taxnotes® state
Volume 101, Number 4 ■ July 26, 2021

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by Jennifer W. Karpchuk

Reprinted from *Tax Notes State*, July 26, 2021, p. 347

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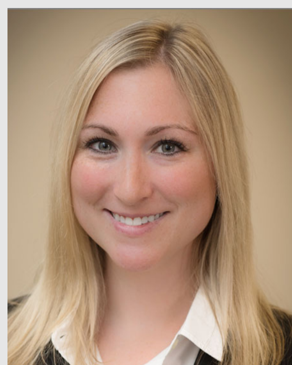

Jennifer W. Karpchuk

Jennifer W. Karpchuk is the co-chair of the state and local tax controversy and planning practice at Chamberlain, Hrdlicka, White, Williams & Aughtry's Philadelphia office. She may be reached at jennifer.karpchuk@chamberlainlaw.com.

In this installment of Pennsylvania's SALT Shaker, Karpchuk explores state and local tax consequences of remote work.

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With vaccines rolling out, many businesses are considering bringing their employees back into the office. Others are considering hybrid models, or fully remote options. To retain talent that has become accustomed to working from home, many employers are offering greater flexibility in where work is performed in a post-COVID-19 world. While from a human resources perspective it may be a no-brainer to acquiesce to the employees, for employers that want to maintain a permanent or hybrid remote workforce, there are important tax considerations that should be contemplated.

Generally speaking, an employee physically located in a taxing jurisdiction will create the all-powerful nexus. However, in light of the pandemic, some states waived their general nexus policies for remote workers who were forced to work from home as a result of the pandemic. Meanwhile, other states decided that the remote employee — even during COVID — creates nexus. For instance, Ohio stated that the Department of Taxation does not have the authority to waive nexus for commercial activity tax or sales and use tax purposes for companies with employees temporarily working in Ohio because of the pandemic. Also, some states did not issue any guidance or stated that nexus is too complex and must be evaluated case by case (for example, Illinois, Kentucky, and Texas). Even for the states that have issued guidance, the important thing to remember is that the guidance is limited and will expire. For instance, Pennsylvania's policy expired June 30. Once the waiver expires, the remote employee can have important tax consequences for the employer. Therefore, companies need to consider what impact remote employees will have on their tax obligations.

Sales and Use Tax

Some states that provided a temporary nexus waiver for income tax purposes did not provide a similar waiver for purposes of sales tax. Post-COVID, and for those states that did not create a COVID nexus exception, remote workers will create nexus considerations for sales and use tax purposes.

Because most states with a sales tax have economic nexus provisions, larger companies will already have nexus with a number of states by virtue of their sales into the state. The larger issue will be smaller companies. For smaller companies that weren't hitting those thresholds, the employee working remotely will trigger nexus and with it a responsibility for registration with the state and collecting, reporting, and remitting the appropriate sales tax — in addition to collecting any applicable exemption certificates. Importantly, whether the company collects the tax is not a big concern for state revenue departments because — by virtue of the physical presence nexus of the remote employee — the company is legally responsible for any applicable sales tax.

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That can become a big headache for a small company — and an unexpected liability, particularly when interest and penalties are tacked on.

Income, Gross Receipts, and Franchise Taxes

In general, a company that has employees working in a given state has long been considered to have nexus with that state. Thus, the company can expect to be subject to the state's gross receipts, income, or franchise tax return filing and payment obligations — absent the protections of Public Law 86-272. Upon the cessation of COVID-related temporary waivers, remote workers will be triggering nexus and employers should be keenly aware of the impact that could have on their companies.

