Employer Tax Issues and the Remote Workplace in the Pandemic

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Speakers

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Overview

- Part 1 – Employee Fringe Benefits
- Part 2 – State Tax Issues
- Part 3 – Managing the Insurance Company Tax Department in a Pandemic

Employee Fringe Benefits

- Application of IRC Section 139 Disaster Relief Benefits
- Application of the IRC Section 132(d) Working Condition Fringe Exclusion for Employer-Provided Home Office Benefits

Section 139: Disaster Relief Payments

- Section 139 provides that “qualified disaster relief payments” are payments to an individual for personal, family, living, or funeral expenses resulting from a “qualified disaster”, which could include expenses such as child care, medical expenses, or increased home office expenses
- Because the COVID-19 pandemic was designated as a national emergency, payments from an employer to an employee can now qualify

Section 139: Disaster Relief Payments

What are the limitations?

- Payments must be reasonably calculated to cover expenses *caused* by the disaster that have not been reimbursed by insurance or otherwise

- Cannot be intended to replace lost income

Section 139: Disaster Relief Payments

Examples:

- Over-the-counter medications, hand sanitizer and home disinfectant supplies
- Unreimbursed medical expenses including co-pays, deductibles, vitamins, and supplements
- Increased expenses associated with being quarantined at home (*e.g.*, increased utilities and home office expenses)
- Expenses associated with setting up or maintaining a home office such as enhanced internet connections, computer monitors, laptops, printers, office supplies, etc. (even if such expenses would not otherwise satisfy the home office deduction requirements)

Section 139: Disaster Relief Payments

More examples:

- Transportation and living expenses for college students returning home (including duplicative meal expenses)
- Increased childcare or tutoring expenses
- Expenses to enhance mental health and physical well-being from social distancing such as meditation apps and home health fitness
- Increased commuting costs, such as taking a taxi instead of using public mass transit

Application of the Working Condition Fringe Exclusion to Employer-Provided Home Office Benefits

- As a result of the pandemic, the number of employees working from home has dramatically increased, raising issues about the tax treatment of computers, monitors, printers and other office supplies that employers provide to employees in support of their work-at-home arrangements

- Under section 132(d), working condition fringes are generally defined as any property or services provided by an employer that, if paid by the employee, would be deductible as a trade or business expense under section 162. The value of a working condition fringe benefit is excludable from an employee's income. To qualify as a working condition fringe, the benefit received by the employee must be related to the employee's duties for the employer

Application of the Working Condition Fringe Exclusion to Employer-Provided Home Office Benefits

- The working condition fringe exclusion will generally apply to most items that an employee needs to work from home
- Employers have long taken the position that the WCF exclusion should apply to laptops and peripheral equipment
- For cash reimbursements, the employee will need to provide documentation of the expense, in the form of a receipt

Application of the Working Condition Fringe Exclusion to Employer-Paid Home Internet/Wi-Fi?

- For years, the IRS routinely audited the tax treatment of employer-provided cell phones because employees did not comply with the stringent recordkeeping requirements applicable to “listed property”

- The IRS conceded this issue in Notice 2011-72, which states that the IRS will treat the employee's use of employer-provided cell phones for reasons related to the employer's trade or business as a working condition fringe benefit and treat any personal use as an excludable de minimis fringe benefit, provided the cell phone usage is provided primarily for noncompensatory business reasons

Application of the Working Condition Fringe Exclusion to Employer-Paid Home Internet/Wi-Fi?

- Although the Tax Cuts and Jobs Act of 2017 (TCJA) removed computers and peripherals like printers, monitors, fax machines, etc. from the definition of listed property, it is unclear whether this should apply to home internet/Wi-Fi or if Notice 2011-72 should be expanded to include home internet

- Therefore, it is unclear whether employer-paid internet should be treated as a taxable perk or if employees must maintain stringent records to exclude a portion of employer-paid home internet service

Polling Question:

During the COVID-19 pandemic, has your company applied section 139 to exclude any cash payments to employees?

