

**DRAFT FOR
DISCUSSION ONLY**

**UNIFORM WAGE WITHHOLDING AND UNEMPLOYMENT
INSURANCE TAX ASSESSMENT ACT**

**NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM LAWS**

March 7, 2003

With Reporter's Notes

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UNIFORM WAGE WITHHOLDING AND UNEMPLOYMENT INSURANCE TAX ASSESSMENT ACT

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UNIFORM WAGE WITHHOLDING AND UNEMPLOYMENT INSURANCE TAX ASSESSMENT ACT

Prefatory Note

From 1966 to 2002 The Internal Revenue Service, Department of Labor, Department of the Treasury, Office of Management and Budget, Small Business Administration, Social Security Administration and various states¹ and private sector organizations² was engaged in a study conducted by the Simplified Tax and Wage Reporting System Program, commonly referred to by the acronym STAWRS.³ The purpose of the STAWRS project was to analyze the statutes governing the withholding of federal income, social security (FICA) and unemployment (FUTA) taxes together with state income tax withholding and state unemployment tax assessment requirements⁴ with a view towards identifying provisions of the various tax assessing and withholding statutes that could be made identical throughout the taxing authorities. This process, frequently referred to as “harmonization”, it is believed, will reduce costs of compliance and administration of these various provisions for federal and State governments as well as employers by simplifying filing requirements (possibly, ultimately, permitting single point filing).

Simplification of statutory compliance through adoption of common requirements across all federal and state taxing authorities will lead not only to reduced compliance costs for private industry but also to reduced resource commitment by the States for purposes of tax compliance education and enforcement. With a single set of statutory compliance rules within a state, that state will, presumably, be able to maintain a single rather than dual compliance and enforcement staffs. Additionally, a “harmonized” state would be able to reduce the costs of public education regarding

¹ The State and Federal agencies represented in this working group were: California Employment Development Department and Franchise Tax Board, Commonwealth of Kentucky, Federation of Tax Administrators, Minnesota Department of Revenue, Montana Department of Labor and Department of Revenue, Nevada Employment Security Division, New York Department of Labor, Social Security Administration, Simplified Tax and Wage Reporting System Program, U.S. Department of Labor, Texas State Comptroller of Public Accounts, U.S. Department of the Treasury (Office of Tax Policy) Wisconsin Unemployment Insurance Division.

² The private sector representation was: American Bar Association, American Payroll Association, Ceridian Tax Service, Inc., Federal Liaison Services, Inc., Paychex, Inc., Planmatics, Inc. Ronald Moore (private consultant and former Chief, IRS.....)

³ The STAWRS program itself has been terminated, however various of its constituent parts have been dispersed to various offices within the Internal Revenue Service. The Harmonized Wage Code project (discussed later in these comments) was transferred to the Small Business/Self Employed office of the Commissioner of Internal Revenue.

⁴ [Per Phil: “State UI is in every instance but one ... a tax solely on employers. NJ may have withholding of some portion of the tax on employees.” CHECK THIS OUT]

1 its withholding requirements.

2
3 As part of their study the STAWRS group has analyzed and compared hundreds of federal and
4 state provisions to determine the existing state of harmony in the way various items of income are
5 treated by the various jurisdictions for purposes of income tax withholding and unemployment
6 insurance assessment and benefits calculation base purposes. As a result of this study STAWRS
7 made recommendations for a Harmonized Wage Code for Income Tax Withholding⁵ and has made
8 substantial progress towards the completion of a Harmonized Wage Code for Unemployment
9 Insurance.

10
11 The STAWRS group found that there are 14 most common elements of income which, if
12 adopted by all states for both income tax withholding and unemployment tax and wage base
13 purposes, would lead to substantial harmonization and significant compliance simplification. These
14 14 elements are the most common elements of compensation paid by most, if not all, employers.

15
16 Eighty-five percent of the 6.7 million employers in the United States employ 20 or
17 fewer workers. It is also known that these ‘small’ employers deal with fewer of the
18 component provisions found in all the state and federal employment tax laws. Thus,
19 most small employers will not be concerned with many of the components, usually
20 those involving more complex forms of remuneration. Therefore, the project team
21 looked at components that are most common among small employers and their
22 employees...”⁶

1 ⁵[TALK TO PHIL RE:AVAILABILITY]The Harmonized Wage Code For Income Tax
2 Withholding (unpublished study, IRS 2001)(copy on file at the U. of Dayton School of Law with
3 Prof. Laurence B. Wohl) (hereinafter sometimes referred to as the “HWC/ITW”). This followed the
4 issuance of the Targeted Harmonized Wage Code (unpublished study, IRS 2001)(copy on file at
5 the U. Of Dayton School of Law with Prof. Laurence B. Wohl) (hereinafter sometimes referred to
6 as the “THWC”) which, despite it earlier issuance, is a derivative of the HWC/ITW. Both reports,
7 though unpublished in hardcopy for general distribution were made available on a internet web site
8 maintained by the Internal Revenue Service. In 2001 the IRS consolidated that site with others it
9 maintained, but in the transition to the new site the HWC/ITW and THWC reports were not made
10 available on the new site.

11
12 The HWC/ITW and the THWC reports focus on inter-jurisdictional harmonization of
13 income tax withholding statutes. Two additional reports which are uncompleted and currently on
14 hold, will focus on inter-jurisdictional harmonization of state unemployment insurance tax, FICA
15 and FUTA (“HWC/UI” report) and on inter-jurisdictional filing date hamonization (sometimes
16 herein referred to as the “HWC/FD” report). All the reports deal, or will deal, only tangentially with
17 intra-jurisdictional harmonization of income tax withholding and unemployment insurance
18 provisions.

