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In this installment of Noonan's Notes, Noonan and Savino explore the tax consequences of remote work arrangements — specifically, how states are going to tax employees who are working temporarily or even permanently in a state different from where their employer is located.

Earlier this year, we chronicled the variety of residency issues arising because of the COVID-19 pandemic and the great migration of taxpayers to tax havens like Florida, Texas, and the like.[1] But there's another big shoe to drop that, in the long term, may be a more significant state and local tax issue. That issue? The tax consequences of remote work arrangements, specifically how states are going to tax employees who are working temporarily or even permanently in a state different from where their employer is located. News outlets from around the country have been covering this constantly,[2] and practitioners and states are scrambling to keep up.[3]

As we did in our article on residency issues a couple months ago, we thought that a deep dive into these telecommuting issues was in order, with a particular focus on New York, which has become the epicenter of telecommuting issues for the past 14 months. So let's get to it.

Telecommuting Tax Overview

Telecommuting tax issues arise in the context of employee-based compensation, specifically related to sourcing a nonresident's compensation for services performed in the state. Under most states' rules, including New York's, a nonresident employee determines the sourcing of their compensation based on their workdays. The formula generally consists of a ratio, the numerator being the number of days worked in New York and the denominator being the total number of days worked everywhere. In defining a workday, most of the time it is easy: a day spent in New York by the nonresident employee on company business constitutes a day worked in New York. But what about remote work? What if the taxpayer, like most of us over the past year, is working in their home in another state on company business? This is where the tax issues arise.

Historically, this has been an easy question to answer, depending on where the employee was working. In determining the source of an employee's workdays, most states used a physical presence rule.

[1] Timothy P. Noonan and Emma M. Savino, "COVID-19: The Year of the Great Migration," *Tax Notes State*, Mar. 1, 2021, p. 897.

[2] Alexis Leondis, "Remote Work and Taxes: Start Preparing for Next Year Now," *Bloomberg*, Feb. 26, 2021; Sam McQuillan, "Telecommuting Boom Puts Employers at Risk for Millions in Taxes," *Bloomberg Tax*, Feb. 23, 2021; Jeanne Sahadi, "Living in One State and Working Remotely From Another? You Could Owe Income Taxes in Both," *CNN Business*, Mar. 30, 2021.

[3] We are doing our part to help by maintaining a blog chronicling what states are doing. Noonan and Savino, "State Guidance Related to COVID-19: Telecommuting Issues," Noonan's Notes Blog (Aug. 10, 2020).

Thus, if the employee was physically present working in a state, then that day would be treated as a day worked in that state, even if the day was worked in the employee's home. But a handful of states have treated these days differently, essentially sourcing days worked at home back to the employer's home state. These rules have colloquially been referred to as "convenience rules," from the oddly named "convenience of the employer rule" in New York.[4] Under this rule, found in New York's tax regulations, days worked outside New York by the employee out of convenience, as opposed to necessity, are treated as days worked by the employee in New York:

> If a nonresident employee . . . performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State. However, any allowance claimed for days worked outside New York State must be based upon the performance of services *which of necessity, as distinguished from convenience*, obligate the employee to out-of-state duties in the service of his employer.[5]

Basically, what this rule says is that if the employee worked from home for their own convenience, and not because of any necessity or requirement by their employer, the days worked at home would be treated as days worked at their assigned work location. This rule is most infamously part of New York tax lore, but Arkansas, Delaware, Nebraska, and Pennsylvania have also used a convenience rule.[6] The rule has only generated significant controversy or litigation in New York, however, and the merits of the convenience rule have been litigated all the way up to New York's highest court, with the New York State Department of Taxation and Finance almost always coming out victorious.[7]

Some of that jurisprudence is a bit unusual and worth a short discussion given how it could affect COVID-19-related telecommuting. More to the point, the New York State Department of Taxation and Finance and the New York courts have broadly defined "convenience" in applying the rule. If a taxpayer is sent to work in another state on a project, client visit, to solicit sales, or so forth, then these would be deemed "necessity" days. But if the employee is doing work out of their home in another state of the nature and type that could have been done in New York, then the day gets sourced back to New York for allocation purposes. New York has taken the position in many cases that even if the employer requires the employee to work at home for one reason or another, the convenience rule could still apply to source that day back to New York.

