

# Pandemic Pandemonium Part 2

## Taxing Telecommuters

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# Agenda

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- Introduction
- Multistate Review
- Caselaw
- Federal Solutions
- Policies, Planning, and Other Strategies
- Other State Employment Tax Issues

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# Introduction

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# The Basics

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- If employee is an in-state resident, then 100% of their compensation income is subject to that state's tax, and employer must withhold 100% state tax
- If employee is a nonresident, then state tax still due to the extent of the taxpayer's workdays in the state:
  - Employer must withhold state tax based on that workday percentage
  - Employee reports allocable income based on that workday percentage
- General Rule: Wages assigned to and taxable in state in which the services were performed
  - Credit for taxes paid to another state avoids double taxation
- But what is a workday?
  - Easy: days spent in in the state by the nonresident employee on company business
  - Not so easy: Remote work.....pandemic pandemonium!
    - Which state gets to tax the telecommuter?

# Pre-Covid: The Convenience of the Employer Rule

- 6 states (NY, PA, DE, NE, AR, CT) have had some form of a “convenience rule”
  - In general, if the employee works from home for their own convenience, the workdays at home will be treated as days worked at the assigned work location
    - “Convenience” has been broadly defined in NY cases
    - Required out-of-state work OK
    - But if the work could be done in NY, could be trouble
- Outside of NYS, not a controversial issue, with most states using a “physical presence” concept to tax remote workers
- Until March 2020.....states started to issue guidance about how they will handle work-at-home sourcing because of Covid-19

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# Multistate Review

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# State Withholding Guidance During COVID-19

- Three approaches to pandemic-related to teleworker withholding:
  1. No guidance – normal withholding rules presumably apply;
  2. Issue guidance that specifically confirms that the pre-pandemic rules remain in full force and effect; and
  3. Adopt temporary laws, regulations, or other guidance that changes the normal pre-pandemic withholding rules.



# Temporary Changes to the Normal Pre-Pandemic Withholding Rules – End in Sight?

- Temporary withholding guidance generally results in:
  - Outbound Nonresidents – Status Quo; and/or
  - Inbound Residents – Hold Harmless
- The “start” and “end” dates vary by state and are either tied to:
  - The federal government’s state-of-emergency.
  - The state’s state-of-emergency.
  - Employer’s mandatory work-from-home order.
  - A specific date (i.e., starting on March 13, 2020 and ending on July 1, 2021).
- When should employers expect enforcement to begin?



# State Responses to Telecommuting and COVID-19

State	Sourced to Employer's Home State	Sourced to Employee's Home State
Alabama	X	
Arkansas	X (until 12/31/20)	X (as of 1/1/21)
California		X
Colorado		X
Connecticut		X (2020 only)
Delaware		X
Georgia	X	
Illinois*		X
Iowa		X
Kansas	X (both until 12/31/20)	X (only as of 1/1/21)
Kentucky		X
Maine	X (until 6/30/21)	
Maryland		X
Massachusetts	X (until 9/13/21)	
Minnesota		X
Mississippi	X	

State	Sourced to Employer's Home State	Sourced to Employee's Home State
Missouri*	X (for some employers if elected until 7/19/21)	X
Montana		X
Nebraska	X (until 7/30/21)	
New Jersey (SALY)	X	X
New York	X	
North Carolina		X
Ohio (municipal income tax)	X (until 12/31/21)	
Oregon		X
Pennsylvania		X (until 6/20/21)
Rhode Island	X	
South Carolina	X (until 9/30/21)	
Vermont		X
Wisconsin		X

\* Withholding required if employee is telecommuting from IL for more than 30 days

## Example: Double Tax on Remote Work?

- **Facts**

- Tim (a New York resident) usually works in NYC for his employer.
- Since March 2020, he has been working remotely from his ski home in Colorado for his New York employer.
- He hopes to be back to NY later this year.

- **Issues**

- Tim is a NY resident, so NY withholding must continue.
- Colorado's rules require Tim to source his wage income to Colorado based on his physical work location in Colorado.
  - Does employer have CO withholding requirement?
- New York, on the other hand, calls those Colorado physical presence workdays New York workdays under its convenience rule.

