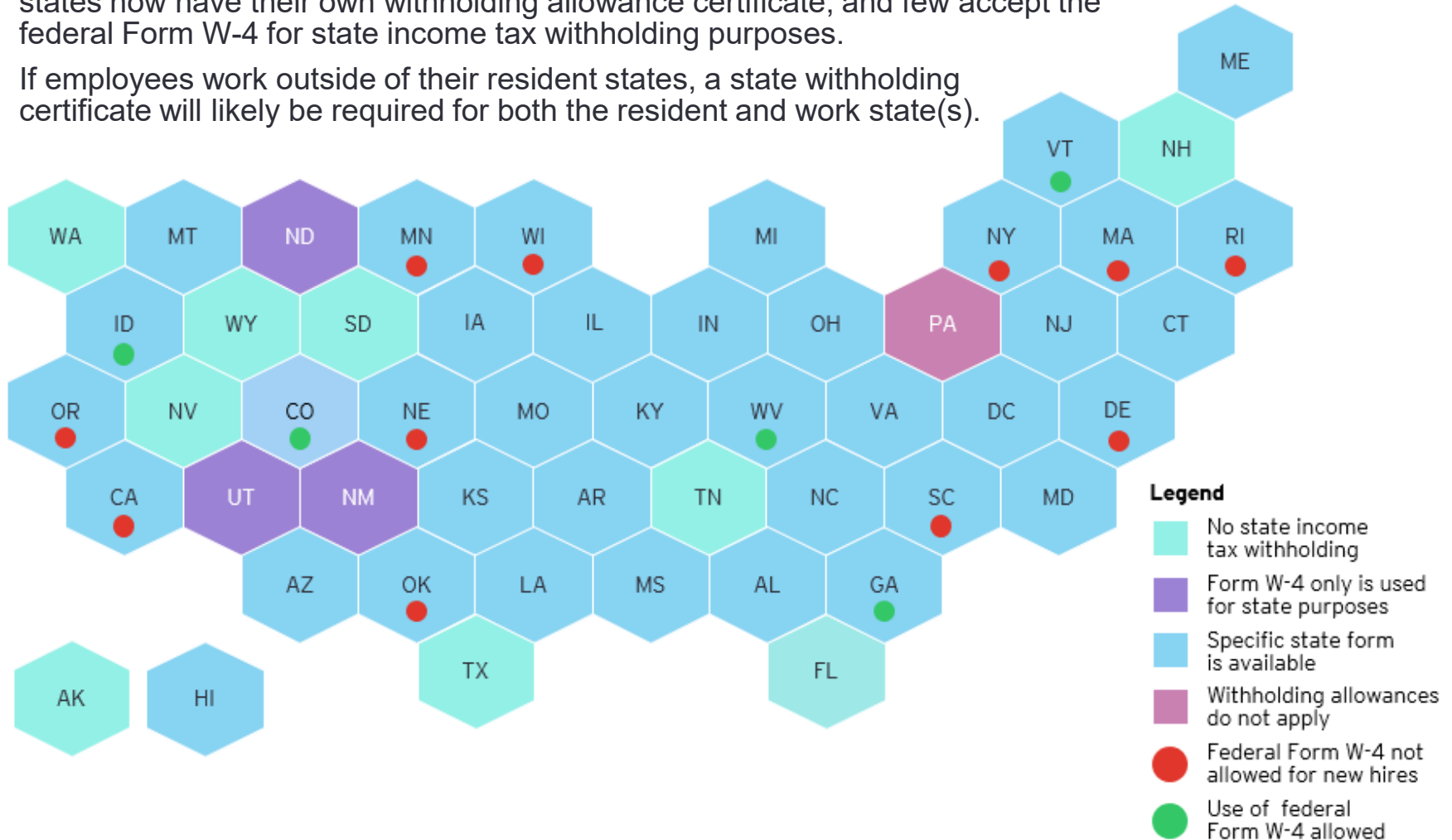
? What are the benefits?

- ▶ Reduced errors because employee address information can be exported from your HR system for upload to the database
- ▶ Reports are created online making for more efficient tax recordkeeping
- ▶ Payroll tax information is available in one place for most all US addresses
- ▶ Audits of employee tax setups can be conducted quickly and efficiently



Step 2: State withholding certificate compliance

- ▶ Particularly since the enactment of the federal Tax Cuts and Jobs Act, many states now have their own withholding allowance certificate, and few accept the federal Form W-4 for state income tax withholding purposes.
- ▶ If employees work outside of their resident states, a state withholding certificate will likely be required for both the resident and work state(s).

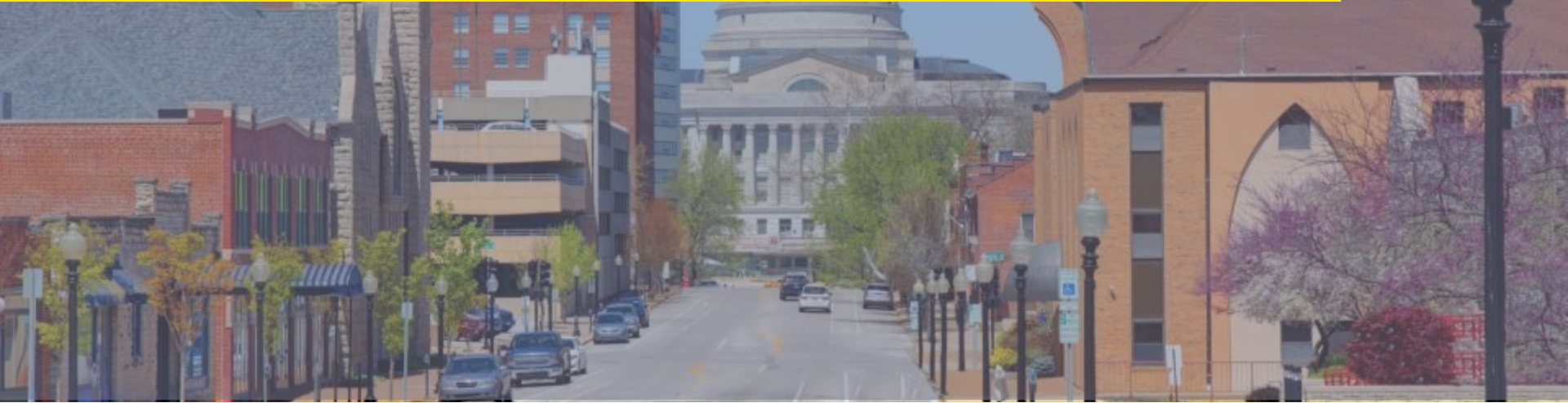


Step 2: State withholding certificate compliance, *continued*

In addition to the regular withholding certificate, most states also have other certificates that are required in connection with resident/nonresident income tax withholding. It is important to be familiar with each state's unique requirements, even if you rely on a forms vendor to handle this process. Below are some of the various income tax withholding certificates states require

