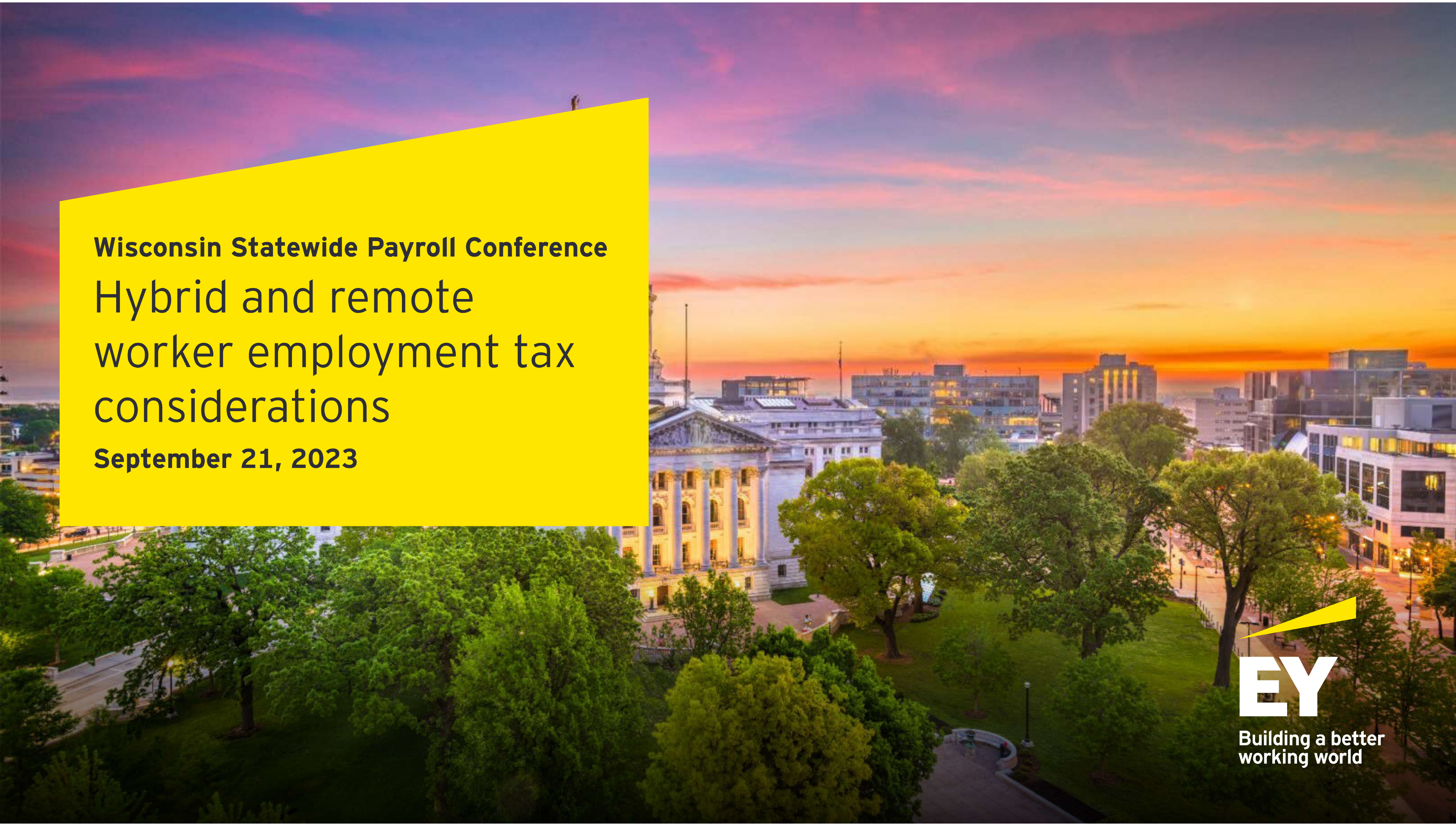


Wisconsin Statewide Payroll Conference

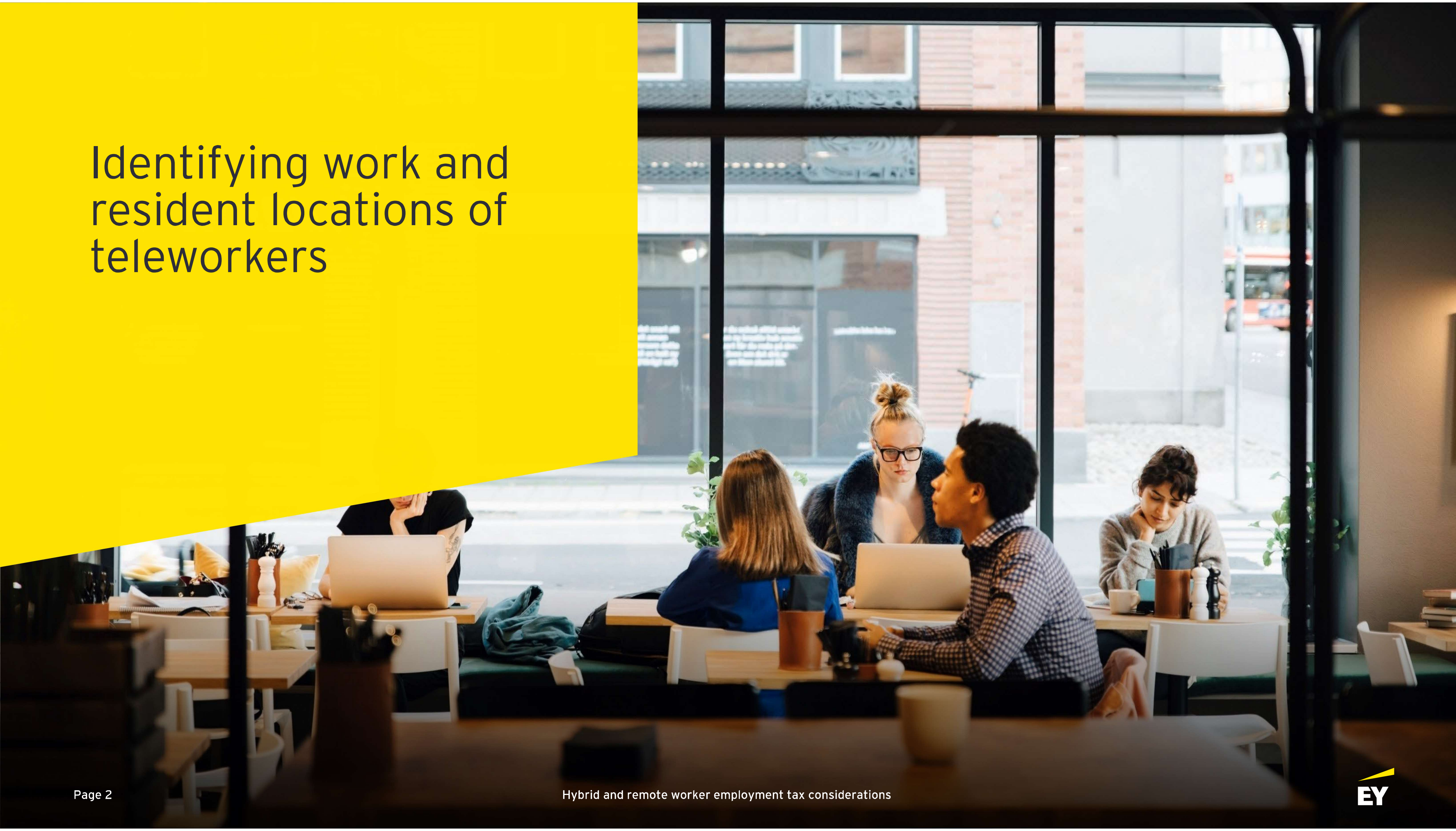
Hybrid and remote worker employment tax considerations

September 21, 2023

EY

Building a better working world

Identifying work and resident locations of teleworkers



Why does the teleworker's physical location matter?

If an employee works from home on more than an occasional basis, the physical location of the telework may be treated just as any place of business of the employer. This has significant implications for employers if the requirements of the teleworker's state/locality are ignored.

