



IN CASE YOU MISSED IT – June 2021 – SPECIAL EDITION – NYS IS GETTING AGGRESSIVE

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Almost every day, federal and state courts issue opinions that affect taxpayers. The IRS and state taxing authorities also publish guidance on myriad topics.

Each month, this column will review a selection of recent court cases or guidance that tax professionals should know about when advising their clients and preparing tax returns.

For more extensive detail on any of these items, please feel free to reach out to the author.

New York State is already questioning nonresidents who filed their 2020 nonresident income tax returns showing a different allocation of income to New York State than they have allocated in prior years.

New York State taxes nonresidents only on that portion of their income that is attributable to a business, trade, profession or occupation pursued in New York State under [NY Tax Law section 631\(b\)](#). Generally, an employee's compensation is allocated to New York State based on the percentage of days the employee worked within the state during the taxable year compared to all of the days that the employee worked during the year. While the governing regulations state that the test is where the work is actually performed and not where the employer is based, the rule is modified by the "convenience of employee/necessity of employer" test pursuant to which work days are treated as non-New York source days *only if* the employee is performing services outside of New York based on the employer's necessity, rather than on the employee's convenience. See [NYCRR 132.18\(a\)](#).

During the pandemic, hundreds of thousands of employees were shut out of their workplaces and worked instead from their homes, many of which were located outside of New York State. The employees are now taking the position that those days worked at home were based on their employers' necessity as, according to New York State law, employers were forced to close their offices and have their employees work remotely. Many taxpayers are thus taking the position that their telecommuting is for the employers' necessity as the employer has no other office to provide them with for use during the pandemic.

According to the NYS Department of Taxation and Finance website, however, the state is taking the position that for any employee whose primary office is in New York State, the days spent telecommuting during the pandemic are still considered to be days worked in the State unless the employer has established a bona fide employer office at the employees' telecommuting locations (i.e., their homes). Unfortunately, the bona

bona fide employer office test is a factor-based test that is very difficult for most home offices to satisfy. The NYS Department of Taxation and Finance issued a technical service bulletin back in 2006, [TSB-M-06\(5\)I](#) (the "Bulletin") providing the factors that must be satisfied in order to establish a *bona fide* home office and thus allowing an employee to treat the compensation earned while working at that home office as being earned outside of New York. Although New York State auditors still rely on this bulletin, many of the factors are outdated and impossible for employees to comply with.

According to the Bulletin, an employee must either satisfy the "Primary" Factor, or it must meet **both** four of the enumerated "Secondary" Factors and three of the "Other" Factors. The Primary Factor requires that the home office contains or is near specialized facilities that cannot be made available at the employer's place of business (such as a test track to test new cars). It is unlikely that most remote employees will be able to satisfy the Primary Factor. Thus, an employee must analyze the Secondary and Other Factors to see if the requisite number of them can be satisfied to establish a bona fide home office.

The Secondary Factors are:

