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Don't miss this month's insights— [*The payroll and employment tax implications of wages paid to a military servicemember's qualifying spouse*](#)

Top stories

US employment tax rates and limits

Our 2025 edition of US employment tax rates and limits includes, as of March 25, 2025, the following:

- Social Security wage base for 2025
- Qualified pension plan limits for 2024 and 2025
- Health Savings Account limits for 2024 and 2025
- Fringe-benefit inflation adjustments and Form W-2 penalties for 2025
- Federal mileage rates and luxury vehicle limits for 2025
- Per diem rates under high-low substantiation method for 2025
- 2023 and 2024 FUTA credit reduction
- State unemployment insurance wage bases and tax rates for 2025
- Disability and paid family leave insurance wage base and rates for 2025
- Federal income tax withholding for 2025
- State income tax withholding tables, supplemental withholding and highest withholding tax rates for 2025

—[*Download the latest report*](#)

Report on state unemployment insurance requirements for employee notices and workplace posters

Most states require that employers tell employees about their potential eligibility for unemployment insurance benefits. There are two forms of communications that most states require: (1) a notice to the employee at the time of separation and/or (2) a poster placed in a conspicuous location in the workplace.

Our special report includes the results of our September 3, 2024 survey of state workforce agency websites and includes links, if applicable, to the states' requirements for unemployment insurance employee separation notices and workplace posters.

—[*Download the latest report*](#)

Federal and state Form W-4 compliance

Our special report provides information employers need to know about federal and state Form W-4 compliance, with topics including:

- IRS Form W-4 regulations
- IRS lock-in letters compliance
- Federal Form W-4 top 10 tips
- Federal Form W-4 frequently asked questions
- Special instructions for US nonresident aliens
- State Form W-4 compliance in 2024
- 2024 State Form W-4 requirements survey
- 2024 state Form W-4 requirements heat map

—[Download the latest report](#)

Federal

IRS releases new FAQs on employee retention credits

On March 20, 2025, the IRS updated its frequently asked questions (FAQs) on the employee retention credit (ERC). The new FAQs address timing of reporting wage expenses on a taxpayer's tax return and how to deal with overstated and understated wage expenses. This is important because it addresses the interaction between the credit and income tax returns by offering another approach for taxpayers to comply with the credit.

—[Read more about this development in *Tax Alert 2025-0847*](#)

State income tax withholding

Georgia law lowers personal income tax retroactive to January 1, 2025, allows for future tax cuts
On April 15, 2025, Georgia Governor Brian Kemp signed into law H.B. 111, which retroactive to January 1, 2025, lowers the state's income tax rate from 5.29% to 5.19%, accelerating the largest tax cut in Georgia's history.

—[Read more about this development in *Tax Alert 2025-0930*](#)

Mississippi lowers personal income tax rates in future years with total phase out possible if revenue goals are met

On March 27, 2025, Mississippi Governor approved H.B. 1, which lowers the personal income tax rates in tax years 2026 through 2030 and provides for a possible total phase out of the income tax after 2030 if revenue goals are met.

—[Read more about this development in *Tax Alert 2025-0936*](#)

Utah law lowers state income tax rate retroactive to January 1, 2025

On March 26, 2025, Utah Governor Spencer Cox signed into law H.B. 106 which, retroactive to January 1, 2025, lowers the state's personal and corporate income tax rate from 4.55% to 4.5%.

—[Read more about this development in *Tax Alert 2025-0852*](#)

Utah Tax Commission releases revised withholding formula reflecting lower income tax rate for 2025

The Utah State Tax Commission has updated Publication 14, *Withholding Tax Guide*, which contains the revised withholding formula and tables resulting from the decrease in the personal income tax rate effective retroactive to January 1, 2025. The updated withholding formula/tables apply to payroll periods beginning on and after June 1, 2025.

—[Read more about this development in Tax Alert 2025-0958](#)

State unemployment insurance

Nebraska adjusts state unemployment insurance tax rates for 2025, reissues 2025 SUI rate notices and lowers SUI tax rates

On March 25, 2025, Nebraska Governor Jim Pillen signed into law LB 297, which reduces the 2025 state unemployment insurance tax rates by returning them to the 2024 rates. Employers will remain in the category assigned to them for 2025 but the 2024 SUI tax rate for that category will apply.

