



# Payroll Insights

Employment tax news to guide you now and for the future

June 2023



## John's fresh take: Tax home challenges for flexible work

In response to the COVID-19 pandemic, organizations across the globe experienced a workplace transformation by expanding and enabling remote work practically overnight. What started as an extraordinary “work from anywhere” experiment is now the norm for many organizations. Today, remote work is commonplace and done through various flexible arrangements to satisfy a variety of business purposes and to attract and retain talent. But the rise in flexible worksite arrangements presents a challenge to employers that provide them and pay or reimburse employees for business travel because the rules for when reimbursed expenses related to business travel can be excluded from an employee’s compensation are complex, often outdated, and derived from court decisions with very specific facts and circumstances. Thus, employers must carefully analyze business travel arrangements to determine whether paid or reimbursed travel expenses are taxable or nontaxable to employees. Key to this analysis is the location of an employee’s tax home, including whether a personal residence may be considered a tax home.

KPMG professionals Robert Delgado, Stephen B. Tackney, Terri Stecher, Melissa Abel, Rob Fagan, and Dontrell A. Lemon have prepared an article examining the definition of tax home for federal income tax purposes and they explore the tax consequences that may arise from employees being “away from home” for business travel. The article explains that employers providing flexible worksite arrangements and reimbursing employees for business travel face challenges because the tax home and associated away from home rules related to excluding business travel reimbursements from an employee’s compensation are complex, often outdated, and derived from fact-specific court decisions. This updates an article first published by KPMG in 2016. For the full article, please [click here](#).

### Federal updates

#### Early wage access and constructive receipt

This year’s “Green Book,” published by the Treasury Department, outlined a proposal for Congress to adopt amendments to clarify the tax treatment of on-demand pay agreements, also known as early wage access. Treasury maintains that employees with early access to wages via an on-demand pay arrangement may be in constant constructive receipt of their wages. As such, Treasury advises employers to withhold and pay employment taxes on employees’ earned wages on a daily basis. Specifically, Treasury’s proposal would amend the following Internal Revenue Code sections:

- Code Sec. 7701 to provide a definition of an on-demand pay arrangement as an arrangement that allows employees to withdraw earned wages before their regularly scheduled pay dates.
- Code Sec. 3401(b) to provide that on-demand pay arrangements are treated as a weekly payroll period, even if employees have access to their wages during the week.



- Code Sec. 3102, Code Sec. 3111, and Code Sec. 3301 to clarify that on-demand pay arrangements are not loans
- Code Sec. 6302 to provide special payroll deposit rules for on-demand pay arrangements.

The provisions are directed at certain taxpayers, whom Treasury claims are “taking aggressive tax positions on the timing of the wage payment for employment tax purposes and the timing of the withholding and deposit of the employment taxes.”

Underlying Treasury’s concerns are several longstanding employment tax rules, including the following:

- Wages are considered paid when they are actually or constructively received by the employee;
- An employee is in constructive receipt of wages when an amount is set apart or otherwise made available so that the employee may draw upon that amount at any time; and
- When employees have unfettered control over the date on which they actually receive their wages, they are typically considered to be in constructive receipt of those wages.

Employers that offer on-demand pay arrangements should maintain either a daily or a miscellaneous payroll period. This, Treasury acknowledges, is administratively infeasible. Treasury recognized that few, if any, employers or third-party payors treat employees with access to on-demand pay arrangements as being in constant constructive receipt of their wages, because it would be a significant financial and administrative burden on the employers or third-party payors to configure their payroll systems and make payroll deposits on a daily basis. Read the KPMG report [here](#).

### **Effect of IRS funding on information reporting**

The IRS has released information regarding its plans to utilize the additional \$80 billion allocated to the agency in 2022. A majority of this budget will be used to improve current systems and the taxpayer experience. This includes lowering the electronic filing threshold for individuals to hopefully streamline the information reporting process, an update that has been delayed from 2019.

In 2023, the [IRS launched](#) a new system to accommodate the lower e-filing thresholds and to push more taxpayers to electronic filing.

Additionally, the regulations provided an e-filing requirement for Form 1042, for which there was no electronic filing system prior to 2023. The regulations require certain withholding agents with 10 or more returns, partnerships with more than 100 partners, and all financial institutions to e-file Form 1041, beginning in 2024. Taxpayers are expected to update their processes for the new filing requirements and begin e-filing in 2023. E-filing was available in 2023 for the tax year 2022, but optional.

