

Expiring COVID Guidance and Identifying Nexus

by Nicholas Scher, J.D., LL.M, Marcum LLP – November 22, 2021

For many companies, COVID-19 disrupted every area of business operations and allowed employees to telecommute from states where they do not normally work, making the annual year-end closing-of-the-books fraught with uncertainty from a state tax perspective. Further, while many states provided COVID-19 relief for businesses with telecommuting employees, some of this relief expires in 2021, adding a layer of complexity to closing the books. When closing the books on 2021, the state tax impact of telecommuting on employers and employees must be considered.

Impact on Corporate Taxes

The presence of employees in a state generally establishes enough of a connection with the state, or nexus, in order for the state to impose corporate income and franchise taxes, as well as sales and use taxes on businesses. Thus, telecommuting employees potentially create physical nexus in new states or cause employers to exceed P.L. 86-272 protection. ^[1]

States including Indiana, Maine, Massachusetts, New Jersey, Pennsylvania and South Carolina waived 2020 physical nexus due to temporary telework during the pandemic and, subsequently, extended the waiver of nexus through all or part of 2021.

As COVID relief provisions expire, practitioners must consider the presence of employees when determining whether a company established nexus in the aforementioned states. Thus, companies whose remote employees did not establish nexus in certain states at the beginning of 2021 are possibly at risk of having nexus and additional filing requirements in those states.

Furthermore, certain states issued guidance regarding the impact of telecommuting employees on the apportionment factor. Rhode Island and South Carolina have specified that employees working in their states due to the pandemic would not increase the numerator of their employers' payroll factor. As COVID relief expires in both states, practitioners should be mindful of the potential apportionment impact.

Impact on Personal Income Taxes

For personal income tax purposes, when employees work from one state for an employer operating in another state, most states take the position that the employee's physical presence dictates where tax is due. States such as New York do not adhere to the general rule. Instead, when determining nonresident withholding and personal income tax obligations, New York sources income from days worked remotely out of

state as days worked in state when the employee's usual work location is in New York and no bona fide employer office has been established where the employee is located. In 2021, New York sent many notices and audited tax returns of nonresident filers who showed a substantial change in income sourced to New York.

Other states, including Massachusetts and South Carolina, issued emergency telecommuting rules in 2020 for sourcing income of nonresidents telecommuting and the availability of resident tax credits for resident employees telecommuting, both of which expire at separate times in 2021.

Remote work may also lead to an individual meeting the residency requirements of more than one state. Generally, states determine residency based on domicile or statutory residence. If a state determines that a taxpayer is a statutory resident in a state other than the taxpayer's domicile, this could result in dual residency, and both states may tax all of the taxpayer's income. The tax impact can be costly.

As we close-the-books on 2021 and prepare for a new filing season, companies must take inventory of their nexus profiles, be mindful of existing COVID-19 guidance and determine whether expiring COVID-19 guidance will increase their compliance costs.

[1] P.L. 86-272 bars a state from imposing a net income tax on a business located outside that state that sells tangible personal property located outside that state for delivery to customers in that state — as long as the business's activities in that state are limited to the solicitation of orders and all orders are approved by the business outside that state.



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