# Nonresident Wage Income Assigned to Minnesota

*Clarifying a 2008 law change*

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***Withholding Fact Sheet 19***

**Fact Sheet**

*This fact sheet explains a law change that passed during the 2008 Legislative Session, which affects how certain types of nonresident wage income are assigned to Minnesota.*

## The Law

For nonresidents, income from wages is assigned to Minnesota to the extent that the work of the employee is performed in Minnesota.

A 2008 law change eliminated a previous exclusion from taxable income for wages earned while a taxpayer was a Minnesota resident and received in a year when the taxpayer was a full-year nonresident. The law change is effective for taxable years beginning after Dec. 31, 2007.

Employers are required to withhold Minnesota tax beginning with payments made after April 1, 2008.

## What Payments are Affected?

The law change does not affect payments received on the sale of stock purchased through statutory stock options or payments from qualified deferred compensation plans. Qualified deferred compensation plans include regular defined benefit pensions, 401(k), IRA, and 457 plans. Either these payments are not "wages" or are prohibited from state taxation by federal law when paid to nonresidents.

The law change does affect a nonresident's income from wages for work performed in Minnesota, such as: (1) severance pay; (2) equity based awards; and (3) other non-statutory deferred compensation. When these payments are assigned to Minnesota, they are subject to Minnesota individual income tax and withholding tax.

### Severance Pay

Severance pay is assigned to Minnesota to the extent that work connected with the employment from which the payment is received was performed in Minnesota.

**Examples:**

1. Employee is a Minnesota resident and works his entire career in Minnesota. His employer downsizes and offers Employee a severance package based upon the number of years worked. Severance payments are to be made over a three-year period. Employee changes his residency to Florida before the first severance payment is issued on Jan. 1 of the following year.

   Because work connected with the employment from which the severance pay was received was performed in Minnesota, the full amount of each severance payment is assigned to Minnesota.

2. Employee's employment contract entitles her to severance payments if she is terminated without cause or pursuant to a change of control in the company. Employee works for 10 years in Minnesota while a resident of Michigan. During this time, Employee is exempt from Minnesota individual income tax due to the income tax reciprocity agreement Minnesota has with Michigan. The employer terminates Employee without cause and severance is paid pursuant to the employment contract over three years. Employee changes her residency to Florida before the first severance check is issued.

   Because work connected with the employment from which the severance pay was received was performed in Minnesota, the full amount of each severance payment is assigned to Minnesota. The reciprocity exclusion does not apply because Employee does not live in a reciprocity state when the severance payments are received.

   If Employee had worked under the contract for nine years in Minnesota and one year in Florida, then 90 percent of each severance payment would be assigned to Minnesota, representing the percentage of time work connected with the employment from which the severance pay was received was performed in Minnesota.

### Equity Based Awards

Equity based awards, such as non-statutory stock options, stock appreciation rights, or restricted stock, are assigned to Minnesota based on the ratio of days worked in Minnesota during the "allocation period" to the total number of days worked for the employer during the "allocation period." The allocation period begins on the date the equity based award is granted and ends at the earlier of: (1) the date the award or corresponding stock is substantially vested; or (2) the date the award or corresponding stock is sold.

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**Examples:**

Each of the following examples assumes the stock options do not have a readily ascertainable fair market value at grant date.

1. Employee works in Minnesota and is a Minnesota resident. In Year 1, Employee is granted non-statutory, vested stock options. After receiving the options, Employee continues to work for two years in Minnesota. In Year 3, Employee changes her residency to Florida where she works for the same employer. In Year 5, Employee exercises the options, recognizing $50,000 of income from wages.

   Because the options were both granted and vested while working in Minnesota, $50,000 is assigned to Minnesota.

2. Employee is a resident of Kentucky. When hired in Kentucky, Employee is granted non-statutory stock options that vest after five years. During Year 2, Employee is assigned to spend six months in Minnesota overseeing the building of a new plant and then returns to his home in Kentucky. In Year 5, Employee retires. At the time of retirement, the options vest and are exercised by Employee. As a result of exercising the options, Employee recognizes $90,000 of income from wages.

   Because the time worked in Minnesota between the option grant and vesting dates is six months out of five years, $9,000 (6/60 x $90,000) is assigned to Minnesota.

3. Employee is a resident of Minnesota. When hired in Minnesota, Employee is granted non-statutory stock options for 1,200 shares that vest ratably over four years; 300 shares vest in each of Years 1, 2, 3, and 4. Employee remains employed in Minnesota during Years 1 and 2 and then changes her residency to Washington where she is employed during Years 3 and 4. Employee exercises all 1,200 shares at the end of Year 6 while a resident of Washington.

