TAX ALERT

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Tax Implications of Teleworking and Remote Working for Employers and Their Employees

As outbreaks of COVID-19 persist, many employers are continuing to encourage or require their employees to work from home (i.e., telework). Such remote working arrangements have tax implications that employers and employees will need to consider.

One of the long-term impacts of the COVID-19 pandemic has been a shift in the way many people work. While teleworking may have initially been viewed as a short-term response to the pandemic, major employers across the country have now implemented either long-term or even permanent remote work solutions. Prior to the outbreak, telework accounted for only 20% of American workers, according to the Pew Research Center. But that number jumped to 71% since March 2020. Of those who have worked remotely over the last year, over half (54%) say they would prefer to work from home even after the pandemic ends.

This new work situation gives employees more flexibility about where to live. The allure of moving may be especially attractive to those in areas with a high cost of living. To make things even more interesting, at least 38 cities and six states are offering, or at least considering offering, tax abatements and cash grants for remote workers who move from areas like San Francisco, New York, and Chicago. New residents who qualify for these grants can receive anywhere from $5,000 to $15,000 if they commit to buying or renting a home in one of these areas for at least two years.

Anecdotally, many California residents sounded the alarm of an “urban exodus.” But researchers are now calling these new move patterns a “shuffle” instead. Despite these grant programs, 84% of moves over the last year occurred within the same metro area. As commute time becomes less of a concern due to teleworking, people have moved outward to nearby suburbs or smaller cities.

In California specifically, interstate moves have become popular as well. Two of the most expensive cities saw a sharp increase in moves outside the metro area, including San Francisco (23%) and San Jose (17%). Cities that saw an influx of new residents include Los Angeles, Stockton, and Sacramento.

The issue of moving doesn’t just involve cost-of-living expenses. Remote and teleworking tax obligations, tax breaks, deductions, and other scenarios can also change depending on where you move and how long you stay there throughout the tax year.

As we wrap up 2021, it’s important to take a close look at the state tax obligations related to teleworking arrangements.

State Tax Obligations for Employers

When an employee works in more than one state, an employer may be obligated to withhold and remit income taxes to each relevant state. In response to COVID-19, some states issued specific guidance on whether remote employees temporarily working in a state due to the pandemic create nexus or a tax obligation for an employer that does not operate in that state.

A company's responsibility for withholding state income tax for remote workers is complicated by the fact that states have different thresholds at which an employer must withhold. For example, certain states have rules that will trigger income tax withholding obligations based on the number of days that a nonresident employee is working in that state. Other states incorporate wage-based threshold measures. Also, states' rules and thresholds for nonresidents' taxation on employment earnings may differ from employers' state income tax withholding requirements.

In addition, it is important to understand which state's unemployment tax will apply, as the unemployment tax is paid to only one state, even if the employee works in multiple states.

It's possible to continue paying unemployment tax in the employee's normal work state if the following three conditions are met:

- The teleworking is temporary
- The employee expects to return soon
- The employee is still controlled from the normal work state.

However, if the employee's services are localized to the telework state for the foreseeable future, unemployment tax may need to be paid to the telework state.

California's Guidance for Employers

The Franchise Tax Board has posted a statement that out-of-state companies will not face state income tax if they have employees teleworking from California during the pandemic who are complying with Gov. Gavin Newsom's March 19 executive order for Californians to stay home. The Governor's stay-home order refers specifically to California residents, giving some concern that a company with non-California residents who are sheltering in California may not be able to rely upon this guidance.

State Tax Obligations for the Employee

The employee and employer need to track all the employee's working locations to make sure they comply with all state tax obligations. When taxpayers live in one state but work in another, they may have tax liability in both states. Certain tax credits are available to minimize taxation of the same income in two different states. Occasionally, neighboring states have reciprocity agreements that dramatically simplify income tax filing obligations for taxpayers.

Some remote workers have been turning to location-tracking apps on their smartphones such as TaxBird, TaxDay and Monaeo, which use location services to track employees at all times. While each tax app has different features and levels of precision, they all satisfy the essential and basic need to prove a remote worker's location to a tax authority.

Home Office Deduction

Certain taxpayers, such as independent contractors and self-employed individuals, may be eligible to claim a home office deduction if they use their home for business. This deduction is available to both homeowners and renters and allows qualifying taxpayers to deduct certain home expenses on their tax returns (thus reducing the amount of a taxpayer's taxable income).

Unreimbursed business expenses of an employee, however, including those incurred maintaining a home office, are no longer deductible as miscellaneous itemized deductions for tax years 2018 through 2025. These deductions were suspended by the Tax Cuts and Jobs Act (TCJA).

Business Expenses

While many individual taxpayers are no longer able to deduct work-related expenses as miscellaneous itemized deductions, they can receive tax-free reimbursement of work-related expenses, such as for the business use of cell phones and internet services. If a business has established an accountable plan as detailed in Publication 15, *(Circular E), Employer's Tax Guide*, it can claim a deduction for employee reimbursements of legitimate business expenses. The reimbursements are not included in the employee's taxable income.

California's Guidance for Employees

The Franchise Tax Board has posted a statement that provides guidance for income sourcing for nonresidents temporarily relocated to California, filing and paying California taxes during COVID-19. A nonresident worker who relocates to California for any portion of the year and has California-sourced income during the period the worker performed services in California will need to file a California nonresident or part-year resident income tax return to report the California-sourced portion of the worker's compensation. One way to calculate the portion of income that is California sourced is to multiply the worker's total amount of income for the year by a ratio of the worker's total number of days performing services in California over the worker's total number of days performing services worldwide.

Potential Opportunities and the Need for Planning Today

The pandemic has changed how people work, and more people are permanently working from home. Such remote working arrangements could potentially have state tax implications that should be considered. We can help you determine any filing or payment obligations.

If you have questions about how teleworking impacts you or your business's tax obligations, reach out to your Seiler advisor for guidance at 650.365.4646.

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