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Brandon Smith

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I. INTRODUCTION

Since the early days of the internet, predictions of its disruptive effect on our lives have been common. As technology progressed over the last few decades, it enabled greater changes in the everyday lives of billions of people. One significant change has been the increasing shift to flexible and hybrid remote work arrangements.[1] While many companies

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[1] Phil Lord, *Covid-19 and the Future of Work*, 98 DENV. L. REV. ONLINE 1, (Mar. 20, 2021), https://www.denverlawreview.org/dlr-online-article/futureofwork.

have offered remote work opportunities as a means of attracting talent by enabling a more flexible schedule, the COVID-19 pandemic accelerated this shift as billions of people were forced to work remotely to combat the spread of the virus.[2] This shift to remote work required millions of workers and their respective employers to make radical changes to their work relationship, and while reopening the economy has allowed many workers to return to the office, many employees will likely continue to work remotely indefinitely because employers and employees capitalize on significant benefits such as eliminating commute times, decreased need for commercial office space, and flexibility for workers with families to stay home with children.[3] However, while remote work has many advantages, it also creates some tax complications.[4] When employees work from different states or cities than where their employer is located, it can dramatically change those employees' tax treatment, as well as business income tax apportionment methods.[5] These disruptions to the workplace have also led to disputes between states regarding state income taxation, with important implications for the development of Commerce Clause jurisprudence in the age of remote work.[6] While the Supreme Court has refused to hear the recent case *New Hampshire v. Massachusetts*, cross-border taxation of out-of-state residents will likely lead to further disputes, meaning it is especially important to find solutions that balance the interests of businesses, employees, and state and local governments.[7]

II. OVERVIEW

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[2] *Id.*

[3] Marjorie B. Gell, *The Shift to a Telecommuting Workforce in the Age of Covid-19: Michigan State and Local Tax Implications*, 52 MI TAX L. 3, 3 (2021), Lexis.

[4] *Id.*

[5] *Id.*

[6] Edward Zelinsky, *Justices Should Review NH's State Telework Tax Case*, LAW 360 (Nov. 4, 2020, 3:37 PM EST), https://www.law360.com/articles/1325656/justices-should-review-nh-s-state-telework-tax-case.

[7] Caroline Kupiec & David Nagle, *The Sup. Ct. Denies Complaint in N.H. v. Mass., Heightening the Importance of Individual Refund Claims*, JD SUPRA (July 8, 2021), https://www.jdsupra.com/legalnews/the-supreme-court-denies-complaint-in-1879149/ (discussing the Supreme Court's dismissal of New Hampshire's suit against Massachusetts that sought to prevent the taxation of New Hampshire residents' wages earned while working remotely for Massachusetts businesses due to the COVID-19 pandemic).

A. *History of State and Local Taxation*

State and local taxes in the U.S. have evolved significantly over time, as the nation's economy, culture, and governmental needs have shifted from the colonial period to the present.[8] During the colonial period, economic activity focused largely on agriculture, while government taxation needs were relatively small, mainly consisting of roads, jails, and general administration.[9] During these pre-independence years, a split in taxation style developed between different regions.[10] The northern colonies preferred property and poll taxes; the southern colonies relied on customs duties and poll taxes; and the middle colonies used property taxes, customs duties, and excises.[11] Over time the colonies expanded and further developed their taxation systems by expanding property taxes to include buildings as well as land, and by imposing the "faculty tax," an early, crudely applied form of the modern income tax where all members of a given profession would be taxed at a similar rate on their estimated earnings.[12] While the ratification of the U.S. Constitution in 1789 eliminated many customs duties, most of the states' taxation systems remained much the same in the early days of the U.S.[13] During these years, property taxes formed the primary source of tax income for the majority of states.[14]

During the 19th century, further developments to state taxation systems had to be made to fund internal improvements and adapt to the changing economy.[15] This included the "general property tax" in the 1820s that attempted to apply a uniform tax to all forms of taxable property, including tangible and intangible forms (although the mobility of intangible property presented issues in locating it for taxation purposes).[16] In the latter half of the nineteenth century, corporate and license taxes

[8] Edward T. Howe & Donald J. Reeb. *The Hist. Evolution of State and Local Tax Sys.*, 78 SOC. SCI. Q. 1, 109 (1997), http://www.jstor.org/stable/42863678.

[9] *Id.* at 110.

[10] *Id.*

[11] *Id.*

[12] *Id.* at 111.

[13] *Id.*

[14] *Id.*

[15] *Id.* at 112–13.

[16] *Id.* For instance, intangible property such as stocks and bonds, in paper form, would have been difficult to locate for taxing purposes at the time. *Id.*

formed an increasing share of some states' revenues, as part of a trend of increasingly specialized taxation forms.[17]

The early twentieth century saw a shift towards state income taxes on individuals and corporations, with thirty-three states adopting these taxes by 1940.[18] Excise taxes on fuel, cigarettes, and liquor formed another significant source of state income during this period, and the retail sales tax—a response to reduced corporate and property taxes during the Great Depression—was successfully implemented during this period as well.[19]

While the U.S. economy has largely shifted from goods-based to service-based, much of the state and local tax systems have largely remained unchanged through the end of the 20th century.[20] As society has become more connected, people have become more mobile, complicating these taxation schemes.[21] Particularly in the latter years of the 20th century and in the early 21st century, the internet has created numerous opportunities and changes to the nature of work, with an ever-increasing percentage of the population able to work remotely from home rather than commuting to the office every day.[22] Since these developments have allowed individuals to work from their homes, which may be in different states from their employers, states have increasingly clashed over how much a state may tax those beyond its borders.[23] These clashes have significant implications for businesses and their employees who may be working remotely in different states due to newly available remote work options.[24]

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[17] *Id.* at 113.

[18] *Id.* at 114. Elasticity in income tax revenue and the difficulty of locating intangibles were major contributing factors to the widespread adoption of state income taxes. *Id.*

[19] *Id.* at 115.

[20] *Id.* at 117–18.

[21] Morgan L. Holcomb, *Tax My Ride: Taxing Commuters in Our National Economy*, 8 FLA. TAX REV. 885, 887 (2008) (discussing the complications that arise when a person lives in one state and either commutes or telecommutes to work in another state, in which case both states may claim the authority to tax the resident's income).

[22] *Id.*

[23] Zelinsky, *supra* note 6 (discussing the Supreme Court's dismissal of New Hampshire's suit against Massachusetts to prevent its taxation of New Hampshire-based remote workers).

[24] *See* discussion *infra* Section 2.

B. *Business Considerations of Remote Work*

While tax considerations are an important part of the shift to remote work, employers should consider numerous other factors when deciding on remote work policies, which may end up being more important in an overall business strategy.[25] The rapid shift to remote work due to the COVID-19 pandemic accelerated an already growing trend of companies offering remote work options to attract employees seeking access to a broader job market, more convenient access to higher-paying jobs, and more affordable housing options.[26] In recent surveys, despite the easing of pandemic restrictions, over one-third of companies surveyed indicated they had remote employees who were not remote pre-COVID, almost half the companies surveyed provided full-time remote work options, and another forty-two percent were considering adding them.[27] In another survey of remote workers, one in three surveyed said they would quit their jobs if they were no longer able to work remotely.[28] All of this means that businesses must now consider remote work options as a means of attracting talent and remaining competitive in a tight job market.[29]

1. Popularity with Employees

Before the start of the COVID-19 pandemic, workplaces were increasingly offering remote work options where it was possible.[30] The option to work from home is popular because it allows employees to avoid long commute times and spend more time with their families, thereby increasing morale and job satisfaction.[31] After the pandemic forced millions of workers to abruptly shift to a work-from-home model, many professionals who had previously worked in a mostly office-based model reported an improved work-life balance, increased comfortability with

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[25] *See* discussion *infra* Sections 2.A–G.

[26] Ethan Oldham, *2022 Remote Work Trends*, LIGHTCAST (Jan. 31, 2022), https://www.economicmodeling.com/2022/02/01/2022-remote-work-trends/.

[27] *Id.*

[28] *Id.*

[29] *Id.*

[30] Ryan Golden, *Most US employers with flexible work plans choose hybrid work, Mercer says*, HR DIVE (July 14, 2021), https://www.hrdive.com/news/most-us-employers-with-flexible-work-plans-choose-hybrid-work-mercer-says/603304/.

