

COMMITTEE DISCUSSION DRAFT #2

# **UNIFORM WAGE WITHHOLDING PROCEDURE ACT**

FOR DISCUSSION PURPOSES ONLY

NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM LAWS

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*With Reporter's Notes*

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ON UNIFORM LAWS

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## **UNIFORM WAGE WITHHOLDING PROCEDURE ACT**

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# **UNIFORM WAGE WITHHOLDING PROCEDURE ACT**

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# UNIFORM WAGE WITHHOLDING PROCEDURE ACT

## PREFATORY NOTE

Beginning in 1966 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<sup>1</sup> and private sector organizations<sup>2</sup> have been engaged in a study conducted by the Simplified Tax and Wage Reporting System Program, commonly referred to by the acronym STAWRS. 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 unemployment tax assessment and withholding requirements 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 its withholding requirements.

As part of their study the STAWRS group has analyzed and compared hundreds of federal and state provisions to determine the existing state of harmony in the way various items of income are treated by the various jurisdictions for purposes of income tax withholding and unemployment insurance assessment and benefits calculation base purposes. As a result of this study STAWRS made recommendations for a Harmonized Wage Code for Income Tax

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<sup>1</sup> 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.

<sup>2</sup> 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.....)

1     Withholding<sup>3</sup> and has made substantial progress towards the completion of a Harmonized Wage  
2     Code for Unemployment Insurance.

3  
4     The STAWRS group found that there are 14 most common elements of income which, if  
5     adopted by all states for both income tax withholding and unemployment tax and wage base  
6     purposes, would lead to substantial harmonization and significant compliance simplification.  
7     These 14 elements are the most common elements of compensation paid by most, if not all,  
8     employers.

9  
10             Eighty-five percent of the 6.7 million employers in the United  
11             States employ 20 or fewer workers. It is also known that these  
12             ‘small’ employers deal with fewer of the component provisions  
13             found in all the state and federal employment tax laws. Thus, most  
14             small employers will not be concerned with many of the  
15             components, usually those involving more complex forms of  
16             remuneration. Therefore, the project team looked at components  
17             that are most common among small employers and their  
18             employees...”<sup>4</sup>

19  
20             For the small employers in particular, most of which do business in a single state, relief  
21     from compliance burdens would be realized if there was harmonization of the most common

---

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

10  
11             The HWC/ITW and the THWC reports focus on inter-jurisdictional harmonization of  
12     income tax withholding statutes. Two additional reports which are uncompleted and currently on  
13     hold, will focus on inter-jurisdictional harmonization of unemployment insurance tax (“HWC/UI”  
14     report) and on inter-jurisdictional filing date harmonization (sometimes herein referred to as the  
15     “HWC/FD” report). All the reports deal, or will deal, only tangentially with intra-jurisdictional  
16     harmonization of income tax withholding and unemployment insurance provisions.

1             <sup>4</sup> 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  
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 elements of compensation because it is with those that they deal almost exclusively. Even for  
2 large employers and those doing business in more than one state the harmonization of the most  
3 common elements of compensation would provide significant alleviation of compliance  
4 complexity. The more the various codes can be harmonized the greater will be taxpayer and  
5 governmental relief from compliance complexity.  
6

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

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

24 The fourteen most common elements of wages<sup>5</sup> are referred to as the Targeted  
25 Harmonized Wage Code or THWC. It appears that these elements, if harmonized throughout  
26 the income tax codes of all states and federal government would be a good first step in  
27 simplifying compliance requirements. These 14 elements have been adopted by this proposed  
28 uniform law. Because these fourteen items are the most common forms of remuneration for  
29 employees' services a large majority of employers will be directly, and positively, impacted by  
30 this conformity. Hopefully, this structure will also simplify the compliance process and  
31 administration of reporting for large and intra-state employers by making the number of their  
32 wage components effecting the majority of their employees the same for all jurisdictions and  
33 both wage bases.  
34

35 States may balk at conforming even their own income tax and unemployment tax wage  
36 bases let alone conforming those wage bases to other states and, possibly, even the federal  
37 income tax withholding and FICA wage bases for a number of good reasons. Two of these

---

1 <sup>5</sup> 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 benefits,  
5 sick pay, fringe benefits and contributions to qualified retirement plans.

1 reasons are that conformity will most likely lead to a loss of revenue, and conformity will reduce  
2 unemployment benefits in some states.<sup>6</sup> A report commissioned by the STAWRS project set out  
3 the following example in explaining the revenue impact of reducing the unemployment insurance  
4 wage base:

5  
6 To illustrate the impact on tax revenues, consider the following:

7 An employer has an employee in state A and an employee in state  
8 B and each earns \$20,000 per year. State A has a taxable wage  
9 base of \$10,000 as opposed to state B's \$21,000. (Taxable wage  
10 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  
12 base].) Consider as well that the reduction in taxable wages  
13 resulting from these definitional changes is \$1,000 per year. There  
14 would be no impact in state A inasmuch as the portion of the  
15 employee's taxable wages would be unchanged. However, in state  
16 B taxable wages would be reduced from \$20,000 to \$19,000 and  
17 there would be a commensurate reduction in tax paid by the  
18 employer.

