REMOTE WORK

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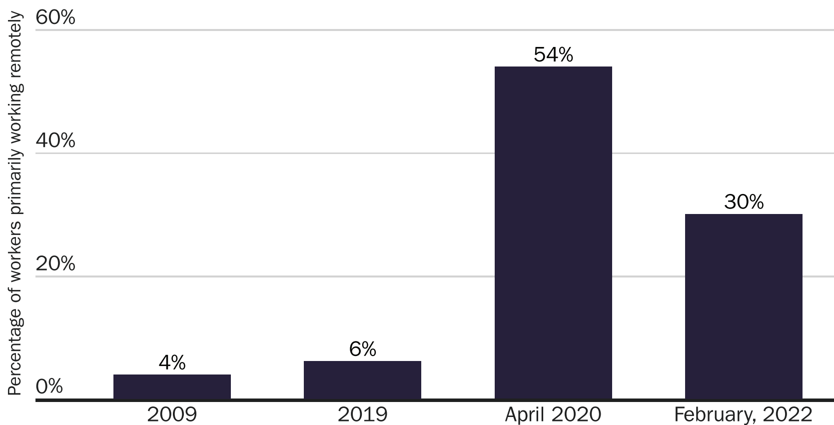
THE ISSUE: REMOTE WORK IS INCREASING (AND BENEFICIAL), BUT U.S. LAW HAS FAILED TO KEEP UP

In 2019, only an estimated 6 percent of American workers primarily worked remotely.[1] By February 2022, due in part to the COVID-19 pandemic, that figure had risen to 30 percent (see Figure 1). Even with some workers subsequently returning to the office, approximately 30 percent of all paid workdays were being done from home as of July 2022, up from about 5 percent in 2017–2018. According to a 2022 McKinsey and Company report, this translates to tens of millions of additional American workers now working from home all or most of the time.[2] Yet public policy has not adapted to this new reality, to the detriment of millions of American workers.

FIGURE 1 Remote work has increased dramatically since 2019



Sources: Patrick Coate, "Remote Work before, during, and after the Pandemic," National Council on Compensation Insurance, January 25, 2021; Lydia Saad and Ben Wigert, "Remote Work Persisting and Trending Permanent," Gallup, October 13, 2021; and Taylor Orth, "Many More Americans Prefer Working from Home than Currently Do," YouGov, February 11, 2022.

Multiple surveys conducted during the COVID-19 pandemic show remote work is popular among employees. A February 2022 Pew Research Center report found that of those working remotely, 76 percent prefer the arrangement, even as concerns over COVID-19 wane and more offices reopen to in-person work.[3] Barrero, Bloom, and Davis (2022) reported that 54 percent of unemployed respondents preferred to find a job that offered remote work.[4] The arrangement has proven particularly popular among parents, who can more easily juggle work and family obligations.[5] In fact, Barrero et al. (2022) found that many workers appear willing to trade wage increases for remote work because they so value the amenity.[6]

This wage tradeoff also benefits employers. Barrero et al. (2022) also found roughly 40 percent of businesses, including more than half of large companies, have expanded remote work arrangements in the last 12 months or plan to do so within the next year.[7] Barrero et al. (2021) reported that 40 percent of employed respondents were more productive in remote work, while only 15 percent reported decreased productivity.[8] Bloom et al. (2022) found that hybrid remote work increased employee retention by 35 percent and boosted overall worker productivity by 30 minutes per week.[9] Other recent studies of remote work have found similar employer benefits.[10]

Employers also have access to a larger pool of workers, including formerly marginalized ones. Businesses report, for example, an increase in hiring Americans with disabilities to fill remote positions, and the proliferation of remote work has made it easier for employers to hire workers located in different states or to abandon the expense of a physical headquarters altogether.[11]

The rise of remote work has empowered American workers to live where they want to live, instead of simply where their employer is located. A March 2022 Upwork survey reports, for example, that 11.7 percent of all respondents either had moved or were planning on moving due to remote work, a figure that would correspond to nearly 24 million people in the general American population.[12] This boost to American labor mobility and economic dynamism has profound benefits for not only the workers involved, but also the communities and regions to which they are moving and the economy overall.[13]

Although further changes to employees' and employers' use of remote work are inevitable as the United States continues to find its post-pandemic footing, it is increasingly clear that remote work will remain popular among, and utilized by, a large portion of the American workforce. Indeed, McKinsey estimated in Spring 2022 that 58 percent of job holders—the equivalent of 92 million people across a wide range of professions—could work remotely, and that more than half (55 million) of those workers could do so full time.[14] Even if these figures were, despite current attitudes, to decline significantly in the months ahead, it would represent a major shift in the workforce and the nation more broadly.

