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TECHNOLOGY MARATHON

Tax and Benefit Issues of Remote Work

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Barton W.S. Bassett

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Presenters



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Agenda

- **Business Travel & Personal Commuting Fringe Benefits Primer**
- **State and Local Income Tax Nexus Considerations and Recent Guidance**
- **Overview of U.S. Federal Income Tax Considerations**
- **Overview of International Tax Considerations**

Business Travel & Personal Commuting Fringe Benefits Primer

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Business Travel Versus Personal Commuting, in General

- Away-from-home Business Travel. In general, employees can exclude as a working condition fringe benefit travel expense reimbursements (e.g., transportation, meals, incidental expenses, lodging) if:
 - the employee has a “tax home”;
 - is away from the tax home substantially longer than a day’s work such that sleep or rest is needed to meet the demands of work while away from home;
 - the employee does not expect to and in fact does not remain in the temporary work location for more than 1 year, without a sufficient break away from the temporary work location; and
 - Reimbursements are made in accordance with the IRC 62(a)(2)(A) and Reg. § 1.62-2 “accountable plan” rules
- Personal Commutes. With limited exception, an employee’s commute between their residence and a “regular work location” is a personal expense, includable in the employee’s taxable wages if paid for or provided by their employer.
- The distance between an employee’s residence and “regular work location” is irrelevant in distinguishing between away-from-home travel and commuting because Federal tax law presumes that an individual’s decision as to where to reside relative to their duty station is personally motivated.
- Corporate Income Tax Deduction Implications. In general, an employer can deduct away-from-home business travel expenses and cannot deduct personal commuting expense costs.

Business Travel Expense Reimbursements as a Working Condition Fringe Benefit

- The IRS defines “travel expenses” as “ordinary and necessary expenses of traveling away from home for your business, profession, or job.” IRS Publ. 463.
- 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).
- Travel expense reimbursements must also satisfy the “accountable plan” substantiation standards (Reg. § 1.62-2):
 - have a business connection
 - be substantiated within a reasonable period
 - any excess must be returned within a reasonable period

Business Travel, Determining the “Tax Home”

First Test, Principal Place of Business. Generally, an employee’s “tax home” is the metropolitan area (city) of their principal or main place of business, not the location of their 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; and
- whether the financial return with respect to each post is significant or insignificant.

Second Test, Regular Place of Abode (a/k/a Personal Residence). If an employee doesn’t have a principal place of business because of the nature of their work, an employee’s “tax home” may be their primary residence, considering the following factors:

- Whether the employee performs part of their business in the area near their residence and use that residence for lodging while doing business in the area (i.e., a business justification for maintaining the residence).
- Whether the employee incurs living expenses at their residence (e.g., utilities, rent/mortgage, home insurance) that they will duplicate at their temporary work location.
- Whether the employee hasn’t abandoned the residence area (i.e., whether they plan to return to the residence after the conclusion of the temporary work assignment).

Itinerants. Employees who fail both tests are deemed to be “itinerants,” whose “tax home” is located wherever they are working – and therefore travel expense reimbursements are taxable.

Business Travel, Distance Concepts

- In addition to having a “tax home,” an employee must also be away from their tax home “substantially longer than an ordinary day’s work” such that it is reasonable for the employee to need to “sleep or rest to meet the demands of work while away from the tax home.” *U.S. v. Correll*, 88 S. Ct. 445 (1967); and Rev. Rul. 75-170.
- Per IRS Publ. 463, the “rest requirement isn’t satisfied by merely napping in your car. You don’t have to be away from your tax home for a whole day or from dusk to dawn as long as your relief from duty is long enough to get necessary sleep or rest.”
 - Example 1: You are a railroad conductor. You leave your home terminal on a regularly scheduled round-trip run between two cities and return home 16 hours later. During the run, you have 6 hours off at your turnaround point where you eat two meals and rent a hotel room to get necessary sleep before starting the return trip. You are considered to be away from home.
 - Example 2: You are a truck driver. You leave your terminal and return to it later the same day. You get an hour off at your turnaround point to eat. Because you aren’t off to get necessary sleep and the brief time off isn’t an adequate rest period, you aren’t traveling away from home.

