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UPDATE: Increased Telecommuting Raises State Tax Issues

Introduction

The COVID-19 outbreak continues to affect the work life of most Americans. As federal, state and local governments continue to impose quarantines, business closures and travel bans to address the outbreak, the number of employees working remotely has remained high. An employee's presence can create a nexus between the business of the employee and the state in which the employee is present. A business is subject to a state's tax laws when it has a constitutionally sufficient nexus with the state. Employees who are telecommuting during this time and the businesses they work for continue to be vulnerable to a number of state tax issues they may never have considered.

Since our last article, "Increased Telecommuting Raises State Tax Issues," many states adopted measures clarifying whether state governments will assert their taxing power on telecommuters and their employers, provide relief from state tax complications for telecommuters and their employers, or a combination of both. A few states have continued to remain silent. This article provides an update on the measures that states and districts within this firm's footprint have adopted.

Recent Developments

Connecticut

Connecticut has not released clear guidance addressing state tax issues during the COVID-19 emergency. No temporary policies have been adopted to address the creation of a sales and use tax nexus or a corporate tax nexus solely because an employee works in the state during the pandemic.

Connecticut has not stayed silent about issues regarding income-sourcing rules. Connecticut employs a version of the "convenience of the employer" rule. The basic rule, used by states including New York, allocates compensation earned by a nonresident employee to the location of the office of the employer unless the work is done in a different state due to employer "necessity." This affects both the personal income tax of the employees and the withholding obligations of the employers. Connecticut, unlike other states with the rule, only applies its state tax if the employee in question resides in a state that also uses the convenience of the employer rule. This is sometimes referred to as a "reciprocal convenience of the employer rule."

Connecticut has joined other states by filing an amicus brief in support of New Hampshire's lawsuit, which was spurred on by Massachusetts' COVID-19 state tax guidance, discussed below, stating Connecticut's willingness to adjust its own convenience of the employer rule if rules such as those promulgated by Massachusetts and New York are struck down as unconstitutional.

District of Columbia

On April 10, 2020, the District of Columbia promulgated OTR Tax Notice 2020-05,[1] which announced that the district will not impose a corporation franchise tax or unincorporated business franchise tax on a business solely because employees are telecommuting to work from the district or solely because company property is used to allow employees to work from home in the district. This protection is only available if the employees are working in the district temporarily because of the declared public health emergency. Notably, the District of Columbia has not mentioned any relief for the creation of a sales and use tax nexus.

The District of Columbia announced it would extend this relief until after the mayor declares an end to the emergency.

Massachusetts

On December 8, 2020, Massachusetts extended its guidance on the tax implications of remote working by issuing Technical Information Release 20-15 (TIR 20-15).[2] In Massachusetts, the presence of one or more employees working remotely or the presence of business property reasonably needed to work remotely because of COVID-19 will not by itself (i) create a withholding obligation with respect to such employees, (ii) subject a business to sales and use tax or (iii) subject a business to corporate excise tax. TIR 20-15 also emphasizes the obligation to maintain written records to substantiate the existence of a "pandemic-related circumstance" that has caused the employee to begin telecommuting; such written records could include a copy of the business's quarantine policy.

On December 8, 2020, Massachusetts issued updates on an emergency regulation, which was originally passed on April 21, 2020, regarding income-sourcing rules.[3] The emergency regulation declares that all compensation received for services performed by a nonresident who immediately prior to the COVID-19 emergency was an employee engaged in performing such services in Massachusetts and who began performing them outside Massachusetts due to a pandemic-related circumstance will continue to be treated as Massachusetts source income subject to personal income withholding. This approach is similar to the somewhat controversial convenience of the employer test adopted by New York and several other states. The regulation does provide that a Massachusetts resident working within the state solely because of the ongoing emergency who continues to incur income tax liability from another state will be eligible for a tax credit for taxes paid to the other state. Additionally, the employer will not be obligated to withhold Massachusetts income tax for the employee if the employer is obligated to withhold income tax for that employee in another state.

While Massachusetts has protected its own citizens from double taxation, as with the convenience of the employer test in other states, this Massachusetts guidance could lead to double taxation for nonresidents whose states do not provide an income tax credit for the Massachusetts tax paid and for taxation that would otherwise not exist for nonresidents whose state does not impose an income tax. New Hampshire, a border state of Massachusetts that does not collect personal income tax, has filed a lawsuit in the United States Supreme Court claiming this rule violates the United States Constitution. New Hampshire argues there is not a constitutionally sufficient nexus for Massachusetts to tax a New Hampshire resident who works from home in New Hampshire. The Supreme Court has not decided whether to take the case, but states including Connecticut and New Jersey have filed amicus briefs in support of New Hampshire's claim.

