Out-of-State Tax Withholding FAQ

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What is the State Controller's Office responsibility to withhold and remit state personal income taxes for employees who reside outside of the state of California (CA)?

When there is no reciprocal agreement in place, the withholding of personal income tax is optional and not mandatory as the nonresident employee is performing services outside of California.

> *California Code of Regulations section 18662-4(b) states, "withholding of tax at source is optional and not required on payments of California source income to the following:*
> *…*
> *(7) Services of a Nonresident Outside of California. Withholding of tax at source is not required on payments for services provided by a nonresident that were performed outside of California."*

A reciprocal agreement between states prevents an employee from having to file two or more tax returns; one as a resident return in the state where he or she lives and one or more nonresident returns in any other states where he or she works.

What is a reciprocal agreement?

A reciprocal agreement between states prevents an employee from having to file two or more tax returns; one as a resident return in the state where he or she lives and one or more nonresident returns in any other states where he or she works.

If there is no reciprocal agreement in place for the state where the employee is working, is the employee responsible to report income to the residing state?

An employee has the responsibility to report personal income tax to the state in which they reside, including where there is no reciprocal agreement in place. Failure to report income may subject the individual to fines and penalties. Individual employees should consult with their tax professional to determine their specific tax reporting responsibilities.

Which states currently have reciprocal agreements with SCO?

SCO has reciprocal agreements with New York and Illinois. This means that SCO will withhold and remit personal income tax from wages or salaries for employees residing in New York and Illinois.

Does an employee teleworking in another state create a "nexus" for state tax withholding? Stated differently, will the State be considered to be "doing business" in the other state of tax purposes?

In order for a state to impose a tax, a connection must exist between the state and the potential taxpayer.

The State of California and its departments and agencies are generally not engaged in actions that would constitute interstate commerce. Therefore, the presence of a teleworking employee in another state would not create a nexus for tax purposes.

What options are available on the form Employee Action Request (EAR), STD. 686, to employees working out-of-state for tax reporting purposes?

Three options are available on the STD. 686:

1. Withhold CA personal income tax and file as a non-resident with the Franchise Tax Board (FTB)
2. Employee will need to file California Nonresident (NR) or Part-Year Resident Income Tax Return, CA 540 NR, and Franchise Tax Board (FTB) will make the determination to process a refund of the personal income tax. https://www.ftb.ca.gov/forms/2019/2019-540nr.pdf
3. File Exempt from California withholding
    - On the EAR for State Allowances, the employee will indicate in Section E II:
        - E08 - Single/Married

  - E09 - 95
- This will report a taxable gross on the Form W-2 for CA, and
- Employee will need to file a California Nonresident or Part-Year Resident Income Tax Return, CA 540 NR, and FTB will make the determination if personal income tax is due.

4. Department creates a header for employees residing out of state
   - This will report a taxable gross on the Form W-2 for NONE, and
   - Employee will need to file a state tax return in their residing state using the amount in NONE as the taxable gross.

Are departments/campuses able to hire employees whom reside outside of the United States?

The U.S. Department of Labor allows U.S. companies to hire foreign workers without the requirement of work permits or immigration visas where the employee is working remotely from the other country.

The State Controller's Office Uniform State Payroll System is not configured to generate payroll for international remote workers.

A department/campus may use a third party payroll provider whom specializes in pay for foreign remote workers.

What if an employee is a nonresident of CA and has CA state withholding and/or taxable gross for CA reported on their Form W-2?

If there is CA withholding reported on the Form W-2, and the employee is not a resident of California, they will need to submit the CA 540NR, California Nonresident or Part-Year Resident Income Tax Return https://www.ftb.ca.gov/forms/2019/2019-540nr.pdf to Franchise Tax Board (FTB). FTB will make the determination to process a refund. The SCO cannot make any corrections after the close of the tax year if withholding has been reported.

If the Form W-2 is only reporting a taxable gross and NO withholding for CA. Please contact SCO Personnel and Payroll Services Division (PPSD), W-2 Unit at PPSDW2DupCor@sco.ca.gov who can make the correction to the Form W-2 and generate a corrected Form W-2 the following month.

What if an employee is a nonresident of CA and has CA state withholding and/or taxable gross reported for the current tax year?

If withholding was taken during the ***current tax year*** for an employee whom is not a resident of California, please contact the PPSD, W-2 Unit at PPSDW2DupCor@sco.ca.gov for correction. Be sure to correct the employee’s employment history to ensure the correct withholding will take place going forward.

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