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The Fiscal Implications of Telework

Background

This report is the second in a three-part series on the implications of telework for the Commonwealth of Massachusetts. MTF's initial report provided an overview of the current policy landscape as it pertains to telework. This report will explore how the location of an employee can impact Massachusetts's jurisdiction to impose various taxes and what the fiscal impacts of those potential changes could be. In our final report, we will explore what a trend to remote working could mean for the broader Massachusetts economy.

Introduction

The COVID-19 pandemic has upended many aspects of how we work and live, and notable among them is the widespread adoption of teleworking by those that are able to do so. Teleworking, also commonly referred to as remote working or telecommuting, is essentially the act of performing your job responsibilities at a place other than the employer's offices. The pandemic has greatly accelerated this trend that began more than a decade ago and could have profound implications for how we live and work in a post-pandemic world. Many of us are personally familiar with the many advantages of telework - flexible workday, less congestion, elimination and/or reduction of commuting time and expenses. We also recognize that our employers benefit from the need for less office space and lower overhead, but we are less aware of the potential financial implications for the state should this trend take hold permanently.

These reports are intended to frame some of the potential impacts for lawmakers as they relate to state tax revenues and our economic competitiveness so that they can proactively manage them.

Tax Implications

(1) Income.

Per M.G.L. c. 62(2), Massachusetts residents are generally taxed on all of their personal income from all sources. Non-residents are taxed on items of gross income from sources *within the Commonwealth*.

(2) Withholding.

Employers have an obligation to withhold taxes on wage income paid to an individual who is subject to the Massachusetts personal income tax.

Both of these straightforward obligations get murky given the extraordinary circumstances surrounding the pandemic. The phrase "within the Commonwealth" is not as clear-cut as it once was. Many people's jobs that were in Massachusetts prior to the pandemic are not now because they are working from homes outside of Massachusetts due to declarations of emergency, employer-ordered restrictions, and/or public health requirements. For them, working from home wasn't a choice, but because different states impose different income tax rules, it could nevertheless cause new tax obligations.

In the short-term, the Massachusetts rules are clear. Massachusetts Department of Revenue has issued guidance,[1] effectively holding that income earned *in Massachusetts* prior to the pandemic is taxable *by Massachusetts* for the duration of the pandemic regardless of where the nonresident is physically located, so long as the change in locale is due to the pandemic. For the employer, this means that their withholding obligation does not change. This rule is intended to minimize sudden disruption for employers and employees during the COVID-19 state of emergency by maintaining the status quo.

But this rule is being challenged by the state of New Hampshire, with 14 other states filing amici briefs in support. If the Supreme Court of the United States (SCOTUS) hears the case, the holding will be a very important precedent for the duration of the pandemic and potentially longer. If SCOTUS does not hold for Massachusetts, the income of all NH residents who were working in the Commonwealth prior to the pandemic but have been working in NH since March would not be taxable in Massachusetts, nor would the income of non-residents from other states. Should Massachusetts lose the income tax associated with the wages of remote workers, the impact on income tax collections would be substantial. For New Hampshire workers alone, the loss could amount to more than $250 million annually.[2] When you add to that figure the potential revenue loss of nonresidents from other states, the potential revenue loss is notable.

Massachusetts Department of Revenue TIR 20-10 instructs companies to continue deducting and remitting tax on the wages of nonresidents who were physically working in Massachusetts prior to the pandemic. Should the Supreme Court find this income is not taxable by Massachusetts, employers would need to adjust the taxes withheld accordingly. This will

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[1] See Massachusetts Department of Revenue TIR-20-10 and 830 CMR 62.5A.3

[2] This figure is derived from taking the 85,000 NH residents working in MA per 2017 census data multiplied by the average annual wage of $75,000 multiplied by a 3.5% effective tax rate.

require employers to know the remote worksites of each employee, and for how long at each, in order to attribute the income to the proper state.

(3) Sales

According to M. G. L. c 64H, section 1, a vendor has nexus for sales and use tax collection purposes if it is "engaged in business in the Commonwealth." Generally, a vendor is engaged in business in the Commonwealth, if it has a physical presence in Massachusetts.[3] This physical presence requirement can apply if a vendor has one or more employees in Massachusetts. (M.G.L. c. 64H, section 34(a)).[4]

Therefore, telework could have implications for a vendor's sales tax collection obligation in the Commonwealth. Per TIR 20-10 and 830 CMR 62.5A.3, that is not the case at the present time. If, however, the Commonwealth loses the pending legal challenge, out-of-state vendors that did not have a physical presence in the state before the pandemic could be considered to have one now if certain conditions are met. For example, if a Salem, NH retailer had a Massachusetts resident who use to physically work in NH but now works remotely from her home in Lawrence, MA, that retailer could now be required to collect taxes on all of its sales to Massachusetts residents when it was not obligated to do so before. While this would likely benefit state coffers by boosting sales tax revenues, it is unclear how much new revenue would be obtained. Massachusetts has already been very aggressive in defining what vendors have a sales tax obligation by utilizing an "economic nexus" standard to extend its taxing authority, so the bump in revenues may not be significant. At a minimum, this telework trend could trigger new sales tax collection and filing obligations for retailers. It could discourage out-of-state vendors without a sales tax collection obligation from hiring Massachusetts residents or allowing Massachusetts residents to work remotely.

