Chair Sample, Vice-Chair Dismang, and Members of the Committee:

I regret that it is not possible to appear before you today as you consider Senate Bill 484, but in lieu of that, as you consider an important piece of legislation regarding Arkansas’s taxation of remote work, I am taking the liberty of sharing the Tax Foundation’s analysis remotely.

Arkansas is one of seven states with an unusual, quite possibly unconstitutional, income sourcing rule that has the potential to make the state less attractive for business in a more remote work-friendly environment. This rule, generally called a “convenience of the employer” rule, wasn’t even adopted by the legislature, but arose from a legal counsel opinion from the Department of Finance and Administration early last year. Arkansas lawmakers have an opportunity to reconsider that administrative decision before potential intervention by the U.S. Supreme Court (New Hampshire has filed suit against a similar rule in Massachusetts) and before the rule drives business relocation decisions.

Ordinarily, states can tax their residents’ income from all sources, and the income of nonresidents when that income is earned in the state. Every state with an income tax also provides a credit for taxes paid to other states to avoid double taxation. Therefore, if a Missouri resident works remotely in Arkansas for a while, she owes income taxes to Arkansas (and will see her Missouri income tax liability reduced). And if an Arkansas resident temporarily relocated to Oklahoma—without changing his Arkansas domicile—he would pay Oklahoma taxes on income earned in Oklahoma, and Arkansas taxes on all income, but with a credit against the Oklahoma taxes.

Two things are important to note here. One, the above is true even with a convenience rule. The convenience test does not override the availability of the credit for taxes paid to other states for Arkansas residents, so it is not currently capturing additional tax revenue from any residents who temporarily relocated during the pandemic, or who spend some time out-of-state each year.

Two, credits tend to be capped at the amount one would have paid under the states’ own tax structure. If someone spent a few months in a higher tax state and owes more to that state than they would have owed in their lower-tax home state, their credit is for the lesser of the amount they actually paid and the amount they would have paid on that income in their home state.

Convenience rules, by contrast, are about people who don’t live in a state and don’t even work there but work for a company located in the state. Under Arkansas’s new regulatorily-adopted
convenience test, a North Carolina-based remote employee of an Arkansas company owes Arkansas income taxes—and, to the taxpayer’s detriment, North Carolina may decide not to offer them a credit for taxes paid to other states (since, according to North Carolina’s income sourcing rules, the income was not actually earned in another state), yielding true double taxation.

Why should Arkansas care? Equity is certainly part of it: double taxation shouldn't occur. But as a more practical bottom-line concern, this policy will force businesses which care about offering remote and flexible work opportunities to their employees post-pandemic to make some decisions that may hurt Arkansas. If working remotely from another state means double taxation, a remote work benefit is not much of a benefit. Accordingly, companies that prioritize remote work may either shift some of their functions out of state (providing an out-of-state office to which to assign non-Arkansas workers) or even move their operations outright.

Lawmakers can and should reconsider this detrimental policy which was adopted without their input.

Legislation accomplishing this purpose, Senate Bill 484, simultaneously addresses another important consideration for a remote work-friendly tax code as well: adopting a 30-day threshold for the state’s taxation of nonresidents earning income in the state. Currently, everyone working in Arkansas for even a day theoretically has to file a tax return with the state, even if their liability is negligible or even nonexistent. Adopting a threshold for most workers (excluding athletes and performers) simplifies tax season for ordinary taxpayers and saves Arkansas the administrative costs of processing zero-dollar and low-dollar returns from nonresident filers.

Convenience rules began in New York. They are aggressive, constitutionally suspect, and, in the long run, detrimental not only to remote workers who could face double taxation, but also to companies that would rather operate from Arkansas but might decide to move to give their employees the option of remote work. And ultimately to Arkansas itself, which might lose out on those companies—and their taxes, and the taxes of the employees that remain local.

In the short run, Arkansas might be able to collect some revenue from nonresidents working remotely for Arkansas companies, but most of those currently working remotely are Arkansas residents. A remote work environment is coming, however, where Arkansas companies might want to hire people who live anywhere in the country or allow their workforce to go anywhere on a permanent basis. Arkansas’s convenience rule won’t stop this so much as encourage individuals and businesses to make choices to avoid it.

Remote work is here to stay. Convenience rules can’t change that. What they can change is the decisions people make. Under this rule, those decisions may not be to Arkansas’s advantage.

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