

State Tax Observations

Do Employees Working from Home During the Pandemic Trigger State Tax Nexus for Their Companies?

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In the time before the coronavirus outbreak – which seems so long ago – companies were addressing state tax considerations of their mobile workforces. Few envisioned suddenly having the bulk of their employees working from home in states away from their assigned offices.

In light of this, companies should not neglect addressing the state income, sales, and withholding tax issues that may have been created from their employees working-at-home during the COVID-19 pandemic. Businesses should also be aware that a handful of states have already issued guidance; much of it taxpayer-friendly.

Where does the tax filing obligation situation arise?

By way of example: the situation arises where a C Corporation has its sole office in New York State and now, for the first time, has its employees telecommuting from New York, Connecticut and New Jersey. Regarding New York, the tax footprint has not changed. But in Connecticut and New Jersey, does the company now have nexus along with obligations to start paying corporate tax, start collecting and remitting sales tax, and start complying with the burden of withholding and paying payroll taxes on behalf of its employees?

Generally, “nexus” for an out-of-state company is created when the company has the requisite minimum contacts with the state that allows the state to tax that company’s income or, in the case of sales and use tax, requires it to collect tax on sales made into that state. The recent U.S. Supreme Court case of South Dakota v. Wayfair made it clear that physical presence is not the only way to meet the required minimum contacts threshold (at least for sales tax purposes). However, it is well settled that the physical presence of employees, even telecommuters, creates nexus and state tax filing obligations.

How have the states weighed in?

A handful of states have now released guidance on whether an employee working in a state away from the office during the pandemic creates physical presence nexus for a company otherwise located in another state and whether that company is required to withhold payroll taxes. The list is growing, but the states that have spoken differ as to the scope of the guidance provided. The landscape continues to change. For now, here is what we know.

New York, Connecticut, and Rhode Island (among others) have yet to release any guidance on these issues.

New Jersey has stated that withholding will not be required due to employees working in the state because of the pandemic. However, the state has not commented on whether temporary telecommuting creates corporate income tax nexus in the state. Nevertheless, the state will temporarily waive its sales tax nexus standard, which is generally met if an out-of-state seller has an employee working in New Jersey.

Maryland has stated that nothing has changed regarding its withholding requirements, as withholding has always been determined by the employee’s physical presence. Thus, compensation paid to a Maryland nonresident who is telecommuting from Maryland is Maryland-sourced income and, thus, subject to withholding. With respect to nexus, while the state acknowledges the temporary stay-at-home orders

issued by state government and social distancing measures recommended by the CDC, it will continue to consider nexus determinations on a case-by-case basis.

In **Georgia, Massachusetts and Mississippi**, nexus is not created during the pandemic by telecommuters working from home or from another location other than the employees' primary work location. Withholding is not required by the company in these states from which the employees are telecommuting. Note, however, that Massachusetts specifically provides that for Massachusetts residents, withholding is not required in Massachusetts due to telecommuting, as long as the employer is still obligated to withhold in the state of the employee's primary work location. For Massachusetts nonresidents, Massachusetts would only require withholding if the employee was performing services in Massachusetts prior to the pandemic.

The **District of Columbia, Indiana, North Dakota and Pennsylvania** have stated that nexus is not created due to telecommuters working from home or from another location other than the employee's primary work location, but these jurisdictions have remained silent on the issue of withholding.

In **Minnesota**, nexus is not created due to telecommuters working from home or from another location other than his or her primary work location, but the state has set forth that telecommuting may trigger new withholding obligations through the application of existing rules.

How does pandemic telecommuting impact income tax apportionment?

Most states have been silent on whether employees temporarily working from home will have any impact on income tax apportionment factors for a company. However, Massachusetts and North Dakota have stated that wages of employees working temporarily from their states due to the pandemic will not be included in the numerator of the payroll factor for the duration of the pandemic. For payroll factor purposes, many states will not be weighing in since, in recent years, they have shifted from a three-factor (property, payroll and sales) apportionment method to a single sales factor approach.

Further, regarding the sales factor, for sales related to services, many states have shifted from a cost of performance sales sourcing methodology (where location of employees matters) to market-based sourcing (which emphasizes where the customer receives the benefit of the services). With this in mind, a temporary shift of employees' working locations should not result in significant sales factor issues for most business taxpayers. However, for those companies which temporarily have employees working from locations in states that still utilize the cost of performance methodology for service income (notably, New York and New Jersey for partnerships and LLCs taxed as partnerships), this is an issue worth considering for the tax years impacted by the pandemic.

Other considerations

Even where nexus is created, and a state provides no relief, companies should not forget that Public Law 86-272 provides protection from income tax nexus, if the employees in the state are merely soliciting for the sale of tangible personal property.

Further, 27 states now provide tax relief to qualified out-of-state businesses, which are performing disaster recovery work in their state. In these states, out-of-state businesses may not be required to register their business with the state or withhold state income taxes for the duration of the disaster.

Contact Us

PKF O'Connor Davies is monitoring the evolving situation regarding state tax nexus, withholding requirements and apportionment effects. If you have any questions regarding state tax issues related to the pandemic or generally, contact:

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