TELECOMMUTING DURING AND AFTER COVID-19: WHAT EVERY EMPLOYER SHOULD KNOW

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Last month, the *TaxStringer* published our article, The Multistate Tax Implications of a Mobile Workforce, on various tax considerations facing employers with an increasingly mobile workforce. How the world has changed in just a few weeks!

All of you sitting in your home office, at your dining room table, or at any clear surface you can find in your house know that our once-mobile workforce has temporarily come to a screeching halt, and people are working from home to the extent they can. Hopefully, this will be a relatively short pause before the country returns to business as usual. Yet, given that employers and employees have increasingly relied on telecommuting to address employee retention, cost management, and other considerations, it's likely that more employees will regularly work from home even after the pandemic recedes.

Whether employees telecommute just during the COVID-19 crisis or beyond the period that they are required to do so, both businesses and individuals need to consider the state tax impacts. For some, telecommuting will have no tax impact, as in the case of a business located in California with employees who all work from their homes in California. Many other businesses cross state lines, however, and employees may be working from their homes in states where the business does not have an office or other physical location. This may have both short- and long-term state tax implications for both businesses and their employees.

Nexus

With the sudden explosion in telecommuting, employers must now consider whether the presence of employees in states where there is no bona fide office of the company creates tax obligations for a variety of taxes, not just employment taxes. In other words, do telecommuters create nexus for the company?

The term "nexus" generally refers to the nature and frequency of contacts that an out-of-state company must establish in a state before it becomes subject to that state's tax laws and jurisdiction. The U.S. Constitution requires some level of minimum contacts between the state and the company or a transaction before the state can impose a tax without burdening interstate commerce. The 2018 U.S. Supreme Court decision in *South Dakota v. Wayfair* made clear that the minimum contact requirement could be met even without physical presence in the state.

With the nexus threshold being so low, would a telecommuter create income tax and/or sales tax nexus for a company that otherwise would not have sufficient contacts or meet the economic nexus thresholds set by the employee's home state? For the vast majority of states, the answer is yes. In the most recent (2019) Survey of State Tax Departments conducted by Bloomberg Tax, virtually all states that responded indicated that the presence of one to six telecommuters in the state would give rise to an income tax filing obligation for the company, and either the presence of a single telecommuter performing back office functions or reimbursements from the company to an employee for a home office would create nexus for sales taxes. This could create a significant unforeseen tax burden for a company with employees telecommuting from multiple states. It may be too soon to say whether companies that have telecommuters only as a result of COVID-19 work-from-home or "shelter-in-place" orders will be relieved of any additional filing obligations that the short-term presence of telecommuters may engender. But the New Jersey Division of Taxation has taken the lead in issuing guidance that if employees are working from home solely as a result of COVID-19-related work-from-home orders, the Division will not consider the legal nexus threshold met for out-of-state companies solely due to the presence of telecommuters in the state.

Of course, in the limited situation where telecommuters are only soliciting orders for tangible personal property—not more than "mere solicitation" and not for services—a company will be protected by Public Law 86-272, which prevents states from imposing net-income taxes on an out-of-state company if the company's activities in the state are only restricted to the "mere solicitation" of sales of tangible personal property, and the orders are sent outside of the state for approval and fulfillment. But beyond that limited exception, the continued presence of telecommuters in a state might very well require a company to file employment, income, and sales taxes in the telecommuter's state. There may also be local taxes, such as municipal gross receipts taxes, that could arise in addition to the state tax burden.

Reciprocal Agreements for Withholding Taxes

Currently, 41 states impose a personal income tax, and in general, states require employers to withhold personal income taxes on behalf of their telecommuting employees. But withholding requirements differ widely among states. The employer of an employee who works both in her resident and nonresident state must be aware of the requirements in the different states. As discussed in our aforementioned article, thresholds for withholding vary widely among states. In many cases, though, employees working from home for even a month or so during the COVID-19 crisis would likely exceed the withholding threshold.

What may alleviate some of the additional withholding requirements for short-term telecommuting arrangements are reciprocal agreements that exist between the employee's resident state and the state where he typically works. Reciprocal agreements allow the residents of each of those states to claim an exemption from withholding tax in the other state. For example, if an employee works in State A but lives in State B, a reciprocal tax agreement between State A and State B typically provides that the employer need only withhold for, and the employee need only file in, State B.

Reciprocal tax agreements typically exist primarily between neighboring states, though not all neighboring states have them (e.g., New York and New Jersey *do not* have such an agreement, whereas Pennsylvania and New Jersey do). Currently there are 25 states that do not have reciprocity agreements in place, including Alabama, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Kansas, Louisiana, Massachusetts, Maine, Montana, Missouri, North Carolina, Nebraska, New Mexico, New York, Oklahoma, Oregon, Rhode Island, South Carolina, Utah, and Vermont. Moreover, a reciprocal agreement between Illinois and Kentucky, for example, will allow an Illinois employer to only withhold Kentucky taxes for an employee who works from her Kentucky home for all or part of the year, but will have no effect on the requirement to withhold both Indiana and Illinois taxes for an employee who works from the Illinois office for part of the year and from his Indiana home for another part of the year. So, reciprocal agreements could provide some relief from additional employment tax obligations but should be looked at closely to ensure that they apply.