Effective tax year 2022, under the American Rescue Plan Act of 2021 (ARPA), the minimum threshold for reporting third party service organizations was lowered from \$20,000 and 200 transactions to \$600, with no minimum number of transactions. However, due to transitory relief provided by the IRS in January 2023, the threshold was pushed back for at least one year. There are ongoing legislative challenges that may nullify the ARPA changes or establish a middle ground threshold. Taxpayers should keep an eye on changes to 1099-K reporting as there will likely be additional variations introduced. State reporting thresholds may differ, regardless of federal transitory relief.

### **Inclusion of FSA medical expense reimbursements in income**

The IRS recently published [Chief Counsel Memorandum 202317020](#), clarifying that reimbursements of section 213(d) medical expenses to an employee from a health FSA provided in a section 125 cafeteria plan may be included in gross income calculations. For such reimbursements to be included, the employee must fail to fully substantiate the expenses that were reimbursed. The IRS details that if the cafeteria plan does not require substantiation, accepts “sampling” of expenses, permits self-certification, or establishes a threshold dollar amount that doesn’t require substantiation, the plan fails to meet the requirements under Prop Reg. section 1.125-6(b) and should not be considered a cafeteria plan.

## Gig worker updates

Gig workers continue to be in the news. Many states are attempting to wrap their minds around the “gig economy” and whether gig workers should be classified as independent contractors or employees. In one instance, Uber and Lyft were told that they can treat drivers as independent contractors. In a decision issued one month later, Grubhub was told that a delivery driver should be classified as an employee for minimum wage and overtime claim purposes. The state has petitioned for a review in the Uber and Lyft case while it is expected that Grubhub will appeal the decision stating that the worker is an employee for wage and hour purposes.

### California

#### Uber and Lyft Can Treat Drivers as Contractors in California

In March 2023, the [U.S. Court of Appeals for the Ninth Circuit](#) ruled that Uber Technologies Inc., Lyft Inc., Postmates, DoorDash, Inc., and similar gig-based business models companies can treat workers as independent contractors. This ruling allows workers to retain their independent status and flexibility while freeing gig companies from paying overtime and other expenses. However, the State of California has petitioned for a review and/or rehearing of [the case](#) to an *en banc* panel rather than the three-judge panel that initially ruled.

#### California Grubhub Driver Wins Employee Status

In April, a federal district court ruled that a [California Grubhub Inc. delivery driver should be classified as an employee](#), not an independent contractor, for purposes of minimum wage protections and overtime claims. The decision hinged on whether the company could pass the ABC test for determining the driver’s independent contractor status

To meet the ABC test, Grubhub had to show that its drivers perform work outside of Grubhub’s usual course of business. The district court was not convinced that Grubhub simply connected the restaurants with diners to facilitate food orders. The court held that delivery services were necessary to the business because Grubhub made more money when there were more deliveries, performed delivery services continuously, and publicly advertised delivery services to diners. Grubhub will most likely appeal the decision.

*Lawson v. Grubhub, Inc.*, No. 3:15-cv-05128 (N.D. Cal. Mar. 30, 2023).

#### Oklahoma Law Sets Worker Classification Criteria for Gig Drivers

[Oklahoma passed bill HB 2464](#), effective November 1, 2023, establishing the classification requirements of an independent contractor for drivers of a transportation network company. Under this bill, for a driver to be considered an independent contractor, the following requirements must be met:

- The driver and the company must agree in writing that the driver is an independent contractor.
- The company may not set specific hours for the driver to be logged into the company’s network or application; and
- The driver must be free to engage in another occupation or use another transportation network company’s network or application

## New EU rules mean cross-border telework may be more attractive

As a result of the Covid-19 global health emergency, the EU suspended the application of several legislative instruments, including the EU rules for coordination of social security.

This suspension of rules for social security is still in force but is set to expire on June 30.

However, [recently EU ruled](#) that social security are based on the *lex loci laboris* principle, which means that a person is covered by social security in the country where they are physically working. This principle applies in several situations, including when a person is working in more than one country.

## Major state updates

### Indiana Nonresident Withholding Relief

On May 4th, 2023, Indiana Governor Eric Holcomb signed [Senate Bill 419](#), which includes the amending of the Internal Revenue Code ((IRC) definition of adjusted gross income. Effective January 1st, 2024, this change in definition will result in certain Indiana nonresident employees from having income. If employment within Indiana exceeds 30 days in the calendar year, all compensation is included in Indiana adjusted gross income, including compensation for the first 30 days of employment. It is important to note, this de minimis threshold only applies to individuals that are not residents of Indiana at any time during the calendar year.

Employers should not incur penalties for failure to withhold from Indiana nonresident employees for the compensation paid for services performed that are less than 30 days in a calendar year in the state of Indiana. Furthermore, a workday in Indiana is considered any day that the employee performed more of their duties in Indiana than any other state that day. Any portion of a day that an employee may be travelling should not be considered when determining the performance of services for that day. In the instance an employee performs services in their resident state and a nonresident state on the same day, it may be considered that the employee performed more of their performance of services in the nonresident state for that day.

