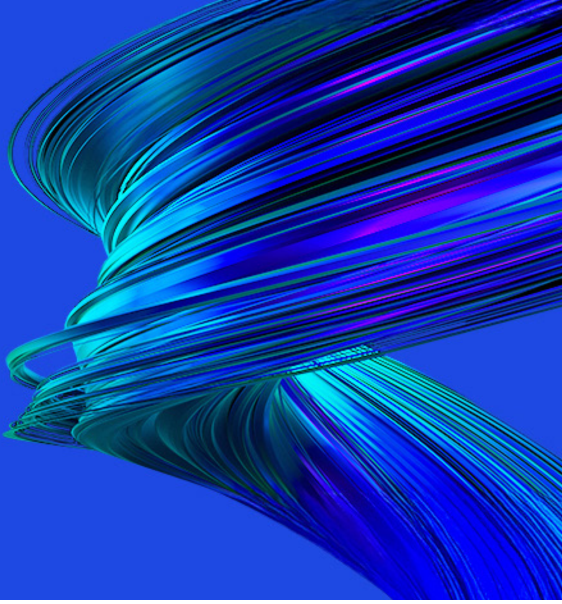

Payroll Insights

Employment tax news to guide you now and for the future

June 2026

John's fresh take: Highlights from PayrollOrg's 44th Annual Congress

At PayrollOrg's 44th annual Congress (the Congress), held from May 12 to May 15 in Nashville, Tennessee, the KPMG employment tax team was proud to be front and center, engaging with the individuals who form the operational backbone of countless organizations.

During the event, I was honored to receive the Special Friend Award, recognizing my support for PayrollOrg's membership, corporate involvement, and advocacy for the continuing education of payroll professionals. Yet, while this award was presented to me, it is fundamentally a testament to the collective dedication of the entire KPMG employment tax team. Our ongoing mission to support the payroll industry relies heavily on this collaborative effort—whether we are leading educational sessions for local chapters or nationally.

At this year's Congress, KPMG professionals led six pivotal sessions tackling some of the industry's most pressing hot topics. From navigating the intricacies of New York audits and untangling California and Washington payroll tax complexities to exploring the innovations in payroll system automation, our goal was to equip attendees with the actionable insights they need to succeed in an increasingly complex regulatory environment.

Beyond the technical tax issues, the Congress highlighted the rapidly evolving role of the payroll professional. Attendees had the opportunity to dive into sessions focused on enhancing leadership and management skills, optimizing existing payroll systems through key performance indicators, and managing the unique challenges of an international workforce.

Of course, a thriving professional community is built on more than just technical sessions. The vibrant atmosphere in Nashville offered ample opportunities to forge meaningful human connections—whether networking with peers at happy hours, discovering new vendor solutions at the Expo, or showcasing team spirit at the highly anticipated costume party.

Ultimately, the Congress was a great reminder of how much the payroll profession continues to evolve. The role requires a strong grasp of compliance, an openness to new technology, and continuous education as rules and regulations shift. The KPMG employment tax team looks forward to continuing our support for this community, sharing knowledge, and helping payroll professionals navigate these ongoing changes in the years ahead.

Federal updates

Treasury department and IRS release guidance on qualified long-term care distributions

Section 334(a) of the SECURE 2.0 Act added section 401(a)(39) to the Internal Revenue Code (Code). Section 401(a)(39) generally permits participants in a defined contribution plan to receive qualified long-term care distributions without incurring the additional 10 percent tax under section 72(t). On May 20, 2026, Treasury and the IRS released Notice 2026-33, which provides guidance to (i) providers of certified long-term care insurance of their disclosure and reporting requirements under the Code, (ii) plan administrators making qualified long-term care distributions, and (iii) individuals receiving qualified long-term care distributions.

A qualified long-term care distribution is a distribution made during the taxable year that, in the aggregate, does not exceed the least of (i) the amount paid by or assessed to the employee during the taxable year, or with respect to, certified long-term care insurance for the employee or their spouse, (ii) an amount equal to 10 percent of the present value of the employee's vested accrued benefit, or (iii) $2,600 (in 2026, to be adjusted for inflation thereafter). Supporting documentation for the employee's request for a qualified long-term care distribution must be filed with the plan, among other requirements.

