FISCAL FACT
No. 724
Aug. 2020

Teleworking Employees Face Double Taxation Due to Aggressive "Convenience Rule" Policies in Seven States

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Key Findings

- When a person lives in one state but works in another, they may have tax liability in both states, but typically receive a tax credit to eliminate double taxation of that income.
- Seven states, however, tax people where their office is even if they do not actually work in the state, and these individuals may be denied their home state's credit for taxes paid to another state, exposing them to double taxation.
- Six states—Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania—had implemented so-called convenience rules prior to the COVID-19 pandemic, while Massachusetts adopted a temporary income sourcing rule with the same effect in response to pandemic-era telework.
- In New Hampshire, which forgoes an income tax and is home to many residents who normally work out of offices in Massachusetts, the state Department of Justice is exploring Massachusetts' new sourcing rule with an eye to possible litigation.
- There is also renewed bipartisan interest in a federal remedy that would restrict states' ability to impose income taxes on people not physically present in the state.

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Introduction

States can tax your income where you live and where you work—but a growing number of states may also seek to tax your income even if you neither live nor work there, an aggressive posture that becomes increasingly consequential as more Americans work remotely both during and potentially after the COVID-19 pandemic. New Hampshire wants to put a stop to it. Federal lawmakers are also considering offering some relief from the practice, either permanently or as a pandemic-specific measure. But absent a federal response, many taxpayers could be in for a rude awakening when their income taxes come due.

So-called "convenience rules" and similar income sourcing rules not only obligate workers to pay tax to jurisdictions where they did not work, but in many cases, they also strip them of eligibility for tax credits designed to avoid double taxation when someone lives in one state and works in another. This is inequitable, inconsistent with widely accepted principles of sound taxation, and potentially incompatible with the Dormant Commerce Clause of the U.S. Constitution.

Companies' unplanned experiment in telework may yield a long-term shift in how we conceptualize the workplace. If so, these rules, which treat an employee as if they worked out of their company's office even if they never actually did so, could become increasingly popular as a short-term revenue option for states facing an exodus of increasingly teleworking employees. They could, however, have an adverse effect on long-term competitiveness, as telework-friendly businesses increasingly choose to locate their offices elsewhere to avoid subjecting their employees to double taxation. As the changing world of business transforms these rules from a nuisance to a source of significant interstate conflict, moreover, Congress may wish to step in, exercising its Commerce Clause powers to better define how far states can reach in taxing interstate economic activity.

Convenience and Similar Sourcing Rules in Action

Massachusetts is demanding income tax payments from some of those who both live and work in neighboring New Hampshire (and elsewhere) during the pandemic, drawing objections and threats of litigation from Granite State officials. This unusual situation, where an employee could owe income taxes to their employer's state even if they never personally set foot in it, is a pandemic-era innovation for Massachusetts, but was already the rule in six states. It can result not only in having tax liability in two states, but in true double taxation: paying taxes to two states on the same income, without any offsets. Rules like the one temporarily adopted in Massachusetts have significant implications for telecommuters going forward.

To understand the issue, it is first necessary to consider what typically happens when someone lives in one state and works in another. Occasionally, neighboring states have reciprocity agreements which dramatically simplify obligations for taxpayers. Consider, for instance, a resident of Virginia, which participates in a reciprocity agreement with the District of Columbia, where the taxpayer's office is located. Under the agreement, the taxpayer only incurs tax liability where she is domiciled (Virginia), and can disregard the District's income tax code entirely. For many people whose residences and offices are on opposite sides of a state line, however, the situation is a little more complex—though with protections to avoid double taxation.

Imagine that this person lives along Virginia's southern border with North Carolina and works out of an office in the Tar Heel State. North Carolina would tax them on the income they earn in the state (which, in this example, would be all of their salary income), and Virginia—as their domiciliary state—would tax them on all income from all sources. At first blush, this appears a recipe for double taxation.

