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Part I: The Tax Framework for Telework

Introduction

The COVID-19 pandemic has upended many aspects of how we work and live, and it remains to be seen whether or not these changes will be merely temporary reactions to the public health crisis or more permanent in nature. One trend that existed prior to the pandemic - teleworking (also referred to as remote working or telecommuting) - has been dramatically accelerated as a result of the pandemic and is likely to be among the lasting changes that result from it. While this trend has many positive effects for employers and employees – flexibility for the workforce, less congestion, diminished commute time and expenses, the need for less office space and lower overhead costs – it has some potentially negative implications that policymakers should understand, particularly as they relate to state tax revenues and our economic competitiveness. This paper will explore the current tax policy landscape for telework and key considerations for policymakers should the increased prevalence of telework prove permanent.

This is the first of a three-part series on the policy ramifications of telework. Future reports will look at how telework could potentially affect Massachusetts's fiscal health and what economic policy issues lawmakers need to consider regarding telework in a post-pandemic environment.

What is telework?

The Telework Enhancement Act[1], passed by Congress and signed into law in 2010, defines telework or teleworking as *"a work flexibility arrangement under which an employee performs the duties and responsibilities of such employee's position, and other authorized activities, from an approved worksite other than the location from which the employee would otherwise work."* In practice, telework is a work arrangement that allows an employee to perform work, during any part of regular, paid hours, at an approved alternative worksite (e.g. home or telework center).

[1] 2010. Telework Enhancement Act of 2010, Public Law 111-292 as referenced by Office of Personnel Management, https://www.opm.gov/FAQs/QA.aspx?fid=88348d96-ddf7-40b3-9126-66c88abe1b00&pid=867f8ff4-e3bd-4563-b325-9ec0b7848cf3

In Massachusetts, the Executive Office of Administration and Finance has defined telework[2] for state employees quite simply as an alternative workplace arrangement that provides employees the opportunity to work at a place other than their regularly assigned work location.

Although the number of people teleworking in recent months has skyrocketed, the trend of employees working in one state and living in another is not a new phenomenon. Employers and their employees who work in multiple states have been grappling for years with the complicated web of different state laws concerning withholding and return filing requirements and other tax issues associated with remote working. In fact, a group of large employers formed the Mobile Workforce Coalition over a decade ago to advocate for a uniform federal regulatory structure for taxing an increasingly mobile workforce. Despite bipartisan support in Congress for this concept, a bill has yet to be enacted, but there is renewed interest given the growing prevalence of remote working.

Growth of Telework

COVID-19 necessitated the widespread adoption of telework for many employees who had not previously utilized it, greatly increasing and accelerating the telework trend. Massachusetts, like many states, declared a state of emergency in March 2020 in response to the pandemic. Businesses that did not provide essential services were ordered to cease in-person operations, and, as a result, many employers and their employees transitioned to working from home. This requirement jumpstarted the adoption of telework, accomplishing in months what otherwise would have taken decades to happen by some estimates.

Prior to the pandemic, about 7% of the U.S. workforce routinely worked from home[3]. That number has grown considerably. Many companies have been pleasantly surprised by the seamless transition to remote working without any loss in productivity. Employees have been pleased with the time and expense savings and the general flexibility and work-life balance that it provides. While there are many categories of jobs that cannot be performed remotely (healthcare, transportation, public safety, personal services), many of those who are able to do so are likely to continue to remain teleworking after the pandemic ends for at least some portion of the work week.[4]

The United States Census Household Pulse Survey recently found that 48.6 percent of respondents reported that "they or a member of their household substituted some or all of their typical in-person work for telework over the last six months. That translates into some

[2] Link to the Executive Office of Administration's Human Resource department, telework policy https://www.mass.gov/service-details/executive-branch-telework-policy#:~:text=Telework%20(also%20known%20as%20telecommuting):%20An%20alternative%20workplace,place%20other%20than%20their%20regularly%20assigned%20work%20location.

