



STATE AND LOCAL TAX CONSIDERATIONS FOR A MOBILE AND REMOTE WORKFORCE: ARE YOU READY?

October 25, 2022

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2022 YEAR-END PLANNING CONSIDERATIONS

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Today's Agenda



State & Local Employment Tax Considerations



State Income Tax Nexus Principles



2022 Year-End Planning Considerations

State & Local Payroll Tax Considerations

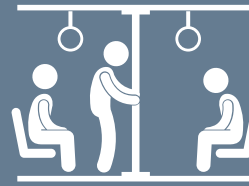


General State Income Tax (SIT) Withholding Rules



General Rule

An employer is required to deduct and withhold state income taxes on wages paid to employees in the state where the employee's services are being performed.



Commuters

An employee who is assigned to the employer's physical work location, but the employee lives in another state.

Withholding Tax: Employees that live in one state but primarily work in another are generally subject to the withholding rules of the work state or office location regardless of where they live. However, an exception exists for states that have reciprocal withholding agreements with neighboring states.

General State Income Tax (SIT) Withholding Rules



Remote (Telecommuter) Employees

An employee assigned to the employer's physical work location but performs some or all services remotely from home in another state.

- ▶ **Withholding Tax:** Various conflicting state rules - either the location where services are actually performed or attributed back to the state of the employee's office ("convenience of employer rule").



Business Travelers

An employee who travels to work in multiple states during the year.

- ▶ **Withholding Tax:** An employee may be subject to withholding taxes on wages earned for services performed in the other state (as a nonresident) based on number of days in another state (sometimes just one day) or exceeding the personal exemption threshold.

State Withholding Tax Implications During COVID-19



COVID-19 pandemic increased the number of employees working remotely due to stay-home orders and closures of physical company offices and other worksites.

As a result, several states issued withholding guidance related to COVID-19:

- ▶ Temporary guidance generally applied only to employees working remotely solely due to COVID-19 during the duration of the declared emergency
- ▶ Majority of this guidance allowed (or required) employers to continue withholding as they were prior to COVID-19 (i.e., based on an employee's primary work location)
- ▶ Many states offered employer withholding relief to the extent remote employment within the state was due to COVID-19
- ▶ Best Practice: If no temporary COVID-19 withholding guidance was released, it appeared employers should continue following the state's general withholding provisions
- ▶ Whether to change state withholding based on remote and teleworking locations of employees during the peak of the pandemic created uncertainty and dilemma for employers with employees working in new locations where guidance is inconsistent across states.

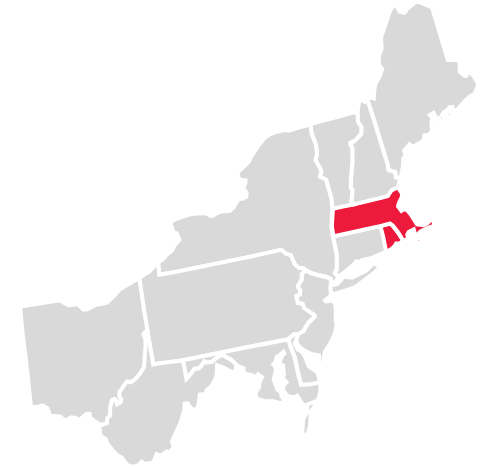
State Withholding Tax Guidance During COVID-19

MASSACHUSETTS:

- ▶ Nonresidents: Employers must source compensation to Massachusetts, and withhold income tax, for personal services performed by a nonresident who immediately before the Massachusetts COVID-19 emergency, was an employee engaged in performing those services in the state; and who during the emergency is performing those services from a location outside the state.
- ▶ Residents: A resident employee suddenly working in Massachusetts due to the COVID-19 pandemic who continues to incur an income tax liability in another state due to that state's sourcing rule will be eligible for a credit for taxes paid to that other state. The employer of such employee is not obligated to withhold Massachusetts income tax to the extent the employer remains required to withhold income tax with respect to the employee in such other state.
- ▶ Expired September 15, 2021 (90 days following the Governor's termination of the state-wide emergency declaration on June 15, 2021)

RHODE ISLAND:

- ▶ Guidance parallels Massachusetts' temporary regulation outlined above. Expired September 13, 2021.



