

# Remote Working Implicates State Payroll Tax, Corporate Income/ Franchise Tax Nexus Concerns

A Lexis Practice Advisor® Article by Cosimo Zavaglia, Handy Hevener, and Justin Cupples, Morgan, Lewis & Bockius LLP



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Employers should be aware that remote working arrangements during the coronavirus (COVID-19) pandemic may inadvertently trigger state payroll tax registration and filing requirements for their businesses, and possibly trigger corporate income/franchise tax “nexus” with another state, subjecting the business to that state’s tax regime.

## The Effect of Employee Stay-at-Home Orders/Payroll Tax Registration

To prevent the spread of COVID-19, several state and local governments have issued stay-at-home orders, effectively mandating remote work for employees of so-called nonessential businesses. Even if not mandated, many employers have opted to allow their employees to work remotely. Employers should be aware that these remote working conditions may inadvertently trigger state payroll tax registration and filing requirements for their business. These remote working conditions may also trigger corporate income/franchise tax “nexus” with a state with which the business did not have nexus before, and thus subject the business to that state’s tax regime.

The thresholds requiring state payroll tax registration and filing requirements vary significantly among states. Many states have specific wage or day thresholds that an employee must meet before an employer is required to withhold state tax. Several other states require employers to start withholding on an employee’s wages the first day that the employee works in the state for the employer. Additionally, employers have to consider reciprocal agreements among various states and unusual state-specific rules such as the “convenience of employer” rule.

For corporate income/franchise tax purposes, the nexus determination hinges on whether a business has sufficient minimum contacts with a particular state for the state to constitutionally subject the business to the state's tax regime. Under general nexus principles, an employee working in a state in which their employer does not otherwise operate can trigger nexus with that state, and therefore expose the employer to the state's tax regime. As a result, most employers are cautious about their business decisions to expand to or locate their employees in other states.

Provided that the above-described remote working conditions are put in place as *temporary* measures for the *health and safety of employees and society at large*, the ordinary application of laws and policies concerning wage tax withholding and nexus will, in many cases, lead to unfair results.

## Potential Avenues of Relief

### Federal Action

The state payroll tax filing requirements triggered by remote working arrangements as a result of COVID-19 may be resolved through coordinated action at the federal level between the U.S. Department of the Treasury, the Internal Revenue Service (IRS), and affected state and local tax authorities, or possibly through Congress. Federal legislation aimed at addressing similar workforce mobility issues has been introduced before, albeit not with a global health crisis as the backdrop. For example, Senate Bill 604, the Mobile Workforce State Income Tax Simplification Act of 2019, was introduced but never enacted.

Recognizing the multitude of tax issues created by the COVID-19 pandemic, Morgan Lewis has submitted a [comprehensive list of relief recommendations](#) to the IRS Office of Chief Counsel. In particular, we highlighted that as a growing number of employees are being required or encouraged to work remotely, state and local tax issues arise when teleworking employees do so from a tax jurisdiction different from their primary office tax jurisdiction, and we have urged for federal-level coordinated action to provide relief to employers.

More recently, Senate Republicans introduced a series of bills and proposals collectively referred to as the "Health,

Economic Assistance, Liability Protection and Schools Act" (HEALS Act), which included taxpayer relief with regard to state payroll tax registration and filing requirements. Essentially, under the HEALS Act, if an employer would not otherwise be taxable in a state except for the employees living in that state that are working remotely due to COVID-19, that state could **not** impose any registration, taxation, or other related requirements on the employer during the covered period. To date, the HEALS Act has not been passed by Congress.

### State Action

In the absence of federal guidance, approximately 20 states have formally published guidance to address state payroll tax registration and filing requirements and/or corporate income/franchise tax nexus issues created by remote working arrangements under COVID-19. These states include Alabama, Georgia, Illinois, Indiana, Iowa, Maryland, Massachusetts, Minnesota, Mississippi, Nebraska, New Jersey, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, and South Carolina. In these states, the guidance is quite varied and often leaves taxpayers with the difficult burden of interpreting and applying a multitude of standards. For example, many of the states that have waived state payroll tax registration and filing requirements or corporate income/franchise tax nexus if the employer's only connection with the state are employees working in the state because of COVID-19 will have their own definition of remote work that qualifies for this relief and/or period of time for which this relief applies. Taxpayers may find that the state tax guidance may not always apply to their specific situation. Setting aside those states that have published guidance, tax officials in several states have opted to informally acknowledge the payroll tax and corporate income/franchise tax nexus issues faced by employers, and have generally stated that they will consider the impact of COVID-19.

