

REMOTE WORKFORCES: TAX PERILS AND OTHER TRAPS FOR UNWARY EMPLOYERS

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Remote or hybrid workforces have certain advantages and may become the new normal, but employers need to consider tax and other legal issues raised by the new arrangements.

Introduction

As a result of the COVID-19 pandemic and stay-at-home orders issued by the governors of most states, in early 2020, many employers and their employees found themselves embarking upon a new journey along a road rarely traveled. Employers were not equipped with a roadmap and had no advance notice or time to carefully plan the journey.

Traditional workforces were jettisoned from their employer's workplace and required to work remotely from home. It started out as what most people thought would be a short-term event. Unfortunately, that hypothesis turned out to be incorrect. Now that the COVID-19 pandemic is over two years old and many workforces are still, in whole or part, remote, it may be the new normal.

The workforce predicament faced by employers is truly intriguing from a sociological perspective. In the beginning, many employers had trepidations about workers performing their job functions remotely. The reluctance stemmed from several unknowns, including:

- Whether employees would be as productive working outside the traditional workplace.

- Whether the quality of work of the remote workers would diminish.
- Whether confidentiality and trade secrets would be marginalized in a remote work environment.
- Whether the employer's technology currently in place would adequately support a remote workforce.
- Whether teamwork would be lost with workers separated from each other and performing their jobs from remote locations.
- Whether having a remote workforce would damage the employer's business culture.
- Whether having a remote workforce would hinder employee recruiting and retention efforts.
- Whether the isolation of working remotely would increase employee physical and mental fatigue.
- Whether customer service and goodwill would be negatively impacted when workers are not performing their job functions at the employer's facilities.

Interestingly, most employers, after investing in hardware and software, have found that

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technology will support their remote workforces. Additionally, they are generally finding (likely due to employer diligence and extra effort):

- Productivity is relatively high.
- The elimination of the expenses associated with having workers onsite has enhanced overall profitability.
- Confidentiality and trade secrets are being maintained.
- Work quality has not been negatively impacted.
- Through virtual meetings and occasional in-person events, as well as the adoption of creative ways to stay in touch with employees and to let them know you appreciate them, teamwork and culture are being maintained.
- Employee recruiting and employee retention appear to be unscathed.
- Employee mental and physical fatigue does not seem to be exacerbated by workers performing their job functions from home.
- Customer service and goodwill in most cases are undisturbed.

On top of all of this good news, employers are finding out that many of their employees strongly desire to remain working remotely on either a full-time or part-time basis. The employees are, in most cases, happy with their remote working arrangements.

Employees report:

- They are more productive at home due to fewer workday interruptions, a quieter work environment, the additional comfort allowed by a home office, and the elimination of a lengthy and/or disruptive commute to and from the workplace.
- They have less stress in part due to the elimination of a daily commute.
- The time savings associated with eliminating a daily commute adds to the quality of life by giving them approximately 12 additional hours per week or more for non-work activities.
- The flexibility of working remotely allows them to eliminate or reduce many expenses, including day care, work clothes, transportation, and dining out during the workday.
- They have more flexibility as to where they live, which may result in cost savings and increased contentment.
- They have less absenteeism.
- Workplace politics are greatly diminished.

The remote workforce saga sounds well and good. Employees are generally happy with the

new arrangement, and employers are finding in most cases that their businesses have not been negatively impacted. In fact, in many cases, productivity has significantly increased. Additionally, employers are finding that there may be other advantages of having a remote workforce, including:

- Employers may be able to reduce their physical footprints, diminishing overhead related to owning, maintaining, and/or leasing real estate.
- Employers may be able, for employee recruiting purposes, to draw upon a larger talent pool spanning a greater geographic area.
- Employers can continue to utilize the technology they acquired (at significant cost) to enable employees to work remotely.

It is vital that employers know where their employees are performing services. The consequences of not knowing where the employees are working could be costly.

So, for many employers, what started as a science experiment, in which they were involuntary participants, may turn out to be a voluntary and continuing (full-time or part-time) arrangement when the COVID-19 pandemic subsides. This type of arrangement, however, raises all kinds of issues and concerns for employers, including compliance with various laws and the introduction of new tax payment and compliance obligations.

Many of the issues are obvious, but some of the issues are more nuanced and may not be on the minds of all employers. Keep in mind that most employers were not equipped with a good roadmap for taking the remote workforce journey. This article is focused on providing a clear and concise guide to those employers that intend to continue the journey post-pandemic.

Importance of knowing where your employees are working

A potential trap may exist for unwary employers when they have even a single employee performing services outside of the state(s) where the employer operates. Historically, such a scenario was likely rare. It probably only occurred when an employer was physically located near a state border and had an employee working periodically from his or her home located in the neighboring state which was in close in proximity to the employer.