[3] Per the World Economic Forum website: (weforum.org)

[4] One in ten workers regularly commute to their office in downtown Boston, Boston Glove, Jon Chesto, February 2, 2021

2.47 million adult Massachusetts residents teleworking in the latter half of 2020.[5] This finding is supported by a December survey of 122 companies by the Massachusetts Competitive Partnership. Per the MACP data, 15 percent of the 130,306 employees of surveyed companies worked from home before the pandemic. In December, 78 percent or over 100,000 were working from home and employers anticipated that over 50 percent would continue to work remotely after COVID.

General tax framework for telework

A key concept for purposes of understanding telework is what constitutes a "resident" versus a "non-resident" and what constitutes "place of work" as they are fundamental building blocks for establishing a state's authority to tax the income.

States have broad authority to tax their *residents* to provide for the public good. The vast majority of states (43 of the 50) exercise this authority by imposing an income tax; however, there is wide variation among the states in their approaches. The ability to tax nonresident income is far more restricted, as the US constitution strictly limits a state's authority to tax value earned outside its borders.

Massachusetts makes full use of its taxing authority by opting to tax <u>al</u>l income of its residents from sources both *within* and *without* the state. Massachusetts taxes earned income, such as wages and salaries, and investment income, such as interest, dividends, and capital gains, but protects residents from being doubly taxed on income earned in another state. In contrast, Massachusetts only taxes nonresident income that is *derived from any trade or business, including employment*, *in the Commonwealth*. Determining whether or not employment occurred in the Commonwealth gets complicated in the current context of telework.

For taxpayers who live in one state and work in another, they could have a tax liability in both states. In order to avoid subjecting the same income to tax twice, most states provide a credit for taxes paid to another jurisdiction on income earned there.

For example, if you are a Massachusetts resident working in Rhode Island, Massachusetts would tax all of that income but provide you with a credit for the amount of taxes you paid to Rhode Island. Many states with an income tax use credits to offset the amount paid by taxpayers to another state on that income.

New Hampshire is one of the 7 states that does not tax income from wages. Therefore, New Hampshire offers no such offsetting income tax credit. To illustrate, a New Hampshire resident

[5] Census Household Pulse Survey, Covers 10 pulse surveys from Aug 31 – Jan 18.

who worked three days a week in Massachusetts prior to the pandemic would pay taxes on that portion of wages (60%) earned in the Commonwealth.

Conversely, a Massachusetts resident working in New Hampshire would not owe taxes on the income earned in NH since NH has the authority to tax that income but opts not to do so, but would owe taxes to Massachusetts on that income without an offsetting credit from New Hampshire.

Other states have gone a step further to ease the compliance burden on taxpayers by enacting reciprocity agreements. These interstate agreements simplify a taxpayer's reporting obligations. For example, Virginia and DC have a reciprocity agreement under which a taxpayer only incurs liability in the jurisdiction of domicile/place of residence. A person living in Virginia and working in DC can ignore the DC income tax laws as they are inapplicable.

Six states (Arkansas, Connecticut, Delaware, Nebraska, New York and Pennsylvania) have chosen a different method, enacting "convenience of the employer" sourcing rules that essentially tax a person where their office is located, whether or not they physically work at the office. This makes the withholding obligations of an employer straightforward but can subject individual taxpayers to different tax burdens than they would have had if the obligation was based on their physical location or domicile.

These different laws make fulfilling one's tax obligation difficult for individuals that work in more than one state and also add complexity for employers who must abide by the myriad of withholding requirements that apply to them.

Massachusetts Tax Treatment of Telework during the Pandemic

Telework during the pandemic has further complicated the multistate income tax framework, both in terms of defining a resident and place of work. Because many people are not allowed to work from an employer site due to government restrictions, they are working remotely. Is that new location their place of work for taxing purposes or is it the place they worked prior to the pandemic? If someone is temporarily working remotely from a place that was neither their place of residence or prior work site, which state or states can claim authority to tax the income earned while there?

To offer much-needed guidance, the Massachusetts Department of Revenue recently issued 830 CMR 62.5A.3 entitled "Massachusetts Source Income of Non-residents Telecommuting Due to the Pandemic" that subjects income earned by a nonresident to Massachusetts income tax during the COVID-19 state of emergency if the income was taxable by Massachusetts prior to the pandemic.[6] An undeniable element of the Massachusetts approach is to stabilize tax revenue during the pandemic.