Unfortunately, policy has not kept pace with these trends and instead continues to impede remote work, especially at the state level.

First, states differ in their income tax treatment of remote employees across state lines. Most states determine an employee's tax treatment by his physical presence, so employees in most states are taxed by their state of residence (assuming they conduct their work there). However, a few states, such as Delaware, Nebraska, New York, and Pennsylvania, follow the "convenience of the employer" standard, thus basing an employee's income taxation on their employer's location.[15]

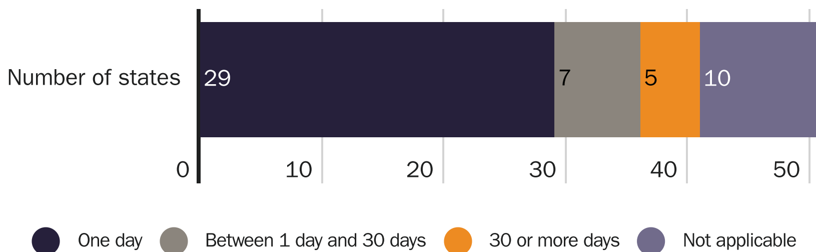
These differing rules can subject remote workers to double taxation. For example, an employee living and working in Maryland for a New York–based employer

could be subject to both Maryland and New York state income taxes because New York is a convenience of the employer state, while Maryland is not.

Moreover, the convenience of the employer rule has already caused interstate taxation problems. In 2020, Massachusetts temporarily adopted these rules for now-remote workers who had physically worked in the state prior to the pandemic. This prompted New Hampshire to sue Massachusetts on the grounds that Massachusetts' regulation unfairly taxed New Hampshire workers, but the U.S. Supreme Court declined to hear the case.[16] The temporary Massachusetts measure expired in September 2021 without any Supreme Court clarification of how such interstate conflicts should be resolved.[17]

States also differ in withholding and filing income tax requirements on nonresidents or part-year residents. As the rise of remote work allows employees greater flexibility to work where they please, some employees may spend time working remotely in different locations across state lines. Employees may therefore be subject to state income tax withholding in multiple states, even if their periods of residence in those places were brief. In fact, most states require income tax withholding after just *one day of work* in that state (see Figure 2). And while states usually issue a tax credit for taxes paid to other states, an employee's overall tax burden might increase if one state has a higher income tax rate.[18] A hypothetical Oregon resident who temporarily works remotely from California, for example, would be subject to California's higher taxes on the California liability amount over and above the Oregon liability amount.[19] That worker would also need to be aware of a credit's availability and would expend time (and perhaps money) trying to earn it.

FIGURE 2 Most states require income tax withholding after just one day in the state



Source: Jared Walczak, "Eight Tax Reforms for Mobility and Modernization," Tax Foundation, January 5, 2022.
Note: Not applicable to Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, Wyoming, and Washington, DC.

Second, state tax policies have made remote work difficult for employers. Physical presence laws had previously intended for physical structures, such as office space or warehouses, to create a tax nexus, thereby subjecting the company to state corporate and sales taxes.[20] However, even one employee's continued presence working remotely may be enough to trigger tax nexus, even if the employer does not have any physical space or other connection to the state.[21] Similar concerns can arise for the majority of U.S. companies organized as "pass-through" entities not subject to corporate taxes (e.g., partnerships or S corporations), because remote workers' physical presence in a state can affect nonresident business owners' personal income tax liability.[22] These tax requirements can therefore discourage companies from hiring remote workers or offering the option to current employees, as the organizations will need to consider the tax implications of having workers in multiple or high-tax states in which the companies themselves are not located.[23]

Consider a corporation based in Virginia. An employee at the company can perform work remotely and decides to move to New Jersey in order to be close to grandchildren. That business would now be subject to New Jersey state corporate taxes, despite not having any sales or any physical connections in the state. Prior to the pandemic and the increased viability of remote work, physical presence laws were understood to account for company and employee utilization of local services, such as fire and police.[24] Yet this Virginia business would not be utilizing any New Jersey services, and the remote employee would be subject to New Jersey individual taxes to account for the employee's utilization of them.