1 ⁶ The Harmonized Wage Code For Income Tax Withholding (unpublished draft study, IRS
2 2000)(copy on file at the U. of Dayton School of Law with Prof. Laurence B. Wohl) (hereinafter

1 For the small employers in particular, most of which do business in a single state, relief from
2 compliance burdens would be realized if there was harmonization of the most common elements of
3 compensation because it is with those that they deal almost exclusively. Even for large employers
4 and those doing business in more than one state the harmonization of the most common elements
5 of compensation would provide significant alleviation of compliance complexity. The more the
6 various codes can be harmonized the greater will be taxpayer and governmental relief from
7 compliance complexity.
8

9 On the other hand, despite the obvious value of simplification, each state has its own unique
10 issues with which to deal, and thus complexity reducing policy compromises may not be appropriate
11 with other jurisdictions or within a single state between its income tax withholding needs and its
12 unemployment insurance needs. However, it is not unreasonable to assume that much, if not all, of
13 each state's legislation dealing with income tax withholding and unemployment insurance tax
14 assessment is done without consideration of other jurisdictions or even other statutory schemes
15 within the same state. Consequently, a review by each jurisdiction, with the assistance of this
16 uniform law, may cause the various States to realize they are able to make modifications to their
17 laws which, while making little if any policy compromises, will assist in the cost reducing
18 simplifications of more uniform assessment and collection practices.
19

20 Though it is likely impossible to construct a single code that will conform in totality each state's
21 income tax withholding and insurance tax provisions or that will cause the various states' codes to
22 conform to other states', it is quite possible to find sufficient areas of compromise to substantially
23 reduce compliance burdens for states and for employers in general and small employers in particular.
24

25 The fourteen most common elements of wages⁷ are referred to as the Targeted Harmonized
26 Wage Code or THWC. It appears that these elements, if harmonized throughout the income tax
27 codes of all states and federal government would be a good first step in simplifying compliance
28 requirements. These 14 elements have been adopted by this proposed uniform law. Because these
29 fourteen items are the most common forms of remuneration for employees' services a large majority
30 of employers will be directly, and positively, impacted by this conformity. Hopefully, this structure
31 will also simplify the compliance process and administration of reporting for large and intra-state
32 employers by making the number of their wage components effecting the majority of their
33 employees the same for all jurisdictions and both wage bases.
34

35 States may balk at conforming even their own income tax and unemployment tax wage bases

3 sometimes referred to as the "draft HWC/ITW). [footnotes omitted] The report also points out that
4 "...15% of the 'large' employers employ more than 50% of all workers in the U.S." Id. at note 17.

1 ⁷ The fourteen items set out by the IRS to be excluded from the withholding tax wage base
2 are (in no particular order of importance): vacation pay, compensation for jury duty, employer
3 provided meals and lodging, group term life insurance, dependent care benefits, tips, employee
4 business expense reimbursements, health insurance, cafeteria plans, moving expenses, death
5 benefits, sick pay, fringe benefits and contributions to qualified retirement plans.

1 let alone conforming those wage bases to other states and, possibly, even the federal income tax
2 withholding and FICA wage bases for a number of good reasons. Two of these reasons are that
3 conformity will most likely lead to a loss of revenue, and conformity may reduce unemployment
4 benefits in some states.⁸ A report commissioned by the STAWRS project set out the following
5 example in explaining the revenue impact of reducing the unemployment insurance wage base:
6

7 To illustrate the impact on tax revenues, consider the following: An employer has an
8 employee in state A and an employee in state B and each earns \$20,000 per year.
9 State A has a taxable wage base of \$10,000 as opposed to state B's \$21,000.
10 (Taxable wage base is that portion of an employee's total wages subject to SUI tax
11 [and may not be the same as that employee's income tax wage base].) Consider as
12 well that the reduction in taxable wages resulting from these definitional changes
13 is \$1,000 per year. There would be no impact in state A inasmuch as the portion of
14 the employee's taxable wages would be unchanged. However, in state B taxable
15 wages would be reduced from \$20,000 to \$19,000 and there would be a
16 commensurate reduction in tax paid by the employer.

17 When considering worker unemployment benefits, there are two types of impacts
18 that can occur. First, there are minimum earning levels in each state that must be met
19 before an employed worker becomes eligible for benefits. If any reduction in wages
20 would drop a worker's earnings below the minimum earnings level, that worker
21 would no longer be eligible for benefits...

22 Second, and more likely, is the potential reduction in weekly benefit amounts
23 (WBA). These amounts are calculated on a worker's earnings, generally a
24 combination of annual earnings and high-quarter earnings. Any reduction of annual
25 or high-quarter earnings reduces the worker's WBA...⁹
26

27 Though traditional contributions might be diminished and benefits reduced under some
28 circumstances, it does not appear that the amount of loss of revenue or aggregate reduction in benefit
29 payments will likely be dramatic if the fourteen items of income are harmonized within a state and
30 among the states and federal government. However, it is possible that, at least as to reduction of

1 ⁸ Anything that reduces the taxable wage base potentially can result in loss of benefit
2 because the base upon which benefits are calculated will be reduced. For example, in California
3 benefits are calculated based upon minimum wage payments during a base period of between \$900
4 and 1,300 depending on certain variable (Cal. Unemp. Ins. Code §1281). Anything that lowers
5 amounts considered as wages under the unemployment insurance regime, therefore, will go to lower,
6 or possibly eliminate benefits.