State/local wage and employment considerations

- Minimum wage
- Frequency of pay
- Overtime pay
- Timing for final wages
- Payment of accrued vacation
- Requirement for unpaid leave
- Requirement for paid leave
- Limitations on deductions from pay
- Direct deposit/pay cards
- Employee notices/posters
- Workers' compensation
- Other employment considerations
- Workplace health and safety considerations
- Pay equity considerations

State/local payroll taxes and business taxes

- State income/withholding
- Local tax/withholding
- Local occupational license fees
- New hire reporting
- State unemployment insurance
- Disability insurance
- Paid family and medical leave insurance
- Other state/local payroll tax
- Corporate income tax
- Corporate franchise tax
- LLC/partnership income tax
- Sales and use tax

Potential risks

- Backpay awards, settlements and legal fees
- Tax penalty and interest
- Loss of employee morale
- Loss of business reputation

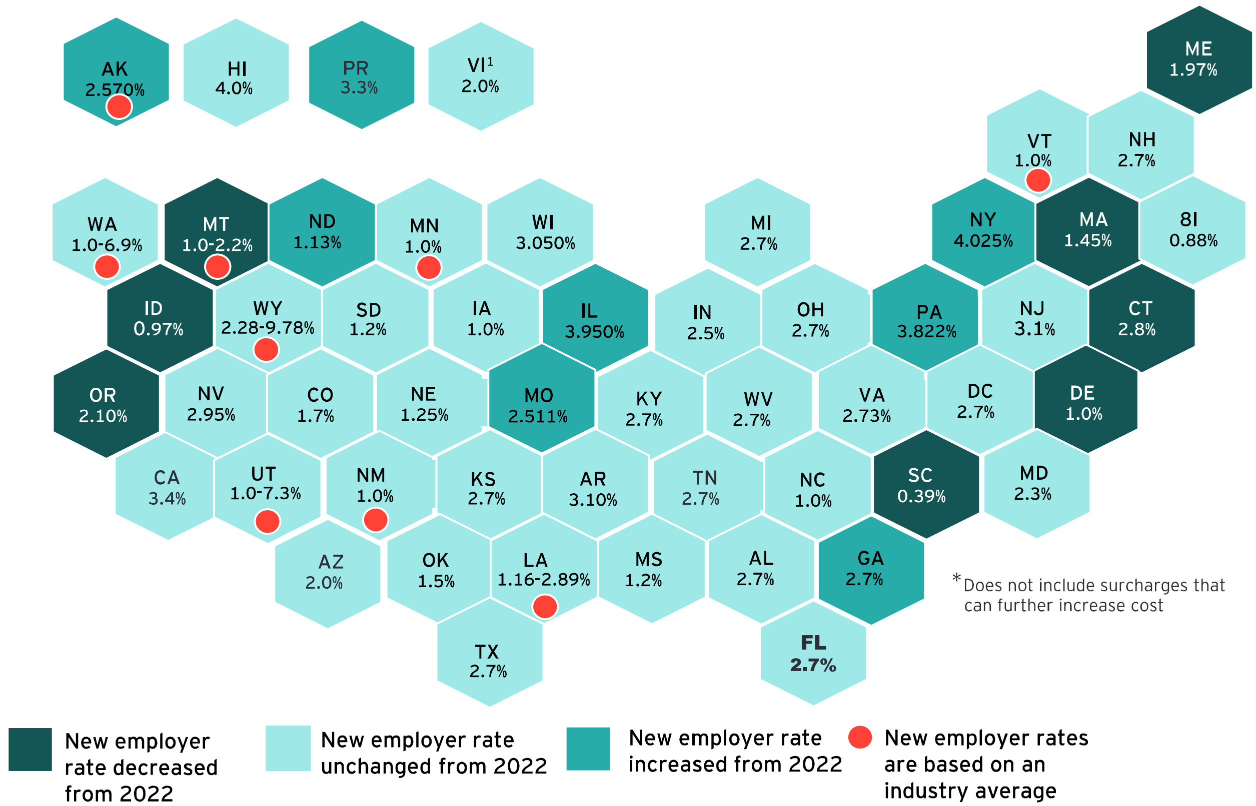
Home office state vs. employer's office state: Case study 2023

In this example, failure of the employer to recognize the physical location of the teleworker in Texas would result in numerous risks, including the failure to withhold and pay various Oregon state and local taxes.