As an example of this rule in action, in *Matter of Unterweiser*, a New York employer eliminated a nonresident employee's desk job and changed her work duties.[8] Because the office was not equipped to meet the requirements of her new position, the taxpayer performed her duties from her home in New Jersey. But the tax department argued, and the Division of Tax Appeals agreed, that the taxpayer was working from home out of convenience, not necessity.

That is not to say taxpayers always lose these cases. In *Matter of Devers*, a New York employer eliminated a nonresident employee's office space and formally "relocated" the taxpayer to its Virginia office, although the taxpayer continued to work out of his home in Connecticut.[9] The taxpayer's access to the New York building was rescinded, and he no longer even communicated with New York personnel on a day-to-day basis at his job. Based on these facts, the administrative law judge determined that the taxpayer worked outside New York by necessity. But the general rule — that most remote-

[4] It is unclear where this moniker came from — should it not be called the "convenience of the employee" rule? Oh well, we will go with the flow.

[5] 20 NYCRR 132.18(a) (emphasis added).

[6] 30 Del. C. section 1124(b); Neb. Admin. R. & Regs. 003.01C; 61 Pa. Code 109.8; Ark. Rev. Legal Counsel Op. 1504 (Sept. 14, 2011). Recently, however, it appears that Arkansas enacted legislation reversing its convenience rule. Arkansas Code section 26-51-202(c).

[7] E.g., *Zelinsky v. Tax Appeals Tribunal of State of New York*, 1 N.Y.3d 85 (2003), *cert. denied*, 541 U.S. 1009 (2004); and *Huckaby v. New York State Division of Tax Appeals*, 4 N.Y.3d 427 (2005), *cert. denied*, 546 U.S. 976 (2005).

[8] DTA No. 818462 (N.Y. Tax App. Trib. July 31, 2003).

[9] DTA No. 819751 (N.Y. Div. Tax App. May 5, 2005).

work arrangements resulted in New York workdays even when the convenience issue was arguable — has resulted in lots of New York taxes and unhappy nonresident workers.

The issue reached a fever pitch about 15 years ago, particularly in the tri-state area, because taxpayers were facing double taxation, with physical presence states like Connecticut taking the position that remote work was taxable in their state while convenience-rule states like New York were taking the opposite position.[10] To alleviate some of these issues, in 2006, the New York State Department of Taxation and Finance came out with a safe harbor rule. Under the new administratively created safe harbor, if a taxpayer could show that their home office qualified as a "bona fide employer office," then days worked at home would be treated as days worked outside New York.[11] See Table 1 for an illustration of the safe harbor factors.

Table 1. New York Convenience Rule Safe Harbor Factors

Issue #1: Is It a Normal Workday?
If not, STOP. It is a non-workday and the rest of the convenience rule does not apply.
Issue #2: Does the Home Office Qualify as a "Bona Fide Employer Office"?
Step 1: The Primary Factor
Employee's duties require the use of special facilities that cannot be made available at the employer's primary place of business, but those facilities are available at or near the employee's home.
If the home office does NOT satisfy the primary factor, proceed to Step 2.
Step 2: The Secondary and Other Factors
The home office may still qualify as a bona fide employer office if it meets four out of the six secondary factors PLUS three out of 10 other factors.

Secondary Factors (4 out of 6)	**Other Factors (3 out of 10)**
1. Home office is a requirement or condition of employment.	1. Employer maintains a separate telephone line and listing for the home office.
2. Employer has a bona fide business purpose for the employee's home office location.	2. Employee's home office address and phone number are on the employer's business letterhead and/or cards.
3. Employee performs some core duties at the home office.	3. Employee uses a specific area of the home exclusively for the employer's business.
4. Employee meets with clients, patients, or customers at the home office.	4. Employee keeps inventory of products or samples in the home office.
5. Employer does not provide the employee with office space or regular work accommodations.	5. Employer's business records are stored at the home office.
6. Employer reimburses expenses for the home office.	6. Employer signage at the home office.
	7. Home office is advertised as employer's place of business.
	8. Home office covered by a business-related insurance policy.
	9. Employee properly claims a deduction for home office expenses for federal income tax purposes.
	10. Employee is not an officer of the company.

