

## Telecommuting & State Income Taxation During Covid-19

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Telecommuting has become the new “norm” in 2020 as most employees are now working from home due to the Covid-19 pandemic. State sourcing rules vary state-by-state, and telecommuting across state lines, in particular, can cause unexpected income tax results for employees. It is important for employees to be aware of these issues and to keep calendars of their work and non-work day counts.

The purpose of this memo is to provide a brief overview of some of the income tax issues that arise from telecommuting. As more specific guidance is needed, TP&R will issue separate guidance. It is important to consider these issues as employees prepare to make their first and second quarter state estimated payments to any state with a possible claim to tax. While all states have postponed their first quarter estimated payments, only about half of states have postponed second quarter estimated payments, as of the date of this memo.

Throughout this memo, keep in mind that states have the authority to tax either based on residence (domicile or imputed residence) or based on services performed in a given state (i.e., sourcing rules), and telecommuting can impact the analysis in both of these categories, as discussed below.

### State Sourcing

In some cases, telecommuting may have little or no impact on an employee’s income tax situation. But telecommuting can quickly change an employee’s state tax liability once the employee starts working from home in a state that is different than the state they usually work in for their employer. Some of the issues that arise include: whether the employer is required to change state withholding, which states the employee will need to source income to, whether the employee will be able to take a credit for tax paid to a nonresident state, and where applicable, how convenience of the employer rules apply. Another potential issue for employees is whether the state they are spending time in, perhaps at a vacation or secondary residence, will consider them to be a resident (discussed further below under statutory residence).

When an employee lives and works in the same state and continues to work from home in that state, nothing changes with respect to state taxation. But many employees do not live and work in the same state. In some instances, an employee may live in one state (the resident state of domicile) and regularly work in a different state (the nonresident state). If the employee has started to work from their home in their resident state certain tax issues may arise. For example, does the employee need to source income to the nonresident state he or she normally works in while working from home, and if yes, will the resident state provide a credit for tax paid to that nonresident state? The answer to these questions will depend on whether the nonresident state has a convenience of the employer rule and whether the resident state has a sourcing component to its credit for tax paid. Depending on each state’s rules, the employee could end up being double taxed. This issue should be brought to the attention of TP&R for further investigation and analysis.

More complex issues may arise if the employee lives in one state (the resident state), regularly works in a different state (the working nonresident state) and the employee is telecommuting from yet another state (the third state). This may occur when an employee is telecommuting from a second home that is located in a state

that is different from both the resident state and working nonresident state. This is discussed below under “Statutory Residents.”

#### ❖ Convenience of the Employer

There are a few states that have what is called a convenience of the employer rule, which applies to employees that telecommute so as to treat time spent away from the normal office as if the employee were actually present in the normal office. Generally, these rules require an employee that is working from home for his or her own convenience to continue to source income to the state where the employer is located if that is the employee’s primary working office. Several states have such a rule: Arkansas (as of February 2020), Connecticut (for CT nonresidents domiciled in a state with its own convenience test), New York, Delaware, Nebraska, and Pennsylvania. There has been some uncertainty as to whether New Jersey imposes a convenience of the employer rule in practice. But an email from the NJ Division of Taxation (March 2020) stated that NJ does not impose such rule because it has not been enacted as part of the New Jersey Gross Income Tax statutes and regulations.

It is uncertain at this time whether any of these states will impose their convenience of the employer rule on employees that are working from home during this pandemic. Since most of the convenience of the employer rules apply when an employee is working from home at the employee’s own behest, as opposed to being required to do so by the employer, there seems to be a logical argument that an employee working from their home either (1) at the request of the employer because of the Covid-19 pandemic or (2) due to state stay-at-home orders requiring that all non-essential businesses close, should have an argument that the convenience rules should not apply. However, until states provide guidance on this, we may have to assume that states may impose these rules despite this pandemic.

Thus far, we have seen two states implement convenience of the employer rules as it applies to employer withholding. Pennsylvania (PA) will continue to require employers to withhold as it applies to its convenience of the employer test. Massachusetts has issued employer withholding guidance indicating that a convenience test will be employed while employees are telecommuting from a home outside of the state. See the State Telecommuting Charts Related to Covid-19 for further information. It remains to be seen, for states that ultimately refuse to budge on these rules, the litigation that may arise from these issues.