- 1 Regular state withholding certificate
- 2 Certificate of nonresidence (generally for reciprocal agreements)
- 3 Certificate of exemption
- 4 Certificate of exemption (native American)
- 5 Certificate of exemption (military spouse)
- 6 US nonresident alien

Missouri case in point



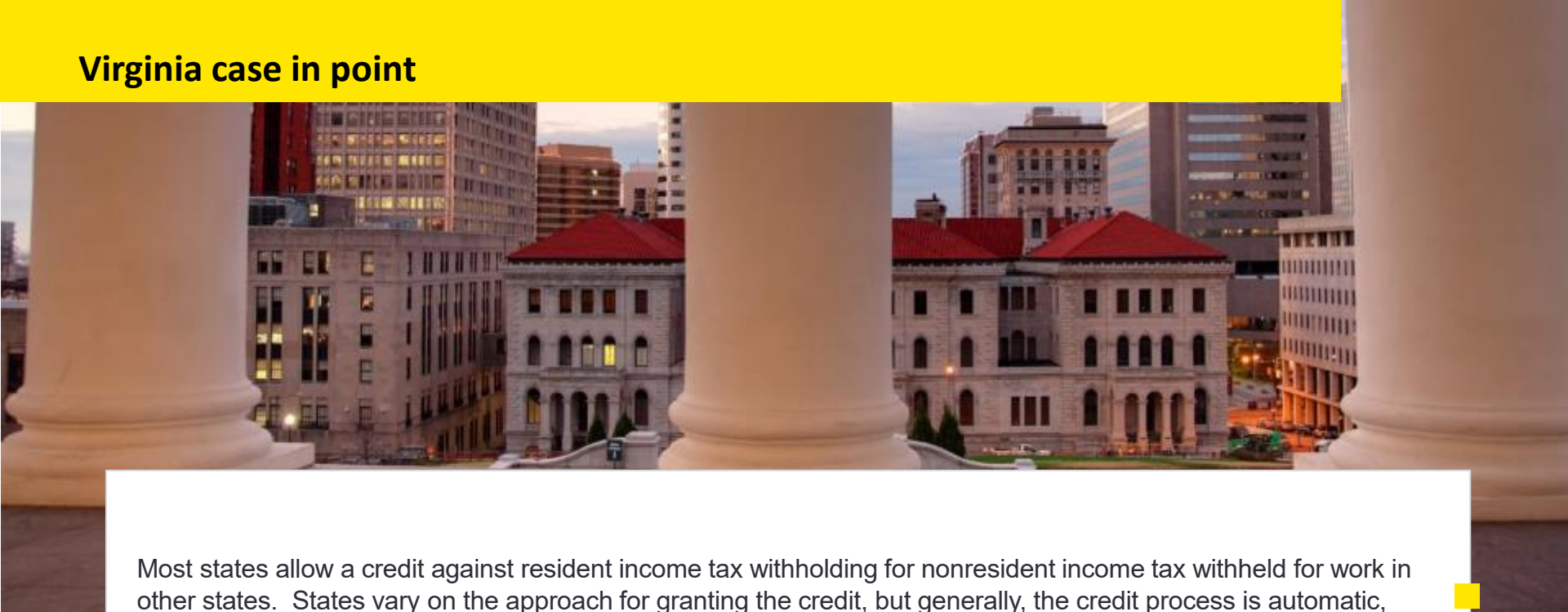
It is a general rule of thumb that nonresident income tax applies only to those wages paid for services provided in the nonresident state. The provision is automatic, meaning the employee does not need to file a special form to prevent withholding on all earned wages, regardless of where services are performed.

The following standard exceptions apply:

- **Reciprocal agreements.** Where there is a reciprocal agreement between the nonresident and resident states, nonresident income tax withholding is not required provided the employee files a certificate of nonresidence.
- **Convenience of the employer rule.** Some states require nonresident income tax withholding on all wages, regardless of where the services were performed, if the employee's out-of-state work is for the employee's own convenience rather than the necessity of the employer.
- **De minimis exception.** Twenty-eight states do not require nonresident income tax withholding for short stays and/or low annual earnings

Missouri tax law (which contains none of the above standard exceptions), if a nonresident performs services partly within and partly without the state, only wages paid for services performed within Missouri are subject to Missouri income tax withholding, provided the employee files with the employer a [Form MO W-4A, Certificate of Nonresidence or Allocation of Withholding Tax](#). (2023 State of Missouri Employer's Tax Guide, p. 4.)

Virginia case in point



Most states allow a credit against resident income tax withholding for nonresident income tax withheld for work in other states. States vary on the approach for granting the credit, but generally, the credit process is automatic, meaning the employee does not need to file a special form to obtain the credit against resident income tax withholding..

Under Virginia tax law, employers may reduce resident income tax withholding for income tax withheld in nonresident states, but only if the employee submits a [Form VA-4B](#), *Virginia Employee's Credit For Income Tax Paid To Another State*.

Form W-4 vendor selection

System requirements (sample)*

Form W-4 requirement	Vendor 1	Vendor 2
Employee can opt of electronic filing (print blank form option)	●	●
Employee can print forms after completing online	●	●
Employee lock-out feature if federal/state/local lock-in letter on file	●	●
Employee prompted with state form when federal form is changed		●
Employee must use state/local form where Form W-4 not allowed		●
All special state withholding certificates are present in the system		
Employee is automatically presented with required state/local forms based on resident and work state address		
System customizes federal and state Form W-4 options and prompts to comply with US nonresident alien requirements		●

* Note that EY maintains much of the state research needed to confirm compliance.