State/local requirements	Teleworker home Oregon	Employer office Texas
State minimum wage	$14.20	$7.25
SUI wage base	$50,900	$9,000
SUI tax rate	2.1% (new employer)	0.23% (experience rate)
State income tax	Yes	No
State transit tax	Yes	No
Local transit tax /income tax	Yes	No
Workers' compensation insurance tax	Yes	No
Paid family and medical leave insurance tax	Yes	No

Setting up a teleworker in a new state could mean higher SUI taxes*

Keep in mind that if a teleworker is operating in a state where the employer doesn't currently have employment, the employer is assigned the new employer rate for a few years, which may be higher than the employer's experience rate in those states where it currently operates



Multistate tax implications for hybrid teleworkers

Multistate payroll tax challenges for hybrid teleworkers

01 Sourcing wages to the correct jurisdictions

To which jurisdictions do income tax and unemployment insurance apply? Pursuant to state income tax, does a reciprocal agreement apply?

02 Convenience of the employer rule

Does the state/locality where the employee reports impose the convenience of the employer rule?

03 De minimis exceptions

When the employee works in the state or locality for short periods, does nonresident income tax apply?

04 Apportionment

For #03, how is the portion of taxable wages that is sourced to the nonresident state apportioned for income tax and withholding purposes?

05 Trailing compensation

Does the state require income tax based on where wages were earned for compensation that accrues over more than one payroll period?

06 Resident and nonresident income tax withholding

Does the resident state allow for reduction of income tax withholding for income tax withheld in the nonresident state? What employee withholding certificates are required?

Sourcing for unemployment insurance and similar taxes

Employer

- Where wages are paid

  and

- There is a covered employee

Covered employee

- Applies only in one state at a time
- Temporary work incidental to the main job location is not considered

The SUI state is where the employee performs some work, and (in this order):

- Where the work is localized
- The employee's base of operations

  or

- The employee's place of control

- If none of the above:
  - The employee's residence

(US Department of Labor, Program Letter 20-04)

Sourcing for unemployment insurance and similar taxes, *example*

Employer

- Headquarters office is in New York
- Employment and employees are SUI covered in all states

Employee

- Works across two states, Texas and Louisiana
- Home office is in Texas
- General manager is in New Mexico

The SUI state is where the employee performs some work, and (in this order):

- Where the work is localized (N/A)
- The employee's base of operations (Texas)

or

- The employee's place of control (New Mexico)

- If none of the above:
  - The employee's residence (Texas)

Since work is not localized in one state, and Texas (rather than New York) is the base where the employee normally receives instructions, mail, etc., Texas is the unemployment insurance state.

Convenience of the employer rule

- In most states, the default rule is that employees who are residents of one state (State A) but work for an employer in another state (State B), are taxed by State B only on wages earned for days the employee is physically present in State B.
- However, if State B has a convenience of the employer rule, a State A resident working from home for his/her own convenience within State A for an employer in State B is subject to State B nonresident income tax for all wages earned in State A and State B despite not being physically present to work in State B.
- Generally, the convenience of the employer rule applies if, for their own convenience, and not the necessity of the employer, employees are performing services from their homes within their resident states, rather than the locations of their employers in nonresident states.
  - New York has a more elaborate "test" as set forth in TCB-M-06(5)I.
  - Alabama applies the rule if an employee is working from home outside of Alabama for an Alabama employer (no reference to convenience of employee or necessity of employer).

States that impose the convenience of the employer rule

Arkansas (reversed effective April 30, 2021)
Legal Opinion No. 20200203

Alabama
Alabama Tax Tribunal ruling, March 8, 2023, and May 19, 2023

Connecticut*
Conn. Gen. Stat. Section 12-711(b)(2)(C)

Delaware
Del. Code. Tit. 30, Section 1124(b)(1)(b)

Nebraska
316 Neb. Admin. Code Section 22-003.01C(1)

