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2020 May Hold Unpleasant Tax Surprises for Telecommuters (1)

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Unsuspecting taxpayers who have been telecommuting from outside their home state since the Covid-19 lockdowns began in March could find that they may have become residents of the other state as of September. Frank Sennott and Win Grimm of Ropes Wealth Advisors and Scott Kaplowitch of Edelstein & Co. look at which states are trying to help individual taxpayers avoid double taxation, which states don't seem to care, and if there is any hope of help from Congress.

The year 2020 will rank as one of the most difficult and tumultuous in memory. An *annus horribilis* by any measure. Unfortunately, for unsuspecting taxpayers who have been telecommuting from outside their home state since the Covid-19 lockdowns began in March, it could yet get worse. Arcane and conflicting state tax laws could put these taxpayers in the middle of a battle between states over who can tax their income.

To appreciate the magnitude of the issue, let's briefly review how multi-state taxation usually works. If you are a taxpayer who lives in one state and works in another, the general rule is that your earned income, and only your earned income, is subject to tax in the state in which you work. The state in which you live will tax your worldwide income, but then allow you to claim a tax credit for the taxes paid to the state in which you work. The credit is equal to the lesser of the actual tax paid in the nonresident state and the tax you paid in your home state on that same income. As a result, you end up paying tax on that earned income at the higher of the two state tax rates, but you avoid paying the tax twice. (Some jurisdictions, such as Maryland and Virginia, have reciprocity treaties to simplify matters. These treaties permit the taxpayer to file and pay taxes only in the taxpayer's home state regardless of the state in which they work.)

These rules are generally familiar to taxpayers who work and reside in different states. If not simple, there is an intuitive logic to them. So why are things different now? To begin, your home state is not simply whatever you choose to call your home state. Generally, your home state is where you are domiciled. It is the state where you maintain a permanent abode and to which you expect to return, even if you leave for a while. You can only be domiciled in one state at a time; however, you can also become statutorily resident in a second state. This usually occurs when a taxpayer maintains an abode in the second state and has been physically present there for 183 days or more. The abode in the second state could include a second home, a rented apartment, or your parents' or child's home.

Taxpayers who lived and worked in one state and fled to another to work remotely when lockdowns started in March may have reached the 183-day limit in that second state. When that happens, the second state may argue that these taxpayers are now subject to tax on their worldwide income, potentially for the full year. If a taxpayer intends to return to his or her home state when offices there reopen, arguably the taxpayer is still domiciled in that state and subject to tax there on worldwide income. Can a taxpayer be domiciled in one state, statutorily resident in another, and subject to tax in both on worldwide income? Which state will grant a credit, if any is allowed, for the taxes paid to the other state? Are you starting to see the issue here?

Matters are made even more confusing by states that impose something called the “Convenience of the Employer” rule. These states include New York, Connecticut, Delaware, Arkansas, Nebraska, and Pennsylvania. While not traditionally a Convenience of the Employer state, the Commonwealth of Massachusetts effectively became one through year-end as part of its Covid state of emergency declarations. The Convenience of the Employer rule comes into play when a taxpayer is employed by a company resident in one of these states, resides and generally works in a different state, but occasionally works for the employer within the state applying the rule. (In New York, one day worked in New York is sufficient to trigger the rule.) These states deem all of the work performed by the employee outside of the state to have been performed within the state unless the employer requires the employee to work out of state for the employer’s convenience. If the employee is working out of state merely at the employee’s convenience, all of the income is taxable in the state asserting the rule.

Employees working remotely in a different state for 183 days or more could find themselves subject to tax in three states: the state where they are domiciled, the state where they are statutorily resident, and the state imposing the Convenience of the Employer rule.

