UNIFORM WAGE WITHHOLDING AND UNEMPLOYMENT INSURANCE PROCEDURE ACT

drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

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UNIFORM WAGE WITHHOLDING AND UNEMPLOYMENT INSURANCE PROCEDURE ACT

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PROCEDURE ACT

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Prefatory Note

In 1996 the Simplified Tax and Wage Reporting System Program, commonly referred to by the acronym STAWRS, was created by the Internal Revenue Service and consisted of a working group of representatives from the Internal Revenue Service, Department of Labor, Department of the Treasury, Office of Management and Budget, Small Business Administration, Social Security Administration and various states[1] and private sector organizations[2]. STAWRS conducted a study to determine the extent of definitional differences for the term "wage" found in federal and state income tax withholding and unemployment insurance statutes with a view towards modifying the term "wage" in each of those various provisions in order to achieve a substantially uniform definition across all the statutory frameworks.

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

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[1] The State and Federal agencies represented in this working group were: California Employment Development Department and Franchise Tax Board, Commonwealth of Kentucky,, 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. Also, the Federation of Tax Administrators was a member of the working group.

[2] The private sector representation was: American Bar Association, American Payroll Association, Ceridian Tax Service, Inc., Federal Liaison Services, Inc., Paychex, Inc., and Planmatics, Inc.

> reported, verify that the information complies with the laws, work with employers to correct reports that do not comply, and provide assistance to employers attempting to comply. The diversity in current laws and filing dates makes it difficult for government agencies to provide consistent, accurate, and timely service to their customers.
>
> The diverse state and federal laws governing wage taxes and withholding significantly increase employer burden....[3]

Reporting complexities caused by existing statutes are very costly to everyone. Small employers must attempt to understand sometimes subtle distinctions, have knowledge of a large number of definitions and attempt to understand the different requirements of them for two different codes within their state. Large and small employers that do business in more than one state must deal with these issues in each state and the administrative complexities caused by multi-jurisdictional differences. On the governmental side of the ledger, states must maintain two separate taxpayer auditing capabilities (and staffs) to insure compliance with two separate laws. By harmonizing the definition of wages substantial compliance cost savings[4], both for private industry and government, were, and are, anticipated.

As part of their study the STAWRS group analyzed and compared hundreds of federal and state statutory provisions and administrative positions to determine the existing degree of harmony of various definitions in various jurisdictions for purposes of determining in each jurisdiction amounts subject to income tax withholding and amounts subject to unemployment

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[3] The Harmonized Wage Code For Income Tax Withholding (unpublished study, IRS, 2001)(copy on file at the University of Dayton School of Law with Prof. Laurence B. Wohl; hereinafter sometimes referred to as the "HWC/ITW") at pg. 1-1. (Emphasis Added) This report together with The Targeted Harmonized Wage Code (discussed, *infra*, note 6) was published electronically on the STAWRS website maintained by the Internal Revenue Service. In 2001 the IRS redesigned its public website, and in the transition to the new website both reports were removed. These reports, together with a supporting data base, are no longer available. Neither the reports nor the data base were published in hard copy.

[4] 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 its income tax withholding requirements and its unemployment insurance tax assessments.

insurance assessment (and, tangentially, unemployment benefits). The project encompassed two studies: one focused on income tax withholding, the Harmonized Wage Code for Income Tax Withholding, and the other, The Harmonized Wage Code for Unemployment Insurance[5], focused on unemployment insurance tax assessment.

The goal of STAWRS was to identify items of compensation that could be excluded from the income subject to income tax withholding and the income subject to unemployment insurance tax assessment. These were to be items that were components of compensation but which were (1) given treatment for income tax withholding purposes differing from one state to another, (2) given treatment for unemployment tax purposes differing from one state to another, and (3) perhaps the most confusing for employers, given treatment by individual states that differed for that state's income tax withholding law and its unemployment tax law. These were items, because of the variety of their treatment, that created significant compliance complexity yet they clearly were items of compensation when paid. STAWRS identified 14 such elements of wages[6] and recommended that they be excluded from wages for income tax withholding purposes. This recommendation forms the backbone of this act though this act goes beyond that recommendation.

This act goes beyond the harmonization of the income tax withholding provisions of the THWC to include a harmonization of those provisions with the unemployment tax provisions of the various states. Adoption of a common definition for these items by all states for both income

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[5] At the time the STAWRS program was terminated, in addition to the completed HWC/ITW, the group was also nearing completion on two additional reports and recommendations: (1) The Harmonized Wage Code/Unemployment Insurance report (sometimes referred to as HWC/UI) focused on inter-jurisdictional harmonization of state unemployment insurance taxes, FICA and FUTA, and (2) The Harmonized Wage Code/Filing Dates (sometimes referred to as HWC/FD).

