

Pandemic Planning: What Should Businesses with Remote Employees Know About State Taxes?

October 14, 2020

With states of emergency and telecommuting stretching through more than half of 2020, businesses are facing serious concerns about state taxes. Below are some of the more significant factors businesses need to consider as they evaluate their state tax footprint for 2020 and beyond. Also discussed are recommended actions companies should adopt to help navigate their state tax compliance obligations. Uncertainty over state tax positions persists as the authorities continue to assess their fiscal responses to the pandemic. However, taxpayers should proactively prepare for whenever guidance is ultimately provided.

State Tax Considerations

Wage Tax Withholding

In general, employers are charged with withholding federal and state income taxes from their employees' wages. Absent a reciprocity agreement, such state taxes are withheld to the state of the employees' work location. However, many employees are currently sheltering in different states than their work state. This raises the question as to which state an employer is obligated to withhold employment taxes. Some states have announced temporary modifications to their sourcing rules to permit employers and employees to use the same methodology as was used prior to the COVID-19 pandemic, but most tax authorities have not yet provided any guidance on the topic.

The fact that no state guidance has been issued on whether workplace disruptions will alter "convenience of the employer" rules adds further complications to these already unclear standards. These "convenience of the employer" laws, present in a small number of states including New York and Connecticut, require an employer to source a telecommuting employee's income to the state in which the employer is

located, not where the employee is actually rendering the services. For those telecommuting from a state other than their working state, the rule requires payroll withholding remittance to their work state and not the state where they are presently sheltering.

Nexus

A basic tenet of state taxation is that having the presence of an employee in a particular jurisdiction gives rise to nexus, which is the constitutional standard needed for a state to impose tax on a business. It now must be considered whether employees under stay-at-home orders will establish state nexus for a company. To date, a few states, including Massachusetts, New Jersey and Pennsylvania, have announced temporary nexus amendments that will not subject entities to state taxation because of the presence of an at-home employee necessitated by the COVID-19 pandemic.

Similar to income tax, sales and use tax and franchise tax, nexus is established through in-state physical presence. For the aforementioned taxes, even fewer states have addressed the potential for nexus exposure. This is particularly troubling for sales tax purposes, because of the near impossibility of a business retroactively charging customers sales tax on transactions that occurred during the stay-at-home order, all while the business did not contemplate its jurisdictional nexus as a result of the sheltering employee.

Apportionment

It is largely unclear if, or how, states may alter their apportionment formulas in response to COVID-19. For states that employ property and payroll factors into their apportionment formula, an employee's location change can create a significant impact on the company's income apportionment. Furthermore, in states that use cost of performance sourcing rules for service revenue, an employee working from home could likewise drastically modify a business' state apportionment. Even for companies projecting a net loss for the year, apportionment is a significant issue, as the losses that are accrued to the various states may be eligible for net operating losses depending on where they are sourced.

Plans of Action

Employment Location Records

Employers with employees who are temporarily telecommuting from a state other than that in which they typically work should track their locations and the numbers of days the employees work in that jurisdiction. This information will assist in determining whether the employer has withheld and remitted taxes to the appropriate authorities. This data is also critical for nexus evaluations and apportionment computations.

Tracking Withholding and Sourcing Obligations

Companies whose employees are temporarily working in different states should take care to understand the wage sourcing rules and related withholding obligations of both the state in which the employees normally work and those of the temporary work jurisdictions. Each state may impose withholding obligations on a different basis. Additionally, as mentioned above, several states have “convenience of the employer” rules that add further complexity to the matter. Finally, certain neighboring states have reciprocal withholding agreements that may nullify a possible sourcing and withholding dilemma.

Reevaluation of Obligations

As states-of-emergency and travel disruptions subside, many of the temporary relief measures provided by state governments will expire. Nevertheless, employees may be able to continue working remotely for extended periods as employers develop return-to-work and telecommuting policies. Businesses therefore need to evaluate their withholding obligations, as well as their nexus and apportionment exposure in those states where employees are teleworking as these relief policies expire.

As the workplace and the world change due to COVID, it is important to consider the effect on your taxes. The changes may result in additional compliance efforts, but can also provide opportunities for tax savings. If you have any questions about your company’s withholding requirements, nexus or apportionment exposure, reach out to Alan Goldenberg, Anchin’s State and Local Tax (SALT) Leader, or your Anchin

Relationship Partner for more information.