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

25 Second, and more likely, is the potential reduction in weekly  
26 benefit amounts (WBA). These amounts are calculated on a  
27 worker's earnings, generally a combination of annual earnings and  
28 high-quarter earnings. Any reduction of annual or high-quarter  
29 earnings reduces the worker's WBA...<sup>7</sup>

---

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

1 <sup>7</sup> 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.

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.<sup>8</sup>

I. SHORT TITLE. This Act may be cited as the Uniform Wage Base Act.

## 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

<sup>8</sup> 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.



1 elsewhere and is unrelated to the question of how to collect the tax. Items subject to income tax  
2 will continue to be subject to that tax even if the item is not subject to withholding.  
3

4 On the other hand, policies underlying unemployment insurance programs are concerned  
5 with dispersal of benefits as well as the collection of sufficient revenues to provide for those  
6 benefits. For purposes of unemployment insurance, items placed in the wage base are important  
7 on two counts. First, an item added to the unemployment insurance wage base makes it easier  
8 for an employee to meet the threshold amounts of income needed to qualify for benefits; and,  
9 second, an item of income added to the wage base increases benefits payable (up to statutory  
10 maximums) to an unemployed former employee. Consequently, putting the issue of complexity  
11 momentarily aside, the income tax withholding regime is indifferent as to items in the wage base  
12 whereas the unemployment insurance tax regime is deeply concerned about the items in the wage  
13 base. For purposes of unemployment insurance each item placed in the wage base and subject to  
14 unemployment insurance tax will lead to increased revenues available for distribution to those in  
15 need.  
16

17 In attempting to harmonize the two separate code constructs there must be a careful  
18 balancing of the need for simplicity, and thus compliance cost reduction, with the need not to  
19 compromise benefits that a state has deemed appropriate for its unemployed. The Act, if  
20 adopted by the States, will create substantial conformity, and thus simplification, between an  
21 adopting State's income tax wage base and its unemployment insurance wage base as well as  
22 substantial conformity of those wage bases among the States<sup>9</sup>.  
23

24 The fifty states, the District of Columbia, and the federal  
25 government have a total of 96 different employment tax laws.  
26 Within the 96 employment tax laws, there are almost 500 different  
27 components or provisions. Employers must maintain separate  
28 wage records for federal income tax withholding, state income tax  
29 withholding, the federal insurance contributions act (FICA), the  
30 federal unemployment tax act (FUTA), and state unemployment  
31 insurance (SUI) taxes. *In many cases, employers must report this*  
32 *information to government agencies at different times, on different*  
33 *forms, and on assorted media. ...*

34 In addition to requiring employers to report tax-and wage-related  
35 information, employment tax laws require government agencies to  
36 process the information reported, verify that the information  
37 complies with the laws, work with employers to correct reports that  
38 do not comply, and provide assistance to employers attempting to  
39 comply. The diversity in current laws and filing dates makes it  
40 difficult for government agencies to provide consistent, accurate,  
41 and timely service to their customers.

---

1 <sup>9</sup> There are 43 different federal and state income tax codes and 53 social welfare tax codes.

1 The diverse state and federal laws governing wage taxes and  
2 withholding significantly increase employer burden....<sup>10</sup>  
3

4 Reporting complexities are very costly to everyone. Small employers must attempt to  
5 understand sometimes subtle distinctions, have knowledge of a large number of definitions and  
6 attempt to understand the different requirements of them for two different codes within their  
7 state. Large and small employers that do business in more than one state must deal with these  
8 issues in each state and the administrative complexities caused by multi-jurisdictional  
9 differences. States must maintain two separate taxpayer auditing capabilities (and staffs) to  
10 insure compliance with two separate laws.  
11

12 Though it will be impossible to construct a single code that will conform in totality each  
13 State's income tax withholding and unemployment insurance tax provisions or that will cause the  
14 various States' statutes to conform to the other States' statutes, it is quite possible to find  
15 sufficient areas of commonality to substantially reduce compliance burdens for states and for  
16 employers in general and small employers in particular. "Eighty-five percent of employers of the  
17 6.7 million employers in the United States employ 20 or fewer workers. ... [T]hese 'small'  
18 employers deal with fewer of the component provisions found in .... federal [and state]  
19 employment tax laws."<sup>11</sup>  
20

