United States: Roundup of state tax changes impacting employees and employers of mobile workforces

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In brief

Various states have made changes to their individual income tax regimes relevant for the 2017 tax year that are likely to impact mobile employees and their employers. This Insight provides a sampling of these changes for states including Illinois, Kansas, Maine, North Carolina, and Indiana.

Broadly speaking, these developments indicate some opposing trends – some states are lowering rates and overall tax burdens on their individual residents, however, others are increasing their tax rates, broadening phase-outs for itemized deductions, and limiting credits to address budgetary issues. Mobility programs should consider the impact on tax equalization calculations, policies, and costs, as well as withholding responsibilities.

In detail

Illinois

Increase in income tax rates

Effective July 1, 2017, Illinois individual income tax rates increased from 3.75% to 4.95%. Following years of no budget, Illinois’ congress passed a budget on July 7, 2017 through an override vote of the Governor’s veto. As part of the budget, Illinois adjusted its personal income tax rates starting July 1, 2017 creating a split-year tax rate. The overnight increase means that income earned before the change will remain taxed at the lower rate and any income earned after the change will be taxed at the increased rate.

Changes to certain credits and related phase outs

The K-12 education expense credit for families with school aged dependents is expanded and a new Instructional Material and Supply Credit for teachers starts with tax year 2017. The bill also includes new phase-outs for many credits for high income earners ($500,000 for federal married filing joint returns and $250,000 for all other returns.) Affected credits include the K-12 Education Expense Credit, Illinois Property Tax Credit, and the Instructional Materials and Supply Credit.

No personal exemption for certain income levels

In a major change, the bill eliminates the personal exemption allowance for individuals with adjusted gross incomes over $500,000 for federal married filing joint returns or $250,000 for all other filing statuses.
**Guidance on choosing an apportionment method**

While the actual reporting requirements on the 2017 income tax return are unknown, the Illinois Department of Revenue provided insight for fiscal year filers which will likely be similar to 2017 calendar year filers (Informational Bulletin FY 2018-02). Taxpayers will have an opportunity to choose either an ‘apportionment method’ for determining their tax rate for 2017, effectively creating a blended rate using the average of the new and old rate of 4.35% for tax year 2017. Alternatively, the ‘specific accounting’ method may be used requiring the taxpayer to complete a yet to be released Schedule SA breaking up each income item between periods – before the rate change or after the rate change – and apply the appropriate tax rate.

If a choice is not made on a timely filed return (including extensions,) the apportionment method will be auto-chosen. Once a method is chosen, it is irrevocable.

For income earners who earn their income ratably throughout the year or earn lump sum payments (equity payouts, severance, bonus payments, etc.) at year end, the ‘apportionment method’ may be the preferred method. If a taxpayer earns lump sum payments early in the year, the specific accounting method may provide a better result.

**Kansas**

**Increase in income tax rates**

As of July 1, 2017, Kansas retroactively increased the income tax and withholding tax rates for individuals, estates, and trusts (Notice 17-02) to the start of tax year 2017. The top rate went from 4.6% in 2016 to 5.2% in 2017. The rates increase again effective January 1, 2018 for all tax years thereafter, with the top rate being 5.7%.

Accordingly, the withholding tax rates used by employers also changed effective July 1, 2017. To account for the change in rate, the Kansas Department of Revenue suggests that all withholding agents apply the tax year 2018 rates immediately to compensate for the shortfall of withholding for the first half of 2017. Additionally, withholding at the 2018 rates to catch up for the first half of the year’s shortfall in withholding will make it easier on payroll departments going forward because they won’t have to adjust withholding amounts when the rates change again in 2018.

Because of these retroactive changes, there will be no underpayment penalties imposed for individuals for tax year 2017 as long as the underpayment is corrected by the filing date of April 17, 2018.

**Reduced phase out of itemized deductions**

Kansas is increasing the limits on itemized deductions and broadening the phase-out income limits (Notice 17-06). This will ultimately allow for many full deductions of items which are otherwise phased out for federal tax purposes.

Starting with tax year 2018, Kansas will begin to allow a portion of unreimbursed medical expenses to be claimed on the Kansas return as a deduction.