State Tax Reciprocity Agreements



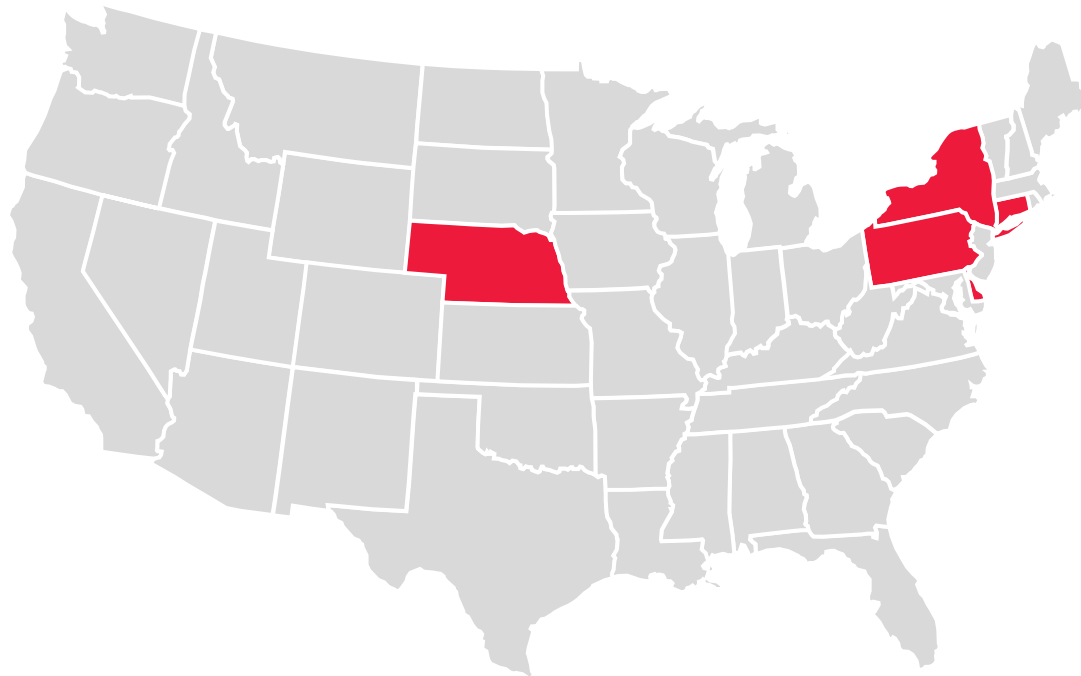
- ▶ **Income Tax Reciprocity:** An employer is generally not required to withhold tax on earned income (wage income) for the state in which the employee is performing the services if the employee lives and works in neighboring states that have reciprocity agreements.
- ▶ **State Exemption Certificate:** Employees must provide employer with a state exemption certificate if they live in a reciprocal state.
- ▶ **Earned Income:** Note that reciprocal agreements typically cover only earned income or wage income (W-2 income).
- ▶ **Exceptions:** In cases where no reciprocal agreement exists, an employer may still have secondary withholding obligation to employee's resident state.

Convenience of Employer Rule

States with a “Convenience of Employer” rule generally impose income tax withholding on wages paid to nonresident employees who typically work or are assigned to work from an employer office within the state, but who work some days outside the state (e.g., from the employee’s home office).

STATES WITH CONVENIENCE OF THE EMPLOYER RULES INCLUDE:

Connecticut, Delaware, Nebraska,
New York State; Pennsylvania (and Philadelphia)



Business Travel by Employees

SHORT-TERM BUSINESS TRAVELER WITHHOLDING CONSIDERATIONS:

For states other than primary live/work states, employer withholding requirements are generally based on wages attributable to the days a nonresident employee works within a particular state or derives income for services performed in the other state.

Some states provide a de minimis threshold which may relieve employer of withholding obligation (no tax withholding obligation until day(s) threshold or wage threshold met).



INTERESTING NOTE: Many employers conduct firmwide meetings in states that do not impose a personal income tax such as: Florida, Texas, Washington.

