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# MOBILE EMPLOYEES – WHAT EMPLOYERS NEED TO MANAGE FROM A TAX STANDPOINT EVENT

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<b>COVID-19</b>	<b>Global Commerce</b>	<b>Regulating Tech</b>

# Agenda

- U.S. federal income tax considerations and recent guidance.
- U.S. state and local tax nexus considerations and recent guidance.
- Best tax practices for remote workers.



**SECTION 01**

# **U.S. FEDERAL INCOME TAX NEXUS CONSIDERATIONS AND RECENT GUIDANCE**



# IRS Guidance

- Revenue Procedure 2020-20 – Relief for Nonresident Individuals in the United States.
- Revenue Procedure 2020-27 – US Citizens and Residents Abroad.
- FAQs.
- Revenue Procedure 2020-30 – Dual Consolidated Loss Rules.



**Tax Treatment of a Foreign Individual**

**Substantial Presence Test**

**Tax Treaty Considerations**

# Revenue Procedure 2020-20 – Relief for Nonresident Individuals in the United States

- **In general** – For “**eligible individuals**” expands the existing medical condition exception to include up to 60 days spent in the United States due to “COVID-19 Emergency Travel Disruption” during “COVID-19 Emergency Period.”
- “**COVID-19 Emergency Travel Disruption**”
- “**COVID-19 Emergency Period**”
- **U.S. Tax Treaties**
- **Claiming Relief**

# Overview – Foreign Earned Income Exception

- **“Qualified Individual”**
- **War, civil unrest, adverse conditions**



# Revenue Procedure 2020-27 – US Citizens and Residents Abroad

- **In general** - Relaxes requirements for a US citizen or resident to be considered a qualified individual under § 911 for certain specified periods during 2019 and 2020.
- **Adverse condition**
- **Requirements**

# Revenue Procedure 2020-27 – Examples

## Example (PRC)

An individual who arrived in China on September 1, 2019, and establishes that he or she reasonably expected to work in China until September 1, 2020, but departed China on January 10, 2020, due to the COVID-19 Emergency.

## Example (non-PRC)

An individual who was present in the United Kingdom on January 1 through March 1, 2020, establishes that he or she reasonably expected to work in the United Kingdom for the entire calendar year, but departed the United Kingdom on March 2, 2020, due to the COVID-19 Emergency, and returns to the United Kingdom on August 25, 2020, for the remainder of the calendar year.

# FAQs

- Allows a nonresident alien, foreign corporation, or partnership to exclude an uninterrupted period of up to 60 calendar days between February 1, 2020, and April 1, 2020, during which services or other activities are conducted in the United States from being taken into account in determining whether the nonresident alien individual or foreign corporation is engaged in a USTB.
- Similar rules and principles apply for purposes of determining whether a nonresident alien individual or foreign corporation is considered to maintain a PE in the United States.
- Considerations - The FAQ encourages taxpayers to retain contemporaneous documentation to support their positions in line with this FAQ guidance.

# Revenue Procedure 2020-30 – Dual Consolidated Loss Rules

- Activities, which normally would have been conducted in the U.S. but were conducted in a foreign country because of COVID-19, will not give rise to a foreign branch for dual consolidated loss purposes under IRC 1503(d).
- Applies if the individual conducts the activities for a period of 60 consecutive calendar days during 2020 (the taxpayer is able to select the period).

