

30th Annual Tax Symposium
November 13, 2021

**THE PANDEMIC WORKFORCE: TAX IMPLICATIONS OF PERKS
PROVIDED BY EMPLOYERS ENTICING TOP TALENT**

By: Kaitlin Brown, Esq.

- I. Remote Work: the Out-of-State Tax Conundrum
 - A. Questions to consider when evaluating states where entity may have tax obligations:
 1. Where is the employer doing business?
 2. Where is the employer registered to do business?
 3. Where is the employer paying employment taxes?
 - B. Locations to consider in registering for taxes
 1. Headquarters
 2. Satellite offices
 3. What about remote employee offices?
 - C. Case study: Michigan employer permitted an employee to work remotely from Remote State during the pandemic because it was the employee's "happy place in the woods." The employer tried to register as doing business in Remote State but was unable to accomplish this task in 2020 for reasons that were no fault of the employer. Thus, it paid the appropriate taxes as if this individual were a Michigan employee. In 2021, when it successfully registered as doing business in Remote State, it began paying taxes on the employee who was working remotely in Remote State.
 1. **Problem:** Employee paid taxes as a Remote State resident starting in March 2020. Remote State claimed that employment taxes were due to Remote State, even though it hadn't even fully registered as a business operating in Remote State at the time.

2. **Solution:** This client had to request a refund from Michigan for the taxes paid from March 2020 through early 2021. In addition, it had to pay the appropriate taxes to Remote State and request a waiver of interest and penalties on the taxes that were owed in Remote State retroactively to March 2020.
3. **Key Arguments:** Registration of business was frustrated by pandemic, when everyone was trying to survive and get by day-to-day based on the ever-changing information and laws; good faith effort stunted by no fault of the employer when the government form included an incorrect fax number; it paid taxes to Michigan and therefore did not have use of the funds during the periods when the taxes were actually due to Remote State.

D. Examples of how states are handling taxes on remote workers

1. Business Tax

- a. Some states have *temporarily* waived the business tax nexus for COVID-19 related remote work
 - i. **Minnesota:** Minnesota Department of Revenue stated it “will not seek to establish nexus for any business tax solely because an employee is temporarily working from home due to the COVID-19 pandemic.”¹ This means that when an out of state employer has an employee working remotely in Minnesota, then Minnesota will NOT assert a business tax nexus against the out of state employer. However, MN residents who move out of state to work are still subject to MN income tax.
 - ii. **Indiana:** IN Department of Revenue stated it “will not use someone’s relocation, that is the direct result of temporary remote work requirements arising from and during the COVID-19 pandemic health crisis,” to assert nexus. Temporary protections may apply when an official work from home order has been issued by federal, state, or local government, or (until 6/30/21) a person is located in Indiana due to doctor’s order or COVID-19 diagnosis plus 14 days.²

¹ <https://www.revenue.state.mn.us/covid-19-faqs-businesses>

² <https://www.in.gov/dor/coronavirus-information/>

- iii. **D.C.:** Office of Tax and Revenue will not see to impose “tax nexus solely on the basis of employees or property used to allow employees to work from home ... temporarily located in the District during the period of the declared public emergency”³
 - iv. **Others:** New Jersey, Mississippi, Pennsylvania, and North Dakota have also issued guidance to waive business tax nexus. This is by no means a comprehensive list, but the point is that the applicable laws must be researched when an employee is working remotely.
- b. Municipal income tax
- i. Ohio municipal income tax⁴: an employee telecommuting at home or a location other than normal principal place of work due to COVID emergency and for 30 days after the emergency expires, the employee is deemed to work at the employer’s principal place of business.
- c. Employment-related taxes
- i. **“The Convenience Rule”:** Existed before the pandemic—if an employer is in one state, but the employee lives and works in another state out of convenience rather than because the employer requires it, then the employee owes income tax to the state where the job is based as well as the state they are domiciled.