Let’s look at an example. Let’s say we have a taxpayer who lives in Connecticut and normally works in New York. The taxpayer left New York to work remotely in her parents’ summer home on Cape Cod, Massachusetts when her employer shut down access to her office in March in response to the Covid-19 outbreak. Sometime in September, she was physically present in Massachusetts for more than 183 days. If she hasn’t given up her apartment in Connecticut and intends to return there when her office reopens, she is arguably domiciled in Connecticut and still subject to tax there on her worldwide income. Massachusetts may assert that she is now statutorily resident in the Commonwealth and subject to tax on her worldwide income since she arrived in March. New York may assert that all of her earned income is still taxable in New York as she is in Massachusetts not at the convenience of the employer, but at her own convenience. (You might ask how she could be working outside of New York at her own convenience when her New York employer shut down its office. New York requires that the home office be a “bona fide employer office” to avoid the Convenience of the Employer rule, and mere telecommuting from the parents’ second home may not meet that standard.)

You might expect the states to be accommodating about all of this given the Covid-19 emergency. While a number of states have indicated that they are prepared to offer relief to Covid-19 telecommuters, the majority of the 43 states that impose income taxes have been silent. New York famously caused a stir when it declared that health care workers who moved there temporarily to help out during the worst of the coronavirus outbreak would be subject to state income tax. The New York State Assembly introduced a bill to confirm that teleworking during the emergency could be deemed to be at the convenience of the employer, but the bill has been hung up in committee. As mentioned, Massachusetts put the Convenience of the Employer rule in effect through year-end with the result that New Hampshire residents who were commuting to Massachusetts prior to the outbreak are still expected to pay Massachusetts income tax on their earnings, even if they have been working from home in New Hampshire since lockdowns began. (New Hampshire has filed suit to stop the Commonwealth.)

You might also expect that the tax credit regimes of the states would eliminate the potential for double taxation, but that's not necessarily the case. The general rule is that a resident state allows a tax credit for taxes paid to another state on income *sourced* from that other state. Let's revisit our example where the taxpayer is domiciled in Connecticut, normally works in New York, but has been working remotely in Massachusetts for 183 days or more. New York may assert the Convenience of the Employer rule and tax the income earned while the employee is in Massachusetts. Connecticut and Massachusetts, though, may assert that that income is not credibly *sourced* to New York when the taxpayer hasn't been there for more than six months, and deny a tax credit. Fortunately, Massachusetts has declared that, at least through year-end, it will allow a telecommuting taxpayer to claim a credit in Massachusetts for taxes paid on that income to another state, but that does not appear to be the case in Connecticut. It also appears that Vermont, Maryland, and Maine, among others, could deny a tax credit for the New York state taxes. Therefore, if the employee telecommuted from Vermont rather than Massachusetts, there could be true double taxation of the income.

What should you do if you have been working remotely in a different state and expect to be there 183 days or more? To start, keep close track of your days spent in and out of each state. Calendars, credit card charges, toll records, and phone records may all be used to track your location. Days spent traveling through a state generally do not count towards the 183-day target, nor do days spent in a state for medical reasons (query whether Covid-related quarantine time can be excluded). If a taxpayer knows he will be statutorily resident in a second state for 183 days or more, he should ask his tax advisor whether he should direct his employer to switch his state tax withholding to that second state to avoid under withholding. (Note that employers may be impacted by this situation as well. If the presence of telecommuters in a state is sufficient to establish a nexus between the state and the employer, adverse state tax consequences may befall the employer. As a result, your employer may refuse to withhold in your new state.)

If the potential tax outcomes described here strike you as unfair, you are not alone. Congress has been considering legislation to regulate state tax rules for telecommuters for several years. There is renewed emphasis in Congress on passing a bill stipulating that an individual cannot be deemed to be working in one state when they are working from home in another state. So far, though, nothing has been passed.

Employees working remotely from home and potentially subject to these multi-state tax issues may wonder if they are at least entitled to a home office deduction on their tax returns. The general rule is that salaried employees are not eligible for a home office deduction, nor can they claim a deduction for unreimbursed business expenses such as a printer or computer monitor they may have purchased. Self-employed individuals working from home, including partners in a partnership, may be able to claim the home office and business expenses deductions and should talk to their tax advisors. The one piece of good news for a telecommuting salaried employee is that so-called “Disaster Relief Payments” (President Trump declared Covid-19 a disaster on March 13, 2020) from an employer, which could include reimbursement for home office items such as a computer monitor, are not included in the employee’s income.

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(Clarifies that New Hampshire has filed a lawsuit against Massachusetts and that tax residency may be backdated to the first of the year.)