

Payroll and Tax Implications for Employees on the Move



March 14, 2023

Agenda

- Overview of common scenarios
- General rules for state income tax withholding
- Exceptions to general rules for state income tax withholding
- Practical guidance and best practices for state income tax withholding
- General rules for unemployment compensation
- Wage-and-hour pitfalls
- Workers' compensation considerations
- Foreign qualification and nexus issues
- International hiring issues
- Questions

Presenters

Christine (“Chrissy”) Green

christine.green@steptoe-johnson.com

Joseph U. Leonoro

joseph.leonoro@steptoe-johnson.com

Common Scenarios

- Employer hired a remote WFH employee who lives in North Carolina. The employee may travel to the employer's only office, which is in West Virginia, a few times per quarter.
- During the pandemic, an employee moved from Pennsylvania to Florida and will WFH from Florida indefinitely.
- Employer is located near a state border and employees who used to work from the office each day now WFH several days per week in different border states.

State Income Tax Withholding – General Rules

- Withholding based on the location of work/services
- Threshold requirements such as the amount paid or the number of days
- May have to withhold in more than one state
- Employee may have to file nonresident state income tax return and/or claim tax credits

What if the employer is not located in and does not have a physical presence in the state where the employee is performing services?

Is this fair?

State Income Tax Withholding - Exceptions

- Temporary relief during the pandemic
- Convenience of the employer rule
- Reciprocal agreements

State Income Tax Withholding – Temporary Relief

- Georgia: If an employee is temporarily working in Georgia due to a work-from-home order, wages earned during this time are not treated as Georgia income and therefore the company is not required to withhold Georgia income tax. If the person remains in Georgia after the temporary remote work requirement has ended (whether voluntarily or if required by the employer), the normal rules for determining the employer's income tax withholding obligation will apply. *GA DOR, Coronavirus Tax Relief FAQs* (July 6, 2020).

VS.

- Illinois: Regarding out-of-state employers and their employees who normally work in an out-of-state location but who will have performed normal work duties for more than 30 days in Illinois due to the Covid-19 pandemic, the Illinois Department of Revenue will waive penalties and interest for such employers who do not withhold Illinois income tax where the sole reason for the Illinois withholding obligation is that the employee is working from home due to the Covid-19 pandemic. The department encourages all employers that have withholding requirements to register and withhold Illinois income tax as soon as applicable to avoid processing delays and increased correspondence. *Illinois Dept. of Rev. Info. Bulletin NO. FY 2020-29* (May 1, 2020).

State Income Tax Withholding – Convenience of the Employer

- If the employee is WFH out of convenience and not necessity, services are still sourced to the employer's state
- Limited to a few states: Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania
- Example: Taylor lives in Pennsylvania and WFH full-time for ABC Corporation located in Delaware. If ABC Corporation permits Taylor to WFH for convenience rather than out of necessity, ABC Corporation will need to withhold Delaware income tax because Delaware will treat Taylor's compensation as Delaware-source income. ABC Corporation may also be required to withhold Pennsylvania income tax.
- Necessity v. Convenience: Strict standards with a focus on specialized facilities or requiring that a home office be a "bona fide employer office"

State Income Tax Withholding – Reciprocal Agreements

- 17 states (including D.C.) have entered into reciprocity agreements with others; usually border states
- Employee who is a resident of State A can work in State B without having taxes for State B withheld from their pay. Employer agrees to withhold for State A
- Employee must provide withholding certificate (state specific) to employer certifying state of residence and exemption information

State Income Tax Withholding – Practical Challenges

- Coordinating with the payroll service provider
- May need to update service agreement and add services
- Monitoring the states where employees are doing WFH
- Similar issues for local taxes
- Be careful with benefits and reimbursements for employee travel

State Income Tax Withholding – Best Practices for Remote Employees

- New hires – Be sure to fully understand the agreed upon remote working arrangement (e.g., full-time remote or hybrid? Temporary? Which states?)
- All employees – Collect updated employee withholding certificates (W-4 and state-specific) and residency certifications
- Check for applicable reciprocity agreements
- Determine if the ‘convenience of the employer’ rule is relevant
- If withholding in two states cannot be avoided, consider drafting a brief letter to the employee explaining the dual withholding and that the employee should seek tax advice

Unemployment Compensation

- DOL's Localization of Work Provisions
 - Four-part test
 - Apply the parts in order

Unemployment Compensation – Test 1

- Is the individual's service localized in this state or some other state?
- Service is localized in a state if it is
 - performed entirely within the state,
 - or, if it is performed both within and outside the state, and the service performed outside the state is incidental to the individual's service performed within the state.
- Service is considered incidental if it is
 - temporary or transitory in nature,
 - or consists of isolated transactions.

