Tax Implications of COVID-19 Telecommuting in Kentucky and its Border States

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As states continue to enforce and extend stay-at-home executive orders, and many businesses opt to allow or continue to require employees to work remotely, many questions have been raised as to tax implications for businesses that may have employees working from home in different states than the employer is located in. Whether it surrounds new withholding requirements, or establishing nexus for corporate income or business taxes, it is important for employers to stay up to date on guidance issued by states in which it now has employees working remotely.

While some states have provided express guidance on tax implications of telecommuting, many have remained silent on the subject. One important observation — many states maintain tax reciprocity agreements with surrounding states. Thus, if an employer is based in a state with a reciprocity agreement with another state in which it now has employees working from home, it will not be required to change its tax withholding practices. This is a very important element of this analysis.

The following provides the most recent guidance issued by Departments of Revenue as to the states' positions on the effect of telecommuting on tax liabilities in Kentucky and its surrounding states.

Kentucky

Like many other governors, Kentucky Governor Andy Beshear issued several executive orders in mid-March closing non-essential businesses and requiring those with the capability to work from home to do so. Following these executive orders and the growing impact of the COVID-19 pandemic, the Kentucky General Assembly passed Senate Bill 150 in an attempt to provide additional relief to struggling Kentucky individuals and businesses. Included in S.B. 150 was a variety of tax relief provisions including the power to waive

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various fees, applications and forms, instructions to the Department to adhere to federal tax filing and payment extensions, waiving all interest through the extended filing date, and power to extend filing deadlines for local Occupational License Tax returns.

While the Department of Revenue, Governor Beshear, and the General Assembly have provided significant tax relief and guidance during the COVID-19 pandemic, there has been *no expressly stated position* as to whether out-of-state employers will be required to withhold Kentucky income tax on those employees now working from home in the state. Kentucky borders seven states. Of those bordering states, Kentucky has reciprocity agreements with Indiana, Illinois, Ohio, Virginia, and West Virginia. While not bordering Kentucky, the state additionally has reciprocity agreements with Michigan and Wisconsin. States bordering Kentucky with no treaty in place are Tennessee and Missouri. This means that for any business resident in a state with a reciprocal agreement that now has Kentucky resident employees working remotely, the business will not be required to start withholding Kentucky income tax.

Kentucky has not issued any guidance on the tax implications of telecommuting. Nor has Kentucky issued guidance regarding telecommuting nexus for local occupational license taxes. Likewise, local governments have also largely failed to address this issue to date.

Illinois

The Illinois Department of Revenue has taken a stance on the other side of the table. Almost two months after Illinois Governor J.B. Pritzker issued a stay-at-home executive order for all Illinois residents, the Department of Revenue published an informational bulletin on May 19, 2020 providing that employers that have had employees working from home in Illinois for more than 30 days *will be* required to register with the Department and withhold Illinois income tax for that compensation. Though this may be an added strain on many employers, the Department also provided that it will waive all interest and penalties for out-of-state employers that fail to withhold income taxes for employees residing and working in Illinois due to the pandemic.

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Many have objected to the Department's position on this issue, finding it unfair that many other states have explicitly excluded telecommuting due to COVID-19 from withholding requirements and believing Illinois should do the same. This order also raises nexus related issues for the employer. Objectors to the Department's position have also argued that it is contradictory to issue tax relief to businesses and then impose additional requirements to out-of-state businesses. However, because of reciprocity agreements, this position does not apply to out-of-state employers based in Kentucky, Iowa, Michigan, or Wisconsin.

Indiana

The Indiana Department of Revenue has provided significant relief to Indiana taxpayers during the COVID-19 pandemic. Aside from its continued filing and payment deadline extensions, waiving use tax requirements for donated COVID-19 supplies, and its "Helping Hoosiers" program providing several extensions as well as debt collection and legal protest relief, the Department issued an FAQ addressing new withholding requirements due to the COVID-19 pandemic. A positive for employers, the FAQ provides that the Department will not use an employee's relocation that is the direct result of temporary remote work requirements due to the coronavirus "as the basis for establishing Indiana nexus or for exceeding the protections provided by P.L. 86-272 for the employer of the temporary relocated employee." It further provides that this guidance is applicable so long as there is an official federal, state, or local work from home order in place, or an employee is subject to an order by a physician in relation to the COVID-19 outbreak or due to an actual diagnosis of COVID-19, "plus 14 days to allow for return to normal work locations."