Business Travel, 1-Year Temporary Travel Limitation

- A traveling employee cannot work continually in the same general location for an employment period exceeding one year. See IRC 162(a)(2).
- This is known as an “indefinite” assignment. An assignment in a single location is considered “indefinite” if it is realistically expected to last for more than 1 year, whether or not it actually lasts for more than 1 year.
- An assignment that is initially temporary may become indefinite due to changed circumstances.
- A series of assignments to the same location, all for short periods but that together cover a long period, may be considered an indefinite assignment.
- From the time that a traveling employee reasonably believes the employment period in a particular geographic location will extend beyond a year, travel expense reimbursements must be taxed.
- If the employee moves to different locations, this one-year rule does not apply. See H. Conf. Rep. No. 102-1018, 102d Cong., 2d Sess. 429, 430 (1992), confirming the 1-year limit applies to a “single location.” See also P.L.R. 9536012, confirming that work in different locations will not trigger the 1-year rule.

Business Travel, 1-Year Temporary Travel Limitation (CONT.)

- If a traveling employee remains employed at the same location for a period approaching 1 year without any break, travel expense reimbursements at that location will no longer be non-taxable, unless the employee leaves the temporary work location for a sufficient amount of time for there to be a “break in service.”
- Limited guidance exists as to how long of a break is required to essentially restart the clock for IRC 162(a)(2) 1-year limitations purposes:
 - I.L.M. 200020055 (Mar. 24, 2000) (a 1-month break was not adequate, where the employment term, initially 6 months, was extended for 8 more months).
 - I.L.M. 200025052 (Apr. 26, 2000) (short break of 2 or 3 weeks is inconsequential, but 1 year will suffice).
 - I.L.M. 200027047 (May 10, 2000) (short break of 2 or 3 weeks is inconsequential, but 1 year will suffice).
 - I.L.M. 200026025 (May 31, 2000) (break of 3 weeks or less not significant, but 7 months is significant).

Business Travel, Accountable Plan Compliance

“Accountable Plan” requirements, per IRC 62(a)(2)(A) and Reg. § 1.62-2:

- The expense reimbursement must be paid for business expenses incurred by the employee in connection with the performance of services as an employee (the “business connection” requirement).
- The amounts must be substantiated by the employee in accordance with the requirements of IRC 274(d) or IRC 162 within a “reasonable period of time” after the expense is paid or incurred (the “substantiation” requirement).
- The employee must be required to return to the employer within “a reasonable period of time” any part of any allowance in excess of substantiated expenses (the “return-of-excess” requirement).

Personal Commuting

- 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 whether employer-assisted commuting expenses are taxable, subject to a few exceptions:
 - Trips between an employee's residence and a work location that the employee does not visit on a "regular" basis. See Rev. Rul. 99-7.
 - Trips between an employee's residence that qualifies as an IRC 280A "home office" and any work location (whether temporary or regular). *Id.*
 - Reg. § 1.132-6(d)(2) excludes as a "de minimis" fringe benefit employer-provided "local transportation fare" if it is provided on an "occasional basis."
 - For non-occasional trips, Reg. § 1.132-6(d)(2)(iii) excludes the value over \$1.50 of commuting transportation (in any employer-provided vehicles, including taxis or car services) that is provided in "unusual circumstances" (e.g., outside of the employee's normal work hours) and where it would be "unsafe" for the employee to use other means of transportation.
 - Limited local lodging (but not transportation or meals) at business meetings and conferences, per Reg. §§ 1.162-32 and 1.26201(b)(5).

IRS Publication 463, Travel, Gift & Car Expenses

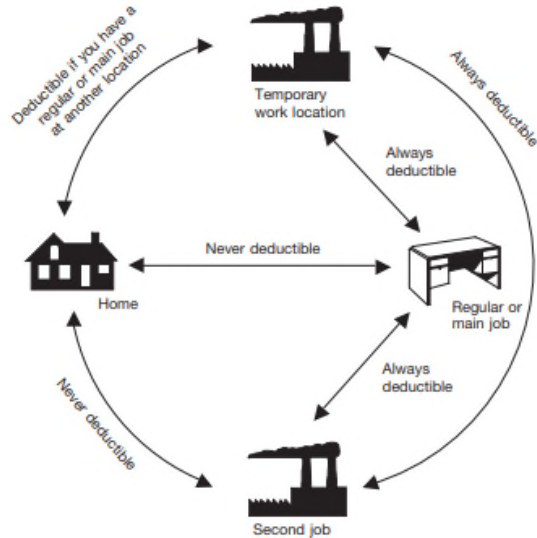


Figure B. When Are Transportation Expenses Deductible?