1 ⁹ Lalith de Silva, Dominic Rotondi, Mikel Lasa, The Impact of the Targeted Harmonized
2 Wage Code on Unemployment Insurance, pg. 10-11, note 7, (unpublished study. Planmatics Inc.
3 2001)(on file at the University of Dayton School of Law with Professor Laurence B. Wohl
4 (hereinafter referred to as the "Planmatics study.") The Planmatics report studied the impact of
5 harmonizing the 14 items in twelve states: California, Connecticut, Georgia, Iowa, Louisiana,
6 Mississippi, Minnesota, Montana, Nevada, New Jersey, Pennsylvania and Texas. Id. at 14.

benefits, though the macro problems will not be significant the micro problems could be devastating. The dollar amounts of benefits paid to any one individual, or individuals within any single employee sector, may be reduced by a significant percentage or eliminated altogether.¹⁰

SECTION 1. DEFINITIONS. In this [act]:

(1) “Disability” means

(2) “Employee” means

(A) a person currently employed by an employer any portion of whose remuneration paid by the employer is subject to withholding of income tax and/or for whom the employer makes contributions under [Title, etc..] of FICA, or

(B) any other person qualifying as a common-law employee of the laws of this State.

(3) “Employer” means the individual or entity at whose direction and for whom an employee performs his or her services and who is not deemed, by the Internal Revenue Service, to be an independent contractor.¹¹

Comment

¹⁰ The most controversial recommendation of the HWC Project is that dealing with ‘meals and lodging.’ ... Most states...[concur with the IRC Section 119 exclusion of meals and lodging from the income tax wage base], but about one-third of the states include ‘meals and lodging’ for UI purposes. This recommendation has caused a great deal of concern ... [in those states that do not exclude meals and lodging for their unemployment insurance wage base] primarily because of the possible impact such payments if made excludable might have on the amount of revenue available and the payment of benefits.” draft HWC/ITW, *supra*, note 4 at 2-8.

The 23 states that do not exclude meals and lodging from the unemployment insurance wage base (including California) have more than 26% of the countries work force. “...California’s data indicate the average benefit claim over its duration is \$2,422 and the average value of the exclusion of the meals and lodging component on affected claims is \$487, amounting to 20% of the claim of the workers affected. This percentage of reduction, or one close to it, could occur in New Jersey, New York and Texas as well.” Planmatics studyt, *supra*, note 7 at pg. v.

¹¹ [Discuss Section 530 and independent contractor issue]

DISCUSS THE WHOLE INDEPENDENT CONTRACTOR STUFF, §530, ETC.

(4) “Employment tax” means, at any given time, the total of income taxes withheld and unemployment insurance taxes withheld and incurred by an employer which are held by the employer and not yet paid to the appropriate government entity.

(5) “Internal Revenue Code” means Title 26 of the United States Code (??? as from time to time amended ???? as in effect on the adoption of this [Act] ????)

(6) “Non-discriminatory” plan means

(7) “Wages” means all forms of remuneration, whether in cash or in a medium other than cash, paid for services to an employee by an employer¹². Wages shall include, but shall not be limited to, the following payments made by an employer to an employee for services rendered to the employer:

(A) Cash

(B) Fair Market Value of property

(C) Vacation Pay¹³

¹² This provision anticipates the definition of employer and employee which will be the focus of some of the Committee’s discussions.

In kind payments of wages (“medium other than cash”) will be included at its fair market value at the time of payment to the employee by the employer. Cash, of course, will be valued at its face value. It is assumed that cash payments of wages made in a denomination other than United States currency will be its official exchange rate value as of the date of payment.

¹³ Delaware is the only state in which vacation pay is not always an element of wages for purposes of both income tax withholding and assessment of unemployment insurance taxes. Delaware excludes as wages vacation pay paid during a period of unemployment.

~~SECTION 2. SCOPE. This [Act] shall define wages for the purposes of [imposing withholding of an employee's income taxes and] assessing and paying of unemployment insurance premiums or taxes by an employer. [NOTE: THE STYLE COMMITTEE SUGGESTED THIS PROVISION BE REMOVED IN ITS ENTIRETY]~~

Comment

The purpose of The Uniform Withholding Tax and Unemployment Tax Wage Bases Act (hereinafter the "Act") is to provide a common definition of wages so items of income subject to income tax withholding will be included in the unemployment insurance tax and benefits wage base in all States. Adoption will make compliance with withholding and unemployment insurance wage base requirements the same in each State. Additionally, both the income tax withholding and the unemployment insurance tax regimes within each adopting State will be the same.

Problematically harmonization of the tax withholding provisions with the unemployment insurance provisions requires the meshing of two different, and somewhat conflicting, policies within each single jurisdiction as well as among the multiple jurisdictions. On the one hand the policies driving income tax withholding are focused on the single issue of collection, almost a simple ministerial act. The question of what income should be taxed has been determined elsewhere and is unrelated to the question of how to collect the tax. Items subject to income tax will continue to be subject to that tax even if the item is not subject to withholding.

On the other hand, policies underlying unemployment insurance programs are concerned with dispersal of benefits as well as the collection of sufficient revenues to provide for those benefits. For purposes of unemployment insurance, items placed in the wage base are important on two counts. First, an item added to the unemployment insurance wage base makes it easier for an employee to meet the threshold amounts of income needed to qualify for benefits; and, second, an item of income added to the wage base increases benefits payable (up to statutory maximums) to an unemployed former employee. Consequently, putting the issue of complexity momentarily aside, the income tax withholding regime is indifferent as to items in the wage base whereas the unemployment insurance tax regime is deeply concerned about the items in the wage base. For purposes of unemployment insurance each item placed in the wage base and subject to unemployment insurance tax will lead to increased revenues available for distribution to those in need.

In attempting to harmonize the two separate code constructs there must be a careful balancing of the need for simplicity, and thus compliance cost reduction, with the need not to compromise benefits that a state has deemed appropriate for its unemployed. The Act, if adopted by the States, will create substantial conformity, and thus simplification, between an adopting State's income tax wage base and its unemployment insurance wage base as well as substantial conformity of those

1 wage bases among the States¹⁴.

