State Mobility Issues For Equity Compensation Professionals
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Introduction

Doing business often requires that employees travel, whether to establish new offices, meet potential customers and vendors, attend trainings, or even relocate for personal reasons. Some movement is temporary, others are permanent, but all could have tax consequences. This publication addresses the issues regarding such movement between U.S. states. We will also briefly address the state tax situation for an employee who moves or travels into or out of the U.S. For the purposes of this publication, the District of Columbia will be deemed included in the term *state*.

A *mobile employee* is an employee who works in more than one tax jurisdiction between the grant of an equity award and when the equity award is taxable under local law. There are different types of mobile employees; these are outlined in more detail below. A tax jurisdiction can be a country, state, city, or region. Each tax jurisdiction that the mobile employee has worked in may tax some or all of the income associated with each equity award.

Rules in states regarding the taxation of equity awards vary. For example, Pennsylvania[1] does not confer tax benefits for statutory stock plans, incentive stock options and employee stock purchase plans. Others such as Rhode Island[2] may have their own version of qualified plans. When an employee works or resides in more than one state while his/her equity award is outstanding, each state may have the right to tax the employee on the income from the equity award. The employee may pay tax in more than one state and may be subject to tax in a state where s/he no longer lives or works or has never lived or worked. This publication focuses on the employer payroll compliance aspects and not the employees' ultimate reporting. The reader should note that the payroll compliance may also vary if there is no corporate nexus in that particular state.

Types of Mobility

For the purposes of this publication, *mobility* is the movement of an employee to a different state. An employee may already be living in one state and working in another, although it is more common to live and work in the same state. Mobility for tax purposes takes different forms:

- *Assignee/Secondee* – an employee who lives in one state but then is sent to live in and work in another state for a period of time, creating a taxable presence in the other state. The intent with these arrangements is that the employee will return to his/her home after the period of assignment. An assignee is likely to stay on his/her home payroll.
- *Transfer* – an employee who moves from one state to another with the duration of the move being indefinite. A transfer will likely change payroll to the new location.

1 For example, *see* 61 PA Code § 101.6(f), which does not distinguish between incentive, qualified, restricted, or nonqualified stock options for determinations of timing income receipt.
2 *See generally,* RI Gen L § 44-3-44 (2017).

- *Traveler* – an employee who goes to work in a new location for a short period of time, usually not establishing residency in the new state. A traveler will remain on his/her home payroll.
- *Commuter* – an employee who lives in one state but commutes to work in another. The payroll system should already have the live-in and work-in states configured appropriately.
- *Telecommuter* – an employee who lives and works in one state but works for an employer located in another state. The payroll system should already have the live-in and work-in states configured appropriately.

The reader should note that the definitions above are colloquial and each company or organization may use these terms differently.

Each type of mobile employee presents its own unique challenges. However, prior to considering the issues for specific travel and work arrangements, we should step back and look at the way states tax residents and non-residents.

Taxation of Residents and Non-Residents

A common mistake is to think that residency in a state is established based only on the number of days spent in that state. Often there are several factors that may lead to tax residency in a state, including:

- Number of days spent in the state
- Intention regarding the stay
- Availability of permanent housing and /or family ties

> Example 1:
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> Bob moves from Massachusetts to Virginia on September 1 with the intention of making Virginia his home indefinitely. Even though he will not spend 183 days in Virginia during the year, he will be deemed to be a Virginia resident from September 1. [3]

Each state's rules vary as to the circumstances in which an individual is considered resident as do the state's rules on breaking residency. For example, the Franchise Tax Board considers an individual who leaves California to take up employment elsewhere as a California resident if they return to California for more than 45 days within a taxable year.[4]

Most states tax residents on worldwide income, i.e., the resident individual's entire income, regardless of where it is earned. The resident state may (or may not) give tax credits or exemptions for income earned in another state.

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3 *See* Va. Code Ann. § 58.1-302, which defines a resident as any person who either maintains a place of abode in Virginia for over 183 days in a taxable year or is domiciled (i.e., has their permanent place of residence to which they intend to return) in Virginia.
4 *See* FTB Publication 1031, *Guidelines for Determining Residency Status* (2018) (available at https://www.ftb.ca.gov/forms/2018/18_1031.pdf).

Most states tax non-residents on sourced income, that is income the non-resident individual earns in that state but not income earned elsewhere. Note, however, this is not true of all states; for example, DC taxes residents only.