Most employees and self-employed persons can use this chart. (Don't use this chart if your home is your principal place of business. See [Office in the home](#), later.)

Home: The place where you reside. Transportation expenses between your home and your main or regular place of work are personal commuting expenses.

Regular or main job: Your principal place of business. If you have more than one job, you must determine which one is your regular or main job. Consider the time you spend at each, the activity you have at each, and the income you earn at each.

Temporary work location: A place where your work assignment is realistically expected to last (and does in fact last) one year or less. Unless you have a regular place of business, you can only deduct your transportation expenses to a temporary work location outside your metropolitan area.

Second job: If you regularly work at two or more places in one day, whether or not for the same employer, you can deduct your transportation expenses of getting from one workplace to another. If you don't go directly from your first job to your second job, you can only deduct the transportation expenses of going directly from your first job to your second job. You can't deduct your transportation expenses between your home and a second job on a day off from your main job.

State and Local Income Tax Nexus Considerations and Recent Guidance

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State Tax Observations

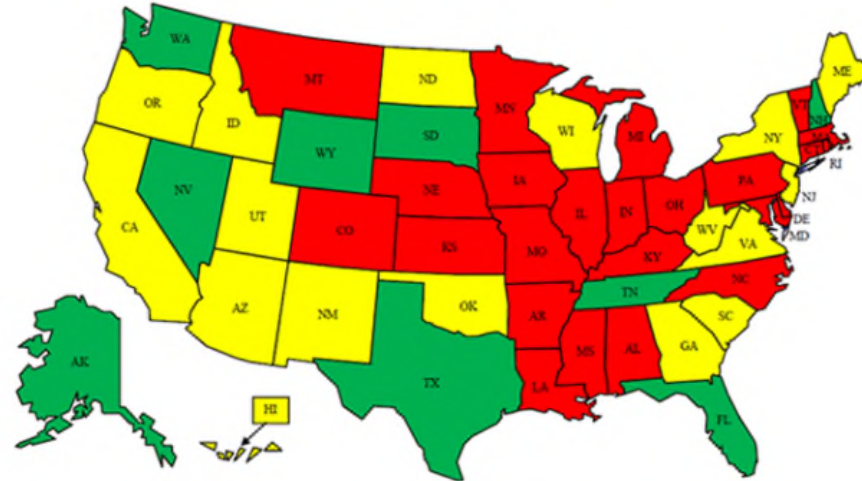
- Payroll Tax
- Corporate Income Tax
- Sales and Use Tax
- Secretary of State Registrations

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).

“Heat Map” on Withholding Triggers, State-by-State

Nonresident Personal Income Tax Withholding



Key

- Nonresident employees subject to tax withholding on *first day* of travel
- Nonresident employees subject to tax withholding after reaching threshold (see Appendix A for details)
- No general personal income tax (or, in the case of Washington, DC, no tax on nonresidents)

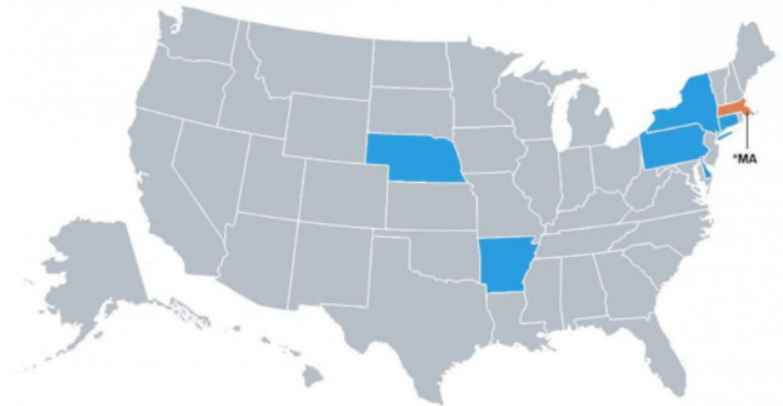
Source: Council on State Taxation

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

 NEWS

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.