Nebraska has 20 rate categories. This change is estimated to lower employer 2025 SUI contributions by \$44 million.

—[Read more about this development in Tax Alert 2025-0894](#)

Other payroll developments

New Ohio law requires employers to provide pay stubs to their employees

For information purposes only. Employers should consider seeking the assistance of experienced employment law attorneys before implementing policy changes.

Effective April 9, 2025, Ohio law under H.B. 106 requires that employers provide their employees with paper pay stubs and specifies when they are due and what information must be included. Ohio law was previously silent concerning pay statements. (Ohio Revised Code Section 4113.14.)

—[Read more about this development in Tax Alert 2025-0840](#)

Bill watch (tracking the status of legislation proposed in January through April 2025)

Federal

HR 561	Status: Introduced 1-20-2025	Topic: No tax on overtime pay
Would allow a tax deduction for overtime compensation received by an individual, subject to income limitations, through 2029. The deduction could not exceed 20% of the individual's regular wages from the same employer. Further, the deduction would not be allowed for an individual with adjusted gross income exceeding \$100,000 (\$150,000 for a head of the household, \$200,000 for a married couple filing a joint return). (See House-passed Budget Resolution H. Con. Res. 14.)		

Federal

S. 1443	Status: Introduced (4-10-2025)	Topic: Mobile Workforce State Income Tax Simplification Act of 2025
For state income tax and withholding purposes, would provide a 30-day safe harbor for employees who travel across state borders for temporary periods to perform work duties.		

Federal

HR 1959	Status: Sent to Committee on Ways and Means (3-6-2025)	Topic: Federal unemployment insurance
Would relieve employers from an increase in their federal unemployment insurance taxes (FUTA) resulting from the state carrying an unpaid FUTA loan.		

Alabama

HB 467	Status: Introduced in House and referred to House Ways and Means Education (3-20-2025)	Topic: No tax on overtime pay
Effective upon enactment, would remove the June 30, 2025, sunset date for excluding overtime pay from Alabama state income tax.		

Alabama

HB 259	Status: Pending in House Ways and Means Education (2-11-2025)	Topic: Relocation tax incentive
Effective October 1, 2025, would provide employees who relocate to or work remotely for certain counties within Alabama a state income tax credit.		

Alabama

HB 379	Status: Passed House, placed on Senate calendar (5-1-2025)	Topic: Nonresident income tax
Effective January 1, 2026, would exempt remote workers from nonresident income tax if they are present within the state for 24 or fewer days in the calendar year.		

Arizona

HB 2081	Status: Passed House (2-10-2025); second reading in Senate (2-25-2025)	Topic: No tax on tips
Effective January 1, 2025, would allow a deduction from Arizona gross earnings for tips.		

Arkansas

HB 1116	Status: Recommitted to Committee on Revenue and Taxation after amendment (3-13-2025)	Topic: Nonresident income tax
Effective January 1, 2026, would end the requirement that employers withhold Arkansas nonresident income if the employee works in Arkansas for less than 15 days in the calendar year and the employee's resident state has a similar provision. The Council on State Taxation has recommended that a 30-day threshold such as that adopted by Illinois (S.B. 1515), Indiana (S.B. 419), Louisiana (S.B. 157) and other states.		

Connecticut

SB 1369	Status: Referred to House Committee on Finance, Revenue and Bonding (3-13-2025)	Topic: New state payroll tax
Effective January 1, 2026, would create a new 1.5% payroll tax to fund the Workforce Child Care Fund, which would provide direct financial assistance to families and childcare providers.		

Georgia

HB 111	Status: Became law (4-15-2025)	Topic: State income tax
Retroactive to January 1, 2025, reduces the state's income tax rate of 5.29% to 5.19% and decreases rates by 10 basis points, or 0.1%, annually, starting in 2026 until the rate reaches 4.99%.		

Hawaii

HB 283	Status: Referred to Committee (1-21-2025)	Topic: State income tax
Effective January 1, 2026, would eliminate the state's income tax.		

