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COVID-19: State Tax Implications of Remote Working Arrangements

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Prior to the coronavirus (COVID-19) pandemic, many state taxing authorities asserted that a business could become subject to their states' tax obligations by having a single employee working from within the states, even if there were no other connections between the business and those states. As a result, some states tried to force such businesses to comply with employer withholding obligations, to pay income, franchise, gross receipts, or other business taxes and to comply with certain other state tax requirements.

For years, many businesses—especially those in industries with typically mobile workforces or located in geographically smaller states where employees frequently cross jurisdictional boundaries—have carefully monitored the locations where their employees live and work and scrupulously tracked tax reporting and payment obligations. However, as in so many other contexts, the COVID-19 pandemic changed the tax compliance landscape almost overnight.

At the beginning of the pandemic, many businesses were forced to move quickly to a work-from-home model. As a result, many employees began working from states other than where their assigned offices were located. In response to concerns and questions raised by many employers, some states announced relief from certain tax obligations ordinarily imposed on a business whose employees work in those states. With so many other concerns on their plates, employers have generally welcomed this relief from additional tax compliance burdens while the pandemic has dragged on. However, businesses are beginning to ask new questions about how long the states' relief measures will remain effective.

Additionally, as many employers consider adopting longer-term (or even permanent) work-from-home or work-from-anywhere policies, businesses are beginning to ask how nexus determinations will evolve over the coming months and years and whether Congress may take decisive action to simplify compliance with related state and local tax obligations.

Businesses should pay careful attention to guidance published by states in which they have employees working away from their traditional offices to determine whether the employees' presence at their remote worksites may establish nexus and employer withholding obligations for the business.

NEXUS

Many U.S. states assert that an employee working from home within those states gives the employer "nexus" with the states for tax purposes, even if the employer does not have a facility or own property in the states. If a business has nexus with such a state, the business may be obligated to pay that state's franchise, income, or other business tax, to collect and remit sales or use tax on taxable sales that the business makes into the state, to remit payroll taxes to the state, and to comply with other tax payment or reporting requirements in the state.

States have varied in their approaches to nexus relief in response to the COVID-19 pandemic. Some states have indicated that nexus for purposes of corporate income tax, and sales and use tax will not be established solely based on employees working remotely due to the pandemic.[1] However, certain states have limited such nexus relief only to corporate income tax or franchise tax.[2] Further, at least one state, Kentucky, announced that it would consider the potential nexus impacts of taxpayers' work-from-home arrangements on a case-by-case basis.[3] Many other states have not yet published guidance on this issue and thus may not intend to deviate from their ordinary nexus interpretations during the pandemic. Businesses should be mindful of nexus guidance published by states in which they have employees working remotely, as a shift in employees' work locations could create nexus for the employer.[4]

EMPLOYER WITHHOLDING OBLIGATIONS

Many states that impose a personal income tax require an employer to withhold from an in-state employee's paycheck the amount of personal income tax the employee is expected to owe. In response to remote working arrangements adopted (or necessitated) as a result of the pandemic, many states have chosen not to enforce employer withholding requirements if the only reason the employer would be subject to such requirements is an employee's working at home as a result of the pandemic. For example, certain states have announced that employers should continue withholding as if the employee had continued to work at the employer's location during the pandemic, even if withholding guidance applicable prior to the pandemic would not have required withholding.[5]

As with nexus, not all states have published guidance to address withholding obligations during the pandemic. In addition, certain states appear to indicate explicitly that they will not deviate from their ordinary employer withholding requirements as a result of the pandemic.[6] Businesses should monitor such guidance in the states in which a withholding requirement could be triggered; it is possible that the state where an employer's facility is located could continue to require withholding with respect to employees who are not currently working in the office, while the state where an employee lives could also impose a new withholding requirement on the employer.

DURATION OF RELIEF

Like the nature of the tax relief states have announced in response to the pandemic, the duration of any such tax relief varies among the states. Some states limit temporary tax relief to work-from-home arrangements necessitated by government lockdown orders or pursuant to the order of a physician.[7] Other states have announced timeframes during which temporary relief applies, such as specifying that relief will remain in effect until a certain date or indicating that relief will remain in effect so long as an executive order pertaining to the pandemic remains in effect.[8] At least one state, Massachusetts, has indicated that its tax relief measures will continue until the earlier of 31 December 2020 or 90 days after the state of emergency in Massachusetts has been lifted.[9] Certain other states appear to take a broader approach by generally permitting relief related to remote working due to the pandemic without further defining what "due to the pandemic" means or how long it will last.[10]