³ Office of Tax and Revenue Notice 2020-07 (September 3, 2020).

https://otr.cfo.dc.gov/sites/default/files/dc/sites/otr/publication/attachments/COVID-19_EMERGENCY_INCOME_AND_FRANCHISE_TAX_NEXUS_UPDATE_Clean002.pdf

⁴ HB 197 - Am. Sub. H. B. No. 197 Section 29. https://search-prod.lis.state.oh.us/solarapi/v1/general_assembly_133/bills/hb197/EN/06?format=pdf

ii. Five states imposed this rule – Arkansas,⁵ Delaware,⁶ Nebraska,⁷ New York,⁸ and Pennsylvania⁹

(A) Arkansas eliminated this rule in 2021¹⁰

(B) Connecticut only applies the rule on a reciprocal basis.¹¹

(C) New York did not relax this rule even during the pandemic.¹²

E. Conflicts in Taxation Responsibilities

1. Over the past year, in particular, there have been cases where taxes are being claimed both by the state where the employer does business and the state where remote employee is working
2. Case Study 1 (during pandemic): Massachusetts adopted a limited rule of convenience in which Massachusetts imposed its income tax on New Hampshire residents who worked at offices in Massachusetts immediately prior to the pandemic, but have been working remotely in New Hampshire during the pandemic.¹³ The tax did not impose new obligations on employers or employees due to COVID-19, but was an attempt to maintain the status quo by requiring employers to continue taxing employees working remotely as if the employees remained in Massachusetts.

⁵ Arkansas set out this policy in a legal opinion dated February 20, 2020. (<https://www.ark.org/dfa-act896/index.php/api/document/download/20200203.pdf>).

⁶ 30 Del. C. Section 1124(b) (pre-COVID rule). Temporary interpretation found here:

<https://revenuefiles.delaware.gov/2021/TIM%202021-2%20-%20treatment%20of%20remote%20work%20in%202020.pdf>

⁷ 316 Neb. Admin. Code 22-003.01C(1)

⁸ 20 N.Y.C.R.R. § 132.18(a)

⁹ 61 Pa. Code § 109.8

¹⁰ Senate Bill 484,

<https://www.arkleg.state.ar.us/Bills/FTPDocument?path=%2FBills%2F2021R%2FPublic%2FSB484.pdf>.

¹¹ Conn. Gen. Stat. § 711(b)(2)(C).

¹² <https://www.tax.ny.gov/pit/file/nonresident-faqs.htm#telecommuting> (specifically, the question beginning: “My primary office is inside New York State, but I am telecommuting from outside of the state due to the COVID-19 pandemic.”).

¹³ *New Hampshire v. Massachusetts*, US S Ct, No. 220154, filed Oct. 9, 2020

- a. **Problem:** New Hampshire alleged it was unconstitutional by imposing income tax on New Hampshire workers who lacked a significant connection with Massachusetts during the pandemic.
 - i. Note: This tax scheme is similar to the “rule of convenience” scheme already used in NY, PA, NB, DE, and AR
 - b. **Solution:** SCOTUS denied to hear the case, but the conflict ended on June 15, 2021 when Massachusetts ended its state of emergency and therefore the pandemic-related tax ended.
3. Case Study 2 (pre-pandemic): Telebright (incorporated in Delaware and with offices in Maryland) had full-time employee who developed and wrote software code from a laptop in New Jersey.¹⁴
- a. **Problem:** Was Telebright really considered as doing business in New Jersey?
 - b. **Solution:** The court held that yes, Telebright was considered “doing business” in New Jersey by applying multiple factors: The nature and extent of activities of the corporation in New Jersey; the location of its offices and other places of business; the continuity, frequency and regularity of activities of the corporation in New Jersey; the employment in New Jersey of agents, officers, and employees; the location of the actual seat of management or control of the corporation; and that the purposes of its organization are carried out in New Jersey by creating computer code that becomes part of Telebright’s web services. The Court found because the Telebright employee was working full-time in New Jersey creating a portion of Telebright’s product and the company benefits from all the protections New Jersey law affords to the employee, there was a sufficient nexus. Additionally, the court held there was no regulatory burden since it already withholds and pays New Jersey state income tax from her salary and is required to remain aware of New Jersey labor and anti-discrimination laws.
 - i. Note: The court considered the statutory text for finding a nexus to the state, due process considerations, and commerce clause

¹⁴ *Telebright Corporation, Inc. v. Director, New Jersey Div. of Taxation*, 25 NJ Tax 333 (2010), *aff'd*, 38 A.3d 604 (N.J. Supper. Ct. App. Div. 2012).