Fortunately, that is where an important structural credit comes in: Virginia offers a credit for taxes paid to other states on income earned in those states, so when the taxpayer files her Virginia tax returns, she can reduce her liability by what she paid in North Carolina. Virginia's top rate of 5.7 percent is slightly higher than North Carolina's flat rate of 5.25 percent, so she might end up paying some residual amount to Virginia (and of course pay on any non-wage income), but she is no worse off than if she had simply done all the work in Virginia, aside from the (not negligible) hassle of complying with two states' tax codes.

If, during the pandemic, she started working from her home in Virginia, she would stop accruing additional tax liability in North Carolina. Her office may be located there, but she is not working there. She is not earning any income from that location. She both lives *and* works in Virginia now, and thus only incurs tax liability in Virginia.

But that is only because North Carolina does not have what Massachusetts has implemented, or what six other states already have on the books—a special sourcing rule that taxes most people based on where their office is located, whether or not they work there. This is not just a hassle for the taxpayer: in many cases, it yields actual double taxation, because the taxpayer's domiciliary state no longer provides the offsetting credit.

In the six states where this provision already existed—Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania—it is called the convenience of the employer rule, or just the convenience rule for short. It is, however, anything but convenient for taxpayers.

Under these provisions, an employee is treated as if they work in their employer's state if their work is performed elsewhere for what is termed the "convenience of the employer"—but convenience is defined very broadly, and the exceptions tend to be quite narrow. States have not always done a good job of spelling out what is meant by "convenience," but generally the only exceptions are for when an employee's work legitimately could not be carried out in the employer's state.

A technician servicing a New York company's products in Vermont could not, by definition, do her job in New York, so that is not for the convenience of the employer. But a remote employee's work theoretically could be performed in the employer's state, no matter how inconvenient or even impossible that might be for a given employee. These states claim that income even if the employee never sets foot in the state.[1]

States with a "convenience rule" have yet to provide clarity on how they will treat unscheduled remote work due to the COVID-19 pandemic. One might hope that states would be flexible, understanding why people may have little choice but to work out of state—particularly when state policies forbade working from the office—but the silence thus far raises concerns. That people are working somewhere other than an office that in some cases is literally not allowed to

1 See, e.g., N.Y. Comp. Codes R. & Regs., tit. 20, § 132.18(a) (2007).

be open is surely not a matter of "convenience," but a state might contend that technically, the employee *could* still be residing and working in their state rather than in another state where they make their residence.

Back in March, Massachusetts—a state which did not previously have such a rule—made this perverse logic explicit. Massachusetts' new sourcing rule is not a convenience rule *per se* because it uses a different, pandemic-contingent standard: the taxpayer continues to have Massachusetts income tax liability if they worked out of Massachusetts prior to the pandemic and are now working remotely from another state. The Commonwealth is currently considering an extension of this policy through the end of the year.[2]

This has, of course, raised the hackles of New Hampshire officials, who govern a state without a wage income tax. Someone who lives in Nashua, New Hampshire but commutes to Boston for work has always owed income taxes to Massachusetts, and there is no offset in New Hampshire because the state has no income tax in the first place. But that is the way of things; Massachusetts is clearly within its rights to tax income earned in the state. But when that person's office becomes their Nashua home, what is Massachusetts' ongoing claim? Just that their employer owns a vacant office building in Boston?

Because New Hampshire does not impose an income tax, credits for taxes paid to another state are a moot point. But returning to a previous example, what if someone lives in Vermont but works for a New York-based company? Suddenly, things get interesting.

When that work is physically performed in New York, everything operates normally: New York taxes the income and so does Vermont, but Vermont offsets liability with a credit for taxes paid on income earned in New York. But if that work is now being performed in Vermont as people work from home, then Vermont no longer regards that work as being performed in New York—for the rather obvious reason that it is not.[3]

Meaning, no credit. Meaning, both states' full income taxes apply.

When this does and does not happen is complex and varies based on states' interpretations and applications of their laws. Vermont's statute is explicit: to merit the credit, the income must be earned while physically present in the other state. Most other state statutes are silent on this point; nothing in, say, Rhode Island law expressly spells out what is required for income to be determined to be derived from Massachusetts.