It is important to note, however, that the Department's FAQ is silent as to changes in withholding requirements, and the Department has not issued any separate guidance on this subject. However, if a company is based in Kentucky, Michigan, Ohio, Pennsylvania, or Wisconsin it is covered by the state's reciprocity agreement and thus does not need to make changes in its withholding practices due to COVID-19 telecommuting.

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Missouri

Missouri has not issued guidance as to how the presence of remote workers in response to state executive orders will affect tax liability either withholding or nexus, and it also does not have reciprocity agreements with other states.

Ohio

In addition to the Ohio Department of Taxation providing several different types of state and local tax deadline extensions, the Ohio legislature passed legislation addressing income tax issues for out-of-state employers with employees now working remotely in Ohio. House Bill ("H.B.") 197 modified the occasional entrant rules to provide that when determining whether an employer has exceeded the 20-day requirement, it should not count the days employees work from home during the COVID-19 emergency. It is important to note, however, that this provision only applies to *local* income tax withholding.

Ohio also has reciprocity agreements with Indiana, Kentucky, Michigan, Pennsylvania, and West Virginia, meaning any employer based in one of these states will not need to change its withholding procedures for Ohio residents.

Tennessee

While the Tennessee Department of Revenue has extended filing and payment deadlines for franchise and excise tax, several business tax filings, professional privilege tax, the Hall income tax, International Fuel Tax Agreement (IFTA) first quarter filings, liquor-by-the drink tax and alcoholic beverages consumption off premises, and vehicle registration, it has not expressly addressed the effect of telecommuting on tax filings. Additionally, Tennessee does not have any reciprocity agreements with surrounding states. So even though Tennessee does not impose an individual income tax, a Tennessee company with Kentucky resident employees working from home may have Kentucky income tax obligations because there is no reciprocal agreement between the states. Likewise, a

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Kentucky business with Tennessee resident employees working remotely may create nexus.

Virginia

Virginia, like Tennessee, has provided relief in the form of individual and corporate income tax filing and payment deadline extensions, interest and penalty waivers, and additional time to file sales tax returns, but it has not addressed implications of telecommuting employees. But, unlike Tennessee, Virginia has reciprocity agreements with the District of Columbia, Kentucky, Maryland, Pennsylvania, and West Virginia. Thus, employers in these states are relieved from withholding liability for their employees living and working in Virginia.

The Council On State Taxation ("COST") wrote a letter on April 21, 2020 asking Virginia Governor Ralph Northam to consider additional amendments to its budget bill to allow for additional COVID-19 tax relief such as withholding to continue at the employer location while employees shelter in place and to avoid nexus opportunism on the part of the taxing authorities. The letter provides, "Many individuals live in a jurisdiction different from where they work. State and local taxes based on the location of an employee should allow employers the option of continuing to treat employees as working at their regular work location for payroll tax purposes, including withholding personal income tax. Virginia should specify that the presence of an employee working in the State due to shelter-in-place restrictions will not create nexus for tax purposes in Virginia." To date, Virginia has not adopted these provisions.

West Virginia

West Virginia has not issued guidance as to what effect if any telecommuting in the state will have on withholding or nexus requirements. West Virginia has withholding reciprocity agreements with Kentucky, Maryland, Ohio, Pennsylvania, and Virginia.

Conclusion

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While it has been the goal of most states to provide assistance to taxpayers during this difficult time, as state revenues continue to plummet, some states that have thus far remained silent on the telecommuting issue may begin to follow Illinois' lead in attempts to gain back some of its revenue loss by finding new streams of tax flow from out-of-state employers. Localities may also attempt to aggressively pursue telecommuting employees as a revenue source.

We continue to follow and report on the changing circumstances surrounding the COVID-19 pandemic. For more information on federal and state government relief and how the pandemic is affecting businesses and individuals, visit the Frost Brown Todd's Coronavirus Response Team page and *Tax Law Defined* blog.

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a Coronavirus Response Team. Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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