State physical presence laws are not the only nexus issues facing companies in the digital age. In 2018, the Supreme Court ruled in *Wayfair v. South Dakota* that states can subject online retailers to state sales tax, even if the company does not have a physical presence in that state.[25] Since then, every state with a statewide sales tax has created economic thresholds over which remote sellers must collect and remit state sales taxes (economic nexus).[26] As Trevor Burrus and Matthew Larosiere argued at the time, the *Wayfair* decision represents an affront to limiting state power, as states can now tax retailers even though the companies lack any connection to the state beyond a few customers.[27] A similar issue exists for remote employers now too.

Finally, federal tax rules discriminate against remote work arrangements. As detailed in August 2022 comments to the Internal Revenue Service (IRS), the American Institute of CPAs (certified public accountants) warned that the agency's failure to update its guidance on the tax treatment of fringe benefits, business expenses, home offices, and related remote work issues has created "unnecessary confusion and stress" for employers, potentially subjecting them and their workers to significant costs or penalties.[28] It is unclear, for example, whether employer-provided work equipment (e.g., a laptop) is a taxable form of compensation. This type of uncertainty can discourage companies from offering

remote work options. The CPA group further explained that federal guidance fails to account for major changes in technology, work culture, and remote work's benefits for employees and employers (which, as noted above, are significant). Thus, current policy erroneously assumes that a worker's home is in the same locality as his employer's office, and that employers "gain nothing" from remote or hybrid work arrangements.[29] As a result, remote workers can face additional tax burdens for engaging in what are now routine business transactions (e.g., regular travel to their employer's office).

Beyond taxes, state occupational licensing restrictions also burden remote workers. As discussed in the Occupational Licensing chapter, these requirements place heavy financial and time-related burdens on qualified workers. Moreover, licensure is oftentimes not transferable across state lines, thus limiting worker mobility. This lack of portability is a barrier to remote work across state lines, as employees may have to become relicensed when moving to another state.[30]

THE POLICY SOLUTIONS: REFORM STATE AND FEDERAL TAX POLICY, AND STATE OCCUPATIONAL LICENSING RULES, TO BETTER ACCOMMODATE REMOTE WORK

Given these problems, states should move to eliminate convenience of the employer laws to avoid double taxing remote workers and allow them more freedom to work wherever they want. Eliminating convenience of the employer rules would also benefit employers, as it would simplify accounting and lower related administrative costs—potentially making them more amenable to offering a remote work option. Moreover, most employment laws and regulations for remote workers—that is, minimum wage or paid leave mandates—are already assessed based on the remote employee's physical location.[31]

States should also significantly increase the number of days of residence needed to trigger state income tax withholding or filing obligations. With the proliferation of remote working possibilities, single-day thresholds for withholding income tax are both impractical for employers and employees and a barrier to remote employment. States should increase the minimum thresholds to indicate a significant period of consecutive residence, and not subject short-term residences to state income taxes. For example, Illinois and West Virginia recently raised their thresholds for withholding to 30 days, and Louisiana raised its threshold to 25 days.[32]

Granted, some convenience of the employer states may be reluctant to change their tax laws. In fact, the New York Department of Taxation and Finance actually increased the aggressiveness of its' convenience of the employer rule during the

COVID-19 pandemic.[33] Moreover, it may be difficult for all states to standardize their income tax withholding and filing requirements. Therefore, congressional action may be necessary to eliminate double taxation, consistent with the Commerce Clause of the United States Constitution.[34] First, Congress could require a minimum threshold of physical and working presence in a state—30 to 90 days—before the employee would be subject to that state's income taxes. These changes would standardize income tax treatments for remote employees and eliminate all convenience of the employer rules. Remote workers should not be taxed by states where they neither worked nor lived for a meaningful period.