[6] The HWC/ITW report resulted in a legislative recommendation titled the Targeted Harmonized Wage Code (sometimes referred to as the THWC) (unpublished study, IRS, 2001; copy on file at the University of Dayton School of law with Prof. Laurence B. Wohl). Both the HWC/ITW and the THWC reports focus on inter-jurisdictional harmonization of income tax withholding statutes. The THWC recommended the exclusion of 14 items of income from the withholding requirements. In other words, though still taxable income to an employee, these items of income would not be subject to withholding by the employer. The fourteen items set out by the THWC to be excluded from the withholding tax wage base are (in no particular order of importance): vacation pay, compensation for jury duty, employer provided meals and lodging, group term life insurance, dependent care benefits, tips, employee business expense reimbursements, health insurance, cafeteria plans, moving expenses, death benefits, sick pay, fringe benefits and contributions to qualified retirement plans.

tax withholding and unemployment insurance tax wage base purposes will lead to substantial harmonization and significant compliance simplification. These items are common forms of employee compensation but are not ubiquitous. They are items that are more likely to occur in a large employer environment for income tax withholding purposes but are items that are frequently part of the unemployment tax wage base for both large and small employers. These items, for the most part, are excluded from a wage base for either income tax withholding or unemployment insurance purposes in some states but not in all. Harmonization of each component across the income tax withholding statutes and the unemployment insurance tax assessment statutes of all states will simplify the compliance process and administration of reporting for large and intra-state employers and small single state employers alike. This act harmonizes the definition of wages for income tax withholding purposes by excluding the same components of compensation from withholding of taxes in all states that have an income tax. It also harmonizes the definition of wages for unemployment insurance assessment purposes by excluding the same components of compensation from the unemployment insurance tax wage base in all states. Additionally, for those states that have an income tax as well as unemployment insurance the definition of wages will be harmonized by the exclusion of the same components of compensation from both wage bases. The act creates substantial conformity of definitions, 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 wage bases among the States[7].

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. The income tax withholding regime is indifferent as to items in the wage base[8] whereas the unemployment insurance tax regime is deeply concerned about the items in the wage base. On the one hand the policies driving income tax withholding are focused on the single issue of collection, a ministerial act of collection rather than a political question of what should be taxed. Items of income that are subject to income tax will continue to be subject to that tax even if 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

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[7] There are 43 different federal and state income tax codes and 53 social welfare tax codes.

[8] Though at first blush it might appear that the income tax withholding provisions of a state or federal 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 taxable income. That is an issue with which the income tax withholding provisions do not deal.

those benefits. For purposes of unemployment insurance each item placed in the wage base and subject to unemployment insurance tax will assist employee's in meeting threshold requirements[9] and lead to increased revenues available for distribution to those in need. Conversely, each item removed from this wage base will make it more difficult for an employee to reach threshold requirements and will reduce the amount of revenue available for distribution. Thus, for purposes of unemployment insurance, components of the wage base are important on three 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; second, an item of income added to the wage base increases benefits (up to statutory maximums) payable to an unemployed former employee; and third, the larger the unemployment wage base the greater the unemployment taxes collected and, thus, the larger the fund to pay benefits.

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[10].

For large employers and those doing business in more than one state the harmonization of the most common elements of compensation provide significant alleviation of compliance complexity. However, relief from compliance burdens for small employers, most of which do business in a single state will likely be as great or greater than for larger employers. Because any one small employer has small numbers of employees it is not likely to have employees dedicated to compliance with federal and state tax and unemployment laws. Consequently, the small employer will (1) undertake the compliance regimen themselves (i.e., an entrepreneur will be responsible for compliance or will assign a most likely already overworked bookkeeper to such responsibility) with the commensurate cost in time and education necessary to comply (a cost that will be spread over a small employee base[11]), (2) comply "by the seat of their pants"

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[9] For unemployment benefits purposes a recipient must have earned a minimum amount (which varies from state to state). Thus, any amounts removed from the unemployment insurance tax assessment wage base will make it more difficult for low income employees to reach the threshold and therefore qualify to receive unemployment benefits. It is certainly possible to maintain two separate wage base calculations – one for benefit calculation and the other for tax assessment calculation – however, that would appear to create a new level of bookkeeping complexity. However, the act does not address this issue.

[10] Not addressed by this act is the question of what methods might be used by individual states to correct for lost revenues to its unemployment insurance fund and the income threshold amounts needed to qualify for benefits for those whose qualifying income is reduced by the exclusion of items from the wage base.

[11] Eighty-five percent of the 6.7 million employers in the United States employ 20 or fewer workers. It is also known that these 'small' employers

frequently, if not regularly, resulting in fines and interest bearing errors, or (3) place the compliance burden with contract professionals (accountants, lawyers and payroll services). [12]

States may balk at conforming their own income tax and unemployment tax wage bases let alone conforming those wage bases to other states' wage bases and, possibly, even the federal income tax withholding and FICA wage bases, for a number of good reasons. Two of these reasons are that conformity may lead to a loss of revenue in a state's unemployment insurance system, and conformity may reduce unemployment benefits in some states.[13] A report

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> deal with fewer of the component provisions found in all the state and federal employment tax laws. Thus, most small employers will not be concerned with many of the components, usually those involving more complex forms of remuneration. Therefore, the project team looked at components that are most common among small employers and their employees...

HWC/ITW, *supra,* note 3, at pg. 1-7 [footnote omitted].