The relief provided by TIR 20-15 and the modification of income-sourcing rules caused by the emergency regulation remain in effect until 90 days after the state of emergency in Massachusetts is lifted.

New Jersey

On March 30, 2020, New Jersey issued guidance providing that if an employee is working in the state due to the COVID-19 emergency, the state will temporarily waive the threshold that treats the presence of an employee as sufficient nexus in order for it to impose its corporate tax on out-of-state corporations.[4] We previously emphasized the New Jersey case *Telebright Corp. v. Director, Division of Taxation*, 25 N.J. 333 (2010), which held that a single employee working from home in New Jersey creates sufficient nexus to subject an out-of-state corporation to New Jersey corporate tax. The New Jersey Division of Taxation's nexus relief is limited to telecommuting caused by COVID-19 and is not intended to change the Division of Taxation's position in the *Telebright Corp.* case. On May 6, 2020, New Jersey expanded on this nexus relief by temporarily waiving the sales tax nexus standard that can be met if an employer has an employee working from the state.[5] This sales tax relief is only available if the business has no other physical presence in the state and does not meet the economic threshold necessary to establish a sales tax nexus without physical presence.

New Jersey typically sources income depending on where the service or employment is performed based on a day's method of allocation. However, the guidance issued on May 6 provides that during the ongoing emergency, wage income will be sourced in accordance with the laws of the employer's jurisdiction. Therefore, New Jersey will not attempt to tax the income earned by an employee telecommuting from New Jersey; rather, the income will be taxed in accordance with the employer's

state rules. The temporary relief also extends to withholding tax. This means employers do not need to change their payroll systems and can continue to withhold income tax in the state where the employer is located, even if an employee is temporarily telecommuting from New Jersey.

New York

As it did prior to the COVID-19 emergency, New York employs the convenience of the employer rule described above. Until recently, no state with a convenience of the employer rule issued extensive guidance, and the forced closing of business offices was believed to possibly qualify as employer necessity. However, on October 19, 2020, the Department of Taxation and Finance for New York released guidance suggesting that for nonresidents with a primary office in New York, days telecommuting during the COVID-19 emergency will be considered days worked in the state of New York unless the employer established a bona fide employer office in the state from which the employee is telecommuting.[6] This guidance is contrary to the predictions regarding how the convenience of the employer rule would be applied during the COVID-19 emergency, and it could cause double taxation if states do not offer a tax credit to offset this tax during the ongoing emergency.

Looking Forward

More than nine months into the COVID-19 emergency, some states have not provided clear guidance on the state tax issues that arose as a result of increased telecommuting, and even the states that have released guidance have failed to address all relevant issues. COVID-19 continues to raise questions regarding nexus, income sourcing, withholding obligations and employment taxes. For more information, please contact the attorneys at Day Pitney.

For more Day Pitney alerts and articles related to the impact of COVID-19, as well as information from other reliable sources, please visit our COVID-19 Resource Center.

COVID-19 DISCLAIMER: As you are aware, as a result of the COVID-19 pandemic, things are changing quickly and the effect, enforceability and interpretation of laws may be affected by future events. The material set forth in this document is not an unequivocal statement of law, but instead represents our best interpretation of where things stand as of the date of first publication. We have not attempted to address the potential impacts of all local, state and federal orders that may have been issued in response to the COVID-19 pandemic.

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[1] Dist. of Columbia Office of Tax and Revenue, Notice 2020-05 (Apr. 10, 2020).

[2] Mass. Dep't. of Revenue, Tech. Info. Release No. 20-15: Revised Guidance on the Massachusetts Tax Implications of an Employee Working Remotely Due to the COVID-19 Pandemic (Dec. 8, 2020).

[3] Emergency Regulation 830 Mass. Code Reg. 62.5A.3.

[4] N.J. Treasury, Div. of Taxation, Tele-commuting and Nexus (Mar. 30, 2020).

[5] N.J. Treasury, Div. of Taxation, Telecommuter COVID-19 Employer and Employee FAQ (May 6, 2020).

[6] N.Y. Dep't. of Tax & Finance, Frequently Asked Questions about Filing Requirements, Residency, and Telecommuting for New York State Personal Income Tax (updated Oct. 19, 2020).

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