

## Tax Penalties for Telecommuting:\*

State Tax Policies that Prevent Both Employees and Employers from Adopting Telework

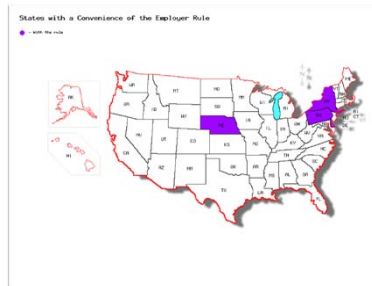
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\*This presentation does not contain legal advice for particular cases. If you are seeking legal advice, please consult with counsel.

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## States With A "Convenience Of The Employer" Rule

- New York
  - 20 NYCRR §132.18(a)
- Delaware
  - Del. Schedule W
- Pennsylvania
  - 61 Pa. Code §109.8
- Nebraska
  - Neb. Admin. Code, Title 316, §22-003.01C(1)



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## New York's "Convenience Of The Employer" Rule

"If a nonresident employee ... performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State...."

20 NYCRR §132.18(a)

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## New York's "Convenience Of The Employer" Rule

".... However, any allowance claimed for days worked outside New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employer...."

20 NYCRR §132.18(a)



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## New York's "Convenience Of The Employer" Rule

- A single day working in New York might be enough to trigger New York taxation on 100% of a nonresident telecommuter's wages
- A telecommuter may be able to escape paying New York taxes on his home state wages if he never comes to New York for work

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## New York's "Convenience Of The Employer" Rule

- The rule puts nonresident telecommuters at risk of double taxation
  - First by the home state
  - A second time by the employer's state



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## New York's "Convenience Of The Employer" Rule

- Some states give a credit to their telecommuting residents to help them avoid double taxation
- Telecommuters living in these states may still be taxed at an unfairly high rate

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## New York's "Employer Necessity" Test Before 2006

Telecommuting was an "employer necessity" only if the nature of the work the telecommuter did at home was such that it could not possibly be done at the employer's New York office

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## New York's "Employer Necessity" Test Before 2006

- Most telecommuters could not pass the pre-2006 "employer necessity" test
- Work that can be done on a telecommuting basis is typically work that can be done anywhere, including a New York office



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## New York's "Employer Necessity" Test After 2006

In May 2006, Department of Taxation and Finance issued new guidance:

TSB-M-06(5)I, available at [www.tax.ny.gov](http://www.tax.ny.gov)

Purports to set forth a "revised position" concerning application of the "convenience of the employer" rule to telecommuters

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## New York's "Employer Necessity" Test After 2006

- Under new guidance, telecommuter must prove two elements
  - Telecommuting days are "normal" work days
  - Telecommuter's home office is a "bona fide employer office"

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## New York's "Employer Necessity" Test After 2006

### Normal work day

"A normal work day means any day that the taxpayer performed the usual duties of his or her job. For this purpose, responding to occasional phone calls or emails, reading professional journals or being *available* if needed does not constitute *performing the usual duties* of his or her job."

TSB-M-06(5)(italics in original)

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## New York's "Employer Necessity" Test After 2006

### Bona fide employer office

"In order for an office to be considered a bona fide employer office, the office must meet either:

- a) the primary factor, **or**
- b) at least 4 of the secondary factors **and** 3 of the other factors."

TSB-M-06(5)I (emphasis in original)

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## New York's "Employer Necessity" Test After 2006

### Primary factor

"The home office contains or is near specialized facilities.

If the employee's duties require the use of special facilities that cannot be made available at the employer's place of business, but those facilities are available at or near the employee's home, then the home office will meet this factor...."

TSB-M-06(5)I

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## New York's "Employer Necessity" Test After 2006

### Secondary factors

1. The employer requires the employee to work from home as a condition of employment
2. The employer has a bona fide business purpose for establishing an office in the precise location where the employee lives
3. The employee performs some of the core duties of his job at his home office

TSB-M-06(5)I

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## New York's "Employer Necessity" Test After 2006

### Secondary factors

4. The employee meets or deals with clients, patients or customers on a regular and continuous basis at his home office
5. The employer does not provide the employee with designated office space or other regular work accommodations at one of its regular places of business

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## New York's "Employer Necessity" Test After 2006

### Secondary factors

6. The employer reimburses the employee for substantially all of the expenses related to the home office; or

The employer pays the employee rent for the home office space and furnishes or reimburses the employee for substantially all the supplies and equipment the employee uses.