[31] Rani Molla, *Many people don't want to work unless it's from home*, VOX (June 24, 2021 8:20 AM), https://www.vox.com/recode/22543409/remote-work-from-home-jobs-supply-demand-hiring-platforms.

technology, and improved relationships with colleagues.[32] Many even reported willingness to take a pay cut, forfeit benefits, or even quit their job in order to avoid returning to the office full-time.[33] Employees working in remote jobs tend to earn higher salaries as well, although this is likely a reflection of the intense competition for such jobs and the fact that they are concentrated in high-education, white-collar fields.[34]

2. Attracting Talent

Along with increased employee satisfaction, offering remote work options potentially allows employers to attract larger numbers of qualified, loyal, and hardworking prospective employees.[35] With significant labor shortages in the current job market in the wake of the COVID-19 pandemic,[36] employers who are able to offer flexible remote work options are more able to attract applicants, with one survey indicating that 85% of workers preferred applying to jobs with remote work flexibility.[37] Given that many of the workers surveyed were willing to quit their job or take a pay cut to continue working remotely, this appears to be one of the most significant factors affecting the decision to apply for jobs in fields that are compatible with remote work.[38]

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[32] Robert Half, *COVID-19 and the Workplace: Employees Weigh In*, ROBERT HALF (Apr. 30, 2020 5:00 PM), https://www.roberthalf.com/blog/management-tips/covid-19-and-the-workplace-employees-weigh-in?utm_campaign=Press_Release&utm_medium=Link&utm_source=Press_Release.

[33] Sara Korolevich, *The State Of Remote Work In 2021: A Survey Of The American Workforce*, GOOD HIRE (Oct. 27, 2021), https://www.goodhire.com/resources/articles/state-of-remote-work-survey/.

[34] The 2017 State of Telecommuting in the U.S. Workforce, FLEXJOBS https://www.flexjobs.com/2017-State-of-Telecommuting-US/ (last visited Feb. 18, 2022); *see* Molla, *supra* note 31; Ethan Oldham, *2022 Remote Work Trends*, Emsi (Feb. 1, 2022), https://www.economicmodeling.com/2022/02/01/2022-remote-work-trends.

[35] *See* Korolevich, *supra* note 33.

[36] Stephanie Ferguson, *Understanding America's Labor Shortage: The Most Impacted Industries*, U.S. CHAMBER OF COMMERCE (Sept. 7, 2022), https://www.uschamber.com/workforce/understanding-americas-labor-shortage-the-most-impacted-industries.

[37] *See* Korolevich, *supra* note 33.

[38] *See id.*

3. Mobility and Flexibility

One important element of remote work that does tie into tax considerations is the increased mobility of a workforce that is no longer tied to a specific physical location.[39] Worker surveys have found that large numbers of workers would consider or are currently considering a move to a different area since commuting is now less of a factor in their housing location decision.[40] In fact, one Zillow survey found that as many as 66% of people surveyed would consider moving, many likely for affordability reasons.[41] As moving to a more affordable area may often mean a move to a different state,[42] this increasing trend could compound the tax issues implicated by these moves.[43]

4. Communication

Team collaboration and communication is one area where remote work presents challenges since the remote format upends the traditional format of office communication.[44] This can be an especially problematic challenge for companies with teams that are partially remote and partially in-office.[45] The fact that some workers may be in different time zones can also present a challenge for these teams.[46] However, with the large number of people forced to work remotely as a result of the COVID-19 pandemic, it appears that many of these issues have improved, as there has been a wider acceptance of solutions such as asynchronous communication.[47]

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[39] *See* Jared Walczak, *Eight Tax Reforms for Mobility and Modernization*, TAX FOUND. (Jan. 5, 2022), https://taxfoundation.org/remote-work-tax-reform-mobility-modernization/#Convenience.

[40] Zillow, *Remote Work Could Open Homeownership to Nearly Two Million Renter Households*, (Sept. 8, 2020), http://zillow.mediaroom.com/2020-09-08-Remote-Work-Could-Open-Homeownership-to-Nearly-Two-Million-Renter-Households.

[41] *Id.*

[42] *Id.*

[43] *See* Walczak, *supra* note 39.

[44] *State of Remote Work 2020*, BUFFER, https://buffer.com/state-of-remote-work/2020 (last visited Feb. 18, 2022).

[45] *Id.*

[46] *Id.*

[47] *Id.; see also* Najette Fellache, *How We Used Async Communication to Adapt to Global Change*, WEET, https://weet.co/blog/asynchronous-communication/using-asynchronous-communication-to-adapt/ (last visited Feb. 18, 2022).

5. Company Culture

Another difficulty in moving to a remote work model is that with physical distance from the workplace, remote workers can often lose sight of the shared values and social norms of their companies, making them feel more disconnected and less valued by their employers.[48] This can create business risks such as lower productivity and higher turnover, and can result in serious long-term effects to a business's reputation.[49] This makes it all the more important for businesses to safeguard and clearly communicate their company culture to their employees.[50]

6. Employee Well-Being

One of the side effects of remote work is isolation, which can contribute to a sense of loneliness.[51] On the other hand, many workers prefer remote work to reduce stress and contribute to their overall quality of life.[52] Recent studies indicate that several workers have experienced negative effects on their mental health as a result of the shift to remote work during the COVID-19 pandemic, with many reporting increased isolation, loneliness, and an inability to escape from work at home.[53]

7. Savings for Employers

As a result of the shift to remote work, many businesses have found little use for their vast commercial office spaces, this allows companies with large workforces to downsize and significantly reduce

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[48] Jake Herway & Adam Hickman, *Remote Work: Is It a Virtual Threat to Your Culture?*, GALLUP (Aug. 25, 2020), https://www.gallup.com/workplace/317753/remote-work-virtual-threat-culture.aspx.

[49] *Id.*

[50] *Id.*

[51] BUFFER, *supra* note 44.

[52] Brie Weiler Reynolds, *FlexJobs 2018 Annual Survey: Workers Believe a Flexible or Remote Job Can Help Save Money, Reduce Stress, and More*, FLEXJOBS, https://www.flexjobs.com/blog/post/flexjobs-2018-annual-survey-workers-believe-flexible-remote-job-can-help-save-money-reduce-stress-more/ (last visited Feb. 18, 2022).

[53] Bryan Robinson, *Remote Workers Report Negative Mental Health Impacts, New Study Finds*, FORBES (Oct. 15, 2021, 7:15 AM), https://www.forbes.com/sites/bryanrobinson/2021/10/15/remote-workers-report-negative-mental-health-impacts-new-study-finds/?sh=74d3e9a74b84.

expenditures.[54] The increased number of commercial real estate vacancies has also created opportunities for employers who may opt for shorter-term leases or perhaps find bargains on office space.[55] Other expenses, such as utilities and travel costs, may be reduced as a result.[56]

Though not always directly related to taxation considerations, these other business concerns are important to keep in mind when analyzing tax issues to focus on solutions that support an overall business strategy.[57] They are also important to consider when devising new tax policies that recognize the new reality of the remote work landscape.[58]

III. BACKGROUND: LEGAL BASIS AND GOALS OF STATE TAXATION

The ability to tax its citizens is one of the defining characteristics of a state.[59] The U.S. Supreme Court has said that "[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government."[60] Like federal income taxes, which are imposed on the worldwide income of U.S. citizens and not just on income earned

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[54] Justin Mahon, *The Impact Remote Work Is Having on Commercial Real Estate*, HILLDRUP (Mar. 5, 2021), https://www.hilldrup.com/tools-and-tips/blog/the-impact-remote-work-is-having-on-commercial-real-estate/.

[55] *Id.*

[56] *See id.*

[57] *Tax administration: Towards sustainable remote working in a post COVID-19 environment*, OECD (July 19, 2021), https://www.oecd.org/coronavirus/policy-responses/tax-administration-towards-sustainable-remote-working-in-a-post-covid-19-environment-fdc0844d/; *see generally* Erin E. Makarius, Barbara Z. Larson & Susan R. Vroman, *What Is Your Organization's Long-Term Remote Work Strategy?*, HARV. BUS. REV. (Mar. 24, 2021), https://hbr.org/2021/03/what-is-your-organizations-long-term-remote-work-strategy (discussing best practices and strategies for companies adopting remote work policies).

[58] *Tax administration: Towards sustainable remote working in a post COVID-19 environment*, *supra* note 57.