The note accompanying this statement in the study points out that "15% of the 'large' employers employ more than 50% of all workers in the U.S.," and further, that the components of their employees' wages are far more complex than those of small employers. (Id. at note 17.)

[12] As pointed out in a study conducted by an outside contractor to the STAWRS group, though small employers, "[a]s a group... generally deal with a smaller number of wage components ... [they], in the aggregate, bear the greatest per employee costs associated with the payroll reporting process." Lalith de Silva, Dominic Rotondi, Mikel Lasa, The Impact of the Tartgeted Harmonized Wage Code on Unemployment Insurance (unpublished study submitted to the Internal Revenue Service by Planmatics Inc., 2001; on file at the University of Dayton School of Law with Professor Laurence B. Wohl) at pg. 5 (hereinafter referred to as the "Planmatics study").

The Planmatics study examined the impact in twelve states of harmonizing the 14 items enumerated by the THWC. The states were California, Connecticut, Georgia, Iowa, Louisiana, Mississippi, Minnesota, Montana, Nevada, New Jersey, Pennsylvania and Texas. Id. at 14.

[13] Anything that reduces the taxable wage base potentially can result in loss of benefit because the base upon which benefits are calculated will be reduced. For example, in California benefits are calculated based upon minimum wages of between $900 and $1,300 earned during a base period. (Cal. Unemp. Ins. Code §1281). Anything that lowers amounts considered as wages under the unemployment insurance regime, therefore, will lower or possibly eliminate benefits available to any specific individual.

commissioned by the STAWRS project set out the following example in explaining the revenue impact of reducing the unemployment insurance wage base:

> To illustrate the impact on tax revenues, consider the following: An employer has an employee in state A and an employee in state B and each earns $20,000 per year. State A has a taxable wage base of $10,000 as opposed to state B's $21,000. (Taxable wage base is that portion of an employee's total wages subject to SUI tax [and may not be the same as that employee's income tax wage base].) Consider as well that the reduction in taxable wages resulting from these definitional changes is $1,000 per year. There would be no impact in state A inasmuch as the portion of the employee's taxable wages would be unchanged. However, in state B taxable wages would be reduced from $20,000 to $19,000 and there would be a commensurate reduction in tax paid by the employer.
>
> When considering worker unemployment benefits, there are two types of impacts that can occur. First, there are minimum earning levels in each state that must be met before an employed worker becomes eligible for benefits. If any reduction in wages would drop a worker's earnings below the minimum earnings level, that worker would no longer be eligible for benefits...
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> Second, and more likely, is the potential reduction in weekly benefit amounts (WBA). These amounts are calculated on a worker's earnings, generally a combination of annual earnings and high-quarter earnings. Any reduction of annual or high-quarter earnings reduces the worker's WBA...[14]

Though traditional contributions might be diminished and benefits reduced under some circumstances, it does not appear that the amount of loss of revenue or aggregate reduction in benefit payments will likely be dramatic if the fourteen items of income are harmonized within a state and among the states and federal government. However, it is possible that, at least as to reduction of 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.[15]

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[14] Planmatics study, *id.* at pgs. 10-11.

[15] "The most controversial recommendation of the HWC Project is that dealing with 'meals and lodging.' ... Most states...[concur with the Internal Revenue Code 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

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

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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 3 at pg. 2-8.

The 23 states that do not exclude meals and lodging from the unemployment insurance wage base have more than 26% of the countries work force and the impact of the meal and lodging exclusion from the unemployment benefits wage base can be substantial. For example, "...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 study, *supra,* note 15, at pg. v.

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SECTION 1. SHORT TITLE. This [act] may be cited as the Uniform Wage Withholding and Unemployment Insurance Procedure Act.

Legislative Note: *It is anticipated that a jurisdiction adopting this act will do so by amending both its statutory provisions dealing with income tax withholding and its statutory provisions dealing with unemployment insurance. If, subsequent to adoption of this act by a State, that State should amend the provisions of this Act as enacted in either its income tax withholding statutory provisions or its unemployment insurance statutory provisions care must be taken to amend both sets of statutory provisions in order to maintain the common definition of wages and the exclusions from wages found in this act. To avoid the problem of a legislature inadvertently adopting an amendment effecting one or the other of these statutory schemes but not both, it would be preferable to adopt this act as a whole and have both the jurisdiction's income tax withholding statute and its unemployment insurance statute incorporate this act's definition of wages and this act's exclusions from wages by reference. No matter which method of adoption is chosen, the adopting State needs to be certain that adoption of the definition of wages and the exclusions therefrom found in this Act do not have an unintended impact on other statutes that currently incorporate by reference the definition of wages found in either its income tax withholding or unemployment insurance provisions.*

It is intended that the definition of wages and the list of exclusions thereto provided by this act will be adopted as the exclusive definition of wages and the exclusive list of exclusions in each adopting State's income tax withholding provisions and unemployment tax provisions. Consequently, in some States adoption of this act will require repeal of existing statutory definitions and exclusions. If an adopting State's legislature determines that for that State's purposes certain items must be included in the definition of wage or added as exclusions from wage which are at variance with the Act, it is recommended that such items be set out in a separate section or sections of their statute so that the deviations from this act can be easily determined by employers.