Overview of U.S. Federal Income Tax Considerations



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Agenda



IRS



Individuals



Businesses

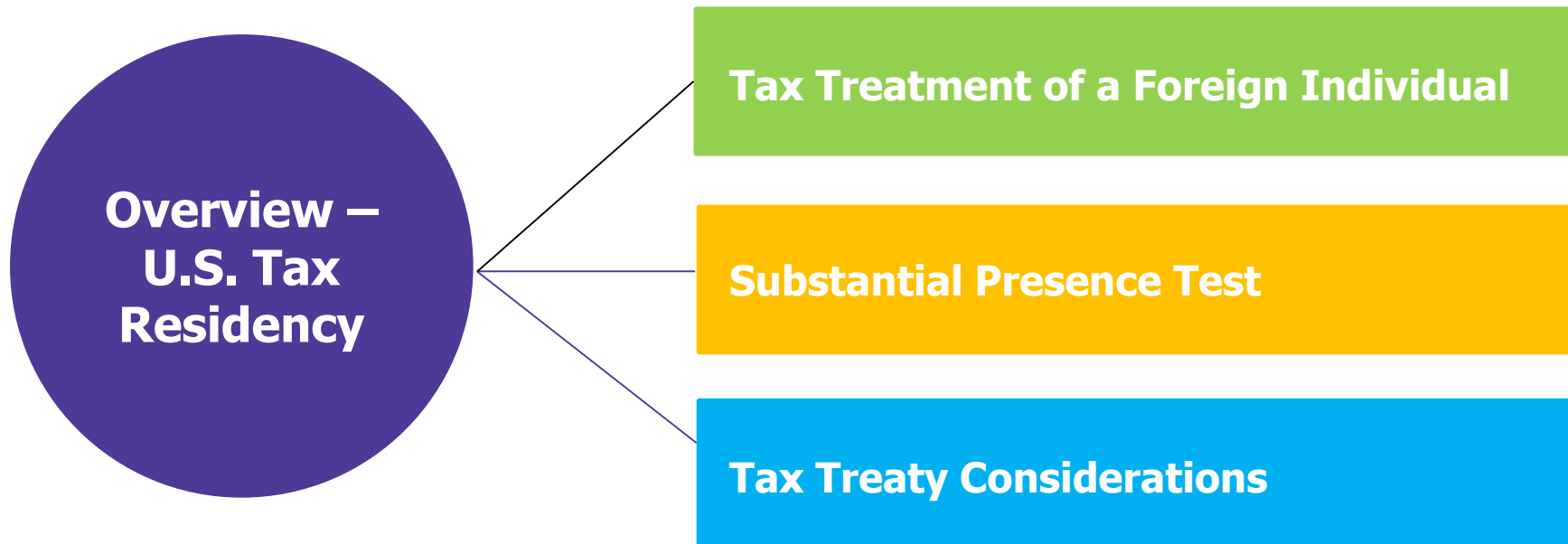
IRS Operations During COVID-19 & Beyond

Challenge
#1

- Lack of funding

Challenge
#2

- Pandemic



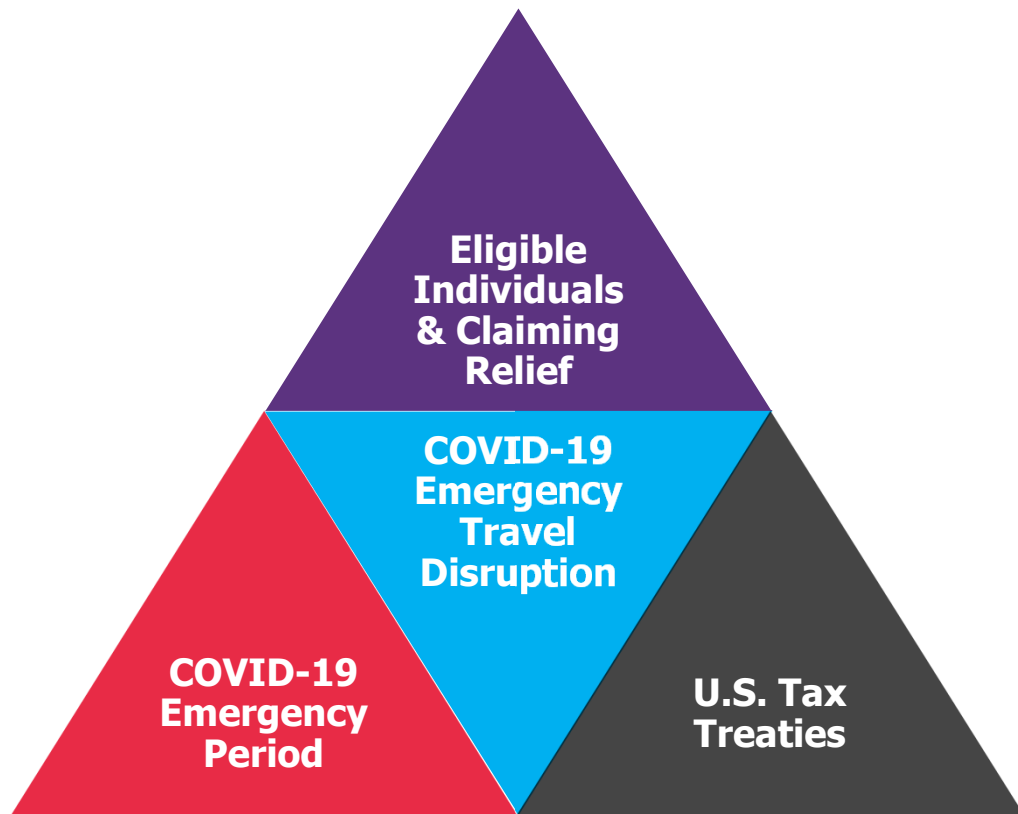
COVID-19 Travel Disruptions



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

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

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



Revenue Procedure 2020-27 – US Citizens and Residents Abroad

In general

Adverse condition

Requirements

IRS FAQs



[FAQs for Individuals Claiming the Medical Condition Exception in 2020 | Internal Revenue Service \(irs.gov\)](#)

[FAQs for Nonresident Alien Individuals and Foreign Businesses with Employees or Agents Impacted by COVID-19 Emergency Travel Disruptions | Internal Revenue Service \(irs.gov\)](#)

Revenue Procedure 2020-30 – Dual Consolidated Loss Rules



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

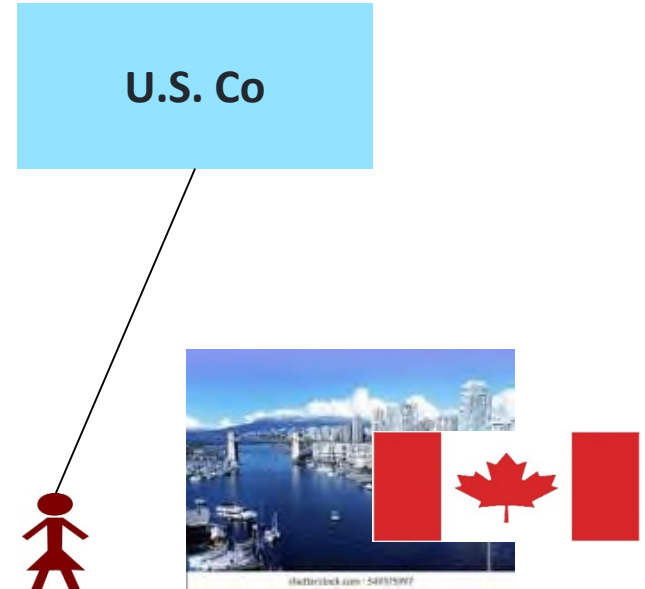
PE Standard

• 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

COVID Surge in International Remote Work

- Crisis environment
- Employees forced to work remote due to travel restrictions and/or family support
 - Unable to commute from home country to work in assigned jurisdiction
 - Employees stranded in foreign jurisdictions
 - Remote work to support family in foreign jurisdiction
 - Employees returning from ex-pat assignments to work in the U.S. during lockdown conditions



OECD Guidance Re COVID and PE Exposures

Guidance addressing tax treaties and the impact of the COVID-19 crisis

Original guidance issued April 3, 2020

<https://www.oecd.org/coronavirus/policy-responses/oecd-secretariat-analysis-of-tax-treaties-and-the-impact-of-the-covid-19-crisis-947dcb01/>

Updated guidance released January 21, 2021

<https://www.oecd.org/coronavirus/policy-responses/updated-guidance-on-tax-treaties-and-the-impact-of-the-covid-19-pandemic-df42be07/>

Post-COVID Remote Work and International Tax Considerations

- **Business Trends**

- End of travel restrictions and increase employee demand for remote options (temporary and permanent)
- Sunset of COVID PE exceptions and flexibility from tax authorities

- **Employers updating remote work/travel policies**

- **Treaty and OECD guidance regarding remote work and PEs**

- General guidance with few definitive guideposts
- Fixed place of business requirement (home offices included)
- “Not of a purely temporary nature”
- Activities of a recurrent nature may be combined