2
3 The fifty states, the District of Columbia, and the federal government have a total of
4 96 different employment tax laws. Within the 96 employment tax laws, there are
5 almost 500 different components or provisions. Employers must maintain separate
6 wage records for federal income tax withholding, state income tax withholding, the
7 federal insurance contributions act (FICA), the federal unemployment tax act
8 (FUTA), and state unemployment insurance (SUI) taxes. *In many cases, employers*
9 *must report this information to government agencies at different times, on different*
10 *forms, and on assorted media. ...*

11 In addition to requiring employers to report tax-and wage-related information,
12 employment tax laws require government agencies to process the information
13 reported, verify that the information complies with the laws, work with employers
14 to correct reports that do not comply, and provide assistance to employers attempting
15 to comply. The diversity in current laws and filing dates makes it difficult for
16 government agencies to provide consistent, accurate, and timely service to their
17 customers.

18 The diverse state and federal laws governing wage taxes and withholding
19 significantly increase employer burden....¹⁵

20
21 Reporting complexities are very costly to everyone. Small employers must attempt to
22 understand sometimes subtle distinctions, have knowledge of a large number of definitions and
23 attempt to understand the different requirements of them for two different codes within their state.
24 Large and small employers that do business in more than one state must deal with these issues in
25 each state and the administrative complexities caused by multi-jurisdictional differences. States
26 must maintain two separate taxpayer auditing capabilities (and staffs) to insure compliance with two
27 separate laws.

28
29 Though it will be impossible to construct a single code that will conform in totality each State's
30 income tax withholding and unemployment insurance tax provisions or that will cause the various
31 States' statutes to conform to the other States' statutes, it is quite possible to find sufficient areas of
32 commonality to substantially reduce compliance burdens for states and for employers in general and
33 small employers in particular. "Eighty-five percent of employers of the 6.7 million employers in
34 the United States employ 20 or fewer workers. ... [T]hese 'small' employers deal with fewer of the
35 component provisions found in federal [and state] employment tax laws."¹⁶

1 ¹⁴ There are 43 different federal and state income tax codes and 53 social welfare tax codes.

1 ¹⁵ HWC/ITW, *supra*, note 3 at 1-1. (Emphasis Added)

1 ¹⁶ HWC/ITW, *supra*, note 3 at 1-7 [footnote omitted]. The note accompanying this statement
2 in the HWC/ITW points out that "15% of the 'large' employers employ more than 50% of all
3 workers in the U.S.", and further, the components of their employees' wages are far more complex
4 than those of small employers. Consequently, harmonization among the states and, ideally the states

1 The Commissioners believe that the Act creates the proper balance between efficiency and cost
2 savings on the one hand and the necessary flexibility required by each State to meet its citizens'
3 unique needs. The Commissioners recognize that issues of jurisdictional integrity and different needs
4 of the various States could create stumbling blocks to harmonization. Nonetheless, the
5 Commissioners believe that adoption of this Act will lead to significant simplification and cost
6 savings for employers and States.
7

8
9 **SECTION 3. REQUIREMENT FOR EMPLOYER TO [WITHHOLD INCOME TAXES**
10 **AND] PAY UNEMPLOYMENT INSURANCE TAXES.** Except as provided at Section 4., all
11 wages are subject to [employer withholding of employee income taxes and] payment by the
12 employer of unemployment insurance taxes.
13

14 **SECTION 4. EXCLUSION OF CERTAIN PAYMENTS FROM DEFINITION OF**
15 **WAGES.**

16 **(1) Effect of Exclusion.** All items set forth in this Section 4. shall be excluded from wages
17 for the purposes of

18 (A) determining amounts subject to income tax withholding,
19 (B) assessment of the unemployment insurance tax, and
20 (C) determining those items of compensation paid to an individual that constitute the
21 amounts used to calculate benefits payable by this State for an unemployed individual under this

5 and the federal government would have a dramatic impact on the compliance complexities faced by
6 all employers but probably a greater impact on the country's largest employers. However, as
7 pointed out in a study conducted by an outside contractor to the STAWRS group, though "small"
8 employers, "[a]s a group... generally deal with a smaller number of wage components ... [they], in
9 the aggregate, bear the greatest per employee costs associated with the payroll reporting process."
10 Planmatics study, *supra*, note 7 at pg. 5.

State's unemployment insurance law.

(2) Exclusions. The following items shall not be treated as wages:

Comment

The reasons harmonization is difficult between a single State's income tax and unemployment tax provisions is not immediately obvious; but, in fact the tensions between income tax and unemployment tax policies are more difficult to reconcile than intra-State harmonization of either the items subject to income tax withholding or the items composing the unemployment insurance wage base. To understand these tensions policies pursued by the income tax withholding laws and the unemployment insurance laws need to be kept in mind. The purpose of the income tax withholding laws is primarily to establish a procedure by which taxes are to be collected and secondarily assist in the characterization of certain income¹⁷ while the unemployment tax structure is intended to raise revenue from employers for a specific employee benefit, and most importantly, to provide a basis upon which benefits are calculated¹⁸. For example, whether employer provided meals are income is determined under income tax statutes independent of the withholding requirements. In other words, taxes will be withheld only if it is *a prior* determined that there is a tax to be collected. Unlike income tax withholding, however, the unemployment insurance provisions make two indivisible determinations: (1) whether, as to the item of payment, the relationship between payor and payee is that of employer-employee, and (2) if so, whether the item in question is income¹⁹. For example, an employer's reimbursement to an employee for purchases

¹⁷ Though at first blush it might appear that the income tax withholding provisions of a state statute may have something to do with the determination of taxable income by defining factors such as wages and employee, the fact is these definitions are important (from the perspective of income tax) only for determining whether a payer of income is required to withhold income taxes or whether the payee has the responsibility of paying owed taxes directly to the state or federal government. Whether an item of income is wages or some other form of income is irrelevant to the question of whether it is income. That is an issue with which the income tax withholding provisions do not deal.

