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As Nexus Waivers Wane, Know the Tax Implications of Remote Workers

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Most people have been itching to get back to normal social lives following the COVID-19 pandemic, but many of those same people continue to relish the flexibility that mandatory remote work had provided. In fact, that flexibility many companies instituted as a necessity may mean the difference between being able to retain a workforce or not. Those that force employees to return to the office may find that they lose some key employees who do not wish to return to the office five days a week. Because of this, many remote work options will likely continue, and with it there will be some significant state and local tax considerations.

During the pandemic, states took varying approaches to nexus: some waived general nexus provisions, others overtly stated that they were not changing their positions on nexus, while others remained silent. Of the states that issued nexus waivers in light of COVID-19, those waivers were never intended to be indefinite. Many will, or already have, come to an end. For instance, Pennsylvania's nexus waiver was in effect until the earlier of June 30, 2021, or 90 days after the Proclamation of Disaster Emergency in Pennsylvania is lifted. The earlier of those options proved to be June 30. So, as we stand, remote workers in Pennsylvania will now trigger nexus for tax purposes in Pennsylvania.

The state and local tax considerations of a remote workforce can be vast, extending to sales and use taxes, corporate income taxes, gross receipts taxes, franchise taxes, withholding taxes, and even some credits.

Sales and Use Taxes

Remote workers may subject a company to sales and use tax registration, reporting, and collection requirements. This is a concern for smaller businesses that previously may not have been hitting economic nexus thresholds in other states, particularly those where their now remote workers are located. Like withholding taxes, sales and use taxes are trust fund taxes, and with that label comes the legal responsibility for the collection and remittance of the tax. Companies that have a presence in a state by virtue of a remote employee need to be cognizant that if they are not collecting sales tax from their customers, they can be held liable for the tax.

Corporate Income, Gross Receipts, and Franchise Taxes

Remote workers can also trigger nexus for purposes of corporate income taxes, gross receipts taxes, and franchise taxes. Public Law 86-272 offers protection in limited circumstances from some of these taxes, and companies that currently claim its protections should pay particular attention to what their remote workforce is doing on behalf of the company. Remote workers who are doing more than solicitation from their home in a Public Law 86-272 protected state may cause the company to lose that protection.

Companies also should consider the effect remote workers may have on apportionment formulas. While many states have moved to single sales factor, a number still employ some variation of a three-factor formula. A remote workforce will affect the payroll factor and likely the property factor – depending on what employer property or inventory a remote worker has in their remote workspace. Moreover, the sales factor could increase in costs-of-performance states – or roughly one-third of the states. If employees are working from home and generating sales from home, proper sourcing could be to the employee's home state. Even in market-based sourcing states, there are certain situations where a company may need to adjust its sourcing, such as in the case of sales of software licenses that are used by a customer's employees. A key aspect of apportionment will be substantiation. Companies need to be sure they are keeping proper and detailed records to support their formulas.

Another, often forgotten, nexus trap involves local business taxes, which can be structured as an annual fee, an income tax, a gross receipts tax, or a hybrid approach. While some local business taxes may be an insignificant nuisance, others can be burdensome. It is important for businesses to analyze the full affect the remote worker will have on the tax burdens of the company at both the state and local level.

Withholding Taxes

Withholding for remote employees can be a struggle. Many employees who work remotely may be working remotely from a location that is not their home address. As we enter the summer months, we may see more taxpayers working from vacation homes outside the state where their employer is located and the state in which they live. There are many open questions regarding what an employer's responsibilities are with regard to withholding in this murky area. Employers should review their policies – particularly in states or localities that employ "convenience of the employer" standards, including Pennsylvania and Philadelphia.

Credits & Incentives

Companies need to understand they could lose valuable tax credits and incentives – especially those tied to job creation within a particular jurisdiction. Where employees are working from home, employers many no longer meet the requirements for certain tax credit or incentive programs. In some cases, they may be at risk of a clawback of those benefits.

There are many state and local tax angles to consider when continuing with a remote workforce. Nexus waivers are disappearing, and taxpayers must carefully evaluate all potential implications of a continued remote workforce and ensure compliance with various state and local tax burdens that a remote workforce can create.

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