Remote Work as the “New Normal”

- Increased demand for remote work driven by recruitment and retention issues
- Tax considerations
 - Tone of policy with respect to limitations
 - Tracking PE risks with multiple personnel traveling to multiple jurisdictions
 - Approval process
 - Managing PE risk
 - Rolling 12-month testing vs. calendar year testing
 - Multiple employees in a jurisdiction
 - Negotiation/signing of contracts



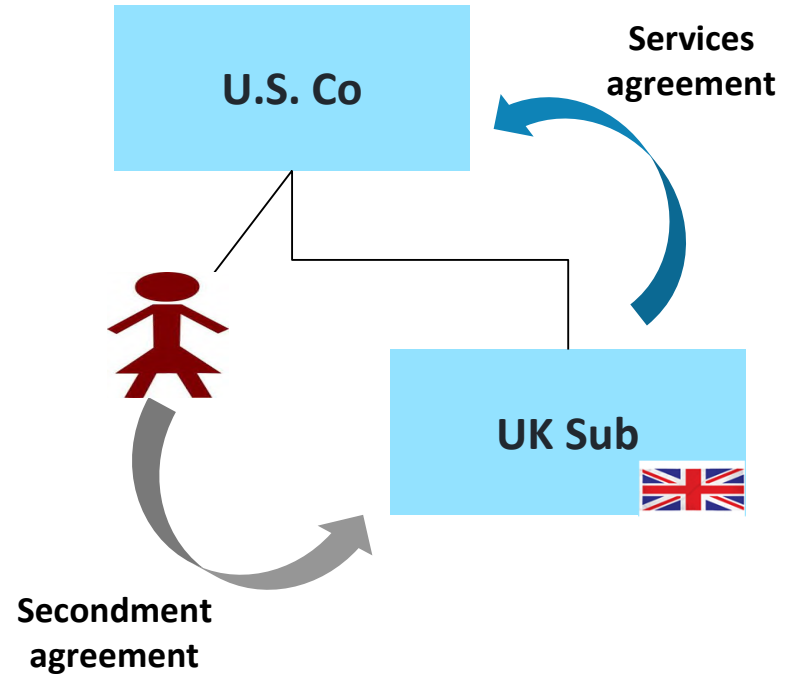
Risk Mitigation Strategies

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



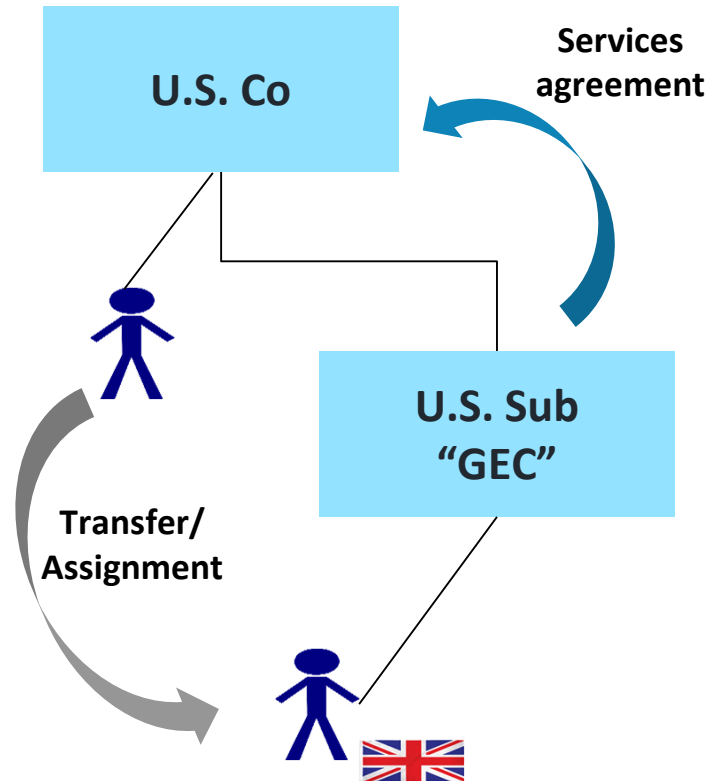
Risk Mitigation Strategies, cont.