> Example 2:
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> Anne is a resident of California and has a total income of $100,000. However, she has earned $30,000 in Utah and the remaining $70,000 in California. Utah taxes Anne on $30,000. California taxes Anne on the full $100,000 but gives a tax credit for taxes paid to Utah on the $30,000.[5]

Sourcing of Income – General Principles

When a person is (or has been) working or living in more than one state, the taxation can become complicated. Every tax jurisdiction that the individual has lived or worked in may want to tax her/his income. Each state has different laws regarding what income to tax, which means looking to state law to determine the *source* of the income. The underlying principle of mobility taxation is the principle of sourcing income. There is no single methodology on how income should be sourced by different states (and countries). The general view is that income should be sourced where it is earned. Most states apply this on a physical presence basis, so the location where the employee is physically working will determine where the income is sourced. Therefore, if an employee works for one day in Colorado, under the general principle, her/his income for that day is deemed to be Colorado sourced.[6] This concept works well for wages where the employee is paid a regular salary amount on a regular pay cycle. However, multi-year income such as equity compensation makes sourcing more complicated. The employee may earn the income over a long time period, often spanning several years, and recognize the income and be subject to tax at a later point in time such as the exercise of the nonqualifying stock option or the release of a restricted stock unit. Under the general sourcing principle, the income is earned over the period in which services are performed. If the equity award is not specific about this, the period starts from the grant date. See discussion under *Sourcing For Equity Compensation,* below.

There are certain notable exceptions to sourcing from the general principle with certain jurisdictions that take different perspectives. These include (but are not limited to):

- *Convenience of the employer* states. Delaware, Pennsylvania, Nebraska, New Jersey and New York apply the "convenience of the employer" test to sourcing. Income is sourced where the employer/employment is based unless the employer requests that the employee work elsewhere. For example, the employee resides in and telecommutes from Tennessee for

5 *See* CA RTC § 18001, which describes the credit (and its exceptions) for taxes paid to another state by California residents.
6 *See* Co. Rev. Stat. § 39-22-109 (2)(A)(II), which describes the circumstances for sourcing a nonresident's income to Colorado.

a New York employer. New York law provides that the income is sourced to New York under the convenience of the employer rules.[7]

- Location at grant. Some tax jurisdictions, notably Singapore, take the position that the location of employment at the time of grant is the source of the income even if the individual then moves elsewhere shortly thereafter. Conversely, equity awards granted prior to establishing residency in Singapore that were not granted in respect of the Singapore assignment or services are not subject to taxation in Singapore. The author knows of no U.S. states that take the same position with the exception of a court ruling in North Carolina that effectively ruled the same way.[8]

For completeness, we should also note that several types of individuals are excluded from the sourcing principles applicable to employees. Special rules apply to sports teams, public figures, and entertainers. Self-employed individuals may have the income sourced to the location of the business for which they are performing services. Many states also have special rules for military personnel and interstate transit workers.

Sourcing for Equity Compensation

The question then becomes how to source multi-year income such as equity compensation when the award is held by a mobile employee. Different tax jurisdictions take different approaches. Some common approaches are

- Based on workdays from grant to vest
- Based on workdays from grant to exercise
- Sourced as wages under the convenience of employer principles
- Based on employment/location at grant

Historically, many tax jurisdictions would source equity compensation based on workdays spent in the state from grant to exercise. In 2004, the Organization For Economic Cooperation and Development (OECD) published a report *Cross-border Income Tax Issues Arising from Employee Stock Option Plans*.[9] This report suggests that tax jurisdictions consider the period between grant and vest of the option as the earnings period. Many tax jurisdictions including the U.S. federal tax laws implemented this suggestion.[10] Similarly, certain states such as New York, Minnesota, and Georgia followed suit.

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7 *See e.g., In re Huckaby v. N.Y.S. Div. Tax Appeals,* 4 NY3d 427 (2005).
8 *See* N.C. Individual Income Tax Admin. Hearing Docket No. 2004-200 (available at https://www.ncdor.gov/documents/individual-income-tax-administrative-hearing-docket-2004-200-12142004), which describes the North Carolina Secretary of Revenue's determination regarding the apportionment of nonqualified stock options.
9 The report is available at http://www.oecd.org/ctp/treaties/33700277.pdf.
10 *See* 26 CFR 1.861-4 (b)(2)(ii)(F) ("In the case of stock options, the facts and circumstances generally will be such that the applicable period to which the compensation is attributable is the period between the grant of an option and the date on which all employment-related conditions for its exercise have been satisfied (the vesting of the option).")

