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New York's "Convenience of the Employer" Rule: From Defending the Fisc to Punishing Telecommuters

A Suggestion of How to Preserve the Rule, While Still Encouraging Telecommuting

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Telecommuting—the much anticipated ability to work at home in a virtual office, separated from but electronically connected to the work-place—promises many social and economic benefits.

Employers who accommodate telecommuting expect to improve their recruiting, reduce employee turnover, cut down on office overhead, and increase their overall productivity. Employees, on the other hand, want telecommuting as an option to reduce stress, save on transportation costs, allow them flexible work hours, and improve their quality of life.[1] Indeed, telecommuting has many fans: the federal government,[2] state and local

[1] James G. Natoli, Director of State Operations, Office for Technology, New York State, *Governor's Task Force on Information Resource Management*, Technology Policy 96-5 (May 12, 1997) ("A telecommuting program can be an effective workforce management tool much the same as flexible hours, voluntary work reduction and compressed work week programs which have been implemented in recent years. Research by Federal and State agencies has confirmed benefits for both the employee and the employer directly attributable to telecommuting programs. In addition to environmental advantages, the benefits of telecommuting programs include the following: Employer benefits: [r]educe turnover and training expenses; [i]mprove ability to retain and recruit staff; [i]mprove attendance; [i]ncrease productivity; and [i]mprove employee morale. Employee benefits: [i]mprove morale and flexibility; [r]educe commuting time and job-related expenses; [l]ess stress; [g]reater empowerment; [i]ncrease family interaction; and [i]mprove quality of life.")

[2] The federal government has long been a proponent of telecommuting. In 1994, President Clinton issued a memorandum to all federal agencies adopting a policy of a more family-friendly workplace, which included telecommuting arrangements. EDWARD WEINER & ROBERT STEIN, U.S. DEP'T OF TRANSPORTATION, THE EVOLVING FEDERAL ROLE IN TELECOMMUTING 10 (Feb. 1, 2005), *at* http://www.teleworkexchange.com/federal-role-in-telecommuting.doc (last visited Jan. 27, 2006). In 1996, the President's Management Council directed all federal agencies to increase telecommuting as part of the National Telecommuting Initiative. *Id*. "The objectives of the NTI were to increase the number of

governments,[3] and private industry.[4] Everyone seems to agree that telecommuting is a good and positive development that should be nurtured and encouraged.

Yet one of the most threatening barriers to telecommuting may be state tax regimes. For example, the New York State Department of Taxation and Finance's policy has been to tax 100 percent of the income of all telecommuters who work for and are paid by New York employers, even if they live in another state and even if they perform as much as 75 percent (or perhaps more) of their work outside of New York. An unintended consequence of this policy may be to discourage such employees of New York businesses from seeking or taking advantage of telecommuting opportunities[5] or, alternatively, to discourage nonresidents from working for New York-based employers.

In *Huckaby v. New York State Div. of Tax Appeals*, 829 N.E.2d 276 (N.Y. 2005), a New York employer hired a Nashville computer programmer (Huckaby) under an agreement that allowed Huckaby to telecommute from Tennessee. He spent only 25 percent of his working time in the employer's New York office training employees and gathering requirements for the computer programs. He worked the remaining 75 percent of his time out of his home office in Nashville. Not satisfied with taxing only the quarter of Huckaby's income earned within the state, New York decided to impose tax on all of it.

(continued…)

federal telecommuters, and promote increased telecommuting in State and local governments, and private industry." *Id*. U.S. Representative Frank Wolf of Virginia sponsored an amendment to the FY 2001 Department of Transportation Appropriations Act "requiring each Federal agency to establish telecommuting programs." *Id*. The act, which became Public Law 106-346, required each executive agency to establish a policy permitting eligible employees to telecommute and to extend the policies to cover all of the agency's employees by 2004. Act of Oct. 23, 2000, Pub. L. No. 106-346, § 359, 114 Stat. 1356 (providing appropriations for the Department of Transportation). Federal agencies continue to promote telecommuting to correct a number of ills, including energy shortages, traffic congestion, traffic accidents, air pollution and terrorism. *See* EDWARD WEINER & ROBERT STEIN, U.S. DEP'T OF TRANSPORTATION, THE EVOLVING FEDERAL ROLE IN TELECOMMUTING 3, 14 (Feb. 1, 2005). "In the wake of the September 11 terrorist attacks, telecommuting has taken on a new, increased emphasis in light of proposals to create a less targetable, more dispersed workforce." *Id*. at 3.

