

**D R A F T**  
**FOR DISCUSSION ONLY**

**UNIFORM WAGE WITHHOLDING  
PROCEDURE ACT**

**NATIONAL CONFERENCE OF COMMISSIONERS  
ON UNIFORM LAWS**

September 2003

*With Prefatory Note and Preliminary Comments*

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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

In 1966 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<sup>1</sup> and private sector organizations<sup>2</sup>. 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. ...*

In addition to requiring employers to report tax-and wage-related information, employment tax laws require government agencies to process the information reported, verify that the information complies with the laws, work with employers to correct reports that do not comply, and provide assistance to employers

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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, 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.

<sup>2</sup> The private sector representation was: American Bar Association, American Payroll Association, Ceridian Tax Service, Inc., Federal Liaison Services, Inc., Paychex, Inc., and Planmatics, Inc.

1 attempting to comply. The diversity in current laws and filing  
2 dates makes it difficult for government agencies to provide  
3 consistent, accurate, and timely service to their customers.  
4 The diverse state and federal laws governing wage taxes and  
5 withholding significantly increase employer burden....<sup>3</sup>  
6

7 Reporting complexities caused by existing statutes are very costly to everyone. Small  
8 employers must attempt to understand sometimes subtle distinctions, have knowledge of a  
9 large number of definitions and attempt to understand the different requirements of them for  
10 two different codes within their state. Large and small employers that do business in more  
11 than one state must deal with these issues in each state and the administrative complexities  
12 caused by multi-jurisdictional differences. On the governmental side of the ledger, states must  
13 maintain two separate taxpayer auditing capabilities (and staffs) to insure compliance with two  
14 separate laws. By harmonizing the definition of wages substantial compliance cost savings<sup>4</sup>,  
15 both for private industry and government, were, and are, anticipated.  
16

17 As part of their study the STAWRS group analyzed and compared hundreds of federal  
18 and state statutory provisions and administrative positions to determine the existing degree of  
19 harmony of various definitions in various jurisdictions for purposes of determining in each  
20 jurisdiction amounts subject to income tax withholding and amounts subject to unemployment  
21 insurance assessment (and, tangentially, unemployment benefits). The project encompassed  
22 two studies: one focused on income tax withholding, the Harmonized Wage Code for Income

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1 <sup>3</sup>

2 The Harmonized Wage Code For Income Tax Withholding (unpublished study,  
3 IRS, 2001) (copy on file at the University of Dayton School of Law with Prof.  
4 Laurence B. Wohl; hereinafter sometimes referred to as the "HWC/ITW") at pg.  
5 1-1. (Emphasis Added) This report together with The Targeted Harmonized  
6 Wage Code (discussed, *infra*, note 6) was published electronically on the  
7 STAWRS website maintained by the Internal Revenue Service. In 2001 the IRS  
8 redesigned its public website, and in the transition to the new website both reports  
9 were removed. These reports, together with a supporting data base, are no longer  
10 available. Neither the reports nor the data base were published in hard copy.

1 <sup>4</sup>

2 Simplification of statutory compliance through adoption of common requirements across  
3 all federal and state taxing authorities will lead not only to reduced compliance costs for private  
4 industry but also to reduced resource commitment by the States for purposes of tax compliance  
5 education and enforcement. With a single set of statutory compliance rules within a state, that  
6 state will, presumably, be able to maintain a single rather than dual compliance and enforcement  
7 staffs. Additionally, a "harmonized" state would be able to reduce the costs of public education  
8 regarding its income tax withholding requirements and its unemployment insurance tax  
9 assessments.

1 Tax Withholding, and the other, The Harmonized Wage Code for Unemployment Insurance<sup>5</sup>,  
2 focused on unemployment insurance tax assessment.  
3

4 The goal of STAWRS was to identify items of compensation that could be excluded  
5 from the income subject to income tax withholding and the income subject to unemployment  
6 insurance tax assessment. These were to be items that were components of compensation but  
7 which were (1) given treatment for income tax withholding purposes differing from one state  
8 to another, (2) given treatment for unemployment tax purposes differing from one state to  
9 another, and (3) perhaps the most confusing for employers, given treatment by individual  
10 states that differed for that state's income tax withholding law and its unemployment tax law.  
11 These were items, because of the variety of their treatment, that created significant compliance  
12 complexity yet they clearly were items of compensation when paid. STAWRS identified 14  
13 such elements of wages<sup>6</sup> and recommended that they be excluded from wages for income tax  
14 withholding purposes. This recommendation forms the backbone of this act though this act  
15 goes beyond that recommendation.  
16