[59] Michael S. Kirsch, *Taxing Citizens in a Global Economy*, 82 N.Y.U. L. Rev. 443, 448–49 (2007).

[60] New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 313 (1937) (holding that while property in New Jersey was not taxable in New York, a New York resident's income derived from this property was subject to New York's taxing authority).

within the country,[61] states may tax their residents on their entire income, including income earned out of state.[62] Since income taxes are assessed as a percentage of income, this arrangement potentially allows for double taxation of a state resident's income when it is earned and taxed in another state, although the Supreme Court has limited the states' ability to do this.[63] While many states will grant these residents a tax credit for taxes paid on income earned in other states, this is not universal and is often subject to important limitations, such as limiting the credit to the residency state's tax rate.[64]

In addition to its own residents, a state may also tax the residents of other states on income earned within its taxing jurisdiction.[65] Therefore, income earned in multiple states will be allocated proportionally to the state where it is earned and subject to taxation in that state.[66] "Source income," or "income attributable to the state" where it is earned, "includes salaries earned in that state, partnership income from a partnership doing business in that state, investments held in that state, real estate income earned in that state, business income from a business in that state or

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[61] Kirsch, *supra* note 59, at 445. The U.S. is alone among developed nations in using citizenship as a basis for taxing income earned outside its borders, although it is subject to some limitations, such as exclusions for foreign earned income up to certain levels provided a number of residency tests are met. *Id.* at 446 n.7. The foreign tax credit is available to prevent double taxation for foreign income as well. *Id.* at 446 n.6.

[62] Shaffer v. Carter, 252 U.S. 37, 57 (1920) (holding that a business's activities and income arising from within the state of Oklahoma were taxable by the state of Oklahoma, even if a party managed the business from out of state).

[63] Comptroller of the Treasury v. Wynne, 575 U.S. 542, 545 (2015) (applying the internal consistency test to Maryland's tax statutes to find that the state's failure to give residents a full credit for taxes paid in another state violated the dormant Commerce Clause).

[64] *Id.*; Zelinsky, *supra* note 6.

[65] David Schmudde, *Constitutional Limitations on State Taxation of Nonresident Citizens*, 1999 DETROIT COLLEGE OF L. AT MICH. ST. L. REV. 95, 106 (2000).

[66] *Id.* For example, "[i]f a person is a resident of State A and earns income in State B, State B would tax what is termed the individual's State B source income[—]income derived in State B." *Id.* For instance, professional athletes, who play "away" games in many different cities and states, must often file tax returns in over a dozen different states for income earned in those states during those games. Andrew Osterland, *State Tax Departments Set Their Sights on Pro Athletes' Earnings*, CNBC (Jan. 11, 2021, 8:30 AM), https://www.cnbc.com/2021/01/11/state-tax-departments-set-their-sights-on-pro-athletes-earnings-.html.

income earned by a performer or athlete from activities in that state."[67] In a simple example where two states have similar tax rates and allocation policies, this is a relatively easy analysis, but it becomes significantly more complex when the different states involved have markedly different rates and policies.[68]

To prevent the double taxation of residents' incomes, states generally allow credits for taxes paid to another state.[69] In such cases, "[w]hen both the state of residence and the state of source have a legitimate claim to tax income, there are widespread understandings that the state of residence ordinarily yields to the state of source to avoid double taxation," although this is not necessarily required.[70] Indeed, several cities have imposed residence-based taxes "without offering full credits for taxes paid to other states on the same income," and it is possible that future state tax policies could attempt to ease the fiscal burden of providing services to their residents by shifting towards residence-based tax policies that do not offer these credits.[71]

A. *Constitutional Limits*

1. The Commerce Clause

States attempting to reach across their borders to tax the residents of another state implicates the Constitution's Commerce Clause, which

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[67] Schmudde, *supra* note 65.

[68] *See Wynne*, 575 U.S. at 546, 564–65 (discussing Maryland's tax scheme that included a "state" and "county" tax, with a credit towards taxes paid to other states that only applied to Maryland's "state" tax, not its "county" tax).

[69] Bradley W. Joondeph, *The States' Multiple Taxation of Personal Income*, 71 CASE W. RSRV. L. REV. 121, 135 (2020).

[70] *Id.* at 135–36 (quoting Walter Hellerstein, *Deciphering the Supreme Court's Opinion in* Wynne, 123 J. TAXATION 1, 4, 7 (2015)) (discussing the assertion among many leading experts that the Constitution requires the residence state to cede to the source state, and concluding that the Constitution does not mandate this result).

[71] *Id.* at 155. "At some point, states could find it important to distribute more equally the burdens of financing the state-funded goods and services to which their residents are entitled (and which they enjoy to the exclusion of nonresidents). States might wish to allocate these costs based simply on their residents' respective incomes, independent of where those incomes were earned. Equity in contributions to the public fisc might become a higher priority than protecting residents from duplicative state-level income taxes, or than taxing income earned in the state on the basis of source." *Id.*

prohibits states from interfering with the flow of interstate commerce.[72] This has been interpreted as preventing states from giving preferential treatment to their own citizens over those of another state, but not all discriminatory treatment is prohibited.[73] Discriminatory taxes have been approved where a state can show that the purpose of the tax is to increase services to the state's citizens or strengthen the market.[74] Under *Complete Auto Transit, Inc. v. Brady*, the following four-part test determines whether a state tax will withstand Commerce Clause scrutiny: (1) the tax must be applied to an activity with a substantial nexus to the taxing state, (2) the tax must be fairly apportioned, (3) the tax must not discriminate against interstate commerce, and (4) the tax must be fairly related to services provided by the state.[75] Under *Boston Stock Exchange v. State Tax Commission*, such taxes may not burden activities taking place outside the state, but if a transaction occurs entirely within the state imposing the tax, it falls under intrastate activity, and the state has complete authority to tax it.[76]

2. The Equal Protection Clause

Under the Equal Protection Clause, which guarantees every citizen equal protection of the laws, any tax that discriminates against a nonresident must pass rational basis scrutiny, meaning it cannot be based on arbitrary classifications.[77] Thus, taxes that discriminate against nonresidents must be rationally related to a legitimate state purpose and cannot be simply for the purpose of preventing nonresidents from participating in the state's market.[78]

3. The Privileges and Immunities Clause

The Privileges and Immunities Clause also provides a check on the ability of states to pass discriminatory taxes.[79] The Supreme Court has

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[72] Schmudde *supra* note 65, at 111.
[73] *Id.*
[74] *Id.* at 111–12.
[75] *Id.* at 112.
[76] *Id.* at 112–13.
[77] *Id.* at 113. Where a discriminatory tax reflects the added cost of doing business with nonresidents and nonresident businesses and does not act as a barrier to such businesses, this has been viewed as rationally related to a legitimate state purpose. *Id.*
[78] *See id.*
[79] *See id.* at 114–15.

defined "privileges and immunities of citizens" as referring to their "fundamental rights," which include the right to economic pursuits such as trade, commerce, and making a living.[80] This guarantee of fair treatment from other states fosters economic cooperation and limits cross-border conflicts such as retaliatory taxes, which can act as barriers to trade.[81] Legitimate exceptions, such as state subsidized social welfare services or increased tuition for out-of-state college students at publicly funded universities, primarily exist to eliminate free-rider problems, where out-of-state residents would otherwise be able to take advantage of in-state programs paid for primarily by residents' taxes.[82]

4. Judicial Perspectives on Cross-Border Taxation

In 2015, the Supreme Court weighed in on the constitutionality of double taxation of nonresident income in *Comptroller of the Treasury v. Wynne*, holding that the state of Maryland's failure to provide a tax credit for "special nonresident" taxes imposed in lieu of county taxes for nonresidents earning income within the state violated the Dormant Commerce Clause.[83] In this case, petitioners brought a challenge to Maryland's policy of offering a tax credit against their state income taxes but not providing a tax credit for county income taxes, which the state also collected.[84] The Supreme Court, focusing on the practical effect of the policy rather than its classification, found that the tax violated the Dormant Commerce Clause because it discriminated against interstate commerce by placing a higher effective tax burden on interstate commuters.[85] The Dormant Commerce Clause originated from the Commerce Clause, which grants Congress the power to "regulate Commerce . . . among the several states."[86] The Court has "consistently held this language to contain a further, negative command, known as the [D]ormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to

