

Never Going Back Again

by Mo Bell-Jacobs, Brian J. Kirkell, and Harlan Kwiatek

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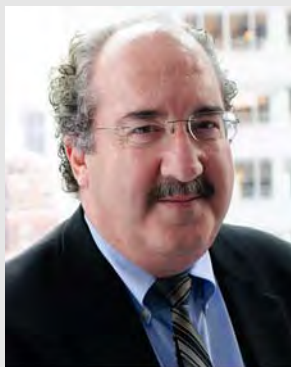
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In this installment of SALT Matters, the authors discuss five issues companies should consider during their planning for a virtual transformation.

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The COVID-19 pandemic has wreaked havoc on both the physical and economic health of the nation. In addition to the devastating toll on people's health, the country has experienced record unemployment, a rash of bankruptcies, and a general state of financial malaise. Unfortunately, the problems are likely to persist as the virus has resurged in many parts of the

country. Widespread government restrictions on business activity are likely to continue into 2021.

One of the consequences of the pandemic is that hundreds of thousands of companies sent their employees home to work remotely. As the health crisis lingers, many companies are rethinking how they do business, with some companies discovering there are benefits to maintaining a permanent remote workforce. The most obvious advantage is that remote workers mitigate health risks associated with infectious diseases. But companies are also recognizing the financial advantages of eliminating infrastructure and office costs and shifting commuting time to working time.

Obviously, the effectiveness and efficiency of permanently conducting operations with remote employees is dependent on the type of industry. Many financial and professional service providers, technology companies, and government contractors can and will continue to use remote employees after the crisis. Some industries, such as manufacturing and processing, will require more onsite employees absent significant automation, but may have secondary data, design, and call center operations that can be conducted remotely. Regardless, all businesses are likely to consider having at least some portion of their workforce stay at home permanently.

However, some companies, particularly those in the middle market, may decide to use the current circumstances to springboard into a virtual transformation, and operate completely remotely. That is, everyone from the CEO on down will work from home. Those companies may maintain an office space, or a fractional interest in a meeting room, to hold live group meetings when the COVID-19 pandemic is over, may have some facilities for storage, and may maintain their own, or hire a third party, service to receive and scan their physical mail. But generally,

employees will not enter a company-owned space on a regular basis.

Businesses planning to have some or all of their employees permanently work remotely should be aware of the significant state and local tax implications. Below are the five issues all companies should consider during their planning for a virtual transformation.

Executive and Owner Considerations

During the current crisis, many senior executives and owners have been working remotely, and doing so effectively and efficiently. For the majority of them, working remotely for an extended period is a new phenomenon, and, before the COVID-19 pandemic, they never would have considered making the transition to a permanently remote environment. However, now more and more of them are looking at a virtual transformation as a sound business decision that will reduce operational costs, relieve stress, free employee time, and drive revenue. In the state tax arena, executives and owners need to consider and address an immense number of issues in making a virtual transformation. But there are two key items particularly focused at the management level.

First, in the absence of any physical office, it becomes difficult to determine the location of a business's headquarters or commercial domicile. While a default position may be to look to the legal domicile of the business, it is probably more appropriate to look to the business's nerve center. In a dispersed virtual environment, this may be the residence of the CEO, other officers, and owners; the stated business address for the delivery of mail, invoicing, and regulatory filings; or any other location where key management decisions are made or records are stored. Why does this matter? Because many state tax determinations depend on a business's headquarters or commercial domicile, including, but not limited to, allocation of nonbusiness income and apportionment of receipts from the sale of intangibles. Accordingly, executives and owners must be careful in choosing where they live when undergoing a virtual transformation, because there may be significant state tax dollars at risk for the business that hinge on their personal states of residence. Just because the

business is going virtual does not mean executives and owners are free agents in terms of where they live.

Second, there are many personal income tax considerations for executives and owners in a virtual environment. Determining personal income tax liabilities depends on the executive or owner's state of residence — an often subjective inquiry. It also depends on where the executive performs her responsibilities, and how much and where the executive travels in the performance of those responsibilities. An executive's personal tax liabilities may also depend on whether and where the company retains an office for management purposes. Of course, many of the rules that govern these determinations will vary by state. Additionally, although many executives and owners will continue to live in the same place even after a virtual transformation rather than simply moving to Florida or New Hampshire, there may be a temptation to spend additional time at vacation homes. This can trigger further residency issues and may even result in some level of multiple taxation of personal income. With this all said, remote employment presents planning opportunities that could involve substantial state and local tax savings.

Executives and owners planning to carry out their responsibilities remotely should get educated on these issues, because they will be able to reap the largest benefits of a virtual transformation, but also may be the center point for significant additional tax costs at both the business and individual levels.