Nonresident de minimis thresholds are usually based on number of workdays in the state

- ▶ An employer is obligated to withhold taxes on an employee after the employee has performed 14 days of services in New York State
- ▶ However, the employee is liable for income taxes on all wages earned from services performed in New York State (or day one).

BDO's Insight

Over 80% of the states in the U.S. have personal income tax and require employers to withhold income tax from employees' wages. It can be extremely difficult to manage the payroll taxes and comply with the state withholding tax regulations if the company has remote and/or mobile employees.

TIPS



- ▶ Do not ignore the state tax withholding requirements
- ▶ Coordinate with HR and operations leaders to stay informed about who the remote employees are and where they are living and working
- ▶ For employees that travel for work, keep track of the location of employees in different states. BDO Quicktrip to track mobile workers

Compliance Considerations Post-COVID-19 Pandemic

Review state and local withholding tax compliance requirements

- ▶ Employers should arrange to have updated state-by-state withholding guidance to meet the employer filing requirements that may impact their remote and teleworking employee population.
- ▶ States have curtailed temporary tax relief provisions attributable to the COVID-19 period
- ▶ Employers that are currently being proactive in meeting compliance requirements will be best positioned to respond to future changes in withholding rules

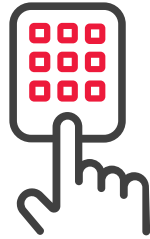
Consider tax implications of a mobile/remote workforce

- ▶ A larger population of remote or teleworking employees may subject the employer to withholding in new states
- ▶ Track employee temporary business travel and permanent relocations to the extent possible; require formal request and approval process for certain situations
- ▶ Determine whether an employee's remote work location is still considered temporary due to COVID-19; or, has the employee been approved to work remote indefinitely?
- ▶ Develop company policy and desktop procedures to address remote employees and "flex" work arrangements post-COVID-19

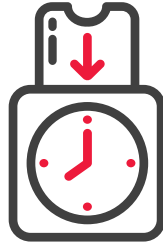
How to Identify Work Locations



Key Fobs/Security Systems



Time Entry Systems



Time-cards



Travel Reimbursement Reports



Software Tracking



GPS



**Ask the employee to self-identify.
Employee communication and education of the tax issues is key (without giving personal tax advice).**

General State Unemployment Insurance (SUI) Tax Rules

Generally, SUI is reported to the state in which the employee performs services. For employees that work in multiple states, the applicable SUI sourcing is determined using a four-tiered hierarchy test:

- 1 SERVICE LOCALIZED WITHIN STATE:** Service performed both within and outside a state is localized in that state if services performed outside the state are incidental to service performed within the state
- 2 BASE OF OPERATIONS:** If the employee's services aren't localized in one state, the state with the next best claim to jurisdiction is where the employee performs some services, and which contains the "base of operations"
- 3 PLACE OF CONTROL:** If the first two tests do not determine jurisdiction, the state with the next best claim to jurisdiction is where the employee performs some services and from which he/she receives direction or control
- 4 PLACE OF RESIDENCE:** If the prior three tests do not determine jurisdiction, the state with the next best claim to jurisdiction is where the employee performs some services and maintains a place of residence

State Income Tax Nexus Principles



Basic Nexus Concepts

What is nexus?

- The minimum activity in a state that creates an income tax reporting and payment responsibility

Physical presence

- Property or employees physically present in the state
- In-state third-party contractors or representatives that perform activities on behalf of taxpayer (may be referred to as agency nexus)

Economic nexus

- Solicitation of and receipts from sales to a state's residents may be sufficient to create nexus
- Some states have a minimum threshold for sales activity (i.e. "factor presence" nexus)

P.L. 86-272

- Federal exemption from income tax if only in-state activity is the solicitation of sales of tangible personal property and orders are filled and shipped from a point outside the state