Note, as temporary remote work arrangements have become more permanent, there have been many other issues that have come up that have not yet been addressed by states. For example, irrespective of any state payroll tax registration and filing guidance, states have not provided personal income tax guidance on how they expect to treat individuals who may have inadvertently become statutory residents in a state where they were sheltering.

# COVID-19 and the Convenience of the Employer Test

Employers that operate in Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania should also note the unique challenge presented by the “convenience of the employer” test in the current environment. While most states source employee wages for payroll withholding purposes to the state where the employee performs the services, these five states have enacted “convenience of the employer” laws. See, e.g., [NYS Dep’t of Taxation and Finance Office of Tax Policy Analysis \(May 15, 2006\)](#).

With some variations across the states, compensation earned by a nonresident employee is allocated to the location of the assigned office of the employee, unless the work the nonresident performs is work that, of necessity and not convenience, obligates the employee to work from a location other than the assigned office. Thus, the wages of an employee may result in a tax withholding requirement in the office state, regardless of whether the employee is working from home in another state.

Generally, states that impose the “convenience of the employer” test apply strict definitions of what constitutes working from home for the employer’s convenience for payroll withholding purposes. Absent specific guidance, it is uncertain where:

- Working remotely from home due to COVID-19 is for the employer’s convenience.
- There is an exemption with respect to COVID-19. –or–
- The states would distinguish between voluntary work-from-home initiatives versus mandatory orders.

As a final note, in states such as New York, employers may want to evaluate whether they are an “essential business” allowed to operate as usual under the COVID-19 remote

working mandates. If so, it is possible that the employer may continue to rely on the “convenience of the employer” rule as normal.

To date, no guidance on the interaction between COVID-19 and the convenience of the employer rule has been released. Morgan Lewis has prepared a chart summarizing the state and local tax responses to COVID-19 issued by various jurisdictions. This chart will be updated regularly.

[See the chart on state and local tax responses >>](#)

## Related Content

### Lexis Tax

- Bender’s State Taxation: Principles and Practice § 3.02, “Nexus”
- Bender’s State Taxation: Principles and Practice § 3.05, “Corporate Franchise Taxes”
- 2017 NYU Institute on State & Local Taxation § 10.06, “State Nexus Developments”
- Bender’s Payroll Tax Guide § 7.20, “Survey of State Income Tax Withholding”
- New York State Department of Taxation and Finance, [New York Tax Treatment of Nonresidents and Part-Year Residents Application of the Convenience of the Employer Test to Telecommuters and Others \(TSB-M-06\(5\)I\)](#)
- State Taxation: The Role of Congress in Defining Nexus ([Congressional Hearings](#))

### Lexis Practice Advisor

- [Coronavirus \(COVID-19\) Resource Kit](#)
- [Doing Business in the State State Law Survey](#)
- [Formation Fundamentals: C Corporations](#)
- [Payroll Taxes: Overview](#)
- [Wage Withholding Provisions State Law Survey](#)
- [Withholding and Estimated Taxes](#)

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**Cosimo Zavaglia, Partner, Morgan, Lewis & Bockius LLP**

Cosimo A. Zavaglia advises corporations, partnerships, and individuals on state and local tax controversy, planning, and transactional matters. Cosimo routinely represents clients in high-stakes state and local tax audits, appeals, and litigations in matters throughout the United States, including defending clients in state False Claims Act cases and sales and use tax, individual residency, withholding tax, corporate income tax, and real estate transfer tax audits and disputes. He also advises clients on developing state and local tax planning strategies for corporate acquisitions, dispositions, restructurings, and mergers.