Second, Congress should update nexus laws to better reflect our 21st-century business environment and stop discouraging companies from utilizing remote workers. Specifically, Congress should clarify the conditions needed to create a tax nexus in a given state. Congress could require, for example, that companies—regardless of business structure (e.g., corporations or partnerships)—must maintain either a physical building or a significant number of employees (such as 20 or more) in a state before being subject to that state's taxes. As Burrus and Larosiere argued after the *Wayfair* decision, the creation of a tax nexus should be based on a company's actual physical presence in a state and its ability to utilize state and local services.[35]

Third, the IRS and the Treasury Department should immediately update guidance regarding the tax treatment of issues related to remote work (e.g., fringe benefits, deductions, and home offices) to reduce the uncertainty that employers and remote or hybrid workers now face. In particular, federal guidance should recognize that it is quite common today for employees to work entirely or primarily from a residence that may be a long distance from their employer's office, and that remote and hybrid work arrangements reflect not only changing technology and American work culture but also that employers derive substantial benefits (e.g., increased profitability, employee retention, and new applicants) therefrom. These changes would help to ensure that current federal law does not impose higher taxes on remote workers than those paid by their in-office counterparts who engage in analogous transactions (e.g., travel to a corporate office).

Fourth, states should make it easier to transfer occupational licenses across state lines. In 2019 Arizona became the first state to universally recognize out-of-state licenses, and 17 additional states have since enacted similar laws universally recognizing at least some out-of-state licenses. As noted in the Occupational Licensing chapter, states should pass universal recognition laws to boost the freedom and mobility of American workers, remote or otherwise.

ACTION PLAN

Rather than being a blip during the depths of the COVID-19 pandemic, remote work has emerged as a popular and viable path of employment for many American workers, benefiting both them and the economy. Both federal and state legislators should take note, and reform tax and licensing laws to make remote work accessible and viable going forward. While states have a role to play in these reforms, ultimately, federal legislation will likely be necessary due to the interstate nature of remote work.

Specifically, the Treasury Department and IRS should

- immediately update outdated federal guidance on issues related to remote work to ensure that these rules no longer discourage or discriminate against remote work and remote workers. Any revised guidance should, consistent with federal law, recognize that remote and hybrid work are common arrangements that employers have voluntarily adopted for their commercial benefit.

Congress should

- prohibit state convenience of the employer rules;
- establish a clear minimum working and physical presence threshold before employees are subject to state income tax withholding and filing requirements—the threshold should be one that only subjects workers who resided in a state for a significant period of time to state income taxes, such as a minimum of 30, 60, or 90 days of consecutive work and residence; and
- update tax nexus laws to account for remote employees. Congress should require that businesses have a substantial physical presence in a state before being subject to state taxes. The physical presence should be determined by the utilization of office, warehouse, or storage space, or by the physical presence of a significant number of employees, in the state.

In the absence of congressional action, state governments should

- repeal convenience of the employer laws and reject any new proposals;
- require at least 30 days of residence to trigger state income tax withholding or filing obligations; and
- require businesses to have a substantial physical presence (office, several employees, etc.) in a state before being subject to state corporate, sales, or other applicable taxes.

State governments also should

- pass universal recognition laws to allow new, remote-working residents with out-of-state licenses to continue working in their licensed profession.

NOTES

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19. Jeanne Sahadi, "Working Remotely in a Different State than Your Employer? Here's What That Means for Your Taxes," *CNN Business,* March 1, 2022.
20. Robert Freedman, "Remote Workers Complicate CFO's State Sales Tax Compliance," CFO Dive, September 8, 2021.
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23. See Freedman, "Remote Workers Complicate CFO's State Sales Tax Compliance." See also Richard Goldstein, "Remote Legal Staff—Understanding the State and Local Tax Consequences of Remote Work," Berdon LLP, June 16, 2022.
24. Trevor Burrus and Matthew Larosiere, "*South Dakota v. Wayfair:* A Taxing Decision," *Cato at Liberty* (blog), Cato Institute, June 21, 2018.

25. Burrus and Larosiere, "*South Dakota v. Wayfair:* A Taxing Decision."
26. Klein, Endres, and Piazza, "Tax Implications of COVID-19 Telecommuting and Beyond."
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