To qualify as a bona fide employer office, the employee could try to satisfy the primary factor — the home office is located nearby specialized facilities — but this is a rare situation that we have only seen a few times. More often, employees try to satisfy the second option under which the home office qualifies as a bona fide employer office by meeting a variety of different factors set forth in the tax department's memorandum. Specifically, and as outlined in Table 1, if a taxpayer meets four out of six secondary factors and three out of 10 other factors, the home office qualifies as a bona fide employer office. We will come back to these safe harbor rules later, but they are critically important and potentially the key to solving

[10] *See, e.g.*, Gene Gavin and Stacey Pavano, "The Long Arm of the Empire State: Convenience Rule Discourages Interstate Telecommuting," 12 *JMT* 6 (Mar.-Apr. 2002) (Gavin was then commissioner of the Connecticut Department of Revenue Services and Pavano was a tax attorney in the department's legal division); *see also* Paul R. Comeau, Noonan, and Joseph N. Endres, "New York's Revised Convenience Rule Provides Some Clarity and Continued Controversy," *J. of Multistate Tax. and Incentives*, 18-27 (Aug. 2006).

[11] N.Y. TSB-M-06(5)I.

many of these telecommuting issues, not only during the pandemic, but even into the future if telecommuting becomes the new normal.

Telecommuting in a Pandemic

As the discussion above indicates, the remote-work issue has always been an area of controversy in New York. But when millions of Americans fled to their home offices in March 2020, this became a national issue. Thus, over the past 14 months, states have scrambled to rearrange their rules and issue guidance around telecommuting. As noted above, we have been following this issue closely, and while an overview of each state's response is way beyond the scope of this article, we encourage you to check out our blog to keep up with that guidance![12]

In New York, we have heard a familiar refrain. In July 2020 the New York State Department of Taxation and Finance, with little fanfare, updated a frequently asked questions page on its website to essentially double down on its convenience rule position. Specifically, the relevant FAQ states as follows:

> My primary office is inside New York State, but I am telecommuting from outside of the state due to the COVID-19 pandemic. Do I owe New York taxes on the income I earn while telecommuting?
>
> If you are a nonresident whose primary office is in New York State, your days telecommuting during the pandemic are considered days worked in the state unless your employer has established a bona fide employer office at your telecommuting location.
>
> There are a number of factors that determine whether your employer has established a bona fide employer office at your telecommuting location. In general, unless your employer specifically acted to establish a bona fide employer office at your telecommuting location, you will continue to owe New York State income tax on income earned while telecommuting.[13]

So what does this all mean? How do employees and employers figure this out? As we did in our residency piece, to get a sense of how these rules apply, reviewing a series of case studies based on real-life examples we have dealt with over the past year is a great way to break down potential issues, so let's examine how these issues arise in a variety of different factual contexts.

Convenience Rule 101

Facts. The taxpayer lived and worked in New York City, but in March 2020 decided to give up her New York lease and move to Florida permanently. Her employer is based in New York City and does not have a Florida office, but it will allow the taxpayer to work remotely on an indefinite basis, with occasional visits back to the New York office. Since COVID hit, the taxpayer's office has basically been open, so employees could come and go if they wanted, though remote work was encouraged and in-office work discouraged.

Analysis. We titled this "Convenience Rule 101" because it really is the plain-vanilla example of how the convenience rule usually applies. And consistent with guidance given by New York on COVID-19, and with its guidance on the convenience rule over decades, the taxpayer here will still be required to pay full New York state taxes on her compensation under the convenience rule. The tax department will undoubtedly take the position that since the taxpayer's primary office is in New York, her days telecommuting during the pandemic and even after the pandemic are considered days worked in New York. However, if she had previously lived in New York City, she avoids city tax on her compensation after moving because these taxes are imposed on residents only. But the state nonresident tax will remain.

One interesting question is whether this conclusion changes if the employer's office was closed, either by government edict or employer

[12] Noonan and Savino, *supra* note 3.

[13] New York State Department of Taxation and Finance, Frequently Asked Questions About Filing Requirements, Residency, and Telecommuting for New York State Personal Income Tax (updated Oct. 19, 2020).

choice. Now we would have a situation in which the employee had nowhere to work in New York. So the only way the taxpayer could perform her duties was from her home in Florida. That sounds an awful lot like "necessity," does it not? If the New York tax department tries to take the position that these workdays get sourced back to New York, we should expect not only some negative press (because, of course, we'll write about it!), but also some interesting legal challenges.

