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REMOTE EMPLOYEES AND RETURN TO WORK: TAX AND BENEFIT ISSUES

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June 1, 2021

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Agenda

- Overview of International Tax Considerations
- Federal Income Tax Considerations
- State and Local Tax Considerations
- Benefits Issues

Overview of International Tax Considerations



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Potential Tax Issues with Cross-Border Employees

- **Business Entities**

- Tax filing/registration and tax liability issue
- Place of effective management and board operations
- U.S. trade or business test
- Permanent Establishment (“PE”) treaty standard and exceptions
 - Limitations to treaty application
- Withholding obligations re employees

- **Individuals**

- Local tax filing and payment obligations
- Equalization agreement/benefit
- Section 911
- Consistency with immigration reporting

PE Standard

• U.S. Model Treaty Provisions

- Article 7, Business Profits: “Profits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits that are attributable to the permanent establishment ... may be taxed in that other Contracting State.”
- Article 5, Permanent Establishment: “[T]he term ‘permanent establishment’ means a fixed place of business through which the business of an enterprise is wholly or partly carried on.” A PE “includes especially”:
 - a place of management;
 - a branch;
 - an office (including some home offices*);
 - dependent agents that have and habitually exercise an authority to conclude contracts that are binding on the enterprise

OECD Guidance Re COVID-19 and PE Exposures

- Guidance on tax treaties and the impact of the COVID-19 crisis
 - Original guidance issued April 3, 2020
 - Updated January 21, 2021
- Guidance issued at the request of concerned countries
- Original guidance notes a PE must have some degree of permanency and at the disposal of the enterprise
 - “[F]or a home office to be a PE for an enterprise, it must be used on a continuous basis for carrying on business of an enterprise and the enterprise generally has to require the individual to use that location to carry on the enterprise’s business”
 - “During the COVID-19 crisis, individuals who stay at home to work remotely are typically doing so as a result of government directives; it is force majeure not an enterprise’s requirement.”
 - Agency PE also considered

OECD Guidance Re COVID-19 and PE Exposures

- Updated PE Guidance from OECD
 - States the updated guidance is intended to provide more certainty
 - Limited in application to situations arising during the COVID-19 pandemic while relevant public health measures to restrict the spread of COVID-19 are still in effect
 - Home office guidance consistent with initial notice
 - Addresses impact of continued use of home office following cessation of public health measures
 - Agency PE risk addressed
 - Tax residency of entities based on “place of effective management”

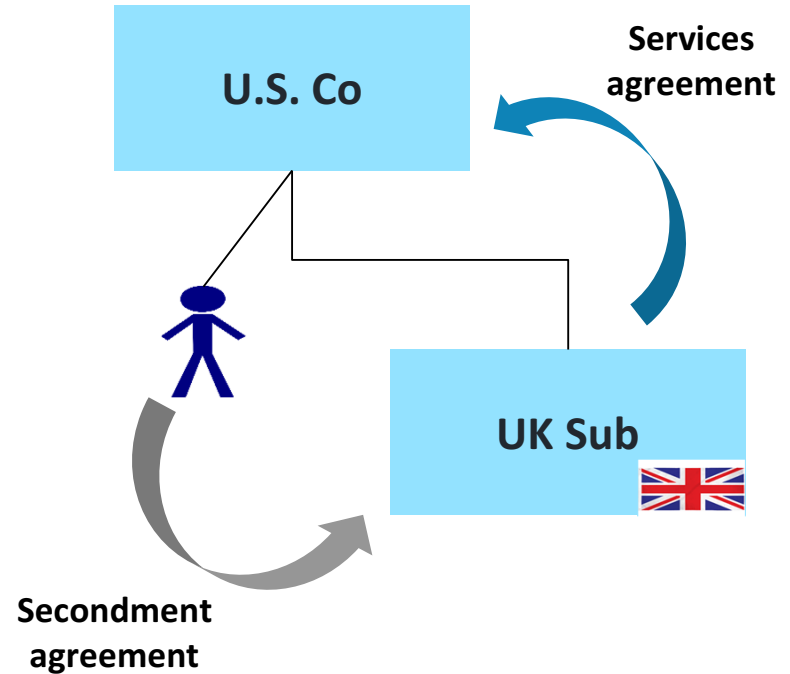
Risk Mitigation Strategies

- Treat as PE and file return/protective return
- Transfer to local affiliate
 - Align job descriptions and intercompany agreements
- Move to independent contractor relationship?