21 The Commissioners believe that the Act creates the proper balance between efficiency  
22 and cost savings on the one hand and the necessary flexibility required by each State to meet its  
23 citizens' unique needs. The Commissioners recognize that issues of jurisdictional integrity and  
24 different needs of the various States could create stumbling blocks to harmonization.  
25 Nonetheless, the Commissioners believe that adoption of this Act will lead to significant  
26 simplification and cost savings for employers and States.  
27  
28  
29

## 30 II. DEFINITIONS:

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1 <sup>10</sup> HWC/ITW, *supra*, note 3 at 1-1. (Emphasis Added)

1 <sup>11</sup> HWC/ITW, *supra*, note 3 at 1-7 [footnote omitted]. The note accompanying this  
2 statement in the HWC/ITW points out that "15% of the 'large' employers employ more than 50%  
3 of all workers in the U.S.", and further, the components of their employees' wages are far more  
4 complex than those of small employers. Consequently, harmonization among the states and, ideally  
5 the states and the federal government would have a dramatic impact on the compliance complexities  
6 faced by all employers but probably a greater impact on the country's largest employers. However,  
7 as 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.

1 A. "Act" means this Uniform Withholding Tax And Unemployment Tax Wage Bases Act.

2 B. "Annuity" means a contract providing for an individual's investment in exchange for  
3 guaranteed payments from the other contracting party in determinable annual installments  
4 for a fixed period of years or until the death of the one receiving payments under the  
5 annuity contract.

6 C. "Deferred compensation plan" means a plan maintained by an employer whereby the  
7 payment of a portion of an employee's compensation for services currently rendered in  
8 the capacity of employee is deferred to future taxable years.

9 D. "Disability" means the inability of an employee to perform significant employment  
10 activity for the employer from which, or on behalf of which, the employee is being  
11 provided benefits and/or compensation during the period of such inability to engage in  
12 significant employment activity.

13 COMMENT

14 This is a relatively loose definition of disability. However, the Act is dealing primarily with  
15 withholding requirements and unemployment wage base issues as they effect employers'  
16 payments for forms of compensation. This provision takes the position that if an employee's  
17 condition is sufficient to satisfy the employer or the employer's insurer that disability payments  
18 should be made that is sufficient evidence that a disability is extant.  
19

20  
21 E. "Employee" means every individual performing services for another individual or entity  
22 if the relationship between him or her and the person or entity for whom or which he or  
23 she performs such services is the legal relationship of employer and employee.

COMMENT

This definition does not address the question of whether an individual relationship is that of employer/employee or customer/independent contractor and leaves the resolution of that characterization to federal and state judicial, regulatory or statutory determination. Generally this is not a major issue, however in those situations when the distinction is both important and unresolved the determination of status is left unaddressed here. The focus of the Act is a determination of which items of wages shall be included for purposes of income tax withholding and unemployment insurance tax and benefits wage base calculation. The Act is not concerned with the issue of characterizing items of income as being or not being wages.

It should be noted that IRC Section 3401(a)(3) provides that wages "...paid for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority are not considered wages for purposes of the withholding tax requirements. Nonetheless, they are not excluded from wages under???? or state unemployment insurance tax or wage base calculations. *See, e.g.,* Cal. Unemployment Insurance Code Sections 682 - 684.

F. "Employee Achievement Award" means a payment by an employer to an employee that meets all the requirements of IRC Sections 74(c) and 274(j)

G. "Employer tax deferred compensation plan" means a tax deferred plan qualifying under the provisions of IRC Sections 401, 403, 408(k), 408(p), and 457.

H. "Employer" means an individual or entity engaging an individual in the capacity of an employee.

I. "FICA" means the Federal Insurance Contributions Act [CITE], commonly referred to as "social security."

J. "FUTA" means the Federal Unemployment Tax Act [CITE] under which employers are assessed taxes, in conjunction with state unemployment insurance acts, for purposes of funding state determined unemployment benefits.

K. "Gratuity" means a payment by a person other than an individual's employer for services

1 rendered by the individual in the course of his or her employment with his or her  
2 employer.

3 L. “IRC” means Title 26 of the United States Code [CITE] (more commonly referred to as  
4 the Internal Revenue Code) as in effect on January 1, 2003, and as thereafter from time to  
5 time amended.

6 M. “Qualified dependent care program” means a program maintained by an employer for its  
7 employees that is in conformance with the requirements of IRC Section 129.

8 N. “Qualified group-term life insurance” means amounts excludable from an employee’s  
9 remuneration subject to income taxation under IRC Section 79.