Today, with the internet and sophisticated communication technologies, this scenario is not limited to employees residing in neighboring states. Further, with the COVID-19 pandemic facing the world, as discussed above, more and more employees are working remotely – it is no longer an isolated event.

Assuming a remote work arrangement is acceptable to both employers and employees, it will continue to be a prevalent employment model post-pandemic. As a result, employers may find themselves with employees working

jurisdiction. Those tax regimes could include (but are certainly not limited to) income taxes, gross receipts taxes, payroll related taxes, as well as sales and use taxes.

The tax regimes could go beyond the state level, extending to the city and/or county levels. Being subject to state and local taxes generally requires both the preparation and filing of tax returns, and the payment of taxes.

Employees are not limited to moving to other parts of the United States. Many employers have experienced employees during the pandemic moving to different countries. These moves open a new can of worms that may include taxation as well as a multitude of other issues that can wreak havoc on an unprepared employer.

Again, if an employer becomes subject to one or more new state or local tax (or even foreign) jurisdictions as a result of satisfying the requisite nexus requirements, it may have new tax reporting and payment obligations (e.g., income taxes, payroll taxes, and/or sales and use taxes).

Nexus. Nexus, for United States tax purposes, is a federal constitutional requirement—a state or local government must have a “minimum connection” with a taxpayer in order to impose tax on it.

States typically subject companies that have physical presence (e.g., employees or property located within their borders) to income tax. Many states also impose an “economic nexus” standard whereby companies that derive sufficient income from a state will be subject to tax there. Many states tie economic nexus to a specific threshold (e.g., as low as \$100,000 in annual sales inside the state).

One limitation on state taxation is Public Law 86-272—a federal law that prevents states from imposing income taxes on businesses located out of state if their business activities are limited to “mere solicitation of orders” for sales of tangible personal property in a state. There is fear, for good reason, that the presence of remote workers may limit the protection offered by Public Law 86-272 where remote workers are now present in a state other than merely to solicit sales.

For example, Oregon maintains a “substantial nexus” standard whereby a corporation has nexus in Oregon where it regularly takes advantage of Oregon’s economy to produce income, which may be established by the corporation engaging in any of the following enumerated nonexclusive activities:

Having an employee working in another state typically creates physical nexus for the employer, subjecting the employer to the tax regimes of that jurisdiction.

in states, and possibly countries, different from where the employer’s business is physically located.¹ As discussed below, it is vital that employers know where their employees are performing services. The consequences of not knowing where the employees are working could be costly.

Many employers have been surprised to find out that employees have moved during the pandemic. The reason for each move varies among employees. Some employees moved for family and lifestyle reasons. Other employees moved to take advantage of lower housing costs, housing availability, or a better climate.

One thing is clear – unless employers keep track of where their employees are working, they may encounter unexpected problems.

Practice Alert: Employers, with the assistance of qualified employment counsel, should consider adopting written policies about remote working, including possible limitations on geographic locations, and advance reporting/approval of temporary or permanent employee geographic moves.

A multitude of issues for employers arise from employees working remotely. These issues are explored below.

State and local taxes

Having an employee working in another state typically creates physical nexus for the employer, subjecting the employer to the tax regimes of that

¹ A whole set of additional issues exist when an employer has employees working in foreign countries. These issues need careful consideration and attention. Unfortunately, they are beyond the scope of this article.

- Maintaining continuous and systematic contacts with Oregon's economy or market.
- Conducting deliberate marketing to or solicitation of Oregon customers.
- Filing or being required to file reports or returns with Oregon regulatory bodies.
- Receiving significant annual gross receipts attributable to customers in Oregon.
- Receiving significant gross receipts attributable to the use of the corporation's intangible property in Oregon.
- Receiving benefits provided by the state, such as: (1) laws providing protection of business interests or regulating consumer credit; (2) access to courts and judicial process to enforce business rights, including debt collection and intellectual property rights; (3) highway or transportation system access for transport of the corporation's goods or services; (4) access to educated workforce in Oregon; or (5) police and fire protection for property in Oregon that displays the corporation's intellectual or intangible property.

Example: If a Washington corporation, located in Vancouver, Washington (just across the Columbia River from Oregon), has no offices or remote workers in Oregon and makes no sales in Oregon, it probably is not subject to the Oregon corporate income or excise tax. However, if some of its employees started to

ditionally, this guidance, by its express terms, ended on 11/1/2020. To date, the ODOR has not extended the application of this guidance or made it permanent.