¹⁸ The Planmatics study stated: "Unlike revenues the impact ... [of the THWC on unemployment] claimant benefits are not directly linked to the taxable wage base. Rather, they are more closely related to workers' occupations, industries in which they are employed, and their level of earnings." Planmatics study, *supra*, note 7 at pg. iv.

¹⁹ There are many sub-issues hidden in the concepts of "wages" and "employee." The question of whether one is an employee or an independent contractor is critically important for a number of reasons including, for our purposes, the question of whether the employer is liable for an assessment of unemployment insurance or FICA on the amount paid to an individual. The classification of an individual as employee vs. independent contractor is far beyond the scope of this Committee's charge (thank goodness!!) and is one that continues to be only partially resolved, at least at the federal level. Additionally, there are similar classification issues in regard to whether a partner is performing services for the partnership as an employee or as a partner and whether a

1 made by the employee at the direction of and for the sole benefit of the employer would not be
2 income subject to tax under the income tax regime²⁰ or under the unemployment insurance regime.
3 However, if an employee receives from an employer meals that qualify as exempt from income tax
4 under statutory provisions similar to Section 119 of the Internal Revenue Code²¹, they will be
5 considered income for purposes of establishing the employee's wage base and amount of benefits
6 available under unemployment insurance. Consequently, the value of these meals will be subject
7 to an unemployment insurance tax on the employer and be considered part of the wage base for
8 determining an unemployed individual's unemployment benefits. Not all income for unemployment
9 insurance purposes is income for tax withholding purposes. Any attempt to harmonize the income
10 tax withholding provisions with the unemployment insurance provisions within a given state will
11 have to recognize the difficulty of dealing with these two different policy concerns.
12

13 Harmonizing the income tax withholding provisions among the States that impose an income
14 tax is more easily accomplished. Though there are differences among the States as to various
15 definitions, there is already significant similarity between existing statutes making the harmonization
16 process less problematic. However, there is significant variation of filing dates that must be
17 addressed to fully harmonize the requirements of the income tax reporting among the states and, as
18 a matter of fact, harmonize the filing and payment date requirements for income tax withholding and
19 unemployment tax withholding within each state.
20

21 **ALSO DISCUSS** the fact that some states have particular exclusions that are unique to that
22 state, but should they add those exclusions, it is unlikely to have a significant impact etc., etc.
23

24
25 (A) A payment made to, or on behalf of, an employee or the employee's beneficiary pursuant
26 to an election by the employee or beneficiary under a plan meeting the requirements of Section 125
27 of the Internal Revenue Code, [or any successor thereto];

9 corporate officer-significant stockholder is an employee for unemployment tax purposes.

10 Also, the question of whether a payment to an employee is a wage or something else is of
11 critical importance. For example, a reimbursement of an expense incurred by an employee on behalf
12 of an employer is clearly not a wage, yet its mis-classification as a wage may result in an additional
13 cost to the employer of a state's assessment of unemployment insurance taxes or premiums.

1 ²⁰ This rather clumsy language is used here because some State statutes may be similar to
2 the federal tax statute. §62(a)(2)(A) excludes such reimbursements from taxable income though
3 they are included in gross income under §61.

1 **Comment**

2 This provision provides that benefits otherwise excludeable from an employee's gross income
3 and subject to income tax and unemployment insurance tax will not be considered includeable in
4 either the income tax or unemployment insurance wage base merely because of constructive receipt
5 issues. Section 125 of the Internal Revenue Code permits taxpayers to select from a group of
6 benefits provided by their employer. Individually, these benefits are permitted, under the Internal
7 Revenue Code, to be provided on a tax free basis to an employer's employees. Without the
8 intervention of this code provision, however, the fact that employees have the opportunity to select
9 which tax free benefit, from a variety of offerings, they prefer to have is sufficient to make these
10 otherwise tax free benefits taxable under the doctrine of constructive receipt. It appears that all
11 states currently have extant a similar provision for income tax withholding purposes. However,
12 many states do not exempt items paid under IRC Section 125 plans from tax liability (or benefit
13 calculation) for unemployment insurance purposes. For any state that does not have a provision
14 excluding from either wage base the items contemplated under IRC Section 125 it will be incumbent
15 upon that jurisdiction to adopt such a conforming provision. In the absence of such provision in the
16 unemployment insurance arena compensation will be paid.
17

18 (B) The value of any meal or lodging furnished to an employee by or on behalf of an
19 employer if, at the time of the furnishing, the value of the meal or lodging is excluded from the
20 employee's income under Section 119 of the Internal Revenue Code, [or any successor thereto];

21 **Comment**

22 This provision excludes from both the income tax withholdings wage base and the unemployment
23 insurance tax and benefits wage base amounts that are excluded because they are items provided by
24 the employer primarily because the physical location for the performance of services requires the
25 employee to live and/or eat on the business premises. No state that imposes income taxes does not
26 already provide such provision or, at least, a provision similar to IRC Section 119 for income tax
27 withholding purposes. However,
28