Hawaii

SB 1470	Status: Became law 4-24-2025	Topic: State income tax
Effective retroactive to January 1, 2025: (1) repeals the maximum tax rate that may be considered in determining the amount of income tax that must be withheld and the requirement that a standard deduction allowance be treated as if it was denominated as a withholding exemption, and (2) for the purpose of income tax withholding, permits the Director of Taxation to prescribe a standard deduction allowance in an amount more or less than one whole exemption.		

Idaho

HB 40	Status: Became law 3-6-2025	Topic: Income tax rates
Effective retroactive to January 1, 2025, lowers personal and corporate tax rates from 5.695% to 5.3%.		

Illinois

SB 174 / SB 2981	Status: Referred to Senate Assignments, co-sponsor added (2-11-2025)	Topic: No income tax on overtime pay
Effective Immediately, would allow a deduction from Illinois taxable income for overtime pay. SB 2981 would allow the overtime deduction in excess of the regular salary.		

Indiana

HB 1001	Status: Passed by the House and Senate with provision for no tax on tips excluded (4-29-2025)	Topic: No tax on tips
Effective January 1, 2025, would have exempted tips from the Indiana adjusted gross income tax.		

Iowa

HF 1024	Status: Placed on House Ways and Means calendar (4-17-2025)	Topic: No tax on tips
Would exempt the first \$25,000 in cash tips received by taxpayers with a net income of less than \$155,000 from individual income taxation.		

Iowa

HSB 114	Status: House Labor and Workforce Committee (1-30-2025)	Topic: Unemployment insurance tax reform
Gov. Reynolds proposes lowering the maximum tax rate to the lowest allowed by federal law (5.4%), cutting the taxable wage base by half, and simplifying the unemployment insurance system by reducing the number of tax tables.		

Kansas

SB 269	Status: Became law (4-10-2025)	Topic: State income tax
Effective January 1, 2025, and if revenue goals are met, will gradually lower the income tax rates until the state's two income tax brackets are collapsed to one at 4%. The budget director will determine by August 15, 2025, whether the 2025 fiscal year's total State General Fund tax receipts exceeded the 2024 fiscal year's amount, adjusted for inflation.		

Maine

LD 106	Status: Placed in legislative files (bill is dead , 4-10-2025)	Topic: Paid Family and Medical Leave Insurance
Effective January 1, 2026, would have established that leave paid under a state paid family and medical leave plan is taxable to the extent the benefits are included in federal taxable income.		

Maine

LD 54	Status: Public hearing by House Committee for Labor (3-4-2025)	Topic: Pay transparency
Effective 90 days after enactment, would require an employer with 10 or more employees to: (1) include on a job posting a statement listing the prospective range of pay the employer will offer to a successful applicant, (2) disclose the range of pay it offers for the position the employee holds upon an employee's request and (3) maintain a record of each position held by an employee and the employee's pay history during the employee's employment and for three years after the employee's termination of employment.		

Maryland

FY 2026 Budget Proposal (p. 9) H.B. 352	Status: Became law (4-7-2025)	Topic: State income tax
Effective retroactive to January 1, 2025, raises the tax rate from 5.75% to 6.5% for taxpayers earning more than \$1 million and raises the rate from 5.75% to 6.25% for taxpayers earning \$500,001 to \$1 million. The law also increases the maximum local tax rate from 3.2% to 3.3% and raises the standard deduction.		

Maryland

SB 0355	Status: Senate Finance Committee hearing (1-16-2025)	Topic: Paid Family and Medical Leave Insurance
For contributions and claims under the Family and Medical Leave Insurance Program, would alter the start date from July 1, 2025, to July 1, 2027, for paying contributions and from July 1, 2026, to July 1, 2028, for submitting claims for benefits, respectively.		

Maryland

HB 102	Status: Became law (4-8-2025)	Topic: Paid Family and Medical Leave Insurance
Delays the start date of the state's paid family and medical leave insurance program from July 1, 2025, to January 1, 2027. Delays the dates on which the payment of contributions for paid family and medical leave insurance begins and the date on which benefit claims may be filed to January 1, 2028.		

Massachusetts

H 3173	Status: Introduced (2-27-2025)	Topic: No tax on overtime pay
Would exempt overtime pay from income tax with the clarification that the provision does not apply to salaried exempt employees.		