New Office Assignment

Facts. The taxpayer is a Connecticut resident who worked in New York City before the pandemic. Since March 2020 she has been working remotely from her home in Connecticut. Her New York City office remained open for most of 2020, but few people were regularly going into the office. In July 2020 her employer reassigned her to the Connecticut office, and she and others are now working in that office semi-regularly.

Analysis. Since remote workdays are sourced back to the taxpayer's primary office, the answer here changes mid-2020. Until July, when the taxpayer is reassigned to the Connecticut office, she will have to pay tax to New York on her wages because these days will be treated as New York workdays under the convenience rule, like the taxpayer in "Convenience Rule 101." But the result changes once she is assigned to the Connecticut office — then her days spent working at home will be treated as Connecticut workdays. The taxpayer must be able to document this in some way, with backup such as a signed letter or agreement from her employer confirming that she is assigned to the Connecticut office.

It probably also makes sense, though presumably it's not required, that she go into the Connecticut office at least sometimes, so that it's clear that it's her real office. When things start to reopen, the taxpayer should make sure that she spends more time working out of the Connecticut office than the New York office, otherwise it raises questions as to whether the Connecticut office was actually her primary office. Better yet, if her employer eliminates her office in New York, it could prevent the tax department from taking the position that her office in Connecticut was not her primary office — it must be her primary office if it is her only office.

All's Well That Ends Well

Facts. The taxpayer is a New Jersey resident, but he normally works in New York City. When the pandemic started in March 2020, he began working from home because his office was essentially closed. Some people continued to go in, but most were enjoying working at home in sweatpants. With the city starting to reopen, he plans to start going into the office in the city at some point in 2021.

Analysis. Like our taxpayer in "Convenience Rule 101," all the days worked at home during 2020 and 2021 will be treated as New York workdays, and he will be required to pay tax to New York on all this wage income. However, unlike some states, New Jersey's resident credit provisions are broad and allow for a credit for taxes paid to other states on income that is also taxed in New Jersey, without regard to the other taxing jurisdiction's sourcing rules to determine whether the income was properly sourced to and taxed by the state.[14] So New Jersey will provide a credit for taxes paid to New York because the income was taxed under New York's convenience rule. And since New York and New Jersey's top tax rates are roughly the same, the taxpayer will not be out of pocket much extra tax on this wage income.

Companywide Telecommuting

Facts. ABC Co. provides market research services, and it is based in New York. The company allowed its employees to work remotely during the pandemic, so many fled to states across the United States, and some may telecommute on a more permanent basis going forward. ABC Co. plans to allow remote work arrangements to continue for many of its employees, particularly those who permanently moved out of state that the company wants to retain.

Analysis. We will tackle this one from the employer side. For those employees who only

[14] N.J. Rev. Stat. section 54A:4-1(a); N.J. Admin. Code section 18:35-4.1(a)(1)(i).

temporarily moved out of state, the employer should continue to withhold full New York state tax on their wages because the wages will be sourced back to New York under the convenience rule. But if the employer plans to allow those employees who permanently moved out of state to continue working from home, it could consider preparing a broad-based telecommuting agreement to cover all remote workers. And if done right, the terms of the agreement could be designed to help the employee meet the secondary and other factors listed in Table 1, so that the employee's office can be considered a bona fide employer home office. Problem solved!

Gone for Good

Facts. Before the pandemic, the taxpayer lived and worked in New York state. When the pandemic started in March 2020, she fled New York and began working remotely from her home in Tennessee. By July 2020 she had taken all the necessary steps to move permanently to Tennessee. Her New York office remained open during the pandemic, but most people were working from home. Now that she lives in Tennessee, she plans to work solely from home — she does not plan to work in the New York office at all, and her employer has agreed to this arrangement.