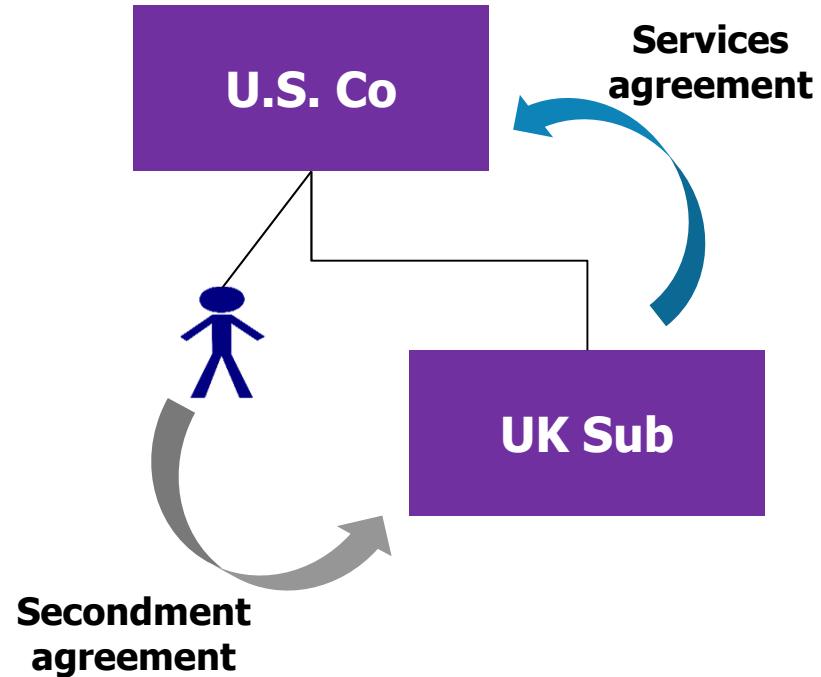
# Revenue Procedure 2020-30 – Considerations

- Taxpayers should maintain documentation to establish that the business activities are temporary or within the 60-day period, and should provide the IRS with the document upon request.



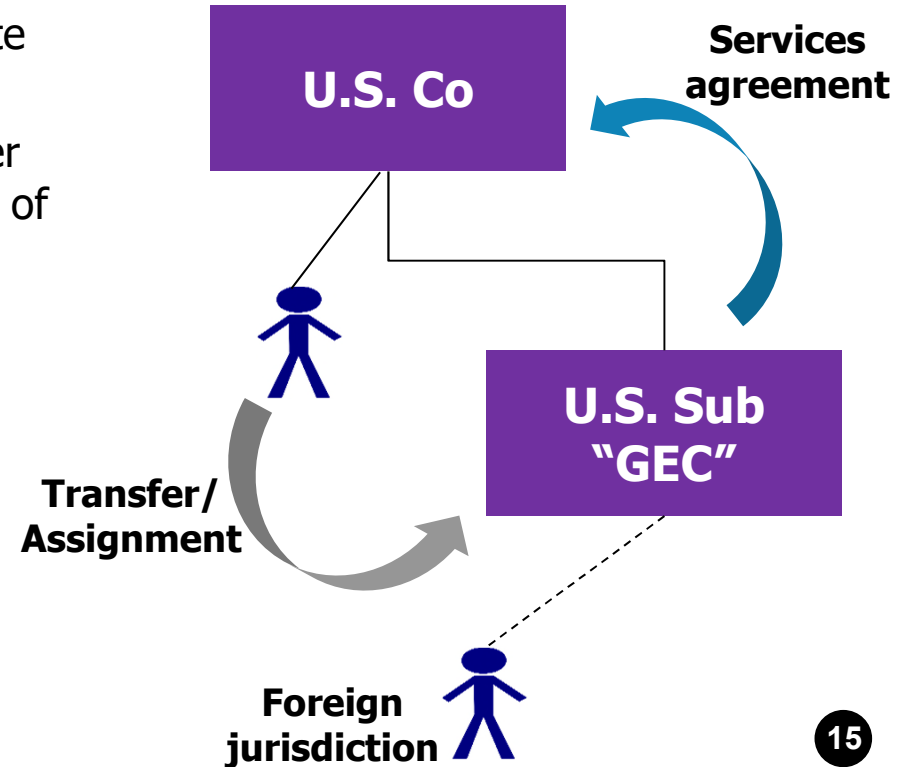
# Mitigation Strategies

- Align job descriptions/requirements
- Secondment or employee leasing
  - Confirm local acceptance/requirements
  - Employment law issues
  - Advisable to use arm's length terms
  - Consider adjustment/addition of intercompany agreements



# Mitigation Strategies, cont.

- Global Employment Company (“GEC”)
  - Establish a controlled subsidiary to segregate cross-border tax exposure within group
  - Use of intercompany agreement and transfer pricing documentation to define profitability of GEC
  - Manage challenges to economic substance