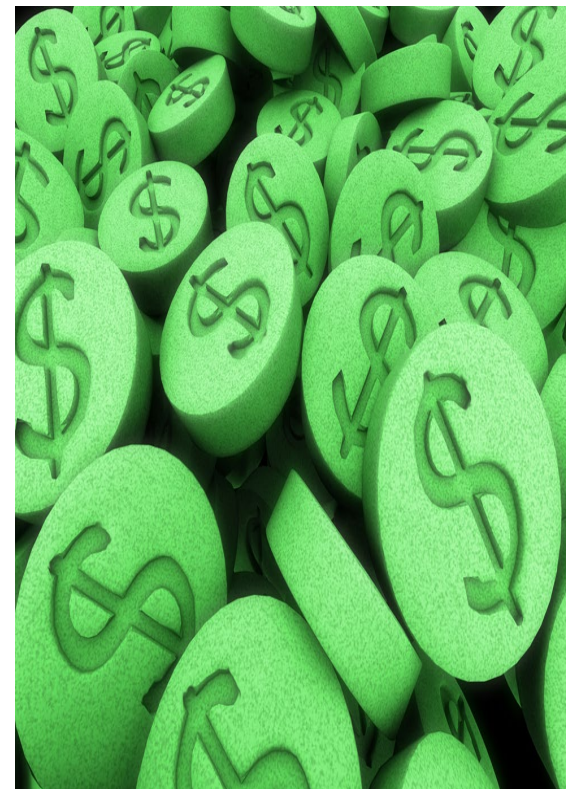
Economic Nexus

Economic Nexus is generally created by the purposeful direction at a market with significant sales or benefits derived by these activities.

- Applies to businesses that earn significant income within the state and “enjoy benefits from doing business there”
- Does not require physical presence in the state
- Economic nexus is generally created by having intangible assets or customers in a state

Each state’s definition varies

- Standards generally include broad language but to date have only been tested for very specific types of activities such as financial related activities or licensing of intangibles
- Today the majority of states do include some type of economic nexus language in their nexus or “doing business” statute



State Corporate Income Tax and Economic Presence Nexus Prior to *Wayfair*

Geoffrey, Inc. v. South Carolina (1993) - first state supreme court to rule that economic presence nexus is constitutional under the Commerce Clause (out-of-state intangible holding company licensing trademarks to affiliated retailer).

Prior to *Wayfair*, a number of states had enacted economic presence nexus statutes with respect to banks and financial institutions or that asserted income tax jurisdiction when any out-of-state corporation had a “significant” or “substantial” economic presence, including: CT; IN (financials); MN (financials and non-financials); NH; TN (financials); WV (financials); WI.

Since 1993, 14 states, including South Carolina, with court decisions confirming economic presence nexus is valid for substantial nexus for income tax purposes: CO; IL; IN; IA; LA; MD; MA; NJ; NM; NC; OK; OR; SC; TX; WV.

- ▶ Licensors of intellectual property
- ▶ Credit card receivables
- ▶ Franchisors

State Corporate Income Tax Economic-FACTOR Presence Nexus Statutes After *Wayfair*

- ▶ In *Wayfair*, the U.S. Supreme Court ruled that South Dakota's more than \$100,000 of sales or 200 or more separate transactions threshold satisfied the substantial nexus requirement.
- ▶ Seventeen states have adopted factor-presence nexus statutes for corporate income tax or gross receipts tax purposes: AL; CA; CO; CT; HI; MI; ME; MA; NY; NV (Commerce Tax); OH ("CAT"); OR ("CAT"); PA; TN; TX; WA ("B&O"); WV.
- ▶ All of these states' sales thresholds exceed \$100,000 and most are \$500,000.
- ▶ More states should be expected to adopt factor-presence nexus statutes after *Wayfair*.
- ▶ Public Law 86-272 protections against state net income taxes still apply!

Based on rulings, Virginia will also assert corporate income tax nexus based on any positive apportionment factor (although tends to be used on audit to challenge filings of nexus combined or consolidated returns).

P.L. 86-272 still applies, but only to sellers of tangible personal property and only if such seller's in-state activity is solicitation of orders or activities entirely ancillary to solicitation.

Where Am I Subject to Tax?

- ▶ In light of *Wayfair*, states now have a “green light” to assert economic presence nexus and factor-presence nexus for state income taxes.
- ▶ Review your business’s sales, by state
 - Is the data “good data”? Know your source of information!
 - Quantify and identify material states.
- ▶ For material states:
 - Does the business already have an in-state physical presence? → does P.L. 86-272 provide immunity from the state’s net income tax?
 - No in-state physical presence, but material sales → does the state assert economic nexus? → does P.L. 86-272 provide immunity?
- ▶ But don’t forget → Market-based sourcing!