SECTION 2. DEFINITIONS. In this [act]:

(1) "Employee" means an individual [who is subject to, or would be subject to if not excluded by Sections 4 through 8, withholding of income tax under the laws of this state or] for whom an employer is required to make, or would be required to make if not excluded by

Sections 4 through 8, at any time during the calendar year, contributions under the unemployment insurance laws of this state. The term does not include an independent contractor.

(2) "Employer" means a person that pays remuneration to an individual who is the person's employee.

(3) "Internal Revenue Code" means Title 26 of the United States Code [, as amended].

(4) "Payment" means a transfer from one person to another of money or property in satisfaction of a legal obligation.

(5) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, public corporation, government, or governmental subdivision, agency, or instrumentality, or any other legal or commercial entity.

(6) "Remuneration" means all payments of compensation for services, reimbursements, and advances made by an employer to, or on behalf of, an employee of the employer, and all tips received by an employee from persons other than the employer arising in the course and scope of the employer-employee relationship.

Legislative Note: *There are a significant number of references throughout this Act to the Internal Revenue Code. For those States which are unable to incorporate into their own statutes statutory provisions by reference they will be required to restate in their statutes the referenced provisions of the Internal Revenue Code. In this event legislative drafters should carefully note that only specific portions or provisions rather than the entirety of the referenced sections of the Internal Revenue Code are being incorporated in this Act.*

The bracketed phrase in subsection (1) is language that must be deleted (together with the brackets) in those adopting states that have no income tax while only the brackets must be delted in those adopting states that have an income tax. This convention should be followed throughout the Act where necessary.

Comment

The definition of employee is intended to exclude any relationship in which the service provider is found to be an independent contractor. The distinction between an employee and an independent contractor has been the subject of intense controversy between the Internal Revenue Service and state authorities on the one hand and Taxpayers on the other hand primarily because the recipient of the services of an independent contractor does not make contributions to FICA or FUTA or state unemployment insurance programs on behalf of the service provider whereas the recipient would be required to make these contributions for compensation paid to an employee.

Though employment status is a question of common law the Internal Revenue Service has instructed taxpayers that there are 20 factors, each of which is given different weighting depending on the circumstances, which must be considered in making the determination of employee or independent contractor status. (*See,* Rev. Rul. 87-41, 1987-1 C.B. 296, Regulations Sections 26 CFR 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1). The states generally conform to these 20 factors though interpretations of these factors vary from state to state and court to court. This act does not address the correctness of any position in this regard, it simply accepts whatever status is deemed appropriate under applicable state law.

Additionally, allocations of income from an entity to a limited partner, non-managing member of a limited liability company (or any variation of this type of entity such as limited liability partnerships) or a shareholder of a sub-chapter S corporation (all of which are entities frequently referred to as "pass-thru entities") are not subject to FICA, FUTA or state unemployment insurance taxes. General partners and managing members of limited liability companies (i.e., those partners or members who are not considered merely passive investors) are subject to self-employment taxes on their distributive share of partnership income imposed under Internal Revenue Code Section 1401 *et.seq.* on all distributions from the partnership. It has not yet been resolved by the IRS or the courts as to whether the allocable share of entity earnings are subject to non-managing members of limited liability companies and similar limited liability entities are subject to the self employment tax.

This act impacts only withholding tax requirements and unemployment taxes imposed by States. It does not affect the assessment or collection of any local taxes even if those taxes are income taxes or some form of unemployment tax.

This Act's definition of wages is intended to include vacation pay. Currently, vacation pay is defined by all states, with the exception of Delaware, as a wage. Delaware does include vacation pay as wages for purposes of both income tax withholding and assessment of unemployment insurance taxes except for vacation pay paid during a period of unemployment, which is excluded.

In kind payments of wages ("medium other than cash") will be included at the property's 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.

In general all States currently provide that tips or gratuities are wages and that the employer has the legal obligation to withhold income taxes and to make unemployment insurance contributions on those wages. This provision assumes that each state has or will have a reporting procedure similar to the federal requirement that the employee provide a monthly statement in writing to the employer stating the amount of tips earned during the preceding month. Because tips are frequently paid for via credit and debit cards the record keeping requirements for both employer and employee are somewhat less burdensome than they may have been when such payments were generally made in cash. Note that this act does provide for exclusion of tips not exceeding $20 per month at Section 7.

An employer is defined as the payor of remuneration. The term "remuneration" is defined in section 2 as including all payments made by an employer to an employee together with tips. Section 3 makes clear that all remuneration other than those items specifically excluded by sections 4 through 8 of the act are wages. The fundamental concepts underlying the act are that (1) only employers pay wages, (2) that all wages are subject to unemployment taxes (or contributions) and, in those states having an income tax, withholding of income taxes, and (3) certain specific items of remuneration are excluded from the definition of wages.

