# Mobile Workforce Issues

2015 TEI Symposium
December 7, 2015

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# Agenda

Part One: Nexus Issues Created By Mobile Employees and Telecommuters

Part Two: Multistate Withholding: Obligations on the Employer

Part Three: Practical Solutions for Compliance (or whether they exist at all)

# Part 1: Nexus Requirements

- Fundamental requirement of both the Due Process and Commerce Clause of the US Constitution that there be “some definite link, some minimum connection between a state and the person, property or transaction it seeks to tax.”

- Employee visits = a definite link!



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# Part 1: Mobile Employees and Nexus

- Can create nexus for
  - Employer – employer taxes, franchise taxes and sales and use taxes
  - Employee – personal income tax
  - Employee nexus
    - Resident subject to tax on all income in resident state
    - Nonresident subject to tax only on income derived from sources in state
    - More on this later

# Part 1: Multistate Nexus Issues - Telecommuters

Nexus and Telecommuting?

- Home office employee = nexus?
- *Telebright* Case (N.J. Super. Ct. App. Div., 2010): software engineer working at home creates nexus for employer
- *Matter of Appeal of Warwick McKinley, Inc., Cal. SBE No. 489090*: marketing company with home office employee (and no other CA activities) had a "regular, systematic and substantial connection" with the state.
- A few states, though, take the position that a telecommuter does not = nexus

# Part 1: Multistate Nexus Issues - Telecommuters

- 36 states and the District of Columbia say income tax nexus would result for an out-of-state corporation with employees who telecommute from homes within their jurisdiction
- 35 jurisdictions report nexus would arise from a single telecommuter who performed back-office administrative business functions
- Is the employee an in-state salesperson? The employee’s activity may still be protected by Public Law.

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# Part 1: Other Issue: “Convenience of The Employer” Rule

- What does the rule require?
  - When non-resident employees commute to non-resident states to work for an employer, they must pay tax on income earned from these work days spent in the non-resident states.
  - To limit a non-resident’s ability to reduce his or her tax liability by working from home, a handful of states have adopted a “convenience of the employer” rule.
  - The terms of the convenience rule simply provide that days worked from home would be treated as work days in the non-resident states, unless the non-resident employee worked outside of the non-resident state by necessity.

# Part 1: "Convenience of The Employer" Rule

- Scope of Issue
  - Only a handful of states apply such an aggressive rule.
  - These states include NY, PA, DE, NJ and NE.
  - The impact of the rule can lead to double taxation.
  - NY has special "safe harbors"
- Federal legislation has been proposed to help ease the burden/confusion of employee withholding.
  - This is going nowhere!

# Part 2: Basics of Employee State Taxation

<u>Importance of Residency Status</u>

- Residents: Taxable on one thing (<u>every</u>thing)
- Nonresidents: Taxable on “source” income only

<u>Basic Residency Tests</u>

- Domicile Test: Permanent/Primary Home
- “Statutory” Tests: 183 days and living quarters
- Other Tests: Non-Temporary/Transitory Purpose

<u>Employer’s Obligation to Know: Where Do You Live?</u>

# Part 2: Basics of Nonresident Taxation

Basics of Nonresident Taxation

- Where is the income “earned?”
- The concept of “sourcing:” Is the income “derived from” sources in the state?

Typical Executive Comp Subject to Sourcing

- Wages/Bonuses
- Stock Options and Restricted Stock
- Deferred Compensation/Retirement Income

# Part 2: Multistate Withholding: Employer Obligations

Employer Withholding: Nexus

- Starting point for all multistate issues
- “Doing Business” or “Transacting Business” is the standard
- Presence of employees in-state usually = nexus
- Circular analysis: withholding is only an issue if employee is working in the state



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# Part 2: Multistate Withholding: Employer Obligations

Thresholds for Withholding

- No Threshold: About half of the states with an income tax have no threshold at all; withholding is required on day #1
- Income Thresholds: A few states only require withholding after a (low) income threshold is reached
- Time Thresholds: Withholding only required after an employee works a certain number of days
  - But, at least in NY, the 14-day threshold does not apply to certain executive compensation such as options
  - And check to make sure the "exemption" applies to employees too

# Part 2: Multistate Withholding: Employer Obligations

Thresholds for Withholding (con't.)

- Reciprocity: Designed to set certain conventions for withholding on nonresident employees living in border states
- Obviously varies on state-by-state basis
- Example: PA resident works in NJ; states agree to allow withholding in state of residence only

# Part 2: Multistate Withholding: Employer Obligations

<u>Low/No Thresholds: Practical Problems</u>

- Frequently-travelling employees
  - Examples: travelling sales people; consultants
- Rules vary state-by-state
  - Withholding thresholds different; so hard to have overall company policy
  - Allocation rules vary: amount to be withheld on certain forms of income (options, for example) varies state-to-state
- Audits are increasing
- Trust Fund Tax = Personal Liability!

# Part 3: Managing Compliance and Practical Solutions

A Federal Solution?

- H.R. 1129 and S. 1645 Mobile Workforce State Income Tax Simplification Act of 2013
  - 30-day threshold for income/withholding responsibility
  - N/A to athletes, entertainers
- Similar legislation has been tabled for over five years

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# Part 3: Managing Compliance and Practical Solutions

<u>Cleaning Up the Past</u>

- Status Quo?
  - Section 404 of Sarbanes-Oxley
- Prospective Compliance
- Voluntary Disclosure

# Part 3: Managing Compliance and Practical Solutions

Doing a Multistate Compliance Review

- How many employees visit?
- How many total visits?
- Total compensation paid to visiting employees?
- Existence of thresholds?
- Active in withholding area?

# Part 3: Managing Compliance and Practical Solutions

## Sample Compliance Chart

| STATE | NO. OF EMPLOYEES VISITING STATE | TOTAL NO. OF VISITS | DE MINIMIS THRESHOLD FOR NONRESIDENTS? | RECIPROCAL AGREEMENTS IN EFFECT? | COMPLIANCE ACTION |
|---|---|---|---|---|---|
| LA | 25 | 563 | No | No | High activity state, with many employees over 25 days. State doesn't appear to have active criminal enforcement outside the sales tax area, but the high number of visits is problematic. Voluntary disclosure may be the best option. |
| NY | 14 | 195 | 14 day rule | No | 5 employees surpass 14 day threshold. NYS has been aggressive both on the withholding tax side and with respect to criminal enforcement. Thus, voluntary disclosure is also the best option. Going forward, put measures in place to track 14 day rule. |
| IL | 10 | 88 | Maybe | IA, KY, MI and WI | Employees' services could be considered localized elsewhere and services in IL incidental if they are temporary, transitory, or isolated; at the very least this could give us an argument for no withholding. Consider future compliance options. |
| SC | 16 | 35 | $1,000 | No | Low number of visits; some could fall below threshold; status quo for now |

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# Part 3: Managing Compliance and Practical Solutions

Special Considerations for Voluntary Disclosures

- Do employees disclose also?
- Is payment on behalf of employee = taxable income?
- Resident credits for employee in home state?

Special Considerations for Audits

- What to do?
- Practical guidance from the front lines

# Part 3: Managing Compliance and Practical Solutions

<u>Going-Forward Compliance</u>

- Require employee reporting of work days
  - IT-2104
  - Company Forms/Disclosures
    - Coordinate with expense reporting requirements
- Can Technology Help?
  - e.g., the MONAEO option: a “Compliance Chart” for the future!

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# Thank You

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