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## New York's "Employer Necessity" Test After 2006

### Other factors

1. The employer maintains a separate telephone line and a separate phone listing for the telecommuter's home office
2. The employee's home office address and phone number are listed on the company's letterhead or business cards
3. The employee uses a specific area of his home, separate from the living area, exclusively for work

TSB-M-06(5)I

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## New York's "Employer Necessity" Test After 2006

### Other factors

4. The employer's business is selling products at wholesale or retail, and the employee keeps an inventory of the products or product samples at home to use for work
5. Business records of the employer are stored at the employee's home office
6. The home office location has a sign indicating that it is a place of business of the employer

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## New York's "Employer Necessity" Test After 2006

### Other factors

7. The employer's advertising material shows the employee's home office as one of the employer's places of business
8. The home office is covered by a business insurance policy or by a business rider to the employee's homeowner insurance policy

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## New York's "Employer Necessity" Test After 2006

### Other factors

9. The employee is entitled to and actually claims a deduction for home office expenses for federal income tax purposes
10. The employee is not an officer of the company

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## New York's "Employer Necessity" Test After 2006

Because it can be hard to prove that days spent working at home are "normal work days" and that a home office qualifies as a "bona fide employer office," many telecommuters will not be able to satisfy the new "employer necessity" test

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### Harm The "Convenience Of The Employer" Rule Causes Businesses

- Businesses interested in telework may suffer because the rule:
  - Prevents them from growing a robust telework program and maximizing the economic benefits of telework
  - Creates significant payroll challenges
    - Creates confusion about where to withhold
    - Creates risk of unexpected and unmanageable withholding obligations

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### Harm The "Convenience Of The Employer" Rule Causes Businesses

Both businesses interested in telework and businesses not interested in telework may suffer, because the rule shrinks their nonresident customer base

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## Harm The "Convenience Of The Employer" Rule Causes New York State

- When the rule causes businesses to become less profitable
  - Business income tax revenue can fall
  - Sales tax revenue can fall
- When the rule drives nonresident workers out of New York
  - Personal income tax revenue can fall



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## Harm The "Convenience Of The Employer" Rule Causes Workers' Home States

- States giving a credit to their telecommuting residents for taxes paid under New York's convenience rule
  - Forfeit personal income tax revenue to New York
  - Subsidize public services in New York even though telecommuting residents spend much of their work time in the home state, relying on the home state's services

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## Harm The "Convenience Of The Employer" Rule Causes Workers' Home States

- States where the "convenience of the employer" rule contributes to prolonged unemployment can lose:
  - Personal income tax revenue
  - Sales tax revenue
  - Business income tax revenue

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## Federal Telework Tax Relief Legislation The Multi-State Worker Tax Fairness Act (H.R. 4085)

- Remedial legislation introduced on February 25, 2014 by U.S. Representatives Jim Himes (D-CT), Rosa DeLauro (D-CT) and Elizabeth Esty (D-CT)
- Previously known as the Telecommuter Tax Fairness Act
- H.R. 4085 would eliminate "convenience of the employer" rule and risk of double or excessive taxation for telecommuting
- Under the bill, a state would be barred from
  - Imposing income taxes on compensation nonresidents earn when they are physically present outside the state
  - Forcing nonresidents to pretend they were present in the state simply because they worked at home for convenience
  - Deeming time spent working at home as "not normal work time," "nonworking time" or unpaid time, unless the employer regarded the time that way

## Federal Telework Tax Relief Legislation

- Broad support for legislation in previous Congressional sessions
  - Lawmakers from states across the country
  - Republicans and Democrats
  - Voters from nearly all 50 states (signed a petition)
  - Federal Communications Commission

## Support for Telecommuter Tax Relief

Stakeholders outside government supporting telecommuter tax relief have included **advocates for**

- Telework and other transportation alternatives
- Small businesses
- Taxpayers
- Homeowners
- Flexible work arrangements
- Work/life balance
- Veterans and military spouses
- Disabled Americans
- Family caregivers
- Energy security

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## Telework As Basis For Nexus In New Jersey

- *Telebright Corp. v. Director, Division of Taxation*, 25 N.J. Tax 333 (2010), *aff'd*, 424 N.J. Super. 384 (2012)
  - Software development company in Maryland had employee who relocated to New Jersey for personal reasons
  - Company agreed to let her telecommute full-time, largely at her own expense
  - Company had no other connection to New Jersey
  - Employee wrote software code; had no responsibility for sales
  - Company withheld New Jersey income tax from employee's salary but never filed a New Jersey Corporation Business Tax return
  - New Jersey Division of Taxation: Company was required to file returns because it was "doing business" in New Jersey