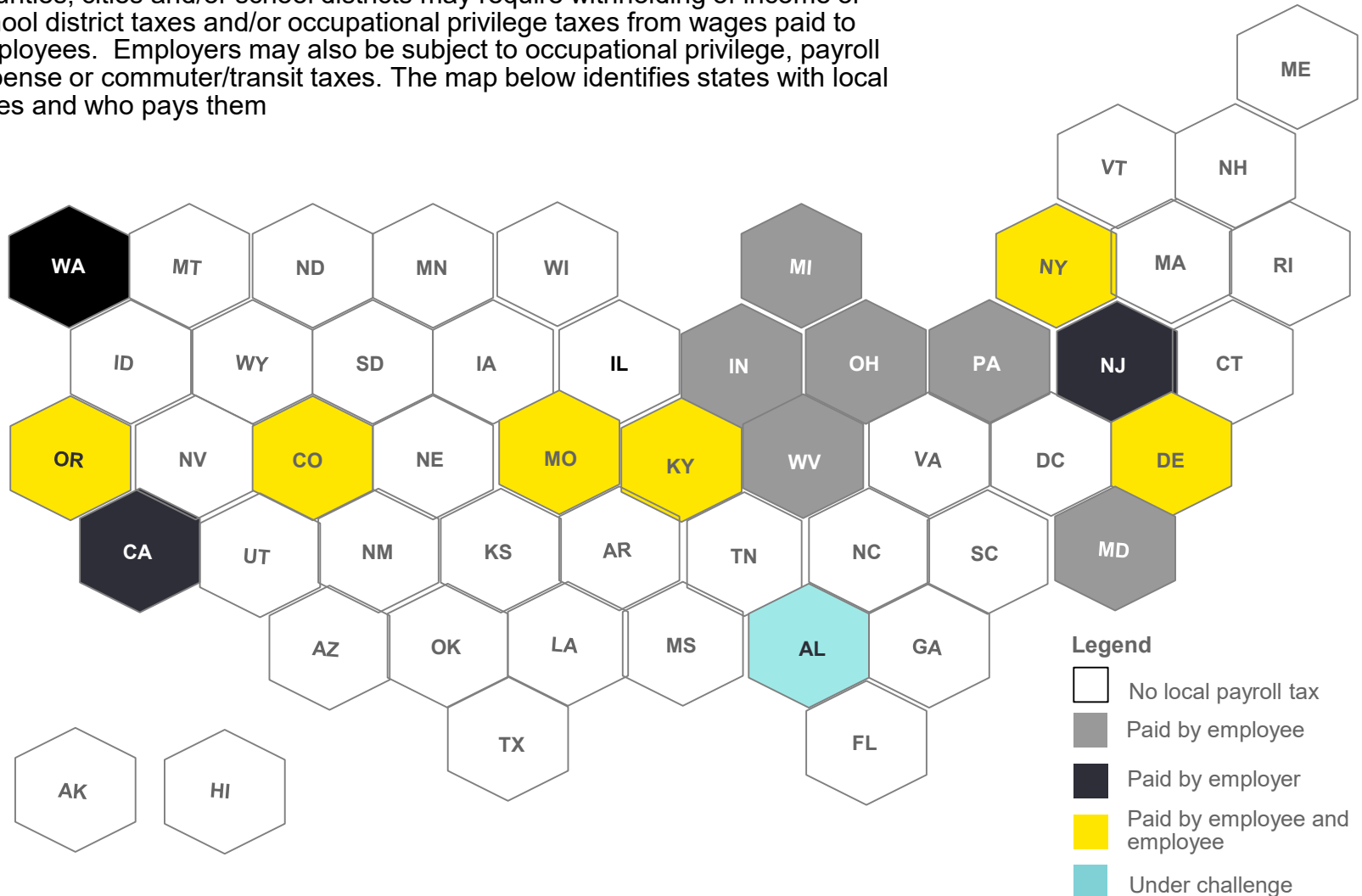
Form W-4 vendor selection

System requirements (sample), *continued*

Form W-4 requirement	Vendor 1	Vendor 2
All fields/instructions on the official federal Form W-4 are present		●
All fields/instructions on state and local forms are present	●	●
Employee is prevented from claiming exempt where not allowed under state/local law	●	●
Employer report is available of employees required to provide a new form in the next year (e.g., claimed exempt on federal Form W-4)		●
Employer report is available of state/local form copies that must be filed with the states/locals (e.g., when allowances over a maximum are claimed)		●
System is timely updated to reflect updates to federal, state and local forms	●	●
System stores history of form changes for the requisite federal, state and local minimum recordkeeping requirements	●	
Overall assessment	7	12

Step 3: Local tax withholding certificates

Counties, cities and/or school districts may require withholding of income or school district taxes and/or occupational privilege taxes from wages paid to employees. Employers may also be subject to occupational privilege, payroll expense or commuter/transit taxes. The map below identifies states with local taxes and who pays them



Step 3: Local withholding certificate compliance: Sample list

State	Local tax type	Employee withholding certificate required
Alabama	Occupation tax	No
Colorado	Occupational Privilege Tax	No
Indiana	County income tax	Yes, state Form WH-4 is used
Kentucky	Occupational License Fee	No
New York	New York City and Yonkers income tax	Yes, state Form IT-2104 and Form IT-2104-1 , <i>New York State, City of New York and City of Yonkers Certificate of Nonresidence and Allocation of Withholding Tax</i> are used
New York	New York/New Jersey Waterfront Payroll Tax	N/A. This is an employer tax
Ohio	Municipal Income Tax	No
Ohio	School District Tax	Yes, use state Form IT-4
Maryland	County Income Tax	Yes, state Form MW507 is used
Pennsylvania	Earned Income Tax (EIT)	Yes , the Residency Certification Form
Pennsylvania	Local Services Tax (LST)	Yes, the Residency Certification Form and the Local Services Tax Exemption Certificate
Pennsylvania, Philadelphia	Earnings Tax	Yes , the Residency Certification Form
Pennsylvania, Philadelphia	Wage Tax	Yes , the Residency Certification Form

Taxable wage definition conformity to federal by states and locals

Sample work locations

State	State income tax wage definition conforms to federal income tax	State authority	Local tax wage definition conforms to state income tax	Local tax wage definition is uniform
Delaware	Yes	Del. Code Ann. 30 § 1101	No	N/A (only one local taxing jurisdiction)
Indiana	Yes	Ind. Code § 6-3-1-11	Yes	Yes
Kansas	Yes	Kan. Stat. Ann. § 79-32,109(a)(1)	Yes	Yes
Kentucky	Yes	Ky. Rev. Stat. Ann. § 141.010(3)	No	Yes
Missouri	Yes	Mo. Rev. Stat. § 143.091	Yes	Yes
New York	Yes	N.Y. Tax Law § 612(a)	Yes	Yes
Ohio (Local school district taxes)	Yes	Ohio Rev. Code Ann. § 5701.11(B)(1)	Yes	Yes
Ohio (Municipal income tax)	Yes	Ohio Rev. Code Ann. § 5701	No (definition follows federal Medicare wages with exceptions)	Yes
Pennsylvania (EIT, LST)	No	Pa. Stat. Ann. 72 § 7301	No (except for Philadelphia)	Yes (except for Philadelphia)

Step 4: Tax registration and change forms

1

At time of hire

If state or local tax accounts have not been opened for the employee's resident or work location, register with the required state and local agencies **BEFORE THE FIRST WAGE PAYMENT**.

Use geocoding technology to identify all applicable taxing jurisdictions (or ask your tax advisor for assistance).

Remember that state unemployment insurance applies only in one state where most of the work will be performed.

2

Change in residence or work location

As soon as you are aware of a change in residence or work location, verify if new state or local tax accounts need to be opened, and if so, register **BEFORE THE NEXT WAGE PAYMENT**.

Consider using an automated survey technology that queries employees periodically about their resident and work location(s).

Consider asking for driver's license or utility bills to confirm resident location.

3

Change in business status

Whenever you are no longer collecting or paying taxes for a taxing authority you must notify the agency of the account closure.

You also must notify taxing authorities if there has been a change in business ownership (and sometimes change in responsible party).

