State and Local Tax: Telecommuting

Remote Employees’ Personal Taxes

Withholding involves deducting income and payroll taxes from employees’ compensation. Generally, workers owe taxes to the state from which they work regardless of the employer’s location. Exceptions include:

- **Reciprocity agreements:** wages are sourced to the employees’ resident state (Ex: New Jersey and Pennsylvania)
- **“Convenience of the Employer” Rules:** wages and compensation are sourced to the employee’s assigned work location regardless of where they are actually working. (Ex: New York, New Jersey, Pennsylvania, Delaware, and Connecticut)

If an employee was working in a state other than their work state and is telecommuting from home, changes in withholding obligations vary by state.

Statutory residency and **domicile** can be significantly impacted by telecommuting and remote work options.

- **Statutory Residency** considers the time spent in-state based on the number of days (varies by state) and one’s permanent place of abode.
- **Domicile** is the location where one intends to maintain their permanent, primary home. A change in domicile considers many factors, evidencing both a physical and emotional relocation and re-establishment of one’s lifestyle elsewhere.
- **Dual residency** is a problematic situation that can result in tax obligations to two states, as one can be a domiciliary of one state and a statutory resident of another.

Nexus

Nexus is a “connection” between a taxing state and a business, and is the constitutional standard required for a state to impose its tax regime on a business.

Income Tax

- Businesses with a physical presence in a state are likely to have nexus with the state for income tax purposes.

- Best practices for businesses with telecommuters:
  - Track employees’ movement to the extent possible
  - Develop a plan to address working from new jurisdictions
  - Employers need to remain in communication with employees regarding work location as this can result in many tax implications
  - Determine if the remote work location is temporary
  - Continuously monitor state compliance rules as teleworking becomes more popular
  - Maintain a compliance matrix

- Employees teleworking from a state where the business otherwise does not have nexus may create nexus with that state, creating potential income tax liabilities.

- Employees telecommuting in various states and localities can create nexus for various other taxes:
  - Sales and use tax
  - Gross receipts and net worth taxes
  - Unemployment insurance, registrations, and licensing
  - Payroll taxes

Apportionment is...

The process multi-state entities use to divide taxable income among states. **States lack uniformity in their apportionment formulas and sourcing methodologies.** Types of apportionment formulas:

- Single sales
- Three-factor sales, property, and payroll
- Three-factor with double-weighted sales
  - Include wages and compensation paid to employees teleworking from the state in the payroll factor

Businesses with employees teleworking from different states **may have to adjust apportionment calculations for service revenue sourcing rules.**

- Businesses in states that use market-based sourcing should not see a change in apportionment due to telecommuting.
- Businesses in states with cost of performance sourcing rules will likely see changes that may be favorable or unfavorable depending on the jurisdiction.

A newly remote workforce in cost of performance states will require the sourcing of revenues to those states where the remote workers perform their work, thereby subjecting the business to income taxes in jurisdictions.

Conversely, there is potential for tax savings if the business is located in a cost of performance jurisdiction but remote workers are providing services from elsewhere.

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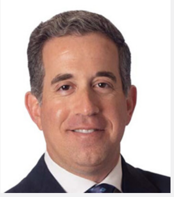

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