- 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 and dependent agent arguments



Ukraine Conflict Resources

Our lawyers have long been trusted advisers to clients navigating the complex and quickly changing global framework of international sanctions. Because companies must closely monitor evolving government guidance to understand what changes need to be made to their global operations to maintain business continuity, we offer a centralized portal to share our insights and analyses.

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Biography



Steven Johnson

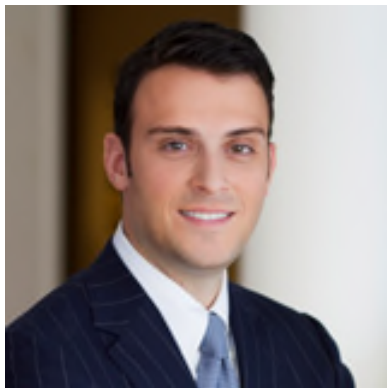
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With experience gained as a trial lawyer in the Tax Division of the US Department of Justice (DOJ), Steven P. Johnson advises clients on tax controversies and litigation matters involving complex tax issues. Before joining Morgan Lewis and working 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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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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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.

Biography



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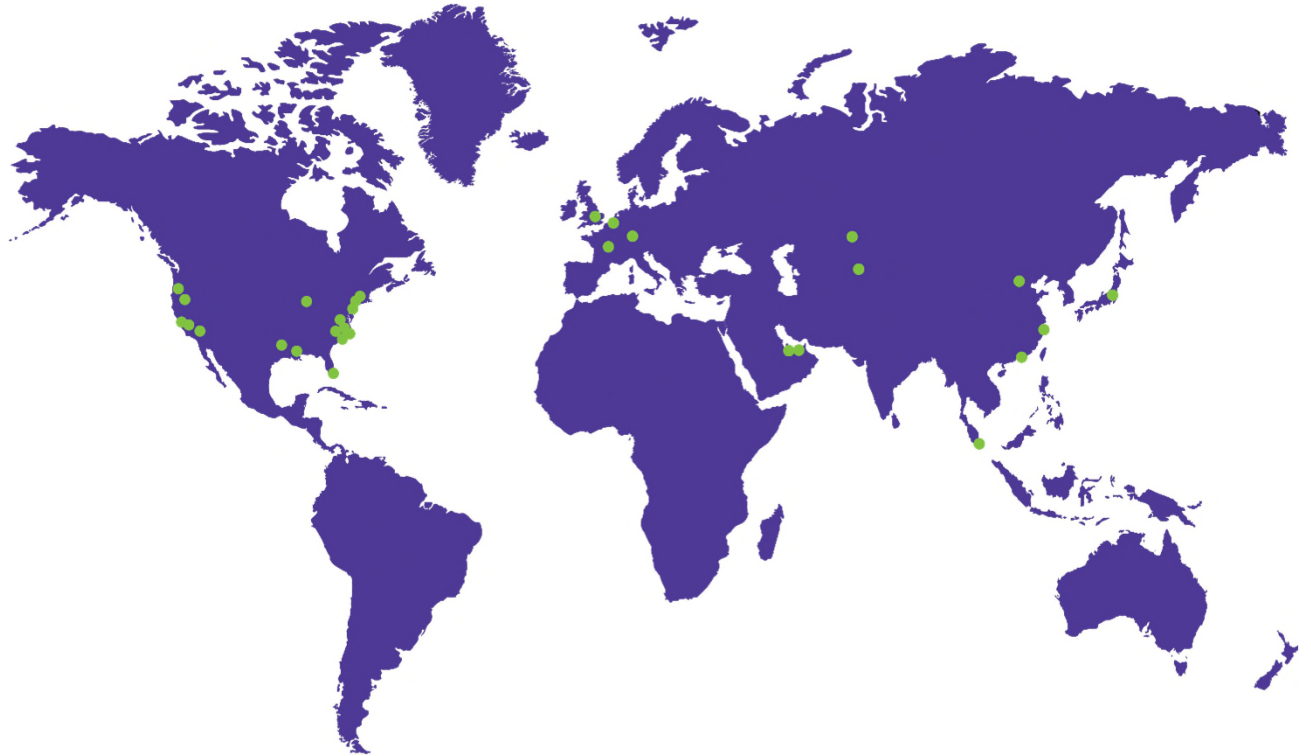
Barton W. S. Bassett counsels Silicon Valley–based and global multinational technology companies on international tax planning for the outbound operations of US companies doing business abroad, and for the inbound operations of foreign companies seeking to do business within the United States. Barton 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 intangible property.

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