

State Tax Observations

Remote Working Is Here to Stay: Is Your Business Ready for Its New State Tax Responsibilities?

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Undoubtedly, the pandemic has impacted how and where we work. Our response to it has left a transformational work-related legacy: Telecommuting. In varying degrees, remote working is rapidly becoming the new normal for many businesses. This seismic shift has far-reaching state tax implications.

With employees working from home or other “remote” locations, businesses – many unaware – have new state withholding tax, unemployment insurance tax, income tax, sales tax, tax registration and other filing obligations. The states are slowly reducing their COVID exceptions to state filing requirements. Further, the states are getting aggressive in finding new payers to tax. Following is a summary of state tax and filing issues that businesses should address.

State Withholding Tax

For a business, state income tax withholding for an employee generally is required in the state where the employee’s services are performed. Also, if an employee works 60% in State A and 40% in State B, withholding should occur in both states at that 60-40 ratio. Of course, each state has its own minimum threshold of wages or days worked in a state before withholding is required. For example, New York uses a 14-day minimum threshold before withholding is required while Illinois applies a 30-day threshold. Employees, however, can claim a resident credit in their home state on taxes paid in nonresident states.

Then it gets complicated. For example, exceptions apply if a specific state does not impose an income tax or a reciprocal agreement exists between the state where the employee works and where the employee resides. For example, New Jersey and Pennsylvania have a reciprocal agreement. Compensation paid to New Jersey residents employed in Pennsylvania is not subject to Pennsylvania income tax. And vice versa.

Further, a handful of states, including New York and (in part) Connecticut, impose a “convenience of the employer” rule. Under the rule in New York, a nonresident employee is subject to New York personal income tax on income earned when the employee is working from the nonresident location, say New Jersey, at the employee’s convenience, rather than as a requirement of the employer. This can result in situations in which the employee is subject to withholding from both the resident and nonresident jurisdictions. It can even result in double taxation where an employee is based in New York but telecommuting from a state such as Colorado. However, there are strategies that businesses can apply to avoid the convenience rule in certain situations.

On the other hand, to ease the burden on companies, many states have provided COVID-19 exceptions to withholding tax requirements for those telecommuting from their state due to COVID-19. New Jersey, Connecticut, Massachusetts and Rhode Island have provided these exceptions. However, in some states, such as Massachusetts, the exceptions are coming to an end. Some states, New York included, never created an exception. Further, at some point, the exceptions will end in all states.

Finally, employers have the burden of staying on top of the issue. They should track where their employees are working, and withhold tax accordingly.

State Unemployment Insurance and Employment-Related Taxes and Filings

With employees working remotely, hand-in-hand with withholding tax responsibilities for a business are duties related to state unemployment insurance, also known as SUI. However, the Department of Labor provides SUI remittance requirement rules that generally follow a hierarchy. Typically, the first criteria on where employers should remit SUI is to the state where the employee primarily works. There is no allocation of SUI, and a different filing obligation than withholding taxes may exist. For example, for an employee working in Florida for a New York-based company, there may be a New York withholding requirement due to the convenience of the employer rule and no requirement in Florida, because Florida is a state without personal income tax. However, there would be a Florida SUI filing responsibility.

Other filing requirements with respect to telecommuting employees may include worker's compensation, disability and new hire state filings.

State Income and Sales Tax

The physical presence of remote workers in a state also triggers nexus for state income, gross receipts, franchise and sales and use taxes. Local taxes such as the Chicago Use Tax, the San Francisco Gross Receipts Tax or the Philadelphia Business Income and Receipts Tax can also be touched off.

As with the withholding rules, some states suspended their nexus requirements in light of COVID-19. However, these exceptions are starting to lapse. Further, businesses should be aware that states have become more sophisticated in identifying a business' nexus-created income and sales tax exposure through state withholding tax filings.

It should be noted that once physical presence nexus exists, whether income tax is triggered requires additional analysis. Public Law 86-272 protects companies from income taxes if employees in a state are merely soliciting for the sale of tangible personal property. Also, it is critical whether or not a state's receipts factor for apportionment purposes uses market (customer)-based or cost-of-performance based sourcing. Further, for flow-through entities (partnerships, LLCs and S Corporations) with nexus in a state, even where such an entity is not subject to income tax – and it could be in certain states – filings, withholdings of income tax, and composite returns may be required of the business for nonresidents.

State Registration and Annual Filing and Other Issues

Businesses should also be aware that in a state where nexus has been created by a new telecommuter, a company will need to register not only with the tax department but with the state's Secretary of State as well. State annual reports will also be required.

Finally, note that this article has not focused on personal income tax issues of domicile and statutory residency issues that could be created when an individual is telecommuting. Nor has it addressed situations for pass-through entity owners in states where nexus for the entity has been established through remote workers. (In such a situation, if income tax becomes significant, pass-through entity taxes should be considered if available.) Tax savings opportunities may exist as well, [such as for an entity required to file the NYC Unincorporated Business Tax](#) – but now with remote workers. Addressing those issues, however, is for another day.

Contact Us

If you have questions or need assistance regarding SALT issues impacted by telecommuting, or state taxes generally, contact your client partner or the following:

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