While other states may have remote worker guidance, it is important to carefully examine the guidance for its application and to determine whether the guidance has lapsed. Relaxed remote worker rules in most states had a limited shelf life that has expired.

Apportionment of income. In some states, the sudden presence of one or more employees may also affect apportionment of income among the other states.

There are states which still use three-factor apportionment (property, payroll, and sales). Each of these factors may be impacted by having remote workers in a state.

- **Payroll.** Generally, the numerator of the payroll factor includes compensation paid to employees in the state where the employees perform their jobs.
- **Property.** Generally, the numerator of the property factor includes the value of property the taxpayer owns or uses in a state. If employees use employer property at their home/remote offices, the value of that property likely needs to be included in the property factor.
- **Sales.** Some states use a cost-of-performance method for apportioning receipts from the sale

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work from their homes located in Oregon, absent guidance to the contrary, the corporation could potentially be subject to the Oregon corporation excise or income tax.

The good news for the Washington corporation in the above illustration is that the Oregon Department of Revenue ("ODOR"), through informal guidance, provided temporary relief for this situation. In this guidance, the ODOR stated that for Oregon corporate excise tax and corporate income tax purposes, the presence of a corporation's remote workers in Oregon between 3/8/2020 and 11/1/2020 will not be treated by the ODOR as a "relevant factor" when making a nexus determination if the employees at issue are regularly based outside Oregon.

Practice Alert: As noted above, this guidance was informal, and as such, an employer's reliance on such guidance may be limited. Ad-

of services, whereby companies include receipts in the numerator if receipts are from an income-producing activity in a state. If employees are performing those services in a state from which they now work remotely, that activity may need to be included in the numerator. The same would generally not apply to market-based sourcing states where receipts are sourced to the state where customers receive the benefits of the services.

Federal preemption

One proffered solution to the nexus issue by Congress was the Remote and Mobile Worker Relief Act (S.3995) (the "Act"), introduced in the U.S. Senate by Senator John Thune in June 2020. The Act was drafted to provide temporary coronavirus remote worker relief by way of limited federal preemption.

Among other things, the Act would:

- Provide that the temporary presence of remote workers in a state as a result of the coronavirus pandemic would not in and of itself create tax nexus; and
- Require receipts or income for state and local income and gross receipts tax purposes to be apportioned and sourced to the tax jurisdiction that relates to the employee's "primary work location" (the address of the employer where the employee is regularly assigned to work when such employee is not working remotely) during

they need to understand the labor and employment rules that apply to the relationship.

These laws may greatly differ, depending upon the particular jurisdiction governing the relationship. The costs associated with and the ability to understand and comply with the labor and employment laws of multiple jurisdictions must be considered by employers before implementing a remote workforce model.

Some of the labor and employment laws and rules of significant importance include:

- Wage and hour rules (payroll reporting, pay dates, minimum wage, overtime, etc.).
- Pre-hiring screening and interview rules.
- Meals and break rules.
- Worker classification laws.
- Rules relating to termination of employment.
- Employee benefits.
- Noncompetition laws.
- Secrecy and trade secrets laws.
- Anti-discrimination laws.
- Workplace safety and related legal requirements.
- Sick leave and time off rules.
- Family leave rules.

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the "covered period" (the period that began when the employee began to telework and that ends on the earlier of the date when the employer allows the employee and not less than 90% of the employer's workforce to return to such primary work location, or 12/31/2020).

The Act, by its terms, did not extend to professional athletes, professional entertainers, certain film and television production employees, or certain public figures.

While the bill reportedly received support from the business community and the American Institute of Certified Public Accountants, it never advanced in the legislative process. Unfortunately, even though it only offered temporary assistance, it never became law. Unless a permanent version of this type of legislation is adopted by Congress, the tax implications of having any remote workers cannot be ignored.

Labor and employment laws

Generally, the labor and employment laws of the state where an employee is physically performing the work govern the employment relationship. Consequently, employers need to know where their employees are working so that they know which labor and employment laws apply. Further,

Authority to do business

In most states, the mere presence of an employee working in the state, absent the presence being temporary or transitory as the employee is traveling to another state, could trigger the requirement that the employer be registered to do business in the state.² The analysis is highly dependent upon the facts and circumstances of each situation, including the activities of the employee within the state. Unfortunately, the interpretation of what constitutes doing business varies among the states.

The consequences of doing business in a state without being registered likewise vary, but it is not uncommon for the business to be subjected to monetary penalties until the registration is completed.³

Other possible consequences of doing business in a state without proper registration include:

- Monetary penalties extending to owners, directors, officers, and agents.⁴

² See *Practical Law Series: Doing Business in the United States*, Thomson Reuters (2021).

³ See *e.g.*, Oregon Revised Statutes 60.704.