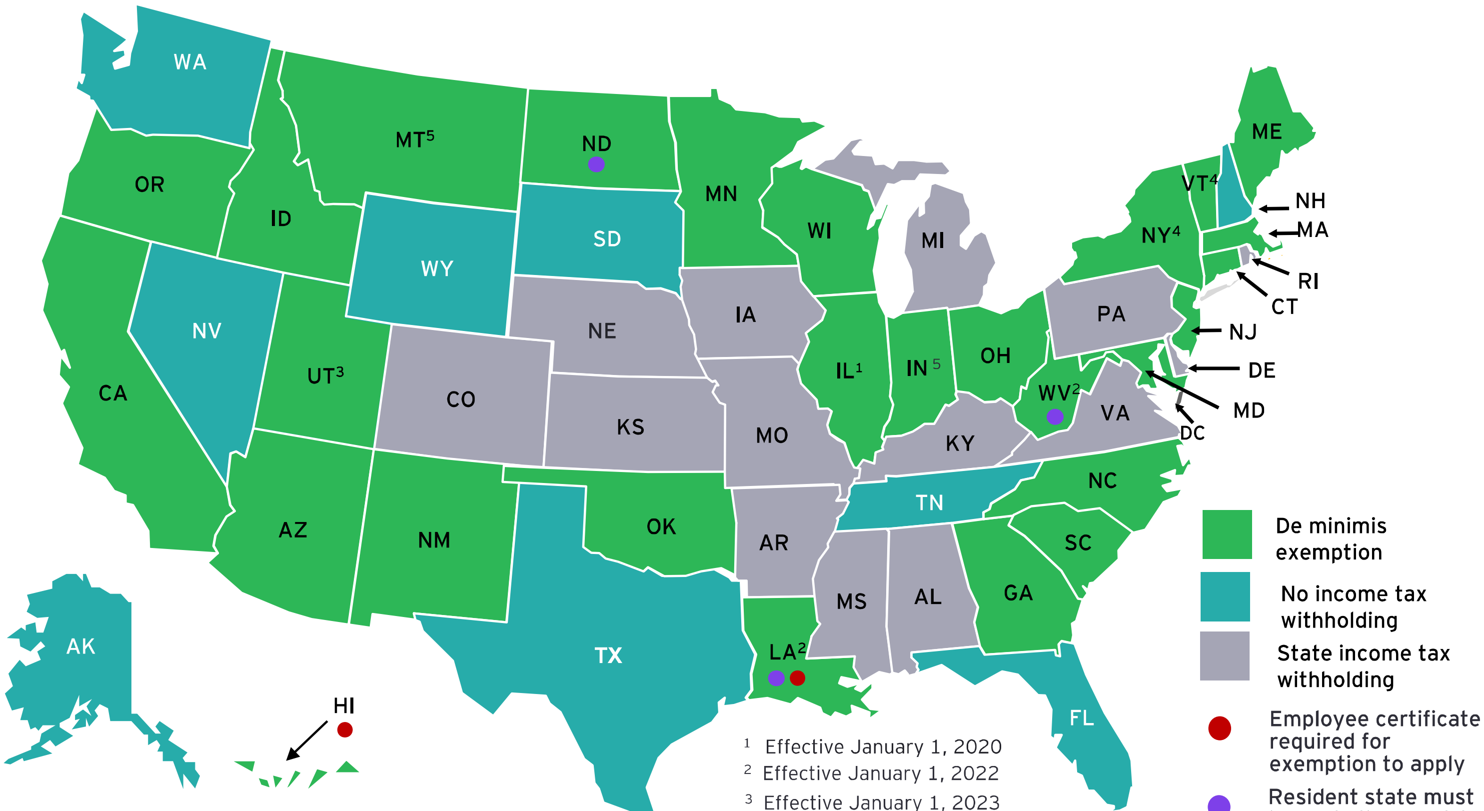
New York
20 NYCRR Section 132.18(a); Technical Memorandum TSB-M-06(5)I)

New Jersey*
A.4694 (enacted in 2023, effective 1-1-2023)

Pennsylvania
61 Pa. Code Section 109.8

*Applies only if resident state also imposes the rule.

De minimis exceptions from nonresident income tax requirements



[1] Effective January 1, 2020
[2] Effective January 1, 2022
[3] Effective January 1, 2023
[4] Applies only to income tax withholding
[5] Effective January 1, 2024

Source: EY state survey of laws and regulations, May 18, 2023

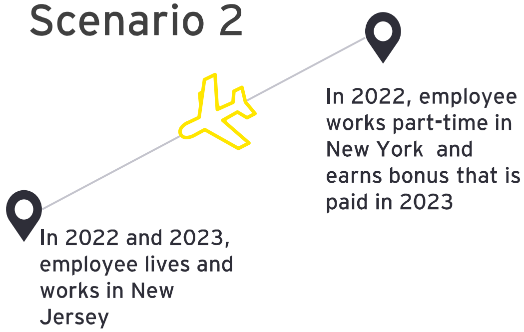
Trailing compensation

Sourcing delayed wage payments to the jurisdiction earned

Scenario 1

Result: New York nonresident income tax on bonus. There is no income tax in Nevada.