10 O. “Sick pay” means any payment (other than a payment due to disability as defined in this  
11 Act) to an employee by an employer, or on behalf of an employer, pursuant to an  
12 employer plan whereby the employee receives remuneration in lieu of that which is paid  
13 to said employee by the employer for employment services performed and such  
14 remuneration is paid by virtue of an employee’s absence from work due to temporary  
15 sickness or personal injury.

16 P. “State” means each of the 50 states and the District of Columbia.

17 Q. “Tip” means gratuity as defined at section J., above, of this Article II.

18 R. “Wages” means, except as specifically excluded by this Act, all forms of remuneration,  
19 whether in cash or in a medium other than cash, paid to an employee by an employer  
20 within the context of his or her employment for (1) services rendered for the employer by  
21 the employee, and (2) for vacation pay paid by the employer.

1 COMMENT

2  
3 Delaware is the only state in which vacation pay is not always an element of wages for  
4 purposes of both income tax withholding and unemployment insurance tax assessment and wage  
5 base benefit calculation. Delaware excludes as wages vacation pay paid during a period of  
6 unemployment  
7

8  
9 III. EXCLUSIONS

10  
11 A. All items set forth in this Article III shall be excluded from wages for the purposes of

12 1. determining amounts subject to income tax withholding,

13 2. assessment of the unemployment insurance tax, and

14 3. determining benefits payable by this State for an unemployed individual under this

15 State's unemployment compensation law

16 B. The following items shall not be deemed wages for the purposes set forth at Section A. of

17 this Article III of this Act.

18 COMMENT

19  
20 The reasons harmonization is difficult between a single State's income tax and  
21 unemployment tax provisions is not immediately obvious; but, in fact the tensions between  
22 income tax and unemployment tax policies are more difficult to reconcile than intra-State  
23 harmonization of either the items subject to income tax withholding or the items composing the  
24 unemployment insurance wage base. To understand these tensions policies pursued by the  
25 income tax withholding laws and the unemployment insurance laws need to be kept in mind.  
26 The purpose of the income tax withholding laws is primarily to establish a procedure by which  
27 taxes are to be collected and secondarily assist in the characterization of certain income<sup>12</sup> while  
28 the unemployment tax structure is intended to raise revenue from employers for a specific

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1 <sup>12</sup> Though at first blush it might appear that the income tax withholding provisions of a state  
2 statute may have something to do with the determination of taxable income by defining factors such  
3 as wages and employee, the fact is these definitions are important (from the perspective of income  
4 tax) only for determining whether a payer of income is required to withhold income taxes or whether  
5 the payee has the responsibility of paying owed taxes directly to the state or federal government.  
6 Whether an item of income is wages or some other form of income is irrelevant to the question of  
7 whether it is income. That is an issue with which the income tax withholding provisions do not deal.

1 employee benefit, and most importantly, to provide a basis upon which benefits are calculated<sup>13</sup>.  
2 For example, whether employer provided meals are income is determined under income tax  
3 statutes independent of the withholding requirements. In other words, taxes will be withheld  
4 only if it is *a priori* determined that there is a tax to be collected. Unlike income tax withholding,  
5 however, the unemployment insurance provisions make two indivisible determinations: (1)  
6 whether, as to the item of payment, the relationship between payor and payee is that of employer-  
7 employee, and (2) if so, whether the item in question is income<sup>14</sup>.

8 For example, an employer's reimbursement to an employee for purchases made by the  
9 employee at the direction of and for the sole benefit of the employer would not be income subject  
10 to tax under the income tax regime<sup>15</sup> or under the unemployment insurance regime. However, if  
11 an employee receives from an employer meals that qualify as exempt from income tax under  
12 statutory provisions similar to Internal Revenue Code §119<sup>16</sup>, they will be considered income for  
13 purposes of establishing the employee's wage base and amount of benefits available under  
14 unemployment insurance. Consequently, the value of these meals will be subject to an  
15 unemployment insurance tax on the employer and be considered part of the wage base for  
16 determining an unemployed individual's unemployment benefits. Not all income for  
17 unemployment insurance purposes is income for tax withholding purposes. Any attempt to  
18 harmonize the income tax withholding provisions with the unemployment insurance provisions

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1 <sup>13</sup> The Planmatics study stated: "Unlike revenues the impact ... [of the THWC on  
2 unemployment] claimant benefits are not directly linked to the taxable wage base. Rather, they are  
3 more closely related to workers' occupations, industries in which they are employed, and their level  
4 of earnings." Planmatics study, *supra*, note 7 at pg. iv.