#### ❖ Credit for Taxes Paid

Many states allow a taxpayer to take a credit for tax paid to another state, but the credit may have a sourcing component such that the credit could be limited. If a state allows a credit for tax paid to another state on income from sources in that state, i.e. income taxed by the other state irrespective of domicile or residence, a taxpayer could find that they end up in a double tax situation. Employee taxpayers that are a resident of more than one state or generally work in a state with a convenience of the employer rule may face double taxation.

##### ➤ Example of credit with sourcing component

Employee is domiciled in New York and has a home in Connecticut. Because of Covid-19, the employee has been staying and working from his home in CT. The employee’s 2020 calendar indicates that employee has spent more than 183 days in CT. Since the employee is a resident of both NY and CT, all of the employee’s income (salary and investment income) is taxed to both states. While the employee may be able to take a credit in each state for tax paid on the compensation earned in the other state, neither state will allow a credit for tax paid on the investment income. The investment income will be subject to both NY and CT income tax.

➤ Example of credit with convenience of the employer rule

Employee is domiciled in Virginia and is a nonresident of New York. The employee's assigned and primary office is in NY, but the employee travels often as required by his employer. While employee has an apartment in NY, employee does not spend more than 183 days in NY. During Covid-19, employee does not want to be in NY so employee works from the VA home. Because employee is a VA resident, VA will tax all of the employee's income. NY will tax the employee's compensation based on the work days employee spends in NY and also the work from home days spent in VA since NY has a convenience of the employer rule. Employee will be double taxed on the VA work from home days because VA's credit for tax paid is only allowed on income derived from sources outside VA.

### Statutory Residents

Many states define a resident as an individual domiciled in the state or a person that meets the state's statutory definition of implied residence based on sufficient contacts and time spent in the state. Every individual has one domicile, but an individual can also be a resident of additional states if the state statutory rule is met. A common statutory resident rule defines a resident as any individual who has a permanent place of abode in the state and who also spends more than 183 days in the state.

Individuals that are spending time in a non-domicile state, for example, a state where they may have a second home, need to be aware that they could become a resident of that state for the year. This would be in addition to their domicile state.

In some cases, an employee may have chosen to work in a nonresident state because they wanted to spend time at their second home, be closer to family, or escape their resident state because it was a hot-spot for the virus. But in other cases an employee may have had to stay in a particular state due to shutdowns or other travel restrictions. It remains to be seen whether states that have a day count test for residency will provide any leniency or not as to special circumstances. We have seen leniency on the federal side with respect to federal income tax rules that have similar day counts, but at the same time it is important to recognize that many states are facing budget deficits that Covid-19 has only exacerbated.

### Keeping Track of Work and Non-Work Days

Since many employees will be faced with these issues in 2020, it is important that they are keeping calendars to track their daily whereabouts. For state sourcing rules, work day counts need to be tracked. For purposes of statutory resident tests, employees also need to track **non-work days** as well. This should be done for each and every day since states may come out with guidance that only apply for the period of time that a state had a shelter-in-place, safer-at-home, or other order in place due to Covid-19. It should also be noted that some states may even require that the employer provide certain documentation related to telecommuting orders.

### State Guidance

Currently, only a handful of states or cities have issued any guidance on telecommuting due to Covid-19, and of those states, many of them have only addressed the nexus rules as it relates to employer withholding obligations. Please refer to the State Telecommuting Charts Related to Covid-19 to see state guidance that has been issued.

## Home Office Expenses

Many employees who are now working from home are asking whether they can deduct the expenses they incur from having a home office. Prior to 2018, unreimbursed employee business expenses were a miscellaneous itemized deduction. The enactment of the Tax Cuts and Jobs Act has disallowed miscellaneous itemized deductions for tax years 2018 through 2025. Even prior to this law, the ability for an employee to deduct home office expenses was very limited and generally only applied if the employee worked at home for the convenience of the employer. This generally could only be met if the employer required the employee to telecommute and did not make an on-premise office space available for the employee.

Some states may have their own deduction for employee business expenses. For example, PA allows a deduction for unreimbursed employee business expenses if they are ordinary, actual, reasonable and necessary. Under current PA law, this deduction would not be available for an employee who is only working from home temporarily during Covid-19. The PA deduction is only permitted if the employer requires the employee, as a condition of employment, to maintain a suitable work area away from the employer's premises, the home office is the employee's principal place for performing employment duties and the home office is used regularly to perform the duties of employment. If the employer provides a suitable work area, or any of the above requirements are not met, the deduction is not available. For any state that may have a similar deduction for unreimbursed employee business expenses, the specific state law would need to be examined.

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