**SECTION 02**

# **STATE AND LOCAL INCOME TAX NEXUS CONSIDERATIONS AND RECENT GUIDANCE**



# State Tax Observations

- Corporate Income Tax
- Sales and Use Tax
- Payroll Tax

# Current State Corporate Income Tax Requirements and Audit Issues

- Nexus
  - Physical Presence
    - *Telebright* – New Jersey Appellate Division found company subject to income tax based solely on presence of one telecommuting computer programmer.
  - Economic Nexus
- Treaty Conformity Issues
- Apportionment Trends
- Consolidated/Combined Filings



# Current Sales and Use Tax Requirements and Audit Issues

- Nexus
  - Physical Presence
  - Economic Nexus
- Taxability Determination (e.g., SaaS)
- Exemptions
- Mitigation

# Current State Payroll Tax Requirements and Audit Issues

- Companies with peripatetic workforces—employees and contractors working in, and moving among, many different states, either in a single year or over the course of the vesting period for bonuses, stock options, restricted stock, or other equity compensation—have special problems due to myriad state laws governing the taxation of residents and non-residents.

# State Taxation of Workers in Multiple States: Impediments/Opposition

- Form W-2 includes spaces in Boxes 15-20 at the bottom of the Form for reporting income to *two different states* (separated by a broken line).
- The IRS instructions to Form W-2 say, “If you need to report information for more than two states or localities, prepare a second Form W-2.”
- Payroll systems may not accommodate (or capture) multiple work locations.
- But employees almost invariably complain if employers report wages in more than one state.

# State Taxation of Workers in Multiple States: Employer Withholding

- The “employer nexus” to trigger withholding, for most states is:
  - Employer office in state, or some other nexus to trigger state income tax; and
  - Payments of any wages subject to income tax in the state (or subject to contribution under the state’s unemployment compensation laws).
- Some states provide thresholds before withholding is triggered, based on days worked, dollars earned, or some combination of the two.

# State Taxation of Workers in Multiple States: Risks of Employer Audits

- As with any payroll audits, it is simpler for state/local tax officials to audit employers, holding them liable for non-withheld income taxes where allocated wages exceed the state's personal exemption, because that is more efficient than finding and auditing individual employees.
- If employers have neither reported nor withheld on the income, it is extremely unlikely that any non-resident of a state would have voluntarily paid income taxes (thereby enabling the employers to abate their liability for nonwithheld income taxes).



# State Taxation of Workers in Multiple States: Risks of Employer Audits

- However, it is nearly impossible for employers to keep track of day-counting income allocation rules (or with 183+ days residency tests).
- Some states have poorly explained rules on income allocations.
- Historically, many states were not aggressive in auditing non-residents or conducting payroll audits.
- Some states (e.g., NY) have been operating “amnesty programs” or “Voluntary Disclosure Agreements” to encourage employers to voluntarily confess their withholding/reporting errors.

# State Taxation of Workers in Multiple States: Stock Option/SAR Allocation Methods

- The state rules governing the taxation of stock options (or SARs) and the income allocation withholding rules for option income received by non-residents vary greatly depending on the state (and some states have never adopted any option-sourcing rules):
  - Grant-to-Vest Method
  - Grant-to-Exercise Method
  - Year-of-Exercise Method
  - Degree of Appreciation Method:
- The variance between the states, and from year to year within certain states, clearly suggests there is no set rule, and the most appropriate method is to allocate the income based on a reasonable facts and circumstances analysis.

# Convenience of the Employer Rule

- “Convenience of Employer” Rule: Several states – CT, NY, NE, DE, and PA – count services performed by any non-resident at the taxpayer's out-of-state home that could have been undertaken at the employer's office in one of these states, as their state-sourced income, unless the services were performed out of state for the employer's necessity, not the employee's convenience.

# Federal Solutions and Uniformity

- Source Tax Act (P.L. 104-95)
- Congress enacted several industry-specific laws that fully or partially block states from mandating withholding on wages of certain non-resident employees of certain types of employers – Railroads; Airlines; Motor Carriers; and Fishing Vessels
- Mobile Workforce State Income Tax Simplification Act
- MTC Model Statute
- Multi-State Worker Tax Fairness Act

# Practical Approaches for Managing Exposure

- From a practical perspective, 100% compliance is almost impossible.
- Establish policy for employees to report travel.
- Determine whether company threshold for withholding is appropriate.
- Ensure HR and marketing communicates with the tax and payroll departments when hiring employees or holding events in states where the company is not filing.
- Remediation of historical exposure

**SECTION 05**

# **BEST TAX PRACTICES FOR REMOTE WORKERS**



# Consider These Issues

- Records, records, records!
  - Keep appropriate documentation.
  - Consider separate drives/folders to avoid inadvertent disclosures.
- Sign here!
  - What kinds of signatures are allowable?
  - Who should sign from which location?
- Internal controls and policies!
  - Know jurisdictions where your employees are working.
  - Ensure consistent communication and message across internal departments.