Nexus and Other Business Tax Issues

Generally, a business is considered doing business in a state if it has employees working there. Doing business in a state will usually subject a company to the state's income, franchise, and gross receipts taxes. While some states have said that employees forced to work remotely because of the pandemic will not subject a company to state taxation, those pronouncements are temporary. Companies should be aware of the rules, which can vary significantly by state, as to when the presence of employees will create nexus for income, franchise, and gross receipts tax purposes. Generally speaking, the nexus threshold is not very high for most states. The

Multistate Tax Commission model rules provide that a company establishes nexus with a mere \$50,000 of payroll in the state. And many states take the position that the presence of a single employee may trigger nexus for income, franchise, and gross receipts taxes.

Permanent remote employees may also affect protections under P.L. 86-272, which apply to businesses that remotely sell tangible personal property to in-state customers and ship the property into the state via common carrier. While the companies most likely to make a virtual transformation are probably not those protected under P.L. 86-272, companies selling tangible personal property will likely move to remote workplaces to some extent. These companies should be aware that the presence in a state of a permanent employee who is not engaged in soliciting sales of products will remove the protection.

Other issues will likely arise, particularly for businesses that have many employees who may be newly working in other states. The presence of such employees could significantly affect the sourcing of services receipts in cost of performance states where the employees perform their work, or in market states where customers have undergone their own virtual transformation. Similarly, the presence of remote employees could affect apportionment calculations in states that use a payroll factor.

Wage Withholding

For years businesses have struggled to correctly withhold income taxes for employees who work in states other than their ordinary states of assignment. The pandemic has magnified those struggles, and a wholesale move to remote employment will exacerbate the problem. For a large company, employees may be working remotely in many different states. It is critical to understand that each state has different thresholds that must be met before withholding is required. Withholding rules are more complex than most people think. For example, individual income tax jurisdiction is governed by an employee's state of residence or state of employment. However, there are many exceptions to this rule. Some states will subject nonresident employees of an in-state employer to

tax on 100 percent of their wages if requirements are met. Other states will subject any employee activity occurring in their jurisdiction to tax. While some states provide for reciprocal individual income tax agreements, most states do not. Moreover, local governments often have withholding requirements. Companies should conduct a thorough review of the withholding requirements in each state — and their localities — before embarking on widespread remote employment.

Credits and Incentives

Another area that companies need to consider if moving to a remote work environment is credits and incentives. Virtually all credit and incentive programs have employment thresholds. Businesses participating in such programs may find themselves unable to meet those thresholds once workers are working remotely out of state. Some states have indicated that they are willing to renegotiate credit and incentive agreements considering the pandemic. But in the long term, states may insist that to meet the required thresholds, remote employees must be working in the state.

At the same time, remote employees may provide an opportunity for companies to seek credits and incentives if their new business model creates remote employment in another state. Some states will actively seek to encourage companies with a remote workforce to place employees in their states. Most current programs require capital investment in addition to increased employment, but not all. And, there is a real expectation that programs will be modified to suit the new virtual environment.

Sales Tax Considerations

Although less important for larger businesses after the *Wayfair* decision, widespread work-from-home policies can affect sales and use tax collection responsibilities. Virtually all states have enacted economic nexus thresholds for remote sales tax collection. But all states continue to enforce physical presence standards. A remote seller that maintains a physical presence in a state by virtue of an employee working there will be required to collect and remit sales tax even if it does not meet the state's economic nexus

threshold. Companies that find themselves with remote employees in states in which they make sales should be aware of the possibility of the collection and remittance requirements. Additionally, to the extent that employees are issued office equipment, computers, and software, the business may have use tax reporting and remittance requirements.

Planning and Vigilance are Key

Before a company decides to permanently adopt a remote workforce, it should analyze the effects of such a move on its state and local tax liabilities. If all the remote employees will continue to live and work in the same state, the inquiry will end quickly. That is unlikely as remote employment creates an opportunity for employees to live in areas more to their liking. Determine carefully whether out-of-state remote workers will affect a company's overall state and local tax liability and filing responsibilities. Examine the effects of remote employees on withholding requirements and existing credit and incentive agreements.

Beyond the initial planning, companies using remote employees must monitor state and local legal and policy developments. A widespread move to remote employees presents a significant change for taxing authorities. Many states are considering policies designed to encourage businesses to locate remote employees in their jurisdictions. Some states are considering permanently easing nexus requirements related to employees. Some are considering streamlining withholding rules and procedures and others are considering incentives for remote job creation. Finally, some states are considering investments in broadband and telecommuting infrastructure to make remote employment more attractive.

At the same time, the overall state and local tax landscape is likely to change over the near term. Many states are facing serious revenue shortfalls. Most state and local governments will be forced to increase taxes in some fashion in the coming year. Companies contemplating a remote workforce should monitor the potential tax changes in states where employees may live and work. ■

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