17 This act goes beyond the harmonization of the income tax withholding provisions of  
18 the THWC to include a harmonization of those provisions with the unemployment tax  
19 provisions of the various states. Adoption of a common definition for these items by all states  
20 for both income tax withholding and unemployment insurance tax wage base purposes will  
21 lead to substantial harmonization and significant compliance simplification. These items are  
22 common forms of employee compensation but are not ubiquitous. They are items that are  
23 more likely to occur in a large employer environment for income tax withholding purposes but

---

1 <sup>5</sup>

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

1 <sup>6</sup>

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

1 are items that are frequently part of the unemployment tax wage base for both large and small  
2 employers. These items, for the most part, are excluded from a wage base for either income  
3 tax withholding or unemployment insurance purposes in some states but not in all.  
4 Harmonization of each component across the income tax withholding statutes and the  
5 unemployment insurance tax assessment statutes of all states will simplify the compliance  
6 process and administration of reporting for large and intra-state employers and small single  
7 state employers alike. This act harmonizes the definition of wages for income tax withholding  
8 purposes by excluding the same components of compensation from withholding of taxes in all  
9 states that have an income tax. It also harmonizes the definition of wages for unemployment  
10 insurance assessment purposes by excluding the same components of compensation from the  
11 unemployment insurance tax wage base in all states. Additionally, for those states that have  
12 an income tax as well as unemployment insurance the definition of wages will be harmonized  
13 by the exclusion of the same components of compensation from both wage bases. The act  
14 creates substantial conformity of definitions, and thus simplification, between an adopting  
15 State's income tax wage base and its unemployment insurance wage base as well as  
16 substantial conformity of those wage bases among the States<sup>7</sup>.

17  
18 Problematically harmonization of the tax withholding provisions with the  
19 unemployment insurance provisions requires the meshing of two different, and somewhat  
20 conflicting, policies within each single jurisdiction as well as among the multiple jurisdictions.  
21 The income tax withholding regime is indifferent as to items in the wage base<sup>8</sup> whereas the  
22 unemployment insurance tax regime is deeply concerned about the items in the wage base. On  
23 the one hand the policies driving income tax withholding are focused on the single issue of  
24 collection, a ministerial act of collection rather than a political question of what should be  
25 taxed. Items of income that are subject to income tax will continue to be subject to that tax  
26 even if not subject to withholding. On the other hand, policies underlying unemployment  
27 insurance programs are concerned with dispersal of benefits as well as the collection of  
28 sufficient revenues to provide for those benefits. For purposes of unemployment insurance  
29 each item placed in the wage base and subject to unemployment insurance tax will assist

---

1 <sup>7</sup> There are 43 different federal and state income tax codes and 53 social welfare tax codes.

1 <sup>8</sup>

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

1 employee's in meeting threshold requirements<sup>9</sup> and lead to increased revenues available for  
2 distribution to those in need. Conversely, each item removed from this wage base will make it  
3 more difficult for an employee to reach threshold requirements and will reduce the amount of  
4 revenue available for distribution. Thus, for purposes of unemployment insurance,  
5 components of the wage base are important on three counts. First, an item added to the  
6 unemployment insurance wage base makes it easier for an employee to meet the threshold  
7 amounts of income needed to qualify for benefits; second, an item of income added to the  
8 wage base increases benefits (up to statutory maximums) payable to an unemployed former  
9 employee; and third, the larger the unemployment wage base the greater the unemployment  
10 taxes collected and, thus, the larger the fund to pay benefits.

11  
12 In attempting to harmonize the two separate code constructs there must be a careful  
13 balancing of the need for simplicity, and thus compliance cost reduction, with the need not to  
14 compromise benefits that a state has deemed appropriate for its unemployed<sup>10</sup>.