[80] *Id.*
[81] *See id.* at 115–16.
[82] *Id.* at 125.
[83] Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 (2015). Maryland imposed a two-part tax on nonresident income earned from in-state sources, and while they did provide a credit against the state income tax portion, they did not provide a credit against the county income tax portion, which the state also collected. *Id.* at 546. They also imposed a "special nonresident tax" on income earned by nonresidents who were not subject to the county tax, which was equal to the lowest county tax rate in the state. *Id.*
[84] *Id.*
[85] *Id.* at 567.
[86] U.S. CONST. art. I, § 8, cl. 3.

legislate on the subject."[87] This reflects concerns about the protectionism and economic "Balkanization" that occurred in the early days of the U.S. under the Articles of Confederation.[88] In short, states "may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State."[89] In this case, the Court found that Maryland's taxation scheme failed the internal consistency test, which examines the economic effects of tax schemes by "hypothetically assuming that every State has the same tax structure," allowing for isolation of the discriminatory effects of such policies.[90] Using this analysis, the Court found that Maryland's tax scheme was "inherently discriminatory and operate[d] as a tariff."[91] Critically, the Court examined the total burden on interstate commerce rather than the effect of the policy on any individual taxpayer in determining whether it met the internal consistency test.[92] However, the Court recognized that a scheme might be constitutional where double taxation results not from impermissible discrimination against interstate commerce, but "from the interaction of two different but nondiscriminatory and intentionally consistent [tax] schemes."[93]

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[87] *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179 (1995) (discussing the Court's Dormant Commerce Clause jurisprudence and collecting cases).

[88] *Wynne*, 575 U.S. at 548.

[89] *Id.* at 549 (quoting Armco Inc. v. Hardesty, 467 U.S. 638, 642 (1984)).

[90] *Id.* at 562.

[91] *Id.* at 565.

[92] *Id.* at 567–68. Justice Alito's opinion gives the following hypothetical to illustrate his point: "Assume that State A imposes a 5% tax on the income that its residents earn in State but a 10% tax on income they earn in other jurisdictions. Assume also that State A happens to grant a credit against income taxes paid to other States. Such a scheme discriminates against interstate commerce because it taxes income earned interstate at a higher rate than income earned intrastate. This is so despite the fact that, in certain circumstances, a resident of State A who earns income interstate may pay less tax to State A than a neighbor who earns income intrastate. For example, if Bob lives in State A but earns his income in State B, which has a 6% income tax rate, Bob would pay a total tax of 10% on his income, though 6% would go to State B and (because of the credit) only 4% would go to State A. Bob would thus pay less to State A than his neighbor, April, who lives in State A and earns all of her income there, because April would pay a 5% tax to State A. But Bob's tax burden to State A is irrelevant; his total tax burden is what matters." *Id.*

[93] *Id.* at 562.

B. *Goals of Taxation*

When examining tax policy, one important consideration is whether a given policy comports with the overarching goals of taxation.[94] The most obvious function is to raise revenue for government operations, without which no government could function.[95] This revenue is then used to provide services to the citizens of a taxing jurisdiction, such as "public schools, police protection, health and welfare benefits, and the operation of the state government."[96] Another function of taxation systems, albeit a controversial one, is the redistribution of wealth in an economic system.[97] Governments often use progressive tax policies to "[reduce] the unequal distribution of income and wealth that results from the normal operation of a market-based economy."[98] A third important function is regulatory, as governments often use taxation policy to encourage and incentivize private activity that aligns with governmental policy.[99] This can often be a more effective and efficient way of enacting regulatory schemes because these taxes can be tailored to the precise activities that are either desired or disfavored.[100]

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[94] Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1, 3 (2006) (discussing and framing policy arguments for replacing income taxes with consumption taxes by analyzing how these policies align with three of the main goals of taxation: raising revenue, redistribution of wealth, and soft regulation).

[95] *Id.* (giving an example of the Russian government of the late 1990s).

[96] *State and Local Taxes*, U.S. DEP'T OF THE TREASURY, https://www.treasury.gov/resource-center/faqs/taxes/pages/state-local.aspx (last visited Feb. 18, 2022).

[97] Avi-Yonah, *The Three Goals of Taxation, supra* note 94. "This function of taxation has been hotly debated over time, and different theories of distributive justice can be used to affirm or deny its legitimacy. What cannot be denied, however, is that many developed nations in fact have sought to use taxation for redistributive purposes, although it also is debated how effective taxation was (or can be) in redistribution." *Id.*

[98] *Id.*

[99] *Id.*

[100] Reuven S. Avi-Yonah, *Taxation as Regulation: Carbon Tax, Health Care Tax, Bank Tax and Other Regulatory Taxes*, 1 ACCT., ECON., & L, no. 1, 1, 4 (2011). For example, among various different methods of combating climate change, the "broad consensus among commentators [is] that carbon taxes are the most effective." *Id.*

Tax policy is an inherently political topic, and political concerns are central to any discussion of tax reform.[101] Generally speaking, political leaders are incentivized to maximize tax revenue to provide as many benefits as possible, while taxpayers wish to minimize their tax liability.[102] Monitoring of the relation between taxation and spending is important within democratic systems as there are political consequences for raising taxes, although the relationship is fairly loose in most modern states.[103] Changes in tax policy are more likely when:

> [P]oliticians . . . are least likely to pay an electoral cost for such behavior, that is, when it is a long time until the next election and when conditions make a tax increase relatively palatable to the electorate: (1) there is a fiscal crisis in state government and (2) other neighboring states have "bit the bullet" recently and adopted a tax.[104]

The ability to impose political consequences through elections, then, is an important tool of the electorate in ensuring the fairness of tax policy.[105]

One of the potential concerns with states taxing nonresidents is that since citizens of a different state have no voting rights, they have no say in how these taxes are implemented or in how tax revenue is spent.[106] While a person working in another state likely chooses to work in the taxing state because they are able to find higher-paying opportunities there, and may avoid such tax consequences by avoiding contact with the taxing state, the economic realities of such a situation may leave the non-constituent with little choice in the matter.[107] Since raising taxes is often

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[101] Edgar Kiser & Steven M. Karceski, *Political Economy of Taxation*, 20 ANN. REV. OF POL. SCI. 75, 76 (2017) (discussing the history of taxation and determinants of tax revenue).

[102] *Id.* at 79–80, 82.

[103] *Id.*

[104] Frances Stokes Berry & William D. Berry, *The Politics of Tax Increases in the States*, 38 AM. J. OF POL. SCI. 855, 855 (1994) (discussing the relationship between "political opportunity" and state tax innovations and changes and finding an empirical relationship between the two).

[105] Schmudde, *supra* note 65, at 109–10.

[106] *Id.* at 110.

[107] *Id.* "If a state is taxing at a higher rate than other states, its employers must pay premium labor rates to induce nonresidents to enter its [marketplace]. This raises the marginal cost of business, and encourages employers to move. This effect is higher in states which have major employment centers near the borders

an unpopular political decision, the incentive to tax nonresidents who are unable to appeal to state legislatures is also high.[108] Efforts on behalf of interstate workers in Congress have also failed to gain much traction.[109] The Multi-State Worker Tax Fairness Act was introduced in the House in June 2021,[110] and in the Senate in May 2021, but has not currently progressed any further in either branch.[111] Due to the complexity of these issues, and the competing state interests at stake, there are few readily available solutions.[112] However, as an increasingly mobile workforce transitions into a redefined, twenty-first century workplace, it will become more important to resolve these issues in a way that accounts for these changes and gives businesses the flexibility to innovate and continue to attract talent going forward.[113]

IV. CURRENT STATE OF THE LAW

In early 2020, as the COVID-19 pandemic began spreading in the U.S., thousands of businesses across the country began a hasty shift to remote work in response to emergency orders designed to limit face-to-face interactions and slow the spread of the virus.[114] For many, this was a relatively smooth transition to a more flexible work model that was already increasingly popular, but it also created complications for state and local

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of neighboring heavily populated states. In a city which is remote from state borders there is little or no effect. When a non-constituent has no economic power or choice, he or she is at the mercy of the other taxing authority." *Id.*

[108] *Id.* at 96–97.

[109] Holcomb, *supra* note 21, at 916–17. While Congress has sole authority to regulate interstate commerce, commuters have had difficulty finding relief through federal legislation, as Congress has intervened very sparingly in local and state tax matters in the last 200 years. *Id.* It is also disputed whether Congress could adequately protect the rights of interstate workers in this manner. *Id.*

[110] *Multi-State Worker Tax Fairness Act of 2021*, CONGRESS.GOV, https://www.congress.gov/bill/117th-congress/senate-bill/1887/text?q=%7B%22search%22%3A%5B%22S.1887%22%5D%7D&r=1&s=3 (last visited Feb. 19, 2022) (showing that the bill has been introduced in the House, but has not passed).