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## Telework As A Basis For Nexus In New Jersey

- *Telebright Corp. v. Director, Division of Taxation*, 25 N.J. Tax 333 (2010), *aff'd*, 424 N.J. Super. 384 (2012)
  - Telebright challenged the Division's determination before the New Jersey Tax Court on the grounds that
    - The company was not "doing business" within the meaning of New Jersey's tax law
    - Subjecting the company to tax violated the Due Process Clause and the Commerce Clause of the U.S. Constitution
  - The Tax Court rejected these claims

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## Telework As A Basis For Nexus In New Jersey

*Telebright Corp. v. Director, Division of Taxation*,  
424 N.J. Super. 384 (2012)

Appellate Division upheld the Tax Court decision:

- Telebright had a sufficient connection with New Jersey to satisfy the U.S. Constitution
  - Employee produced computer code for Telebright in New Jersey
  - Employee and Telebright enjoyed legal protections in New Jersey
- Fact that employee worked from home, rather than a company office, is irrelevant for purposes of determining whether the tax satisfies the substantial nexus requirement of the Commerce Clause
- Telebright failed to explain why calculating and paying New Jersey corporation business tax would constitute an undue accounting burden

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## Public Law No. 86-272 15 U.S.C. §381

- Prohibits states from imposing a net income tax on income that a foreign corporation derives within the state as a result of interstate commerce when 3 conditions apply:



1. The corporation's business activity within the state is limited to soliciting orders for sales of tangible personal property
2. The orders are sent outside the state for approval or rejection
3. If the orders are approved, they are filled by shipment or delivery from a place outside the state

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## Telework As A Basis For Nexus In Other States

- 2013 Survey of State Tax Departments

Bloomberg BNA, *Tax Management Multistate Tax Report*,®  
Special Report, vol. 20, no. 4, Apr. 26, 2013

- 38 jurisdictions reported that having 6 or fewer employees who telecommute from their homes in the jurisdiction and who all perform non-solicitation activities would create nexus for an out-of-state corporation
- Approximately 18 states asserted expressly that telework would create nexus in the state even if
  - The company made no sales in the state; or
  - The employees telecommute only part-time

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## Telework As A Basis For Nexus In Other States

- 2013 Survey of State Tax Departments

Bloomberg BNA, *Tax Management Multistate Tax Report*,®  
Special Report, vol. 20, no. 4, Apr. 26, 2013

- 33 jurisdictions reported that a foreign company would have nexus if 1 employee telecommutes from home in the jurisdiction and performs back office administrative functions - like payroll - rather than activities directly related to the employer's business
- 34 jurisdictions reported that a foreign company would have nexus if 1 employee telecommutes from home in the jurisdiction and performs product development functions - like computer coding.

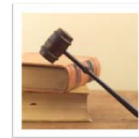
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## Telework As A Basis For Nexus In Other States

- **2013 Survey of State Tax Departments**  
 Bloomberg BNA, *Tax Management Multistate Tax Report*,®  
 Special Report, vol. 20, no. 4, Apr. 26, 2013
- BNA cautions that the states' survey answers "should not be relied upon as definitive policy statements"
- **Companies should**
  - Research how telecommuter's home state will view the particular telework arrangement being considered
  - Learn the law in the telecommuter's home state
  - Learn how the tax department in that state will treat the arrangement



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## Impact Of Treating Telework As A Basis For Nexus

- **Impact of policy on growth of telework**
  - Promotes telework
    - Validates telework as a business practice that benefits employers
    - Implicitly rejects common misperception that telework is an employee perk or accommodation

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## Impact Of Treating Telework As A Basis For Nexus

- **Impact of policy on growth of telework**
  - Deters telework
    - Compels out-of-state companies to refuse to allow telecommuting because of the risk of additional tax exposure
    - Companies may not allow current employees to telecommute
    - Companies may not hire new staff on a telecommuting basis

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## Impact Of Treating Telework As A Basis For Nexus

- **Impact of policy on businesses**
  - Out-of-state companies
    - Nexus policy forces them to limit their telework programs and lose business benefits of scattered workforce
  - In-state companies
    - Nexus policy limits their sales by prolonging the unemployment of jobless residents in the state

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## Impact Of Treating Telework As A Basis For Nexus

- **How policy harms a state imposing the policy**
  - When in-state businesses lose sales, state loses
    - Sales tax
    - Business income tax
  - When state residents suffer prolonged unemployment, state loses
    - Personal income tax

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