Unemployment Compensation – Test 1 – Factors

- Factors to consider whether work is incidental or transitory
- Is it intended by the employer and the employee that the service be an isolated transaction or a regular part of the employee's work?
- Does the employee intend to return to the original state upon completion of the work in the other state or is it the employee's intention to continue to work in the other state?
- Is the work performed outside the state of the same nature as, or is it different from, the tasks and duties performed within the state?
- How does the length of service with the employer within the state compare with the length of service outside the state?

Unemployment Compensation – Test 2

- If there is no finding of localized work under test 1, then move to test 2
- Does he/she perform some service in the state in which his/her base of operations is located?
 - Place, or fixed center of more or less permanent nature, from which the individual starts work and to which the individual customarily returns to receive
 - instructions from the employer,
 - or communications from customers or other persons,
 - or to replenish stocks and materials,
 - to repair equipment,
 - or to perform any other functions necessary to exercise the individual's trade or profession at some other point or points.

Unemployment Compensation – Test 3

- If test 1 and test 2 do not apply, then move to test 3
- Does he/she perform any service in the state from which the service is directed and controlled?
 - The place at which the basic authority exists and from which the general control emanates, rather than the place at which a manager or foreman directly supervises the performance of services under general instructions from the place of basic authority.

Unemployment Compensation – Test 4

- If tests 1, 2, and 3 do not apply, then does the individual perform any service in the state in which he/she lives?
- If none of the other tests apply, all of an individual's service is covered in the state in which he lives, provided that some of his services are performed in that state

Wage-and-Hour Considerations

- Fair Labor Standards Act
- State and Local Wage-and-Hour Laws and Wage Payment Laws
- State and Local Benefit and Leave Laws

Common Wage-and-Hour Pitfalls

- Minimum wage
- Overtime
 - Different thresholds
 - Different exemption rules
- Garnishment rules
- Benefit requirements
- Pay equity
- Expenses
- Recordkeeping

Workers' Compensation Considerations

- Are remote workers covered?
 - Does the injury arise out of and in the course of employment?
 - Location is usually not relevant
- If there is coverage, which state law applies?

Workers' Compensation Pitfalls

- Why does it matter?
 - Criminal penalties
 - Civil penalties
 - Liability for lost wages
 - Liability for medical benefits
- States apply different tests
 - Typically, very fact specific
 - Travel
- Reciprocal agreements between states

Workers' Compensation Best Practices

- Create a telecommuting policy
- Establish guidelines for a home office
- Conduct checks when possible
- Set fixed hours and meal and rest periods
- Put insurance carrier on notice

Foreign Qualification to Do Business

Does having a single remote WFH employee cause an out-of-state employer to be “doing business in” another state?

- Entity formed in Delaware but “doing business in” (or “transacting business in”) West Virginia must register (or “qualify”) to do business in West Virginia
- “Doing business in” is not well-defined
- Most state statutes provide a non-exhaustive list of activities that do not constitute “doing business in” which usually include holding meetings, defending litigation, maintaining a bank account, and borrowing money
- Have yet to see case law on telecommuting or WFH employees

Employer Income Tax Nexus

Does having a single remote WFH employee cause an out-of-state employer to have an income/business tax nexus in another state?

- Example: Employer is located in Texas. An employee is WFH in West Virginia. Does the employer have income tax nexus in West Virginia? Is the employer required to file West Virginia income tax returns or pay West Virginia income tax?
- Some states have “factor-based” standards for nexus requiring certain thresholds of property, payroll, and sales in a state before an out-of-state business has nexus. For example, Colorado’s thresholds are \$50,000 of property, \$50,000 of payroll, \$500,000 sales, or 25% of total property, payroll, or sales. 39 Colo. Code Regs. § 22-301.1
- For states without “factor-based” standards, beware of the “critical mass” concept

International Hiring Issues

US Employee Moves to Foreign Country:

- If a US citizen moves outside of the US, US employer may have tax registration/withholding requirements in a foreign country
- Need to obtain foreign counsel
- US citizens still subject to US taxation

US Employer Hires Foreign Person:

- Usually see arrangements where a non-US person sets up a foreign entity to receive payments
- Foreign certification forms and treaty exemptions – Forms W-8 (BEN and BEN-E), Form 8233 (services performed in the US) may be needed

Questions?



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