29 At present, 23 states treat meals and lodging as wages in their [unemployment
30 insurance] laws and would be affected by this recommendation [to exclude meals and
31 lodging from the compensation wage base]. These states include California
32 (included in this study), New Jersey, New York, and Texas. They represent in
33 excess of 26% of the nation's work force. In terms of impact on affected claims,
34 analysis of California's data indicate the average benefit claim over its duration is
35 \$2,433 and the average value of the exclusion of the meals and lodging component
36 on affected claims is \$487, amounting to 20% of the claim of the workers affected.
37 This percentage of reduction, or one close to it, could occur in New Jersey, New

1 York and Texas as well.²²

2
3 The report making the above quoted statement pointed out that in California this reduction
4 represents only "...about 0.2% of the total benefit outlay, it represents almost a 20% reduction for
5 the 7600 affected claimants. Additionally, 660 claimants, or 0.1% of the claimant population would
6 lose their eligibility entirely."²³ Of course, for those who have remuneration from their employers
7 other than meals and lodging at or in excess of the maximum taxable unemployment insurance wage
8 base the exclusion of the value of meals and lodging is of no consequence.
9

10
11 (C) A payment to, or on behalf of, an employee by the employee's employer to the extent
12 the employer reasonably believes that the payment (or portion thereof) will qualify for deduction
13 under Section 217 of the Internal Revenue Code, as determined without regard to Section 67 of the
14 Internal Revenue Code, or exclusion under Section 132(a)(6) of the Internal Revenue Code [or any
15 successor thereto].

16 **Comment**

17 This provision requires the exclusion from the wage base for purposes of income tax
18 withholding and unemployment insurance tax and wage base calculation amounts paid for what are
19 commonly referred to as moving expenses. All states that impose income taxes already provide such
20 a provision except for two states with no provision. Generally it can be presumed that employer
21 paid or reimbursed moving expenses will be paid only to those whose regular wages already exceed
22 the maximum unemployment insurance wage base. Thus, this provision should have no impact on
23 the benefits payable to any employee receiving unemployment benefits nor any employer's
24 unemployment insurance tax liability even if a state's deductions or exclusions are not as generous
25 as those provided under the Internal Revenue Code.
26

27 (D) A premiums paid by an employer for group-term life insurance on the life of an
28 employee to the extent the premium is excluded from the employee's federal taxable income under
29 Section 79 of the Internal Revenue Code [or any successor thereto].

1 ²² Planmatics study, *supra*, note 7 at pg. v.

1 ²³ *Id.* at 34.

1 **Comment**

2 There is no state that imposes either an income tax or an unemployment insurance tax that does
3 not have either a provision similar to this provision or has no provision that would subject such
4 premiums to income tax or have implications on their unemployment insurance regime.
5

6 (E) An amount paid an employee by an employer as an employee achievement award as
7 defined at Section 274(j) of the Internal Revenue Code [or the successor thereto];

8 **Comment**

9 Discuss the elements of 274(j) and why payments are exempt.
10

11 (F) A payment (including any amount paid by an employer for insurance or annuities, or into
12 a fund to provide for any payment) made to, or on behalf of an employee or any of the employee's
13 dependents under a plan or system maintained by the employer which makes provision for all or
14 specific classes of the employer's employees, and their dependents, generally or for a class or classes
15 of the employer's employees, or for a class or classes of employees and their dependents, on
16 account of

17 (i) sickness, if mandated under [this state's workers' compensation law], or

18 (ii) sickness, if not mandated under [this state's workers' compensation law], made after
19 six consecutive months after the commencement of the non-mandated payments,

20 (iii) a disability resulting from an accident and received under [this state's workers'
21 compensation law],

22 (iv) medical or hospitalization expenses in connection with sickness or a disability
23 resulting from an accident, or

24 (v) death;

1 (G) A payment or series of payments made to an employee, or any of the employee's
2 dependents, under a nondiscriminatory plan or system maintained by the employer, which

3 (i) is paid upon or after the termination of an employee's employment as an employee
4 with the employer because of the employee's death or retirement on account of disability, and

5 (ii) would not have been paid if the employee's employment as an employee had not
6 been so terminated;

7 (H) A payment made by an employer to a survivor or the estate of a former employee after
8 the calendar year in which the employee died if the payment is not considered income in respect of
9 a decedent in accordance with [cite state law provision].

10 **Comment**

11 In general only income from sick pay or wage continuation plans maintained by the employer
12 but not mandated by a state's workers' compensation law are included in an employee's income
13 wage base for purposes of either income tax withholding or unemployment insurance benefit
14 determination or tax assessment. Additionally, amounts paid due to an employee's death but are
15 considered income in respect of a decedent are not excluded.
16

17 (I) A payment made or incurred or benefit provided by the employer which affords an
18 employee dependent care assistance pursuant to a qualifying dependent care program under [cite
19 state law] if, at the time of the payment or provision of the benefit, it is reasonable to believe the
20 payment or benefit is excludable from the employee's federal [and state] taxable income;

21 **Comment**

22 This provision excludes the value of benefits provided by an employer to an employee under an
23 employer provided dependent care plan providing non-discriminatory access to dependent care for
24 young children who are dependents and dependent adults who are unable to care for themselves due
25 to physical or mental incapacity. It is intended that these individuals be the same as those defined
26 as "qualifying individuals" at IRC Section 21(b)(1). It is further intended that the State statutory
27 provisions will require a written, non-discriminatory plan similar to that under and meeting the
28 requirements of IRC Section 129. Inclusion of this provision will require many states to adopt

dependent care provisions not currently extant. Currently, 42 states have concurring statutes and 1 state has no provision (9 states have no income tax). On the unemployment insurance side of the ledger, however, only 15 states' statutes conform to these requirements, and 35 states have no provisions dealing with this issue. Two states, Alabama and Michigan provide that payments made directly to the care giver or care facility are not wages to the recipient employee while benefits provided through a wage reduction plan are considered wages to the recipient employee (presumably because of some degree of constructive receipt).