It is important to note that this change in provision does not impact Indiana local income taxes. Thus, Indiana local income taxes should remain unchanged and should be withheld as previously under Indiana law.

### Montana Nonresident 30-day De-minimis Threshold

On May 18th, 2023, Montana Governor Greg Gianforte signed [House Bill 447](#) which includes the exemption of some Montana nonresident employees from Montana withholding when performing services in Montana.

If employment within Montana exceeds 30 days in the calendar year, all compensation should be included in Montana adjusted gross income, including compensation for the first 30 days of employment. When considering days performing services, a Montana nonresident employee is considered to be in Montana when present and performing services for any port of a day in Montana. However, any portion of a day that an employee may be travelling should not be considered when determining the location where services were performed for that day. This exemption applies if services are performed in more than one state in any calendar year.

One exclusion from HB447 is any individual that qualifies as a key employee. A key employee is," an individual who, for the year immediately preceding the current tax year, had annual compensation from the employer of greater than \$500,000." Other individuals also excluded from the safe harbor include:

- Professional athletes or members of professional athletic teams;
- Professional entertainers who perform services in the professional performing arts;
- Persons of prominence who perform services for compensation on a per-event basis;
- Persons who receive lottery winnings on lottery tickets purchased in Montana;
- Persons who perform construction services to improve real property, predominantly on construction sites, as laborers; and
- Qualified production employees.

This will become effective January 1, 2024. Employers should not have penalties imposed for failure to withhold from Montana nonresident employees for compensation paid for services performed that are less than 30 days in a calendar year in the state of Montana.

It is important to note, this update in House Bill 447 does not have any impact or change to other Montana employment taxes.

## Federal, state and locality updates

### FUTA Credit Reduction in 2023

The U.S. Department of Labor has released their 2023 State Unemployment Insurance Trust Fund Solvency Report. Based on this report, California, Connecticut, Illinois, New York, and the US Virgin Islands are at risk of being assessed a [FUTA credit reduction for 2023](#) since they had outstanding balances on their federal unemployment tax account as of Jan. 1, 2023.

If another FUTA credit reduction is assessed in 2023, California, Connecticut, Illinois, or New York employers would effectively pay at a tax rate of 1.2%. Similarly, if the US Virgin Islands is assessed a second FUTA credit reduction in 2023, employers might pay an effective tax rate of 5.4% according to the report.

### IRIS Update

The IRS has released [Publication 5719, Information Returns Intake System \(IRIS\) Test Package for Information Returns](#), which provides instructions and filing guidance related to the IRIS program to be used for information return filing beginning in 2024 (for the 2023 tax year). The Publication was released May 11 and provides filing and transmittal information for both filers and software developers. Along with the guidance, the IRS will also be releasing test scenarios to be used as examples for the new filing process.

### I-9 Update

Effective July 31, 2023, [employers will no longer be able to remotely inspect Form I-9, Employment Eligibility Verification](#) documents provided by employees. Employers have until August 30, 2023, to physically examine documents that were remotely examined.

### Form W-2 Update/Box 12

On April 28, the IRS released a draft of the [2024 of Form W-2, Wage and Tax Statement](#). Updates include a new code for Box 12 (Code ii: Medicare waiver payments excluded from income under Notice 2014-7) and a change in the e-filing threshold for employers (10 forms).

### Form W-2C Update

On May 2 the IRS released a draft of the [2024 Form W-2c, Corrected Wage and Tax Statement](#). Updates include making all copies fillable online and a notice to employers on Copy D regarding printed copies.

### Federal Per Diem Update

Effective May 1, the US State Department updated [per diem rates](#) for over 250 locations. Locations included various countries as well as specific cities such as Mexico City, Paris, and Seoul.

### Alabama

Alabama is considering [bill proposal H.B. 217](#) which would exempt overtime pay, time worked in excess of 40 hours a week by a full-time employee, from the calculation of income tax. Under existing law, gross income is defined for the purpose of state income tax. Also existing law exempts certain amounts from the calculation of gross income.

### Arkansas

Arkansas recently passed [Arkansas S.B. 434](#), otherwise known as Act 644, which reduced the electronic filing requirement from 250 employees to 125. An employer may be exempt from the electronic filing requirement if they can demonstrate that filing electronically would be burdensome.

### Georgia

On May 1, Governor Brian Kemp signed [SB 61](#), which extended Georgia's sick leave law permanently. Prior to SB 61, the law would have expired on July 1, 2023. The law provides employees, of employers with at least 25 employees, with up to 5 days of earned sick leave each year. The leave can be used to care for immediate family members.