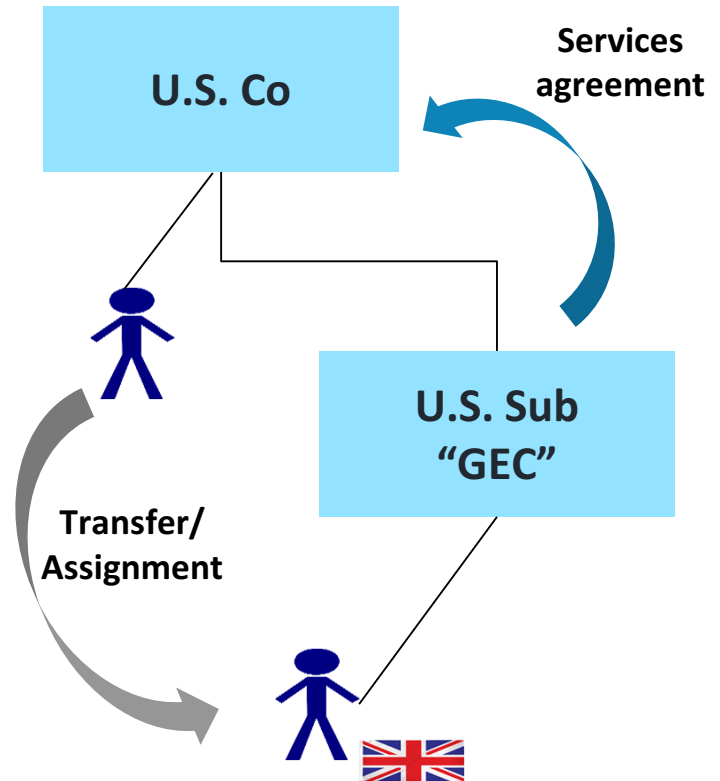
Risk Mitigation Strategies, cont.

- Secondment or employee lease
 - Confirm local acceptance/requirements
 - Employment law issues
 - Advisable to use arm's length terms
 - Consider adjustment/addition of intercompany services agreement



Risk Mitigation Strategies, cont.

