Statement of
Federation of Tax Administrators

Before the
Subcommittee on Regulatory Reform, Commercial and Antitrust Law
Of the
House Committee on the Judiciary
In the
U.S. House of Representatives

H.R. 1129
Mobile Workforce State Income Tax Fairness and Simplification Act of 2013

April 29, 2014

Patrick Carter
Director, Division of Revenue for the State of Delaware
Past President, Federation of Tax Administrators

Mr. Chairman and Members of the Subcommittee:

The Federation of Tax Administrators appreciates this opportunity to appear before you on H.R. 1129, the Mobile Workforce State Income Tax Simplification Act of 2013, a bill that would limit the ability of state and local governments to impose and enforce existing income taxes on individuals working in multiple states. I am Patrick Carter, the Director of the Division of Revenue for the State of Delaware and also a past president of the Board of Trustees of the Federation of Tax Administrators.

Introduction

The Federation of Tax Administrators (FTA) is an association of the principal tax and revenue agencies in each of the fifty states, the District of Columbia, New York City and the City of Philadelphia. Our purpose is to improve the practices and standards for tax administration through research, information exchange, training programs and by representing the interests of state tax administrators before Congress and the federal executive branch.

The general position of the Federation with respect to this legislation is embodied in Resolution 2012-2, adopted by the membership at its 2012 Annual Meeting in Washington, D.C. A copy of the resolution is attached as an addendum to this testimony.

Primary Basis for the FTA's Opposition to H.R. 1129

FTA opposes enactment of H.R. 1129 as introduced for a number of reasons, the most critical of which are:

1. H.R. 1129 runs directly counter to a fundamental, underlying principle of income taxation – namely that income should be taxed where it is earned or where the services giving rise to the income are performed. This is the principle on which the federal government's own individual income tax is based, as well as the income taxes imposed by states. Abrogation or abandonment of this "source" principle will allow individuals to avail themselves of a state's economic marketplace without paying for that benefit (in competition with that state's residents and instate businesses).

2. The 30-day threshold, while less than proposed in earlier versions of the legislation, still amounts to a full six work-weeks, which is greater than what is currently allowed by most states with statutory thresholds. Quoting from the dissenting views in the report of the Judiciary Committee on the 2011 version of the legislation, the 30-day threshold is "excessive," "goes too far," and will lead to "severe state revenue losses."

3. The State of New York alone estimates that it would experience a revenue loss of $106 million annually as a result of H.R. 1129.

4. Supporters claim that for states other than New York, H.R. 1129 is "neutral," arguing that tax not withheld or paid in one state will be withheld and paid in another. However, states with income taxes already experience enforcement difficulties when taxpayers claim to have changed domiciles (when in fact they have not), attempting to shift income to one of the nine states that have no broad-based individual income tax. H.R. 1129 will provide similar opportunities for workers who reside or work in non-tax jurisdictions to improperly shift income into those jurisdictions from other taxing jurisdictions where the income is actually earned.

5. Most states, like the federal government, rely on income taxes to fund important governmental functions. And just as the federal government does, states require employer recordkeeping, reporting and withholding of tax from employee wages as the primary mechanisms to ensure tax compliance. H.R. 1129 limits states' ability to require employer recordkeeping, reporting and withholding. Studies done over the years by the IRS and reported to Congress, as well as studies by the states, show that employer withholding and information reporting is essential to minimizing the "tax gap" (the amount of underreported taxes that would otherwise result). Most recently, the IRS reported that income subject to withholding and information reporting, combined, is on average underreported by only 1 percent. Income subject to neither withholding nor information reporting is on average underreported by 56 percent.

6. H.R. 1129 undercuts the important recordkeeping, reporting and withholding mechanisms that the states need to enforce their income tax statutes by allowing employers to rely, not on their own records, but on a one-time estimate made by the employee, a year in advance, as to where the employee expects to be working for the coming year. At best, such employee estimates are unlikely to be reliable. At worst, employees are offered an incentive to make inaccurate estimates — for example, when an employee who resides in a non-tax state travels to states that impose income taxes. Under H.R. 1129, states could not require an employer to keep records to show where its employees actually worked, leaving state tax administrators with little means to verify whether employee estimates are accurate.

7. While H.R. 1129 does not apply to certain individuals (professional athletes, professional entertainers and public figures), it does not exclude highly compensated individuals. The bill ignores how much an individual is compensated for services performed in a state.

