STATE INCOME TAX: WHERE DO YOU OWE?

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Of the fifty states in the United States, only nine do not charge a state income tax. State income taxes are used to fund public services such as law enforcement and road maintenance. Instead of having a state income tax, Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming have relatively high sales tax and property tax. If you live in a state that does not have a state income tax but work in one that does, you might still have to pay state income tax. This note provides the step-by-step process used by the state of New York to determine if a state income tax can be assessed. If you live in a state with state income tax and work in one without it, you are not obligated to pay in both states. In 2015, Congress passed a law that protected workers from double taxation (Woodall 2015). Only one state can collect income tax on employee earnings.

The number of at-home workers jumped from 56% to a high of 70% in April 2020, averaging 58% in September (Lardieri 2021). Of the employees surveyed, fifty-five percent were not aware that there could be possible tax consequences for changing states while working remotely and not changing their tax withholding to match the location of their remote worksite (Vera 2020).

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If the state of employment does not recognize the nature of the position as work-from-home and collected state income tax, an employee is faced with additional tasks to recover the funds. Below is a scenario that many employees face due to the complicated state income tax laws. This note seeks to help those in a similar situation to amend prior year tax returns and recover lost wages paid improperly in state income tax.

Prior literature addresses living in one state and working in another. The present note addresses living and earning in a state that does not have a state income tax, while working for a company that is in another state with state income tax, with no expectations of going to the office. New York is used as the example state.

Background and Development

Work-From-Home

A job that does not require attendance in the office can give employees the flexibility to work from anywhere. Eighteen jobs that do not require the employee to be in the office and can be performed anywhere in the world are listed in Exhibit 1. There are tax guidelines that determine if a job can be assessed with a state income tax. To demonstrate this scenario, a fictitious online teacher is used.

Exhibit 1. Work from Anywhere Jobs

Source: Volkner (2020)

Copywriting	Consulting
Virtual Assistance	Online Teaching
Translation	Trading
SEA (Search Engine Advertising)	Sports Betting & Arbitrage Trading
Social Media Marketing	Affiliate Marketing
Web design	Online Poker
SEO (Search Engine Optimization)	E-Commerce
Graphic Design	Blogging
Programming	Data entry

As a college professor, Amy enjoyed teaching in the classroom and online. She accepted a part-time job teaching 100% online for a university in New York state. She did not know that New York taxes out-of-state telecommuters for the days they work at home. However, she was not a telecommuter. Her job was always going to be conducted from her home state of Florida and never required her to be in New York. As a work-from-home employee, Amy did her job at home and not in an office.

Telecommuter

A telecommuter is someone who is physically distant from his or her place of employment and has reduced regular commutes to the primary office (Domanico 2021). Deploying the concept of for the *"convenience of the employer,"* New York's taxation of out-of-state telecommuters can cause telecommuters to be double-taxed or taxed at New York's higher income tax rate (Zelinsky 2015).

The New York Codes, Rules, and Regulations state that *"any allowance claimed for days worked outside New York State must be based upon performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his employee."* For purposes of taxation, if the days are deemed *'not necessity'*, and occur in the home office state, nonresident taxation will be applied (20 NYCRR § 132.18(a) 2021).

Income is taxed by the primary office in New York but if the employee is telecommuting by choice or for the convenience of the employee, and residing in a different state, that state may also inadvertently assess tax on the employee's earnings. A nonresident whose primary office is in New York state will have days telecommuting considered days worked in the state unless the employer has established a *bona fide* employer office at the telecommuting location.

Method

State Income Tax

While at her full-time job, a discussion between Amy and a fellow professor and CPA led to a disagreement about New York state income tax liability. Amy argued that she earned the money from New York and thus owed the state income tax, while her colleague, an expert in tax, argued that it was not earned in New York and should not be subject to the state income tax. Amy first had to determine if she was deemed a resident or nonresident of New York.

If a nonresident, she would be assessed tax on taxable income derived from within the state (Imposition of Tax Act 2022). As a full or part-time resident, she would be eligible for a non-refundable resident credit for taxes paid to another state (Credit for income tax of another state Act 2021).

If Amy were a nonresident who performed services partly in and partly out of the state of New York, New York Title 20 CRR-NY 171.6 statute criteria would need to be followed.