Most taxing authorities have forms for these purposes.

4

Recurring self audit

At least quarterly, create a list of all resident and work location states and locals from the HR system against the state and local returns filed and tax payments made to identify accounts that need to be opened or closed. Geocoding technology can assist with this process.

Confirm that the state for unemployment insurance is properly assigned to the employee.

Tax registration case in point



- ▶ In a 2023 ruling by the Alabama Tax Tribunal, an employee working from his home in Idaho for an Alabama employer was assessed Alabama income tax for work performed in Idaho
- ▶ The tax deficiency was identified by the Alabama Department of Revenue because the employer reported all wages for services within Alabama and Idaho on the 2020 Alabama Form W-2
- ▶ When the employee requested a corrected Alabama Form W-2 and an Idaho Form W-2, he was told that the employer could not issue an Idaho Form W-2 because they “had no business operations there”
- ▶ In fact, because the employee was working from a home office in Idaho, registration with the Idaho Department of Revenue was necessary, and an Idaho Form W-2 required, without regard to the Alabama withholding and Form W-2 reporting requirements
- ▶ Further, nothing in the Alabama withholding regulations specifically required that wages for services performed outside of Alabama by an Alabama nonresident be subject to Alabama income tax withholding (or Alabama Form W-2 reporting)
- ▶ The Tax Tribunal ruling in this case has implications now for all remote workers providing services outside of Alabama (unless, and until the ruling is overturned)

When employees notify employer of change in residence after close of the tax year



It is not uncommon that employees notify employers of a change in residence only after they receive a Form W-2. When this occurs, these are steps to take:

- ▶ Require that employee provide copies of utility bills from the first month they changed their state of residence
- ▶ Require the employee provide a copy of his/her driver's license
- ▶ Require the employee complete any new state withholding certificate for the current state/locality of residence
- ▶ Issue a Form W-2 showing wages paid in the correct state of residence
- ▶ Issue a Form W-2c reducing taxable wages in the incorrect state for the period the employee was resident in a new state.
 - ▶ Note that state income tax withholding cannot be adjusted. Instead, the employee will need to file for a refund based on the Form W-2c you provide, and pay taxes based on the Form W-2 you provide for the new state
- ▶ Be aware that you are technically liable for state income tax you failed to withhold in the new state of residence. Keep documentation of the employee's latest communication concerning the change in residence in the event of an audit
- ▶ Always send communications no later than December 1 of each year asking employees to confirm that their address information is correct
- ▶ Employee surveys of resident and work locations should be performed throughout the year, at least quarterly

Teleworker tax legislation and legal challenges



2023 legislative and administrative actions to address hybrid employee income tax policies



Court cases

- **Alabama, state income tax.** On March 8, 2023, the Alabama Tax Tribunal upheld an Alabama Department of Revenue assessment of income tax on the wages that a remote worker earned from his Alabama employer while working from his home office in Idaho (convenience of the employer rule). ([Mark E. Bollinger v. State of Ala. Dep't of Rev., Inc. 22-390-LP](#)) A similar ruling was made by the tribunal on May 19, 2023, involving a Florida employee working remotely for an Alabama employer. ([Michael J. Baty v State of Ala Dep't of Rev, Inc. 22-928-LP](#))
- **Missouri, St. Louis earnings tax.** In a January 2023 decision ([Boles v. City of St. Louis: Cause No. 2122-CC00713](#)), the trial court agreed that employees working for a St. Louis employer outside of St. Louis during the COVID-19 emergency were owed refunds of the earnings tax for 2020 and beyond. The Missouri Supreme Court declined to rule on whether affected taxpayers can file a class action; therefore, the question remains whether individuals will have to file separate lawsuits to claim refunds.



State legislation

- **Indiana [SB 419](#).** Effective January 1, 2024, exempts from Indiana source income compensation received by nonresident employees for services they provide within Indiana for 30 days or less during the calendar year.
- **Montana [H.B.447](#).** Effective January 1, 2024, exempts from Montana source income compensation received by nonresident employees for services they provide within Montana for 30 days or less during the calendar year. Key employees with annual compensation of more than \$500,000 are excluded from the provision.
- **New Jersey [A.4694](#).** Effective January 1, 2023, imposes the convenience of the employer rule if the nonresident employee's resident state imposes a similar rule.

Guidance on New Jersey's convenience of the employer rule

- The New Jersey Division of Taxation (Division) has issued [initial guidance](#) explaining the following:
 - Penalties and interest will not apply until September 15, 2023.
 - In determining states that have a “similar rule” (triggering states), Pennsylvania is not included due to the reciprocal agreement between the states and Connecticut is also excluded because its rule is also triggered only if the resident state has a similar rule.
 - Employers should apply the rules of the resident state (triggering state) in determining when the convenience of the employer rule applies.
 - For example, a New York resident who, for his own convenience, performs services in his New York home for a New Jersey employer, is subject to New York's test in determining whether the convenience of the employer rule will apply to the New Jersey nonresident.

2023 withholding guidance

- Because New Jersey's convenience of the employer rule is effective retroactive to January 1, 2023, the Division instructs that employers must begin withholding (or individuals begin making estimated tax payments) as soon as possible so that taxpayers will have the correct amount of New Jersey income tax paid by April 15, 2024.
- The Division also suggests that as an accommodation to their employees, employers should consider making withholding adjustments so that their employees will have the correct New Jersey income tax withheld from their wages.



New Jersey's convenience of the employer rule: next steps



1 Identify

Identify New Jersey nonresidents working from home for a New Jersey office



2 Determine applicability

Determine whether the New Jersey nonresidents are residents of a triggering state



3 Analyze

Analyze the convenience of the employer test of each nonresident's resident state to determine whether New Jersey's convenience of the employer rule will apply

4 Compute tax

Where New Jersey's convenience of the employer rule applies, determine the 2023 withholding adjustment