> Example 3: Grant to Vest Sourcing
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> Charles is granted a nonqualifying stock option, which cliff-vests on the fourth anniversary of grant, while he is employed and working in Georgia. After three years, Charles relocates to take up a new position with his employer in Oregon; he remains employed in Oregon when he exercises the stock option. The portion of the stock option income sourced to Georgia is based on the three years spent in Georgia over four years vesting period, or 75%.[11]

Prior to the publication of the OECD paper, many jurisdictions would treat the period from grant to the exercise of a stock option as the earnings period. Some jurisdictions, such as Massachusetts[12], continue to do so.

> Example 4: Grant to Exercise Sourcing
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> Diane is granted a nonqualifying stock option, which cliff-vests on the fourth anniversary of grant, while she is employed and working in Massachusetts. After three years, Diane relocates to take up a new position with his employer in Oregon; she remains employed in Oregon when she exercises the stock option on the fifth anniversary of grant. The portion of the stock option income sourced to Massachusetts is based on the three years spent in Massachusetts over five-year period from grant to exercise or 60%.

Other states base their sourcing on the principle of the earnings period being from grant to exercise; e.g., Connecticut considers the period from the first date in the year of grant to the last day in the year of exercise.[13]

Some states take a completely different approach altogether. In North Carolina Ruling 2004-200, the decision was reached that stock options are sourced to the location of employment at grant regardless of whether the individual remains in North Carolina at exercise. As mentioned above, Singapore takes a similar approach. Ohio's Information Release IT 1996-01, reissued March 21, 2018, uses the 'degree of appreciation' methodology for stock options.[14]

Many states, however, do not have a specified sourcing methodology for equity compensation. In this case, the taxpayer should determine a reasonable position and apply it consistently. The author's preference is to follow the federal sourcing rules in the absence of any other guidance.

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11 *See* Ga. R&R § 560-7-4-.05, which describes the rules and provides examples for equity apportionment in Georgia.

12 *See* 830 CMR 62.5A.1(3)(c)(2) ("The amount of such [income derived from nonqualified stock options] that is taxable to Massachusetts is determined…for the period between the option grant date and the option exercise date….")

13 *See* Conn. Reg. §12-711(b)-18(a).

14 *See* Ohio Dept. of Tax. IT 1996-01 (available at https://www.tax.ohio.gov/Portals/0/ohio_individual/individual/information_releases/1996-01FederalPreemptiononRetirementIncomeIR.pdf).

Special Issues Related to Each Type of Mobile Employee

Each type of mobile employee presents its own compliance challenges. An in-depth review is outside the scope of this publication. However, we will briefly discuss that challenges associated with each type of mobile employee:

Assignees/Secondees: When employees are assigned or seconded from one state to another, the main issue will be identifying the state in which the employee is resident. As the move is intended to be temporary, the employee may not break residency in the former state but may (or may not) establish residency in the new state.

Transfers: With a transfer that is an indefinite move, the employee will likely break residency in the old state and establish residency in the new state.

Travelers: Travelers typically do not break residency in their home state. Depending on the state they travel to and the type of activities they perform there, travelers may or may not be subject to tax in the work (travel) state. Some states have *de minimis* for non-resident travelers to be subject to tax. The *de minimis* may be for number of days or amount of income. New York, for example, requires employer payroll compliance for an employee who has worked in New York for more than fourteen (14) days in the tax year; however, compensation paid in one year relating to a prior year is excepted from this rule.[15] Oklahoma applies a threshold for non-residents working in Oklahoma of $300 of income for each calendar quarter.[16]

Given the difficulties for employers trying to navigate the laws of every state in order to comply, Congress has tried to pass federal legislation to standardize the taxation of non-resident business travelers for all states. The Mobile Workforce State Tax Simplification Act (or its predecessors) has been introduced in every congressional session since 2009. The Act would impose a thirty (30) day *de minimis* for non-resident employees working in state without being taxed subject to some exceptions such as sports teams, performers, etc., as noted previously. The latest Act[17] passed the House but did not pass in the Senate and was cleared from the books with the new Congress on January 3, 2019. As of the date of publication, the Congress of 2019-2021 has not yet introduced a similar bill.[18]

Commuters: Commuters typically live in one state but work in another, e.g. living in Connecticut but working in New York. Often the employer will have payroll compliance responsibilities for both the live-in and work-in states and the employee may be required to file taxes in both. However, if the states have a reciprocal agreement (see *Avoiding Double Taxation* below), then payroll reporting may not be required for the work state. In the case of commuters, most payroll systems can identify the reporting requirements as long as the correct live-in and work-in

15 *See Withholding on Wages Paid to Certain Nonresidents Who Work 14 Days or Fewer in New York State*, N.Y.S. Dept. of Tax. and Fin., Technical Memorandum TSB-M 12(5)I (July 5, 2012) (available at https://www.tax.ny.gov/pdf/memos/income/m12_5i.pdf).
16 *See* Ok. Stat. § 68-2385.1(e)(4), which excludes remuneration paid for services performed in Oklahoma by a nonresident if that income is not greater than $300 in a calendar quarter.
17 *See* H.R. 1393 (115th): Mobile Workforce State Income Tax Simplification Act of 2017.
18 *See* https://www.govtrack.us/congress/bills/115/hr1393 for the current legislative history of H.R. 1393.

addresses are populated. It is important for equity compensation administrators to understand how payroll is treating the employee and apply taxation accordingly and consistently.