15  
16 For large employers and those doing business in more than one state the harmonization  
17 of the most common elements of compensation provide significant alleviation of compliance  
18 complexity. However, relief from compliance burdens for small employers, most of which do  
19 business in a single state will likely be as great or greater than for larger employers. Because  
20 any one small employer has small numbers of employees it is not likely to have employees  
21 dedicated to compliance with federal and state tax and unemployment laws. Consequently,  
22 the small employer will (1) undertake the compliance regimen themselves (i.e., an  
23 entrepreneur will be responsible for compliance or will assign a most likely already  
24 overworked bookkeeper to such responsibility) with the commensurate cost in time and  
25 education necessary to comply (a cost that will be spread over a small employee base<sup>11</sup>), (2)

---

1 <sup>9</sup>

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

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

1 <sup>11</sup>

2 Eighty-five percent of the 6.7 million employers in the United States employ 20 or  
3 fewer workers. It is also known that these 'small' employers deal with fewer of  
4 the component provisions found in all the state and federal employment tax laws.



1 comply “by the seat of their pants” frequently, if not regularly, resulting in fines and interest  
2 bearing errors, or (3) place the compliance burden with contract professionals (accountants,  
3 lawyers and payroll services).<sup>12</sup>  
4

5 States may balk at conforming their own income tax and unemployment tax wage  
6 bases let alone conforming those wage bases to other states’ wage bases and, possibly, even  
7 the federal income tax withholding and FICA wage bases, for a number of good reasons. Two  
8 of these reasons are that conformity may lead to a loss of revenue in a state’s unemployment  
9 insurance system, and conformity may reduce unemployment benefits in some states.<sup>13</sup> A  
10 report commissioned by the STAWRS project set out the following example in explaining the  
11 revenue impact of reducing the unemployment insurance wage base:

---

5 Thus, most small employers will not be concerned with many of the components,  
6 usually those involving more complex forms of remuneration. Therefore, the  
7 project team looked at components that are most common among small employers  
8 and their employees...”  
9

10 HWC/ITW, *supra*, note 3, at pg. 1-7 [footnote omitted].  
11

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

1 <sup>12</sup>  
2 As pointed out in a study conducted by an outside contractor to the STAWRS group, though  
3 small employers, “[a]s a group... generally deal with a smaller number of wage components ...  
4 [they], in the aggregate, bear the greatest per employee costs associated with the payroll reporting  
5 process.” Lalith de Silva, Dominic Rotondi, Mikel Lasa, The Impact of the Targeted  
6 Harmonized Wage Code on Unemployment Insurance (unpublished study submitted to the  
7 Internal Revenue Service by Planmatics Inc., 2001; on file at the University of Dayton School of  
8 Law with Professor Laurence B. Wohl) at pg. 5 (hereinafter referred to as the “Planmatics  
9 study”).  
10

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

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

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

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

20 Second, and more likely, is the potential reduction in weekly  
21 benefit amounts (WBA). These amounts are calculated on a  
22 worker's earnings, generally a combination of annual earnings and  
23 high-quarter earnings. Any reduction of annual or high-quarter  
24 earnings reduces the worker's WBA...<sup>14</sup>  
25

26 Though traditional contributions might be diminished and benefits reduced under some  
27 circumstances, it does not appear that the amount of loss of revenue or aggregate reduction in  
28 benefit payments will likely be dramatic if the fourteen items of income are harmonized  
29 within a state and among the states and federal government. However, it is possible that, at  
30 least as to reduction of benefits, though the macro problems will not be significant the micro  
31 problems could be devastating. The dollar amounts of benefits paid to any one individual, or  
32 individuals within any single employee sector, may be reduced by a significant percentage or  
33 eliminated altogether.<sup>15</sup>

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1 <sup>14</sup> Planmatics study, *id.* at pgs. 10-11.

1 <sup>15</sup>  
2 "The most controversial recommendation of the HWC Project is that dealing with 'meals and  
3 lodging.' ... Most states...[concur with the Internal Revenue Code Section 119 exclusion of  
4 meals and lodging from the income tax wage base], but about one-third of the states include  
5 'meals and lodging' for UI purposes. This recommendation has caused a great deal of concern ...  
6 [in those states that do not exclude meals and lodging for their unemployment insurance wage  
7 base] primarily because of the possible impact such payments if made excludable might have on

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

---

8           the amount of revenue available and the payment of benefits.” draft HWC/ITW, *supra*, note 3 at  
9           pg. 2-8.