Further, the amount of each category of itemized deduction (charitable contribution, residential mortgage, real and personal property taxes, and medical expenses) subject to phase out will decrease each year ultimately allowing a full deduction on the Kansas return starting in tax year 2020.

**Withholding tax due date**

Kansas also revised the withholding tax document filing due date from the last day of February to January 31st. Any business deducting and withholding taxes for employees or payees is now required to file all required forms including, but not limited to, Form KW-2, Form W-2, and Form 1099 by January 31st of the following year (Notice 17-16).

**Maine**

**Repeal of income tax surcharge**

Maine Governor LePage recently signed into law a bill that repeals the 3% income tax surcharge on individuals earning greater than $200,000 retroactively starting with fiscal year 2017. (See Maine Tax Alert.)

In response to the repeal of this 3% income tax surcharge, Maine Revenue Services has released revised 2017 withholding tables that employers are instructed to begin using immediately. See the employer’s withholding tax guide.

**North Carolina**

**Decrease in income tax rates**

Individual income tax rates continue to decrease due to legislative changes made by the North Carolina General Assembly in 2015. Effective January 1, 2017 the North Carolina individual income tax rate decreased from 5.75% to 5.499% as scheduled.

North Carolina law requires income tax to be withheld from wages at a rate that is 0.1% higher than the individual income tax rate. Therefore, the withholding rate on wages paid on or after January 1, 2017 will be 5.599%.

Recent changes enacted by the North Carolina General Assembly further reduce the tax rate from 5.499% to
5.25% for tax years beginning on or after January 1, 2019.

**Indiana**

**Decrease in tax rates**

Effective January 1, 2017, Indiana reduced the gross income tax rate for individuals from 3.3% to 3.23%. Also effective January 1, 2017, the local income tax rate imposed by a county is now identical for residents and nonresidents subject to local income tax. See [Departmental Notice #42](#) which summarizes the changes.

**Increased scrutiny for homestead deduction**

Indiana residents who own an Indiana home and use it as their primary place of residence may qualify for a homestead deduction, which reduces their annual property tax assessment. Recently, local governments have increased the scrutiny on these deductions to ensure a taxpayer is only claiming one homestead or that the property wasn’t being rented during the year. Many expatriates decide to rent out their residence while on assignment - this could result in a higher property taxes being assessed (notification of the increase could occur several years later).

**Foreign tax credit notices**

The Indiana Department of Revenue provides a credit for income taxes paid to a foreign country on an Indiana resident income tax return. We have seen an increase in tax notices denying this credit over the past year. The Department will typically allow the credit once a copy of the federal Form 1116 and the foreign country tax return have been submitted with a response to the notice. Taxpayers should be aware of the potential notice that may delay/reduce the refund or request an additional payment and the need to provide additional supporting documentation after the individual income tax return has been submitted.

**The takeaway**

**Impacts for mobile employees and their employers**

The above-described rate increases and other changes for Illinois and Kansas will generally increase the US state income tax liability for individuals and may increase the cost of inbound assignments.

Rate decreases and other changes relating to Maine, North Carolina, and Indiana will likely result in lower US state tax costs for individuals (in Maine, for those individuals earning more than $200,000.) They may reduce the tax cost to the company for US inbound assignments, but may increase the tax cost to the company for US outbound assignments because the hypothetical state tax collected would be reduced.

Companies using tax equalization policies should consider updating their hypothetical tax and withholding estimates for 2017 immediately to minimize any year end surprises. Further, hypothetical calculations and cost projections relying on marginal tax rates should be updated.

Rate changes (including repeal of surcharges) will likely require more effort on the company’s part to update and maintain the correct withholding rates, and report this information to the state sooner.

Tax equalization policies should be continually reviewed to determine if any tax revisions are warranted due to state tax changes. For example, companies should be aware of the potential impact of the Indiana homestead deduction change and determine if this would be covered under an existing policy.
Let’s talk

For a deeper discussion of how this issue might affect your mobile workforces, please contact your PwC Global Mobility Services engagement team or one of the following professionals:

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