Another potential sales tax revenue implication is the amount that Massachusetts could forego as a result of these nonresidents switching permanently to telework for some or all of the work week. If nonresidents are no longer spending on lunch, coffee, and other consumables, as well as taxable goods, the amount of foregone sales tax revenue could add up. For example, if the 85,000 NH residents spent $10 a day on taxable items in Massachusetts and now work from home, MA loses out on almost $14 million in annual sales tax revenue.

[3] At the federal level, Public Law 86-272 requires a physical presence for a state to have jurisdiction over a vendor; however, this rule is applicable only to the sale of tangible personal property.

[4] According to M.G.L. c. 64H, s.1, an employee shall be considered to be located in the commonwealth if (a) his service is performed entirely within the commonwealth or (b) his service is performed both within and without the commonwealth but in the performance of his services he regularly commences his activities at, and returns to, a place within the Commonwealth.

4. Corporate

A business corporation is generally subject to the corporate excise under M.G.L. c. 63 when it does business *in Massachusetts*. A business corporation is considered to be doing *business in Massachusetts when it has one or more employees conducting business activities on its behalf in Massachusetts.*[5]

Like income and sales tax, the corporate excise tax obligations in effect prior to the pandemic remain unchanged for now. Should SCOTUS not hold for Massachusetts, two aspects of corporate tax would be affected. The first is the threshold question of whether a company will be obligated to file a corporate tax return in the Commonwealth. Since one of the determinants of whether a company conducts business in Massachusetts is if it has one or more employees here, telework could subject the corporation to a new filing obligation in Massachusetts. For example, if a Vermont or Rhode Island-based company that had no obligation to pay corporate taxes prior to the pandemic now has Massachusetts residents working remotely for it, that change could create sufficient nexus to require the company to pay taxes in the future. Even if the company's activity in Massachusetts is minimal, it would be subject to the corporate minimum tax.

Corporations with multiple locations have to pay taxes in the several taxing jurisdictions in which they operate and must apportion their income among them. Each state has different apportionment formulas and rules, making this a complicated area of taxation and one in which companies can be taxed on the same income twice. In Massachusetts, we use a three-factor apportionment for all corporations other than manufacturers and mutual fund service corporations. This formula considers the amount of payroll, property and sales that a corporation has in Massachusetts relative to its total payroll, property and sales, (double weighing the sales factor), and subjects that proportion of its income to the corporate tax rate of eight percent. For example, if a corporation had $1,000 in income, and 5% of its sales, 20% of its property and 50% of its payroll were in Massachusetts, it would pay $16.00.

Apportionment Formula

Corporate Tax Factors			
	Sales factor	Property factor	Payroll factor
Numerator	MA sales	MA property	MA payroll
Denominator	All sales	All property	All payroll

[5] 830 CMR 63.39.1(3)(b)(5), and 5(b)(3)

Tax Liability					
$1,000 X	$\frac{\text{2X Sales factor + Property factor + Payroll factor}}{4}$				X 8.0% (Corp. Rate)
$1,000 X	$\frac{80}{4}$	X 8.0%	= $1,000 X 20% X 8%	=	$16.00

To illustrate the impact of telework, if the payroll factor in the example above was reduced by half because of telework, the impact would be a 30% reduction in the amount of corporate excise that the company would pay ($11.20 versus $16.00.)

The standard for determining a MA employee is different for payroll factor purposes than withholding. In the instance where a person who used to work in Massachusetts now opts to work remotely somewhere else on a full-time basis, the payroll factor in Massachusetts would be reduced accordingly and could increase the payroll factor in the state of the non-resident. For an employee who works in multiple states, the entire payroll of any individual is attributed to the state in which the corporation's base of operations is located, Massachusetts in our example. Telework could impact the payroll factor in one of two ways. A corporation could encourage employees to work remotely full-time, and/or incent a person who already worked remotely part of the time to do so full-time to reduce its payroll factor. A corporation could also look to change its base of operations. The recent migration of companies from California and New York to lower-cost jurisdictions, such as Texas and Florida, demonstrates that some companies are sensitive to the different tax burdens that states impose.

Conclusion

As this report attempts to demonstrate, the trend toward telework has both short and long-term fiscal implications for Massachusetts. In the short-term, there is a question of whether Massachusetts can continue to lay claim to the income of nonresidents who used to work here but are now working remotely for the duration of the pandemic. That question may be answered by the Supreme Court of the United States should it decide to hear the case brought by the state of New Hampshire challenging the Commonwealth's taxing authority to do so. If Massachusetts loses the case, MTF estimates a revenue loss of $167 million, but this loss could reach almost $500 million (details of the revenue loss are provided in the Appendix). Even if Massachusetts prevails and state tax collections are unaffected in the short-term, the trend toward teleworking poses significant implications longer term for the three main sources of the Commonwealth's tax revenue – income, sales and corporate – with income tax being the most impacted.

