Payroll Insights

Employment tax news to guide you now and for the future

September 2023

John's *fresh take*: New Jersey's implementation of the Convenience of Employer Rule

On July 21, 2023, Governor Phil Murphy signed A. 4694 officially establishing New Jersey's implementation of the Convenience of the Employer Rule. The new rule applies to those employees who work in other states which also impose convenience of the employer rules. Those states are Connecticut, Delaware, Nebraska, New York, and Pennsylvania. The state's Division of Taxation has published guidance on their website pertaining to the implementation of the rule and its application to employees in other states which also impose similar rules. Based upon the initial guidance and as discussed below, the new rule should not apply to residents of Connecticut or Pennsylvania.

The New Jersey Division of Taxation guidance provides specifically that "under the convenience rule, a nonresident taxpayer's employee compensation from a New Jersey employer for the performance of personal services is sourced to the employer's location (New Jersey) if the employee is working remotely from an out-of-state location (e.g., at home in their resident state) for the employee's own convenience rather than for the necessity of their employer."

Although Pennsylvania has a "convenience of the employer" rule in place, the New Jersey rule should not be applicable to Pennsylvania residents because of the reciprocal agreement in place between the two states. The reciprocity remains in place so long as the employee has claimed reciprocity by completing the New Jersey Form NJ-165, *Employee's Certificate of Nonresidence in New Jersey*. In addition, the Division of Taxation provides that the convenience rule should not apply to Connecticut residents working in New Jersey. However, this is subject to change as the state intends to coordinate with the Connecticut Department of Revenue Services and issue further guidance.

The New Jersey convenience of the employer is retroactive to January 1, 2023, and the Division of Taxation has provided that the affected employers begin withholding and/or encourage employees to make estimated payments for tax year 2023 as soon as possible. Employers should "consider" making adjustments to withholdings as an accommodation to employees so that they are not underpaid upon filing their New Jersey nonresident personal income tax return for 2023. The Division of Taxation "will not impose penalties and interest, as long as the taxpayer begins complying with the new law as of September 15, 2023."

Based upon the above, employers should not be required to retroactively adjust employee withholdings to satisfy the New Jersey convenience of the employer rule. Instead, employers should be compliant with the new convenience of the employer rule by September 15, 2023, so as to avoid any penalties associated with the underwithholding of New Jersey state income tax (SIT).

Example Application of the New Jersey Convenience of Employer Rule

Based upon current guidance from the New Jersey Division of Taxation on how to apply the New Jersey convenience of employer rule, the example below provides the SIT withholding requirements when an employee has the following fact pattern:

a. Is a New York City resident and employee of Employer X (NJ based employer);

b. Performs services in New Jersey 60% of the time;

c. Performs services from home in New York City 20% of the time; and

d. Performs services in Florida 20% of the time for business purposes and as required by Employer X.

Based upon the facts of the above scenario, all wages paid to the employee for services performed in New Jersey and New York (for the employee's convenience) should be subject to New Jersey SIT withholding, along with New York incremental SIT (i.e., residual) withholding, as applicable. In addition, all wages paid to the employee should remain subject to New York City resident tax withholding.

Furthermore, all wages paid to the employee for services performed in Florida (non-income tax state) should be subject to New York SIT withholding because the employee is performing services outside of New Jersey for business purposes and not for the employee's convenience because Florida does not have an income tax but the employee is still a resident of NY. Please note, manual intervention within payroll may be required if the employee's wages default to being subject to New Jersey SIT withholding pursuant to the convenience of employer rule configuration. In addition, all wages paid to the employee should remain subject to New York City resident tax withholding.

Separately, if the employee is to perform services in Florida for **the employee's own convenience**, then the New Jersey convenience of employer rule should remain applicable. The wages should then be sourced to New Jersey for SIT withholding, along with New York incremental SIT withholding. In addition, all wages paid to the employee should remain subject to New York City resident tax withholding.