10  
11           The 23 states that do not exclude meals and lodging from the unemployment insurance  
12           wage base have more than 26% of the countries work force and the impact of the meal and  
13           lodging exclusion from the unemployment benefits wage base can be substantial. For example,  
14           “...California’s data indicate the average benefit claim over its duration is \$2,422 and the average  
15           value of the exclusion of the meals and lodging component on affected claims is \$487,  
16           amounting to 20% of the claim of the workers affected. This percentage of reduction, or one  
17           close to it, could occur in New Jersey, New York and Texas as well.” Planmatics study, *supra*,  
18           note 15, at pg. v.

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

**SECTION 2. DEFINITIONS.** In this [act]:

(1) "Employee" means an individual whose remuneration for services paid by the individual's employer is subject to, or would be subject to, if not excluded ~~under subsection~~ **by paragraph (5) of this Section 2**, withholding of income tax under the laws of this state or for whom an employer makes contributions under the unemployment insurance laws of this state.

## Preliminary Comments

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 and federal 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**

1 **considered merely passive investors) are subject to self-employment taxes on their**  
2 **distributive share of partnership income imposed under Internal Revenue Code Section**  
3 **1401 on all distributions from the partnership.**  
4

5 (2) "Employer" means a person that pays remuneration for services to an individual who  
6 does not have the status of independent contractor.

7 (3) "Employment tax" means, at any given time, the total of **federal and state** income  
8 taxes withheld from an employee's wages and **federal and state** unemployment insurance  
9 taxes incurred by an employer on those wages which are held by the employer and not yet paid  
10 to the appropriate government entity.

#### 11 **Preliminary Comments**

12 **This act impacts only federal and state imposed taxes. It does not effect the**  
13 **assessment or collection of any local taxes even if those taxes are income taxes or some**  
14 **form of unemployment tax.**  
15

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

17 (5) "Wages" means all remuneration, including any remuneration in a medium other than  
18 cash valued at its fair market value, received by an employee from the employee's employer  
19 and aggregate tips received by the employee in excess of \$20 a month from a person other  
20 than the employer for services arising in the context of the employment relationship between  
21 the employer and the employee.

#### 22 **Preliminary Comments**

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

28  
29 In general all States currently provide that tips or gratuities are wages and that the

1 employer has the legal obligation to withhold income taxes and to make unemployment  
2 insurance contributions on those wages. This provision assumes that each state has or will  
3 have a reporting procedure similar to the federal requirement that the employee provide a  
4 monthly statement in writing to the employer stating the amount of tips earned during the  
5 preceding month. Because tips are frequently paid for via credit and debit cards the record  
6 keeping requirements for both employer and employee are somewhat less burdensome than  
7 they may have been when such payments were generally made in cash.  
8

9 This definition of wages is intended to include vacation pay. Currently, vacation pay is  
10 defined by all states as a wage with the exception of Delaware. Delaware does include  
11 vacation pay as wages for purposes of both income tax withholding and assessment of  
12 unemployment insurance taxes except for vacation pay paid during a period of unemployment  
13 which is excluded.  
14

15 *Legislative Note: It is anticipated that a jurisdiction adopting this statute will amend both*  
16 *its statute dealing with income tax withholding and its statute dealing with unemployment*  
17 *insurance. In that event, if, subsequent to adoption of this act, a jurisdiction should amend the*  
18 *provisions of this Section 1. of this act in either its income tax withholding statute or its*  
19 *unemployment insurance statute care must be taken to amend both statutory provisions in*  
20 *order to maintain the common definition of wages. To avoid the problem of a legislature*  
21 *inadvertently adopting an amendment effecting one or the other of these statutory schemes but*  
22 *not both, it would be preferable to adopt this act as a whole and have both the jurisdiction's*  
23 *income tax withholding statute and its unemployment insurance statute incorporate this act's*  
24 *definition by reference. No matter which method of adoption is chosen, the jurisdiction needs*  
25 *to be certain that adoption of the definition of wages in this act does not have an unintended*  
26 *impact on other statutes that currently incorporate by reference the definition of wages found*  
27 *in either its income tax withholding or unemployment insurance provisions.*  
28

29 The term does not include:

30 (A) the value of any meals or lodging furnished by or on behalf of an employer if, at  
31 the time of furnishing, it is reasonable to believe that the employee will be able to exclude the  
32 value from income under Section 119 of the Internal Revenue Code;