Scenario 2



Result: New York nonresident income tax and New Jersey resident income tax applies to the bonus.

- In many US states and localities, lump sum payments such as accrued paid time off, severance, equity compensation, and nonqualified deferred compensation must be sourced to the jurisdiction(s) where the compensation was earned for income tax withholding purposes.

- For US state income tax purposes, an exception applies to qualified retirement and to top-heavy plans (Supplemental Executive Retirement Plan (SERP) or nonqualified deferred compensation) that are paid in substantially equal periodic payments over a period of not less than 10 years (P.L. 104-95).

Teleworker tax legislation and legal challenges

2023 legislative and administrative actions to address hybrid employee income tax policies

Court cases

- **Alabama, state income tax.** On March 8, 2023, the Alabama Tax Tribunal upheld an Alabama Department of Revenue assessment of income tax on the wages that a remote worker earned from his Alabama employer while working from his home office in Idaho (convenience of the employer rule). (*Mark E. Bollinger v. State of Ala. Dep't of Rev., Inc. 22-390-LP*) A similar ruling was made by the tribunal on May 19, 2023, involving a Florida employee working remotely for an Alabama employer. (*Michael J. Baty v State of Ala Dep't of Rev, Inc. 22-928-LP*)

- **Missouri, St. Louis earnings tax.** In a January 2023 decision (*Boles v. City of St. Louis: Cause No. 2122-CC00713*), the trial court agreed that employees working for a St. Louis employer outside of St. Louis during the COVID-19 emergency were owed refunds of the earnings tax for 2020 and beyond. The Missouri Supreme Court declined to rule on whether affected taxpayers can file a class action; therefore, the question remains whether individuals will have to file separate lawsuits to claim refunds.

State legislation

- **Indiana** SB 419. Effective January 1, 2024, exempts from Indiana source income compensation received by nonresident employees for services they provide within Indiana for 30 days or less during the calendar year.
- **Montana** H.B.447. Effective January 1, 2024, exempts from Montana source income compensation received by nonresident employees for services they provide within Montana for 30 days or less during the calendar year. Key employees with annual compensation of more than $500,000 are excluded from the provision.
- **New Jersey** A.4694. Effective January 1, 2023, imposes the convenience of the employer rule if the nonresident employee's resident state imposes a similar rule.

Guidance on New Jersey's convenience of the employer rule

- The New Jersey Division of Taxation (Division) has issued initial guidance explaining the following:
  - Penalties and interest will not apply until September 15, 2023.
  - In determining states that have a "similar rule" (triggering states), Pennsylvania is not included due to the reciprocal agreement between the states and Connecticut is initially excluded because its rule is also triggered only if the resident state has a similar rule.
  - Employers should apply the rules of the resident state (triggering state) in determining when the convenience of the employer rule applies.
    - For example, a New York resident who, for his own convenience, performs services in his New York home for a New Jersey employer, is subject to New York's test in determining whether the convenience of the employer rule will apply to the New Jersey nonresident.

2023 withholding guidance

- Because New Jersey's convenience of the employer rule is effective retroactive to January 1, 2023, the Division instructs that employers must begin withholding (or individuals begin making estimated tax payments) as soon as possible so that taxpayers will have the correct amount of New Jersey income tax paid by April 15, 2024.

- The Division also suggests that as an accommodation to their employees, employers should consider making withholding adjustments so that their employees will have the correct New Jersey income tax withheld from their wages.

New Jersey's convenience of the employer rule: next steps

1 Identify

Identify New Jersey nonresidents working from home for a New Jersey office

2 Determine applicability

Determine whether the New Jersey nonresidents are residents of a triggering state

3 Analyze

Analyze the convenience of the employer test of each nonresident's resident state to determine whether New Jersey's convenience of the employer rule will apply

4 Compute tax

Where New Jersey's convenience of the employer rule applies, determine the 2023 withholding adjustment