5 Communicate

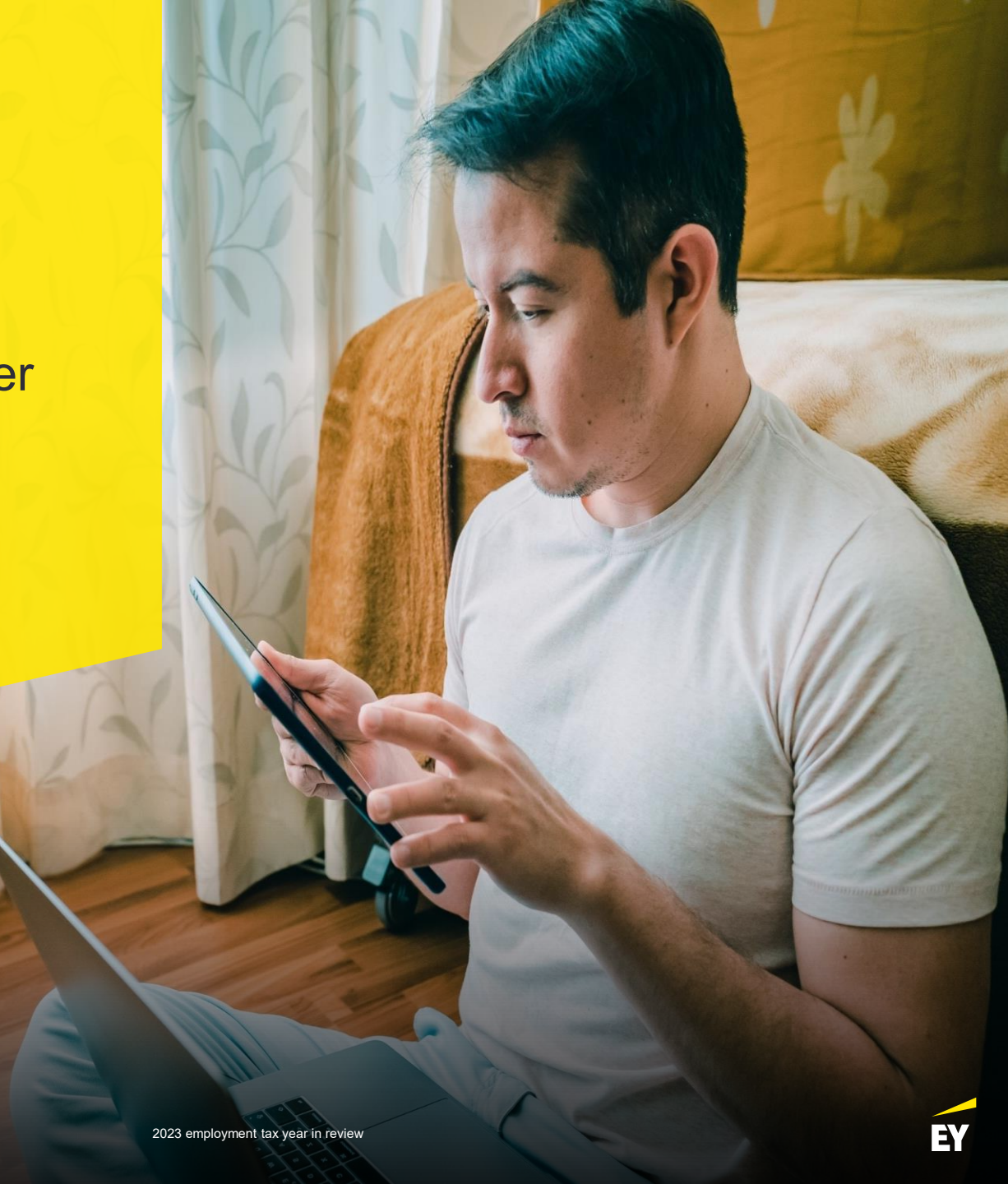
Communicate to affected employees the additional withholding required and why



6 Withhold tax

Deduct the withholding adjustment from future 2023 wages or make other arrangements for payment of the added New Jersey state income tax

Evaluating and managing teleworker arrangements



Telework: Considering potential cost and benefits



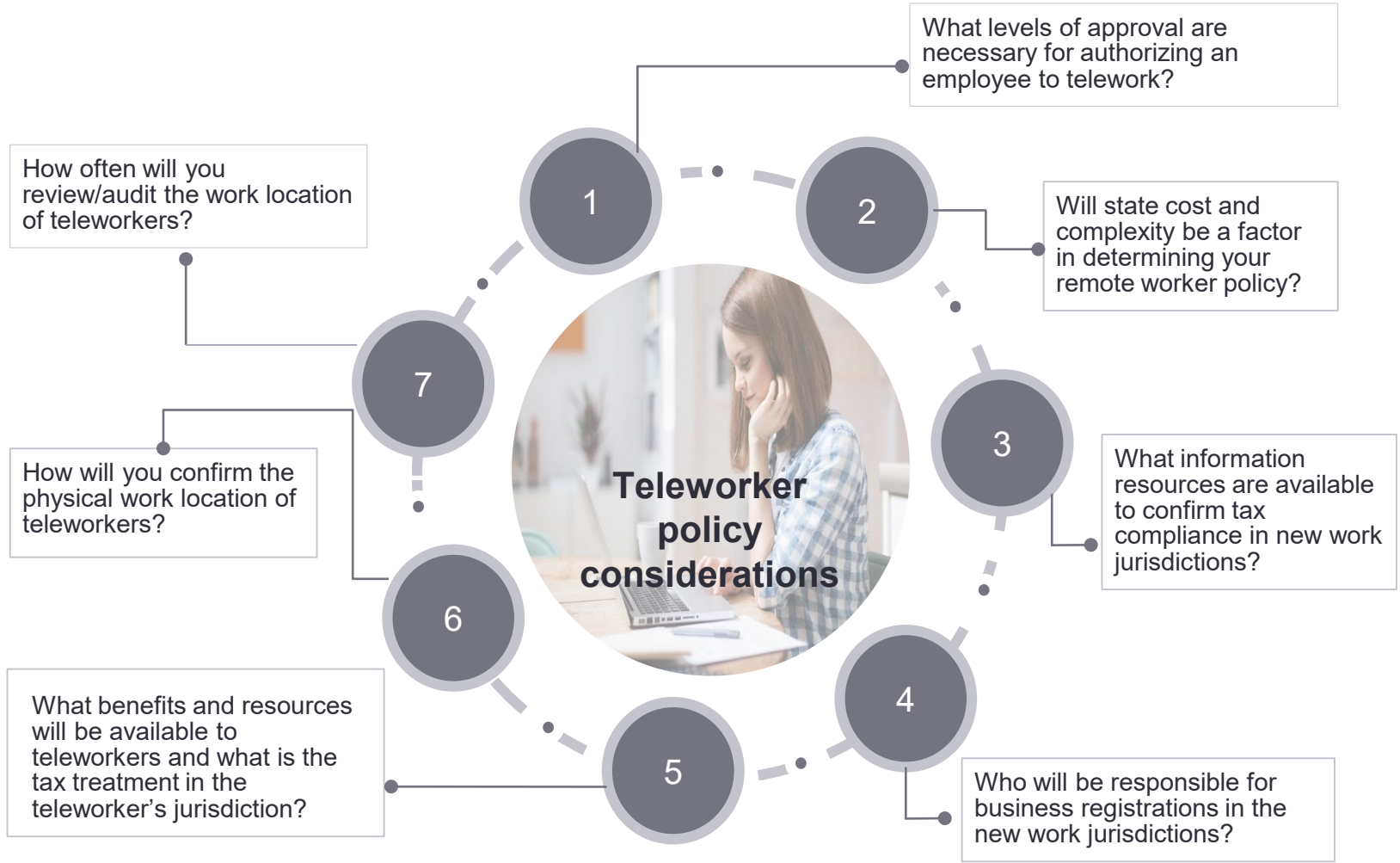
Potential benefits

- Attract more talent
- Potential to hire outside of limited geographic region
- Improve employee satisfaction
- Lower facility costs