### 33 **Preliminary Comments**

34 This provision excludes from both the income tax withholdings wage base and the  
35 unemployment insurance tax and benefits wage base amounts that are excluded because they  
36 are items provided by the employer primarily because the physical location for the  
37 performance of services requires the employee to live and/or eat on the business premises. No  
38 state that imposes income taxes does not already provide such provision or, at least, a

1 provision similar to Internal Revenue Code Section 119 for income tax withholding purposes.  
2 However, as stated by a report made to STAWRS:

3  
4 At present, 23 states treat meals and lodging as wages in their [unemployment  
5 insurance] laws and would be affected by this recommendation [to exclude  
6 meals and lodging from the compensation wage base]. These states include  
7 California (included in this study), New Jersey, New York, and Texas. They  
8 represent in excess of 26% of the nation's work force. In terms of impact on  
9 affected claims, analysis of California's data indicate the average benefit claim  
10 over its duration is \$2,433 and the average value of the exclusion of the meals  
11 and lodging component on affected claims is \$487, amounting to 20% of the  
12 claim of the workers affected. This percentage of reduction, or one close to it,  
13 could occur in New Jersey, New York and Texas as well.<sup>16</sup>  
14

15 The report making the above quoted statement pointed out that in California this  
16 reduction represents only "...about 0.2% of the total benefit outlay, [however,] it represents  
17 almost a 20% reduction for the 7600 affected claimants. Additionally, 660 claimants, or 0.1%  
18 of the claimant population would lose their eligibility entirely."<sup>17</sup> Any attempt to harmonize  
19 the income tax withholding provisions with the unemployment insurance provisions within a  
20 given state will have to recognize the difficulty of dealing with these two different policy  
21 concerns. Of course, for those who have remuneration from their employers other than meals  
22 and lodging at, or in excess of, the maximum taxable unemployment insurance wage base the  
23 exclusion of the value of meals and lodging is of no consequence.  
24

25 **The Commissioners are most troubled by the prospect of low income workers being**  
26 **disadvantaged for the benefit of administrative convenience no matter how small the**  
27 **number of effected workers. Possible methods of achieving the administrative goal**  
28 **without disadvantaging these people is suggested in the legislative note accompanying**  
29 **this provision. However, if a method cannot be determined by a state to reconcile this**  
30 **conflict, then the Commissioners recommend that this provision not be adopted by that**  
31 **state.**  
32

33 *Legislative Note: The Commissioners are troubled by the implications of excluding*  
34 *items from the unemployment wage base that will result in the loss of benefits to the lowest*  
35 *wage individuals. Consequently, it is presumed that a state adopting this provision will*  
36 *amend its unemployment tax regime to eliminate the burden imposed on these employees.*  
37 *One method of approaching this issue would be for the state to increase the rate of*  
38 *unemployment tax on other income paid to individuals whose compensation is in part*  
39 *excluded under this provision and to reduce the benefit threshold amount for those*

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1 <sup>16</sup> Planmatics study, *supra*, note 7 at pg. v.

1 <sup>17</sup> *Id.* at 34.

1 *individuals. Another possible method to ameliorate the problem concerning the*  
2 *Commissioners would be to base unemployment tax assessment and benefit threshold in*  
3 *part on an hours worked basis rather than amount of compensation basis.*  
4

5 As an example of this problem consider an employee who receives from an employer  
6 meals that qualify as exempt from income tax under statutory provisions similar to Section  
7 119 of the Internal Revenue Code<sup>18</sup>. Though the value of the meals is correctly excluded from  
8 the income tax withholding wage base it is considered income for purposes of establishing the  
9 unemployment insurance tax imposed on the employer and considered part of the wage base  
10 for determining an unemployed individual's unemployment benefits. Not all income for  
11 unemployment insurance purposes is income for tax withholding purposes.  
12

13 (B) any payment made to, or on behalf of, an employee or the employee's beneficiary  
14 under a cafeteria plan under Section 125 of the Internal Revenue Code, if the payment would  
15 not be treated as wages without regard to the plan and it is reasonable to believe that Section  
16 125 of the Internal Revenue Code would not treat the payment as included as taxable wages  
17 because of the constructive receipt of the payment;