POSSIBLE CONGRESSIONAL INTERVENTION

For over a decade, businesses and tax practitioners have been advocating for a simplified, uniform approach to the many compliance challenges facing employers with increasingly mobile workforces. The Mobile Workforce State Income Tax Simplification Act of 2019 (the Mobile Workforce Act) is one example of such an effort that has garnered significant bipartisan support.[11] In general, the Mobile Workforce Act would require an employer to withhold personal income tax from an employee's wages only in (1) the state of the employee's residence, and (2) any state in which the employee performs duties for greater than 30 days during a calendar year.[12] Under the Mobile Workforce Act's provisions, an employer is entitled in many circumstances to rely on an employee's annual determination of the time the employee expects to spend performing work duties in a state.[13]

In June, the Remote and Mobile Worker Relief Act of 2020 was introduced with modifications meant to address the unique challenges facing employers during the COVID-19 pandemic.[14] These modifications include the establishment of a "covered period" commencing on the date an employee began working remotely due to the pandemic and ending on the earlier of 31 December 2020 or the date on which the employer allows at least 90 percent of its workforce (including the subject employee) to return to work at the employee's ordinary location.[15] During this covered period, wages earned by the employee are deemed to have been earned at the ordinary work location unless the employer maintains a daily location tracking system and elects to treat such wages as having been earned where duties were performed.[16] The pandemic-specific provisions also make clear that no out-of-state business will be deemed to have established nexus with a jurisdiction solely because its employee performs duties from somewhere other than the ordinary work location.[17]

Although these bills have been proposed on a bipartisan basis, broader Congressional support is mixed, in large part depending on whether a member's state or district would be a winner or a loser in its ability to collect revenues. For example, states and cities with a high number of commuters and business travelers coming to work each day—such as New York City, home of powerful Senate Minority Leader Charles Schumer—may not want to relinquish their tax base if fewer commuters come to work at their ordinary office locations, especially when budgets are strapped due to pandemic-related expenditures and reduced revenue streams. Similarly, states and cities with bedroom communities could gain considerable revenue if their working-from-home residents were taxed based on where they live, as opposed to the location of their employer or assigned office.

Given the disparate revenue impacts on states and cities, the political rancor in Congress over the need for additional COVID-19 relief, and the fact that a hotly contested election is only weeks away, the chances of legislation to provide consistency and certainty on the remote workforce issue in this Congress seem equally as remote. However, if working at home and virtual meetings retain the toehold they have gained even after the pandemic has passed, the revenue impacts of jurisdictions' current policies will become even more significant, providing an opening to revisit the issue in the new Congress beginning in 2021.

WHERE THE STATES MAY GO FROM HERE

Despite their differing approaches to reopening for business, many state taxing agencies would agree that they did not foresee at the outset how long the pandemic would drag on or that job losses, shutdowns, and the resulting decrease in retail spending would have depressed tax revenues. As businesses consider their post-pandemic work policies, it is important to keep in mind that the states will not necessarily remain patient and accommodating in their nexus, employer withholding, and other tax determinations. After the pandemic has subsided, the pressure of projected budget shortfalls could prompt some states to seek additional sources of revenue by taking aggressive positions in response to work-from-home and work-from-anywhere policies. Further, certain state taxing authorities have published tax relief related to work-from-home informally and could later try to revoke such guidance.

Footnotes

1 See, e.g., TIR-20-10: Revised Guidance on the Massachusetts Tax Implications of an Employee Working Remotely due to the COVID-19 Pandemic, Mass. Dep't of Rev., July 21, 2020; ADV 2020-24: Division Addresses Questions Involving Nexus and Apportionment, R.I. Dep't of Rev., Div. of Tax., May 28, 2020; S.C. Info. Letter #20-11, S.C. Dep't of Rev., May 15, 2020; S.C. Info. Letter #20-24, S.C. Dep't of Rev., Aug. 26, 2020; Telecommuter COVID-19 Employer and Employee FAQ, N.J. Div. of Tax., May 27, 2020; Tele-Commuting and Corporate Nexus, N.J. Div. of Tax., Mar. 31, 2020.

2 See, e.g., COVID-19 Frequently Asked Questions, Iowa Dep't of Rev., May 15, 2020; Oregon COVID-19 Tax Relief Options, Ore. Dep't of Rev., July 28, 2020; COVID-19 Tax Guidance, N.D. Office of State Tax Commissioner, Apr. 15, 2020; COVID-19 Frequently Asked Questions for Tax Relief and Assistance, Cal. Franchise Tax Board, Sept. 11, 2020 (stating that California will not treat a corporation that had no previous connections with California as "doing business" when an employee is teleworking in California in response to the governor's executive order); OTR Tax Notice 2020-05 COVID-19 Emergency Income and Franchise Tax Nexus, D.C. Office of Tax and Rev., Apr. 10, 2020.