Michigan

HB 4170	Status: Passed House, transmitted to Senate (3-20-2025)	Topic: State individual income tax
Effective January 1, 2025, would lower the income tax rate from 4.25% to 4.05%.		

Michigan

HB 4001	Status: Passed House, transmitted to Senate (2-4-2025)	Topic: Minimum wage
Effective immediately, would introduce a new schedule for general minimum wage increases through January 1, 2029, and maintain the tipped minimum wage at 38% of the regular hourly minimum wage. It also would adjust the unemployment rate threshold for annual minimum wage increases from 8.5% to 7.5%.		

Minnesota

SF 589	Status: Referred to Taxes (1-27-2025)	Topic: No tax on overtime pay
Effective January 1, 2026, would exempt overtime pay required under federal law from Minnesota state income tax.		

Minnesota

SF 46, HF 950	Status: Referred to Taxes (1-16-2025)	Topic: Nonresident income tax
Effective January 1, 2026, would exempt certain nonresident employees from Minnesota nonresident income tax and withholding if they work in the state for fewer than 30 days in the calendar year.		

Missouri

H.B. 100 and SB 151	Status: Further action postponed (2-11-2025)	Topic: State income tax
Effective January 1, 2026, would implement a flat 4% income tax rate and, starting in 2027, provide for 10 annual reductions of 0.1 percentage points, while retaining the budget requirements established under SB 3 (2022) .		

Missouri

HB 798	Status: Passed House, passed by Senate Executive Committee (4-9-2025)	Topic: State income tax
Effective January 1, 2026, would implement a flat 4.7% income tax rate and, starting in 2027, the 4% flat tax would be reduced when the revenue grows by at least \$1 million and the Tax Reform Fund is at least \$120 million at the end of the fiscal year.		

Missouri

H.B. 567	Status: Passed House, placed on Senate informal calendar (4-23-2025)	Topic: Employment law
Effective immediately, would repeal the changes under voter-approved Proposition A , which raised the minimum wage to \$13.75 effective January 1, 2025, with annual cost of living adjustments each year thereafter, and requires employers to provide paid leave to employees.		

Mississippi

HB 1	Status: Became law (3-27-2025)	Topic: State income tax
Starting in 2027, gradually reduces the state's income tax rate until it is phased out completely by 2037.		

Montana

H.B. 210	Status: Became law (4-7-2025)	Topic: Unemployment insurance
Effective January 1, 2026, adds a lower contribution tax rate schedule and changes the tax schedule rate trigger, thereby lowering the average tax rate from 1.12 to 0.95 in new Schedule I.		

Montana

SB 203	Status: Tabled by the House (4-16-2025)	Topic: State income tax
Effective retroactive to January 1, 2025, would increase the income thresholds before taxable income tax is taxed at the higher marginal tax rates of either 5.9% or 4.1%. S.B. 323 , which failed to pass in the Senate, included a reduction in the top marginal income tax rate, from 5.9% to 5.4% in 2026 and to 4.9% in tax year 2027. The bill also proposed increasing Montana's earned income tax credit from 10% to 15% of the federal credit.		

Montana

HB 337	Status: Became law (4-28-2025)	Topic: State personal income tax
Reduces Montana's top marginal income tax rate from 5.9% to 5.65% effective in 2026 and to 5.4% effective in 2027. Montana Governor Greg Gianforte had called for a reduction in the maximum individual income tax rate from 5.9% to 4.9%, in addition to an expansion of the Montana earned income tax credit.		

New Jersey

S. 3741	Status: Introduced in Senate (10-7-2024)	Topic: No tax on tips
Effective January 1, 2025, would exclude tips from New Jersey gross income tax.		

New York

FY 2026 budget	Status: Governor reaches agreement with House and Senate Leaders (4-28-2025)	Topic: State income tax, Payroll Mobility Tax
The budget would include: (1) a \$1 billion tax cut for middle-class and low-income New Yorkers and (2) reduce the Payroll Mobility Tax for small businesses and eliminate it for self-employed individuals earning \$150,000 or less. The bill would also repay the state's outstanding federal unemployment insurance loan, which would remove the federal unemployment insurance surtax the state's employers are required to pay for loan balances outstanding as of November 11.		