(J) A fringe benefit provided to or for the benefit of an employee or any cash reimbursement for any fringe benefit paid to an employee if, at the time of provision or reimbursement, it is reasonable to assume that the benefit is excludable from the employee's federal [and state] taxable income under [cite state code similar to Internal Revenue Code Section 132];

Comment

Of those jurisdictions imposing an income tax forty-two have provisions that provide this treatment for purposes of income tax withholding and one state has no provision. For purposes of unemployment insurance withholding only thirty-three states have provisions similar to this provision. Ten states currently have no or minimally matching provisions.

(K) A payment that is a reimbursement for expenses incurred on behalf of, or as an allowance provided by, an employer, for but not in excess of, those expenditures that meet the requirements of Section 62 of the Internal Revenue Code and that are not in excess of the lesser allowance or those expenses actually incurred by the employee for the expenditures;

Comment

Though the THWC report indicates that all states provide this exclusion for both income tax and unemployment insurance tax purposes, there are numerous states that do not currently comply with the reporting requirements set out in the Internal Revenue Code. If those states should adopt reporting requirements similar to those mandated for federal tax purposes no additional compliance costs would be incurred by employers or employees who are currently complying with the federal requirements.

(L) A payment made to, or on behalf of, an employee or the employee's beneficiary from

1 or to a plan or plans described in Section 3306(b)(5)(A) through (F) of the Internal Revenue Code.²⁴

2 **Comment**

3 This provision deals with contributions to pension, profit-sharing and similar arrangements that
4 meet the requirements for tax exemption under Sections 401 and 501 of the Internal Revenue Code
5 All states provide similar exclusions for both income tax and unemployment insurance tax purposes
6 but the provisions for many states are complex and could be simplified. It should be noted that these
7 amounts are subject to FICA taxes when contributed to such a plan.
8

9 (M) Gratuities that in the aggregate for an employee do not exceed \$20 during any given
10 month, paid by third parties or by an employer on behalf of third parties, for services performed as
11 part of the employment relationship;

12 **Comment**

13 In general all States currently provide that tips or gratuities are wages and that the employer has
14 a duty to withhold and to make unemployment insurance contributions on those wages. This
15 provision assumes that each state has or will have a reporting measure similar to the federal
16 requirement that the employee provide a monthly statement in writing to the employer stating the
17 amount of tips earned during the preceding month. Because services for which tips are a significant
18 form of remuneration are frequently paid for via credit and debit cards the record keeping
19 requirements for both employer and employee are somewhat less burdensome than they may have
20 been when such payments were generally made in cash.
21

22 (N) A payment received as the result of transitory passage through this state by an individual
23 engaging in the interstate transportation of goods or people;

24 **Comment**

25 This provision makes it unnecessary for an employer of common carrier vehicle drivers to
26 allocate income among states through which a truck, train, bus, airplane or other similar vehicles
27 transporting merchandise or people through a state, so as to be able to withhold taxes from or pay
28 unemployment insurance taxes based on amounts earned simply because of travel through a state.
29 Seventeen States currently have such a provision and the remaining States' statutes are silent on the
30 matter. Nonetheless, those states that have not addressed the issue statutorily appear, to apply this

1 ²⁴ These are payments from deferred compensation plans that are defined at Section C. of
2 Article II. of the Act.

1 non-withholding and unemployment insurance wage base exclusion.
2

3 (O) Wages for services performed in a foreign country provided that

4 (i) the foreign country in which the services are performed withholds taxes on the
5 wages paid; and

6 (ii) the wages are excluded from United States income pursuant to Section 911 of the
7 Internal Revenue Code; and

8 (iii) the wages are excluded from income under [the statutes of this state.]

9 **Comment**

10 Forty six states have adopted provisions similar to this provision. In general the exclusion under
11 IRC Section 911 requires that wages be paid (1) for services performed (2) by a citizen of the United
12 States (3) whose tax home is a foreign country and who (4) has been a bona fide resident of foreign
13 countries for an uninterrupted period of at least an entire taxable year or (5) is a US citizen or
14 resident who is present in foreign countries for 330 days within any consecutive 12 month period.
15

16 At present no state imposes an income tax on “foreign” wages. If a State did include such
17 income in its taxable base, it would be impossible to enforce a withholding requirement on a foreign
18 corporation that had no presence in the state, but it could enforce withholding requirements on any
19 corporation that is present in the state. Additionally, if a state exercised jurisdiction over a
20 corporation and chose to include this income in the unemployment wage base there would be an
21 impact on an employee’s benefit wage base as well as an imposition of unemployment taxes on the
22 employer.
23

24 (P) A payment, whether periodic or not, from an employer tax deferred compensation plan,
25 commercial annuity or an Individual Retirement Accounts if the payee elects not to have income
26 taxes withheld on the payment;

27 **Comment**

28 This provision applies only to income tax withholding and permits an opt out of withholding.
29 The default is that there will be withholding on these amounts. However, a written election, along
30 with protecting the payor, will require an informed election by the recipient. Because such
31 distributions are currently excluded from the unemployment insurance tax assessments and wage

1 base calculations this provision will have no impact on those state laws.
2

3 (Q) sick pay, unless the payee elects in writing to have income tax withheld on the payment;

4 (R) an amount paid under a scholarship or fellowship to an individual who is a candidate for
5 a degree at an educational organization described at Section 170(b)(1)(A)(ii) of the Internal Revenue
6 Code [or the successor thereto] and used by that individual for qualified tuition and related expenses,
7 as the term is defined at Section 117(b)) of the Internal Revenue Code;

8 **Comment**

9 Arizona, California, Indiana, Ohio, Kansas, and Mississippi are the only jurisdictions that have
10 provisions comparable to this one. None of the other States or the District of Columbia have any
11 provision dealing directly with this issue, though discussions with the STAWRS team indicates that
12 most states currently follow the federal rule through administrative policy.
13

14 The language of this provision is largely the same language of IRC Sections 117(a) and (b).
15 Thus, like the federal law, this provision is intended to exclude from an individual's gross income
16 only those amounts which are used to pay for tuition, fees, books, supplies and equipment required
17 for enrollment at, or to take courses pursuing a degree at, "an educational organization which
18 normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of
19 pupils or students in attendance at the place where its educational activities are regularly carried
20 on..." IRC Section 170(b)(1)(A)(ii).
21

22 (S) amounts paid to an individual by a court, or by a governmental entity on behalf of a
23 court, for jury service.