#### 18 **Preliminary Comments**

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



1 (C) remuneration paid to, or on behalf of, an employee for moving expenses if, at the  
2 time of the payment, it is reasonable to believe that a corresponding deduction is allowable to  
3 the recipient under Section 217 of the Internal Revenue Code, as determined without regard to  
4 Section 67 of the Internal Revenue Code, or is excludeable from the employee's federal gross  
5 income under Section 132(a)(6) of the Internal Revenue Code;

#### 6 **Preliminary Comments**

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

17  
18 (D) premiums paid by an employer for group-term life insurance on the life of an  
19 employee to the extent the premium is excluded from the employee's federal gross income  
20 under Section 79 of the Internal Revenue Code;

#### 21 **Preliminary Comments**

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

26  
27 (E) payments made to an employee by an employer as an employee achievement  
28 award as defined in Section 274(j) of the Internal Revenue Code;

#### 29 **Preliminary Comments**

30 Employee achievement awards are small awards given to employees for achievement in

1 longevity or safety. For federal income tax purposes, if awards are not pursuant to a written  
2 plan, the sum of all achievement awards paid to any one employee during any year that the  
3 employer can deduct as a business expense cannot exceed \$400 per year. If awards are made  
4 pursuant to an established written plan or program that does not discriminate in favor of  
5 highly paid individuals (i.e., a qualified plan), then the sum of all achievement awards paid to  
6 an employee during any year that the employer can deduct as a business expense cannot  
7 exceed \$1,600 (including any awards from a non-qualified plan).  
8

9 (F) payments paid by an employer for insurance or annuities or into a fund to provide  
10 for any payment made to, or on behalf of, an employee or any of the employee's dependents:

11 (i) because of sickness, if not mandated under [this state's workers' compensation  
12 law], made after six calendar months following the month in which the employee ceased  
13 working for the employer, if it is reasonable to believe that the payments are not subject to  
14 taxation as income to the recipient of the payments under [the income tax laws of this state];  
15 or

16 (ii) under a plan or system maintained by the employer which makes provision for  
17 the employer's employees, or the employees' dependents, generally or for a class or classes of  
18 the employer's employees, or for a class or classes of employees and their dependents, on  
19 account of:

20 (I) sickness, if mandated under [this state's workers' compensation law];

21 (II) disability resulting from an accident and received under [this state's  
22 workers' compensation law] if it is reasonable to believe that it is not subject to income  
23 taxation to the recipient of the payments **under** [the income tax laws of this state];

24 (III) medical or hospitalization expenses in connection with sickness or a  
25 disability resulting from an accident; or

26 (IV) death;

1 (iii) Notwithstanding ~~the~~ subparagraphs (i) and (ii), if an employee makes an  
2 election in writing to have income tax withheld on any payment of sick pay, the payment shall  
3 be considered wages for purposes of withholding of income taxes;

4 (G) a payment or series of payments made to an employee, or any of the employee's  
5 dependents, for death or disability which:

6 (i) is paid on or after the termination of an employee's employment with the  
7 employer because of the employee's death or retirement due to disability; and

8 (ii) would not have been paid if the employee's employment had not been so  
9 terminated;

10 (H) a payment made by an employer to a survivor or the estate of a former employee  
11 after the calendar year in which the employee died;

#### 12 **Preliminary Comments**

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

20 (I) a payment made or the value of benefits provided which afford an employee  
21 dependent care assistance pursuant to a qualifying dependent care program if, at the time of  
22 the payment or provision of the benefit, it is reasonable to believe the payment or benefit is  
23 excludable from the employee's federal gross income under Section 129 of the Internal  
24 Revenue Code;  
25

1 **Preliminary Comments**

2 This provision excludes the value of benefits provided by an employer to an employee  
3 under an employer provided dependent care plan providing non-discriminatory access to  
4 dependent care for young children who are dependents and dependent adults who are unable to  
5 care for themselves due to physical or mental incapacity. It is intended that these individuals  
6 be the same as those defined as “qualifying individuals” at Internal Revenue Code Section  
7 21(b)(1). It is further intended that the State statutory provisions will require a written, non-  
8 discriminatory plan similar to that under and meeting the requirements of Internal Revenue  
9 Code Section 129. Inclusion of this provision will require many states to adopt dependent  
10 care provisions not currently extant. Currently, 42 states have concurring statutes for income  
11 tax withholding and 1 state has no provision (9 states have no income tax). On the  
12 unemployment insurance side of the ledger, however, only 15 states’ statutes conform to these  
13 requirements, and 35 states have no provisions dealing with this issue. Two states, Alabama  
14 and Michigan provide that payments made directly to the care giver or care facility are not  
15 wages to the recipient employee while benefits provided through a wage reduction plan are  
16 considered wages to the recipient employee (presumably because of some degree of  
17 constructive receipt).