Telecommuters: Telecommuters work from one (or more) state(s) for an employer based in another state. In general, telecommuters are taxed based on their physical location when performing the work. However, see the description of the *Convenience of Employer* rules under *Sourcing of Income – General Principles* above.

Retirement, Termination and Death

Often an employee will terminate from the employer or retire and move to another state prior to the transaction date, which triggers taxable income recognition for the equity award. The individual is now resident in a state where s/he has not worked for the employer. As a resident of that state, s/he is likely taxable on worldwide income. In general, any post termination/ retirement period should not be used to determine the sourcing of the income. This period is not part of the earnings period because there are no workdays for the employer.

Whether the employer is responsible for withholding state tax and/or reporting income to the resident state depends on the state and possibly on whether the employer is registered for payroll or has corporate nexus in that state.

The income reporting and tax withholding requirements for equity compensation upon the death of the participant are complicated. State mobility may complicate the compliance further. The author is not aware of any specific statutes regarding the sourcing of income in the case of equity compensation being paid out to an estate or beneficiaries. However, in the absence of any guidance, the general tax principles discussed above should apply.

Avoiding Double Taxation

Given the differences in sourcing methodology, there are several scenarios in which an individual can be subject to tax in more than one state on the same income. There are several ways in which double taxation may be mitigated.

First, some states have reciprocity agreements in which state A agrees not to tax the residents of state B for work performed in state A. These are common in the Northeast between neighboring states. The employee may be required to complete a form stating that s/he is resident in a reciprocal state before the employer can stop payroll reporting for the work state.

Second, most states allow residents to take a tax credit for taxes paid to another state for income that is doubly taxed. However, in most cases the amount of income on which a tax credit is allowed is limited to the income sourced to the non-resident state as determined by the resident state rules. In addition, the tax credit is limited to the resident state tax rate or the actual taxes paid to the other state, whichever is lower. Note that not all states allow the employer to reduce withholding for a tax credit to another state; in these situations, the credit would have to be claimed on the individual's state tax return resulting in a cash flow inconvenience until his/her return is filed.

Example 5:

Edward moves from Nebraska to New Jersey. He was granted an RSU while living and working in Nebraska, which vests and is released after he established residency in New Jersey. New Jersey does not have a special rate for supplemental income. His New Jersey tax rate is 7%. New Jersey allows a tax credit for taxes withheld for Nebraska.[19]

	New Jersey (Resident)	**Nebraska (Non-resident)**	**Total**
Income Sourced	$7,000	$5,000	$12,000
Income Reportable	$12,000	$5,000	$17,000
Tax Rate	7%	5%	
Tax Withheld	$590 ($840 less credit of $250)	$250	$840

Third, some states may exclude income of resident individuals that is sourced to and taxed by another state. For example, Colorado excludes from withholding the amount of income for residents which is sourced to and subject to tax in another state.[20]

The reader should note that several payroll systems may not be able to process a transaction where the sum of the state taxable incomes is more than the amount of the federal taxable income. As shown in Example 5 above, the sum of the income reportable to both states is $17,000, whereas the total income is only $12,000. Some payroll systems may treat the federal taxable amount as $17,000. For situations like this, the reader is advised to seek professional advice on the best route to follow given the states concerned.

State Disability, Unemployment Insurance and Other Payroll Taxes.

Employers in all states have to contribute to Federal Unemployment Tax (FUTA) and the state equivalents. Some states also have a corresponding employee deduction either for unemployment, disability, or a similar insurance benefit. These payroll taxes are not necessarily allocated the same way as income taxes.

To allow continuity of coverage, all states have agreed to one set of tests to determine where the wages are reportable for FUTA purposes. The tests are applied in the order shown below. The state for which FUTA is paid is determined by the first test that produces a definite result. The tests are

19 *See* N.J. Tax Topic Bulletin GIT-3W (available at https://www.state.nj.us/treasury/taxation/pdf/pubs/tgi-ee/git3w.pdf).
20 *See* DR 1098 Colorado Income Tax Withholding Tables For Employers (available at https://www.colorado.gov/pacific/sites/default/files/DR1098.pdf).