- c. **Key Takeaway:** The fact that the employer was fully aware that the employee was working full time in NJ was sufficient for the court to find a nexus. The court did not care that the employer did not intend to avail itself to NJ laws.

4. COVID-19 Pandemic Considerations

- a. These conflicts between state laws and imposition of out-of-state laws on the worker and the business directly affects employers who permit employees to work out of state during COVID-19.
- b. Employers should consider applicable state laws and case law to determine whether and which taxes may be owed in the state where the remote employee is working.

II. Stipends and Shift Premiums: the Gifts that Come Back to Bite

A. Fair Labor Standards Act requires overtime to be paid based on a non-exempt employee's regular rate.¹⁵

- 1. Regular Rate is defined as: "all remuneration for employment paid to, or on behalf of, the employee."¹⁶
- 2. Exclusions from regular rate:
 - a. **Certain Gifts on Special Occasions:** "sums paid as gifts; payments in the nature of gifts made at Christmas time or on other special occasions, as a reward for service, the amounts of which are not measured by or dependent on hours worked, production, or efficiency."¹⁷
 - b. **Paid Time Off and Expenses Properly Reimbursable by Employer:** "payments made for occasional periods when no work is performed due to vacation, holiday, illness, failure of the employer to provide sufficient

¹⁵ 29 U.S.C. § 207(a)(1).

¹⁶ FLSA Section 207(e).

¹⁷ FLSA Section 7(e)(1).

work, or other similar cause; reasonable payments for traveling expenses, or other expenses, incurred by an employee in the furtherance of his employer's interests and properly reimbursable by the employer; and other similar payments to an employee which are *not made as compensation for his hours of employment.*"¹⁸

- i. "Where an employee incurs expenses ... where he is required to expend sums by reason of action taken for the convenience of his employer, section 7(e)(2) is applicable to reimbursement or such expenses."¹⁹
- ii. To be properly excluded from an employee's regular rate under this section, the expense must be reasonable and if "disproportionately large, the excess amount will be included in the regular rate."²⁰
- iii. "Reimbursement of the actual or reasonably approximate amount of expenses that an employee incurs while furthering the employer's interest may be excluded from the regular rate. Examples include, but are not limited to: ... [c]ell phone plans."²¹
- iv. Payment of a convenience provided to employees is excludable as "other similar payment" under Section (e)(2) only if there is "no connection to hours worked, services rendered, job performance, or other criteria linked" to employee's work. These are often called "perks" and include gym memberships, wellness programs, parking benefits, tuition reimbursement/payments including payments for employee's family member, and others. This is true regardless of whether payment is made to employee, education provider, or a student-loan repayment program.
- v. "wellness programs, such as health risk assessments, vaccination clinics, nutrition and weight loss programs, smoking cessation, and financial counseling, and mental health wellness programs" are also considered "perks" [that] are excludable.

¹⁸ FLSA Section 7(e)(2).

¹⁹ 29 CFR § 778.217(a).

²⁰ 29 CFR § 778.217(c).