Potential cost/risk

- Employer-paid payroll taxes
- Mandatory compensation/benefits
- State/local audit activity
- Potential for increased HR and employment tax complexity
- Potential for Increased payroll service charges
- Business taxes

Teleworker tax policy considerations



Form W-2 reporting considerations



Form W-2 considerations

Truncation of the SSN on Form W-2



- ▶ The IRS issued final regulations that give employers the option of truncating the SSN on copies of Forms W-2 and W-2c provided to employees effective with information statements required to be furnished after December 31, 2020. ([T.D. 9861](#); [REG-105004-16](#).)
- ▶ Truncation is allowed only on forms provided to employees and not on copies filed with the IRS or SSA.
- ▶ The formatting of the truncated SSN is shown in this example:
XXX-XX-1234 or ***-**-1234
- ▶ Truncation of the SSN is not required on statements that insurance companies are required to provide to employers (due by January 15) detailing third-party sick payments for the prior year.
- ▶ Some states may still require the full SSN to be furnished on state copies of Forms W-2 provided to employees.

Form W-2 considerations, *continued*

Threshold for filing Forms W-2/1099 electronically



- ▶ The Taxpayer First Act ([Pub. Law No. 116-25](#)) lowers the threshold for the mandatory electronic filing of information returns (Forms W-2 and the 1099 series).
- ▶ Under [amended regulations](#), the 250-return threshold is lowered to 10 or more of all returns (Form W-2 series, Form 1099 series, ACA returns, etc.) effective for tax year 2023 filed in 2024.
 - ▶ This means that filers must combine almost all information return types to determine if electronic filing is required.
- ▶ A waiver from this lower electronic filing threshold applies to areas without internet access.
- ▶ For larger employers, the lower electronic filing thresholds could affect the way Forms W-2c are filed. For instance, currently up to 250 Forms W-2c can be filed on paper. Now, only one Form W-2c must be filed electronically if the combined information returns exceed 10 for the tax year
- ▶ Note that many states have conformed (or will conform) to the federal electronic filing threshold.

Form W-2 considerations, *continued*

Reporting of nonemployee compensation (Form 1099-NEC)



- ▶ Effective with tax year 2020 (filed in 2021) the IRS requires [Form 1099-NEC](#) to be used to report nonemployee compensation.
- ▶ Form 1099-NEC must be furnished to payees and filed with the IRS by January 31.
- ▶ Effective for tax year 2021, the Form 1099-NEC is included in the federal/state combined reporting program.
- ▶ Form 1099-NEC resolves the issue of the differing filing due dates for wages reported on Forms W-2 and the due date for Forms 1099-MISC for other than nonemployee compensation.
 - ▶ Through tax year 2019, Forms 1099-MISC generally had to be filed by March 31 (February 28 if filed on paper); however, Forms 1099-MISC reporting nonemployee compensation had to be filed by January 31, the same due date that applies to Forms W-2.
- ▶ Forms 1099-MISC continues to be used to report wages subject to federal income tax paid after the employee's death.

Form W-2 considerations, *continued*

A Form W-2c is not required for de minimis errors, but only if the employee requests the waiver.

Employee waiver applies to de minimis errors

- ▶ Dollar error no more than \$100
- ▶ Withholding tax error no more than \$25

For more information see [Notice 2017-09](#)

Employee must provide consent to employer that includes:

- ▶ Clear statement of employee's election
- ▶ Employee name, address, SSN
- ▶ If desired, tax year the election applies
- ▶ If desired, type of statement (e.g., W-2)
- ▶ Consent methods can be phone, mail, email, online (but online cannot be the only method available)

Other requirements:

- ▶ Form W-2c is required within 30 days of employee revocation of consent
 - ▶ Employers may issue Form W-2c even if employee provided a waiver consent
- ▶ Employee waiver consent must be retained for the statute of limitations




Claiming federal employment tax credits retroactively

Claiming federal employment tax credits retroactively

- If an employer was eligible for federal employment tax credits but failed to claim them in the appropriate tax quarter, the tax credits may be claimed retroactively using Form 941-X (or the comparable corrected return) for up to the statute of limitations.
- Federal employment tax credits that can be claimed retroactively include:
 - COVID-19 paid leave credits (expired September 30, 2021)
 - Paid family and medical leave credit under IRC [Section 45S](#) (expires December 31, 2025)
 - Employee Retention Tax Credit (expired September 30, 2021)
 - [Disaster zone \(DZ\) credit](#)
 - 2018, 2019 and 2020
- Employers cannot use Form 941-X to retroactively claim the deferral of employer Social Security tax that applied for covered wages paid from March 27, 2020, to December 31, 2020.
- **The IRS announced that it has placed a moratorium on the processing of new Employee Retention Tax Credit claims through the end of December 2023 out of concern for improperly-filed claims and third-party scams and improper marketing. (See *EY Tax Alert* [2023-1561](#).)**

Claiming federal employment tax credits retroactively, *continued*

The statute of limitations for filing Form 941-X is generally three years from April 15 following the tax year of the original Form W-2.



Tax year	Deadline for filing Form 941-X
2018	April 15, 2022
2019	April 15, 2023
2020	April 15, 2024
2021	April 15, 2025
2022	April 15, 2026
2023	April 15, 2027
2024	April 15, 2028

Year-end reporting considerations



Year-end payroll tax reconciliation steps

DECEMBER

1

Geographic survey

Extract for the tax year a list of employee work and resident locations. Flag the locations where SIT/SUI returns have not been filed and identify/resolve gaps.

2

Income tax withheld

Flag employees with no federal, state or local income tax withheld and confirm that an exemption from income tax withholding is reasonable. Identify appropriate resolution where necessary.

3

Taxable wages

Reconcile year-to-date FIT wages to SIT wages and explain differences; reconcile year-to-date FUTA and SUI taxable wages and explain differences. Differences should reflect only inconsistency in federal/state wage definitions.

4

Wage limits

Confirm that year-to-date Social Security, FUTA and SUI taxable wages do not exceed the annual wage limit; confirm that taxes paid and withheld are correct based on wages times applicable tax rate. Identify appropriate resolution where necessary.