SECTION 3. WAGES SUBJECT TO INCOME TAX WITHHOLDING AND UNEMPLOYMENT INSURANCE. Except as otherwise provided in Sections 4 through 8, all remuneration is wages subject to [withholding of income taxes under [cite to the income tax laws of enacting state and]] the unemployment insurance [tax][contribution] under [cite to the unemployment insurance laws of the enacting state]. The value of a payment of remuneration that is not in the form of money is at its fair market value on the date of payment.

Legislative note: *The sections of state law referenced in the brackets should be amended to either*

(1) delete the existing definition of wages by including a sentence saying, in effect: "'Wages' shall mean wages as defined in Section 3 of the Uniform Wage Withholding and Unemployment Insurance Procedure Act ," or

(2) add to the section a sentence saying, in effect, "For purposes of determining [amounts to be withheld for purposes of income taxes and] amounts of [taxes][contributions] due under the unemployment insurance laws the term 'wages' shall be defined as defined in Section 3 of the Uniform Wage Withholding and Unemployment Insurance Procedure Act."

Comment

Liability for the unemployment insurance taxes rests entirely on the employer with the exception of Pennsylvania which imposes a tax on employees. Some states refer to the employers' liability as a tax and others refer to the liability as a contribution.

SECTION 4. CERTAIN REMUNERATION EXCLUDED FROM WAGES. The following are excluded from wages:

(1) a payment made to, or on behalf of, an employee or the employee's beneficiary under a cafeteria plan under Section 125 of the Internal Revenue Code, if the payment would not be treated as wages without regard to the plan and at the time of payment it is reasonable to believe that Section 125 of the Internal Revenue Code would not treat the payment as included as taxable wages because of the constructive receipt of the payment;

(2) a payment made by an employer to, or on behalf of, an employee for moving expenses if, at the time of the payment, it is reasonable to believe that the payment is allowable as a deduction by the employee for tax purposes under Section 217 of the Internal Revenue Code, as determined without regard to Section 67 of the Internal Revenue Code, or that the payment is excludable from the employee's federal gross income under Section 132(a)(6) of the Internal Revenue Code;

(3) a payment made to an employee by an employer as an employee achievement award as defined in Section 274(j) of the Internal Revenue Code [and];

(4) a fringe benefit provided by the employer to or for the benefit of an employee if, at the time provided, it is reasonable to believe that the benefit is excludable from the employee's federal gross income under Section 132 of the Internal Revenue Code[;] [and]

[(5) the fair market value of any meals or lodging furnished to an employee by or

on behalf of an employer if, at the time furnished, it is reasonable to believe that the employee will be able to exclude the value from income under Section 119 of the Internal Revenue Code].

Legislative Note: *The Commissioners take note that subsection (5) has the effect of excluding items from the unemployment wage base that will result in the loss of benefits to the lowest wage individuals. Consequently, it is presumed that a state adopting this provision will amend its unemployment tax regime to eliminate the burden imposed on these employees. One method of approaching this issue would be for the state to increase the rate of unemployment tax on other income paid to individuals whose compensation is in part excluded under this provision and to reduce the benefit threshold amount for those individuals. Another possible method to ameliorate the problem concerning the Commissioners would be to base unemployment tax assessment and benefit threshold in part on an hours worked basis rather than amount of compensation basis. The Commissioners also believe that a State can adopt this act without enacting this exclusion.*

Comment

This provision excludes from both the income tax withholdings wage base and the unemployment insurance tax and benefits wage base amounts that are excluded because they are items provided by the employer primarily because the physical location for the performance of services requires the employee to live and/or eat on the business premises. No state that imposes income taxes does not already provide such provision or, at least, a provision similar to Internal Revenue Code Section 119 for income tax withholding purposes. However, as stated by a report made to STAWRS:

> At present, 23 states treat meals and lodging as wages in their [unemployment insurance] laws and would be affected by this recommendation [to exclude meals and lodging from the compensation wage base]. These states include California (included in this study), New Jersey, New York, and Texas. They represent in excess of 26% of the nation's work force. In terms of impact on affected claims, analysis of California's data indicate the average benefit claim over its duration is $2,433 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.[16]

The report making the above quoted statement pointed out that in California this

[16] Planmatics study, *supra,* note 7 at pg. v.

reduction represents only "...about 0.2% of the total benefit outlay, [however,] it represents almost a 20% reduction for the 7600 affected claimants. Additionally, 660 claimants, or 0.1% of the claimant population would lose their eligibility entirely."[17] Any attempt to harmonize the income tax withholding provisions with the unemployment insurance provisions within a given state will have to recognize the difficulty of dealing with these two different policy concerns. Of course, for those who have remuneration from their employers other than meals and lodging at, or in excess of, the maximum taxable unemployment insurance wage base the exclusion of the value of meals and lodging is of no consequence.

The Commissioners are most troubled by the prospect of low income workers being disadvantaged for the benefit of administrative convenience no matter how small the number of effected workers. Possible methods of achieving the administrative goal without disadvantaging these people is suggested in the legislative note accompanying this provision. However, if a method cannot be determined by a state to reconcile this conflict, then the Commissioners recommend that this provision not be adopted by that state.