Generally, however, the taxpayer's domiciliary state is likely to assert that income earned while both living and working in their state is rightfully theirs to tax, concluding that just because an employee's office is in another state does not mean that her income is "derived from sources outside the state," so when a state with a convenience rule (or a temporary sourcing rule like Massachusetts') steps in and asserts the right to tax it as well, the result is double taxation.

2 830 CMR 62.5A.3.

3 32 V.S.A. § 5825.

TABLE 1.

Convenience Rules Create Double Taxation for Teleworking Employees

Estimated Income Tax Liability for a Vermont Resident with $100,000 in Income and an Office in New York Under Three Scenarios

	Commute into New York Office from Vermont	Vermont Remote Work with Convenience Rule	Vermont Remote Work without Convenience Rule
New York Liability	$5,458	$5,458	$0
Vermont Pre-Credit Liability	$4,627	$4,627	$4,627
Vermont Tax Credit	($4,627)	$0	$0
Total Liability	$5,458	$10,085	$4,627

Sources: State tax schedules; Tax Foundation calculations.

Sometimes a state with a convenience rule may respect the similar rules of other jurisdictions. Massachusetts' temporary sourcing rule, for instance, exempts from tax the income of a Massachusetts-based taxpayer who is subject to similar taxes from another state, like New York.[4] And in a few cases, a state without its own convenience rule has taken the high ground, allowing its residents to continue to claim the credit for taxes paid to other states during the pandemic despite changing circumstances. New Jersey is an example of this approach, with the Garden State helping its residents avoid double taxation by forgoing its own taxes on their newly-in-state earnings, since New York and other nearby states with convenience rules have not relented.[5]

Legal Considerations

Convenience rules have survived legal challenges in the past, with the notable challenges coming before New York's Court of Appeals.[6] It is difficult to say whether New Hampshire might be able to mount a successful federal challenge to the laws of Massachusetts and elsewhere.

Under the Dormant Commerce Clause, taxpayers must have some level of minimum economic contacts with a state to be subject to its taxes and must in some way avail themselves of the benefits of the state's economy. New York's courts concluded that working for a New York-based company with New York offices meant that employees were availing themselves of the state's market, and that this represented sufficient contacts to tax their income.

But New York does not, of course, tax all U.S.-based employees of firms headquartered in New York, even though all of them benefit from the parent company's location; the state implicitly recognizes that some claims of taxable nexus with a state are too tenuous. New Hampshire could have strong constitutional arguments to raise on behalf of its residents who are being taxed by New York, Massachusetts, or other states, regardless of whether they ever set foot in them.

4 830 CMR 62.5A.3.

5 Jared Walczak, "New Jersey Waives Telework Nexus During COVID-19 Crisis," Tax Foundation, Mar. 31, 2020, https://taxfoundation.org/new-jersey-waives-telework-nexus-covid-19-crisis/.

6 *Zelinsky v. Tax Appeals Tribunal of the State of New York*, 42 1 N.Y.3d 85, 801 N.E.2d 840, 769 N.Y.S.2d 464 (2003). See Paul R. Comeau, Timothy P. Noonan, and Joseph N. Endres, "New York's Revised Convenience Rule Provides Some Clarity and Continued Controversy," *Journal of Multistate Taxation and Incentives* 16:18 (August 2006), https://www.hodgsonruss.com/newsroom-publications-NewYork_srevisedconvenienceruleprovidessomeclarity.html.

Congressional Options

Alternatively, Congress could step in. The Multi-State Worker Tax Fairness Act, first introduced by the Connecticut U.S. Senate delegation of Richard Blumenthal (D) and Chris Murphy (D) in 2016[7] and recently revived as H.R. 7968 by Representatives James Himes (D-CT), Jahana Hayes (D-CT), and Chris Pappas (D-NH),[8] would restrict states' ability to tax nonresident telecommuters, stipulating that an individual cannot be deemed to be present or working in a state for tax purposes when they are working from their home in another state.