Employers should be aware that it is *optional* for a defined contribution plan to permit qualified long-term care distributions, but if allowed, the deadline to amend a defined contribution plan to allow for such distributions for a plan that is not a governmental plan, a section 403(b) plan maintained by a public school, or an applicable collectively bargained plan is December 31, 2027. Applicable collectively bargained plans have until December 31, 2028 to amend, while governmental plans and section 403(b) plans maintained by a public school have until December 31, 2028 to amend.

Qualified long-term care distributions are not treated as rollovers and 20 percent withholding under section 3405(c)(1) is not required; however, the withholding requirements of section 3405(b) and Treas. Reg. § 35.3405-1T still apply. Payment of qualified long-term care distributions must be reported to the employee by the payor on Form 1099-R, *Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

Labor department proposes durable joint employer standard aimed at court compliance

Joint employment represents a significant liability risk for organizations because it requires labor law standards to be applied in aggregate across multiple entities that share control over a worker. For payroll professionals, this means that obligations under, for example, the Fair Labor Standards Act (FLSA), such as overtime calculations, and the Family and Medical Leave Act (FMLA), such as employee headcount for eligibility, should typically be calculated based on the combined workforce rather than for each entity in isolation. Because joint employers are held "jointly and severally liable," a compliance failure by one party may result in full legal and financial responsibility for the other.

On April 23, 2026, the Department of Labor (DOL) Wage and Hour Division issued a Proposed Rule (2026-07959) to revise how joint employer status is determined, addressing matters that led the US District Court for the Southern District of New York to largely vacate the 2020 joint employer rule.

The 2020 rule required *actual* control over another employer's workers and not just the right to control the workers for joint employer status to apply. In 2020, Judge Gregory H. Woods held that requiring exercised control, rather than considering the reserved right to control, was inconsistent with the FLSA's broad definition of employ ("to suffer or permit to work") and found the rule "arbitrary and capricious" under the Administrative Procedure Act. The proposed rule responds by recognizing both "reserved" control (the contractual right to control) and control that is actually exercised, with actual control given greater weight.

The proposed rule identifies four non-exhaustive factors for determining joint employment; whether a company: 1. has the power to hire or fire a worker; 2. substantially supervises or controls the worker's schedule or conditions of employment; 3. determines the rate and method of payment; and 4. maintains the worker's employment records. The DOL notes that additional factors, such as the permanence of the relationship between entities, the location of the work, and the degree of economic dependence may also be considered, consistent with existing circuit court approaches.

The DOL aims to align the joint employer analysis across the FLSA, FMLA, and Migrant and Seasonal Agricultural Worker Protection Act (MSPA). According to the Wage and Hour Division, courts have used varying joint employment tests under these statutes, and the DOL has not issued comprehensive guidance on the issue in recent years. The proposed rule consolidates and clarifies the standard in regulation for these laws.

The comment period on the proposed rule ends June 22, 2026.

DOL rolls back prior overtime expansion rules

Effective May 15, 2026, the DOL is vacating the 2024 overtime rules under the Biden administration that would have expanded overtime eligibility to millions of workers and is reinstating the prior standard established under the Trump administration.

The rules established in 2024, now rescinded via a technical amendment, revised the duties test for workers who qualified as a "bona fide executive, administrative, or professional" employee and raised the salary threshold for white-collar exemptions to $58,656. Two federal district courts vacated that regulation before it took effect, and the DOL recently dismissed its appeals of those rulings in the US Court of Appeals for the Fifth Circuit.

In the final rule, published in the Federal Register as 29 CFR Part 541, the DOL formally restores the 2019 overtime rule from the first Trump administration, including reinstating the lower white-collar salary exemption threshold of $35,568. The department characterizes this action as a technical correction, noting that its Wage and Hour Division has already been enforcing overtime requirements under the 2019 standards since the district court decisions.

The technical amendment did not go through notice-and-comment rulemaking. DOL Wage and Hour Administrator Andrew Rogers explained the update is intended to ensure that the overtime exemption criteria are clearly defined, and regulations accurately reflect the standards the DOL enforces.

IRS issues draft Forms 1042-S and 1042-T

The IRS released drafts of the 2026 Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, Form 1042-T, *Annual Summary and Transmittal of Forms 1042-S*, and Form 1042, *Annual Withholding Tax Return for U.S. Income of Foreign Persons*. These forms are used to report a numerous category of payments to foreign persons. From an employer perspective, these forms may be used to report wages paid to a US nonresident employee that are subject to a reduced income tax withholding rate due to an income tax treaty or visa status. The IRS has not indicated any significant differences between the 2025 forms and the 2026 draft forms.

