DEPARTMENT OF REVENUE

# Withholding Fact Sheet 19, Assigning Employee Income to Minnesota

This fact sheet explains how you as an employer assign income to Minnesota.

## What wage payments are assigned to Minnesota for tax purposes?

It depends on your employee's Minnesota residency.

| If, for tax purposes, your employee is a | Then assign wages to Minnesota |
|---|---|
| Full-year Minnesota resident | At the time they received the wages |
| Part-year Minnesota resident | For the time they are a Minnesota resident |
| Nonresident of Minnesota | To the extent they performed services in Minnesota |

## How are payments on the sale of statutory stock options allocated to Minnesota?

If an employee receives these payments, allocate them to Minnesota if they received them while they were a Minnesota resident.

## How are payments from qualified deferred compensation plans allocated to Minnesota?

If an employee receives these payments, allocate them to Minnesota if they received them while they were a Minnesota resident. Qualified deferred compensation plans include regular defined benefit plans, 401(k), IRA, and 457 plans. Payments made to nonresidents are either not wages or not subject to state tax.

## How are severance payments allocated to Minnesota?

It depends on where an employee provides their services and if they are a Minnesota resident when receiving payments.

**For full-year and part-year Minnesota residents,** allocate all severance payments to Minnesota if they receive the payments while they are a Minnesota resident.

**For nonresidents of Minnesota,** allocate severance payments based on their percentage of time worked in Minnesota. For example, if a nonresident employee worked nine years in Minnesota and one year in Florida, allocate 90% of their severance pay to Minnesota.

### Example 1

Your employee is a Minnesota resident and works their entire career in Minnesota. You offer the employee a severance package based on their number of years worked. You make severance payments over a three-year period. The former employee changes their residency to Florida before you make the first severance payment.

You will allocate the full amount of each severance payment to Minnesota because all services were performed in Minnesota.

### Example 2

Your employee is a resident of Michigan working in Minnesota for 10 years. While working in Minnesota, the employee was exempt from Minnesota income tax due to the state's reciprocity agreement with Michigan. The employee is eligible for severance payments made over three years based on their contract with your company. The former employee changes their residency to Florida prior to receiving their first severance payment.

The full amount of your former employee's severance pay is assigned to Minnesota because the full amount of their services was performed in Minnesota. The reciprocity agreement does not apply because the former employee was not a Michigan resident when you made severance payments.

cise 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.

## How are equity-based awards allocated to Minnesota?

It depends on where an employee provides their services during the "allocation period" and if they are a Minnesota resident when receiving awards. The allocation period begins on the date the equity-based award is granted and ends on 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.

Equity-based awards include non-statutory stock options, stock appreciation rights, and restricted stock. Allocate these awards to Minnesota based on the ratio of days your employee worked in Minnesota during the allocation period to their total days worked for you during the allocation period.

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If your employee was not a Minnesota resident at the time you make award payments, allocate awards to Minnesota based on the ratio of days worked in Minnesota out of the entire allocation period.

If an employee was not a Minnesota resident during the award's allocation period, but they receive the award after becoming a Minnesota resident, allocate the entire award to Minnesota.

The examples below assume that the stock options do not have a readily ascertainable fair market value at the grant date.

### Example 1

Your employee works in Minnesota and is a Minnesota resident. In year 1, you grant non-statutory vested stock options. After receiving the options, the employee continues to work for two years in Minnesota. In year 3, your employee changes their residency to Florida and continues to work for your business. In year 5, your employee exercises the options and recognizes $50,000 of income as wages.

You will allocate the full amount of $50,000 to Minnesota because the award was granted and vested while your employee worked in Minnesota.

### Example 2

Your employee is a Kentucky resident. When they were hired, you granted non-statutory stock options that vest after five years. During year 2, you assign the employee to work six months in Minnesota. Your employee retires in year 5. At retirement, the options vest and your employee exercises them. Your employee recognizes $90,000 of income when exercising the options.

Since your employee worked six months in Minnesota out of 60 total months, you will allocate $9,000 of the award to Minnesota (6/60 x $90,000).

### Example 3

Your employee is a Minnesota resident. When hiring your employee, you grant them non-statutory stock options for 1,200 shares that vest ratably over four years (300 shares vest in each of the four years). Your employee works for your business in Minnesota for year 1 and year 2. Then, they change their residency to Washington in years 3 and 4. Finally, they exercise their options as a Washington resident in year 6.

- **For years 1 and 2,** you will allocate all shares vested in these years to Minnesota. The employee worked in Minnesota for the full time those shares were vesting.
- **For year 3,** you will allocate the shares vested based on two of the three years during the vesting period being for service performed in Minnesota. The wages assigned to income for this year are from 200 of the 300 shares.
- **For year 4,** you will allocate to Minnesota half of the income from wages recognized from the exercise of options. Two of the four years during the vesting period for the year 4 options were for services performed in Minnesota. You will assign the income from 150 of the 300 shares as wages to Minnesota.

Overall, you will assign the income from exercising 850 of the 1,200 shares as wages to Minnesota.

## How is other non-statutory deferred compensation allocated to Minnesota?

It depends on where your employee provides their services during the "allocation period" and if they are a Minnesota resident when receiving the compensation. The allocation period is the period of time during which the employee accrued the right to the deferred compensation.

If your employee is a Minnesota resident at the time of payment, allocate the total amount to Minnesota. If they are a nonresident at the time of payment, allocate compensation to Minnesota based on the ratio of days worked in Minnesota out of the entire allocation period.

### Example 1

Your business has a supplemental retirement plan (SERP). The income from this plan does not qualify to be pre-empted from state taxation when paid to a nonresident. You have an employee who is a California resident and works in California for two years. They change their residency to Minnesota for the next 11 years. At the end of their employment, your employee is entitled to a monthly payment of $4,000 each month for five years under the SERP.

The allocation period for the deferred compensation is the 13 total years of service. Since the employee worked in Minnesota for 11 years out of 13, you will allocate $3,385 (11/13 x $4,000) to Minnesota**.**

### Example 2

You have an employee with annual compensation exceeding $1,000,000. In year 1, your employee worked in Minnesota and deferred $500,000. In year 2, they worked 210 days in Minnesota then moved to New York where they worked for 155 days. They deferred $750,000 in year 2. In year 3, your employee worked 331 days in New York and then retired. They deferred $1,250,000 in year 3. Your employee is still a New York resident and receives the deferred compensation over the next five years.

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Your employee accrued the right to the deferred compensation on an annual basis, which makes each year its own allocation period.

- **For year 1**, you will allocate all compensation to Minnesota because the employee worked in Minnesota the entire year.
- **For year 2,** your employee worked 210 days in Minnesota out of 366. You will allocate $430,328 (210/366 * $750,000) to Minnesota.
- **For year 3,** you will not assign the deferred compensation to Minnesota because your employee did not work in Minnesota that year.

The total deferred compensation assigned to Minnesota is $930,328 out of $2,500,000, which is 37.21%. For each payment made to the employee for the deferred compensation, 37.21% is subject to Minnesota Withholding Tax. If there are earnings on the deferred compensation that constitute wages, you will allocate them to Minnesota in the same manner.

## Example 3

Your employee is a Texas resident and resides in Texas for five years. During year 6, they are assigned to a project in Minnesota for two years. As an incentive to finish the project, you offer a bonus of $50,000 to complete the two-year assignment. In year 8, your employee returns to Texas and receives the $50,000 bonus three months later.

You will allocate your employee's entire $50,000 bonus to Minnesota because the accrual period is based on the two years they worked in 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.