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[6] The regulation states "all compensation received from personal services performed by a non-resident who, immediately prior to the state of emergency was an employee engaged in performing such services in the pandemic and who, during such emergency is performing such services from a location outside of Massachusetts

Another key reason for adopting this regulation is to minimize disruption for Massachusetts taxpayers until the pandemic ends by providing certainty about the income's taxability. In other words, given all the pandemic-related challenges, a new taxing regime would not be one of them. What this means for non-residents is that if you worked in and paid taxes to the Commonwealth on that income prior to the pandemic, you are obligated to continue to do so, even though you may not have set foot in Massachusetts since March, so long as you are working remotely as a result of the pandemic.

While this approach makes sense from Massachusetts' perspective, as it preserves income tax revenues from nonresidents at pre-pandemic levels, New Hampshire views this regulation quite differently. In fact, NH has filed a lawsuit against the Commonwealth of Massachusetts, seeing this tax policy as an affront to its sovereignty and an attempt by Massachusetts to tax income earned entirely outside its borders.[7] As NH argues in its motion, more than 103,000 NH residents who work for a MA employer[8] are being required to pay taxes to the Commonwealth, even though they are not utilizing Massachusetts' roads, public safety and other such services as they once were. From NH policymakers' perspective, Massachusetts is trying to" balance its budget on the backs of hard-working Granite staters."[9]

New Hampshire asserts that the Massachusetts regulation is an affront to its sovereignty. New Hampshire residents' are paying taxes to MA on income arguably earned in New Hampshire when New Hampshire has deliberately chosen not to tax that income. While New Hampshire may be the most aggrieved, other states have joined in opposition to Massachusetts' assertion. Currently, 14 states have filed amicus briefs, and that number could grow.

Future Considerations

The New Hampshire legal challenge illustrates the tensions that have arisen and will continue to rise among states as more individuals work remotely and each state wants to lay claim to those tax revenues. It also demonstrates how working remotely could be a tax trap for the unwary. Individuals must educate themselves on the potential tax obligations that they could face as a result of this physical change in location and what will be required of them to comply with states' varying filing obligations. For example, in order to make use of tax credits, a taxpayer may have to file returns in multiple states. Employers must also be knowledgeable about their employees' telework locations in order to comply with withholding obligations. This might require employers to impose reporting requirements on employees as to their whereabouts in order to be able to do so.

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due solely to the Massachusetts COVID-19 state of emergency, will continue to be treated as Massachusetts source income subject to personal income tax under M.G. L. c 62 and personal income tax withholding."

[7] Motion for Leave to File Bill of Complaint in *State of New Hampshire v. Commonwealth of Massachusetts*, paragraph 44, page 13.

[8] U.S. Bureau of the Census, Longitudinal Employer Household Dynamics, 2017

[9] Motion for Leave to File Bill of Complaint in *State of New Hampshire v. Commonwealth of Massachusetts*, paragraph 44, page 13.

The pending case brought by the state of New Hampshire could have far-reaching consequences in both the short and long term for the tax treatment of teleworkers who are non-residents. The Supreme Court of the United States could decline to hear the case on procedural grounds or because the case is moot due to the temporary nature of the Massachusetts regulations. Alternatively, the Court could hear the case but narrowly base its decision on the unique circumstances of the pandemic. If the SCOTUS opts to hear this case, (and it is the only court with jurisdiction since it stems from a dispute between the states), the case could determine if and how states are able to tax teleworkers' income for the duration of the pandemic. If Massachusetts prevails, there will be no immediate impact on state tax revenue collections because all of the non-resident income that was taxable prior to the pandemic will remain so. If Massachusetts loses the case, however, there could be sizeable revenue implications. The next report in this series will explore the potential fiscal implications of telework for Massachusetts in more detail. In our final report in this series, MTF will explore the longer-term implications of the telework trend for the Massachusetts economy.