- i) **The home office is a requirement or condition of employment.** Although in theory this could be incorporated into an employment contract, it is unlikely to be respected while the employer continues to maintain headquarters in New York City with office space sufficient to provide the employee with an office. Case law has held against employees where they could not establish that an office could not have been set up for them with adequate space in their employer's facilities; see for example [Matter of Simms v. Procaccino](#) and [Matter of Page v State Tax Commission](#). It is anticipated that many employees will fight any assessment by New York State on the ground that no office in New York State could be provided for them during the pandemic so by necessity they had to work from home to continue their employment, and thus they believe they should satisfy this requirement.
- ii) **The employer has a bona fide business purpose for the employee's home office location.** As many employees can now perform their work anywhere via a cellphone and computer, it will be difficult to formulate a specific business purpose for establishing an office in the home of each employee. It is unclear whether purposes such as employee retention and reduction of office costs could satisfy this requirement as "business purposes," or if something more specific is required. The example provided in the Bulletin is of an engineer who needs to be near several projects in his home state that he must visit regularly to meet project deadlines as a proper business purpose for the home office.
- iii) **The employee performs some of the core duties of his or her employment at the home office.** This factor should be easily satisfied when the employee is performing all of his or her duties at the home office via phone and computer.
- iv) **The employee physically meets or deals with clients, patients or customers on a regular and continuous basis at the home office.** Many employees never meet with clients, patients or customers, so they could certainly not be meeting with them in their home offices and thus will not be able to satisfy this requirement.
- v) **The employer does not provide the employee with designated office space or other regular work accommodations at one of its regular places of business.** This could be satisfied if the Corporation closed or downsized its New York office and only provided a temporary "visitor's" cubicle for the employee to use. Similar to factor i) above, it is expected that taxpayer's will argue that the forced closures during the pandemic prevented the employer from providing employees with any designated office space and/or other regular work accommodations at one of its regular places of business.
- vi) **Employer reimbursement of expenses for the home office.** The employer must reimburse substantially all of the expenses related to the home office, which for this purpose means 80% or more of the home office expenses. These expenses include utilities and insurance or a fair rental value, plus reimbursement for all the supplies and equipment used by the employee. It is possible that certain employers have reimbursed employees for these expenses during the year.

Even if an employee could satisfy four of these six Secondary Factors, an employee must also meet three of the following Other Factors:

- i) **The employer maintains a separate telephone line and listing for the home office.** This could be satisfied with a dedicated phone line in the employee's home office if the employer was willing, although most people likely use a cellphone these days.
- ii) **The employee's home office address and phone number is listed on the business letterhead and/or business cards of the employer.** It is unlikely that either the employer or the employee would desire this.
- iii) **The employee uses a specific area of the home exclusively to conduct the business of the employer that is separate from the living area.** This factor should be able to be satisfied by many employees.
- iv) **The employer's business is selling products at wholesale or retail and the employee keeps an inventory of the products or product samples in the home office for use in the employer's business.** This factor will not apply to many employers or employees.
- v) **Business records of the employer are stored at the employee's home office.** This factor could potentially be satisfied by business records that are stored electronically on the home computer.
- vi) **The home office location has a sign indicating a place of business of the employer.** It is unlikely that either the employer or the employee would desire to satisfy this factor.
- vii) **Advertising for the employer shows the employee's home office as one of the employer's places of business.** It is unlikely that either the employer or the employee would desire to satisfy this factor.
- viii) **The home office is covered by a business insurance policy or by a business rider to the employee's homeowner insurance policy.** The employer or the employee should be able to satisfy this factor.
- ix) **The employee is entitled to and actually claims a deduction for home office expenses for federal income tax purposes.** Unfortunately this factor can no longer be met as the federal deduction has been eliminated.
- x) **The employee is not an officer of the company.** This factor may be satisfied by many employees.

Interestingly, New Jersey appears to agree with New York's approach to telecommuting during the pandemic. The [New Jersey website](#) states that “during the temporary period of COVID-19 pandemic, wage income will continue to be sourced as determined by the employer in accordance with the employer's jurisdiction” and thus a New York employer can continue to source their telecommuting employees to New York and their employees will continue to receive a credit for any New York taxes paid against their New Jersey tax liability.

Takeaway—The interesting question will be what happens after the pandemic when people decide that they like telecommuting and wish to continue to do so, at least on a part-time basis. There is currently a case brought by the state of [New Hampshire](#) before the U.S. Supreme Court addressing whether Massachusetts' tax rule—which similarly to New York subjects nonresident earned income received for services performed outside Massachusetts to Massachusetts state income tax—is unconstitutional confiscation. If New Hampshire should prevail, New Jersey and Connecticut will be quick to follow and cease to respect New York's “right” to tax nonresidents on work performed outside of New York. Additionally, there are rumblings among New Jersey state officials to change the law so that New Jersey residents who work from home for New York companies will be taxed at New Jersey rates in the future, but coordination with New York tax enforcement will be required to prevent the New Jersey residents from paying tax twice on the same income.

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