²¹ FLSA Fact Sheet #56A

- c. **Discretionary Bonuses:** “sums paid in recognition of services performed during a given period if ... (a) both the fact that payment is to be made and the amount of the payment are determined at the sole discretion of the employer at or near the end of the period and not pursuant to any prior contract, agreement, or promise causing the employee to expect such payments regularly.”²²
- d. **Certain Profit Sharing/Thrift or Savings Plan Payments:** “sums paid in recognition of services performed during a given period if ... (b) the payments are made pursuant to a bona fide profit-sharing plan or trust or bona fide thrift or savings plan, meeting the requirements of the Administrator set forth in appropriate regulations which he shall issue, having due regard among other relevant factors, to the extent to which the amounts paid to the employee are determined without regard to hours of work, production, or efficiency.”²³
- e. **Talent Fees:** “sums paid in recognition of services performed during a given period if ... (c) the payments are talent fees (as such talent fees are defined and delimited by regulations of the Administrator) paid to performers, including announcers, on radio and television programs.”²⁴
- f. **Irrevocable Payments Through Third Party Pursuant to Bona Fide Plan:** “contributions irrevocably made by an employer to a trustee or third person pursuant to a bona fide plan for providing old-age, retirement, life, accident, or health insurance or similar benefits for employees.”²⁵
- g. **Extra Compensation at Premium Rate for Excess Hours:** “extra compensation provided by a premium rate paid for certain hours worked by the employee in any day of workweek because such hours are hours worked in excess of eight in a day or in excess of the maximum workweek applicable to such employee under subsection (a) of this section or in excess of the employee’s normal working hours or regular working hours, as the case may be.”²⁶
- h. **Extra Compensation at Premium Rate for Working on Saturday, Sunday, or Regular Days of Rest, When Already at Least Overtime Rate:** “extra

²² FLSA Section 7(e)(3)(a).

²³ FLSA Section 7(e)(3)(b).

²⁴ FLSA Section 7(e)(3)(c).

²⁵ FLSA Section 7(e)(4).

²⁶ FLSA Section 7(e)(5).

compensation provided by a premium rate paid for work by the employee on Saturdays, Sundays, holidays, or regular days of rest, or on the sixth or seventh day of the workweek, where such premium rate is not less than one and one-half times the rate established in good faith for like work performed in no overtime hours on other days;²⁷

- i. **Extra Compensation at Premium Rate based on Contract, When Already at Least Overtime Rate:** “extra compensation provided by a premium rate paid to the employee, in pursuance of an applicable employment contract or collective-bargaining agreement, for work outside of the hours established in good faith by the contract or agreement as the basic, normal, or regular workday (not exceeding eight hours) or workweek (not exceeding the maximum workweek applicable to such employee under subsection (a) of this section, where such premium rate is not less than one and one-half times the rate established in good faith by the contract or agreement for like work performed during such workday or workweek; or”²⁸

- j. **Income from Employer-Provided Grants or Rights Based on Stock, if Certain Conditions are Met:** “any value or income derived from employer-provided grants or rights provided pursuant to a stock option, stock appreciation right, or bona fide employee stock purchase program which is not otherwise excludable under any of paragraphs (1) through (7) if—
 - i. (A) grants are made pursuant to a program, the terms and conditions of which are communicated to participating employees either at the beginning of the employee’s participation in the program or at the time of the grant;

 - ii. (B) in the case of stock options and stock appreciation rights, the grant or right cannot be exercisable for a period of at least 6 months after the time of grant (except that grants or rights may become exercisable because of an employee’s death, disability, retirement, or a change in corporate ownership, or other circumstances permitted by regulation), and the exercise price is at least 85 percent of the fair market value of the stock at the time of grant;

²⁷ FLSA Section 7(e)(6).

²⁸ FLSA Section 7(e)(7).

- iii. (C) exercise of any grant or right is voluntary; and
- iv. (D) any determinations regarding the award of, and the amount of, employer-provided grants or rights that are based on performance are—
 - (A) (i) made based upon meeting previously established performance criteria (which may include hours of work, efficiency, or productivity) of any business unit consisting of at least 10 employees or of a facility, except that, any determinations may be based on length of service or minimum schedule of hours or days of work; or
 - (B) (ii) made based upon the past performance (which may include any criteria) of one or more employees in a given period so long as the determination is in the sole discretion of the employer and not pursuant to any prior contract.”²⁹

B. Red Flags – Payments that are included in establishing regular rate upon which overtime is due:

1. **Cash in lieu of fringe benefits**³⁰

- a. When employers pay their employees a proportionate part of certain fringe benefits, such payments may be excluded from the regular rate under section 7(e)(2), provided that they meet the following criteria:
 - i. (1) they represent bona fide fringe benefits,
 - ii. (2) they are the cash equivalent of such benefits, and

²⁹ FLSA Section 7(e)(8).

³⁰ <https://www.govinfo.gov/content/pkg/FR-2019-12-16/pdf/2019-26447.pdf> (see pages 22 and 26).