In the final installment in this series, MTF will explore some of the broader economic implications of this telework trend.

Appendix – Potential Revenue Impact of New Hampshire Litigation

As described in the bulletin above, New Hampshire contends that Massachusetts should not be able to continue collecting income tax on New Hampshire residents who worked in Massachusetts prior to the pandemic but are now working remotely due to pandemic related-circumstances. Should the court hear this case and decide in New Hampshire's favor, there would be fiscal consequences for Massachusetts. This appendix outlines the methodology MTF used to provide a revenue estimate of that potential revenue impact.

Preliminary Estimate of Potential Revenue Loss	
Revenue Exposures	
NH commuters available to telework	85,262
Commuters from other states	117,434
Assumed salary	$74,188
Foregone Massachusetts effective rate	3.5%
Initital max revenue loss estimate	$526.3
Revenue loss offsets	
MA commuters available to telework	$90,300
Potential Massachusetts revenue gain	$234.5
Adjustment for 40% telework rate	$175.1
Preliminary estimate of lost revenue	***$116.7***
Revenue $ in millions	

Upper bound revenue impact

According to the most recent census data, 85,262 New Hampshire residents reported commuting to Massachusetts for work. To create an upper bound of revenue loss, we can assume that: (1) all of these workers now work remotely, (2) are making the average Massachusetts salary of $74,188; and (3) pay the average effective Massachusetts income tax rate of 3.5 percent after taking into account deductions and exemptions. The annual revenue loss for that population based on these assumptions would be $221.4 million. If, however, the average salary of a non-resident exceeds the Massachusetts average, the effective tax rate would be higher and the revenue lost greater.

This $221.4 million does not account for the 117,434 other non-residents who currently work in Massachusetts. Should Massachusetts lose out on revenue from this additional population, it would result in a further $304.9 million loss for a total of $526.3 million. However, for a number of reasons, this figure does not account for several important factors that will materially impact the revenue change.

Prevalence of telework

While telework has increased significantly during the pandemic, it is highly improbable that all people who can work remotely will choose to do so. To account for that, MTF reduced the 85,262 New Hampshire residents by 60 percent, in line with US Census findings on the frequency of commuters switching to telework during the pandemic. This adjustment reduces revenue loss from New Hampshire to $89 million and $122 million for residents of other states.

Possible positive revenue impacts for Massachusetts

Given that New Hampshire has no tax on earned income, a New Hampshire resident would have a significant incentive to avoid paying the Massachusetts income tax if given a choice to telework for some or all of their workweek. The reverse is also true. For those non-residents who are subject to a higher rate of income tax in their home state, they are incented to continue working remotely in Massachusetts. The prevalence of this situation is less clear and in some cases, Massachusetts could see some increased tax revenue from a change in the treatment of nonresident income.

Therefore, in order to estimate possible tax revenue impacts of the New Hampshire rule on Massachusetts, we need to look at non-residents commuting into Massachusetts along with Massachusetts residents working remotely in other states. Based on census data, we estimate that 27,134 more non-residents (not including New Hampshire) work in Massachusetts than Massachusetts residents working out-of-state.

	From State to MA	From MA to State	Net	Income Tax Rate on single filer at $75K
CT	21,636	29,883	-8,247	5.50%
ME	5,022	1,521	3,501	7.15%
NH	85,262	33,501	51,761	0.00%
NY	6,235	6,760	-525	6.21%
RI	65,434	45,577	19,857	4.75%
VT	2,861	2,459	402	6.60%
Other States	16,246	4,100	12,146	
Total	***202,696***	***123,801***	***78,895***	
Total without NH	***117,434***	***90,300***	***27,134***	

	MA filers gained/lost	Assumed Taxable Income	Assumed tax revenue impact
CT	8,247	$611.83	$21.41
ME	-3,501	-$259.73	-$9.09
NY	525	$38.95	$1.36
RY	-19,857	-$1,473.15	-$51.56
VT	-402	-$29.82	-$1.04
Other states	-12,146	-$901.09	-$31.54
Total	***-27,134***	***-$2,013.02***	***-$70.46***
$ in millions			

If we assume that all of these workers were to telecommute and only pay withholdings to their state of residence, Massachusetts will lose approximately $70.5 million in tax revenue.

Bottom line

It is impossible to know the annualized revenue impact if Massachusetts were no longer collecting income tax on nonresident employees employed by Massachusetts companies.

However, using census data on commuting patterns and the prevalence of telework, MTF estimates that the revenue loss range to between $115 million and $530 million in annual revenue after accounting for the following factors:

- The data used to create this estimate do not account for Massachusetts residents who telework via vacation homes or secondary residences. These taxpayers would not be included in Census data capturing pre-pandemic commuting patterns.
- The data does not account for commuters who split time between telework and in-person commuting.
- The data uses a national estimate of telework substitution (38 percent) and does not account for the fact that the prevalence of telework is likely impacted by the type of work common for commuters between states in New England and the specific incentive that commuters from states with no income tax would have to telecommute.

Based on the above calculations, we estimate that the annualized revenue loss would likely exceed $100 million.