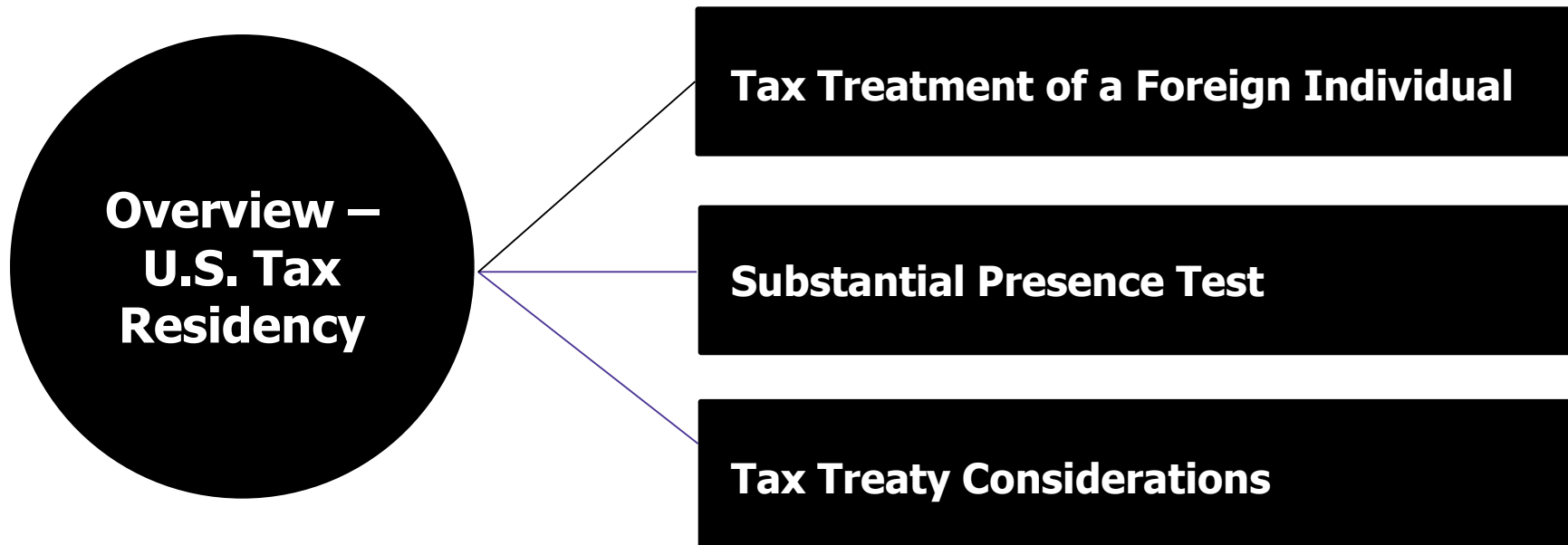
- Global Employment Company (“GEC”)
 - Establish a controlled subsidiary to segregate cross-border tax exposure within group
 - Use intercompany agreement and transfer pricing document to define profitability of PE operations
 - GEC makes PE tax filings (consider use of protective returns where available)
 - Address local employment issues
 - Manage economic substance considerations



U.S. Federal Income Tax Considerations

The background of the slide is a dark, abstract digital landscape. It features a dense field of vertical lines of varying heights, each topped with a small, glowing dot. The lines and dots are primarily in shades of blue, purple, and red, creating a vibrant, futuristic aesthetic. The lines appear to be connected at their bases, forming a grid-like structure that recedes into the distance, giving a sense of depth and perspective.

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IRS Guidance

- Revenue Procedure 2020-20 – Relief for Nonresident Individuals in the United States.
- Revenue Procedure 2020-27 – US Citizens and Residents Abroad.
- Supplemented by Rev. Proc. 2021-21 (addresses Iraq).
- FAQs.
- Revenue Procedure 2020-30 – Dual Consolidated Loss Rules.

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**

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**

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).
- 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.

The background features a complex, abstract pattern of glowing lines and dots. The lines are thin and curve across the frame, creating a sense of depth and movement. The dots are small and scattered, adding to the digital or data-like aesthetic. The colors are primarily blue, purple, and red, with some white highlights.

State and Local Income Tax Nexus Considerations and Recent Guidance

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State Tax Observations

- Payroll Tax
- Corporate Income Tax
- Sales and Use Tax
- Secretary of State Registrations