Federal updates

2020 Employee Retention Credit ending in 2024

The statute of limitations for claiming the 2020 Employee Retention Credit (ERC) will be ending in 2024. Employers have three years from the date of filing their original Form 941, Employer's Quarterly Federal Tax Return, to file an amendment to claim the Employee Retention Credit (ERC). Accordingly, the statute of limitations for claiming the 2020 ERC generally ends in April of 2024. Further, employers claiming the 2021 ERC generally have until April of 2025. As employers consider this looming deadline, there will likely be an uptick in Form 941-X filings and delays in processing through April of 2025.

With the expected increase in filings, there will be added pressure on the IRS to process claims in a timely manner. Currently, the IRS has a large backlog of ERC claims to work through. The average ERC claim can take anywhere from three to six months to be processed and applied to employers' accounts.

While the White House has requested additional funds for the IRS in their budget request, there are signs that the full amount may not actually be granted. On July 13, the House advanced the Financial Services-General Government appropriations bill, under which IRS funding would be $2.9 billion less than what was requested by the White House. Decreased funding to the IRS could lead to slower processing times as well as a delay in the modernization process. With a decreased budget, the delays in processing ERC claims could be extended and would expand to other areas of processing as well. Thus, the backlog is likely to continue through the end of 2023 and would only get worse with the influx of additional filings for 2020 credits.

Employers considering taking the 2020 credit should be aware of the changes in the next year and act accordingly to maximize the credit available to them due to the COVID-19 Pandemic.

IRS releases generic legal advice memorandum

On July 21, 2023, the IRS released a generic legal advice memorandum (GLAM) clarifying the requirements for an employer's Employee Retention Credit (ERC) qualification. In the GLAM, the IRS has clarified that employers that experienced supply-chain disruptions are not eligible to claim the ERC, unless specific qualifications are met. Employers must be able to (1) identify an actual governmental order suspending their supplier's operations; (2) provided substantiation that the lack of supplies caused more than a nominal impact on operations; and (3) substantiate that the employer was not able to obtain critical goods or materials from an alternate supplier.

Proposal to expand overtime protections

The U.S. Labor Department's proposal to expand overtime protections has been sent to the White House for review. The White House budget office will release the proposal to the public, once cleared. It is expected that the change will increase the salary threshold of the current requirements ($35,568) thereby expanding overtime protections to more individuals.

Updated per diem values

The U.S. State Department released updated per diem values for more than 160 foreign locations on August 1, 2023. The update includes rate changes for various foreign countries, territories, and cities to maximize the tax-free reimbursements available to employees while traveling abroad on business.

Updated Employment Eligibility Verification form

An updated version of Form I-9, *Employment Eligibility Verification*, and instructions were released by the IRS on August 1, 2023. The new form is required to be used by employers no later than October 31, 2023 and will replace the 2019 version on that date. The update comes after the Department of Homeland Security released 8 CFR Part 274a which provides certain employers with alternative procedures for reviewing documentation, rather than requiring the in-person physical examination method previously followed. During the COVID-19 pandemic, employers were allowed to virtually examine employee's I-9 documentation through August 31, 2023.

Final revisions for Forms W-2c and W-3c

The IRS released the final revisions for Forms W-2c, *Corrected Wage and Tax Statement*, and W-3c, *Transmittal of Corrected Wage and Tax Statements*, on August 3, 2023. All copies of Form W-2c, except for Copy A are fillable online, however, the Form W-3c is not. The General Instructions provided for the forms should be followed by employers when determining filing requirements and methods.

State updates

California: The California Employment Development Department forecasted that the state's unemployment insurance trust will soon be paying more in claims to individuals than it will collect taxes from employers, with a resulting imbalance of $1.5 billion by 2024. Thus, tax rates are expected to continue to rise over the next year. In conjunction with the state's outstanding federal loan, employers could see an estimated $423 million collected in payroll taxes during 2023, and over double that amount in 2024.