3 See Frequently Asked Questions, Ky. Dep't of Rev., July 16, 2020; see also Tax Alert 05-04-20, Comptroller of Md. (indicating that the Maryland Comptroller's Office will continue to review and consider the specific facts and circumstances of each taxpayer in order to make a fair determination with respect to nexus and income sourcing, but will recognize the temporary nature of a taxpayer's pandemic-related workplace changes, and generally will not use such temporary measures to impose business nexus, to alter the sourcing of business income or to impose additional withholding requirements).

4 Businesses should also consider how work-from-home policies may impact state income tax apportionment calculations, especially in states that apportion based on a payroll factor. Certain states have indicated that an employee's working at home as a result of the pandemic will not affect the employer's apportionment calculation. See, e.g., Ala. Dep't of Rev. Coronavirus (COVID-19) Updates, Ala. Dep't of Rev., May 12, 2020 (indicating temporary telework requirements due to the pandemic will not alter apportionment of income); TIR-20-10: Revised Guidance on the Massachusetts Tax Implications of an Employee Working Remotely due to the COVID-19 Pandemic,

Mass. Dep't of Rev., July 21, 2020 (indicating that, for apportionment purposes, services performed by an employee working remotely in Massachusetts solely as a result of the pandemic will not increase the employer's payroll factor and the presence in Massachusetts of business property reasonably needed for such employee's use while working remotely will not increase the employer's property factor).

5 See, e.g., Telecommuter COVID-19 Employer and Employee FAQ, N.J. Div. of Tax., May 27, 2020 (indicating that wage income will continue to be sourced as determined by the employer in accordance with the employer's jurisdiction during the temporary period of the COVID-19 pandemic even though typically income is sourced based on where the service or employment is performed); TIR-20-10: Revised Guidance on the Massachusetts Tax Implications of an Employee Working Remotely due to the COVID-19 Pandemic, Mass. Dep't of Rev., July 21, 2020 (indicating that all compensation received for services performed by a nonresident who, immediately prior to the Massachusetts COVID-19 state of emergency was an employee engaged in performing such services and who began performing services from a location outside Massachusetts due to a pandemic-related circumstance, will continue to be treated as Massachusetts source income subject to personal income tax withholding).

6 See, e.g., COVID-19 Frequently Asked Questions, Iowa Dep't of Rev., May 15, 2020; COVID-19 Tax Relief; Frequently Asked Questions, Ky. Dep't of Rev., July 16, 2020.

7 See, e.g., Coronavirus Tax Relief FAQs, Ga. Dep't of Rev., May 6, 2020.

8 See, e.g., S.C. Info. Letter #20-11, S.C. Dep't of Rev., May 15, 2020; see also S.C. Info. Letter #20-24, S.C. Dep't of Rev., Aug. 26, 2020 (indicating initially that such relief was applicable from 13 March 2020 through 20 September 2020 but extending the relief until 31 December 2020); COVID-19 Frequently Asked Questions for Tax Relief and Assistance, Cal. Franchise Tax Board, Sept. 11, 2020 (indicating that relief is applicable until the govenor's Executive Order N-33-20 is no longer in effect).

9 See TIR-20-10: Revised Guidance on the Massachusetts Tax Implications of an Employee Working Remotely due to the COVID-19 Pandemic, Mass. Dep't of Rev., July 21, 2020.

10 See, e.g., Ala Dep't of Rev. Coronavirus (COVID-19) Updates, Ala. Dep't of Rev., May 12, 2020.

11 See Mobile Workforce State Income Tax Simplification Act of 2019, S. 604, 116th Cong. (1st Sess. 2019); see also Mobile Workforce State Income Tax Simplification Act of 2019, H.R. 4796, 116th Cong. (1st Sess. 2019). Bills that address remote working in the Second Session include (i) Mobile Workforce State Income Tax Simplification Act of 2020, H.R. 5674, 116th Cong. (2d Sess. 2020); (ii) Remote and Mobile Worker Relief Act of 2020, S. 3995, 116th Cong. (2d Sess. 2020); (iii) Remote Worker Relief Act of 2020, H.R. 8056, 116th Cong. (2d Sess. 2020); and (iv) American Workers, Families, and Employers Assistance Act, S. 4318, 116th Cong. § 403 (2d Sess. 2020).

12 See S. 604, 116th Cong. § 2 (1st Sess. 2019).

13 See id.

14 See S. 3995, 116th Cong. (2d Sess. 2020). This bill's original co-sponsors include Republican Senator John Thune and Democrat Senator Sherrod Brown.

15 See id. at § 3.

16 See id.

17 See id.

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