Convenience of the Employer

There are a handful of states that impose a so-called (and misnamed) "convenience of the employer rule" to determine whether that state will tax the wages of a telecommuter. Under this rule, if an employer is located in Connecticut, New York, Delaware, New Jersey, Nebraska, or Pennsylvania, or the employee's principal office of the employer is located in one of those states, then compensation earned while working at home will be treated as if earned in the employer's location in those states, if the employee is working from home for her own convenience and not the employer's necessity. (Note: Although New Jersey does not explicitly have a convenience of the employer rule in its tax laws or regulations, most practitioners agree that, in practice, the state imposes a rule similar to that of New York.)

For example, if the employer is located in New York and the employee is based out of or reports to that office, New York treats the employee as if he is physically working in that office for withholding tax (and personal income tax) purposes, even though he is actually telecommuting from a home office in Vermont. Thus, New York would require the employer to withhold New York taxes from that employee on wages earned while working from his Vermont home. Vermont could also treat those same wages as subject to Vermont withholding and taxation. It should be noted that this rule applies only to nonresident employees and not independent contractors.

This begs the question: What is a "necessity" and what does the employee's "convenience" mean? As is often the case, New York has published the most guidance on this question and has generally taken a very narrow approach to what constitutes the employer's necessity. In most cases, it will apply only to the requirement that an employee telecommute so she is close to specialized facilities, or the employer has gone to great lengths to treat the employee's home office as a bona fide office of the business.

But the COVID-19 crisis is unique in the requirement by many states for employees of most businesses to work from home. Because nonessential businesses may face penalties if their employees come to the office, one would hope that either the convenience rule would not be applied to days worked at home during "shelter-in-place" orders or that states mutually agree which state may tax the income earned during this period.

Nevertheless, employers should be aware that once "shelter-in-place" or similar orders are lifted, employers may be subject to convenience rules on employees who continue to telecommute part or full time, if those employees would otherwise be working in states that have a convenience rule on the books. Unfortunately, convenience rules burden both employers and employees, whereby two states may claim the right to tax the same earned income with no offsetting credit! Despite almost annual attempts by Congress to address this problem over the last decade, no multistate solution is in sight.

Unemployment Tax and Workers' Compensation

Although most states impose income taxes on compensation earned where the employee is physically working, the same may not be true with respect to unemployment taxes. Employers pay unemployment taxes to one state for each worker. But which state collects the tax if, say, an employee works from home in Massachusetts for an Ohio-based company? Generally, states apply the following four-prong hierarchy to determine the state where unemployment taxes get paid:

- The state of localization.
- The employee's base of operations.
- The location of direction and control of the employee.
- The employee's place of residence.

For telecommuters, determining the correct state for unemployment taxes might primarily depend on whether the individual exclusively works from home or combines telecommuting with working from an office and/or traveling to customer locations. If he *only* works from home in Pennsylvania, even if the company headquarters is in Maryland and its customers are spread throughout the United States, unemployment tax will likely get paid to Pennsylvania because all of the company's services are localized there. But if the employee sometimes goes to work in Maryland or goes to customer sites in New Jersey and New York, the first prong of the test might not apply.

Similarly, the second prong—base of operations—might be difficult to ascertain if the telecommuter does not travel to a company location or occasionally travels to various company offices for meetings. The location of direction and control of the employee could be the primary business office of the company. But if supervisors are also telecommuting, applying this prong of the test might produce a strange result: for example, unemployment insurance for a telecommuter for a Georgia company who works from home in South Carolina and is supervised by an employee who works from home in North Carolina would be paid to North Carolina under the third prong. Given that the employee is very unlikely to file for unemployment in North Carolina, this does not seem to be the correct result. In such an instance, the fourth prong of the test—the employee's state of residency—might make the most sense.

Unlike unemployment insurance taxes, workers' compensation is typically intended to cover employees working in any location for the employer. When a company begins having employees work from home, either temporarily or permanently, it should make sure that the workers' compensation insurance policy covers the home office location to avoid the potential for significant penalties if an employee is injured "on the job" while at home.

Considerations for Telecommuting Employees

Typically, an employee is already filing an income tax return in her home state even if she works exclusively in another state, unless she lives in Florida, Texas, or another jurisdiction with no personal income taxes. Thus, for income tax purposes, the only consideration for an employee who might be working for part of the year from home is how much of her income should be taxed by her home state versus her typical work state. Absent guidance from the states to the contrary, the employee should determine how many workdays she physically worked in the home state versus any other state, then allocate her income among those states accordingly. This may be contrary to her employer withholdings if the employer continues to withhold taxes in the prior work state, requiring the employee to claim a refund of taxes from the employer state and pay additional taxes in her home state.

What Comes Next?

No one knows how long many employees will be mandated to work from home or whether this is only the first step of the "shelter-in-place" orders as the pandemic runs its course. The longer employees are required to work from home, the more necessary it will be to get official guidance from states or even Congress on to how to address the various employment tax issues that will confront employers.

Employers who may have already had some telecommuters or who might allow employees to telecommute partially or fully for their jobs in the future should be aware of the state tax ramifications of the arrangement. Cost savings from telecommuters could be offset by tax and tax preparation costs, as a result of new filing obligations in other states. State taxing jurisdictions, hungry for revenue to offset the costs of the COVID-19 crisis, may start looking more closely at companies with expanded footprints in their states through the presence of telecommuters once the crisis is over.

Ultimately, the benefit of allowing employees to telecommute may outweigh the costs, but companies should have a full understanding of that cost as they navigate the current landscape.

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