1 <sup>14</sup> There are many sub-issues hidden in the concepts of "wages" and "employee." The  
2 question of whether one is an employee or an independent contractor is critically important for a  
3 number of reasons including, for our purposes, the question of whether the employer is liable for an  
4 assessment of unemployment insurance or FICA on the amount paid to an individual. The  
5 classification of an individual as employee vs. independent contractor is far beyond the scope of this  
6 Committee's charge (thank goodness!!) and is one that continues to be only partially resolved, at  
7 least at the federal level. Additionally, there are similar classification issues in regard to whether a  
8 partner is performing services for the partnership as an employee or as a partner and whether a  
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 <sup>15</sup> 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 they  
3 are included in gross income under §61.

1 within a given state will have to recognize the difficulty of dealing with these two different  
2 policy concerns.  
3

4 Harmonizing the income tax withholding provisions among the States that impose an income  
5 tax is more easily accomplished. Though there are differences among the States as to various  
6 definitions, there is already significant similarity between existing statutes making the  
7 harmonization process less problematic. However, there is significant variation of filing dates  
8 that must be addressed to fully harmonize the requirements of the income tax reporting among  
9 the states and, as a matter of fact, harmonize the filing and payment date requirements for income  
10 tax withholding and unemployment tax withholding within each state.  
11  
12  
13

- 14 1. Any payment made to, or on behalf of, an employee or his or her beneficiary pursuant  
15 to an election by said employee or beneficiary under a plan meeting the requirements  
16 of Internal Revenue Code Section 125, or any successor thereto.

17 COMMENT  
18

19 This provision provides that benefits otherwise excludable from an employee's gross  
20 income and subject to income tax and unemployment insurance tax will not be considered  
21 includeable in either the income tax or unemployment insurance wage base merely because of  
22 constructive receipt issues. IRC Section 125 permits taxpayers to select from a group of benefits  
23 provided by their employer. Individually, these benefits are permitted, under the Internal  
24 Revenue Code, to be provided on a tax free basis to an employer's employees. Without the  
25 intervention of this code provision, however, the fact that employees have the opportunity to  
26 select which tax free benefit, from a variety of offerings, they prefer to have is sufficient to  
27 make these otherwise tax free benefits taxable under the doctrine of constructive receipt. It  
28 appears that all states currently have extant a similar provision for income tax withholding  
29 purposes. However, many states do not exempt items paid under IRC Section 125 plans from tax  
30 liability (or benefit calculation) for unemployment insurance purposes. For any state that does not  
31 have a provision excluding from either wage base the items contemplated under IRC Section 125  
32 it will be incumbent upon that jurisdiction to adopt such a conforming provision. In the absence  
33 of such provision in the unemployment insurance arena compensation will be paid.  
34  
35  
36

- 37 2. The value of any meals or lodging furnished to an employee by or on behalf of an  
38 employer if at the time of such furnishing such value is excluded from the employee's



1 income pursuant to Internal Revenue Code Section 119, or any successor thereto.

2 COMMENT

3  
4 This provision excludes from both the income tax withholdings wage base and the  
5 unemployment insurance tax and benefits wage base amounts that are excluded because they are  
6 items provided by the employer primarily because the physical location for the performance of  
7 services requires the employee to live and/or eat on the business premises. No state that imposes  
8 income taxes does not already provide such provision or, at least, a provision similar to IRC  
9 Section 119 for income tax withholding purposes. However,

10  
11 At present, 23 states treat meals and lodging as wages in their [unemployment  
12 insurance] laws and would be affected by this recommendation [to exclude meals  
13 and lodging from the compensation wage base]. These states include California  
14 (included in this study), New Jersey, New York, and Texas. They represent in  
15 excess of 26% of the nation's work force. In terms of impact on affected claims,  
16 analysis of California's data indicate the average benefit claim over its duration is  
17 \$2,433 and the average value of the exclusion of the meals and lodging  
18 component on affected claims is \$487, amounting to 20% of the claim of the  
19 workers affected. This percentage of reduction, or one close to it, could occur in  
20 New Jersey, New York and Texas as well.<sup>17</sup>

21  
22 The report making the above quoted statement pointed out that in California this reduction  
23 represents only "...about 0.2% of the total benefit outlay, it represents almost a 20% reduction for  
24 the 7600 affected claimants. Additionally, 660 claimants, or 0.1% of the claimant population  
25 would lose their eligibility entirely."<sup>18</sup> Of course, for those who have remuneration from their  
26 employers other than meals and lodging at or in excess of the maximum taxable unemployment  
27 insurance wage base the exclusion of the value of meals and lodging is of no consequence.

- 28  
29  
30  
31 3. Payment to, or on behalf of, an employee by the employee's employer to the extent  
32 the employer shall reasonably believe that the payment (or portion thereof) will  
33 qualify for deduction under Internal Revenue Code Section 217 (as determined  
34 without regard to Internal Revenue Code §67) or exclusion under IRC §132(a)(6).

---

1 <sup>17</sup> Planmatics study, *supra*, note 7 at pg. v.