New York

AB A3009B	Status: Amend and Recommit to House Ways and Means (3-10-2025)	Topic: State income tax
Effective January 1, 2025, through December 31, 2032, would set the tax rate at 10.75% on income between \$10 million and \$25 million, 11.75% on income over \$25 million but less than \$100 million and 12% on income over \$100 million. The tax rates for the first five of the existing nine brackets would be lowered.		

New York

SB S1514	Status: Passed Senate, referred to House Committee on Labor (3-5-2025)	Topic: Worker classification
Would empower the commissioner of labor to issue stop-work orders against employers for misclassifying employees as independent contractors or providing false, incomplete, or misleading information to an insurance company on the number of employees.		

North Carolina

HB 48	Status: Passed House, referred to Senate Committee on Rules (2-27-2025)	Topic: Unemployment insurance
Would raise the maximum Unemployment Insurance (UI) weekly benefit amount from \$350 to \$450 and provide an employer tax credit equal to the employer's UI tax payment made on or before January 31, 2025.		

North Carolina

HB 459	Status: Referred to House Committee on Rules (3-20-2025)	Topic: State income tax
Effective retroactive to January 1, 2025, would set the state's individual income tax rate at 4.25%, up from 3.99% for tax years beginning after 2025. The bill would also amend the general revenue amount that would trigger a reduction of the state's individual income tax rate beginning with fiscal year 2027-28.		

North Carolina

HB 11	Status: Referred to Committee on Finance (3-11-2025)	Topic: No tax on tips, overtime pay
Effective January 1, 2025, would provide tax deductions for overtime pay, bonus compensation up to \$2,500 and qualified tips.		

Ohio

H.B. 30	Status: Committee on Ways and Means hearing (2-5-2025)	Topic: State personal income tax
Effective January 1, 2025, would lower the tax rates to 2.75% and 3.125% and create a flat tax of 2.75% starting in 2026.		

Oklahoma

S.B. 1 , H.B. 1806	Status: Referred to Senate Revenue and Taxation Committee (2-4-2025); referred to House Appropriations Committee (2-4-2025)	Topic: State personal income tax
Effective January 1, 2025, would reduce the state's graduated income tax rates by 0.25% if revenue collections exceed an itemized estimate of \$400 million.		

Oklahoma

H.B. 1200	Status: Passed House, placed on Senate calendar for floor consideration (4-28-2025)	Topic: State personal income tax
Effective January 1, 2026, would amend the state's income tax brackets for individual taxpayers to provide that single taxpayers and married taxpayers filing separately would be taxed at a rate of 0% for the first \$3,750 of income, 2.75% on the next \$1,150 of income, and 3.75% on the next \$2,300 of income. The remainder of the income would be taxed at a rate of 4.7% in tax years after 2027. Marginal tax rates would be further reduced by 0.25% if tax collections exceed \$400 million in growth as adjusted for inflation; each additional tax revenue growth exceeding \$400 million would result in further marginal tax rate reductions of 0.25%.		

Pennsylvania

S.B. 206	Status: Referred to Finance (1-29-2025)	Topic: State personal income tax
Effective January 1, 2026, would eliminate the state's income tax on individual taxpayers, trusts and estates.		

Rhode Island

S. 329	Status: Introduced (2-21-2025)	Topic: State income tax
Would impose an additional 3% income tax on certain taxpayers with taxable income over \$625,000 for tax years beginning after January 1, 2026.		

South Carolina

Governor Henry McMaster Budget Proposal	Status: Proposed (1-13-2025)	Topic: State income tax
Governor McMaster has proposed lowering the top tax rate from 6.2% to 6.0%.		

South Carolina

HB 4216	Status: Passed by House Committee (5-1-2025)	Topic: State income tax
Would collapse the current three income tax brackets and replace them with a flat 3.99% in tax year 2026. The state's current rates are 0%, 3% and 6.2%.		

South Dakota

SB 26	Status: Became law (3-26-2025)	Topic: Unemployment insurance
Effective January 1, 2026, would reduce employer contribution rates and increase the administrative fee rate for reemployment assistance.		

