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PERSPECTIVE

Remote workers and out-of-state employers raise tax issues

By Suzanne Mulvihill

As more and more workers are required or encouraged to work from home in response to the COVID-19 pandemic, the consideration of jurisdictional income taxation becomes relevant — particularly when the worker performs services in a different state than originally contemplated at the beginning of the employer-employee relationship.

On March 19, Gov. Newsom issued Executive Order N-33-20, commonly known as the shelter-in-place mandate, requiring non-essential workers to work from home or their place of residence. California isn't unique in this circumstance as similar types of this order appear in most, if not all, jurisdictions within the United States.

As a consequence, to the extent feasible, a much larger percentage of the workforce now telecommutes. Technology allows this ability for many, and with just a few minor adjustments, a virtual office can be created anywhere. This effectively opens the door for people to work from second residences, vacation homes, rental properties, and creates the opportunity to spend months on end with extended family and friends without missing work. Naturally this drastic change in workforce location brings up a myriad of issues, some that most might not even consider. This article discusses the California Franchise Tax Board's position on remote worker telecommuting when the employer or employee is a non-resident.

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California Nexus for Out-of-State Employers

Most people are painfully aware of California's seemingly ubiquitous tax reach. Doing business in the state of California for tax purposes, "means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." Cal Rev. & Tax Sec. 23101 (a). It is a rather nebulous concept that has revealed — subject to federal law discussed in further detail below — only the slightest activity within California's borders will trigger a nexus in California. Doing business also includes businesses that are organized or commercially domiciled in California, or its California sales, property or payroll exceed amounts published annually by the FTB. Cal Rev. & Tax Sec. 23101 (b). Accordingly, if these threshold criteria are met, an out of state business is deemed to be doing business in the state of California and thus subject to income taxation and withholding. However, in light of the COVID-19 pandemic and the shelter-in-place order, the FTB has offered a special dispensation from its ordinary course of conduct.

Out-of-State Businesses with Remote Workers Temporarily Located in California due to Covid

The FTB recently published guidelines pertaining to its treatment of out-of-state businesses and its employees working remotely in the state of California. Specifically, assuming the only connection an out-of-state employer has is the presence of an employee working remotely within California due to the executive order, California will not deem such company as doing business in the state of California for tax purposes. Nor will the income attributable to such worker be included in the minimum threshold amount pursuant to Cal. Rev. & Tax Code Sec. 23101(b)(2)(4). Furthermore, the wages of employees who typically perform services in another state for an out-of-state employer will not be subject to Unemployment Insurance Tax, Employment Training Tax and Disability Insurance withholding. In addition, the FTB has asserted that California will treat the presence of an employee working remotely within the state's borders due to the executive order as engaging in de minimus activities for purposes of Federal Public Law 86-272 protection. The federal law prohibits a state from taxing the net income of an out-of-state company if its only activity is the solicitation of orders for the sale of tangible personal property within the state. Of course, these dispensations are only temporary and will likely expire when public health or state officials have lifted the applicable shelter-in-place orders.

Non-Residents Working Remotely in California

In general, and under normal circumstances, if you are physically present in California for at least nine months you are presumed to be a resident for purposes of the California personal income tax. Cal. Rev. & Tax Code Sec. 17016. Conversely, presence within California for less than nine months does not constitute a presumption of non-residency. Cal. Code Regs., tit. 18, Section 17016. Still, the nine month presumption might be overcome if the stay is due to circumstances beyond an in-

dividual's control. *See Appeal of Edgar Montillion Woolley*, 1951-SBE- 005, July 19, 1951; see also Residency Sourcing and Technical Manual, www.FTB.ca.gov. The FTB has acknowledged that the extraordinary nature of the COVID-19 pandemic requires a different lens be used in making the determination of whether an individual is in (or out of as the case may be) California for other than a temporary or transitory purpose. Whereas ordinarily the determination is based on the facts and circumstances of each particular case (Cal. Code Regs., tit. 18, Section 17014(b)), the FTB recognizes there are exigent factors present in light of COVID-19. The non-exhaustive 19-factor test established in the *Appeal of Stephen Bragg*, 2003-SBE-002 (May 28, 2003) in determining California nexus will be used - in addition to the following COVID-19 specific criteria:

1. When the individual entered California;

2. Whether and how long the individual remained in California after the COVID-19 period;

3. Whether the individual remained in California throughout the COVID-19 period;

4. Whether the individual provided COVID-19-related services in California; and

5. Whether the individual cared for an at-risk family member or friend.

Mitigating factors notwithstanding, the FTB still intends to take the initial position that any nonresident who relocates to California for any portion of the year will have California source income during the period of time they performed services in California, and will accordingly require the taxpayer file a California Nonresident or Part-Year Resident Income Tax Return. A nonresident, however, can assert its non-resident status by attaching a signed statement to their return setting forth the basis of their contention, essentially making a *Woolley* rule claim. The taxpayer should be mindful that such a claim is not conclusive evidence of such status, and may open the door to further FTB inquiries. Whether and to what extent the FTB will deem an individual subject to California taxation for temporarily relocating within the state will depend upon an analysis of all facts and circumstances including, without limitation, the 19-factor test articulated in the *Bragg* case and the COVID-19 specific criteria. Of course, even if the FTB concludes a resident status, courts might not be in agreement, citing *Woolley* and its progeny.

This begs the question of whether a nonresident is truly stranded in California due to COVID-19 if the state where they are domiciled doesn't have inbound travel restrictions. Or if the executive order even technically applies to nonresidents at all. Both "residents" and "individuals living in California" are referenced in the mandate, but it isn't clear as to the exact scope. Arguably, once the restrictions are loosened up or lifted altogether as to any industry, the argument of being "stranded" might not bode well, particularly if one remains in California for nine months or more when the audit potential is at its highest.

Takeaways

Based on the newly issued FTB position, as well as prevailing case law, the following conclusions can be made:

1. Out-of-state businesses will not be deemed to be doing business in the state of California solely by reason of a nonresident employee working remotely in the state throughout the duration of the executive order. However, the other methods the FTB asserts nexus still apply, such as the sales and property ownership thresholds.

2. A person's nonresident status should be preserved if working remotely in California due to travel restrictions and the executive order mandate under *Woolley*. However, the question of whether a person is truly "stranded" in California, and falls squarely within the *Woolley* rule depends upon the individual facts and circumstances of that particular situation, although it appears the FTB will consider additional COVID-19 specific criteria in each case.

3. It is critical to remember that the FTB is not the final arbiter on this question of residency, although it generally bases its positions on prevailing law. The COVID-19 pandemic is truly an enigma and should be treated accordingly. ■

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