(1) Localization. Services are *localized* in a state if all the work is performed within one state and constitutes “employment” under the law. Work performed outside the state that is incidental to the work performed in state is ignored.

(2) Base of operations. When services are normally performed in two or more states, then the test of localization is not applicable as services cannot be said to be localized in any one state. The next test, base of operations, considers where the employee’s base of operations is located; it may be the employee’s business office, or an office maintained in the employee’s home. The base of operations, in the absence of other and more controlling factors, may be the place to which the employee receives mail, keeps supplies and equipment, or where the employee maintains her/his business records.

(3) Operations and control. If the base of operations test does not result in a definitive state, the next test is where the employee’s work is directed and controlled from, provided the employee undertakes some services in that state.

(4) Employee’s residence. When coverage cannot be determined by the other tests, an employee’s service in its entirety is covered in the state in which he lives provided that some of his service is performed in that state.

The reader should note that Illinois also uses the above-mentioned tests for determining income tax allocations.

The state for FUTA purposes may not match the state for income tax purposes. The reader should determine if the payroll system can manage this difference.

Local Taxes

According to the Tax Foundation, as of 2011 there were almost 5000 municipalities and school districts in the U.S. that impose an income tax.[21] Some apply tax on current residents only, such as New York City, and others collect taxes from non-residents as well as residents, such as Yonkers.[22] Many localities, however, do not have any guidelines on mobile employee taxation. In such cases, the company should take a position and apply it consistently. Some payroll systems require local taxes to be collected on the amount of the relevant state taxable income.

21 *See Local Income Taxes: City- and County-Level Income and Wage Taxes Continue to Wane*, Bishop-Henchman and Sapia (Aug. 31, 2011). Available at https://taxfoundation.org/local-income-taxes-city-and-county-level-income-and-wage-taxes-continue-wane/

22 *See Employer’s Guide to Unemployment Insurance, Wage Reporting, and Withholding Tax*, NYS-50, pp.26-27 (Rev. Jan. 2014). Available at https://www.tax.ny.gov/pdf/publications/withholding/nys50.pdf

State Issues for International Mobility

There are state issues for global mobility where employees move or travel to or from the U.S.

For moves into the U.S., some of the equity compensation paid may be excluded from federal income tax through the application of a double tax treaty. However, many states do not follow income tax treaties and, therefore, any equity compensation received after moving to the U.S. may be subject to state tax on the full equity compensation even when federal taxes may only apply to a portion of the income.

Similarly, a non-U.S. business traveler visiting a particular state may be tax exempt from federal taxes under the terms of a treaty but may be subject to state taxes for income earned during his/her business trip.

> Example 6:
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> Francois is a French citizen and resident who travels for work to Connecticut for one week every month. Francois qualifies for an exemption from U.S. federal income taxes under the terms of the France: U.S. double tax treaty. Similarly, he is exempt from U.S. social taxes under the terms of the France: U.S. totalization agreement. However, Francois will be subject to Connecticut income tax on the income relating to workdays in Connecticut.

When the employee moves out of the U.S., his/her equity compensation may need to be sourced for state and federal purposes. The sourcing may not be the same for federal and state purposes as noted in *Sourcing for Equity Compensation,* above.

If the individual is a U.S. citizen or green card holder, s/he may be subject to U.S. federal tax on worldwide income but may break state residency and be subject to state tax on state sourced income only.

Practical Considerations

When implementing or evaluating state mobility compliance policy or process, there are many considerations each company should think through including:

- Where the company’s largest exposure(s) are and making sure the process effectively addresses these.
- How can you gather mobility information? Which system is the system of record?
- What can the payroll system handle? Some payroll systems can only allocate state income such that the total of all state taxable income has to be equal to federal taxable income. Some payroll systems cannot handle multistate taxation.
- Where the rules are not clear, what positions will the company take?
- How will the new process be communicated?
- Will the company implement policies to help employees with liability in more than one state such as tax return preparation assistance or tax equalization?

DISCLAIMER AND CREDITS

This publication is intended for informational purposes only and not for the purpose of providing tax, legal, or other advice. This publication is intended to educate companies about general rules for income reporting and tax withholding obligations for mobile employees who have equity awards. As laws and regulations change frequently, please note that the information contained herein may not be current. The information within this publication is not a substitute for professional advice. Each company's situation is different and therefore the reader should not rely on, nor act or refrain from acting based on, the information contained herein without seeking appropriate professional advice. Neither NASPP nor Rutlen Associates, LLC, shall be liable for any losses sustained through the reliance on, or otherwise arising from, the information contained in this publication.

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