1 <sup>18</sup> *Id.* at 34.

1 COMMENT

2  
3 This provision requires the exclusion from the wage base for purposes of income tax  
4 withholding and unemployment insurance tax and wage base calculation amounts paid for what  
5 are commonly referred to as moving expenses. All states that impose income taxes already  
6 provide such a provision except for two states with no provision. Generally it can be presumed  
7 that employer paid or reimbursed moving expenses will be paid only to those whose regular  
8 wages already exceed the maximum unemployment insurance wage base. Thus, this provision  
9 should have no impact on the benefits payable to any employee receiving unemployment  
10 benefits nor any employer's unemployment insurance tax liability even if a state's deductions or  
11 exclusions are not as generous as those provided under the Internal Revenue Code.  
12

- 13  
14  
15 4. Premiums paid for qualified group-term life insurance on the life of an employee.  
16

17 COMMENT

18  
19 There is no state that imposes either an income tax or an unemployment insurance tax that  
20 does not have either a provision similar to this provision or has no provision that would subject  
21 such premiums to income tax or have implications on their unemployment insurance regime.  
22

- 23  
24  
25 5. Amounts paid an employee by an employer as an Employee Achievement Award.  
26

- 27  
28 6. The amount of any payment (including any amount paid by an employer for insurance  
29 or annuities, or into a fund to provide for any payment) made to, or on behalf of an  
30 employee or any of his or her dependents under a plan or system maintained by the  
31 employer which makes provision for all or specific classes of the employer's  
32 employees, and their dependents, generally or for a class or classes of the employer's  
33 employees (or for a class or classes of employees and their dependents), on account  
34 of  
35 a. sickness

1 (1) if mandated under this state's workers' compensation law, and

2 (2) any payment made not mandated under this state's workers' compensation law  
3 after six consecutive months from the commencement of such non-mandated  
4 payments.

5 b. accident disability payments received under this state's workers' compensation  
6 law,

7 c. medical or hospitalization expenses in connection with accident disability or  
8 sickness, or

9 d. death;

10 7. any payment or series of payments by an employer to an employee or any of said  
11 employee's dependents which is paid -

12 a. upon or after the termination of an employee's employment relationship with said  
13 employer due to

14 (1) death, or

15 (2) retirement for disability, and

16 b. under a plan established by the employer which makes provision for his  
17 employees generally, or a class or classes of his employees, (or for such  
18 employees or class or classes of employees and their dependents), other than any  
19 such payment or series of payments which would have been paid if the  
20 employee's employment relationship had not been so terminated.

21 c. by an employer to a survivor or the estate of a former employee after the calendar  
22 year in which such employee died provided such payment is not considered

1 income in respect of a decedent in accordance with [cite state law provision].

2 COMMENT

3  
4 In general only income from sick pay or wage continuation plans maintained by the employer  
5 but not mandated by a state's workers' compensation law are included in an employee's income  
6 wage base for purposes of either income tax withholding or unemployment insurance benefit  
7 determination or tax assessment . Additionally, amounts paid due to an employee's death but are  
8 considered income in respect of a decedent are not excluded.  
9

- 10  
11  
12 d. Any payment made or incurred or benefit provided by the employer which affords  
13 an employee dependent care assistance pursuant to a qualifying dependent care  
14 program as set forth at [cite state law] if at the time of such payment or such  
15 provision of a benefit it is reasonable to believe that the employee will be able to  
16 exclude such payment or benefit from his or her federal and state taxable income.

17 COMMENT

18  
19 This provision excludes the value of benefits provided by an employer to an employee under  
20 an employer provided dependent care plan providing non-discriminatory access to dependent  
21 care for young children who are dependents and dependent adults who are unable to care for  
22 themselves due to physical or mental incapacity. It is intended that these individuals be the same  
23 as those defined as "qualifying individuals" at IRC Section 21(b)(1). It is further intended that  
24 the State statutory provisions will require a written, non-discriminatory plan similar to that under  
25 and meeting the requirements of IRC Section 129. Inclusion of this provision will require many  
26 states to adopt dependent care provisions not currently extant. Currently, 42 states have  
27 concurring statutes and 1 state has no provision (9 states have no income tax). On the  
28 unemployment insurance side of the ledger, however, only 15 states' statutes conform to these  
29 requirements, and 35 states have no provisions dealing with this issue. Two states, Alabama and  
30 Michigan provide that payments made directly to the care giver or care facility are not wages to  
31 the recipient employee while benefits provided through a wage reduction plan are considered  
32 wages to the recipient employee (presumably because of some degree of constructive receipt).  
33  
34  
35

- 36 e. Any fringe benefit provided to or for the benefit of an employee or any cash

1 reimbursement for any such benefit paid to an employee if, at the time of  
2 provision or reimbursement, it is reasonable to assume that such benefit will be  
3 excluded from the employee's taxable income pursuant to [cite state code similar  
4 to Internal Revenue Code Section 132].