State and local updates

Alabama

On April 16, 2026, Alabama Governor Kay Ivey signed into law House Bill 527, which includes provisions for a tax deduction of up to $1,000 related to qualified overtime compensation. The deduction applies to tax years 2026 through 2028. Like the federal deduction, this is claimed on the employee's personal income tax return.

Connecticut

Connecticut is set to broaden its pay transparency obligations and tighten limits on training repayment agreements under a sweeping labor and employment measure signed by Governor Ned Lamont.

Public Act No. 26-12, "An Act Concerning Workforce Development and Working Conditions in the State," (the "Act") addresses a wide range of workplace issues, including updates to and new protections for workers employed under service contracts, carves out an exemption from state minimum wage and overtime rules for Minor League Baseball players, and expands existing requirements for employers to provide time and space for nursing employees.

Most of the Act's provisions will take effect Oct. 1, 2026. The new protections for service contract workers will follow on July 1, 2027.

Once in force, the Act will place Connecticut among at least 14 states that require employers to include salary or wage ranges in job postings, going beyond the state's current rule that only requires disclosure of pay information upon request by applicants or employees. Lawmakers intend for these changes to promote pay equity among employees, particularly for minorities, by arming them with more complete information during the job search and pay negotiation process.

The Act also widens the scope of an existing restriction on agreements that compels employees to reimburse an employer for training or similar expenses if they leave before a specified time, paralleling recent limits on "stay or pay" arrangements in California and New York. The Act applies to employers regardless of size, replacing the prior threshold of 26 or more employees.

Florida

Beginning August 1, 2026, the Florida Department of Revenue (DOR) is changing to a new system for employer electronic reemployment tax return filing and payments.

Employers should update their bookmarks for the employer portal to: https://floridarevenue.com/taxes/eservices/Pages/filepay.aspx.

Hawaii

On May 21, Hawaii Governor Josh Green signed Hawaii Senate Bill 3125 (the Bill) into law, which adds a new top income tax bracket for the 2026 tax year (with returns due in 2027). Under the Bill, household income above $1 million (for taxpayers with married filing jointly status) will be taxed at a 13 percent top marginal rate.

The 13 percent rate is structured as a 2 percent surcharge on income over $1 million, added to Hawaii's existing 11 percent top ordinary income tax rate. All lower brackets are retained, but the income thresholds are moved upward. Lawmakers indicated that the threshold adjustments are intended to account for rising wages and living costs and to allow the state to increase revenue from high earners while maintaining tax relief for most residents. They estimate that about 90 percent of Hawaii taxpayers will see a benefit from the higher thresholds. Households with income above $1 million will pay the higher rate only on earnings above that level.

The change is expected to be most significant for high-earning employees, investors with sizeable ordinary income, and owners of pass-through businesses whose profits are reported on personal returns. Legislators also noted that the Bill contains provisions designed to safeguard small business owners who pay tax as individuals rather than through a corporate structure.

Illinois

Beginning July 1, 2026, employer 401(k) contributions are no longer subject to Illinois unemployment insurance (UI) tax pursuant to the February 2, 2026 amendment to Section 2730.155 of the Illinois Labor Code. Contributions made by employers before July 1, 2026, remain taxable for state UI.

The change does not alter the treatment of employee 401(k) deferrals, which continue to be included as taxable wages for UI. The exclusion of employer 401(k) contributions and inclusion of employee 401(k) contributions for UI taxable wages aligns with the federal unemployment tax treatment. The maximum wages subject to Illinois UI tax in 2026 is $14,250.

Oklahoma

Oklahoma Letter Ruling 25-007 addresses employer income tax withholding requirements of wages paid to nonresident employees performing services in Oklahoma for an Oklahoma employer. The Oklahoma Tax Commission (the Commission) concluded that, as a general rule, withholding applies to all employees performing job-related services in Oklahoma, even if they are not state residents. The sample scenarios included in the Letter Ruling include periodic management meetings at the company's Oklahoma office and project meetings with employees at the Oklahoma office. The Commission noted that a scenario whereby an employee attends a noncompany-sponsored conference in Oklahoma may not be subject to Oklahoma income tax withholding on the related wages, but more information was needed.

However, the Letter Ruling also notes that the de minimis rule in the Oklahoma statute section 2385.1(e) can exempt those wages from withholding if the compensation for services performed in Oklahoma is less than $300 in a calendar quarter.