[3] *See* SOUTHERN CALIFORNIA ASSOCIATION OF GOVERNMENTS, 2004 REGIONAL TRANSPORTATION PLAN (March 2004) (citing telecommuting as one of the methods to be used by the region to reduce the number of vehicle miles traveled in the Los Angeles region with the resultant effect of maximizing mobility and accessibility, ensuring safety and reliability, preserving the region's transportation system, maximizing productivity of the system and protecting the environment), *at* http://www.scag.ca.gov/rtp2004/2004draft/FinalPlan.htm (last visited Jan. 26, 2006); NEW YORK CITY DEP'T OF TRANSPORTATION, SIMPLE STEPS TO IMPROVING AIR QUALITY IN NEW YORK CITY, *at* http://www.nyc.gov/html/dot/html/masstran/simplesteps.html (last visited Jan. 22, 2006) ("Telecommute. Work at home sometimes. You'll save time and money, and reduce emissions and congestion.").

[4] *See* DR. BRADEN ALLENBY, VICE PRESIDENT, ENVIRONMENT, HEALTH AND SAFETY FOR AT&T, TESTIMONY TO CONGRESS—TELEWORK: THE AT&T EXPERIENCE (March 22, 2001) (testimony before Congress), *at* http://www.att.com/telework/article_library/congress_testimony.html (last visited Jan. 26, 2006)). Dr. Allenby's report cites several benefits AT&T receives when employees telecommute. "For example, we estimate that we save about $25 million per year in real estate through virtual office programs. But that's just the tip of the iceberg." *Id*. In surveys measuring perceived productivity, 77 percent of teleworkers reported higher productivity while working from home. "We calculate that this increased productivity of our teleworkers is worth about $100M per year." *Id*.

[5] "[The taxpayer] criticizes the convenience test as . . . a discouragement to telecommuting. Maybe so." Huckaby v. New York State Division of Tax Appeals, 829 N.E.2d 276, 284 (N.Y. 2005), *cert denied*, 126 S. Ct. 546, 163 L. Ed. 2d 459 (U.S. 2005).

Not surprisingly, poor Huckaby appealed, certain that, this time, New York was overreaching.

Incredibly, the Court of Appeals of New York, the state's highest appellate court, upheld the Department's decision.[6] Because Tennessee does not have a personal income tax, Huckaby avoided the risk of double taxation, but he also was forced to pay a large portion of his income to the State and City of New York for the privilege of spending only 25 percent of his working time there.

Moreover, New York State's personal income tax rates are among the highest in the nation.[7] In 2005, the maximum marginal tax rate was 6.85 percent for joint filers earning more than $40,000, 7.35 percent for joint filers earning more than $150,000, and 7.7 percent for joint filers earning more than $500,000. Among its contiguous neighbors, New York has among the highest rates, topped only by Vermont's 9.5 percent and New Jersey's 8.97 percent top bracket rates.[8]

While New York permits individuals who work in multiple states to allocate their income between states, the Department promulgated a policy that severely limits when employees are allowed to allocate. The so-called "convenience of the employer" rule prevents individuals from allocating unless their employers require them, as a condition of that job, to work outside New York. "The 'convenience of the employer' would therefore more aptly be called the 'necessity of the employer' test."[9]

Dating back to a time before the internet, e-mail, and other electronic technologies made telecommuting practical for most employees, this rule was initially designed to prevent nonresidents from abusing the fact that they cross states lines in their daily commutes. The Court of Appeals cited the hypothetical example of an employee who, although he works in his New York employer's office full time every weekday, dabbles on work out of his home on weekends. The policy prevents such an employee from using his home time to allocate 2/7ths of all of his income to a state other than New York. "The policy justification for the 'convenience of the employer' test lies in the fact that since a New York State resident would not be entitled to special tax benefits for

[6] *Huckaby*, 829 N.E.2d 276, 284-85 (N.Y. 2005).