Analysis. The key to this one is that the taxpayer will not work in New York at all going forward. When a nonresident performs no services in New York, according to *Hayes v. State Tax Commissioner* (which the tax department cites approvingly in its nonresident allocation guidelines) the convenience rule does not apply.[15] The convenience rule only kicks in when a nonresident taxpayer is working both within and outside the state. And how do you prove that the taxpayer is not working in New York anymore? The easiest way is for the taxpayer simply to not travel to New York, and that can be shown through cell phone records, credit card receipts, or other location-tracking apps. If the taxpayer does spend time in New York, she must be careful not to do any work and must avoid going into the office. Proving this is a bit more difficult, but office swipe card records, or lack thereof, can be helpful here.

Double Tax on Remote Work

Facts. The taxpayer lives and works in New York City, but decided to use the pandemic as the opportunity to spend more time at his ski home in Colorado, so he has been working remotely from there. He does not want to move to Colorado permanently, and he plans to return to New York City sometime in the fall of 2021 when things start to feel normal again.

Analysis. Look away; this one is ugly. Since the taxpayer is a resident of New York City, he continues to pay state and city tax on all his income. But what about Colorado? Colorado is a physical presence state and will treat all days worked in Colorado as Colorado workdays, so he will have Colorado-sourced income too.[16] Because of this, technically, his employer should be withholding Colorado tax in addition to New York state and New York City tax on his wages.

Even worse, New York will not provide him a resident credit for tax paid to Colorado. Under New York's resident credit rule, taxpayers may take a credit for taxes paid to other jurisdictions on income derived from sources in the other jurisdiction, and the credit is determined by looking at *New York sourcing rules* to determine whether the income was derived from sources in the other jurisdictions.[17] This means that New York will look at its nonresident rules to determine how to source this income; i.e., it will apply the convenience rule. Since under New York's rule, these days are treated as New York workdays, the taxpayer cannot take a resident credit. This results in double taxes, and it is this result that hopefully catches the attention of state courts, and maybe even the U.S. Supreme Court, which is deciding whether to hear New Hampshire's lawsuit against Massachusetts's

[15] *Hayes v. State Tax Commissioner*, 401 N.Y.S. 2d 876 (3d Dept. 1978) ("A nonresident who works in another State but who performs no work in New York is not subject to New York State tax liability no matter for whose convenience or necessity he performs the work."); and New York State Department of Taxation and Finance, Nonresident Allocation Guidelines, 19 (2013).

[16] Colo. Code Regs. section 39-22-109(3)(b)(i).

[17] N.Y. Tax Law section 620(a); and 20 NYCRR 120.1; 20 NYCRR 120.4(d).

attempted imposition of a convenience-type rule on New Hampshire residents.[18]

Conclusions and Takeaways

These are just some of the typical situations that we have encountered over the last year, but every situation has its own nuances. But there are a few main points that we can take away from these scenarios.

Just because you left New York does not mean you don't owe tax to New York. As you can imagine, we have had many conversations with taxpayers over the last year in which they were unhappy to learn that even after moving to a tax haven, like Florida, they would still owe tax to New York on their wages if they did not make any other changes. The convenience rule is there to pull taxpayers back in, but as explained, there are ways to avoid its clutches.

Get it in writing. Whether a taxpayer is trying to be assigned to a different office or establish a bona fide employer home office, he should have an agreement in place with his employer. We expect that New York is going to be sending lots of notices when taxpayers do not allocate all their wage income to New York, when they previously worked in the state — we've already started to see them! — so being able to prove the new setup is key.

Don't forget about resident credits. While we did not go into detail on the mechanics of the resident credit — it is well beyond the scope of this article — it might provide some nonresident taxpayers some double tax relief, like in "All's Well That Ends Well" above. That said, resident credit rules are not always as broad as New Jersey's, so it is important to understand the relevant state resident credit.

Finding relief in New York during COVID-19. While many states have come out with different guidance to provide relief to taxpayers who are working remotely, New York doubled down on the convenience rule. And if you think New York is going to change this policy, don't hold your breath. But that does not mean taxpayers cannot come out on top. As outlined above, we have seen many taxpayers take advantage of the bona fide employer office rules to eliminate application of the convenience rule. Or employees can get assigned to non-New York offices. Or they can just not come back to New York altogether. The point is that there are a multitude of ways to plan around the harmful effects that the convenience rule could bring. It just took a pandemic for folks to start figuring that out! ■

[18] *New Hampshire v. Massachusetts*, No. 22O154 (U.S. filed Oct. 19, 2020).