18  
19 (J) fringe benefits provided to or for the benefit of an employee if, at the time of  
20 provision or reimbursement, it is reasonable to believe that the benefit is excludable from the  
21 employee's federal gross income under Section 132 of the Internal Revenue Code;

22 **Preliminary Comments**

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

27  
28 (K) a payment that reimburses expenses incurred on behalf of an employer or as an  
29 allowance provided by an employer for, but not in excess of, those expenditures that meet the  
30 requirements of Section 62(a)(2)(A) of the Internal Revenue Code and that are not in excess of  
31 the lesser of the allowance or the substantiated expenses incurred by the employee for the  
32 expenditures;

1 **Preliminary Comments**

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

8  
9 (L) a payment made to, or on behalf of, an employee or the employee's beneficiary  
10 from or to a plan or plans described in Section 3306(b)(5)(A) through (F) of the Internal  
11 Revenue Code;<sup>19</sup>

12 **Preliminary Comments**

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

19  
20 (M) a payment made to an employee as the result of the employer's transitory passage  
21 through this state while engaged in the interstate transportation of goods or people;

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

26 **Preliminary Comments**

27 Forty six states have adopted provisions similar to this provision. At present no state

---

1 <sup>19</sup>

2 ~~These are payments from deferred compensation plans that are defined at Section C. of Article~~  
3 ~~H. of the act.~~

1 imposes an income tax on wages earned by and paid to a state resident while out of state. If a  
2 State did include such income in its taxable base, it would be impossible to enforce a  
3 withholding requirement on a foreign corporation that had no presence in the state, but it could  
4 enforce withholding requirements on any corporation that is present in the state. Additionally,  
5 if a state exercised jurisdiction over a corporation and chose to include this income in the  
6 unemployment wage base there would be an impact on an employee's benefit wage base as  
7 well as an imposition of unemployment taxes on the employer.  
8

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

14 (P) any reduction in tuition provided by an employer that is an organization described  
15 in Section 170(b)(1)(A)(ii) of the Internal Revenue Code to an employee of the employer,  
16 including a retired or a disabled employee, and the surviving spouse of a deceased employee,  
17 or a dependent of the employee for the education, below the graduate level, of the employee or  
18 dependent of the employee at the organization or another organization described in Section  
19 170(b)(1)(A)(ii) of the Internal Revenue Code; and

## 20 **Preliminary Comments**

21 Arizona, California, Indiana, Ohio, Kansas, and Mississippi are the only jurisdictions that  
22 have provisions comparable to this one. None of the other States or the District of Columbia  
23 have any provision dealing directly with this issue, though discussions with the STAWRS  
24 team indicates that most states currently follow the federal rule through administrative policy.  
25

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

1 where its educational activities are regularly carried on...” Internal Revenue Code Section  
2 170(b)(1)(A)(ii).

3  
4 (Q) an amount paid to an individual for jury service by a court, or by a governmental  
5 entity on behalf of a court.

#### 6 **Preliminary Comments**

7 All states exclude this payment from income tax withholding requirements as well as  
8 unemployment insurance purposes. However, some states accomplish this exclusion by  
9 excluding such payments from the definition of wages and others simply exclude jury service  
10 from the definition of employment. For those taking this later approach, this provision will  
11 require them to amend that portion of their statutes to conform to a treatment of these  
12 payments as exclusion from the definition of wages.  
13

#### 14 **SECTION 3. FILING AND PAYMENT DATES.**

15 (a) All employment taxes must be reported quarterly unless it is reasonable to believe  
16 that the total amount owed by the employer for the entire calendar year will not exceed  
17 \$2,500, in which case the employment taxes must be reported annually.

18 (b) All reports of employment taxes must be filed and submitted to [insert state rule]  
19 on forms, or electronically, as prescribed by [the responsible state agency].

20 (c) All payments of employment taxes must be made by the employer by check,  
21 electronically, or any other form as required by [insert appropriate state agency].