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# Caselaw

## New Hampshire v. Massachusetts

- New Hampshire files a Motion for Leave to File Bill of Complaint in the United States Supreme Court on behalf of its residents, requesting that the Court find the Massachusetts' temporary emergency regulation is unconstitutional "extraterritorial assertion of taxing power."
  - *New Hampshire v. Massachusetts*, No. 220154 (U.S. docketed Oct. 23, 2020) (petition pending review).
- The Court asked the Solicitor General to weigh-in.
- Will a state impacted by another state's permanent or temporary convenience test also seek review by the Court?
- Is the State of New Hampshire the right plaintiff?

## Other Litigation Related to Remote Work

### Ohio Municipalities and H.B. 197 (2020)

- The Buckeye Institute has filed five lawsuits challenging H.B. 197, which temporarily deems remote work performed during the Covid-19 pandemic to occur at an employee's principal place of business.
- *Morsy v. Dumans et al.*, No. CV21-946057, Cuyahoga County Court of Common Pleas (filed April 8, 2021).
  - Pennsylvania resident challenged Cleveland (and H.B. 197) on Due Process Clause, Commerce Clause, and state law (improper delegation) grounds.
- Four Ohio residents have filed suit challenging H.B. 197 on Due Process Clause and state law grounds.

# Other Litigation Related to Remote Work

## City of St. Louis

- St. Louis issued Covid-19 guidance that provides days worked outside the city while teleworking will be deemed worked at the nonresident employees' primary work location within the city.
- *Boles, et al., v. City of St. Louis*, No. 2122-CC00713, St. Louis City. Cir. Ct. (filed April 13, 2021).
  - Claims include: Federal Due Process and Fourth Amendment (unreasonable search and seizure of wages) and State Constitution (Hancock Amendment).
- S.B. 604 (passed Senate on April 1) and H.B. 688 (committee reported to pass on April 15).

## Other Litigation Related to Remote Work

### *Zelinsky v. Dep't of Tax'n and Finance*

- Notice of Appeal filed with Division of Tax Appeals in July (Div. of Tax App. No. 830517), challenging the application of New York's convenience rule for the 2019 tax year.
- Similar to his 2003 case, *Zelinsky v. Tax Appeals Tribunal*, 1 N.Y. 3d 85 (2003), *cert. denied* 72 U.S.L.W. 3672 (U.S. Apr. 26, 2004) (No. 03-1177), the taxpayer argues that the New York convenience rule violates the Commerce and Due Process Clauses.
- Citing Wayfair and other authorities, the taxpayer argues that Covid-19 changed the circumstances around remote work and the economic reality of modern e-commerce, sufficient to deviate from *stare decisis*.

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# Federal Solutions

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# Federal Legislation Addressing Remote Work Tax Issues

- **Mobile Workforce Simplification**
  - State may not impose tax or withholding obligation) on nonresident unless present and working in the state for 30 days in a year
  - Alternative to employer to use a time and attendance reporting system to a state
  - Over 30 days, liability due on all days in state
  - Does not address convenience of employer
- **Multi-State Worker Tax Fairness Act (S. 1887 2021)**
  - Federal preemption of the convenience of the employer test
  - Introduced by Democrat Sens. from CT, NH and WI



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# Policies, Planning, and Other Strategies

## Solutions: New York Example

- **Facts**

- Taxpayer lives and works in New York, but she has decided to give up New York lease and move to Florida for good.
- Taxpayer's employer is based out of NYC and doesn't have a Florida office, but OK with remote work indefinitely, with some visits here and there.
- So taxpayer telecommutes from her home office in Florida.

- **Issues**

- Easy domicile case, and NYC tax savings.
- But...NYS nonresident allocation?
  - Wages will still be subject to NYS tax based on "convenience rule"
  - Employer still required to withhold 100% NY tax

# NY Example: July 2020 NYS FAQ on Covid Telecommuting

**My primary office is inside New York State, but I am telecommuting from outside of the state due to the COVID-19 pandemic. Do I owe New York taxes on the income I earn while telecommuting?**

*If you are a nonresident whose primary office is in New York State, your days telecommuting during the pandemic are considered days worked in the state unless your employer has established a bona fide employer office at your telecommuting location.*