Utah

HB 106	Status: Became law (3-25-2025)	Topic: State income tax
Effective retroactive to January 1, 2025, lowers the state's personal and corporate income tax rate from 4.55% to 4.5%.		

Utah

HB 279	Status: Became law (3-25-2025)	Topic: Earned wage access
Effective May 7, 2025, provides rules governing employee earned wage access services.		

Vermont

H 77	Status: Referred to House Committee on Ways and Means (1-23-2025)	Topic: State income tax
Effective January 1, 2026, would increase the income thresholds for the state's income tax brackets for individuals, trusts, and estates and would create a new 12.75% rate for single filers with income over \$1 million.		

Virginia

HB 1965	Status: Did not pass before legislative session ended	Topic: No tax on tips
Effective January 1, 2026, would provide an individual income tax deduction for cash tips, including tips paid by electronic means, that are included on statements furnished to the taxpayer's employer for federal tax purposes.		

Washington, Seattle

Proposition 1A	Status: Passed by voters (2-20-2025)	Topic: Payroll expense tax
Effective January 1, 2025, creates a new 5.0% payroll expense tax on annual compensation above \$1 million paid in Seattle to an individual employee. The tax is separate from the existing Seattle Payroll Expense tax.		

Washington, Burien

Initiative Measure 1	Status: Passed by Voters (2-20-2025)	Topic: Minimum wage
Effective March 25, 2025, institutes a minimum wage matching neighboring Tukwila .		

West Virginia

HB 3103	Status: Assigned to House Finance (3-4-2025)	Topic: Exempt retirement benefits from income tax
Effective January 1, 2025, would exempt retirement benefits from personal income tax.		

West Virginia

SB 99	Status: Assigned to Senate Finance Committee (2-12-2025)	Topic: Return to West Virginia tax credit
Would create a \$25,000 tax credit against personal income tax liability for qualified taxpayers who returned to West Virginia on or after January 1, 2025, and at one point (1) both resided and were employed in the state for a minimum of 10 years, or (2) were born in the state, and then subsequently resided out of state for 10 consecutive years.		

Wisconsin

SB 36 / AB 38	Status: Senate Fiscal estimate received (2-28-2025); referred to House Ways and Means (2-28-2025)	Topic: No tax on tips
Would create an income tax exemption for cash tips received by an employee from the employer's customers.		

Wisconsin

AB 50 (2025-2027 budget bill)	Status: Senate Finance Committee public hearing (4-29-2025)	Topic: Income tax
Effective retroactive to January 1, 2025, would add a fifth income tax bracket with (1) a rate of 9.80% for individuals and married joint filers with taxable income exceeding \$1 million and for married separate filers with taxable income exceeding \$500,000 and (2) an increase from \$700 to \$1,200 for the income tax personal exemption for taxpayers, their spouses, and dependents.		

This month's insights

State income tax withholding and employment tax considerations when wages are paid to a military servicemember's qualifying spouse

To relieve military servicemembers and their spouses from filing state income tax returns in multiple states, the [Military Spouses Residency Relief Act](#) (MSRRA) allows them to retain their state residency (legal residency) when they move to another state under military orders.

The MSRRA's definition of legal residency is a legislative construct requiring no physical connection to where the MSRRA-covered employee currently lives and works.

For income tax withholding purposes, the MSRRA allows employers to withhold state income tax only in the state of legal residency, which must be designated by the MSRRA-covered employee. Most states have a form that employees can submit to their employer for this purpose.

Example: Employee Mark is the spouse of a military service member who was given orders to transfer from New Jersey to Hawaii. Mark gives his employer Hawaii [Form HW-7, Exemption From Withholding On Nonresident Employee's Wages](#). Mark's employer will not withhold Hawaii income tax but may be required to withhold New Jersey income tax if it has a business connection with New Jersey as defined in N.J. Admin. Code Section 18:7-1.9.

MSRRA payroll tax processing considerations

Generally, when an employee works and lives in the same state, resident income tax withholding applies to all wages paid to the employee; however, the usual rules do not apply to MSRRA-covered employees, and numerous payroll tax processing steps must be considered.