On May 4, Governor Brian Kemp signed [SB 129](#) to allow employees to take two hours of leave to vote early, in person. The state already provides two hours for voting on primary/election dates and the new bill extends that leave to voting early as well.

## Idaho

Idaho has updated their 2023 withholding methods under [HB01](#) (2022). The rate has been reduced from 6% to 5.8% based on the bill, signed by Governor Brad Little on September 1, 2022.

## Maine

Governor Janet Mills signed [LD 12](#) into law on May 8. The bill will go into effect 90 days after the state legislature's special session adjourns and expands the number of employers subject to severance pay. [Under the bill](#), any employer that owns a facility that has employed at least 100 individuals in the preceding 12 months is now covered by the severance pay requirements of the state.

## Maryland

Maryland has delayed the state of their paid family leave program contributions to October 1, 2024, from October 1, 2023, [under SB 828](#) (signed May 3 by Governor Wes Moore). The start of paid benefits has also been delayed to January 1, 2026, from January 1, 2025.

## Minnesota

Minnesota has recently passed [bill HF 2](#) to create a Paid Family Medical Leave program, ensuring paid time off for a worker's serious medical condition, pregnancy, bonding with a new child, or caring for a sick family member. This program would be funded by employer and employee contributions of 0.7% of employee wages and would go into effect July 1, 2025.

## New York

A challenge to New York's Convenience of the employer rule has arisen. Edward A. Zelinsky, a New York law professor and Connecticut resident, has recently requested that the New York Division of Tax Appeals overturn the state's "convenience of the employer" test. Zelinsky previously challenged this rule regarding income taxes paid in 1994 and 1995 and lost. The case consisted of multiple appeals all the way to the New York Court of Appeals. Now with ever changing state tax laws amidst the aftermath of Covid-19, he has challenged this rule again. No decision has been made, but the outcome will potentially have a great impact on all residents and employees of the state of New York.

## New York Increase to Minimum Wage

New York increased minimum wage across the state under [SB 4006-C](#) signed by Governor Kathy Hochul on May 3 to keep up with the rising cost of living by increasing New York's minimum wage for three years and then tying future increases to inflation.

- On January 1, 2024, the minimum wage will increase from to \$16 in New York City and the counties of Nassau, Suffolk and Westchester, and to \$15 in all other parts of the state. New York City, Nassau County, Suffolk County, and Westchester County will increase to \$17/hour over the next three years; by 2026. The rate will increase to by \$0.50 every year thereafter until calendar year 2026.

## North Carolina

Similar to Alabama, North Carolina is considering bill proposal [HB 490](#) to exempt both overtime pay and up to \$2,500 of bonus pay from the income tax calculation. Currently HB 490 is with the House Finance Committee.

## Ohio

On May 2, three Ohio localities passed income tax rate changes in their primary elections with various effective dates, and one school district introduced a local tax effective in 2024.

- [Bucyrus](#) increased the local income tax rate from 2% to 2.25% effective July 1, 2023.
- [Lordstown](#) increased the local income tax rate from 1% to 1.5% effective July 1, 2023.
- [Willard](#) increased the local income tax rate from 1.275% to 1.75% effective January 1, 2024.
- [Blanchester](#) Local School District (Clinton) introduced a 1% tax effective January 1, 2024.

## Pennsylvania

The Pennsylvania Senate is currently considering [SB 671](#), a bill that would prevent Philadelphia from implementing a "convenience of the employer" provision for nonresidents. This would prevent Philadelphia from

imposing a local earned income tax on nonresidents of Philadelphia working remotely for a Philadelphia employer.

According to the Sterling Act, Philadelphia has the authority to levy a tax on the wages earned by employees who work for Philadelphia employers (currently 3.79% wage tax on residents and a 3.44% tax on nonresidents). SB 671 would allow nonresidents who work part of the time outside of the city to only owe tax on wages earned within city limits.

### Washington

On May 4, Governor Jay Inslee signed [HB 1217](#) into law. Effective January 1, 2024, the bill requires employers settling wage complaints in the state to include 1% of monthly interest on all amounts owed in settlement amounts. The bill will allow employers to request a waiver or reduction of the interest in the settlement process.



### Meet one of our Employment Tax professionals: Holly Skoufos

Holly Skoufos is an associate with our team in San Francisco, California and started with the firm in November 2022. Holly assists with tax dispute resolution, independent contractor reporting, and payroll annual and quarterly reporting compliance at the federal, state, and local levels. Holly enjoys exploring the Bay Area with family, friends, and her dogs, and is looking forward to traveling this summer.

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