[7] Of the 41 states and the federal district that imposed personal income taxes in 2005, only 10 states and the District of Columbia had a higher top-bracket rate than New York State's 7.7 percent. Of the 35 states and the federal district that had multiple rates in 2005, only four states and the District of Columbia had a higher bottom-bracket rate than New York's 4 percent. Federation of Tax Administrators, State Individual Income Taxes, *at* http://www.taxadmin.org/fta/rate/ind_inc.html (last visited Jan. 26, 2006) (chart of individual income tax rates by state).

[8] Connecticut's rates are 3 percent and 5 percent; Massachusetts has a single rate of 5.3 percent; New Jersey's rates range from 1.4 percent to 8.97 percent; Pennsylvania has a single rate of 3.07 percent; Vermont's rates range from 3.6 percent to 9.5 percent. State Tax Guide (CCH) ¶ 700-070, *at* http://tax.cchgroup.com/primesrc/bin/highwire.dll (last visited Jan. 26, 2006).

[9] *In re* Zelinsky v. Tax Appeals Tribunal, 801 N.E.2d 840, 845 n.3 (N.Y. 2003), *cert. denied*, 541 U.S. 1009 (2004).

work done at home, neither should a nonresident who performs services or maintains an office in New York State."[10]

Critics, however, claim that the policy is now antiquated and that, by taxing telecommuters who spend relatively little time in New York on 100 percent of their income, the state has pushed the rule too far. Even the New York State Department of Taxation and Finance, after successfully defending the *Huckaby* case last spring, indicated that it has overextended the policy's intended reach.

Commissioner of Taxation and Finance Andrew Eristoff, in comments at an annual state tax conference on January 19, suggests that the Department's rule has not "taken cognizance of the existence" of telecommuting.[11] The Department is now drafting a technical notice to address telecommuting and will present the notice to a tax advisory council in March. "We can keep the convenience-of-employer rule while still recognizing the reality of telecommuting," Eristoff said.[12]

As interpreted under *Huckaby*, here are some examples of how the current "convenience of the employer" policy works under various scenarios:

Scenario No. One: Tax Credit Granted in State of Residency

When both the state of the employer's location and the taxpayer's state of residency impose income taxes, the effect of double taxation or higher levels of taxation can be ameliorated or even removed altogether if either or both states grant a credit for income tax paid to the other state. If the state granting the tax credit places limits on the credit, however, there is potential for double taxation.

Example A:

Ed, a professor at New York University and a Connecticut resident, commutes into New York City three days each week to deliver lectures. Two days each week, Professor Ed chooses to work out of his Connecticut home preparing examinations, writing student recommendations, and conducting scholarly research and writing.[13]

Ed earns an adjusted gross income of $160,000, all from his position at NYU. New York State subjects 100 percent of that income to its income tax and New York City

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[10] *Huckaby*, 829 N.E.2d 276, 284 (N.Y. 2005) (quoting *In re* Speno v. Gallman, 35 N.Y.2d 256, 259 (N.Y. 1974)).

[11] *See* John Herzfeld, *State Considering Changes in Rule Upheld in '*Huckaby*' Case, Official Says*, DAILY TAX REPORT No. 13 (BNA, Inc.), Jan. 20, 2006, at H-5.

[12] *Id*.

[13] These facts are taken directly from *Zelinsky*. The professor's salary in this example is borrowed from an example in a Connecticut Special Notice, *see* next note; the *Zelinsky* case did not state the professor's salary.

separately subjects all of it to the city's income tax. The New York State tax is $9,600 and the City tax is $720. Connecticut separately imposes an income tax of $2,400.[14]

Because NYU does not <u>require</u> the professor to work two days each week in Connecticut, New York will apply the convenience-of-the-employer rule to allocate 100 percent of Ed's income to New York.[15] Connecticut grants a credit for taxes on income paid to other states, but it limits the credit to the actual amount of Connecticut income tax paid by the resident; in other words, the Connecticut income tax cannot be reduced below zero.