Effective January 1, 2024, the hourly minimum wage in California is expected to increase to $16 from $15.50. Under the new ballot measure, the minimum wage would also be increased to $17 in 2025.

Effective January 1, 2024, the hourly minimum wage in Petaluma, California will increase to $17.45 from $17.06. The city plans to release materials for employee notice requirements by September 2023.

Colorado: Effective January 1, 2024, the hourly minimum wage in Denver, Colorado will increase to $18.29 from $17.29. The minimum wage for tipped workers will increase to $15.27 (using a $3.02 maximum tip credit) and minors in the certified youth employment program will be entitled to 85% of the minimum wage ($15.55 per hour).

Delaware: Delaware Governor John Carney signed H.B. 236 on July 25, 2023. Under the bill, the state's 2024 unemployment tax rates will continue to range between 0.30% and 5.60% for experienced employers and 1.20% for new employers.

Illinois: Illinois Governor J.B. Pritzker signed Public Act 103-0009 on June 7. The Act reduced the state allowance to $2,425 from $2,625. As a result, the Department of Revenue updated the withholding formula for the remainder of the year. The formula uses the $2,425 allowance for new employees and $2,225 for existing employees.

The Illinois Department of Revenue (IDOR) released the following General Information Letters in response to taxpayers' inquiries:

- Regarding the minimum wage credit, the IDOR confirmed that tips received by an employer would not be considered compensation, but any amount paid by the employer to ensure the employee's compensation meets the minimum wage requirements would be under 86 Ill. Admin. Code 100.3100. The IDOR also clarified that no minimum wage credit may be claimed by the employer for employees who have not worked for at least 90 consecutive days.
- Regarding wages earned by an Illinois resident performing both inside and outside of the state, the taxpayer requested that the IDOR approve their proration method used to allocate the employee's wages and that accounts for the differences in taxability of deductions and compensation in both of the employee's work states. In its response, the IDOR confirmed that, effective December 31, 2020, a day allocation method should be used to determine an individual's compensation sourced to the state. If a day allocation method is not available due to the employer's time and attendance system, then an employer should complete Form IL-W-6, *Certificate of Days Worked in Illinois for Non-Residents*.
- Regarding the state's Form W-2, *Wage and Tax Statement*, reporting requirements for Illinois residents working in states that do not impose an income tax. The IDOR clarified that Publication 130, *Who Is Required to Withholding Illinois Income Tax*, should be followed when determining the reporting requirements for employees working out of state. Under IITA, 35 ILCS 5/701, the wages paid to a resident employee for services performed in a state without an income tax should be considered compensation paid in Illinois and reported as such in Box 16 of Form W-2.

On July 1, 2023, the Illinois department of Revenue released Form IL-W-$, *Employer's and other Payee's Illinois Withholding Allowance Certificate and Instructions*. The form should be completed by employees to ensure their employer withholds the correct amount of Illinois income tax from their wages during the tax year.

Maine: Maine's paid family and medical leave program is set to begin collecting employee contributions in 2025 and paying benefits in 2026. The maximum premium of 1% will be split evenly between employers and employees with a maximum wage base equal to the social security wage base in the applicable tax year. Contributions will be made quarterly by employers with at least 15 employees. Those that have few than 15 employees will not be required to make the employer contribution but will be required to collect and remit the employee portion. Governor Janet Mills signed LD 258 on July 11, 2023.

Massachusetts: 830 CMR 62B.00 was repealed and replaced with 830 CMR 62B.2.1. the new regulation explains the withholding requirements for Massachusetts wages and other payments. Under the new regulation, employers and employees are defined in the same way as under Internal Revenue Code (IRC) § 3401. Furthermore, income subject to withholding is that which is (a) taxable under Massachusetts personal income tax law; or (b) considered wages under IRC §3401, a payment under § 3405, a pension contribution to governmental units and free public libraries, or compensation for performances by performers. On July 20, 2023, the Massachusetts Department of Revenue released an updated regulation regarding withholding and estimated taxes detailed above.