As an example of this problem consider an employee who receives from an employer meals that qualify as exempt from income tax under statutory provisions similar to Section 119 of the Internal Revenue Code. Though the value of the meals is correctly excluded from the income tax withholding wage base it is considered income for purposes of establishing the unemployment insurance tax imposed on the employer and considered part of the wage base for determining an unemployed individual's unemployment benefits. Not all income for unemployment insurance purposes is income for tax withholding purposes.

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

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[17] *Id*. at 34.

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

Also excluded by this provision are employee achievement awards. These payments are small awards given to employees for achievement in longevity or safety. For federal income tax purposes, if awards are not pursuant to a written plan, the sum of all achievement awards paid to any one employee during any year that the employer can deduct as a business expense cannot exceed $400 per year. If awards are made pursuant to an established written plan or program that does not discriminate in favor of highly paid individuals (i.e., a qualified plan), then the sum of all achievement awards paid to an employee during any year that the employer can deduct as a business expense cannot exceed $1,600 (including any awards from a non-qualified plan).

Of those jurisdictions imposing an income tax forty-two have provisions that provide for exclusions from wages similar to Section 132 of the Internal Revenue Code. One state has no provision. For purposes of unemployment insurance withholding only thirty-three states have provisions similar to Section 132. Ten states currently have no or minimally matching provisions.

SECTION 5. LIFE, DISABILITY, SICKNESS, AND MEDICAL INSURANCE BENEFITS EXCLUDED FROM WAGES.

[(a)] The following are excluded from wages:

(1) all premiums paid by an employer for group-term life insurance on the life of an employee;

(2) a payment, including any amount paid by an employer for insurance or an annuity or into a fund to provide for any insurance or annuity payment, made to, or on behalf of, an employee or any of the employee's dependents under a plan or system established by an employer which makes provision for the employer's employees generally, the employer's employees generally and their dependents, a class or classes of the employer's employees, or a

class or classes of the employer's employees and their dependents because of:

(A) sickness or accident disability, but in the case of payments made to an employee or any of the employee's dependents, this subparagraph excludes from the term "wages" only payments received under a workers' compensation law;

(B) medical or hospitalization expenses in connection with sickness or accident disability; or

(C) death;

(3) a payment for sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of six calendar months following the last calendar month in which the employee worked for the employer;

(4) a payment made to, or on behalf of, an employee, or any of the employee's dependents, under a plan or system established by an employer which makes provision for the employer's employees generally, the employer's employees generally and their dependents, a class or classes of the employer's employees, or a class or classes of the employer's employees and their dependents which is paid upon or after the termination of an employee's employment relationship because of death or retirement for disability, which would not have been paid if the employee's employment relationship had not been terminated because of death or retirement for disability; and

(5) a payment made by an employer to a survivor or the estate of a former employee after the calendar year in which the employee died.

[(b) An employee may make an election to have income tax withheld on any payment of sick pay pursuant to subsection (a)(2)(B).]

Comment

An employee election instructing the payor to withhold income taxes under this provision shall be made in such a manner as is required by each enacting state regarding this, or this type of, election. It should be noted that for federal income tax withholding purposes, and election in writing is required. (*See,* Internal Revenue Code §3402(o)(4))

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

In general only income from sick pay or wage continuation plans maintained by the employer but not mandated by a state's workers' compensation law are included in an employee's income wage base for purposes of either income tax withholding or unemployment insurance benefit determination or tax assessment. Amounts paid due to an employee's death but are considered income in respect of a decedent (as defined at Internal Revenue Code Section 691) are not excluded and this act does not intend to change that treatment.

SECTION 6. DEPENDENT CARE AND RETIREMENT PAYMENTS

EXCLUDED FROM WAGES. The following are excluded from wages:

(1) a payment made for, or the value of benefits that provide, employee dependent care assistance pursuant to a qualifying dependent care program if, at the time of the payment for or provision of the benefit, it is reasonable to believe the payment or benefit is excludable from the employee's federal gross income under Section 129 of the Internal Revenue Code; and

(2) a payment made to, or on behalf of, an employee or the employee's beneficiary from or to a pension, profit-sharing, or similar retirement plan described in Section 3306(b)(5)(A) through (F) of the Internal Revenue Code.

Comment

This provision excludes the value of benefits provided by an employer to an employee under an employer provided dependent care plan providing non-discriminatory access to dependent care for young children who are dependents and dependent adults who are unable to care for themselves due to physical or mental incapacity. It is intended that these individuals be the same as those defined as "qualifying individuals" at Internal Revenue Code Section 21(b)(1).

It is further intended that the State statutory provisions will require a written, non-discriminatory plan similar to that under and meeting the requirements of Internal Revenue Code Section 129. Inclusion of this provision will require many states to adopt dependent care provisions not currently extant. Currently, 42 states have concurring statutes for income tax withholding 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).