However, if she was a nonresident, the employer must have established a *bona fide* employer office at the telecommuting location, which would be in New York. In general, if the employer specifically acted to establish a *bona fide* employer office at the telecommuting location, the employee will continue to owe New York state income tax on income earned while telecommuting.

Did the school from New York establish a *bona fide* telecommuting location? There are several factors to apply to determine if a home office is a bona fide employer office, in three categories:

a) the primary factor, or
b) at least 4 of the secondary factors and
c) 3 of the other factors.

Results

The Experts Respond

According to the New York State Department of Taxation and Finance (2006), there are several factors to be considered to determine if a home office is a *bona fide* employer office. Amy must meet the primary factor or four of the secondary factors and three of the other factors to determine that she has a home office that is a *bona fide* employer office.

Primary Factor. If the home office contains, or is near, specialized facilities that cannot be made available at the employer's place of business, but if those facilities are available at or near the employee's home, then the home office will meet this factor. For example, if the employee's duties require the use of a test track to test new cars, and a test track is not available at the employer's offices in New York City, but is available near the employee's home, then the home office will meet this factor. Amy's home office does not meet the primary test, because it is not a specialized facility

Secondary Factors. Minimally, four factors need to be met:

1) The home office is a requirement or condition of employment. If the employer requires the employee to work from his or her home office as a condition of employment, the home office will meet this factor. For example, if a written employment contract states that the employee must work from home to perform specific duties for the employer, then the home office will meet this factor. Amy's home office does not meet the secondary factor, as there is no contract that states where she must work.

2) The employer has a *bona fide* business purpose for the employee's home office location. If the employer has a *bona fide* business purpose for establishing an office in the locale where the employee's home is located, then the home office will meet this factor. For example, if the employee is an engineer working on several projects in his or her home state and it is necessary that the employee has an office near these projects to meet

project deadlines, then the home office will meet this factor. Amy's home state does not meet the secondary factor. She does not have any projects that need to be completed in a home office location specifically set in Florida.

3) The employee performs some of the core duties of his or her employment at the home office. If some of the core duties of employment are performed at the home office, then the home office will meet this factor. For example, the core duties of a stockbroker include the purchase and sale of stock. Accordingly, if the stockbroker executes stock purchases and sales from the home office, this will constitute performing some of the core duties at the home office. However, if the stockbroker merely reads business publications on the weekend, this will not constitute performing any core duties at the home office. In such a case, Amy does perform her duties from her home office and meets this secondary factor.

4) The employee meets or deals with clients, patients, or customers on a regular and continuous basis at the home office. If an important part of the employee's duties includes physically meeting with clients, patients, or customers in the normal course of the employer's trade or business, and those meetings are performed on a regular and continuous basis at the home office, then the home office will meet this factor. For example, the employer has clients located near the employee's home office and the employee must meet with the clients once a week to perform the duties of his or her job. If the meetings with clients are on a regular and continuous basis at the employee's home office, then the home office will meet this factor. Being an online professor, Amy's job did not meet this standard, as she would never physically meet with students. Meeting virtually does not meet this requirement.

5) The employer does not provide the employee with designated office space or other regular work accommodations at one of its regular places of business. If the employer does not provide the employee with designated office space or other regular work

accommodations at one of its regular places of business, then the home office will meet this factor. For example, an employer wishes to reduce the size of the office space maintained in New York to decrease rental expenses and, therefore, no longer provides designated office space or other regular work accommodations for one of its employees. Instead, the employer allows the employee to work from the employee's home. If the employee must come to the office, the employee must use the *"visitors"* cubicle, conference room, or other available space that is also used by the other employees of the company. In this instance, the home office would meet this factor. Amy's home office does meet the 5th secondary factor as the employer does not provide any type of office or work accommodations at the school in New York. If she were to come as a visitor, a visitor cubicle, conference room, or other available space would be provided.

6) The employer reimburses expenses for the home office. If the employer reimburses the employee for substantially all expenses (e.g., utility expenses, insurance) related to the home office, or the employer pays the employee a fair rental value for the home office space used and the employer furnishes or reimburses the employee for substantially all the supplies and equipment used by the employee, then the home office will meet this factor. Substantially means 80% or more of the expenses. Amy does not receive reimbursement for her home office expenses and does not meet the sixth secondary factor.

Other Factors

1) The employer maintains a separate telephone line and listing for the home office. Amy does not meet this factor, since a separate telephone line and listing for the home office is not maintained.