5 COMMENT  
6

7 Of those jurisdictions imposing an income tax forty-two have provisions that provide this  
8 treatment for purposes of income tax withholding and one state has no provision. For purposes  
9 of unemployment insurance withholding only thirty-three states have provisions similar to this  
10 provision. Ten states currently have no or minimally matching provisions.  
11  
12  
13

- 14 f. Any payment that is a reimbursement for expenses incurred on behalf of, or as an  
15 allowance provided by an employer, for but not in excess of, those expenditures  
16 that meet the requirements of Internal Revenue Code Section 62 and that are not  
17 in excess of the lesser allowance or those expenses actually incurred by the  
18 employee for such expenditures.

19 COMMENT  
20

21 Though the THWC report indicates that all states provide this exclusion for both income tax  
22 and unemployment insurance tax purposes, there are numerous states that do not currently  
23 comply with the reporting requirements set out in the Internal Revenue Code. If those states  
24 should adopt reporting requirements similar to those mandated for federal tax purposes no  
25 additional compliance costs would be incurred by employers or employees who are currently  
26 complying with the federal requirements.  
27  
28  
29

- 30 g. Any payments made to, or on behalf of, an employee or the employee's  
31 beneficiary from or to a plan or plans described in IRC Section 3306(b)(5)(A)

1 through (F).<sup>19</sup>

2 COMMENT

3  
4 This provision deals with contributions to pension, profit-sharing and similar arrangements  
5 that meet the requirements for tax exemption under Internal Revenue Code Sections 501 and  
6 401, et. seq. All states provide similar exclusions for both income tax and unemployment  
7 insurance tax purposes but the provisions for many states are complex and could be simplified. It  
8 should be noted that these amounts are subject to FICA taxes when contributed to such a plan.  
9

10  
11 h. Gratuities, which in the aggregate for an employee do not exceed \$20 during any  
12 given month, paid by third parties or by an employer on behalf of third parties, for  
13 services performed as part of the employment relationship.

14 COMMENT

15  
16 In general all States currently provide that tips or gratuities are wages and that the employer  
17 has a duty to withhold and to make unemployment insurance contributions on those wages. This  
18 provision assumes that each state has or will have a reporting measure similar to the federal  
19 requirement that the employee provide a monthly statement in writing to the employer stating the  
20 amount of tips earned during the preceding month. Because services for which tips are a  
21 significant form of remuneration are frequently paid for via credit and debit cards the record  
22 keeping requirements for both employer and employee are somewhat less burdensome than they  
23 may have been when such payments were generally made in cash.  
24

25  
26  
27 i. Remuneration earned by an individual engaging in the interstate transportation of  
28 goods or people as the result of transitory passage through this state.

29 COMMENT

30  
31 This provision makes it unnecessary for an employer of common carrier vehicle drivers to  
32 allocate income among states through which a truck, train, bus, airplane or other similar vehicles  
33 transporting merchandise or people through a state, so as to be able to withhold taxes from or pay  
34 unemployment insurance taxes based on amounts earned simply because of travel through a state.

---

1 <sup>19</sup> These are payments from deferred compensation plans that are defined at Section C. of  
2 Article II. of the Act.

1 Seventeen States currently have such a provision and the remaining States' statutes are silent on  
2 the matter. Nonetheless, those states that have not addressed the issue statutorily appear, to  
3 apply this non-withholding and unemployment insurance wage base exclusion.  
4

5  
6 j. Wages for services performed in a foreign country provided that

7 (1) the foreign country in which the services are performed withholds taxes on the  
8 wages paid, and

9 (2) the wages are excluded from United States income pursuant to Internal  
10 Revenue Code §911, and

11 (3) the wages are excluded from income under [the statute of the relevant state.]

12 COMMENT  
13

14 Forty six states have adopted provisions similar to this provision. In general the exclusion  
15 under IRC Section 911 requires that wages be paid (1) for services performed (2) by a citizen of  
16 the United States (3) whose tax home is a foreign country and who (4) has been a bona fide  
17 resident of foreign countries for an uninterrupted period of at least an entire taxable year or (5) is  
18 a US citizen or resident who is present in foreign countries for 330 days within any consecutive  
19 12 month period.  
20

21 At present no state imposes an income tax on "foreign" wages. If a State did include such  
22 income in its taxable base, it would be impossible to enforce a withholding requirement on a  
23 foreign corporation that had no presence in the state, but it could enforce withholding  
24 requirements on any corporation that is present in the state. Additionally, if a state exercised  
25 jurisdiction over a corporation and chose to include this income in the unemployment wage base  
26 there would be an impact on an employee's benefit wage base as well as an imposition of  
27 unemployment taxes on the employer.  
28  
29  
30

31 k. Periodic and nonperiodic payments from employer tax deferred compensation

32 plans, commercial annuities and Individual Retirement Accounts provided that the  
33 payee elects not to have income taxes withheld on such payments.