5

Information boxes

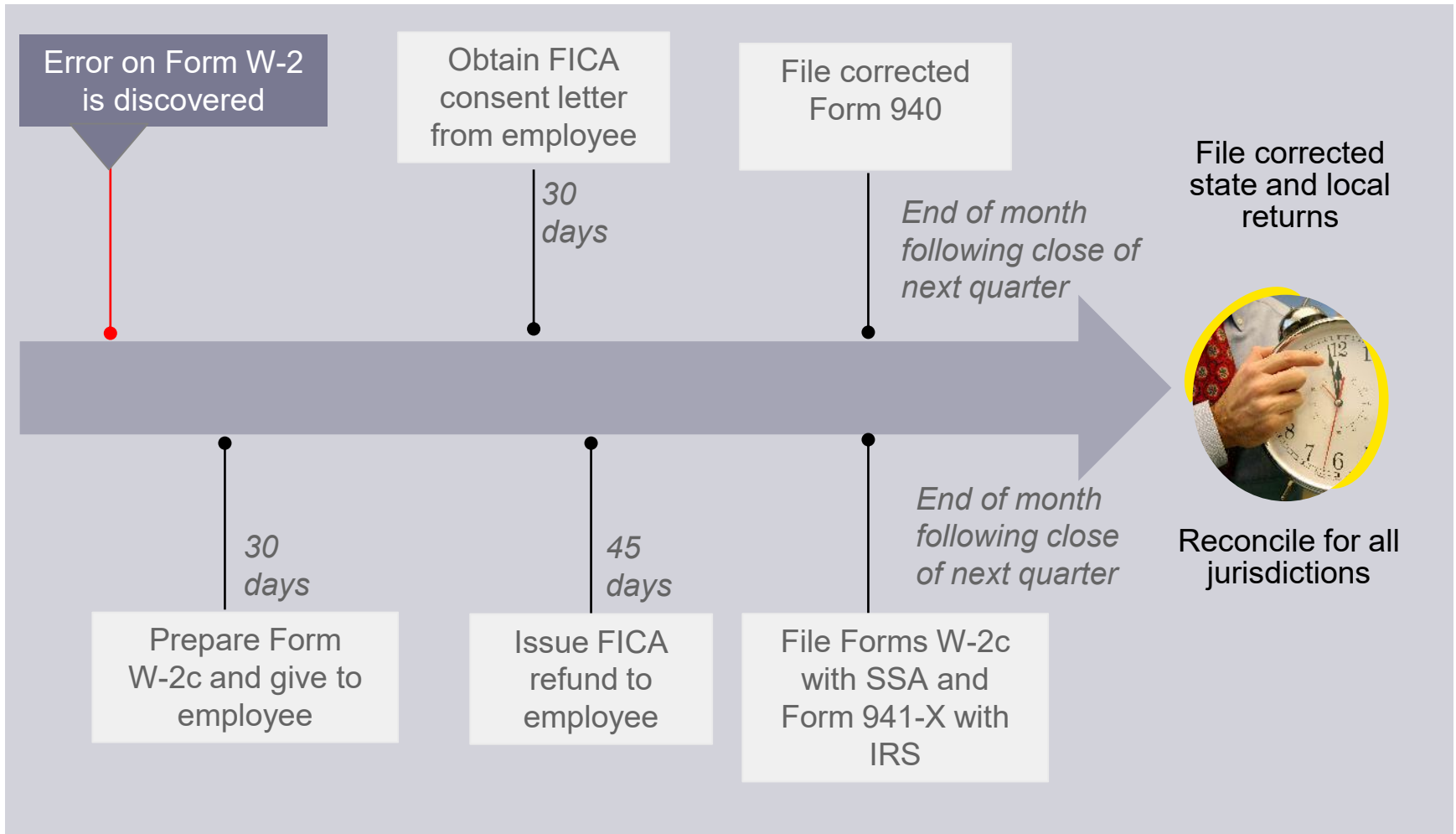
Review earnings and deduction codes to confirm that federal and state Form W-2 information box requirements are correct (e.g., boxes 10, 11, 12 and 14)

Federal Combined Annual Wage Reporting (CAWR) Reconciliation of Forms 941/941-X to Forms W-2/W-2c

The IRS and Social Security Administration compare the reported amounts below. Unresolved discrepancies (positive or negative) can result in a civil penalty equal to 10% of the largest dollar amount (usually, Medicare wages).

W-2 Box	941 Line	Description
2	3	Federal income tax withheld
3	5a	Social Security wages
3	5b	Social Security tips
5	5c	Medicare wages
5	5d	Wages subject to Additional Medicare Tax

Amending employment tax returns: Timeline



1

The special accounting rule/no federal income tax withholding on personal-use auto — employee notices should be provided by January 31, 2023, if the special accounting rule was used in 2022 or, by January 31, 2024, if you will elect not to withhold federal income tax from the value of personal use of company cars in 2024.

2

Charitable contributions — you are required to provide employees with a report of the annual total of charitable contributions paid through payroll deduction. Consider using Form W-2, box 14, for this purpose. See [IRS Publication 1771](#).

3

Earned Income Tax Credit (EITC) — for federal purposes, Form W-2, Copy B, includes the notice that employers are required to provide to employees concerning their eligibility for the Earned Income Tax Credit. Some states and localities require a separate notification (other than Form W-2, Copy B) and may also impose a different annual deadline for making it available to employees.

See more information on the federal EITC [here](#).

1

Expiring Form W-4 — notify employees who claimed exemption from federal income tax withholding in 2023 that they are required to furnish you with a 2023 Form W-4 by February 15, 2024. Verify state rules concerning withholding allowance certificates claiming exemption and include state expiring information on the same employee notice.

2

2024 withholding tax changes — notify employees of any change in the amount of tax they will pay in 2024 for Social Security, Medicare or federal, state and local income tax withholding.

3

Additional Medicare Tax reminder — employees with wages in excess of \$200,000 in 2023 should be reminded of their requirement to file with the IRS [Form 8959](#), *Additional Medicare Tax*.

4

Multistate employees — for employees who worked in more than one state, consider providing a detail of the taxable wages that were paid within each work state. This is particularly relevant for employees working in New York because employers are required to report federal taxable wages (Form W-2, box 1) as state taxable wages (Form W-2, box 16).

For more information on multi-state payroll tax compliance,
see our [special report](#).

Nonqualified deferred compensation (NQDC)

FICA/Additional Medicare tax

- ▶ At time of vesting (**special timing rule**)
- ▶ Increase/decrease in balance not taken into account after vesting (**nonduplication rule**)
- ▶ If not taxed at vesting, taxable on balance in each year of distribution

Federal income tax

- ▶ At time of distribution

Correcting FICA timing errors

- ▶ Special timing rule may be retroactively applied for the statute of limitations (three years)
- ▶ Beyond the statute of limitations, special timing rule no longer available and FICA is computed on ending balance in each year of distribution
- ▶ When computed in year of distribution, taxable up to the Social Security wage base in the year of distribution vs. special timing rule where NQDC likely only subject to Medicare tax

Box 11 reporting

- ▶ Report in box 11 the amount in box 3 and box 5 that was earned in a prior year
- ▶ Report in box 11 the amount in box 1 that was earned in a prior year
- ▶ If earned and distributed in the same year, do not report in box 11