State Taxation of Workers in Multiple States: Employer Withholding

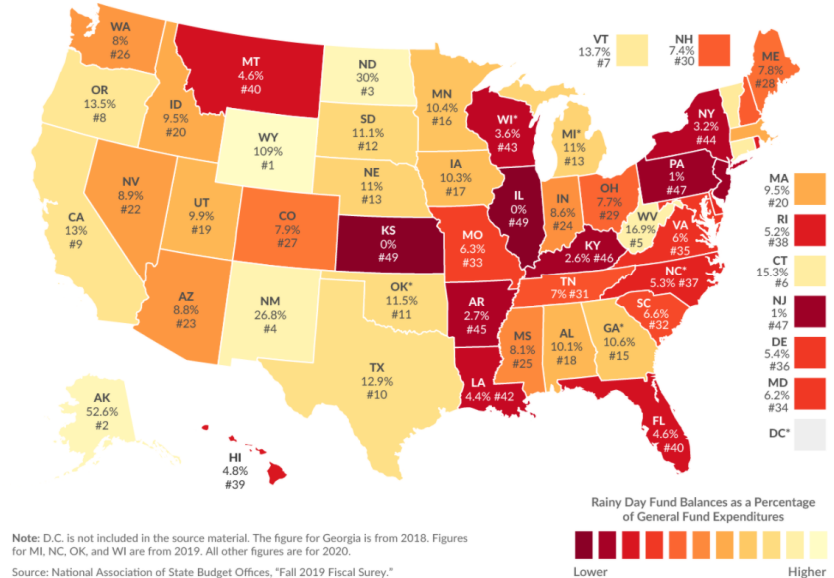
- The “employer nexus” to trigger withholding for most states is:
 - Employer office in state, or some other nexus to trigger state income tax; and
 - Payments of any wages subject to income tax in the state (or subject to contribution under the state’s unemployment compensation laws).
- Some states provide thresholds before withholding is triggered, based on days worked, dollars earned, or some combination of the two.
- Some require withholding on the first day of work (although for lower-paid workers, minimal allocated income may be less than the standard deduction and a personal exemption).

State Leniency During 2020, But When Will States Decide that Pandemic Emergency Relief Is No Longer Warranted?

- **Answer?**
 - It's already starting to happen
- **Cash-Strapped States**
 - Significant fiscal challenges as a result of COVID-19*
- **Prepare for Future Audits**
 - Stay up to date on state guidance
 - Regularly consult with advisors
 - Documentation

How Healthy Is Your State's Rainy Day Fund?

Rainy Day Fund Balances as a Percentage of General Fund Expenditures

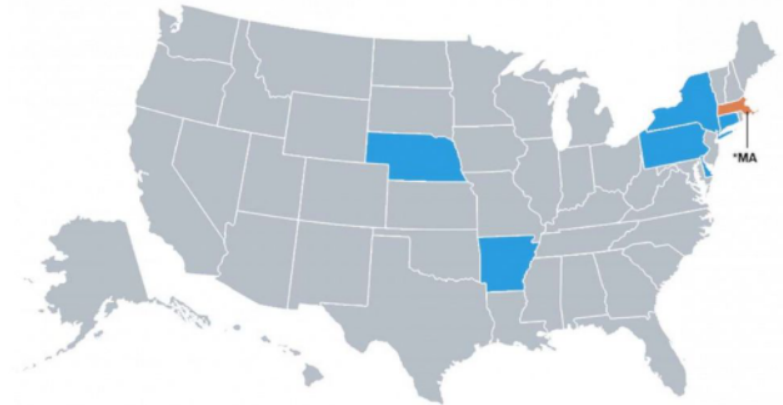


Employee State Income Tax Withholding Standards, In General

- Resident Employees
 - If an employer is doing business in a state, then income tax withholding is generally required on all wages paid to resident employees regardless of the state where wages are earned.
 - States have various rules about whether (and how much) credit is allowed against resident income tax withholding for income taxes withheld in other states.
- Nonresident Employees
 - State income tax withholding applies to wages that nonresident employees earn for work they perform (or, in some states, “deemed to perform”) in the nonresident state.
 - Wages earned outside of the nonresident state are generally not subject to state income tax withholding – subject to exceptions for “convenience of the employer” states.
- Reciprocal Agreements

“Convenience of the Employer”

- Connecticut, Delaware, Nebraska, Massachusetts, New York, Pennsylvania (as well as Arkansas until recently), and localities in Missouri and Ohio tax wages attributable to services performed by employees outside of the state if the services could have been performed at the employer’s in-state office, unless:
- The out-of-state services were performed out of the employer’s “necessity” (i.e., there must be a direct business benefit in having employee work away from physical office), and not for the convenience of the employee.
- For employers with offices in “convenience” states, allowing employees to work remotely in non-convenience states can result in potential double state income tax liability.