[111] *Id.* (showing that the bill has been introduced in the Senate, but has not passed).

[112] Schmudde, *supra* note 65, at 107.

[113] Holcomb, *supra* note 21, at 887.

[114] Lord, *supra* note 2, at 2.

income taxation.[115] To ease the transition, many states provided guidance allowing for temporary measures such as suspending nexus requirements, keeping withholding requirements unchanged, and not considering temporary changes to employees' work locations as altering the apportionment of their income during the pandemic.[116] However, the lack of guidance on how to treat remote workers has caused confusion and uncertainty for employers, who will have to continue to come up with solutions to these problems as remote work continues.[117] Research indicates that flexible work arrangements are here to stay.[118] Before the COVID-19 pandemic, as many as 80% of employees in one survey said they preferred jobs with the option to work remotely over jobs that didn't, and the pandemic has only accelerated employer adoption of these work formats.[119] Considering the number of benefits in the modern workplace for employers who offer remote work, including reduced turnover, increased employee job satisfaction, happiness, and productivity, it seems unlikely that this trend will slow in the near future. [120] For these reasons, it is important for employers to understand what changes in state and local tax policies can mean for their businesses.[121]

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[115] Mark F. Sommer, Daniel G. Mudd, & Elizabeth D. Mosley, *Kentucky Tax Talk: Pandemic Raises Telecommuting Issues*, LAW 360 (June 19, 2020), https://www.law360.com/articles/1284598/kentucky-tax-talk-pandemic-raises-telecommuting-issues.

[116] Chuck Jones, Lori Stolly and Patrick Skeehan, *10 State and Local Tax Predictions for 2021*, LAW 360 (Jan. 25, 2021, 4:57 PM EST), https://www.law360.com/articles/1348180/10-state-and-local-tax-predictions-for-2021.

[117] *Id.*

[118] Golden, *supra* note 30. In other studies, 74% of professionals surveyed expected remote work to become the new norm, and 76% of entrepreneurs surveyed agreed with this assessment, while 97% of employees surveyed said they did not want to return to the office full-time. Ashira Prossack, *5 Statistics Employers Need To Know About The Remote Workforce*, FORBES (Feb. 10, 2021), https://www.forbes.com/sites/ashiraprossack1/2021/02/10/5-statistics-employers-need-to-know-about-the-remote-workforce/?sh=174bc610655d.

[119] *Id.*

[120] Dragomir Simovic, *The Ultimate List of Remote Work Statistics - 2021 Edition*, SMALL BIZ GENIUS (June 11, 2021), smallbizgenius.net/by-the-numbers/remote-work-statistics/#gref.

[121] *See id.*

A. *Nexus Requirements*

Under the *Complete Auto Transit* test, the first requirement a state tax must meet is that the activity being taxed have "substantial nexus" with the taxing state.[122] This "substantial nexus" requirement is "'closely related' to the due process requirement that there be 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'"[123] In *Wayfair*, the Supreme Court settled the question of what constitutes a sufficient nexus in the context of states taxing online vendors by saying it is met where "the taxpayer purposefully 'avails itself of the substantial privilege of carrying on business' in that jurisdiction."[124] This, however, is not particularly helpful for businesses trying to make sense of the complex nexus requirements, which implicate both the Due Process Clause and the Dormant Commerce Clause.[125]

In the 1992 case *Quill Corp. v. North Dakota*, the Supreme Court separated the nexus analysis into a Due Process Clause analysis and a Dormant Commerce Clause analysis.[126] The Due Process prong of the analysis focused on the fundamental fairness of state taxation and providing notice to the taxpayer of the state's taxing jurisdiction.[127] This is satisfied "when the taxpayer purposefully avails themself of the state's marketplace and the state provides some benefit in return to the taxpayer."[128]

The Dormant Commerce Clause prong of the analysis, on the other hand, requires a "substantial nexus" with the taxing state, which involves "personal nexus" with the taxpayer and "transactional nexus" with the activity being taxed.[129] The *Quill* Court also articulated that personal nexus "could be, and perhaps must be, satisfied by physical

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[122] Schmudde, *supra* note 65, at 112.

[123] South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2093 (2018) (citation omitted) (holding that South Dakota was not prohibited from collecting sales tax from remote sellers outside the state selling products in the state, overturning the "physical presence" requirement, and finding that nexus for sales tax purposes may be established by virtual presence within the state).

[124] Hayes R. Holderness, *Navigating 21st Century Tax Jurisdiction*, 79 MD. L. REV. 1, 2 (2019) (quoting *Wayfair*, 138 S. Ct. at 2099).

[125] *Id.* at 3.

[126] *Id.* at 7 (discussing Quill Corp. v. North Dakota, 504 U.S. 298, 313 (1992)).

[127] *Id.*

[128] *Id.* at 8.

[129] *Id.* at 9.

presence of the taxpayer."[130] Most importantly, the Dormant Commerce Clause prong of the analysis is focused on whether the tax imposes burdens on interstate commerce.[131] Transactional nexus requires some local connection to the activity being taxed; for example, in *McLeod v. J.E. Dilworth Co.* and *General Trading Co. v. State Tax Commission of Iowa*, two cases where an out-of-state company shipped goods into the taxing state, the Supreme Court reached different results because one involved a sales tax being imposed when the sale took place in another state, and the other involved a use tax being imposed where the goods were clearly to be used within the state.[132] Though the analysis often focuses on whether the activity was local or interstate in nature, the Court's decisions have indicated that an activity must have some local connection in order to be subject to taxation by the state.[133]

In *Wayfair*, the Court abandoned the physical presence requirement for personal nexus, finding that the company's sales of over $100,000 into South Dakota showed that it met the requirement of availing itself of the "substantial privilege of carrying on business in South Dakota."[134] While the Court did not provide further guidance on what level of business was necessary to fulfill the personal nexus requirement, it did indicate that compliance costs and virtual presence were important factors in the analysis.[135] However, the Court effectively sidestepped the transactional nexus issue since both sides agreed that South Dakota had the authority to tax the transactions, leaving transactional nexus in online transactions open to interpretation.[136]

Against this backdrop, and in response to *Wayfair*, which allowed South Dakota to tax remote transactions, many states passed laws imposing taxes on these transactions, using specified guidelines to

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[130] *Id.* at 11.

[131] *Id.* at 12.

[132] *Id.* at 14 (referencing McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944) and General Trading Co. v. State Tax Comm'n, 322 U.S. 335, 338 (1944), where the different results were based on the classification of the tax and the purpose of the goods).

[133] *Id.* at 16.

[134] *Id.* at 20–21 (quoting South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018)).

[135] *Id.* at 21.

[136] *Id.* at 23.

determine what constitutes nexus for sales tax purposes.[137] However, the complications created by the COVID-19 pandemic and the rapid shift to remote work forced many states to provide temporary guidance on nexus requirements for companies with remote employees, with most states providing that employees working remotely within the state as a result of the health crisis did not create nexus for the purpose of state income taxation or corporate income taxation.[138] However, this temporary guidance has expired in most states,[139] meaning that businesses with workers who won't be returning to the office fully must now take greater care in keeping track of where their employees are working remotely and of their reliance on temporary relief measures.[140] As many of these deadlines have yet to expire, it remains to be seen how states will react to changes in the tax base as a result of the changing guidance.[141]

B. *State-Specific Rules*

1. The "Convenience of the Employer" Rule

New York's rule for sourcing income has been one of the more controversial rules among those imposed by states, reaching non-resident "income 'derived from sources in' New York, including income from a 'business, trade, profession or occupation carried on' in the state."[142]

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[137] *Id.*; *Economic Nexus and South Dakota v. Wayfair, Inc.*, AVALARA, https://www.avalara.com/us/en/learn/sales-tax/south-dakota-wayfair.html (last visited Oct. 9, 2022); *State-by-State Guide to Economic Nexus Laws*, AVALARA, https://www.avalara.com/us/en/learn/guides/state-by-state-guide-economic-nexus-laws.html#introduction (last visited Oct. 9, 2022).