*There are a number of factors that determine whether your employer has established a bona fide employer office at your telecommuting location. In general, unless your employer specifically acted to establish a bona fide employer office at your telecommuting location, you will continue to owe New York State income tax on income earned while telecommuting.*

<https://www.tax.ny.gov/pit/file/nonresident-faqs.htm#telecommuting>

# Options?

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- **Option #1: Open a Real Office in Florida**
  - Assign as taxpayer's "primary office"
  - But should be used regularly, paid for by employer, etc.
- **Option #2: Assign to a different company office?**
  - Be careful...
- **Option #3: 100% Telecommuter?**
  - Even a few New York workdays, probably too many (*Huckaby*).
  - No New York workdays, maybe okay (*Hayes*).
    - 1977 *Hayes* case: Nonresident, who under his agreement to provide consultant services could have been required to work in New York but who did not work in New York at all, was not subject to New York State personal income tax liability no matter for whose convenience or necessity he performed the work
- **Option #4: Create a "Bona Fide Employer Office"**
  - Working the Secondary and Other Factors
  - See next slide
  - Use of formal remote work agreements?

# The TSB-M Factors

**Step 1: Primary Factor:** Employee's duties require the use of special facilities that cannot be made available at the employer's place of business, but those facilities are available at or near the employee's home

If the home office does NOT satisfy the primary factor, proceed to Step 2

**Step 2: The Secondary and "Other" Factors:** The home office may still qualify as a "bona fide employer office" if it meets four out of the six Secondary Factors PLUS three out of the ten "Other" Factors

## **Secondary Factors (4 out of 6)**

1. Home office is a requirement or condition of employment
2. Employer has a bona fide business purpose for the employee's home office location.
3. Employee performs some core duties at the home office.
4. Employee meets with clients, patients, or customers at the home office.
5. Employer does not provide the employee with office space or regular work accommodations.
6. Employer reimburses expenses for the home office.

## **"Other" Factors (3 out of 10)**

1. Employer maintains a separate telephone line and listing for the home office.
2. Employee's home office address and phone number are on the employer's business letterhead and/or cards.
3. Employee uses a specific area of the home exclusively for the employer's business.
4. Employee keeps inventory of products or samples in the home office.
5. Employer's business records are stored at the home office.
6. Employer signage at the home office.
7. Home office is advertised as employer's place of business.
8. Home office covered by a business-related insurance policy.
9. Employee properly claims a deduction for home office expenses for federal income tax purposes.
10. Employee is not an officer of the company.

# Multistate Policies – Step 1: Review Policies

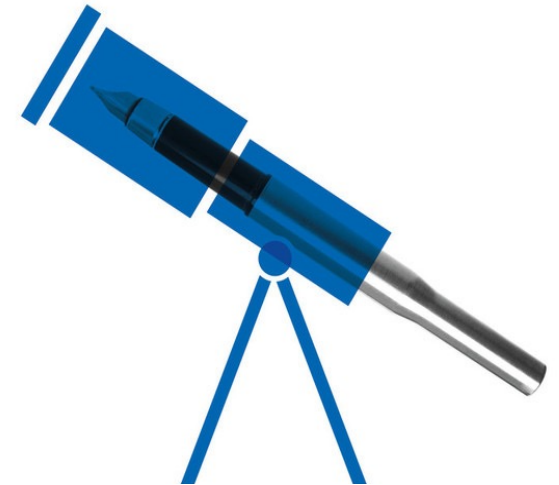
Many companies currently have telework policies, but these probably did not anticipate the widespread remote work now required.

HR/Tax may not currently have reliable information about where employees are located, but other functions may be keeping records.

States can be expected to audit the issue and will be looking for records of compliance, particularly for payroll tax.

# Multistate Policies – Step 2: Review Goals

- Permanent v. Short-Term Teleworking
  - All Employees v. Departments/Business Segments
  - Regional Considerations
- Nexus and Filing Footprint
  - P.L. 86-272 protections?
- Quantification of Risk
- Analyze Feasibility of Options – Business and Tax
- Restrict, Restructure, or Reclassify?





