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The trouble with telecommuting employees

GUEST COLUMN

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Technology has made it very easy for employees to work from home, even though "home" might be in a different state than where their employer is based. Although many companies allow employees to telecommute from their homes in other states, they may not realize that doing so might create income or sales tax obligations in the telecommuting state. A recent tax ruling from Colorado demonstrates this problem, and there would be a similar result in most other states where an employee may be telecommuting from.

The problem arises when an employee telecommutes from a state where his or her company does not have any other presence. In order for a company to be subject to that state's income or sales tax rules, the company must have "nexus" there. Take the example of a company based in South Florida that we'll call MiamiCo. MiamiCo has an office and manufacturing facility in Miami, but has no presence in any other state, doing all of its sales by telephone solicitation or advertising. Because MiamiCo has no office or employees in any other state, and does not send sales reps to any other state, it files income and sales tax returns only in Florida.

Let's assume that a MiamiCo employee who handles customer credit matters chooses to work from her condominium in Keystone, Colo., where she conducts business over the telephone and computer from 6 a.m. to 2 p.m. local time and then hits the ski slopes in the late afternoon.

The recent Colorado tax ruling says that the presence of a single telecommuting employee is adequate to establish tax obligations there. As such, MiamiCo would be obligated to file a Colorado income tax return and collect Colorado sales tax there. This position would also be taken by several other states.

Many companies are under the false impression that they are protected from such tax obligations by a federal law that limits states' ability to impose tax obligations on a company. However, this protection is very limited: It only applies when a company's sole contact with the "taxing state" is the presence of employees who only solicit sales, and it only applies to that state's income tax.

In our example, MiamiCo would not be eligible for this protection because the telecommuting employee works in the company's credit department. She does not solicit sales. Even if she did only solicit sales – thus allowing the company to rely on the federal law to protect it from state income tax filing requirements – MiamiCo would still have Colorado sales tax obligations on sales to customers made there.

It is also important to note that this federal law would not protect a company in a service-oriented business. (In other words, the law only applies to companies that sell tangible personal property.) Furthermore, it does not apply to a state that imposes a tax on gross receipts, like Texas, Ohio, Michigan or Washington, since the law only applies to a state tax on net income. As a result, the protection of this federal law is very narrow and would rarely completely protect a company from all tax obligations imposed by a "taxing state" if it allows an employee to telecommute from home there.

State governments are experiencing dire budget shortfalls and are aggressively pursuing all potential sources of revenue. Taxing authorities have the ability to cross-match W-2 information sent to a resident to determine if an employer is filing state returns. This is how many states might discover that a company like MiamiCo has employees telecommuting in their state.

To avoid potential state tax liability, companies should carefully analyze the tax ramifications of allowing an employee to telecommute from another state if it does not already have a presence in the telecommuting state.

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