In this example, Professor Ed would be able to use the credit for the $10,320 in taxes he paid to New York State and New York City to reduce his Connecticut income tax to zero. While he did not have to pay double taxes on any of his income, because New York's collective tax rates are higher than Connecticut's, Ed's overall state income tax burden increased as a result of working for a New York employer.

Example B:

The facts are the same as in Example A, except this time the university <u>requires</u> Professor Ed, in addition to lecturing three days a week in New York City, to deliver lectures three days a week at a satellite campus in Connecticut. One day a week, Ed splits his day equally between the New York campus and the Connecticut satellite campus. On his days in Connecticut, the professor must maintain office hours on the satellite campus whenever he is not lecturing, either working with students or conducting scholarly research and writing.

Again, Ed earns an adjusted gross income of $160,000 from his position at NYU. New York State subjects half ($80,000) to the state income tax and New York City also subjects half to the city's income tax. The New York State tax is $4,800 and the City imposes another $360 in income tax. Connecticut assesses an income tax of $2,400.[16]

In this example, since NYU *requires* Ed to work half of his time in Connecticut and half of his time in New York, the convenience-of-the-employer test does not require full allocation to New York.[17] Although his work on the Connecticut campus may stem from his employment with NYU, the professor is still able to allocate his income equally between New York and Connecticut. Therefore, New York State should only apply its personal income tax to 50 percent of Ed's annual earnings from his NYU salary.

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[14] These figures are modified from an example provided in a Connecticut special notice, which explains how the credit for income taxes paid to other jurisdictions is calculated. Connecticut Special Notice No. 92(2) (Jan. 1, 1992).

[15] *See In re Zelinsky*, 801 N.E.2d 840 (N.Y. 2003).

[16] *See* Connecticut Special Notice No. 92(2) (Jan. 1, 1992) (providing an example of how the credit for income taxes paid to other jurisdictions is calculated using these same dollar amounts).

[17] *See In re Zelinsky*, 801 N.E.2d 840, 844 (N.Y. 2003).

Connecticut would grant the professor a credit of $1,200 for income taxes paid to New York State. Because 50 percent of his adjusted gross income is reported on another jurisdiction's income tax return, Ed may take a credit for as much as 50 percent of his Connecticut income tax liability. In this example, Professor Ed would pay $6,360 in total personal income tax to New York State, New York City, and Connecticut — $3,960 less (or *more than* 38 percent in tax savings) than Ed had to pay in Example A.

Zelinsky **and Double Taxation**

In *Zelinsky*,[18] the unfortunate Professor Ed actually paid taxes twice on his income because he voluntarily paid Connecticut income tax by allocating his income between New York State and Connecticut. Because New York taxed 100 percent of his income and because Professor Ed had already paid income tax to Connecticut, at least some of his income was taxed by both jurisdictions.[19] Connecticut did not provide a credit for the portion of the Ed's income that he had voluntarily allocated to Connecticut but that was taxed a second time by New York. In justifying this counterintuitive result, the *Zelinsky* court stated: "[I]t was his own choice to allocate his income that created the threat of double taxation, not the convenience rule."[20] The court apparently assumed that if Professor Ed had not allocated some of his income to Connecticut, then Connecticut would have allowed him a credit for the taxes paid to New York State and New York City up to the full amount of his Connecticut income taxes. While this assumption may or may not have been correct, it is not entirely clear how Connecticut would have treated the professor's income from his New York job that may have been earned for services performed at his residence in Connecticut.[21] Presumably, to avoid double taxation, Professor Ed would have had to apply for a refund from Connecticut before the statute of limitations ran out.