A) Yes

B) No

C) Don’t know

State Tax Issues

- Income Tax Withholding for Remote Employees
- Corporate Nexus Issues for Remote Employees

Employer State Income Tax Withholding Obligations

- As a general rule, unless a state has a reciprocity agreement with a neighboring state, most states require employers to withhold income taxes based on the location of where the work is physically performed

- For example, if a resident of Nevada works in California for a California employer, the employer must withhold California income taxes from the employee's wages

Employer State Income Tax Withholding Obligations

- Further complicating the issue, most states also require employers with operations within their state to withhold state income taxes from the wages of residents for services in other states if that state has no income tax (or even a lower income tax withholding rate)

- Complying with these state withholding rules has long been a daunting task for employers, particularly those with a mobile workforce

New York's Convenience of the Employer Test for Withholding on the Wages of Remote Employees

- Under the so-called "convenience of the employer rule," to determine whether New York will tax the wages of a telecommuter, if the employee's principal office is located in New York, then compensation earned while working at home in another state will be treated as if earned in New York, if the employee is working from home for her own convenience and not the employer's necessity

State Responses to Taxing Telecommuters During Pandemic

- Several states have released COVID-19 guidance that they won't require employers to withhold income taxed on employees' wages based on temporary work within the state triggered by a COVID-19 quarantine/stay-at-home order

- New York DOR has not released any guidance on the impact of COVID-19 on New York's application of "convenience of the employer" test on taxing nonresidents that work from their homes for personal reasons. NY Senate proposed S. 8386, which would relax the requirement during the stay-at-home order (3/27/20 – 9/7/20), but there has been no action on that bill. However, a reasonable application of this test would be to conclude that the nonresident employees are not working out of state for personal reasons and therefore it would be proper to tax these individuals based on the location of where their services are actually performed (i.e., the residency state). Under this fact pattern, the NY DOR should treat the NY location as closed and therefore the services should not be sourced to that location

Polling Question:

Pre-pandemic, did your company track employees' physical work location for purposes of determining the proper state income tax withholding for nonresident services?

A) Yes

B) Yes, but only if the services were significant and reoccurring

C) No

D) Don't know

State Nexus – General Overview

- In Complete Auto Transit, Inc. v. Brady, the Supreme Court set out a four-prong test a state tax must satisfy under the Commerce Clause, which included the nexus test

- Under the nexus prong, a state violates the commerce clause if there is no sufficient nexus between the activity and the state imposing the tax

- States have different interpretations of what constitutes a sufficient state nexus for purposes of imposing a corporate income tax

State Nexus – New Jersey

- The New Jersey Corporation Business Tax Act "requires every foreign corporation that is not exempt to pay an annual franchise tax for the privilege of doing business, employing or owning capital or property, or maintaining an office, in" New Jersey

- The Tax regulations defined "doing business" as "all activities which occupy the time or labor of men for profit." Any for-profit corporation "carrying out any of the purposes of its organization within the State shall be deemed to be 'doing business'"

- The regulations specifically listed five non-exclusive factors to be considered in determining whether a corporation was "doing business" in New Jersey:

  - nature and extent of activities of the corporation in New Jersey
  - location of corporation's offices and other places of business
  - continuity, frequency and regularity of the activities of the corporation in New Jersey
  - employment in New Jersey of agents, officers and employees; and
  - location of the actual seat of management or control of the corporation

State Nexus – New Jersey

- In Telebright Corporation v. Director, New Jersey Division of Taxation, decided in 2012, an employee for Telebright Corporation moved to New Jersey and worked remotely for Telebright after relocating. She developed and wrote software code from a laptop in New Jersey, which was then used to create products provided to the company's customers. She was supervised and reported to a project manager in Boston, with whom she communicated by email and phone. Telebright had no locations in New Jersey
  - The court affirmed the New Jersey Tax Court's opinion that a "foreign corporation that regularly and consistently permits one of its employees to telecommute full-time from her New Jersey residence is doing business in New Jersey [and] is subject to the New Jersey Corporation Business Tax Act"