22 (d) All payments of employment taxes must be made to the [insert appropriate state  
23 agency] as follows:

#### 24 **Preliminary Comments**

25 This provision anticipates a rather substantial administrative change in States’ physical  
26 collection of withholding and unemployment insurance taxes. Currently, these taxes are  
27 collected by two separate entities – the income taxing authorities and the entity responsible for  
28 administering the unemployment insurance law. As drafted, this section of the act would  
29 require the collection function to be conducted by the same agency or department which

1 would then be responsible for the ministerial act of properly allocating the funds between the  
2 State's income taxing authority and the department responsible for enforcing the State's  
3 unemployment compensation law.  
4

5 Ideally, this same "collection" agency will be able to verify compliance with both the  
6 income tax withholding and unemployment insurance tax laws because there will be no  
7 divergence between those laws regarding the definition of wages; at least to the extent of the  
8 conforming items set out in this act.  
9

10 (1) if the total amount owed at the end of a calendar year is no more than \$2,500, no  
11 later than January 31 of the following year;

12 (2) if the total amount owed on June 30 or December 31 is greater than \$2,500, but no  
13 more than \$5,000, no later than the end of the calendar month following the June or December  
14 in which the amount exceeds \$2,500;

15 (3) if the total amount owed is greater than \$5,000, but no more than \$50,000, no later  
16 than the 15<sup>th</sup> day of the calendar month immediately following the month in which the amount  
17 exceeds \$5,000;

18 (4) if the total amount owed is greater than \$50,000, but no more than \$100,000, no  
19 later than the third business day immediately following the Friday of the week in which the  
20 amount exceeds \$50,000; and

21 (5) if the total amount owed is greater than \$100,000, no later than three business days  
22 following the day the amount exceeds \$100,000.

### 23 **Preliminary Comments**

24 In general payment thresholds and dates as well as filing dates for both withheld income  
25 taxes and unemployment insurance taxes are specified by statute only in general terms. The  
26 specifics are left to the various concerned administrative agencies. However, to enhance the  
27 possibilities of conformity, this recommended provision is set forth with greater detail than is  
28 found in most current state statutes.  
29



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

11  
12 In any event, ignoring transition problems (which may, in some cases, be  
13 insurmountable), common dates for compliance will greatly ease burdens imposed on all  
14 employers. Further, the costs of auditing and assuring compliance incurred by the States  
15 presumably will be reduced simply because complexity is reduced.

16  
17 This provision also does not provide for a look back period as does the Internal Revenue  
18 Code and some state withholding statutes. A look back provision permits payors to base their  
19 payment thresholds, and thus frequency of payment of taxes, on prior year compensation  
20 history. Because the income taxes withheld and the taxes owed for unemployment insurance  
21 purposes are based upon current compensation, it does not appear that look back rules are  
22 essential to timely and accurate compliance with the payment rules. In an era of instant  
23 information and computerized payroll systems, it does not appear that essential data for proper  
24 compliance is difficult to aggregate. On the other hand it is recognized that payments based  
25 upon current payrolls may cause cash management problems for employers which have  
26 significantly fluctuating payrolls. Nonetheless, payments based upon current compensation  
27 rather than look back estimates will make it less likely that employers will become in arrears  
28 in payments of their Trust Fund obligations (i.e., their obligations to pay over withholding  
29 taxes). For large taxpayers, at least for federal taxes, this is not an issue because regardless of  
30 any look back rules at any time an employer has accumulated \$100,000 of payroll taxes they  
31 must be paid over to the government by the next business day after such accumulation. For  
32 mid-size taxpayers, particularly those with quickly growing business or those the business of  
33 which is highly volatile, the problem of temptation to use rather than pay over Trust Fund  
34 monies may cause them much difficulty and deprive the government of monies owed.

#### 35 36 **SECTION 4. EFFECTIVE DATE AND TRANSITION RULES**

37 (a) The effective date of this [Act] is **[seven years after NCCUSL adoption.]**

38 (b) Reserved

#### 39 **Preliminary Comments**

1           **No transition rules are specified in this act. Because of many different existing**  
2 **collection dates and amounts in the various states, it would be impossible to address the**  
3 **transition issues facing each state in a single process. It is intended by the**  
4 **Commissioners that by deferring the effective date of this act for 7 years after its**  
5 **adoption by the Commission on Uniform State Laws that this will give all states**  
6 **sufficient time to effect the transition with the least impact possible.**