In Example A, assuming that Connecticut honored the allocation of 100 percent of Professor Ed's income to New York, there would be no double taxation. Ed would pay the full amount of New York State and New York City income taxes but should pay no Connecticut tax. His total personal income tax liability would be $10,320, an amount significantly higher than the $2,400 his neighbor, who earned the same salary but

[18] *Id*.

[19] Although *Zelinsky* does not state whether New York City also taxed 100 percent of the professor's income, because the New York State Department of Taxation and Finance administers and collects both the city and state income taxes, N.Y. Tax Law § 1312, in all likelihood the Department imposed both state and city taxes on 100 percent of the professor's income. Therefore, the professor's income was taxed by three taxing jurisdictions, New York State, New York City and Connecticut, on at least some of the same portions of his income.

[20] *See In re Zelinsky*, 801 N.E.2d at 848.

[21] Connecticut permits residents who earn income outside the state to take a credit "in the amount of any income tax imposed on such resident . . . by another state of the United States or a political subdivision thereof or the District of Columbia on income derived from sources therein and which is also subject to tax under this chapter." Conn. Gen. Stat. § 12-704(a)(1). The Connecticut regulations explain that income is derived from sources in another jurisdiction if that income, if earned in Connecticut, would have been sourced to Connecticut.

worked for a Connecticut employer, would have to pay. Such is the cost of telecommuting for a New York employer.

In Example B, Professor Ed pays at the New York rates on the half of his salary earned in New York City and pays the Connecticut tax rate on the half of his salary earned in Connecticut. When the convenience-of-the-employer rule does not prevent allocation of income between multiple taxing jurisdictions, there does not appear to be any risk of multiple taxation.

Both New York and Connecticut would likely respect Ed's even allocation of income because the professor divided his working time equally between the states and did so to meet the needs of his employer. (Taxpayers can more clearly determine how to allocate income between two states, especially when one state uses the convenience-of-the-employer test, when the employer expressly requires the division of work between the states and the employee does not have the option to decide in which state he will perform his work.[22]) In Example B, Professor Ed pays $6,360 in total state personal income taxes—substantially less than what he must pay in Example A but more than a neighbor who works for a Connecticut employer.

Scenario No. Two: No Income Tax in State of Residency

Most states (41, plus the District of Columbia) impose broad-based personal income taxes. Seven states, however, impose no personal income taxes of any kind and two others impose only limited types of personal income taxes.[23] Tennessee, a state with a limited personal income tax, only taxes dividends from stocks and interest from bonds and does not impose a personal income tax on salaries or wages.

Example C:

A New York employer hires a Tennessee resident, Tom, to perform computer programming services and permits him to work primarily from his Tennessee home. Tom travels to the New York office only to gather guidelines for computer programs and to instruct other employees in use of the programs. He spends 75 percent of his working time in his home office in Tennessee.[24]

Because Tom is allowed, but not required, to perform his work in Tennessee, New York will invoke the convenience-of-the-employer rule to allocate all of his income to New

[22] *But see* In the Matter of the Petition of Arthur Gray, Jr., No. 819457 (New York Div. of Tax Appeals Feb. 24, 2005) (allocating 100 percent of the taxpayer's income to New York, despite the fact that the employer instructed the taxpayer to vacate his office and encouraged the taxpayer to establish a home office in Connecticut).

[23] "Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming impose no personal income taxes; New Hampshire and Tennessee impose taxes on only limited types of personal income." HELLERSTEIN, State Taxation (3d ed. 2005).

[24] These facts are taken directly from *Huckaby*. 829 N.E.2d 276 (N.Y. 2005).

York.[25] Since Tennessee does not impose a personal income tax on wages and salaries, Tom will not pay any income tax to Tennessee.