[138] Tim Bjur, *2021 State Income Tax Nexus for Telecommuters*, WOLTERS KLUWER (Mar. 9, 2021), https://www.wolterskluwer.com/en/expert-insights/wbot-2021-state-income-tax-nexus-chart-for-telecommuters.

[139] *KPMG Report: Expiring Nexus and Withholding Relief in Multiple States (COVID-19)*, KPMG (Aug. 2, 2021), https://home.kpmg/us/en/home/insights/2021/08/tnf-kpmg-report-expiring-nexus-withholding-relief-multiple-states.html.

[140] *Id.*

[141] *Id.*

[142] Scott Brian Clark, *Generations Winter 2022 – Application of New York's 'Convenience of the Employer' Rule in Times of COVID-19*, DAY PITNEY LLP (Mar. 15, 2022), https://www.daypitney.com/insights/publications/2022/03/fog5-ny-convenience-of-employer-rule-covid19/; Yud Harrindranauth, James Thomas & Shawn Smith, *Working Remotely: Making the Convenience Rule Work for Telecommuting*, EY (July 13, 2021), https://www.ey.com/en_us/financial-services/tax/working-remotely-making-the-convenience-rule-work-for-telecommuting.

Nonresident remote employees of New York businesses are typically treated as having earned all income in New York, "regardless of where the employee lives."[143] New York's regulation states that "any allowance claimed [by nonresidents of New York] for days worked outside New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the services of his employer."[144] In short, this rule provides an exception to the general policy of allocating income to the state based on physical location.[145] Guidance from the New York State Department of Taxation and Finance stated in 2020 that "if you are a nonresident whose primary office is in New York State, your days telecommuting during the pandemic are considered days worked in [New York] unless your employer has established a bona fide employer office at your telecommuting location."[146] The requirements for establishing a "bona fide employer office" make this a very narrow exception, as employees must meet either one primary factor, that the "office contains or is near specialized facilities," or several other factors including the home office being a condition of employment, or that the "employer does not provide the employee with a designated office space at its regular places of business."[147] A number of other states have adopted variations of

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143 *Id.*

144 *Id.*

145 *Id.*

146 *Id.*

147 *Id.* Pursuant to New York Department memorandum TSB-M-06(5)I, for tax years beginning in 2006, a day of work spent at a home office is treated as a day worked outside of New York "if the taxpayer's home office is a bona fide employer office." To be considered "bona fide," an employer office must satisfy either (1) a primary factor or (2) at least four secondary and three other factors. The primary factor is that the "home office contains or is near specialized facilities." Secondary factors are the following: (1) the home office is a condition of employment, (2) the employer has a bona fide purpose for the home office location, (3) the employee performs core duties from the home office, (4) the employee meets or deals with clients regularly at the home office, (5) the employer does not provide the employee with a designated office space at its regular places of business and (6) the employer provides reimbursement of substantially all expenses for the home office. Other factors are (1) the employer maintains a separate telephone line for the home office, (2) the home office address is listed on business letterhead, (3) the employee uses a specific area of the home exclusively for the business, (4) the employee keeps inventory of products or samples at the home office, (5) business records are stored at the home office, (6) the home office has a sign indicating that it is a place of business, (7)

New York's rule, making this an important approach to consider.[148] Massachusetts' application of their similar emergency rule for income earned in other states during the COVID-19 pandemic has been the subject of litigation, and the results remain to be seen.[149]

2. Reciprocity Agreements

For people living or working in states applying some form of a convenience rule, there may be a reciprocity agreement in place between the residency state and the source state, especially if those states are close together, or are situated in such a way that it is common for employees to commute across state lines for work.[150] These agreements allow employers to withhold income tax based on the state of residency rather than the source state, so they will only be taxed in one state.[151] However, many states are not part of these agreements, and because they are generally based on physical proximity, these agreements may not cover as many remote work arrangements as may be desired.[152]

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advertising for the employer lists the home office, (8) the home office is covered by business insurance, (9) the employee is entitled to home office expense deductions and (10) the employee is not an officer of the company. *Id.*

[148] Sidney Kess, *Remote Work Arrangements: Payroll and Income Tax Issues for Employers and Employees*, CPA JOURNAL (Aug. 2021), https://www.cpajournal.com/2021/08/20/remote-work-arrangements/ (stating that Connecticut, Delaware, Nebraska, New Jersey, and Pennsylvania, in addition to New York, have adopted a convenience of the employer rule that makes a distinction based on whether the remote working situation is for the employer's convenience or the employee's).

[149] *Id.*; Darla Mercado, *Your Taxes Are Going to be Messy if You Worked in Another State During Covid-19*, CNBC (Sep. 8, 2020 3:26 PM EDT), https://www.cnbc.com/2020/09/08/hiding-from-the-pandemic-in-another-state-prepare-for-tax-probmes.html.

[150] Daniel Kurt, *Tax Residency Rules by State*, INVESTOPEDIA (Mar. 19, 2021), https://www.investopedia.com/tax-residency-rules-by-state-5114689#citation-9; *see also* Tonya Moreno, *States With Reciprocal Tax Agreements*, THE BALANCE, https://www.thebalance.com/state-with-reciprocal-agreements-3193329 (updated Mar. 23, 2022) (providing a list and interactive map of U.S. states which have income tax reciprocity agreements with other states).

[151] TaxAct, *States - Reciprocal Agreements*, TAXACT, https://www.taxact.com/support/17826/2020/states-reciprocal-agreements (last visited Feb. 19, 2022).

[152] *See* Moreno, *supra* note 150 (indicating that, as of March 23, 2022, sixteen states and Washington, D.C., had reciprocity agreements that would allow nonresident workers living in reciprocal states to avoid taxation).

3. Withholding Requirements

Withholding requirements for state income taxes were also subject to temporary guidance in the same timeframe as the temporary nexus guidance, with most states providing that employers with employees working remotely due to the COVID-19 pandemic would not be subject to different withholding requirements as a result.[153] As that guidance also expires, businesses will have to continue to adjust based on updated guidance, which some states have simplified to make it easier for businesses relying on cross-border reciprocity agreements.[154] However, the widely varying treatment of remote workers' income from state to state indicates significant challenges ahead for businesses in navigating the "new normal."[155] These differences have already led to sharp disagreements between states over where income should be properly sourced, with the Massachusetts-New Hampshire conflict being a prime example.[156] Massachusetts's temporary guidance provided that income of employees who had been working within the state prior to the COVID-19 pandemic would continue to be treated as Massachusetts-sourced income for nexus and withholding purposes, which prompted the neighboring state of New Hampshire to file a lawsuit with the U.S. Supreme Court, claiming that Massachusetts was taxing New Hampshire residents unconstitutionally.[157] While "the Court declined to hear the case as [an original jurisdiction matter],"[158] this issue will likely continue to come up because post-pandemic remote work appears to be here to stay.[159] This is especially true in states with large commuter populations, particularly

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[153] *Tax Challenges Expected from Widespread Remote Work*, GRANT THORNTON (July 29, 2021), https://www.grantthornton.com/library/alerts/tax/2021/SALT/general/tax-challenges-expected-from-widespread-remote-work-07-29.aspx.
[154] *Id.*
[155] *Id.*
[156] *Id.*
[157] *Id.*; *see* Darien Shanske, *Agglomeration and State Personal Income Taxes: Time to Apportion (With Critical Commentary on New Hampshire's Complaint Against Massachusetts)*, 48 FORDHAM URB. L.J. 949, 958 (2021); *see also* Harrindranauth, *supra* note 142 (explaining that New Jersey and Connecticut filed a joint amicus brief asking the Court to hold that these Massachusetts and New York taxation schemes are unconstitutional).
[158] GRANT THORNTON, *supra* note 153.
[159] *Id.*

those surrounding Massachusetts and New York, such as New Jersey and New Hampshire.[160]

4. Tax Credits and Exemptions

In response to these varied approaches to sourcing remote workers' income, some states have enacted new state income tax credits and exemptions for residents paying taxes on income sourced to other states.[161] Connecticut, for example, allowed residents a tax credit for income taxes paid to another state, such as New York, in an effort to prevent its residents from being subject to double taxation, however, this credit was to apply only to the 2020 tax year.[162] On the other hand, Louisiana has begun to offer a two-year, 50% income tax exemption for people establishing residence after December 1, 2021, to attract remote workers to the state.[163] This approach presents an interesting opportunity for states trying to expand their tax base.[164]