# Morgan Lewis Coronavirus/COVID-19 Resources

We have formed a multidisciplinary **Coronavirus/COVID-19 Task Force** to help guide clients through the broad scope of legal issues brought on by this public health challenge.

To help keep you on top of developments as they unfold, we also have launched a resource page on our website at

[www.morganlewis.com/topics/coronavirus-covid-19](http://www.morganlewis.com/topics/coronavirus-covid-19)

If you would like to receive a daily digest of all new updates to the page, please visit the resource page to [subscribe](#) using the purple “Stay Up to Date” button.



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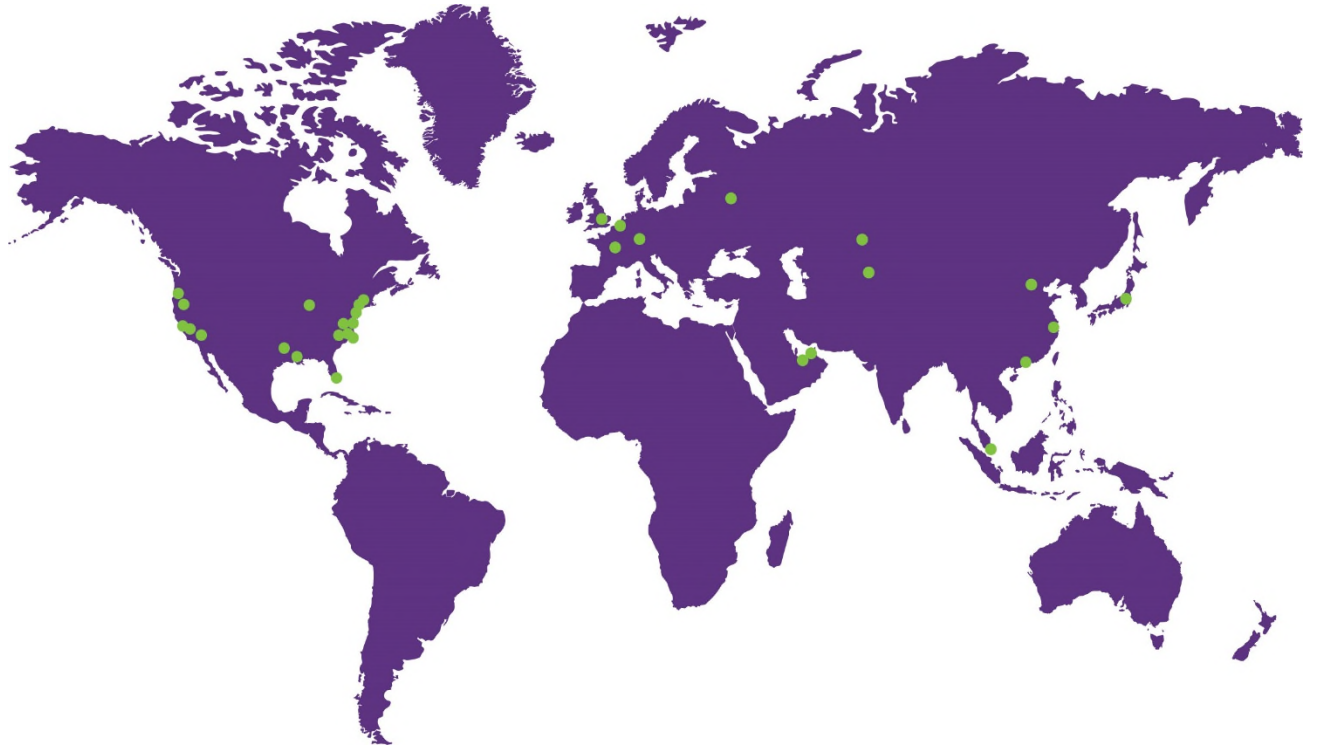
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