Thus, Tom's income is taxed only once. The bad news, however, is that he must pay an extremely high income tax rate, despite living in a state with no income tax. Indeed, he pays the same tax as an employee earning the same amount who resides and works in New York. Similarly, an employee with the same salary who works full time at the New York employer's offices but who commutes daily from a no-income tax state would also pay the same amount of income tax.[26]

The convenience-of-the-employer rule, as interpreted by New York, has several public policy flaws. First, it appears to promote inequitable treatment of similarly-situated taxpayers living and primarily working in other states. If a New York-based company opens a manufacturing plant in Tennessee and employs Tennessee residents to work there, those employees do not have to pay New York income taxes. Even if an employee at that plant works all day on a computer that links with computers at the New York office of the employer, and even if he traveled to New York for occasional meetings, he still would not pay New York income taxes. If the same employee traveled to New York and performed work at the New York office often enough, however, he could be required to allocate his income between New York and Tennessee and would have to pay at least some income tax to New York. However, New York would never be able to tax *all* of his income.

The same treatment should be afforded to employees who work from their own home offices outside New York, even if they do so at their own option. When the employee works primarily in another state, there is much lower risk that he is conducting a sham to reduce his New York income taxes. When the work location is not within daily commuting distance or when the cost of regularly commuting would be prohibitively expensive, particularly if it is at the employee's own expense, the risk of a sham becomes virtually nonexistent.

Improper Reach of the Convenience-of-the-Employer Rule

The convenience-of-the-employer rule was adopted to protect the state from shams by nonresidents and to promote the fair treatment of resident employees. It is supposed to protect the public fisc by preventing nonresident employees who work in the state from using their interstate commute to avoid paying their fair share of income taxes to the state where they work. The policy also prevents nonresident commuters from shifting their tax burden onto the shoulders of resident workers who cannot allocate income to a lower-tax jurisdiction.

[25] *See Huckaby*, 829 N.E.2d 276 (N.Y. 2005).

[26] This would include (1) states that do not impose an income tax on income earned at an employer's location in another state and (2) states that grant a full credit against income tax liabilities for income taxes paid to the state where an employee performs his work.

When the state tries to sweep in nonresidents who work *primarily* in other states, however, it abuses the rule. If an employee spends most of his working time in another state, the taxing state loses its justification to tax 100 percent of his income. By allowing the employee to allocate his income (as opposed to taxing all of it), the state retains the source of income it fairly earned by providing services to the employer and the employee. Allocating also treats the employee and his home state fairly according to the benefits it has provided to the employee.

If an employee works primarily at his home, his state of residence provides most of the same benefits and services that the taxing state provides to the employee and his employer on an employee's day at the office. The employee's state of residence provides a civil society, the protection of police and rescue services, protection of the home workplace, and basic infrastructure. Whereas the taxing state provides the economic environment to support the employer, the employee's home state provides a general marketplace for the employer, a specific market for the employee's services, and a source of resident employees. By providing these workplace benefits, the employee's state of residence should be able to claim and tax its fair share of the employee's work-related income.

New York's expansive use of the convenience-of-the-employer rule does not promote fairness or equity. Even if the residency state chooses to impose a lower tax rate or, like Tennessee, no income tax at all, the employee has still not shortchanged New York. States choose different methods and amounts of taxation, and a state that assesses no income tax usually manages to tax a resident in other forms. For example, Tennessee imposes the nation's highest state sales tax at a rate of seven percent.[27] Revenue from sales tax and special excise taxes represented 77 percent of Tennessee's tax collections in 2004.[28] The resident employee who does not pay income tax to Tennessee must still bear these higher sales taxes to fund the services and benefits provided by the state. It is not necessarily fair to impose New York's income taxes on top of that burden.

Indeed, even if an employee's state of residence imposed no tax of any type upon its residents, that is the right and choice of the state. A telecommuting resident is not cheating New York simply because he does not pay an equal tax as New York residents. The benefit of lower or no taxes is a boon granted by the residence state, not a siphoning of taxes from New York's coffers.

[27] Tennessee is tied with Mississippi and Rhode Island for the highest state sales tax rate. At 9.75 percent, Tennessee also has the seventh highest maximum combined state and local sales tax rate in the nation. Federation of Tax Administrators, *2004 State Tax Collection by Source*, *at* http://www.taxadmin.org/fta/rate/04taxdis.html (last visited Jan. 26, 2006) (chart of sources of taxation income by type of tax for each state).