   Six hundred shares vested prior to Employee leaving Minnesota, 100 percent of income from wages recognized from the exercise of these shares is assigned to Minnesota. Because the time worked in Minnesota between the option grant and vesting dates for the 300 shares that vested in Year 3 is two out of three years, 66.67 percent (2/3rds) of income from wages recognized from the exercise of these shares is assigned to Minnesota. Finally, because the time worked in Minnesota between the option grant and vesting dates for the 300 shares that vested in Year 4 is two out of four years, 50 percent (2/4ths) of income from wages recognized from the exercise of these shares is assigned to Minnesota. In sum, 79.17 percent ([600+200+150]/1,200) of the income from wages recognized upon exercise will be assigned to Minnesota.

## Other Non-Statutory Deferred Compensation

Other non-statutory deferred compensation is assigned to Minnesota in the ratio of days worked in Minnesota during the "allocation period" to the total number of days worked for the employer during the "allocation period." The allocation period is the period of time during which the employee accrued the right to the deferred compensation.

**Examples:**

1. Employer maintains a supplemental retirement plan (SERP) that provides income that does not meet the criteria necessary to be preempted under federal law from state taxation when paid to a nonresident (title four of the United States Code, section 114; codified in Minnesota Statutes, section 290.17, subd. 2).

   Employee is a resident of California and works for the employer for two years in California. Employee then changes her residency to Minnesota where she works for 11 years. Upon terminating employment, Employee changes her residency to another state. Employee is entitled under the SERP to a monthly payment of $4,000 for five years.

   Because Employee accrued the right to the deferred compensation throughout Employee's 13 years of service, the allocation period is 13 years. Because the time worked in Minnesota during the allocation period is 11 out of 13 years, 85 percent or $3,385 of each monthly payment (11/13 x $4,000) is assigned to Minnesota.

2. Employee defers compensation earned annually in excess of $1,000,000. In Year 1, Employee worked in Minnesota for 365 out of 365 days, deferring $500,000. In Year 2, a leap year, Employee worked in Minnesota for 210 days and worked in New York for 156 days, deferring $750,000. In Year 3, Employee worked in New York for 331 days and then retired, deferring $1,250,000. While a resident of New York, Employee receives all deferred compensation within a five-year period.

   Because Employee accrued the right to the deferred compensation on an annual basis, each year is a distinct allocation period. For Year 1, $500,000 is assigned to Minnesota because Employee worked in Minnesota for 365 out of 365 days. For Year 2, $430,328 (210/366 x $750,000) is assigned to Minnesota because Employee worked in Minnesota for 210 out of 366 days. For Year 3, none of the $1,250,000 deferred in that year is assigned to Minnesota because Employee did not work in Minnesota during that year.

   Because $930,328 of the $2,500,000 deferred is assigned to Minnesota, a corresponding 37.21 percent ($930,328/$2,500,000) of each payment received by Employee is subject to Minnesota withholding tax and individual income tax. Any earnings on the deferred compensation that constitute wages are also assigned to Minnesota in the same manner.

3. Employee is a Texas resident and resides in Texas for five years. During Year 6, Employee accepts a two-year assignment in Minnesota overseeing the development and installation of new computer software at a branch office. As an incentive, Employee is offered a $50,000 bonus for remaining in Minnesota for the duration of the two-year assignment. In Year 8, Employee returns to Texas and three months later receives the $50,000 bonus.

   Because Employee worked in Minnesota for the entire 24 months during which the right to the $50,000 bonus accrued, $50,000 is assigned to Minnesota.

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If in addition to the requirements above, the Employee had been required to be employed at the time of payment to receive the bonus, then the percentage of time Employee worked in Minnesota while accruing the right to the deferred compensation would be 24 out of 27 months. As such, $44,444 (24/27 x $50,000) would be assigned to Minnesota.

4. An employer maintains a qualified pension plan that provides income that meets the criteria necessary to be preempted under federal law from state taxation when paid to a nonresident (title four of the United States Code, section 114; codified in Minnesota Statutes, section 290.17, subd. 2). In addition, the employer maintains a supplemental retirement plan (SERP) that provides income that also meets the federal law preemption criteria.

   Employee is a resident of Minnesota and works in Minnesota accruing benefits under the employer's qualified pension plan and SERP. Employee retires and becomes a resident of Arizona, thereafter receiving a combined payment of $4,000 per month for five years under the qualified pension plan and SERP.

   Because the payments qualify as income that meets the criteria necessary to be preempted under federal law from state taxation when paid to a nonresident, the payments are not assigned to Minnesota.

## Information and Assistance

Additional forms and information, including fact sheets and frequently asked questions, are available on our website.

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This information is available in alternate formats.