Significance of Market-Based Sourcing

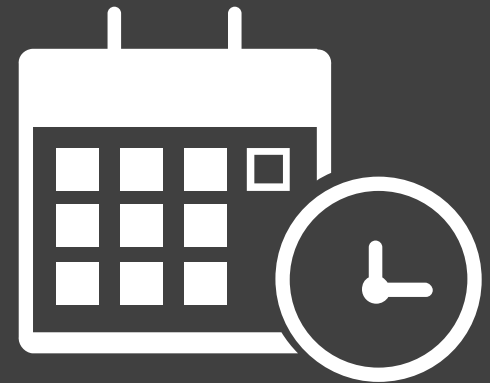
- ▶ The sales thresholds of state factor-presence nexus statutes are tied to the state's sales factor sourcing provisions.
- ▶ The majority of states require service providers and licensors of intangibles to use market-based sourcing.
- ▶ All of the states with factor-presence nexus statutes require the use of market-based sourcing (except Colorado, which will starting with the 2019 tax year).

A remote seller of tangible personal property may also be subject to a factor-presence nexus statute based on the destination state sourcing rule.

After *Wayfair*, Public Law 86-272 should take on added importance for corporate taxpayers.

However, nexus can have benefits, such as avoiding sales factor throwback or qualifying an affiliated group for state nexus combined or consolidated returns.

2022 Year-End Planning Considerations



Accrual vs. Cash Method

- ▶ Accrual Basis - Usually Used for Financial Reporting Purposes
 - Revenue Recognized when Earned
 - Expenses are Recognized when Incurred

- ▶ Cash Basis - Temporary Deferral of Receivables & Payables and Related Taxes
 - Revenue is Recognized when Received
 - Expenses are Recognized when Paid
 - Accrued Pension & Profit Sharing is Deductible if Paid by Filing Date of the Tax Return
 - Credit Card Purchases are Considered a Cash Purchase
 - What to Watch Out For:
 - Undeposited Cash Received is Income
 - Unissued Checks are not Expense

Entity Tax Rates and State Benefits

▶ Qualification for Cash Basis

- Profession Service Firms qualify without regulatory income limitations (currently at \$27,000,000).
- PSC Two Part Test:
 - 95% ownership by professionals who perform services
 - 95% of revenues generated from professional services.

▶ Entity Type Tax Rates

- S Corp - Individual Rates Plus W-2
- LLC (Partnership) - Individual Rates Plus Self-Employment Tax
- C Corp - PSC 21% at Entity Level
 - W-2 and Dividend Income.

Potential Tax Benefits

- ▶ PTE Tax Consideration
 - Adopted by Massachusetts with a 10% benefit claw back at individual level.
 - Adopted by many additional states across the country.
 - Arbitrage Can Result with Non-Resident Member / Shareholders
 - Analysis as to benefit should be performed to determine benefit.
- ▶ ERC (Employee Retention Credit For 2020 and 2021)
 - If Qualify, Benefit Could be Significant
 - Will Require Amending Payroll and Income Tax Returns.

General Planning

- ▶ Section 179 up to \$1,080,000; \$2,700,000 cap on expendable equipment before limitation.
- ▶ 100% Bonus Depreciation 2022 (automatic unless opting out)
 - 80% 2023
 - 60% 2024
 - 40% 2025
 - 20% 2026
- ▶ 179D Deduction for Energy Efficient Interior Improvements
 - Current Legislations Requires Careful Consideration
 - Third Party Study is Recommended
- ▶ R&D Credits
 - Third Party Study is Recommended



Other Considerations

- ▶ MA Millionaire Tax
 - Likely to Pass

- ▶ PFML Benefits
 - Proper W-2 Inclusion

- ▶ PPP Loans
 - Close to running its course

- ▶ Excess Business Losses Limitation Applicable Again
 - \$270,000 / \$540,000

- ▶ Business Interest Limitation
 - 30% of Adjusted Income

- ▶ Meals
 - Restaurants Purchases 100% allowable
 - Otherwise 50% is Deductible

Questions?





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