5. Business Income Tax Apportionment

In addition to changes in dealing with employees, businesses must also consider the changing guidance on apportionment of business income, which has also been subject to expiring temporary guidance from states.[165]

Apportionment of business income is needed to prevent double taxation where a business earns income in more than one state.[166] This is based on the unitary business principle, which arose during the nineteenth century in response to the growth of the railroad industry, and which allows states to tax the entire business, even if it earns income across several states.[167] At the time, the Supreme Court allowed states to use "any reasonable formula," giving them much flexibility in determining how to apportion business income.[168] In modern practice, most states use formula

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[160] *Id.*
[161] *Id.*
[162] *Id.*
[163] *Id.*
[164] *Id.*
[165] *Id.*
[166] Shanske, *supra* note 157, at 955.
[167] *Id.*
[168] *Id.*

apportionment based on three factors—in-state property, in-state payroll, and in-state sales—as a percentage of the business's totals.[169]

The move to remote work will likely sway these apportionment formulas because the in-state payroll calculations will change in states using payroll as a factor as states limit their temporary guidance.[170] While several states' temporary guidance provided that apportionment formulas would not change based on COVID-related remote work,[171] as states rescind COVID-related emergency orders, businesses will have to be aware of these changes if a significant portion of their workforce continues to work remotely in different states.[172]

V. ANALYSIS

A. *Tax Considerations for Companies with Remote Workers*

1. Withholding Requirements and Tax Rates in Different Jurisdictions

While the COVID-19 pandemic forced many states to provide temporary guidance to shield businesses from the effects of transitioning to remote work,[173] that temporary guidance is now ending.[174] Where employees work remotely from places other than where a business is located—such as in other states, cities, or counties—complex challenges might arise for the business in meeting tax compliance requirements such as proper withholding for state income and payroll taxes.[175] Because even

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[169] Patrick Derdenger, *Arizona Corporate Income Tax of Multistate Businesses*, STEPTOE & JOHNSON LLP (2006), https://www.steptoe.com/images/content/1/5/v1/1591/2551.pdf.

[170] GRANT THORNTON, *supra* note 153.

[171] Elizabeth Smith, Isabelle Farrar & Andrew Yarrows, *Key Tax Considerations for Cos. with Remote Employees*, LAW 360 (Aug. 3, 2020, 5:19 PM), https://www.law360.com/articles/1296841/key-tax-considerations-for-cos-with-remote-employees.

[172] *See id.*

[173] Jones, Stolly & Skeehan, *supra* note 116.

[174] KPMG, *supra* note 139.

[175] *See* Julia E. Judish & Ian S. Wahrenbrock, *Pandemic Work-from-Home Arrangements Have Tax and Employment Law Consequences*, PILLSBURY L. (Nov. 30, 2020), https://www.pillsburylaw.com/en/news-and-insights/Remote-Work-Tax-Employment-Concerns.html; *see also* GRANT THORNTON, *supra* note 153.

a single worker using a home as an office may establish nexus for taxation purposes, employers must be careful to keep track of where each employee works and what the current guidance is for each state.[176]

Some permanently remote employees may choose to move to states with more favorable tax structures, especially for financial reasons.[177] In addition to changing a business's withholding requirements for state income tax purposes, this could also affect a business's income tax liability because the nexus created by workers relocating to another state would also apply to apportionment formulas for business income taxes.[178]

2. Business Income Tax Apportionment

The income of a multijurisdictional business must be apportioned among the states it does business in to prevent double taxation and to fairly allocate the burden of doing business in a given state.[179] Similar to individual state income tax rules, many states provided temporary guidance allowing businesses to disregard remote workers working from different locations than they usually would for apportionment purposes, while other states announced there would be no changes, forcing businesses to adapt to these changes during the pandemic.[180] In addition to the challenges faced by businesses in complying with the rules as a result of these changes, taxing jurisdictions may also face challenges such as revenue shortfalls if there are significant changes to the tax base as a result.[181]

3. Registration in Other States

Businesses with remote workers in other states should be aware that the nexus imposed by employees in other states they do not otherwise do business in might require them to register as a foreign corporation in

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[176] Judish & Wahrenbrock *supra* note 175; Smith, Farrar & Yarrows, *supra* note 171.

[177] *See* ZILLOW, *supra* note 40.

[178] *See* Derdenger, *supra* note 169.

[179] Shanske, *supra* note 157, at 955.

[180] Gell, *supra* note 3, at 4–5.

[181] *Id.* at 3–4.

those states, which could impose additional regulatory and administrative costs on those businesses.[182]

4. Temporary Measures

Due to the rapid transition to remote work during the COVID-19 pandemic, state legislatures enacted a set of temporary measures to allow businesses to continue operating with as little confusion as possible in regards to income sourcing rules.[183] However, states included specific end dates when they enacted these temporary measures, many of which have now expired or are soon expiring.[184] A number of states provided guidance to ease the transition for businesses, while some, such as Massachusetts and New York, took more aggressive approaches, relying on a "convenience-of-the-employer" rule that treated income previously sourced to the state as still sourced to the state, even if the worker was in a different state.[185] In other states, a remote worker's presence for even a single day could be enough to trigger income, franchise, and other business taxes, while other states provided guidance that remote worker presence would not establish nexus that did not already exist.[186] Other states were more specific with respect to categories of taxes, as some stated that nexus would be waived for corporate taxes only.[187]

B. *State Conflicts*

The aggressive approach of states using the convenience-of-the-employer rule has led other states to claim that this is an overreach of state taxation powers.[188] However, the approach of states like Massachusetts and New York may align more closely with recent Supreme Court decisions such as the *Wayfair* decision, which abolished the physical presence requirement for nexus, finding that virtual presence within a state is enough for a business to establish nexus for tax purposes.[189] This holding

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[182] Sandra Feldman, *Does a Remote Workforce Trigger Foreign Qualification Requirements?*, WOLTERS KLUWER (Aug. 25, 2021), https://www.wolterskluwer.com/en/expert-insights/does-a-remote-workforce-trigger-foreign-qualification-requirements.

[183] Jones, Stolly & Skeehan, *supra* note 116.

[184] KPMG, supra note 139.

[185] Kupiec, *supra* note 7; Zelinsky, *supra* note 6.

[186] Gell*, supra* note 3, at 5.

[187] *Id.*

[188] Zelinsky, *supra* note 6.

[189] Shanske, *supra* note 157, at 954–55.

raises two questions: (1) whether there should be separate standards for businesses and individuals,[190] and (2) what those standards should be,[191] given that the world is increasingly online.[192] State residence is more meaningful for individuals than businesses.[193] However, the prevalence of virtual work and the ability to virtually perform many everyday tasks suggest physical presence is an outdated standard for establishing nexus.[194] While the Supreme Court denied certiorari in the case of *New Hampshire v. Massachusetts*, the controversy is likely far from over because, according to the United States, the issues "would more appropriately be considered on developed factual records concerning affected individuals and with the benefit of authoritative interpretations of the relevant tax provisions by Massachusetts courts."[195] Since the residents of New Hampshire being adequately positioned to litigate was also likely a reason the Supreme Court denied review, it is probable that this case will resurface in some form.[196]

The physical presence standard aligns more closely with one of the most important goals of taxation: funding state governmental services of which the residents of the state are the primary beneficiaries.[197] However, states like New York have pointed to a perceived lack of compliance regarding "[individuals] living and working in New York (for at least part of the year), but filing as residents of another state in which a home is maintained."[198] *Zelinsky v. Tax Appeals Tribunal* explains that

> [t]he convenience test was originally adopted to prevent abuses arising from commuters who spent an hour working at home every Saturday and Sunday and then claimed that two[-]sevenths of their work days were non-New York days and that two[-]sevenths of their income was thus non-New York income, and either free of tax (if

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[190] *Id.* at 959.

[191] Shanske, *supra* note 157.

[192] *Id.* at 950.

[193] *See id.* at 959.

[194] *Id.*

[195] Kupiec & Nagle, *supra* note 7 (quoting Brief for the United States as Amicus Curiae, New Hampshire v. Massachusetts (2021) (No. 22O154)).

[196] *Id.*

[197] Avi-Yonah, *The Three Goals of Taxation, supra* note 94, at 3.