2) The employee's home office address and phone number are listed on the business letterhead and/or business cards of the employer. Amy does not meet this factor, since

her home office address and phone number are not listed on business letterhead and/or business cards.

3) The employee uses a specific area of the home exclusively to conduct the business of the employer that is separate from the living area and will not qualify if the area is used for both business and personal purposes. Amy does not meet this factor, because she can complete her tasks anywhere in her home or any other location in the world.

4) The employer's business is selling products at wholesale or retail and the employee keeps an inventory of the products in the home office for use in the employer's business. Amy does not meet this factor, because her position does not sell products and she does not keep inventory.

5) Business records of the employer are stored at the employee's home office. Amy could meet this factor if storing student records on her home computer qualifies as business records.

6) The home office location has a sign indicating the place of business of the employer. Amy does not meet this factor, since a sign for the New York university is not being displayed outside her home office.

7) Advertising for the employer shows the employee's home office as one of the employer's places of business. Amy does not meet this factor, since advertising for the New York university does not show her home office as one of the places of business for the institution.

8) The home office is covered by a business insurance policy or by a business rider to the employee's homeowner insurance policy. Amy does not meet this factor since a separate business insurance policy or rider is not necessary for this type of position.

9) The employee is entitled to and claims a deduction for home office expenses for federal income tax purposes. Amy does not meet this factor because office expenses cannot be deducted from her federal income taxes since she is a W-2 employee.

10) The employee is not an officer of the company. Amy does meet this factor because she is not an officer of the university in New York.

Amy must meet the primary factor or four of the secondary factors and three of the other factors to determine if her home office is a *bona fide* employer office. Amy does not meet the primary factor but meets one of the secondary factors and two of the other factors. Therefore, Amy's home office does not qualify as a *bona fide* employer office.

In the changing work environment, employees need to carefully review their individual situations for the most advantageous tax treatments to not pay more tax than owed.

Kirk Stark, a professor of tax law at UCLA, concluded that the state of primary residence can tax the employee's total income, but any state where income is earned outside of the primary state can also tax the income earned in that state (Gross 2020). Some states have reciprocity agreements with other states, and will give credits for income tax paid, but not all, leading to double state income tax.

Thankfully, Amy lives in a state that does not have a state income tax, so there is no need to worry about an inadvertent double state income tax. However, she needs to determine if her home office was a *bona fide* employer office that would require her to pay New York state income tax, or not.

Conclusion

Amy is in a class of workers who do not fall under the definition of a telecommuter. After teaching at the New York school for four years, she discovered that the school erroneously deducted New York state income taxes from her earnings. She was required to file a New York state non-resident tax return which considered her filing status and included all of the income earned in Florida with her husband as New York earnings. In this case, $2,526 of New York state income taxes were paid over the last four years as can be seen in Exhibit 2.

Exhibit 2. Taxes Paid

Source: IRS.gov 2021

Tax Year	NY wages	Fed wages	NY state income tax
2017	$4,545	$242,904	$237
2018	$8,021	$232,840	$480
2019	$8,020	$222,166	$465
2020	$22,571	$289,275	$1,344

Since Amy does not have a home office that qualified as a *bona fide* home office established by her employer, she is not a telecommuter, nor does she earn her income in New York. Amy will need to file an amended New York state income tax return by completing IT-203-X for the last 3 years. The statute of limitations in the state of New York is within three years of the date the original return was due or filed, or within two years of the date the tax was paid, whichever is later (2019, September), along with a letter of explanation. The letter should state that she does not meet the Department of Taxation and Finance criteria of the state of New York for a telecommuter. As a permanent Florida resident, she has never traveled to New York as part of her employment with the university and her position is and always has been 100% online, not warranting travel to New York.

It is estimated that 25-30% of the workforce work a flexible schedule including work from home (Meyer 2020). Of those surveyed, half want to continue to work remotely. Knowing the tax ramifications related to where employees earn their income is important and should be planned for. Employees need to be aware of their state income tax liability and plan accordingly, no matter which state is being claimed as their primary residence. For Amy, this was a $2,526 discovery that was partially refunded by the state of New York, upon filing her amended return. Any employee working remotely should ask himself or herself important questions: Should I be assessed a state income tax from my employer's state? Should I be assessed a state tax from my state of residence? Do I need to file an amended return to receive a refund?

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