⁴ See *e.g.*, California Corporations Code Section 2259; Utah Code Section 16-10a-1502; Revised Code of Washington Section 9.24.040.

⁵ Although most states allow a business without registration to defend itself in a lawsuit, they may not let the business institute

a lawsuit or bring counterclaims or affirmative defenses. See Section 24 of the Model Business Corporation Act.

⁶ See, *e.g.*, Montana law appears to make a contract entered into between a business that lacks authority to do business in the state and the state or an agency or political subdivision thereof voidable by the state or the agency or political subdivision thereof. Montana Code Annotated Sections 35-14-1502(4) (for corporations) and 35-8-1001(4) (for limited liability companies).

- Inability to access courts in the state to institute a lawsuit or bring counterclaims in a lawsuit instituted by another party.⁵
- Albeit rare, inability to enforce a contract entered into with a party in the state.⁶

state, the coverage offered by the employer's insurance company may not extend to the remote worker. Aside from an angry workforce, lack of coverage could lead to lawsuits instituted against the employer by the affected employees for breach of contract (among other legal theories).

Presence for disputes (personal jurisdiction)

The mere presence of an employee working in a state may be sufficient to subject the employer to the jurisdiction of the courts of that state in a lawsuit commenced against it even though it has no other activity in the state. So, an employer may find itself defending a claim in a court located in a state far away from its state of operations. For employers operating in industries where lawsuits are commonplace, being subjected to lawsuits in the courts of other jurisdictions may be so intolerable that they will want to consider limiting or eliminating the remote workforce model.

Workers' compensation insurance

Having an employee working in another state generally requires that the employer register for and obtain workers' compensation insurance in the state where the employee is performing the services. Failure to do so may expose the employer to liability, including penalties for noncompliance with the state's workers' compensation laws as well as uninsured liability for any injured employees.

Unemployment insurance

Like workers' compensation insurance, most states have their own unemployment insurance programs. Having an employee working in another state generally requires that the employer register for and pay the unemployment insurance premiums for the employee through the state unemployment insurance program where the employee is performing the services. Failure to do so may expose the employer to liability, including penalties for noncompliance with the state's unemployment insurance laws.

Health, life, and disability insurance benefits

Employer-provided insurance benefits (health, dental, life, and disability) are usually underwritten/provided by insurance companies authorized to write insurance in the state where the employer is located. If a remote worker resides in another

Potential hybrid arrangements

Since employees in large numbers are expressing a desire to continue working remotely, it is possible that some employers will post-pandemic allow the model to continue or adopt hybrid work arrangements for their workforces. Under a hybrid model, employees will work at the employer's place of business a portion of each work period (e.g., 60%) and work remotely the remainder of the work period (e.g., 40%). If the employer's work location and the employee's remote work location are in the same jurisdiction, that should be easy for the employer to navigate.

However, if the two locations are in different jurisdictions it may not be so easy to navigate. For income tax and payroll tax matters, it may be a matter of tracking each employee's time by location and pro-rating wages.

For insurance benefits, although there is no clear guidance, there may be no issue as long as the insurer understands the arrangement and underwrites it accordingly. For unemployment insurance and workers' compensation insurance, however, it is not clear whether the employer will be required to pay into the programs of one or both states (and if it is one state, it is not clear whether it is the state where the employer is located or the state where the employee is working remotely).

Equally mindboggling is how labor and employment laws will apply to hybrid workers. For example, in the situation where the hybrid workplace stretches over two states, it is unclear which state's wage and hour laws, sick leave laws, family leave laws, noncompetition laws, or trade secrets laws apply. Caution is advised as these waters are unnavigated and may be full of sharks.

Conclusion

Workforces in the world today are more mobile than ever before. Employees can work remotely from just about anywhere provided they have access to the internet. If anything, the COVID-19 pandemic has proven that a remote workforce may be a viable option for many employers and

their employees. For one, the cost of commercial real estate is expensive. A remote workforce may help reduce that operating expense.

That said, employers need to know where their employees are performing services. Too many traps exist for employers who fail to keep an eye on the issues that accompany a mobile workforce. Additionally, employers need to analyze the costs of complying with the laws of multiple jurisdictions resulting from having a mobile workforce.

Lastly, employers need to be vigilant, keeping track of the workforce, at least geographi-

cally speaking. A remote employee could move to another state (or even a foreign country) without the employer ever knowing. Again, technology can make remote working fairly seamless. That move, however, could subject the employer to unwanted liability and/or compliance obligations.

Now, more than ever, it is critical for employers to know the whereabouts of their workforce and to understand the potential legal issues at play in remote work arrangements. The remote worker model may be here to stay. ■