[28] Federation of Tax Administrators, *2004 State Tax Collection by Source*, *at* http://www.taxadmin.org/fta/rate/04taxdis.html (last visited Jan. 26, 2006) (chart of sources of taxation income by type of tax for each state). In contrast, New York obtained 53.8 percent of its 2004 tax collections from its individual income tax. Sales taxes and specific excise taxes represented nearly 36 percent of 2004 tax collections. *Id.*

Similarly, if a corporate taxpayer establishes its primary operations in a low-tax jurisdiction, sells its products into a high-tax jurisdiction such as New York, and then fairly allocates its income according to what it earned in each of the two states, New York cannot complain that it is losing tax dollars to the low-tax jurisdiction. Each state establishes its own level and scheme for taxing its citizens.

Obviously, many taxpayers would be glad to do away with the convenience-of-the-employer rule altogether, particularly when it is used by a high tax jurisdiction like New York to grab tax revenue from people telecommuting from low tax states. The New York State Department of Taxation and Finance nevertheless appears fond of the policy and recent cases show that it is successfully brandishing the rule to reach farther and farther afield. Although Commissioner Eristoff stated an intention to modify the Department's policy regarding telecommuters, the Department has not provided any details and it is unclear how much it will voluntarily limit itself.

Because the New York courts have held that the Department's aggressive use of the rule is both constitutional and proper under state law, other states can be expected to embrace this approach. Moreover, because the rule affects only nonresidents, who cannot vote in the taxing jurisdiction, it appears likely similar rules will prove popular with legislatures and voters.

Possible Alternative

If the New York State Department of Taxation and Finance is serious about modifying the convenience-of-the-employer rule to make it more telecommuter-friendly, let us suggest a possible alternative to the *Huckaby* interpretation. Because the rule was created by regulation, the Department could easily promulgate any needed changes without having to seek changes to New York law. Other states applying a version of the convenience-of-the-employer rule should likewise consider the following alternative.

New York could adopt a rebuttable presumption that a nonresident employee who chooses to telecommute from another state part of the time does so to reduce his New York income tax burden. To prevent a flood of frivolous tax filings and allocation claims, New York could set a minimum threshold percentage of the work year — a floor. If nonresident workers spend at least this threshold percentage of the year working outside of New York, then they may provide evidence to rebut the presumption. The Department could further lighten its load by establishing a ceiling above which the burden shifts and it is presumed that the worker is *not* trying to unfairly reduce his income taxes and allocation of income is deemed proper.

None of these presumptions prevents taxing authorities from applying the convenience-of-the-employer test to any individual worker, where justified and appropriate. In any given case, the state tax department would have the opportunity to prove the worker was claiming hours worked in another jurisdiction as part of a sham to reduce his overall income tax burden. At the same time, employees who work most of the time outside the taxing jurisdiction could fairly allocate their income without the need to prove the legitimacy of their work location. Finally, workers who divide their work evenly between two jurisdictions could obtain the benefit of allocation as long as they could establish that the percentage they allocate to the taxing state truly reflects how much time they worked there.

Suggested Thresholds

Thirty percent Floor

The simplest approach, and the easiest to enforce, would be for New York to establish a bright-line subrule under the convenience-of-the-employer test — nonresident workers who voluntarily perform work outside the state for less than 30 percent of their annual work hours can *never* allocate. New York is free to assess on all of a worker's income.

Workers who elect to work in another state for 30 percent or more of their annual work hours, however, would be permitted to allocate their income, but only if they provide evidence acceptable to the Department that establishes the exact number of hours worked in each jurisdiction. The types of evidence required could be detailed in regulations and required to be provided as part of the workers' income tax returns.