8. H.R. 1129 will also create situations in which individuals in relatively similar situations are treated substantially differently for state income tax purposes. For example, employees and independent contractors will be subject to different rules (federal versus state-level thresholds). Employees from states without an income tax who work in another state but do not exceed the proposed 30-day threshold will pay no tax to any state, while employees from states with an income tax who do likewise will presumably pay tax to their home state on the income earned in the other state.

9. H.R. 1129 contains provisions and terms that are ambiguous, which may lead to litigation and ultimately lead to differences in the ways that states interpret and apply the rules. For example, the bill uses the term "employment duties" but does not define that term. This term is critical to counting days toward the 30-day threshold and is likely to be subject to dispute in cases where an employee may stay in the state for some period, but may claim not to be performing "employment duties" during the entire stay.

10. If, as the states fear, H.R. 1129 results in manipulation or abuse by some individuals, states will have to increase enforcement efforts in this area. This may lead to additional time and resources spent on audits or investigations, perhaps directly focused on individual employees, or on other administrative alternatives necessary to supplement the lack of employer recordkeeping, reporting and withholding.

11. Finally, H.R. 1129 represents a substantial intrusion by the federal government into state sovereignty.

FTA's Involvement with the Issues Addressed in H.R. 1129

Employees and employers have always been required to keep records to comply with state and local income tax reporting and collection regimes. (Similar requirements are imposed under the federal income tax system for employees who claim non-taxable travel reimbursements or who spend periods of time working overseas.) As workers travel more, states understand that these requirements will affect more businesses, and may pose a relatively higher burden on small businesses.

But as with all types of enforcement, states are not generally concerned with de minimis activities. Most have explicit or implicit thresholds that they have adopted by law or regulatory policy. Nor is H.R. 1129 limited to smaller employers and businesses, but would apply to any employer regardless of the size or the sophistication of its recordkeeping systems. In addition, records may still be required for other accounting, federal tax, travel reimbursement or employee benefit purposes. (Note that, while these exist, employers will not have to use those records for state withholding under the bill). Moreover, improvements in information technology have greatly lessened the burden of recordkeeping for tax reporting purposes and such improvements are likely to continue.

Nevertheless, the states and the FTA have worked with the Committee's staff and industry representatives for almost a decade on this legislation, seeking a balanced solution to tax enforcement concerns and business compliance requirements. The states have proposed a solution to be enacted by state lawmakers which we believe would be preferable, but this solution may not have had the support needed to make it a reality because, in part, industry groups have focused their efforts instead on this federal legislation.

Conclusion

We ask that Congress continue to balance the interests of the states to make sure that the states can maintain a functioning individual income tax system and that tax liabilities can be properly enforced. It makes sense for Congress to minimize the intrusion into state authority and avoid disruption of state revenue systems. Any solution must be directed squarely at the problem and not create other unintended consequences.

Thank you, Mr. Chairman.

Addendum

Federation of Tax Administrators Resolution 2012-2
(Note that references in this resolution are to a prior version of this legislation.)

Background

The fundamental principle of individual income taxation is that income is taxable where it is earned or where the services giving rise to the income are performed. In addition, the state of a taxpayer's residence may tax all income regardless of where earned, but is generally required to offer a credit for taxes paid to other states to assure that income is not subject to multiple taxation. This is the same tax policy embraced by the U.S. government and by all other income-taxing governments.

As United States work patterns shift to increasingly include interstate commuting, telecommuting and multistate travel, more workers find themselves with tax obligations to more than one jurisdiction. Likewise, employers are faced with an increased responsibility for withholding income taxes for multiple jurisdictions. State and local laws and practices vary with respect to de minimis thresholds for withholding. There also is variance in enforcement programs aimed at compliance among persons (and their employers) that are temporarily in the jurisdiction.

H.R. 1864, the Mobile Workforce State Income Tax Fairness and Simplification Act, passed in May 2012 by the House of Representatives, would authorize a state or locality to impose an income tax liability and a withholding requirement only when a nonresident has performed services in the jurisdiction for at least 30 days in a calendar year. The bill contains an exception for professional athletes and entertainers.

In response to bills introduced in previous Congresses, the Multistate Tax Commission developed a state model mobile workforce statute. The work product reflects input from industry and employer representatives.