Public Law 86-272

For employers that continue to allow their employees to work remotely after temporary rules are lifted, it's important to be aware of potential issues that can arise in any states in which the employer claims the protection of P.L. 86-272. This law prohibits imposition of a state income tax on an out-of-state company whose activities in the state are limited to solicitation of orders for sales of tangible personal property. Orders must be sent outside the state for approval and fulfillment, and shipment or delivery must originate from a point outside the taxing jurisdiction. Importantly, companies can lose the benefit of P.L. 86-272 if the company does more than solicitation — such as salespeople accepting orders or installing products. Therefore, if a company is now protected by P.L. 86-272 in some states, it needs to be aware of (1) whether it has remote employees in those states, and (2) what exactly those remote employees are doing for the company. Even one employee can cause an employer to lose the protection of P.L. 86-272 if that employee's activities go beyond the mere solicitation of business. If companies do not keep careful track of what remote employees are doing, they risk losing the valuable protection P.L. 86-272 affords.

Apportionment

Apportionment formulas are used to determine the amount of income or receipts that should be subjected to a particular state's taxes. Most states have moved to a single sales factor. However, some states still employ a three-factor formula based on a proportion of the business's property, payroll, and sales in the state compared with everywhere. The presence of a continued work-from-home environment can most obviously affect the calculation of the property and payroll factors. For instance, the presence of inventory or other employer-provided property — such as employer-owned or leased computers and printers — in an employee's work-from-home location could affect the computation of the property factor.

Also, the sales factor could be increased in states that source sales based on cost of performance. Roughly a third of states still employ some form of this sourcing method. If receipts are sourced based on where the income-producing activity is performed, for some companies that may be where an employee is working and generating the sale. In a cost of performance state, that could lead to sourcing to the employee's home state. However, many states have moved to market-based sourcing. For these states, generally the remote employee will not affect the employer's sales factor. Yet, there could be unique situations in which a taxpayer could need to adjust its sales factor sourcing to where its customer's employees are actually using the product (for example, software licenses used by a customer's employees). As always, documentation is crucial; companies must be able to support their apportionment. The presence of remote employees is certain to be a consideration on future audits.

Local Business Taxes

A lot of businesses forget about local business taxes. For some, they can be nothing more than a nuisance fee. Yet in other jurisdictions the failure to account for local business taxes can lead to a costly mistake. If a company allows an employee to work from home thinking that it already has nexus with the *state*, it needs to ensure it has considered any business taxes that may exist in the *locality* where the employee is working. Local business taxes come in many shapes and sizes — ranging from a simple annual fixed fee for the "privilege" of engaging in business in a particular

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location, to taxes based on net income or gross receipts, to others based on a hybrid approach — like Philadelphia's business income and receipts tax. Therefore, companies should be aware of any business taxes that may be present in not only the state, but also the locality its employees are working from remotely.

Employment Taxes

Many employees are working remotely from home, which may be in a different state than their offices. To further complicate things, remote workers may not necessarily be working from home, but perhaps vacation homes or elsewhere outside their domiciliary states. Questions are arising about what an employer's duty is to determine where its employee is working from. Because states have varying rules regarding what constitutes work primarily performed within the state, employers should carefully consider each state's rules. Remote work may also trigger local payroll taxes in an employee's location that may not otherwise have applied.

Unlike withholding and payroll taxes, unemployment insurance is subject to federal uniform standards set by the Labor Department. In accordance with those standards, many employers during the pandemic would have continued to pay unemployment insurance to the state where the employee normally worked. Such a practice would continue unless and until the telework arrangement lasts for such a period that the work for the year is primarily performed from the employee's home. Permanent remote workers or hybrid remote workers may necessitate a change to the state to which the unemployment insurance should be paid.

Opportunity Zones and Tax Credits

A number of tax credits and Opportunity Zones are tied to job creation. When an employer anticipated employees working from specific locations and those individuals are now working remotely, the employer may no longer meet the job creation requirement within that particular jurisdiction. It is important to evaluate any credits received based upon job creation within a particular state or locality to ensure the remote workforce is not creating an unintended, and negative, tax situation.

Remote work is here to stay and, with it, state and local tax consequences. Businesses should ensure they are considering all the potential effects on state and local taxes their remote workforce creates. ■

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