24 **Comment**

25 Discuss — all states exempt but some do it by exempting amounts from wages and others
26 exempt by excluding jury service from the definition of employment — and for these later they will
27 have to amend that portion of their statutes.
28
29

30 **SECTION 5. FILING AND PAYMENT DATES.**

31 (1) All employment taxes must be reported quarterly unless the total amount of

1 employment taxes owed by the employer does not exceed \$2,500 for the calendar year, in which
2 case the employment taxes are to be reported annually.

3 (2) All reports of employment taxes must be filed and submitted to [insert state rule] on
4 forms prescribed by [the responsible state agency].

5 (3) All payments of employment taxes must be made by the employer to the [insert
6 appropriate state agency] in accordance with the following schedule:

7 **Comment**

8 This provision anticipates a rather substantial administrative change in States' physical
9 collection of withholding and unemployment insurance taxes. Currently, these taxes are collected
10 by two separate entities – the income taxing authorities and the entity responsible for administering
11 the unemployment insurance law. As drafted, this section of the Act would require the collection
12 function to be conducted by the same agency or department which would then be responsible for the
13 ministerial act of properly allocating the funds between the State's income taxing authority and the
14 department responsible for enforcing the State's unemployment compensation law.

15
16 Ideally, this same "collection" agency will be able to verify compliance with both the income
17 tax withholding and unemployment insurance tax laws because there will be no divergence between
18 those laws regarding the definition of wages; at least to the extent of the conforming items set out
19 in this Act.
20

21 (A) If the total employment taxes then currently owed is \$2,500 or less, no later than
22 January 31 of the year immediately following the end of the calendar year the taxes become due;

23 (B) If the total employment taxes then currently owed is greater than \$2,500 but no more
24 than \$5,000, on July 30 and January 31 of each year;

25 (C) If the total owed by an employer is greater than \$5,000, but no more than \$50,000,
26 no later than the 15th day of the calendar month immediately following the calendar month in which
27 the amount owed exceeds \$5,000;

28 (D) If the total then currently owed is greater than \$50,000 but no more than \$100,000,

1 no later than the 3rd business day immediately following the last Friday of the semi-weekly period
2 in which the amount owed exceeds \$50,000;

3 (E) If the total then currently owed is greater than \$100,000, no later than three business
4 days following the day the amount owed exceeds \$100,000.

5 **Comment**

6 In general payment thresholds and dates as well as filing dates for both withheld income taxes
7 and unemployment insurance taxes are specified by statute only in general terms. The specifics are
8 left to the various concerned administrative agencies. However, to enhance the possibilities of
9 conformity, this recommended provision is set forth with greater detail than is found in most current
10 state statutes.

11
12 Analysis of the various States' filing requirements and payment thresholds show a wide variety
13 of dates and amounts. In fact, there are approximately 90 different threshold amounts and 109
14 different filing dates among all the 50 States and the District of Columbia. Employers are unlikely
15 to have to deal with more than a few jurisdictions and/or more than a few payment threshold
16 amounts. Consequently, any one multi-state employer will have far fewer than the nearly 200
17 different filing and payment requirements. Nonetheless, the multitude of dates and amounts with
18 which any one employer may need to comply under the current state of the law is daunting. Further,
19 the burden on small employers doing business in only one or two states can be dramatic because the
20 cost of keeping track of the various filing and payment dates in relation to the size of the employer
21 may be high.

22
23 In any event, ignoring transition problems (which may, in some cases, be insurmountable),
24 common dates for compliance will greatly ease burdens imposed on all employers. Further, the
25 costs of auditing and assuring compliance incurred by the States presumably will be reduced simply
26 because complexity is reduced.

27
28 This provision also does not provide for a look back period as does the IRC and some state
29 withholding statutes. A look back provision permits payors to base their payment thresholds, and
30 thus frequency of payment of taxes, on prior year compensation history. Because the income taxes
31 withheld and the taxes owed for unemployment insurance purposes are based upon current
32 compensation, it does not appear that look back rules are essential to timely and accurate compliance
33 with the payment rules. In an era of instant information and computerized payroll systems, it does
34 not appear that essential data for proper compliance is difficult to aggregate. On the other hand it
35 is recognized that payments based upon current payrolls may cause cash management problems for
36 employers which have significantly fluctuating payrolls. Nonetheless, payments based upon current
37 compensation rather than look back estimates will make it less likely that employers will become
38 in arrears in payments of their Trust Fund obligations (i.e., their obligations to pay over withholding
39 taxes). For large taxpayers, at least for federal taxes, this is not an issue because regardless of any

1 look back rules at any time an employer has accumulated \$100,000 of payroll taxes they must be
2 paid over to the government by the next business day after such accumulation. For mid-size
3 taxpayers, particularly those with quickly growing business or those the business of which is highly
4 volatile, the problem of temptation to use rather than pay over Trust Fund monies may cause them
5 much difficulty and deprive the government of monies owed.
6