[198] Shawn Novak, *State individual income taxes: basic concepts and planning considerations*, CPA JOURNAL (Sept. 1993), http://archives.cpajournal.com/old/14476921.htm

> the state of their residence had no income tax) or subject to a lower rate than New York's.[199]

The *Zelinsky* court noted that the work the petitioner performed at home was "inextricably intertwined" with New York because his income came from teaching students in New York and that the school hired him to do these duties in New York.[200] It explained that although he was not living in the state, his relationship with New York allowed him to earn an income, and that he received "a host of tangible and intangible protections, benefits and values to the taxpayer and his employer" as a result of this relationship, entitling the state to fairly apportion his income there.[201] The court also expressed a reluctance to "subsidize such personal convenience" while simultaneously "discouraging commuting into New York City and facilitating erosion of the tax base."[202] This illustrates a significant challenge in the shift to remote work: states and cities that have invested resources in attracting businesses and building their economies may face large reductions in their tax base from residency-based sourcing rules, disincentivizing future investment.[203]

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[199] Zelinsky v. Tax Appeals Tribunal, 801 N.E.2d 840, 846 (N.Y. 2003).
[200] *Id.* at 846.
[201] *Id.* at 848. The *Zelinsky* court explains:

> The taxpayer is able to earn his salary . . . because of the benefits he receives . . . from New York. He benefits directly from an employment opportunity and an office here. He benefits from a salary on every day that he works, which he is able to earn entirely within this state . . . . [E]ven his scholarly writings, drafted at home, attach prominence to his position as a professor at Cardozo Law School. New York thus provides a host of tangible and intangible protections, benefits and values to the taxpayer and his employer, including police, fire and emergency health services, and public utilities. Petitioner's election to absent himself from the locus of his New York employment does not diminish what New York provides in order to enable him to earn that income.

Id.
[202] *Id.* at 847.
[203] *See id.*

C. *Legislative Solutions*

Introduced in 2021 in both chambers of Congress, the Multi-State Worker Tax Fairness Act of 2021, sponsored by senators from Connecticut and New Hampshire, attempts to address these issues by preventing states from applying convenience-of-the-employer rules.[204] This would require states to tax based on physical presence alone, which would significantly simplify the application of sourcing rules, give taxpayers greater predictability, and encourage the adoption of remote work.[205] However, this legislation has not progressed through Congress and currently has an uncertain future, given that Congress has historically been hesitant to interfere with state and local taxation policies.[206]

D. *Other Possible Solutions*

Such complex state tax disputes are not amenable to easy solutions, as any potential solutions must balance a multitude of state sovereignty and revenue interests, as well as the Dormant Commerce Clause and Due Process Clause rights of citizens.[207] In addition, solutions should address the rapidly accelerating trend of remote work, as well as the increasingly virtual nature of the world we live in, creating workable standards for businesses and individuals in the years to come.[208] The physical presence standard that is favored by states with large commuter and remote worker populations, such as New Hampshire and Connecticut, may require a twenty-first century update to reflect the changing nature of the economy.[209] However, the "convenience rule" used by states like New

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[204] *Multi-State Worker Tax Fairness Act of 2021*, *supra* note 110 (proposing an amendment to title 4 of the United States Code that would "limit the extent to which States may tax the compensation earned by nonresident telecommuters and other multi-State workers").

[205] *Himes, Pappas, Kuster, Hayes Introduce Multi-State Worker Tax Fairness Act*, CONGRESSMAN JIM HIMES (June 30, 2021), https://himes.house.gov/2021/6/himes-pappas-kuster-hayes-introduce-multi-state-worker-tax-fairness-act.

[206] Holcomb, *supra* note 21, at 916–17; *see Multi-State Worker Tax Fairness Act of 2021*, *supra* note 110.

[207] *See supra* Part III.1.

[208] Thomas Locher, *Exploring How Remote Work Could Impact the Way Countries Tax Individuals*, TAX FOUND. (July 6, 2021), https://taxfoundation.org/remote-work-tax-revenue/.

[209] *See Multi-State Worker Tax Fairness Act of 2021*, *supra* note 110 (showing legislation sponsored by senators from New Hampshire and Connecticut, two states with particularly large commuter populations).

York appears flawed and could create problems in the future if nexus continues to be based on where employees used to work rather than the nature of their current work.[210] With the Supreme Court's application of the internal consistency test in *Comptroller of the Treasury v. Wynne*, it is possible the Court might extend this reasoning from the commuting context to the remote work context, given the conflicts that may arise from the application of different tax rates in these situations.[211]

One suggested approach, using apportionment formulas similar to those used to apportion business income, also merits consideration; however, determining the optimal factors to consider could be challenging and potentially much more complex for taxpayers to apply than physical presence apportionment.[212] Any apportionment formula would likely need to be modified in order to best serve the needs and interests of states, businesses, and individuals which must determine how to apply it.[213] A modified individual income apportionment formula would have to use apportionment factors that are readily available and easily quantifiable in order to minimize compliance costs.[214] While there are no widely accepted factors at present, adding a factor to the physical location analysis, such as the proportion of the employee's business being conducted with persons and entities in their home state versus in their employer's state, might

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[210] Walczak, *supra* note 39, TAX FOUND. (Jan. 5, 2022), https://taxfoundation.org/remote-work-tax-reform-mobility-modernization/#Convenience.

[211] *See id.*; *see also* Zelinsky, *supra* note 6; Comptroller of the Treasury v. Wynne, 575 U.S. 542, 567 (2015). The reasoning behind the Supreme Court's holding in *Wynne* could be applied to the remote worker context since remote workers and commuters are similarly situated and potentially subject to the same double taxation. *See Wynne*, 575 U.S. at 567.

[212] Holcomb, *supra* note 21, at 895. While states have consistently applied business income tax apportionment formulas for years, they have never used these types of formulas to apportion individual income taxes, likely because apportionment of individual income has historically been less important. S*ee also* Robert J. Peroni, *Back to the Future: A Path to Progressive Reform of the U.S. International Income Tax Rule*, 51 U. MIA. L. REV. 975, 984 (1997) (arguing that modern business activities such as global trading, electronic commerce, and communications technology advances will move the international tax system toward residence-based taxation in the future).

[213] Holcomb, *supra* note 21, at 895.

[214] Scott A. Hodge, *The Compliance Costs of IRS Regulations*, TAX FOUNDATION (June 15, 2016), https://taxfoundation.org/compliance-costs-irs-regulations/ (discussing the high cost of compliance with increasingly complex IRS regulations).

relieve some of the concerns states have expressed when applying convenience-of-the-employer rules, although the predictability and workability of such a rule could be problematic.[215]

VI. CONCLUSION

The potential double taxation of remote workers' income that might occur through application of convenience-of-the-employer rules presents unexpected tax consequences to businesses and employees taking advantage of widely available and desirable remote work arrangements.[216] To encourage and incentivize innovation, states should work to find solutions that balance these concerns while providing predictability and workability for taxpayers to reduce compliance costs and attract business.[217] Residence-based and physical location-based income sourcing provide some of the simplest and most workable methods, but the current ability of states to tax further than that, up to the constitutional limit via convenience rules, causes state income tax sourcing policies to conflict, creating confusion for taxpayers and businesses.[218] While efforts in court on behalf of physical-location sourcing states have so far proved unsuccessful, the Supreme Court may step in soon to clarify the constitutional limits of such policies, as the Court has recently taken up commuter taxation cases and may see the need to extend that reasoning to the remote work context.[219] Legislation that would prevent states from applying convenience rules would likely be the ideal solution, but appears unlikely to pass in the near future given Congress' reluctance to pass legislation protecting interstate workers.[220] In the meantime, businesses and employees should be aware of local and state income sourcing policies for remote work and should take special care to keep track of remote workers' locations for the purposes of sourcing and withholding.[221] Finally, when choosing whether and to what extent to adopt remote work policies, businesses should be aware of all the legal and non-legal costs and benefits of remote work in order to make the most informed decisions.[222]

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[215] Walczak, *supra* note 39.

[216] Comptroller of the Treasury v. Wynne, 575 U.S. 542, 564 (2015); *see also* Locher, *supra* note 208.

[217] Hodge, *supra* note 214.

[218] Walczak, *supra* note 39.

[219] *See Multi-State Worker Tax Fairness Act of 2021*, *supra* note 110.

[220] Holcombe, *supra* note 21, at 916–17.

[221] AVALARA, *supra* note 137; Schmudde, *supra* note 65.

[222] Gell, *supra* note 3; *see also* Simovic, *supra* note 120.