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Employee Benefit Plan Review

Mobile Employees: Tax Issues to Consider in Remote Working Policies

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As the U.S. transitions from the acute phase of COVID-19, the lasting impact of changes ushered in by the pandemic is becoming clear, most notably the shift toward remote work. While no longer a necessity, remote work remains extremely popular, with 57 percent of workers saying they would be willing to leave a job if remote work was no longer permitted.[1] In 2023, almost 13 percent of full-time U.S. employees worked exclusively from home and over 28 percent worked a hybrid model,[2] with around 22 percent of the workforce expected to be fully remote by 2025.[3]

Historically, the main tax issue employers have focused on in connection with remote working policies has been whether the employer creates a "permanent establishment" in the jurisdiction in which the employee performs services by virtue of such services (and, as a result, whether that jurisdiction can tax the employer). Given that more companies today operate fully remotely, this issue remains an important one for employers to consider. However, there are other significant tax issues beyond permanent establishment issues that should be considered in remote employment relationships.

Taxation of Travel Expenses to Employer

Skipping the commute and working from home can save employees thousands a year in transportation, food and childcare costs.[4] When a (full-time or hybrid) remote employee does travel to the employer's office, a key issue arises: the tax treatment of their travel expenses. Whether such expenses can be considered tax-free reimbursable expenses or commuting expenses taxable to the employee depends on the facts and circumstances of the situation, including the employee's tax home and whether the employee is required to be in the office on a regular basis (e.g., a hybrid working arrangement) versus an ad hoc meeting where attendance is required by the employer for the employer's convenience.

Trailing Payments for Services

Fully remote opportunities have opened the door for U.S. workers to move further away from their employer's offices, with 28 percent of U.S. workers planning to move more than four hours away from their employer's office two years into the pandemic.[5] An often-overlooked issue that can arise as employees move across states is whether compensation earned in one year and paid in a later year (e.g., as a result of vesting or constituting nonqualified deferred compensation) is being properly attributed for tax purposes to the tax home of the employee when the employee performed the services attributable to such compensation. For example, query whether an employee who earns nonqualified deferred compensation in New York and then moves to Texas prior to payment can receive such payment without it being subject to New York taxes.

Double Taxation

Depending on the jurisdiction, an employee may be subject to double tax depending on where the employer and employee are located. For example, an employee who historically performed work for a New York employer but moved to California for remote work may be subject to both New York and California taxes, as New York typically considers remote work compensation to be New York source compensation under the convenience of the employer rules and California considers remote work compensation to be California source income since services are performed in California. Ensuring employees are aware of such consequences and that employers are properly withholding and reporting with respect to such compensation should be a key component of any remote work policy.

State and Local Tax Credits

Several states and localities provide tax credits for employees working on premises. During the pandemic, many such jurisdictions waived such onsite work requirements. However, such waivers are expiring over time. As a result, employers will need to track their workforce to determine whether they are still eligible for and properly claiming such credits, including in connection with any remote work policies.

State Statutory Considerations

Employers also need to consider whether the remote work arrangement will subject the employer and/or the employment arrangement to state statutory regimes, including:

(1) State unemployment, disability or other tax regimes;
(2) Applicable state and local tax withholding; and
(3) Minimum wage or similar employment laws.

Several states have implemented laws requiring employers to reimburse reasonable and necessary business expenses incurred by employees in the course of their employment, including with respect to remote work. Further, employee movement across states can dramatically affect the enforceability of restrictive covenants the employer may have with the employee, which may affect the employer's willingness to let employees move to certain jurisdictions for remote work without modifications of the employment arrangement.

Tracking

In order to be aware of and properly address such issues, employers need a method to properly track remote employees and where they are providing services, including when such work is on a long-term temporary basis. An employee may view a six-month jaunt as something their employer need not be aware of, but for some jurisdictions, this can be a sufficient time frame to implicate permanent establishment and other issues.

Conclusion

With 73 percent of all teams expected to include remote workers by 2028,[6] even before the changes sparked by the COVID-19 pandemic, it is clear that remote work is here to stay. Given this, employers should work with tax and employment counsel in drafting remote work policies to ensure they do not overlook the types of complex issues related to remote work highlighted above.

Notes

1. https://www.flexjobs.com/blog/post/remote-work-flexible-schedules-key-factors-compensationpackages/#:~:text=Some%20Disconnect,full%2Dtime%20post%2Dpandemic.
2. https://wfhresearch.com/wp-content/uploads/2023/02/WFHResearch_updates_February2023.pdf.
3. https://www.upwork.com/press/releases/upwork-study-finds-22-of-american-workforce-will-be-remote-by-2025.
4. A 2020 study estimated that workers can save around $4,000 a year by working from home. See https://www.theladders.com/career-advice/this-ishow-much-money-the-average-employee-is-saving-by-not-commuting.
5. https://www.upwork.com/research/new-geography-of-remote-work.
6. https://www.upwork.com/press/releases/third-annual-future-workforce-report.

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