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

SECTION 7. SCHOLARSHIPS AND EDUCATIONAL EXPENDITURES EXCLUDED FROM WAGES. The following are excluded from wages:

(1) a payment made for a scholarship or fellowship to an employee or a dependent of the employee who is a candidate for a degree at an educational organization described in Section 170(b)(1)(A)(ii) of the Internal Revenue Code and used by the individual for qualified tuition and related expenses, as the terms are defined in Section 117(b) of the Internal Revenue Code; and

(2) tuition reduction for education, below the graduate level, at the employer or at any other organization described at Section 170(b)(1)(A)(ii) of the Internal Revenue Code, provided by an employer that is an organization described in Section 170(b)(1)(A)(ii) of the Internal Revenue Code to an employee of the employer, a retired or a disabled employee of the employer, the surviving spouse of a deceased employee of the employer, or the spouse of or a dependent of the employee.

Comment

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

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

SECTION 8. NON-FRINGE BENEFIT PAYMENTS EXCLUDED FROM WAGES. The following are excluded from wages:

(1) a payment made to an employee for expenses incurred or anticipated to be incurred by the employee on behalf of the employee's employer or as an allowance provided by the employer for, but not in excess of, those expenditures that meet the requirements of Section 62(a)(2)(A) of the Internal Revenue Code and that are not in excess of the lesser of the employer established expense allowance or the substantiated expenses incurred by the employee for the expenditures;

(2) a payment made to an individual by a court, or by a governmental entity on behalf of a court, for jury service;

(3) a payment made to an employee for services performed outside of this state if, at the time of the payment, it is reasonable to believe that the payment is excludable from the employee's gross income under [cite statutes of this state] for income tax or unemployment insurance purposes;

(4) a payment made to an employee as the result of the employee's transitory passage through this state while engaged in the interstate transportation of property or people; and

(5) tips aggregating less than $20 in any calendar month paid to an employee by persons other than the employer for services arising in the course and scope of the employment relationship between the employer and the employee.

Legislative Note: *If a state wishes to add additional exclusions considered unique to that state, they should insert them after subsection (5).*

Comment

All states exclude payments from courts for jury service from income tax withholding requirements as well as unemployment insurance purposes. However, some states accomplish this exclusion by excluding such payments from the definition of wages and others simply exclude jury service from the definition of employment. For those taking this later approach, this provision will require them to amend that portion of their statutes to conform to a treatment of these payments as exclusion from the definition of wages. This provision does not exclude wage continuation or similar payments made by an employer to an employee during the period in which the employee is serving on a jury.

Forty six states have adopted provisions similar to this provision which exclude amounts paid to an employee. At present no state imposes a withholding requirement on out of state employers on wages earned by and paid to a state resident while out of state. If a State did include such income in its withholding wage base, it would be impossible to enforce a withholding requirement on a foreign corporation that had no presence in the state, but it could enforce withholding requirements on any corporation that is present in the state. Additionally, if a state exercised jurisdiction over a corporation and chose to include this income in the unemployment wage base there would be an impact on an employee's benefit wage base as well as an imposition of unemployment taxes on the employer even if the employer is out of state and has no contacts with the state.

Though the THWC report indicates that all states provide an exclusion from both income tax withholding and unemployment insurance tax purposes for reimbursed employee expenses. There are, however, numerous states that do not require taxpayers or employers to comply with the reporting and documentation 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. However, adoption of this provision will require the adoption of State reporting and documentation rules similar to those imposed by the Internal

Revenue Code and the regulations thereunder.

The provision allowing states to add additional exclusions from the definition of income for income tax withholding or unemployment insurance purposes should be used sparingly. It is contemplated that state legislatures will avail themselves of the opportunity to exclude additional items only in the exceptional case (1)when there is an item of income that is found primarily in the adopting state rather than generally among many states and (2) if the item is not excluded it will cause a significant burden to the state's taxpayers or the administration of the state's laws.

SECTION 9. PLACES AND DATES FOR FILING AND PAYMENT.

(a) All reports of unemployment [taxes][contributions] must be filed on the dates and submitted to [insert the appropriate state agency] as prescribed by [the responsible state agency].

(b) All payments of unemployment [taxes][contributions] must be made by the employer to and in the form required by [insert appropriate state agency] on the last day of the month immediately following the end of each calendar quarter.

(c) All reports of income taxes withheld in accordance with [insert state statute imposing the requirement that employers withhold income taxes] must be filed with [insert the appropriate state agency] in the form prescribed by [the responsible state agency] on the last day of the month following the end of each calendar quarter.

(d) Except as otherwise provided in subsection (e), all income taxes withheld in accordance with [insert state statute imposing the requirement that employers withhold income taxes] must be deposited with and in the form required by [insert appropriate state agency] on the following dates:

(1) if the total amount of undeposited withheld income taxes does not exceed $2,500 at any time during a calendar year, no later than January 31 of the immediately following calendar year;

(2) if the total amount of undeposited withheld income taxes on either a June 30 or a December 31 is greater than $2,500, but no more than $5,000, no later than the 15th day of the calendar month immediately following the June 30 or December 31 on which the undeposited withheld income taxes exceed $2,500;

(3) if the total amount of undeposited income taxes withheld is greater than $5,000, but no more than $50,000, no later than the 15th day of the calendar month immediately following the month in which the undeposited withheld income taxes exceed $5,000; and

(4) if the total amount of undeposited withheld income taxes is greater than $50,000, no later than the first business day immediately following the day on which the undeposited withheld income taxes exceed $50,000.