- iii. (3) There is a clear understanding between the employer and employees that the payments are in lieu of such fringe benefits.³¹

This guidance goes on to state that there “should also be a designation on the payroll records that such payments are in lieu of the specific fringe benefits. However, the absence of such a designation per se will not cause such otherwise bona fide fringe payments to be considered part of the regular rate provided in fact that the tests set forth above are met.”

2. **Reimbursement of expenses for the benefit of employee:** Payments of expenses are only excludable when in furtherance of the employer’s interest. This could include cash in lieu of benefits (if not otherwise excludable), car allowance (if not business related), etc.
3. **Lifestyle spending accounts**³²
4. **Non-Discretionary Bonuses:** If a bonus is promised in terms of the fact of payment to be made or the amount of payment, then it must be included in the regular rate.³³ “The bonus, to be excluded under section 7(e)(3)(a), must not be paid pursuant to any prior contract, agreement, or promise.”
5. **Shift premiums otherwise not excluded (e.g., less than 1.5 times regular rate)**
6. **Split rates within a workweek.**
7. Key considerations if trying to avoid the stipend from increasing the regular rate upon which overtime must be paid:
 - a. Compensation for hours worked, services rendered, or performance **MUST** be included in the regular rate
 - b. If a payment is a wage supplement, even if it is not directly related to employee performance or hours it is still compensation for the purpose of “regular rate”

³¹ Section 32d03h of the Field Operations Handbook

³² <https://www.compt.io/perk-stipends-everything-you-need-to-know>

³³ 29 C.F.R. § 778.221(c)

- c. Determining whether a “perk” or benefit may be excluded is a case-by-case basis that is determined by reviewing the statute
- C. How to calculate regular rate upon which overtime is owed, when additional income must be included:
1. Determine pay at standard hourly rate (total hours x standard hourly rate)
 2. Determine shift premium pay (# of hours worked on shift x shift differential rate)
 3. Determine any additional compensation that must be included
 4. Establish total compensation (straight time pay + shift premium pay + other compensation)
 5. Calculate regular rate (total compensation/total hours)
 6. Calculate the overtime owed (regular rate x 1.5 x number of overtime hours worked)
 7. Calculate the total pay owed ((regular hours x regular rate) + (overtime hours x overtime rate) OR (total hours x regular rate) + (overtime hours x .5 of the regular rate)³⁴
- D. Even if not includable in regular rate, consider whether fringe benefits are taxable wages.³⁵ The general rule is that fringe benefits are taxable wages unless specifically excluded. The following are examples of some benefits that are potentially exempt from income taxes, Social Security and Medicare taxes, and FUTA according to IRS Publication 15-B:
1. Accident and health benefits.
 2. Achievement awards.
 3. Adoption assistance.

³⁴ 29 CFR § 778.110.

³⁵ https://www.irs.gov/publications/p15b#en_US_2021_publink1000193638

4. Athletic facilities.
5. De minimis (minimal) benefits.
6. Dependent care assistance.
7. Educational assistance.
8. Employee discounts.
9. Employee stock options.
10. Employer-provided cell phones.
11. Group-term life insurance coverage.
12. HSAs.
13. Lodging on your business premises.
14. Meals.
15. No-additional-cost services.
16. Retirement planning services.
17. Transportation (commuting) benefits.
18. Tuition reduction.
19. Working condition benefits.