Nonqualified deferred compensation: Box 11 reporting

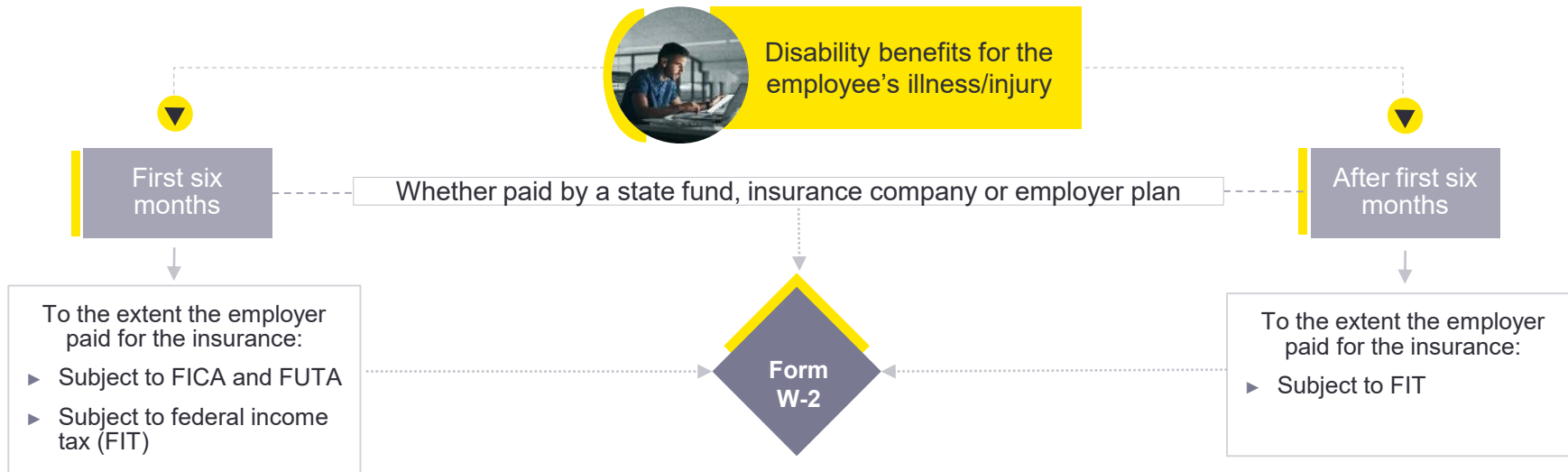
Improper reporting of nonqualified deferred compensation is one common error to watch for, particularly in connection with Form W-2, box 11. See the examples below for an understanding of the reporting rules.

Employee	2023 event	W-2, Box 1	W-2, Boxes 3/5*	W-2, Box 11	W-2, Box 12
Martha	Earned or “set aside” \$2,000	N/A	N/A	N/A	
Jane	Vested \$5,000* (earned 2018–2022)	N/A	\$5,000	\$5,000	
Mark	Distributed \$6,000 (earned 2018-2022)	\$6,000	N/A	\$6,000	
Betty	Deferred, vested and distributed \$8,000	\$8,000	\$8,000	N/A	

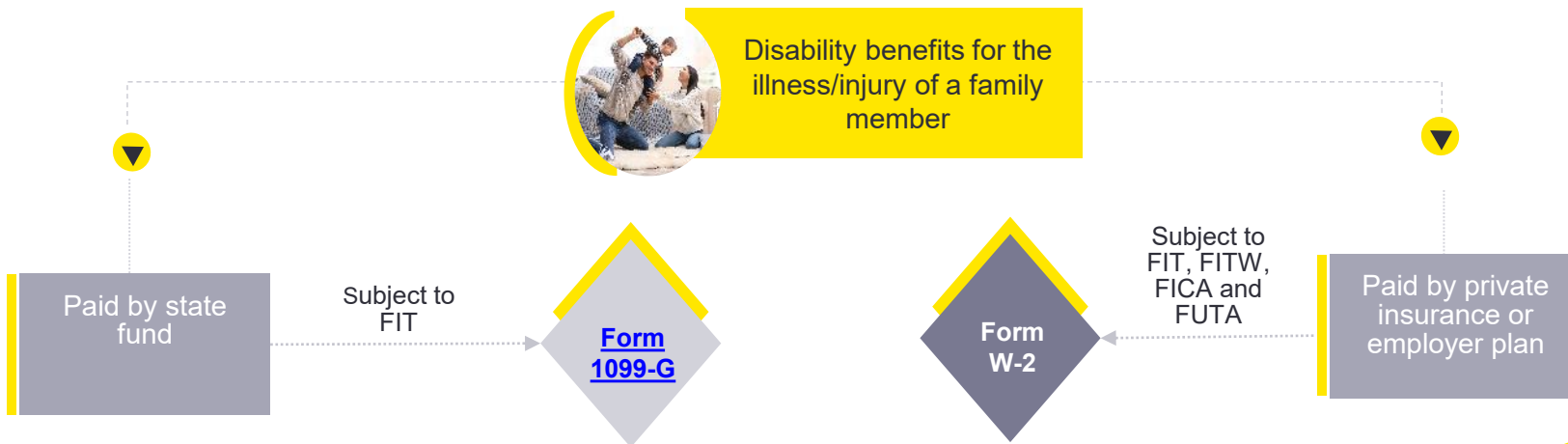
*If the FICA wages are erroneously not reported in the year of vesting and such tax years are no longer open for issuing Forms W-2c, the FICA wages are taxable and reported in the year of distribution and the nonduplication rule no longer applies.

Federal taxation of disability pay and paid family and medical leave benefits

Read more in our [special report](#)



Read more in our [special report](#)



Work closely with your third-party providers

- Federal, state and local tax courts have routinely ruled that reliance on a third-party payroll service provider does not relieve the employer of liability for the underpayment of payroll taxes and any related penalties that may apply.
- The IRS [explains](#) that depending on the facts and circumstances and the type of third-party arrangement, an employer that uses a third party to perform federal employment tax functions on its behalf may remain solely liable for federal employment taxes or may become jointly and severally liable for the taxes.
- To reduce the risk of liability for federal, state and local tax and reporting penalties, it is imperative that employers carefully review their wage and tax records and perform reconciliations before issuing Forms W-2 and filing their final 2023 employment tax returns.
- For more information on managing payroll outsourcing arrangements, see our [special report](#).



Resources

US employment tax rates and limits for 2023

August 25, 2023



Managing your third-party payroll provider



Employment tax rates and limits (2023)



Federal/state Form W-4 compliance (2023)



Courtesy withholding



Taxation of paid family and medical leave insurance benefits



Third-party sick pay



Managing wage repayments





- [2023 Form W-2](#)
- [2023 Form W-2 and W-3 instructions](#)
- [SSA specifications for filing electronically](#)
- [SSA AccuWage \(testing files\)](#)
- [IRS specifications for substitute forms \(Pub. 1141\)](#)
- [Request a year-end training session](#)

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