Oklahoma letter rulings may not be used as precedent for other employers, but they can be a useful indicator of how the Commission may rule in similar circumstances.

Oregon

On April 29, 2026, the Oregon DOR proposed rules for amendments to the Oregon Administrative Rules Section 150-314-0205 to adjust the threshold for penalties for substantial understatement of tax annually for inflation. The DOR plans to publish the applicable threshold amount for each tax year on their website. Comments on the proposal are due June 1, 2026.

Currently, the statute provides a penalty of 20 percent of the amount of any underpayment of net tax attributable to the understatement. The DOR assesses a substantial understatement of net tax penalty if the understatement exceeds $3,750 for corporations (excluding a personal holding company and S corporations) or $2,550 for individuals and all other taxable entities.

U.S. Virgin Islands

On April 30, 2026, the U.S. Virgin Islands' Department of Labor (VIDOL) repaid the federal government its outstanding Title XII Unemployment Insurance Loan principal. The VIDOL expects to repay the remaining interest on the loan before the federal repayment deadline of November 10, 2026.

States and US territories may borrow funds from the federal government, referred to as a Title XII Unemployment Insurance Loan, to supplement their unemployment benefit programs. Pursuant to the Internal Revenue Code, states with an outstanding balance for two or more years will be subject to a credit reduction for federal unemployment (FUTA) tax purposes, unless the balance is repaid by November 10. The credit reduction increases each year the balance is unpaid.

The 2026 credit reduction for the U.S. Virgin Islands was 4.5 percent. For employers, that was an increase in FUTA tax of up to $357 per employee. Employers in the VI will avoid significant increases in FUTA tax liability if the balance is repaid in full by November 10, 2026. Tax year 2027 would be the first year since 2011 that UI wages in VI would not be subject to a credit reduction.

Utah

On April 27, 2026, Utah released updated Publication 14, *Withholding Tax Guide*, effective June 1, 2026, which includes withholding tax tables. Notably, the income tax rate decreased from 4.5 percent to 4.45 percent, and the base allowance increased from $450 to $485 for a single taxpayer.

Virginia

On April 22, 2026, Virginia enacted House Bill 1207 (2026) establishing a mandatory Paid Family and Medical Leave (PFML) insurance program. Employer and employee contributions begin July 1, 2028, and benefits are payable beginning January 1, 2029. The Virginia Employment Commission (VEC) will administer the program and provide guidance and required notices.

Virginia has offered a separate voluntary PFML insurance framework through private insurers since July 1, 2022. The new mandatory program does not cover state government as an employer, but state employees will receive comparable benefits. PFML eligibility will align with unemployment insurance rules, so many part-time and small-business employees may qualify.

Contribution rules:

- Employers with more than 10 employees remit the full PFML contribution; employers may withhold up to 50 percent from employee wages to cover the contributions due. They may withhold less or pay the full amount but cannot withhold more than 50 percent.
- Employers with 10 or fewer employees withhold 50 percent from employee wages but owe no additional employer share.
- Wages up to the federal Social Security limit may be subject to PFML contributions.
- PFML deductions cannot reduce wages below the state minimum wage (currently $12.77 per hour).
- The VEC will set contribution rates by October each year, beginning 2027; the wage base will match the Social Security wage limit.

Employers must:

- Give written PFML notice at hire, annually, and when leave is requested or anticipated, explaining rights, benefit amounts, claim procedures, job protection, anti-retaliation protections, and complaint rights.
- Post a VEC-provided notice in a conspicuous place in English, Spanish, and any language spoken as a first language by at least 5 percent of the workforce.

Benefits:

- Up to 12 weeks of PFML per benefit year.
- Weekly benefit equals 80 percent of the employee's average weekly wage, capped at 100 percent of the state average weekly wage.
- Leave is available for bonding with a new child; caring for a family member or covered service member with a serious health condition; the employee's own serious health condition; certain military-related exigencies; and obtaining safety services related to domestic violence, pervasive harassment, sexual assault, or stalking (for the employee or a family member).

Private plans:

- Employers may apply to the VEC to use a private plan that is at least as generous as the state program.
- Approval must be renewed every two years and can be revoked if requirements are not met.
- Approved employers may collect contributions up to the allowable withholding for the public plan to fund the private plan and, while approved, need not remit those amounts to the state PFML fund.

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