III. Increased Salaries: the Need for Payroll Audits and Assessing Equitable Pay

A. Essentials for auditing payroll

1. Confirm proper classification of employee versus independent contractor

- a. IRS 20 factors test: This test has been synthesized into three basic categories that should be considered to confirm the appropriate classification as employee or independent contractor.
 - i. Behavioral Control – facts that show if the business has a right to direct and control what work is accomplished and how the work is done, through instructions, training or other means
 - ii. Financial Control – facts that show if the business has a right to control the financial and business aspects of the workers’ job. This includes: (1) The extent to which the worker has unreimbursed business expenses; (2) The extent of the worker's investment in the facilities or tools used in performing services; (3) The extent to which the worker makes his or her services available to the relevant market; (4) How the business pays the worker; and (5) The extent to which the worker can realize a profit or incur a loss
 - iii. Relationship of the Parties – facts that show the type of relationship the parties had. This includes: (1) Written contracts describing the relationship the parties intended to create; (2) Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay; (3) The permanency of the relationship; and (4) The extent to which services performed by the worker are a key aspect of the regular business of the company
- b. ABC Test: This test has been adopted by several states. It requires all of the following three factors be met for a worker to be considered an independent contractor:
 - i. The worker is not under the control of the employer for the performance of work.
 - ii. The work must not be within the usual course of the employer’s business.
 - iii. The worker must be “customarily engaged” in an independent trade or business that is the same as the work performed for this employer.
- c. DOL “Economic Realities” test: This test looks to whether an “employment relationship” by determining whether the individual is dependent on the business they serve. If so, that individual is an

employee. The DOL looks at several factors the Supreme Court has found to be significant:

- i. Whether the services of the worker are part of the basic business of the employer
- ii. The permanency of the relationship
- iii. How much the worker invests in facilities and equipment
- iv. How much control the employer has over the worker
- v. The worker's opportunity for profit and loss
- vi. The amount of initiative, judgment, or foresight the person needs to compete in the open market
- vii. The degree of independent business organization and operation.

B. If employee, confirm proper classification as exempt versus non-exempt employee.

1. To be exempt, the employee must have certain exempt duties (e.g., professional, executive, administrative, outside sales) and meet the salary basis test, when applicable.
 - a. **Professional:** Compensation on a salary basis at a rate not less than \$684/week; primary duty is performance of work requiring knowledge of advanced type in field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction OR requiring invention, imagination, originality or talent in recognized field.³⁶
 - b. **Executive:** Compensation on a salary basis at a rate not less than \$684/week; primary duties include management of the enterprise in which the employee is employed or of a customarily recognized department/subdivision thereof; customarily and regularly directs the

³⁶ 29 C.F.R. § 541.300

work of two or more employees; has authority to hire/fire other employees.³⁷

- c. **Administrative:** Compensation on a salary basis at a rate not less than \$684/week; primary duty is performance of office or non-manual work directly related to management/general business operations of the employer or employer's customers; primary duty includes exercise of discretion and independent judgement with respect to matters of significance.³⁸

 - d. **Outside Sales:** Making sales within the meaning of the Act or obtaining orders or contracts for services or for the use of facilities for which a consideration will be paid by the client/customer; and who is customarily and regularly engaged away from the employer's place(s) of business in performing such primary duty.³⁹ The salary basis test does not need to be met for outside salespersons.
2. If exempt:
- a. Confirm that the salary meets the minimum threshold, as applicable.
 - b. Establish as a distinct line items any incentive bonuses or commissions, to show that the salary is paid regularly and in compliance with the FLSA, without unlawful deductions.
3. If non-exempt:
- a. Confirm rate of pay articulated on the applicable basis (e.g., hourly rate, piece rate, or weekly salary with hourly expectation that results in an

³⁷ 29 C.F.R. § 541.100

³⁸ 29 C.F.R. § 541.200

³⁹ 29 C.F.R. § 541.500

hourly equivalent with obligation to report hours worked in excess of the expectation)

- b. Confirm that, when calculating overtime, you are using the proper overtime rate.
- C. Assess the various strata of employees, by position, years of experience, and other relevant factors to confirm whether pay is equitable for legitimate business reasons.
 1. Identify any significant gaps in pay and the respective reason for such discrepancies.
 2. Evaluate how and when to resolve pay gaps that do not have a legitimate basis. For example:
 - a. If discrepancy is based on time of hiring, such as the supply and demand of talent requiring a high rate of pay versus low rate of pay, then there was probably a legitimate reason for the discrepancy but also a need to reconcile the amounts to reinforce morale.
 - b. If differences are (whether intentionally or not) resulting in disparities based on a protected class (e.g., age, gender, race, ethnicity, etc.), then evaluate whether there is any implicit bias or structural problem with the onboarding process and reconcile the problem.
 3. Consider making adjustments either openly and directly mid-year or quietly through typical annual bonus/pay raise process.