*MASSACHUSETTS ISSUED A TEMPORARY INCOME SOURCING RULE THAT TAXES EMPLOYEES STATE BUSINESSES WHO WORKED IN OTHER STATES THIS YEAR.

SOURCE: TAX FOUNDATION



 Tax Foundation

Example: Remote 100% of the Time (Employee Has No Physical Office Assigned)

- Employer Headquartered in a Convenience State:
 - Imperative for employer to document: (1) the remote work arrangement with the employee and within the payroll system, and (2) the “necessity” for such arrangement (e.g., employee no longer allotted office space).
 - Employer should withhold under state laws where employee works remotely.
 - Failure to thoroughly document an employee’s transition to working remotely outside the convenience state increases the risk that “convenience” states will not recognize employee remote relocations and attempt to collect unwithheld state income tax from the employer.
- Employer Headquartered in a Non-Convenience State:
 - Employer should withhold under state laws where employee works remotely.

Example: Hybrid Work Arrangement: Primarily Remote Work with Some In-Office Work

- Physical Office in a Convenience State:
 - When an employee's remote work state is different from the physical office state, employers should continue to withhold on 100% of wages (i.e., for both in-office and remote work) for the convenience state, and on wages attributable to working remotely for the remote-work state (once the state income threshold has been reached).
 - An exception applies if it can be established that the employee has been instructed to work part of the time remotely at the direction of the employer (i.e., for business necessity, and not for the employee's convenience).
 - Documentation substantiating the necessity of the partial remote work arrangement is key; and so is tracking the number of days an employee works in the physical office versus remotely, so that the employee can claim tax credits for income taxes paid to other states.
- Physical Office in a Non-Convenience State:
 - Employer should apportion wages based on time an employee spends working in the physical-office state and the remote-work state.

The background is a dark blue space filled with a complex network of glowing lines and dots. The lines are thin and vary in color, including shades of blue, purple, and red. They appear to be connected at various points, creating a sense of depth and movement. The dots are small and bright, scattered throughout the scene, some appearing as if they are at the end of a line. The overall effect is that of a digital or data landscape.

Leveling the Playing Field Between In-Office & Remote Employees

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Business Expense Reimbursements

- Best practice to reimburse reasonable and necessary expenses within the course and scope of employment (mandatory in California)
- If remote work is optional, then reimbursing home-office expenses is likewise generally discretionary, but when remote work is required or “strongly encouraged,” then home-office expenses are more likely within the course and scope of employment
- Reimbursement formulas can be used, but it is recommended that:
 - Reimbursements be separately reported from employee compensation, and
 - Employees be permitted to request additional reimbursement above formula level by submitting receipts

Working Condition Fringe Benefit

- Under IRC 132(d), the “working condition” fringe benefit exclusion applies to property or services provided to employees (or independent contractors) that would have been deductible under IRC 162 or 167, if the expense had been paid directly by the employee (or contractor).
- Expenses must satisfy certain substantiation standards under the “accountable plan” rules (Treas. Reg. § 1.62-2):
 - have a business connection
 - be substantiated within a reasonable period
 - any excess must be returned within a reasonable period
- Helpfully, computers and cell phones are no longer “listed property,” and thus are tax-exempt so long as a “primary business use” is proven.

Parking

- IRC 132(f)(1)(C) allows an employer to provide up to \$270/month in “qualified parking” to employees on a tax-free basis.
- Since TCJA, employers generally cannot deduct the cost of providing “qualified parking” to employees.
- In final regulations issued in December 2020, various “qualified parking” valuation methodologies provide a few planning opportunities to minimize the employer’s deduction disallowance:
 - Rural/remote facility lots are exempt if there is no commercial parking with a charge; and
 - Lots 50% open to the public are exempt (so some employers might consider eliminating employee-reserved parking, and opening up lots for a charge to the public, while parking lots & garages are underutilized by employees)