This would represent the most straightforward and long-term solution to the problem of convenience and similar sourcing rules. Separately, however, the Health, Economic Assistance, Liability Protection and Schools (HEALS) Act, introduced by Senate Republicans, includes a temporary provision which partially restricts such double taxation through 2024.[9] Under the provision, remote employees would only be subject to income tax in their state of residence and in any states where they work for more than 90 days during calendar year 2020 and for more than 30 days during calendar years 2021-2024.[10]

Notably, this only indirectly addresses convenience rules and similar sourcing rules. It does not, strictly speaking, establish that a state cannot tax nonresident income earned elsewhere; instead, it establishes a threshold for a minimum number of days that someone must work in the state to be taxable at all. This is both broader and narrower than a direct response to convenience rules. It is broader inasmuch as it affects taxation of in-person activity as well, establishing a uniform minimum threshold before a state's tax code applies to a nonresident. It is narrower, however, inasmuch as anyone meeting that threshold could still be taxed for work they perform out-of-state provided their office is located in the state.

With the 90-day threshold for 2020, anyone with a typical work schedule[11] who began working remotely before May 11th, and remained remote through the end of the year, would be given a safe harbor against another state's convenience rule. There are, however, 79 working days after Labor Day, so those returning to the office later in the year could still find themselves taxed by two states—without an offsetting credit—on income earned during the time that they were working remotely.

Even less targeted short-term measures can be valuable during the pandemic. Ultimately, however, a more robust solution may be warranted, one which, like the Multi-State Worker Tax Fairness Act, stipulates that states cannot tax nonresidents on income earned out-of-state simply because their company has offices in-state. Such a bright-line rule would be well within Congress's Commerce Clause powers.

7 Multi-State Worker Tax Fairness Act of 2016, S.2813, 114th Cong., 2d Sess., (2016).

8 Multi-State Worker Tax Fairness Act of 2020, H.R.7968, 116th Cong., 2d Sess., (2020).

9 The HEALS Act consists of several bills. See specifically, the American Workers, Families, and Employers Assistance Act, S.4318, 116th Cong., 2d Sess., (2020), Sec. 403.

10 This approach is more consistent with what has traditionally been considered "mobile workforce" legislation, but the 90-day threshold for 2020 is intended as a partial solution to issues posed by the interaction of telework and convenience rules as well.

11 Counting weekdays, excluding federal holidays.

State Taxation and the Post-Pandemic Economy

A global pandemic upended the ways we live and work, and some of these changes will be temporary, reversing as the virus ebbs. Others, however, will endure, with the pandemic accelerating nascent trends, like greater acceptance of telework. While many jobs will return to office settings, not all will, and more flexibility is likely in the future. A greater openness to remote work will run headlong into conflicting state tax provisions designed for simpler, less mobile times. There will be implications for employers and employees alike, and convenience rules are just one of several issues that policymakers must address to avoid state tax discrimination against telework arrangements.

In the short term, states may be tempted to impose—or continue to embrace—convenience rules to stave off revenue declines as workers relocate elsewhere. In this new environment, however, doing so brings a greater potential for litigation or corrective federal legislation. In the longer term, however, even if convenience rules survive legal and congressional scrutiny, they render a state incredibly unattractive for businesses that wish to develop a remote work culture. By locating their offices in such a state, businesses can expose many of their employees to double taxation. This becomes an incentive to locate (or relocate) elsewhere.

Convenience rules sever whatever tie exists between a tax and the government services it funds. While most taxes (unlike some fees) fund a broad array of services and cannot be understood as a strictly user-pays arrangement, there is at least some connection between the taxpayer and the expenditure of the funds. Taxpayers pay for the governance of the area where they work—a place from which they derive some direct benefit. Taxing people who never set foot in a state, under a vague and inconsistently applied notion that they are availing themselves of the state's market simply because their company has an office there, is bad tax policy.

States have broad latitude to tax in-state activity as they wish, subject to a few constitutional constraints. Aggressive tax structures which seek to tax activity that takes place wholly or almost entirely beyond the state's borders, however, represent bad tax policy, raising constitutional questions and meriting the attention of federal lawmakers.