PALLAS CAPITAL ADVISORS

The Unexpected COVID State Income Tax Trap

April 2021

COVID-19 AND TELECOMMUTING - *HOPEFULLY ONLY ONE OF THESE IS HERE TO STAY*

Since the Federal and many States' income tax filing deadlines for individuals have been pushed back to May 17, 2021, we will again address income tax planning – specifically telecommuting – particularly for those individuals who live in a state that is different from the state in which they normally would report to work.

An interesting and fairly recent PWC Survey shows that both Employer and Employee attitudes about the benefits of remote-working are reflecting a gradual acceptance that with today's technology, the ability to work remotely seems to be here to stay, even post-COVID-19. Of course, this new work paradigm will have an impact across multiple sectors: human resources, IT infrastructure, employee compensation design, new home building/remodeling, and of course commercial real estate.

For many Americans, the process of telecommuting has been a learning experience – and a lot of that learning has been around navigating previously lesser-known video-conferencing technologies such as Zoom, Microsoft Teams, Google Meet, and others. For the most part, employers and employees alike seem to have adapted quickly, and now it is getting hard to remember the time before video-conferencing *modus operandi* for connections with colleagues and clients alike. Unfortunately, another learning experience may come from the "school of hard knocks" *per se* – some individuals may be surprised to find they need to file returns and perhaps pay taxes to more than one state for 2020. Another survey – this one by the American Institute of CPAs (AICPA), reveals that many U.S. taxpayers are unaware of the potential state tax liabilities related to working remotely.

LIVE AND WORK IN A DIFFERENT STATE?

An individual who lives in one state and works in another may have to file two state tax returns: one in his/her home state and a "nonresident" return in the state where he/she works. Usually, that does not result in paying twice. Typically, the employer withholds taxes from the worker's paycheck for the work state, and the home state gives the employee a credit or deduction for the taxes paid to the "work" state. (That is the case in 43 states and Washington, D.C., according to the C.P.A. institute. In fact, more than a dozen states have tax agreements with their neighbors. Virginia, for instance, has reciprocal tax arrangements with several states and the District of Columbia.)

In 2020 some states added more complexity by issuing special tax rules for the pandemic. Fifteen states and the District of Columbia announced they will not tax people working there remotely because of COVID-19, according to data compiled by the American Institute of CPAs.

IS YOUR JOB BASED IN A DIFFERENT STATE?

Some states, such as Massachusetts and Pennsylvania, intend to tax remote workers whose jobs are based in-state even while they are working remotely out of state due to the pandemic, according to Eileen Sherr, a state tax specialist with the AICPA. For example, a resident of Connecticut who is working from his Connecticut home for a Massachusetts-based employer will be taxed by Massachusetts. Adding to the tax misery - the states in which these people are actually working (i.e., for most, where they actually live – in this example, Connecticut) may have rules that tax those individuals as well.

Six states took this approach even before COVID-19 changed office work: Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania. The State of New York has so far said that it will continue the policy despite the pandemic. Thus, if you don't live in New York, but your "primary office" is there, "your days telecommuting during the pandemic are considered worked in the state" unless your employer has a formal office at your remote work location.

Perhaps unexpectedly, New York's neighbor, New Jersey, has said it will give its newly telecommuting residents a credit for those New York taxes for 2020. This is the case, even though historically New Jersey has been entitled to the revenue because the taxpayers are now working within its borders.

Now, bit closer to the Pallas home, thousands of New Hampshire residents regularly commute to work in Boston and other cities in Massachusetts - even though those workers are staying home and working from New Hampshire, Massachusetts has stated that it is entitled to tax revenue from those "Massachusetts sourced" earnings. In October 2020, New Hampshire filed a lawsuit asking the U.S. Supreme Court to rule on this issue. (More than a dozen other states — including New Jersey — have filed briefs urging the court to consider the case.) Fortunately, these workers in New Hampshire are not being double taxed because New Hampshire is one of nine states that have no state income tax.

WHAT CAN YOU DO?

The pandemic may have brought this issue to a head, but even after, as remote work could remain popular, federal action may be needed to make state income tax rules for telecommuting more uniform. A group called the Mobile Workforce Coalition says it is building bipartisan support for reform.

If you worked in a state other than your usual one in 2020, how should you approach tax season?

1. Consider using tax preparation software that may help you cut through the confusion by asking questions that will determine the steps you need to take for filing in each state.

2. If you are working remotely in a different state, make sure your employer knows so it will withhold taxes from your paycheck correctly. It also may be helpful if your employer has assigned you to an existing office in another state and then withheld taxes for that state.

3. "Domicile" counts. State tax law often considers where the worker's true home is in addition to time spent in-state. While not a comprehensive list, key factors include where someone votes, has a club or religious affiliations, has a driver's license, etc.

4. **Seek professional help** if your situation is complicated—such as if you got married, sold a home, or had a large windfall or loss.

HELPFUL RESOURCES

The Wall Street Journal has recently published a very useful Tax Guide for 2021, which has been updated to include the most recent March stimulus legislation – The American Rescue Plan Act of 2021. The guide is available for WSJ+ subscribers and includes information on:

- Income-Tax Rates and Brackets
- Investment-Tax Rates and Brackets
- Pandemic Stimulus Payments
- State Taxes on Remote Work
- Cryptocurrency
- Mortgage-Interest Deduction
- Temporary Charitable Donation Deductions
- Emergency Withdrawals From Retirement Accounts
- Flexible Spending Account Withdrawal
- Tax Information for First-Time Taxpayers and Business Owners
- What President Biden's Tax Agenda Means For You

CONCLUSION

If you are one of the millions of Americans who have been telecommuting due to the pandemic, you surely are grateful for the technology that allows you and your employer the flexibility to continue work in a manner that is deemed safe and allows for productivity to continue – even flourish. But being informed of state income tax rules can help you avoid unpleasant surprises down the road.

Please reach out to the team at Pallas Capital Advisors if you have any questions on your particular situation.

Sincerely,

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