Does local income tax withholding follow the wages or the person?

What was once a more straightforward question, has caused some confusion since 2020. Does local income tax withholding follow the wages or the person? If it follows the wages, you withhold taxes where the wages are earned. If it follows the person, you withhold taxes where the person earning those wages is located.

For state tax purposes, withholding mostly follows the person, except in 2020, when employers sent employees home to work. As an administrative convenience, many states allowed employers to continue to withhold for the work location. In other words, withholding followed the wages.

The trickier issue is municipal income taxes. Here, the issue is usually home rule—how much power does a state give a municipality to enact an income tax ordinance? The answer, of course, depends on the state and the municipality, which means we can reach some interesting conclusions.

Cleveland commuter is due a tax refund

This commuter lived in Pennsylvania and typically stayed in Cleveland during the week. Before 2020, she received tax refunds for the days she worked outside Cleveland. However, her employer continued to withhold Cleveland taxes during 2020 under the auspices of § 29 of H.B. 197, which allowed employers to continue to withhold for employees' principal place of work.

She applied for a tax refund, which was denied. Then she sued. An Ohio Court of Common Pleas' answer to our question is that local withholding follows the person. It ruled in the commuter's favor. The key to the court's decision, and how it distinguished this case from an earlier case, was her Pennsylvania domicile.

Court: The law hasn't kept pace with technology. The ability of an employee to communicate virtually with her office and to perform her job duties from home didn't create a sufficient fiscal relation to the city or state. The city of Cleveland and the state of Ohio didn't establish a basis for jurisdiction to tax a nonresident of Ohio on income generated by work performed at her home in Pennsylvania.

The case is *Morsy v. Dumas*.

Michigan municipality can tax nonresidents

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Just to the north of Ohio is Michigan. Like Ohio, Michigan allows municipalities to levy income taxes on nonresidents who earn wages within their jurisdiction. The city of Jackson levies a 0.5% income tax on nonresidents who work in the city.

Employees who were nonresidents of Jackson were sent home to work in 2020 but remained subject to the tax. So they sued the city in three separate class actions. They made three arguments:

- The collection of the nonresident tax from those working at home constituted an unlawful exaction without due process.
- The collection of taxes was an illegal taking of property without just compensation.
- The city was unjustly enriched.

City: Employers were required to withhold city income taxes, so the withheld taxes weren't an illegal taking. Employees could have refiled their municipal W-4s to claim they were providing 100% of their services outside the city; doing so would have zeroed out their withholding.

This persuaded a state trial court to rule that the employees didn't have a case. The employees appealed. A state appellate court affirmed the trial court's decision. In other words, withholding follows the wages.

Appellate court: The employer's hands were tied when it came to withholding. These employees should have claimed a tax refund on their 2020 city taxes.

The case is *Hofmeister v. City of Jackson*.

The takeaway

In neither case was the employer sued. Even so, you're not off the hook.

If nonresident employees work from home permanently, your municipality can't claim they're subject to its income taxes. Provide them with the proper forms to claim an exemption from withholding.

On the other hand, your permanent telecommuters will be subject to their municipality's income taxes, which means you must register as an employer and withhold.

If employees work on a hybrid basis, you withhold for the work state and their home state since they're present

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in both jurisdictions. Employees will work out the double tax issue on their income tax returns.

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