State Nexus – Virginia

- Virginia requires “sufficient business activity” using its applicable apportionment factors in order to impose corporate income tax. The existence of a positive apportionment factor establishes income from Virginia sources

- In 2016, the Virginia Department of Taxation issued a ruling, which states that a single employee working from a home office in Virginia creates corporate income tax nexus for a corporation with no other Virginia ties

    - The employee’s primary responsibilities included “bookkeeping and accounting matters, human resources and payroll, customer support conducted entirely by e-mail, and legal consultative matters” (administrative services) but did not include working on software, computers, website templates, or the solicitation of new customers

- The Virginia Department of Tax concluded that accounting support service, customer service on legal matters, consulting, and customer support “are sufficient to create nexus for corporate income tax purposes” unless they are de minimis

State Nexus – Other States

- Other states have indicated that the following *could potentially constitute* substantial nexus to a state for corporate income tax purposes:
  - Consulting and recruiting work, even with no clients in the state (CA)
  - Online administrative duties (FL)
  - Telecommuting generally (OR)
  - Telecommuting—non-solicitation activities (SC)
  - Using a salesperson's home (NY)
- Other states have indicated that the following *do not constitute* substantial nexus to a state for corporate income tax purposes:
  - Officer working from home office out of state on strategic planning, mergers and acquisitions, and related activities (TN)
    - In this specific scenario, the corporation did not own any of the furniture or equipment in the employee's office and did not reimburse the employee for any office expenses (except for a cellphone)
    - Additionally, neither the employee's home phone nor cell number appeared on the employee's business card.
  - Sales employees and technical advisors in a state whose activities are only directed at customers in other states (IN)

State Nexus – Pre-COVID-19

- In a survey conducted in 2020 before the “shelter-in-place” and “work from home” policies were enacted, 36 states and D.C. (78%)* stated that having “one to 6 employees telecommuting from home doing non-solicitation activities” was enough to create nexus for corporate income tax
  - *Only 46 states and D.C. impose a corporate tax on income
- Only Indiana and Mississippi explicitly responded “No”
- The responses were similar for questions asking about “one employee telecommuting from home doing back office functions” (33 states and D.C.) and “one employee telecommuting from home doing product development functions” (34 states and D.C.)

State Nexus – COVID-19 Relief

- At least 20 states have indicated that telecommuting during COVID-19 will not create nexus if the employer previously had no connection to the state

- Other states have not yet provided any guidance on how they intend to proceed during COVID-19

Managing the Tax Department in a Pandemic

- Managing the tax team
- Thinking and acting strategically
- Managing the relationship with the federal government

Polling Question:

When do you envision your company having employees back in the office regularly?

A) January 2021

B) July 2021

C) January 2022

D) Never

Managing the Team

- Initial focus has been on accomplishing tasks, e.g., quarterly reporting, filing returns
- Technology, what has worked and what has not
- Supporting employees, e.g., training, daycare, maintaining work-life balance
- Hiring new employees and integrating them into the department process
- Substitutes for casual interaction and informal information sharing

Thinking and Acting Strategically

- How do we continue to be viewed as a strategic partner while remote working?
- Are there any strategic opportunities presented by the pandemic?
- Communication with the C-suite, e.g., what's on the CFO's mind?
- Envisioning the post-pandemic tax department

Polling Question:

During the last few months has your Tax Department been -

A) Very strategic

B) Somewhat strategic

C) Task oriented

Managing the Relationship with the Federal Government

- Anticipating and preparing for the next round of tax legislation
- Policy outreach and communication with members of Congress and congressional staff, Department of Treasury and IRS staff
- How does your Washington team stay abreast of Hill thinking?
- Working with your IRS audit team