March 15, 2022

Generations Winter 2022 - Application of New York's 'Convenience of the Employer' Rule in Times of COVID-19

Dealing with the pandemic has been a challenge for everyone, yet at this point, many people have worked out the complexities of working from home, a hotel room, a vacation home or Mom's house. Many are resigned to working outside the office, while others view it as a much more preferable way to work. From the tax law point of view, one immediate consequence of this development is the technical issue of how to properly report and apportion wages or income among the states or local taxing jurisdictions in which people work or are located, particularly where people are working temporarily or permanently in a state different from the state in which their employer is located. A formerly simple issue has become complicated by the continued enforcement of antiquated laws that were intended for a different day.

In most states, the sourcing of a nonresident employee's compensation or wage income is based on the employee's location or physical presence for that workday. Generally, a ratio or fraction is applied to apportion a worker's income among those jurisdictions in which he or she was physically located during the year. The numerator of the fraction is the number of days worked in the particular state and the denominator is the total number of days worked everywhere. In defining a workday, most states take the position that a day or part of a day spent in New York on company business constitutes a full day worked in New York. But what about remote work? What if the worker is working from his or her home, vacation home, a hotel room or parents' house in another state? How does the tax law allocate income in those situations?

The simple answer is that most states apply a physical presence rule. Thus, if a worker was physically present working in a state, that day would be treated as a day worked in that state, even if the day was worked in the employee's home. A handful of states, including New York, do this allocation differently. Those states essentially source days worked at home back to the state where the employer's office is located. The rule in these states, called the "convenience of the employer rule," requires that an employee's compensation will be sourced back to his or her office location under the theory that the days worked outside the office are done so out of convenience to the employer and, so, are treated as days worked by the employee at his or her office location. Basically, the rule says that if an employee works from home for his or her own convenience, and not because of any requirement of the employer, those days worked at home will be treated as days worked at the employee's assigned work location.

Over the years, this doctrine has become an infamous aspect of New York tax law. Yet Arkansas, Connecticut, Delaware, Nebraska and Pennsylvania, in addition to certain municipalities, have also come to apply the convenience rule. This rule continues to generate significant controversy in New York and elsewhere. The merits of the convenience rule have been litigated all the way up to New York's highest court, with the New York State Department of Taxation and Finance almost always coming out on top. However, the issue now arises as to whether the pandemic and our "new normal" work environment, including the various shelter-at-home edicts imposed during the past two years, may now give taxpayers additional leverage to argue the fundamental unfairness and unconstitutionality of the rule.

In one case that arose in the 1990s, a professor at Cardozo Law School in New York City taught in New York three days per workweek and worked from his home in Connecticut the other two days. The professor apportioned the percentage of his salary reflecting the number of days he commuted to the law school to New York and allocated the remainder to Connecticut. However, the New York State Department of Taxation and Finance maintained that the professor's entire salary was subject to New York tax because he chose to work at home merely for his own convenience. The professor contested the assessment on constitutional grounds, but an administrative law judge rejected his challenge, as did the Tax Appeals Tribunal, the Appellate Division and the New York Court of Appeals, the state's highest court.

In upholding the tax, the Court of Appeals held that the convenience test did not unfairly burden commerce or discriminate against commerce. Rather, the court held that the rule serves to prevent nonresidents from manipulating their New York tax liability in a way that residents could not. The court further responded that even if double taxation did result, that alone did not serve to invalidate the tax because the New York tax was fairly apportioned and the Commerce Clause does not protect residents from their own state taxes. The court further held that the tax did not violate the Due Process Clause because the professor had a minimum connection with New York through his employment there.

More recently, the same professor has reprised his case, but this time invoking the new realities of the COVID-19 environment as a further challenge to New York's law. That case currently is in litigation and we shall see whether the New York courts' view on the issue has changed in light of dramatically changed circumstances.

In another case in New York, from 2005, the Court of Appeals held that New York could apply its convenience of the employer rule to tax a Tennessee telecommuter on 100 percent of his income even though he earned only 25 percent of that income in New York. The taxpayer, Thomas Huckaby, was a Tennessee resident working for a New York company. Huckaby and his employer agreed that he could continue to work from Tennessee, traveling to New York only as needed. For the two relevant tax years, Huckaby filed New York nonresident income tax returns, allocating his income between Tennessee and New York based on the number of days he spent working in each state. Because he spent a quarter of his time in New York, he paid taxes to New York on a quarter of his income. However, under the convenience of the employer rule, New York's Department of Taxation and Finance disallowed Huckaby's allocation and taxed him on his entire income, including the 75 percent he earned in Tennessee.

The taxpayer challenged the department's position, arguing that New York's application of the convenience rule violated his Due Process and Equal Protection rights under the U.S. Constitution as well as New York's statute. Although the Court of Appeals' decision was split, the majority thought that applying the convenience rule complied with both the Constitution and the New York statute.

To help better define the issue, in 2006 New York came out with a safe harbor rule for determining what would constitute a bona fide office allowing an employee to source his or her income to a home or other remote office. The determination under this rule as to what constitutes a bona fide office is based on an array of factors. Unfortunately, the factors are quite difficult to meet, so taxpayers seldom have any success with this safe harbor.

Today, one might rightly ask whether the new remote work environment brought about by COVID-19 changes anything. Although the logical answer should be "yes," unfortunately, at least in New York, the answer is still "no," even in situations where employees work from home pursuant to shelter-at-home rules in their home state.

Some states have come out with different guidance to provide relief to taxpayers who are working remotely, but New York continues to cling to its traditional approach. One bright spot is New Jersey, which has so far "tolerated" New York's convenience rule and offers a credit to New Jersey residents who pay tax to New York under that rule.

The United States Congress has also been considering the issue. Under a proposal made some years ago, a state's ability to tax a nonresident would extend only to days when the employee was physically present in the state. That proposal was not passed into law, and with all that is going on in Washington these days, there is little reason to believe it will see the light of day anytime soon.

Would you like to receive our *Day Pitney Generations Newsletter?* Sign up here.

Day Pitney Generations Newsletter - Winter 2022 (pdf)

Authors

R. Scott Beach

Partner

Greenwich, CT | (203) 862-7824

Stamford, CT | (203) 977-7336

rsbeach@daypitney.com