Cosimo works closely with a broad range of clients, including Fortune 500 companies, enterprising startups, and high-net-worth individuals, to develop solutions to mitigate state and local tax risks. He advises in all stages of state and local tax controversy—from initial information gathering, through negotiations and settlement, as well as litigation and appeals, if necessary. Cosimo also obtains formal and informal rulings from state and local tax authorities in many jurisdictions on several issues across tax types and has represented companies and industry groups in legislative and regulatory matters. Prior to joining Morgan Lewis, Cosimo worked in the state and local tax practice of PricewaterhouseCoopers LLP.

In addition to writing extensively on tax subjects, Cosimo has lectured on a broad range of state and local tax topics throughout the country, including for the Tax Executives Institute. He is also active in pro bono work and is a member of the pro bono committee for the New York office.

**Handy Hevener, Partner, Morgan, Lewis & Bockius LLP**

Mary B. “Handy” Hevener helps US and multinational enterprises minimize corporate payroll taxes and maximize benefits-related tax deductions. She focuses her practice on the tax and information reporting treatment of employee and independent contractor benefits outside qualified retirement plans, including stock options and other stock-based compensation; executive income deferrals; golden parachutes; and fringe benefits that range from health and life insurance, to employee loans, cars, planes, and prizes.

Handy also advises on executive benefits triggered by corporate mergers and acquisitions (M&A), and spinoffs, including golden parachute issues and stock option deduction allocations. She counsels on the design of compensation and benefit programs, as well as employment and consultant contracts. She handles corporate and payroll tax audits at both the US federal and state levels, penalty abatements, and Internal Revenue Service (IRS) ruling requests.

She also is a lead attorney in tax litigations of first impression, including the payroll taxation and deduction of employee meals and per diem payments; corporate aircraft deductions; stock option taxation; bonus accruals; Railroad Retirement taxes on stock and contract payments; the FICA taxation of tipped employees’ compensation; and the tax treatment of payments (including termination and settlement payments) to former employees made outside qualified retirement plans.

Handy is part of a group handling audits and appeals involving payroll tax, airline excise tax, and corporate deduction issues for companies in the healthcare, railroad, airline, and technology industries where the proposed taxes and penalties, in the aggregate, total more than \$3 billion. These cases affect US and overseas employees receiving stock and stock options, reimbursements for travel costs and moving expenses, tax return preparation, and meals in company cafeterias.

Listed in *Chambers USA: America’s Leading Lawyers for Business* (2011–2018), and recognized as 2019 “Lawyer of the Year” in the practice area of Litigation and Controversy - Tax in New York City by *The Best Lawyers in America*, Handy is co-leader of the firm’s Fringe Benefits and Payroll Tax Task Force. As such, she often works in concert with lawyers from the employee benefits and executive compensation, and tax practices.

Prior to joining Morgan Lewis, she served as an attorney-adviser for the US Treasury Department’s Office of the Tax Legislative Counsel. In that role, she focused on tax issues affecting current and deferred employee benefits (including parachute payments), and tax-exempt organizations. She also worked on legislation and IRS guidance affecting alternative minimum taxes, Social Security taxes, and a variety of excise taxes.

Handy has served for 35 years as a member of the New York University’s Institute on Federal Taxation’s Advisory Board, and she speaks frequently before the Tax Executives Institute. As a volunteer, she served as one of the original members of the Information Reporting Program Advisory Committee to the IRS.

**Justin Cupples, Partner, Morgan, Lewis & Bockius LLP**

Justin D. Cupples focuses his practice on providing the highest quality State and Local Tax (SALT) counsel and advocacy to Fortune 500 companies and large multistate organizations. Justin obtains significant state tax savings for his clients by developing and implementing state tax return positions, defending state tax audits, and advocacy through administrative appeals and litigation.

Justin has argued several hundred appeals in Pennsylvania alone, resulting in favorable decisions and settlements for his clients. However, the scope of his state tax practice is national. Justin has represented clients in audit defense and appeals in more than 30 states for matters spanning income, franchise, gross receipts, sales & use, real estate, and utilities taxes.

Justin works thoughtfully and closely with his clients to help them choose the best course of action in each particular situation. Whether the client needs complex multistate tax litigation help, creative solutions for difficult business problems, an aggressive advocate in a particular jurisdiction or basic tax advice, he always provides the highest quality service.

Prior to joining Morgan Lewis, Justin worked as a senior tax manager for a Big 4 accounting firm and in-house tax counsel for a Fortune 50 company.

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