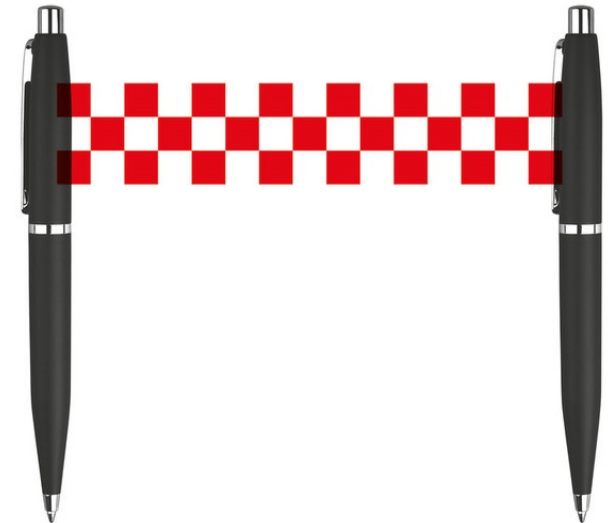
## Multistate Policies – Step 3: Revise or Draft Policies and Other Documents



- Develop teleworking and/or business traveler policies with internal stakeholders, reviewing all employee-facing documents and conducting internal Q&A
- Can an employer manage SALT risk associated with a teleworking employee while maintaining the business' goal incenting telework to attract/retain talent?

# Multistate Policies – Step 4: Implementation (...Seriously)

- License and Registration
- Employer Withholding
- Other Employment Taxes
- C&I Tracking and Compliance
- CNIT Considerations and Compliance
- Coordination with Legal, HR, etc.
- Maintenance, including Frequent Review/  
Best Practices

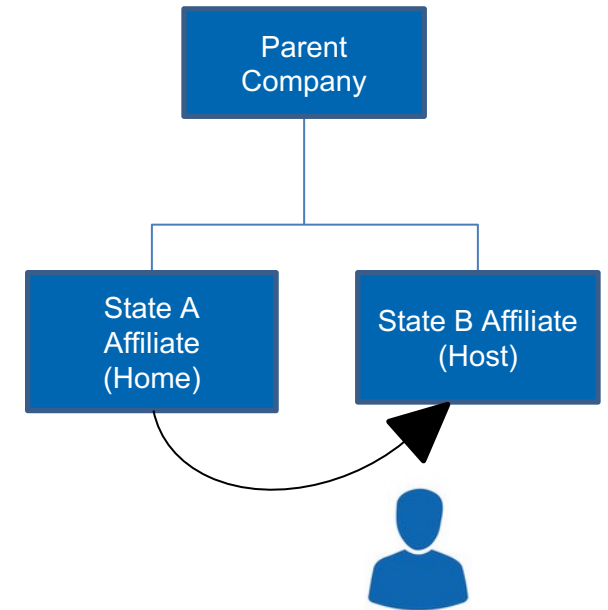


# Prohibit Employees from Teleworking in Certain States

- As part of developing teleworking policies, tax departments should identify state(s) where the presence of an employee would unduly increase tax risk for the employing entity, e.g., non-nexus states, separate reporting states, P.L. 86-272 states, etc.
- Employers may prohibit employees from working in those higher risk states through policies, hiring, and other on-boarding processes.
- Consistency and communication are key!

# Switch to “Local” Payroll – Long-Term WFH Employee

- Employee transfers from the Home payroll to the Host payroll
- Tax compliance issues are undertaken by the Host
- Often driven by SALT compliance in host state (generally not preferable for an entity to file payroll in another state)
- May involve multistate reporting/compliance, (new hire, UI, etc.) intercompany service agreements, and transfer pricing input on whether the employee’s role fits within the functions of the Host