In its review of H.R. 1864 and in various discussions with proponents of the bill, FTA made several points:

- H.R. 1864 represents a substantial preemption and intrusion into state tax authority;
- While FTA recognizes concerns regarding the administrative burdens imposed by current practices, the 30-day threshold remains beyond a level necessary to deal with the vast majority of individuals who would be temporarily in a jurisdiction;
- H.R. 1864 would substantially disrupt the current tax system in favor of a system based on taxation by the resident jurisdiction;
- H.R. 1864 would substantially disrupt the revenue flows in certain states, particularly New York State;

- A simple “days threshold” will expose some jurisdictions to substantial revenue disruptions, so a “dollar threshold” that would limit the exposure of the states should also be applied.
- Independent state action is a viable and preferred substitute for federal legislation.

Policy

The ability to tax income where it is earned is fundamental to state tax sovereignty and state and local income tax systems. Moreover, this ability is absolutely necessary in under our constitutional framework, where a state may choose to not employ an income tax. FTA finds the Act is not an appropriate balance between administrative simplification and adherence to standard tax policies and it inappropriately disrupts state and local revenue flows. FTA does not support the Act as passed by the House.

Congress and the U.S. federal agencies should refrain from enacting measures, taking actions or making decisions that would abrogate, disrupt or otherwise restrict states from imposing taxes that are otherwise lawful under the U.S. Constitution or from effectively administering those taxes. Congress should undertake an active program of consultation with states as it considers measures that would preempt state tax authority. Finally, states should actively pursue such uniformity and simplification measures as are necessary and effective to address concerns of administrative burden in complying with the tax laws of multiple states. FTA will encourage and support uniform actions by states as the preferred solution to issues that prompt federal preemption.

While federal preemption is generally to be resisted, preemptive legislation can, at times, promote administrative issues such as simplification, uniformity, and taxpayer compliance, albeit at some cost to state sovereignty. FTA will evaluate proposed federal legislation that preempts state taxing authority against several criteria. (1) Has the preferred solution of uniform state action been pursued and exhausted? (2) Recognizing that the benefits of federalism will impose administrative burdens on commerce, is there disinterested evidence that the administrative burden and complexity posed by current state and local practices is impeding the growth of commerce? (3) Does the proposed preemption address administrative issues such as simplification, uniformity, and taxpayer compliance? (4) Can meaningful simplifications and uniformity be achieved through state action? (5) Would preemption disrupt state and local revenue flows and tax systems? (6) Would preemption cause similarly situated taxpayers to be taxed differently -- specifically, does the proposal create advantages for multistate and multinational businesses over local business? (7) Does the preemption support sound tax policy? (8) Does the preemption create unknown or potential unintended consequences? (9) Have state tax authorities and taxpayer representatives together agreed to a beneficial change in federal law? (10) Does the proposed preemption materially narrow the scope of state laws?

In addition, FTA makes the following specific comments on the Act and similar legislation:

Coordinated state action should be pursued and exhausted.

Federal legislation should not proceed until proponents of the Act have worked with New York State officials to resolve the fiscal impact on that state.

If Congress elects to take action in this area, any resolution of the issue should, at a minimum, meet the following criteria:

- The action should be clearly limited to wages and related remuneration earned by nonresident employees. The legislation must also be clear that it is not intended to impair the ability of states and localities to tax non-wage income earned from the conduct of other economic activities in the taxing jurisdiction.
- The action should provide that a state or locality may impose income tax liability on and a withholding obligation with respect to the wage and related remuneration of a nonresident if the nonresident is present and performing services exceeding a de minimis threshold in a calendar year.
- Alternatively, the threshold could be formulated as limiting state and local income taxation (and withholding) to those nonresidents present and performing services in the jurisdiction whose earnings exceed a de minimis threshold in wages and related remuneration in the prior year.
- The action should provide that all persons paid on a "per event basis" are excluded from the coverage of the bill.
- The action should provide for the allocation of a day to a nonresident jurisdiction when services are performed in the resident jurisdiction and another jurisdiction in a single day.
- The action should cover wages and remuneration earned within a jurisdiction in a calendar year so as to not disrupt taxation of any deferred amounts. It should not, however, impair the ability of states and localities to tax income arising from the conduct of other economic activities in the taxing jurisdiction.
- The effective date of any action should be delayed until the beginning of the second calendar year following enactment to allow sufficient time for implementation by state and local governments and affected employers.

This discussion should not be interpreted to imply that FTA considers that a physical presence standard is in any way an appropriate standard for establishing jurisdiction to tax in other contexts, particularly for the imposition of business activity taxes on entities doing business in a state. FTA is firmly opposed to federal legislation that would establish a physical presence nexus standard for the imposition of business activity taxes.

This resolution shall be in effect for three years from the date of enactment unless replaced by a subsequent resolution.