34 COMMENT

1 This provision applies only to income tax withholding and permits an opt out of withholding.  
2 The default is that there will be withholding on these amounts. However, a written election,  
3 along with protecting the payor, will require an informed election by the recipient. Because such  
4 distributions are currently excluded from the unemployment insurance tax assessments and wage  
5 base calculations this provision will have no impact on those state laws.  
6  
7  
8

9 l. Sick pay unless the payee elects, in writing, to have income tax withheld on such  
10 payment.

11 m. Scholarship or Fellowship paid to an individual who is a candidate for a degree at  
12 an educational organization described at IRC §170(b)(1)(A)(ii) and used by that  
13 individual for qualified tuition and related expenses (as such term is defined at  
14 IRC §117(b)).

#### 15 COMMENT 16

17 Arizona, California, Indiana, Ohio, Kansas, and Mississippi are the only jurisdictions that  
18 have provisions comparable to this one. None of the other States or the District of Columbia  
19 have any provision dealing directly with this issue, though discussions with the STAWRS team  
20 indicates that most states currently follow the federal rule through a administrative policy.  
21

22 The language of this provision is largely the same language of IRC Sections 117(a) and  
23 (b). Thus, like the federal law, this provision is intended to exclude from an individual's gross  
24 income only those amounts which are used to pay for tuition, fees, books, supplies and  
25 equipment required for enrollment at, or to take courses pursuing a degree at, "an educational  
26 organization which normally maintains a regular faculty and curriculum and normally has a  
27 regularly enrolled body of pupils or students in attendance at the place where its educational  
28 activities are regularly carried on..." IRC Section 170(b)(1)(A)(ii).  
29  
30

#### 31 C. Filing and Payment Dates 32 33 34 35 36

37 1. For purposes of this Section C. the term "Employment Taxes" shall mean, at any



given time, the total of income taxes withheld and unemployment insurance taxes incurred by an employer which are held by the employer and not yet paid to the appropriate government entity.

2. All Employment Taxes are to be reported quarterly unless the total amount of Employment Taxes owed by the employer shall not exceed \$2,500 for the calendar year in which case the Employment Taxes are to be reported annually.

a. All reports of Employment Taxes shall be filed and submitted to (insert state rule) on such forms as are prescribed by said agency.

b. All payments of Employment Taxes shall be made in accordance with the schedule set forth at Section C.3. of this Article III of the Act to [insert state agency].

## COMMENT

This provision anticipates a rather 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 require 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.

3. All Employment Taxes shall be paid according to the following schedule.

a. Provided the total Employment Taxes then currently owed by an employer is

1 equal to or less than \$2,500, the Employment Taxes shall be paid to the State no  
2 later than January 31 of the year immediately following the end of a calendar year.

3  
4 b. Provided the total Employment Taxes then currently owed by an employer is  
5 greater than \$2,500 but equal to or less than \$5,000, the Employment Taxes shall  
6 be paid to the State on July 30 and January 31 of each year.

7 c. At any time the total of Employment Taxes then currently owed by an employer is  
8 greater than \$5,000, but less than \$50,000, the Employment Taxes shall be paid to  
9 the State no later than the 15<sup>th</sup> day of the calendar month immediately following  
10 the calendar month in which this \$5,000 threshold amount is attained.

11 d. At any time the total of Employment Taxes then currently owed by an employer is  
12 greater than \$50,000 but less than or equal to \$100,000, the Employment Taxes  
13 shall be paid to the State no later than the 3<sup>rd</sup> business day immediately following  
14 the last Friday of the semi-weekly period at which this \$50,000 threshold amount  
15 is attained.

16 e. At any time the total of Employment Taxes then currently owed by an employer is  
17 greater than \$100,000, the Employment Taxes shall be paid to the State no later  
18 than three working days following the day this \$100,000, threshold amount is  
19 attained.

20 COMMENT  
21

22 In general payment thresholds and dates as well as filing dates for both withheld income  
23 taxes and unemployment insurance taxes are specified by statute only in general terms. The  
24 specifics are left to the various concerned administrative agencies. However, to enhance the

possibilities of conformity, this recommended provision is set forth with greater detail than is found in most current state statutes.

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 one multi-state employer 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 only one or two states 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.

In any event, ignoring transition problems (which may, in some cases, be insurmountable), 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.

This provision also does not provide for a look back period as does the IRC 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.