# Pros and Cons of Transfers to Local Payroll

## Pros

Mitigates nexus risk

Administration

## Cons

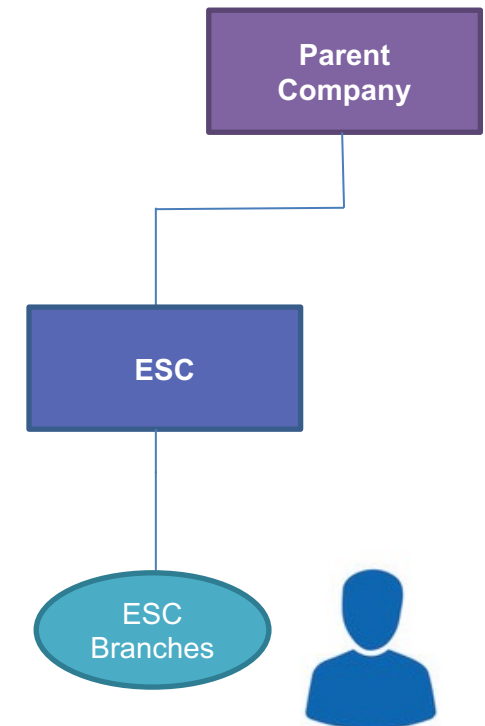
Employee may not maintain “home” benefits and RSUs

Employee salary may be reduced to local COLA

Not flexible or available for short periods

# Employment Services Company (ESC)

- A separate legal entity that provides employee services to other entities in return for a management or service fee
- Generally used as the employer for employees which travel to or may be seconded to out-of-state/multistate entities within the group
- An ESC may fulfill several roles in an organization:
  - Permanent legal employer for mobile employees and/or employees with multistate/global roles
  - Payroll company
  - Temporary or permanent employer for remote workers (multistate and/or global assignees)
  - Administrator for multistate/global assignments
- Primarily useful in separate filing states where parent company has no nexus



# Pros and Cons of ESCs

## Pros

Limits nexus risk, starts statute of limitations

Employee maintains “home” benefits and RSUs

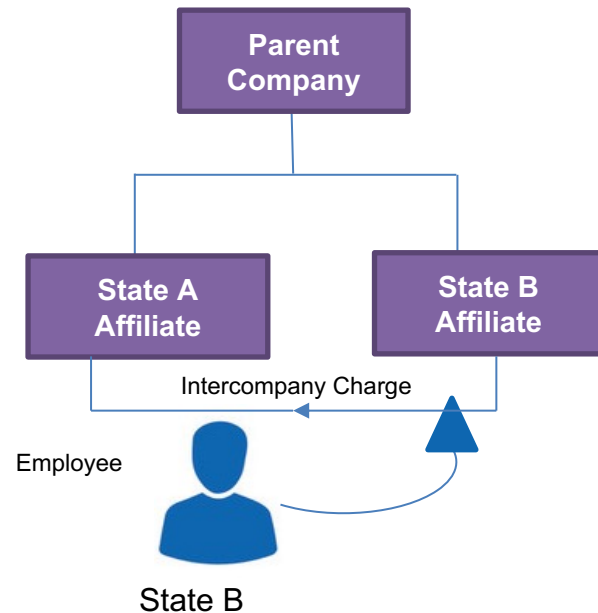
## Cons

Filing requirements and expense in multiple jurisdictions

Complexity in administration

Intercompany payments

# Secondment



- Long term assignment to perform work for a local affiliate but employee wants to retain benefits (not a new hire)
- A “Home” entity enters into an agreement with a “Host” entity whereby an employee will temporarily become the employee of the Host entity while remaining on the payroll of the Home entity
- The Host entity is often, but not always, an affiliate of the Home entity
- The Host entity is responsible for local law compliance
- The Host entity reimburses the Home entity for the labor, typically at cost



# Pros and Cons of Secondment

## Pros

Limits  
nexus/corporate  
income tax  
exposure

Employee  
maintains  
benefits and  
RSUs

## Cons

May be  
scrutinized in  
some separate  
company states

Multiple  
intercompany  
agreements

Administrative  
burden and  
expense

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# Other State Employment Tax Issues

# State Unemployment Insurance – “Localization”

Localized Service  
(includes “incidental”  
out-of-state service”)

If not Localized, then  
1) Base of Operations  
2) If not 1), then  
Direction and Control

## Important Points:

- “All or nothing” sourcing regime (“localization of work”) is very different from withholding source taxation rules.
- Localization rules generally uniform.
- Application to other state employment taxes (PFL, SDI, and LTC contributions).
- See DOLETA, UIPL Letter No. 20-04; *see also* California (UI) and Massachusetts (PFL) guidance for the Covid-19 period.

If none of the above,  
then  
Employee’s Residence

## Other Considerations:

- Election under Interstate Reciprocal Coverage Agreement
- Election for Voluntary Coverage
- Credits

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