Remote Workers: State and Local Tax Implications for Nonprofits

By: Steven Woolf

As COVID-19 thankfully appears to be receding, one significant byproduct of the pandemic for some employers still remains: the large increase in the number of employees who have been telecommuting, often for significant lengths of time and in a number of different jurisdictions. As businesses opened back up, a number of organizations, including nonprofits, continue to permit employees to telecommute, with some retaining this status on an indefinite basis.

Allowing employees to telecommute from states that differ from the traditional location of the business operation can create a host of issues for employers. The two biggest tax issues relate to income tax withholding and so-called “nexus.” In tax law, “nexus” is a term meaning that there’s a connection between a taxing authority, such as a state, and a business or nonprofit that is considered to be doing business in that state. The two issues are:

(1) Does the presence of employee(s) working from home create taxable nexus for the employer in that state? and

(2) Which state is owed income tax when an employee telecommutes from an out-of-state location?

These issues can be problematic for any employers, including nonprofits, especially those lacking sophisticated tax and reporting systems.

Nexus: For a state to impose income or sales tax on an entity, the state and the entity must have nexus. Many states provided “safe harbors” during the pandemic so that remote workers teleworking in that state for an employer in another state would not create nexus for either income or sales and use tax purposes. Now that many COVID-19 restrictions have been lifted, many of the nexus safe harbors are also expiring, even as many staff members continue to work remotely. As a result, employers are well-advised to talk with their professional advisors to determine if there are out-of-state filing requirements as a result of a newly mobile workforce.

Income Tax Withholding: Each state has its own rules for income tax withholding (other than Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming, where there is no income tax). The general rule is that an employer must withhold income tax in the state where the work is physically performed. There are, however, exceptions to this rule, including so-called “threshold requirements” based either on number of days worked, amount of income earned, or both.

A further complication can be the application of the “convenience of the employer” rule that is applied by several states such as Connecticut, Delaware, Nebraska, New York, and Pennsylvania. Under the convenience rule, in-state workdays include not only those on which the employee was physically present in the state, but also days the employee worked out of state *unless* they were working out of state “for the necessity of the employer and not the convenience of the employee.”

State Approaches to Pandemic Remote Work. A number of states provided special income tax withholding rules to address the “temporary” situation during the COVID-19 pandemic. For example:

- Nonresidents who were working in Massachusetts “immediately prior to the Massachusetts COVID-19 state of emergency,” but who are “performing services from a location outside Massachusetts due to a pandemic-related circumstance,” generally must treat income earned for those services as having been earned in Massachusetts.
- In Georgia, wages earned by employees temporarily working in that state during the pandemic were not considered Georgia income, although this

guidance was limited to the period where there was a government work-from-home order or where work from home was ordered by a physician.
- Illinois clarified that out-of-state employers must withhold income tax for employees who normally work outside Illinois but who have worked for more than 30 days in Illinois.

Again, the bottom line for nonprofit employers with out-of-state workers is: consult with professional advisors to assure that your nonprofit is in compliance with these changing rules.

In the long term, professional employer organizations, or PEOs, can be one solution to the complexities of having remote staff, especially for smaller nonprofits. For nonprofits that foresee having employees continuing to work in multiple states, a PEO can be an affordable solution to simplify compliance and expand the range of benefits offered at the same time. This article from 2019 is more timely than ever as many people seek a long-term remote work arrangement.

While remote employees aren't an option for all nonprofits, where it is a possibility, it can help alleviate staffing shortages and open up the pool of potential applicants. Just keep in mind the importance of having systems in place to ensure compliance as you bring on more remote employees.

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