(e) If an employer's obligation to deposit undeposited withheld income taxes under subsection (d) is less during any period than it was for the immediately preceding period, the employer shall make a deposit on the date that would be the required date by subsection (d) if the amount of the obligation were the same as for the immediately preceding period unless the employer files on that date a notice with, and in the manner prescribed by, [the appropriate state agency] that the employer's deposit requirements have changed.

Comment

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

the size of the employer may be high. The Act simplifies this compliance complexity, and, ignoring transition problems, common dates for compliance will greatly ease burdens imposed on all employers. Further, the costs of auditing and assuring compliance incurred by the States presumably will be reduced simply because complexity is reduced.

Because the federal rules governing unemployment taxes require that the states collect such taxes on a quarterly basis only a quarterly schedule has been indicated for those taxes.

The income tax withholding provisions are a modification of the federal deposit schedule. The Act's deposit schedule permits a somewhat extended payment period as compared to the federal schedule for small employers and a slightly accelerated schedule for large employers.

The federal deposit schedule is based upon a rolling measure of an employer's levels of withheld taxes for the immediately previous four quarters (sometimes referred to as "the look back period." This provides employer's with a method of planning their cash flow and the Internal Revenue Service with some capability to monitor employers' compliance with deposit requirements. The Act does not provide a "look back" period. Rather, the Act imposes deposit obligations for withheld income taxes based upon current rather than historical wage amounts. It is believed the simplification this provides over the federal method is, on balance, more important than whatever anticipatory evaluation of cash flow might be provided employers. On the other hand, to assist state governments in enforcing compliance with deposit requirements the Act provides that an employer must timely notify the state if the employer's current wage withholdings would require less frequent deposits than its immediately preceding deposit requirements. For example, if Company A has withholding amounts during February of 2004, of $25,000 then the Act requires that Company A deposit the withheld taxes with the state's collection agent by March 15, 2004. Additionally, the state will be expecting another deposit on April 15, 2004, for the withheld income taxes during the month of March. The state expects this because it assumes that the withheld income taxes during March will be approximately the same as those withheld in February (i.e., the employer's payroll will stay reasonably consistent). However, the Act provides that if the employer's payroll should change after February so that in the following months of March, April, May and June the total income taxes withheld by the employer is only $4,500 (i.e., the employer's payroll has been dramatically reduced) the employer will still be required to make monthly payments of withheld taxes unless and until the employer files a notification with the state that his payment obligation has changed from monthly to semi-annually.

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

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

This provision also does not provide for a look back period as does the Internal Revenue Code and some state withholding statutes. A look back provision permits payors to base their payment thresholds, and thus frequency of payment of taxes, on prior year compensation history. Because the income taxes withheld and the taxes owed for unemployment insurance purposes are based upon current compensation, it does not appear that look back rules are essential to timely and accurate compliance with the payment rules. In an era of instant information and computerized payroll systems, it does not appear that essential data for proper compliance is difficult to aggregate. On the other hand it is recognized that payments based upon current payrolls may cause cash management problems for employers which have significantly fluctuating payrolls. Nonetheless, payments based upon current compensation rather than look back estimates will make it less likely that employers will become in arrears in payments of their Trust Fund obligations (i.e., their obligations to pay over withholding taxes). For large taxpayers, at least for federal taxes, this is not an issue because regardless of any look back rules at any time an employer has accumulated $100,000 of payroll taxes they must be paid over to the government by the next business day after such accumulation. For mid-size taxpayers, particularly those with quickly growing business or those the business of which is highly volatile, the problem of temptation to use rather than pay over Trust Fund monies may cause them much difficulty and deprive the government of monies owed.

Deposits are to made in a form as prescribed by each state. Some states may require deposits with bank depositories while others may require check or electronic payments. There is no intention that this Act should in any way effect each state's preference in this regard.

SECTION 10. EFFECTIVE DATE. The [act] takes effect on January 1 [insert appropriate year].

Comment

No transition rules are specified in this act. Because of many different existing collection dates and amounts in the various states, it would be impossible to address the transition issues facing each state in a single process. It is intended by the Commissioners that by deferring the effective date of this act for as many as four years after the acts adoption by the state that this will give all states sufficient time to effect the transition with the least impact possible on taxpayers and tax administrators. This somewhat lengthy period is also an acknowledgment that, particularly in the case of unemployment tax administration, it will take some time after adoption for the state tax administrators to make the necessary computer software adjustments necessary to comply with the act. This act does not provide for a date by which all state legislatures should adopt this act. This should not be interpreted as a suggestion that the states

can defer action on this act for an extended period of time. It is presumed by the commissioners that all the states will consider the adoption of this act as quickly as is possible.

SECTION 11. UNIFORMITY OF APPLICATION AND CONSTRUCTION. In applying and construing this Uniform Act, consideration must be given to the need to promote uniformity of the law with respect to its subject matter among states that enact it.

SECTION 12. REPEALS. The following acts and parts of acts are repealed:

(1)

(2)

(3)