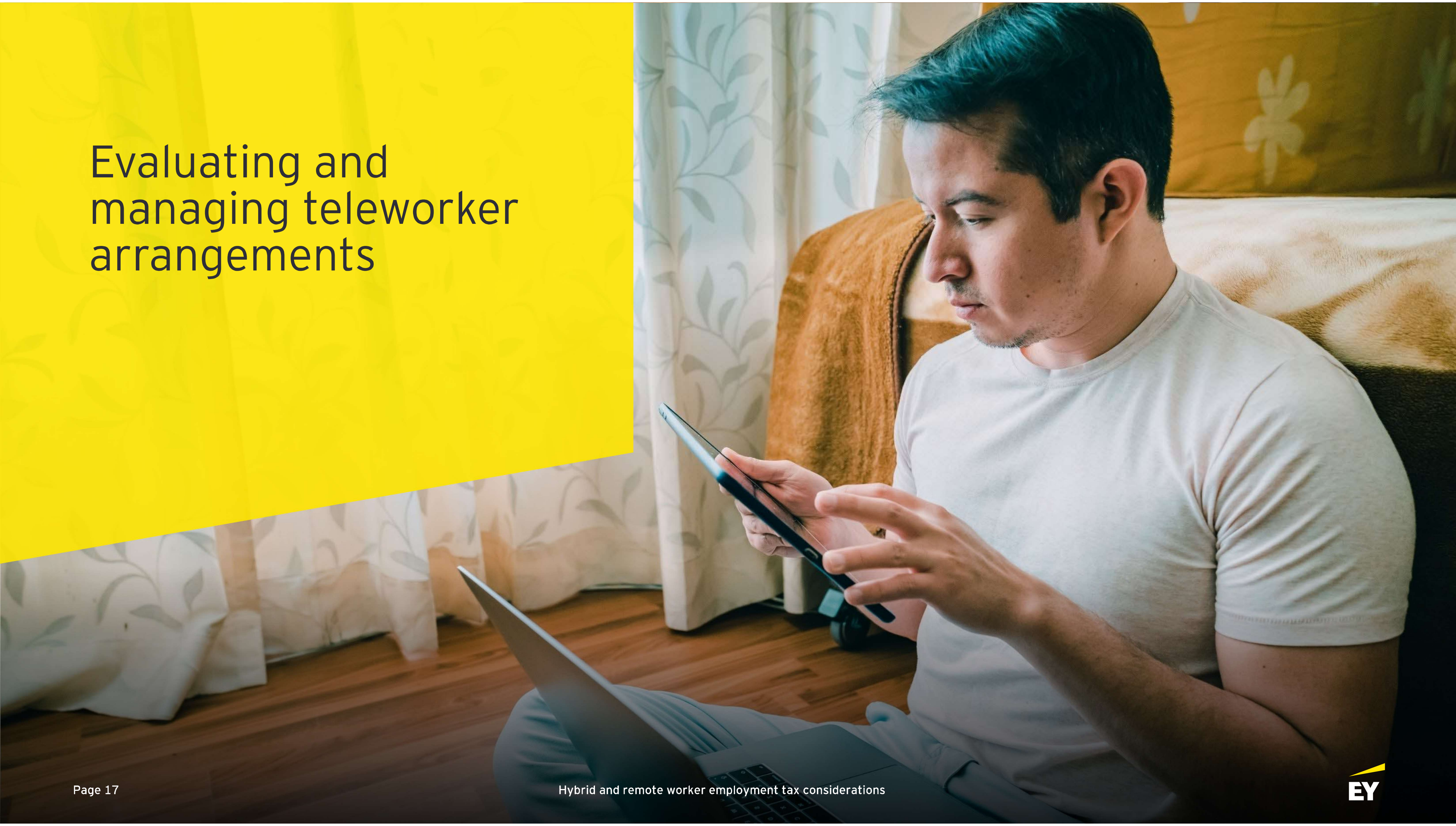
5 Communicate

Communicate to affected employees the additional withholding required and why

6 Withhold tax

Deduct the withholding adjustment from future 2023 wages or make other arrangements for payment of the added New Jersey state income tax

Evaluating and managing teleworker arrangements



Telework: Considering potential cost and benefits

Potential Benefits

- Attract more talent
- Potential to hire outside of limited geographic region
- Improve employee satisfaction
- Lower facility costs

Potential Cost/risk

- Employer-paid payroll taxes
- Mandatory compensation/benefits
- State/local audit activity
- Potential for increased HR and employment tax complexity
- Potential for Increased payroll service charges
- Business taxes