Employer-Provided Vehicles

- Many employees who are assigned employer-provided cars, or participate in car reimbursement plans, had worried during 2020 because they used the cars so little for business
- If the “fraction of business use” declined dramatically, the car’s “annual lease value” (ALV) taxable to the employee could increase by potentially thousands of dollars, but the IRS regulations prohibit switches to “cents-per-mile”.
- In Notice 2021-7, the IRS allowed a switch to “cents per mile” (57.5¢ in 2020) to measure the value of personal use of company cars valued at under \$50,400, from March 31–Dec. 31, 2020, even if the car had been valued using ALV. Employers may continue to use cents per mile (56¢) in 2021.
- Note: This Notice does NOT help on the “FAVR” car plans, which reimburse employees for use of their own cars if at least 6,250 miles are driven each year.

Travel Expenses

- Employees can exclude (and employers can deduct) travel expense reimbursements if the employee (1) has a “tax home” and (2) is away from the tax home long enough to reasonably require sleep or rest.
- Generally, an employee’s “tax home” is the city of his/her principal place of business, not the location of the personal residence.
- Determining which location is the principal place of business is a question of fact, based on an analysis of the following primary factors:
 - total time ordinarily spent at each business post;
 - degree of business activity at each such post;
 - whether the financial return with respect to each post is significant or insignificant; and
 - Whether employment at a particular location is known to be temporary or permanent.

Commuting Expenses

- Commuting expenses are generally personal in nature and therefore not eligible for exclusion as a working condition fringe benefit.
- The fact that an employee's residence and regular place of business are a significant distance apart does not change this income inclusion (or deduction disallowance) for commuting expenses.
- Yet if an employee has a regular place of business outside the home, the employee may exclude and deduct daily transportation expenses incurred in going between the residence and another "temporary work location," regardless of distance between the two. Thus, for taxpayers with "regular work locations" transportation expenses to a temporary location are deductible.
- And if an employee has a qualifying 280A home office, the residence is the regular/principal place of business, and therefore may deduct daily transportation expenses incurred in going between the residence and another work location, regardless of whether the work location is regular or temporary.
- However, if the taxpayer does not have a home office, daily transportation expenses between the residence and another regular place of business are not excludable from income and are not deductible.

Commuting Expenses

- And since the TCJA, commuting expenses between an employee's residence and place of employment are not deductible, "except as necessary for ensuring the safety of the employee." IRC 274(l).
- Reg. § 1.274-14(b) (finalized in December 2020) allow a commuting expense deduction when "unsafe conditions" are present, which exist "if a reasonable person would, under the facts and circumstances, consider it unsafe for the employee to walk to or from home, or to walk to or use public transportation at the time of day the employee must commute," taking into account "the history of crime in the geographic area surrounding the employee's workplace or residence at the time of day the employee must commute." Reg. § 1.61-21(k)(5).

280A Home Office

- IRC 280A(c)(1) recognizes a residence as a home office only if it is a:
 - portion of a dwelling “used exclusively on a regular basis” either as the principal place of business for any trade or business of the taxpayer (including for performing substantial administrative or management activities where there is no other fixed location where those activities occur), or
 - place where patients, clients, or customers meet or deal with the taxpayer in the normal course of the trade or business.
- For employees, the “exclusive use” must be “for the convenience of [the] employer” (i.e., for business reasons of the employer, and not for the convenience of the employee).
- Employees who work at home less than 50% of the time do not have 280A home offices, and so the limitations on commuter expense reimbursements apply.
- But employees who work at home more than 50% of the time may be able to establish a 280A home office, from which limited trips (no more than 35 trips per year) to their business office may not be subject to the limitations on commuter expense reimbursements.