Missouri: The City of St. Louis submitted an appeal to the Missouri Court of Appeals on July 31, 2023 (Daly v. Boles, Mo. Ct. App. E.D., ED111495, July 31, 2023). The original case argued that employees teleworking outside of the city should not be subject to the 1% earnings tax. The trial court ruled in favor of the employees based on its interpretation of services performed in the city, however, it denied their class action request. The city has now appealed the ruling on the basis that the trial court misinterpreted the wording of "Rendered in the City" in their ruling. The city believes that "rendered" should include those services which are "delivered" and/or "transmitted" in the city. The appeal comes two weeks after the employees submitted a preemptive review with the appeals court for their class action ruling. The July 31, 2023, appeal was denied, resulting in the "normal" appeals process taken by the city.

Nevada: Nevada's unemployment insurance wage base will increase from $40,100 to $40,600. The wage base is calculated based on the average annual wage paid to Nevada employees effective January 1, 2024,

New York: The New York Department of Taxation and Finance released an updated guidance on the state's Metropolitan Commuter Transportation Mobility Tax (MCTMT). The new guide provides updates on the zones to which the MCTMT applies, the applicable rates for employers, and information for self-employed individuals. For purposes of calculating MCTMT, there are two zones:

- Zone 1: New York, Bronx, Kings, Queens, and Richmond Counties; and
- Zone 2: Rockland, Nassau, Suffolk, Orange, Putnam, Dutchess, and Westchester Counties.

Tax rates for the two zones, determined based on tables provided by the State and each employer's quarterly payroll expense, range from 0.11% to 0.60% and are due quarterly. The new rates and zone definitions are effective August 1, 2023.

Pennsylvania: The Pennsylvania Department of Revenue issued Personal Income Tax Bulletin 2023-1, *Submission of Federal Form 1099-MISC and 1099-NEC and Non-Resident Withholding on Pennsylvania-Source Compensation, Net Profits, and Lease Payments*. The Bulletin provides guidance on filing Forms 1099-MISC, *Miscellaneous Income*, and 1099-NEC, *Non-Employee Compensation*, as well as withholding obligations for non-resident payments. Forms 1099 should be filed with the Department of Revenue by January 31 of the year following payment and provided to the employee by March 31 of the same year. Furthermore, payors should not be required to withhold Pennsylvania income tax on payments made to payees who earn less than $5,000 annually from the payor. Payors who are required to withhold income tax on payments reported on Forms 1099 should follow the guidance provided in the Bulletin for filing requirements and deposit timing.

Puerto Rico: Puerto Rico released the 2023 Forms 499R-2/W-2PR, *Withholding Statement*, and 499R-2C/W-2CPR, *Corrected Withholding Statement*, on July 26, 2023. The current year forms did not reflect any substantive updates from those used for 2022.

Oregon: Under H.B. 2576 all disputes regarding local taxes should be brought by taxpayers to the Oregon Tax Court, rather than general county courts effective September 24, 2023. The taxes most likely to be affected are the Portland area Metro Supportive Housing income tax, Multnomah County Preschool for All tax, and Multnomah County business income tax.

Wisconsin: Wisconsin provides clarification on Worker Classification requirements between Employees and Independent Contractors. Guidance for determinations can be found on both the Internal Revenue Service (IRS)'s website as well as that of the Wisconsin Department of Workforce Development. Penalties for misclassification of workers range from the amount of tax that should have been due to a $25,000 fine, depending on the infraction and the employer's industry. Interest also generally applies to any outstanding amounts due. Wisconsin released *Wisconsin Tax Bulletin 222* on July 27, 2023.

Meet one of our Employment Tax professionals: Anne Williams

Anne is a senior associate in KPMG's New York City office, with 2.5 years of employment tax experience. Anne works with clients on a variety of topics including corrective reporting at the federal and state levels, work from anywhere considerations, and notice resolutions. When not in the office, Anne enjoys running and spending time with her family in Vermont.

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