Teleworker tax policy considerations

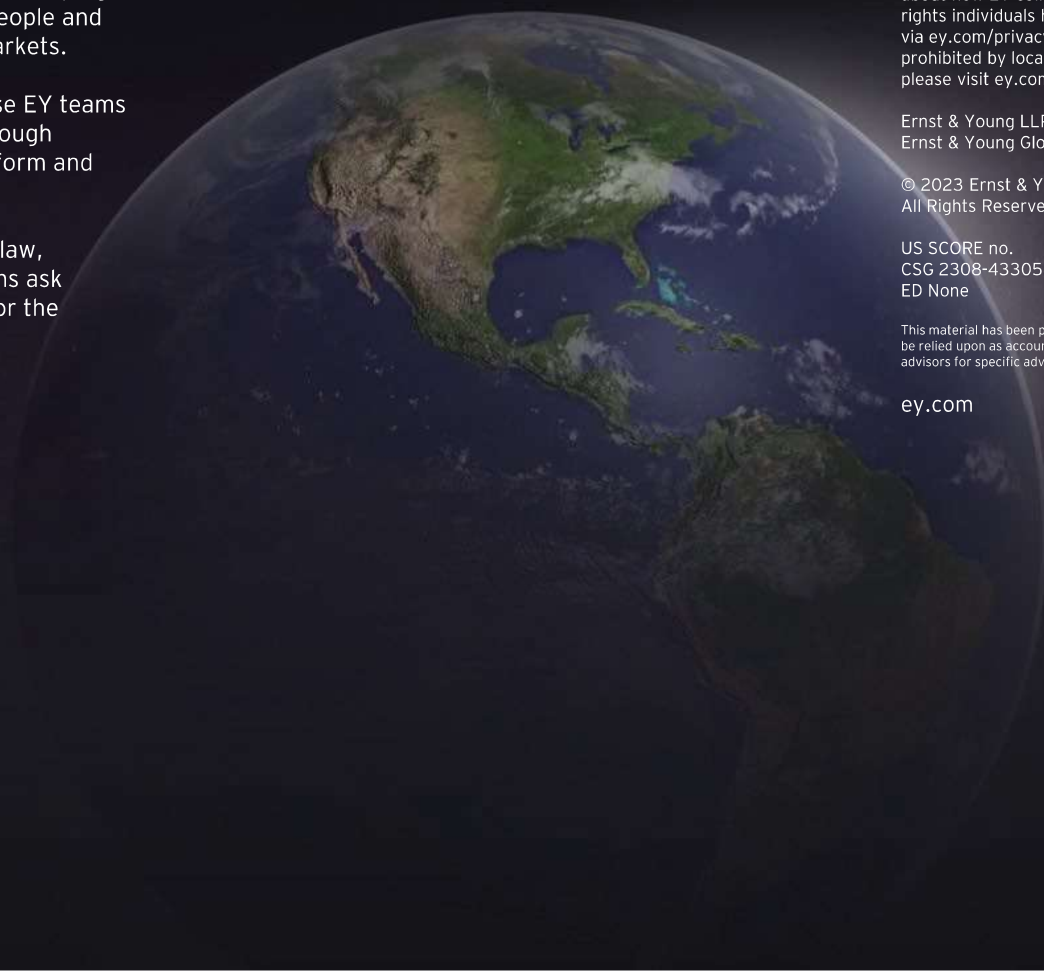
1. What levels of approval are necessary for authorizing an employee to telework?
2. Will certain states be excluded from telework arrangements based on cost and complexity?
3. What information resources are available to confirm tax compliance in new work jurisdictions?
4. Who will be responsible for business registrations in the new work jurisdictions?
5. What benefits and resources will be available to teleworkers and what is the tax treatment in the teleworker's jurisdiction?
6. How will you confirm the physical work location of teleworkers?
7. How often will you review/audit the work location of teleworkers?

EY | Building a better working world

EY exists to build a better working world, helping to create long-term value for clients, people and society and build trust in the capital markets.

Enabled by data and technology, diverse EY teams in over 150 countries provide trust through assurance and help clients grow, transform and operate.

Working across assurance, consulting, law, strategy, tax and transactions, EY teams ask better questions to find new answers for the complex issues facing our world today.



US SCORE no.
CSG 2308-4330584
ED None

ey.com