280A Home Office Transportation Expenses vs. Personal Residence Transportation Expenses

- Rev. Rul. 99-7 concedes that an employee is not “commuting” when the employee has “daily transportation costs” between an IRC 280A home office maintained by the employee and other business locations – whether those business locations are visited regularly, and irrespective of how far away those business locations are from the office.
- If an employee does NOT have an IRC 280A home office, and travels on day trips between the home and any place that is visited “regularly” (e.g., that the employee has been visiting for more than 12 months, or intends to visit for more than 12 months), then, per this ruling, day-trip travel would not be deductible.
- But, per CCA 200026025 (May 31, 2000), the IRS said (albeit only informally) that if the visits were “no more than 35 times during each calendar year” that the location might not be deemed to be a “regular” work location. But travel one day a week is more than 35 days a year!

The Home Office

- Thus, for employees who are working at a “regular office” of the employer for as little as one day each week (and who don’t have a 280A home office), the IRS likely will contend that the regular office is going to be the “tax home” – because (a) it’s a regular place of business and (b) it’s where the employee’s earnings are coming from.
- Under that construct, not only are day trips deemed to be nondeductible commutes, but also overnight trips may not be deductible – with ONE narrow exception for “local lodging” (which does NOT cover travel or meal expenses).
- Specifically, Reg. §§ 1.162-31 and 1.262-1(b)(5) (updating the rules in Notice 2007-47), create a special limited exclusion for local and “not-lavish” lodging in the area of the worker’s tax home, provided to employees or independent contractors for periods that do not exceed five days and do not occur more frequently than once per quarter, where the lodging is necessary for the individual to participate in business meetings or be available for some other bona fide business function. (In the case of employees, the employer must have required an employee to stay at the business function overnight.)

Business Meals

- Business meals are generally 50% deductible, but thanks to the Consolidated Budget Appropriations Act, 2021, business meals* from a “restaurant” are 100% deductible during 2021-2022.
- Per Notice 2021-25, “restaurant” means a business that prepares and sells food or beverages to retail customers for immediate consumption, regardless of whether the food or beverages are consumed on the business’s premises.
- So whether served and consumed in a restaurant, brought back to the office, or delivered by a meal delivery service, business meals are fully deductible through 2022.

* Deductibility also requires that the meal is not lavish or extravagant under the circumstances, and that an employee is present at the furnishing of the meal.

Remote Work Policy Considerations

Importance of Setting Expectations

- Establish remote working parameters (& clarify where remote and in-office rules differ)
 - Teleworking as an accommodation or as a job requirement
 - Productivity & performance
 - Work-hour expectations
 - Break period expectations
 - Recordkeeping expectations

Importance of Setting Expectations

- Establish remote working parameters (& clarify where remote and in-office rules differ)
 - Protecting proprietary information
 - Absences (sick leave & vacation)
 - Home as the work-place
 - Expense reimbursement
 - Choice of law

Additional Best Practices

- Telecommuter training & telecommuter manager training
- Require employment contract that addresses work-from-home expectations for employees who voluntarily opt to primarily work remotely
- For employees working remotely, assume they are working from their home/residence address of record, unless employees say otherwise
- Warn that proof of remote work location may be required
- Don't give too much tax advice; instead, encourage employees to consult their own tax advisors

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.

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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

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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Barton W. S. Bassett counsels Silicon Valley–based and global multinational technology companies on international tax planning for the outbound operations of US companies doing business abroad, and for the inbound operations of foreign companies seeking to do business within the United States. Barton advises clients on structuring mergers and acquisitions (M&A), internal restructurings and operations, joint ventures, external and internal financings, and transfer pricing matters, including the transfers and licenses of intellectual property (IP).

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With experience gained as a trial lawyer in the Tax Division of the US Department of Justice (DOJ), Steven P. Johnson advises clients on tax controversies and litigation matters involving complex tax issues. Before joining Morgan Lewis and working for the DOJ, Steven served as a law clerk to Judge Tucker L. Melancon of the US District Court for the Western District of Louisiana. He holds a Masters in Tax Law (LL.M.) from Georgetown Law School.