- *Payroll address v. legal residency address*

The address a MSRRA-covered employee provides on the federal and state Form W-4 is likely the

current mailing address, which is the state where the military servicemember has been assigned to work and not the state declared by the MSRRA-covered employee as their legal residency. Accordingly, the employer cannot assume that the state address on the Form W-4 is the state for resident income tax withholding purposes. Instead, the employer must determine the state of legal residency from the MSRRA-covered employee and enter this information into the payroll system.

- *Income tax withholding registration*

If the employer does not currently withhold income taxes in the MSRRA-covered employee's designated state of legal residency, the employer must determine if: (1) it has a legal obligation to withhold (i.e., there is nexus in the state) or (2) it will withhold the state income tax as a courtesy to the employee. If either (1) or (2) applies, the employer will need to register with the department of revenue of the designated state of legal residency.

It is important to note that courtesy withholding can create state unemployment insurance problems (see below).

- *State unemployment insurance*

Under federal law, an employee can only have one work state for unemployment insurance purposes. The work state is determined by applying a four-prong test. ([US Department of Labor, Program Letter 20-04.](#)) For most employees, the work state is where most of their services are performed. In most cases, the work state of an MSRRA-covered employee is the state to which the US military assigned the military servicemember to work.

For instance, in the above example, the MSRRA-covered employee is living and working in Hawaii where his spouse is currently stationed and has designated New Jersey as his state of legal residency. Further assume that the employer has no business connection to New Jersey and is withholding New Jersey state income tax as a courtesy to the employee.

Although Hawaii is the work state for state unemployment insurance, New Jersey may attempt to collect state unemployment insurance because the employer registered there only for voluntary income tax withholding. If the employer does not correctly identify New Jersey's error, state unemployment insurance could be paid to the wrong state (i.e., New Jersey rather than Hawaii), or worse, state unemployment insurance may be erroneously paid to both Hawaii and New Jersey.

When registering for state income tax withholding only, it is important to communicate that the employer is voluntarily withholding state income tax and has no business connection to the state and no obligation for state unemployment insurance or other business taxes that may apply (e.g., sales and use tax). Many states allow employers to make this clarification on the registration form.

- *Forms W-2*

The address on the Form W-2 should generally be the same address as reported on the federal/state Form W-4; however, as previously explained, the mailing address of the MSRRA-covered employee may not be the state of legal residency designated by the employee. This inconsistency could trigger a state income tax withholding audit for the employer and the employee, with the state asserting that income tax should have been withheld, and a state income tax return filed, for the state shown on the Form W-4. The employer can resolve this matter by providing the state department of revenue with a copy of the form the employee provided claiming the MSRRA income tax exemption.

Tips for managing MSRRA-covered wages

Following are tips to consider for preventing errors and dealing with challenges that the MSRRA state income tax exemptions can pose.

1. Always require that MSRRA-covered employees complete the required state income tax withholding form for claiming the income tax exemption. If no such form is available, create a template that includes all the necessary information. Keep these forms in your tax files for as long as they are valid for state income tax withholding audit purposes.
2. Request that MSRRA-covered employees provide you with a written statement of their designated state of legal residency and keep this documentation in your tax files.
3. For multi-state employers, maintain a current list of state forms that employees must complete to claim the income tax exemption under the MSRRA. Having this list on hand will prevent delays in establishing the correct state for resident income tax withholding purposes.
4. Question the federal/state Form W-4 of MSRRA-covered employees that shows as their address the place they have designated as the state of legal residency rather than the current mailing address. The Form W-4 should show the current mailing address and not the address designated as the legal residency.
5. If you are not currently withholding income tax in the designated state of legal residency, be sure to register with that state's department of revenue if you are required to withhold or will provide courtesy withholding for that state.
6. Confirm that you are paying state unemployment insurance only to the employee's work state and not necessarily to the state designated as legal residency.
7. Ask MSRRA-employees to reconfirm their state income tax exemption request annually as well as their designated state of legal residency.
8. Flag and monitor MSRRA-covered employees perhaps by establishing a field in the employee's payroll system record to show "MSRRA-covered." This will assist you in easily preparing reports for internal reconciliation/monitoring or state audit purposes.

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