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Sarah-Jane Morin's practice encompasses a variety of transactions with a focus on representation of public and private companies, private equity funds, venture capital funds, real estate funds, portfolio companies, and alternative investment vehicles in the tax aspects of complex business transactions and fund formations, including domestic and cross-border investment strategies, sponsor investment strategies, limited partner investment strategies, mergers, acquisitions, integrations, buyouts, recapitalizations, debt and equity restructurings, and ongoing operations and tax compliance issues. Additionally, she advises on international tax issues, including the tax aspects of offshore vehicles (CFC/PFIC/GILTI regimes), anti-deferral rules (Subpart F), withholding, cost sharing, and transfer pricing.

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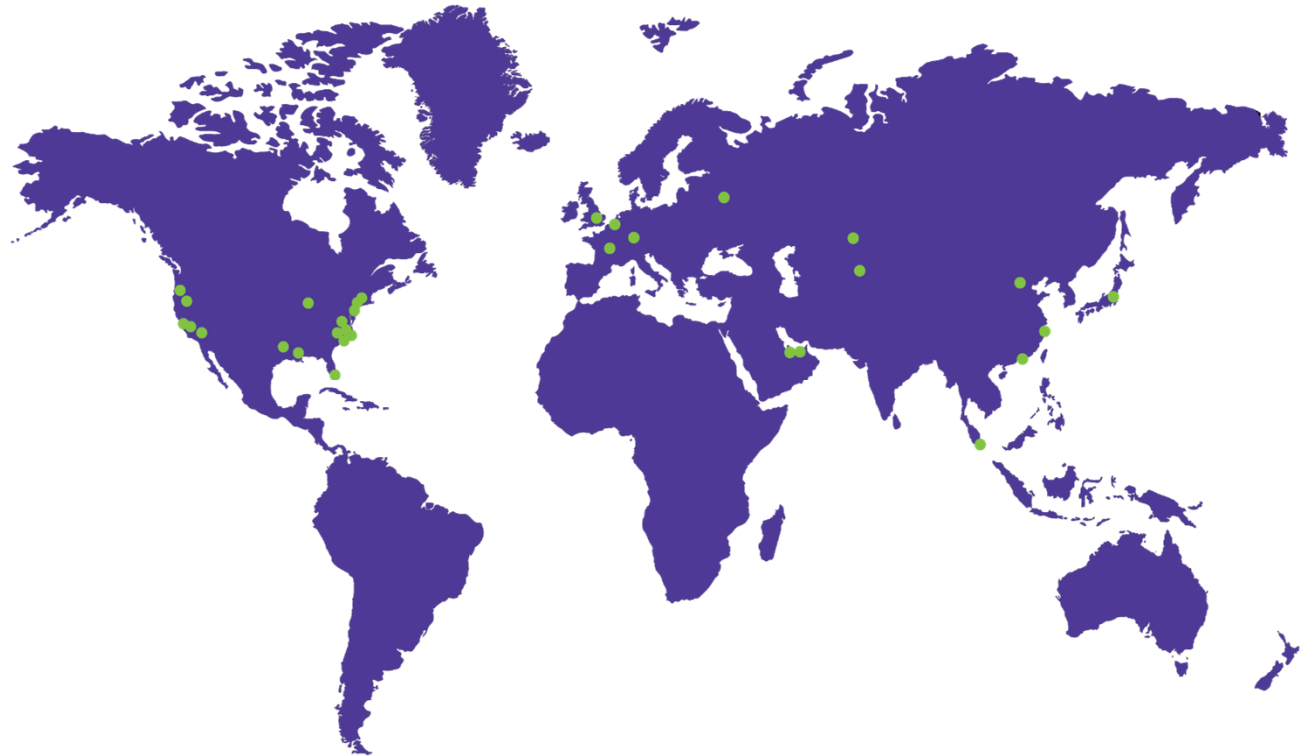
Cosimo A. Zavaglia advises corporations, partnerships, and individuals on state and local tax controversy, planning, and transactional matters. Cosimo routinely represents clients in high-stakes state and local tax audits, appeals, and litigations in matters throughout the United States, including defending 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.

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