The suggested 30 percent threshold is, of course, arbitrary, and the bright line could be set at any amount. However, the 30 percent mark holds promise for several reasons. First, a worker who works equal hours seven days a week can only reach this threshold by working outside the state at least two days each week. For example, a worker who works 8 hours a day every day of the week spends 56 hours working each week. To meet the 30 percent threshold, the worker would have to show that he works at least 16.8 hours outside of New York every week. If he works at home only on the weekends, he would have to work more than two full eight-hour days over the weekend for an entire year to earn the right to allocate. At that point, the worker is no longer working casually a little each week for tax benefits. He has also received significant benefits from his state of residence (or from the other states where he is working). Documenting this amount of hours to overcome the presumption is not easily done without substantial fraud.[29] Although any specific threshold will be arbitrary and might seem unfair in close cases, the rule is certainly less arbitrary and more fair than simply denying allocation to all individuals, even those who spend most of their time working outside of New York.

Sixty percent Ceiling

On the other end of the spectrum, New York could set a ceiling so that workers who elect to spend at least 60 percent of their annual work hours outside the state are presumed to have valid nontax reasons for telecommuting. These workers would be permitted to allocate their income without having to provide proof that the allocation is

[29] Barring an audit, no tax system can stop or deter taxpayers who will resort to substantial fraud to avoid income taxes. A taxpayer who would commit this type of abuse would just as likely claim that he never worked in the taxing jurisdiction or that he worked outside the taxing jurisdiction at the necessity of the employer. Audits are the answer for these sorts of abuses, not rules that prevent taxpayers from claiming certain facts.

proper, unless audited. Again, the 60 percent threshold is arbitrary, but it has its merits. At this level, the employee is spending substantially more time working outside New York than within it. His job, for all intents and purposes, is located somewhere else. Providing proof of where he spends each of his out-of-state working hours becomes more and more burdensome. Consequently, it becomes more difficult for the worker to conduct a sham.

For instance, an employee working five 8-hour days at his employer's location in New York would have to spend an additional 66 hours working outside the state *each week* to reach this presumption. False reports of hours at this 106-hour level would be obvious and easily detected,[30] and the ludicrousness of such a claim would deter all but the boldest of taxpayers.[31] Finally, employees actually working this many hours outside New York State should be allowed to allocate their income because New York is providing far less than 100 percent of the benefits the worker is receiving as an employee. Using this bright-line test, the state does not lose all its potential income. Instead, it claims its fair share of the worker's income based upon how much of his time the worker actually spends in the taxing state.

Considering Other Percentages

Although there are arguments for setting a higher ceiling than 60 percent, doing so would increase the gap between the threshold and ceiling in which the taxpayers must provide proof of hours and, thus, would increase the Department's and the worker's administrative burden. Although it may depend upon the types of evidence required, maintaining proof of hours spent working in two or more locations is significantly more burdensome than merely tracking the hours for allocation purposes. When the hours that must be proven exceed the hours upon which the tax is fairly paid, the burden has grown substantially.

Similarly, New York could set a floor level higher than 30 percent, which would reduce the overall administrative burden by reducing the window for which taxpayers would be able and required to file proof supporting their proposed allocation. It would increase the amount of tax collected by New York by requiring more workers to pay tax on 100 percent of their income. However, at the 30 percent level, only workers who truly conduct an interstate worklife may allocate. This bright line sets a bar that no casual work-at-home-on-weekends worker can easily meet. It winnows out all the workers who truly work a full week at their employer's location and then tack on a few hours elsewhere for tax advantages. Further winnowing will only withhold the benefits of allocation from workers who really do obtain significant work-related benefits from outside New York State.

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[30] For example, tax departments that use automatic electronic auditing of some or all income tax returns could easily add a formula that would kick out any returns claiming the 60 percent ceiling exception from the convenience-of-the-employer rule that also showed work hours averaging more than 100 hours per week.

[31] Consider that to reach 66 hours in addition to a 40-hour work week, the taxpayer would have to work something similar to 2 additional hours each week night, in addition to a commute, and two 14-hour days each weekend *for an entire year*.

Application of the Alternative Rule to the Examples

Example A:

Professor Ed now works three days each week in New York City and two days each week at his Connecticut residence. If his average work days in New York City and in Connecticut over the course of the tax year are equivalent, then Ed spends 40 percent of his working hours outside of New York. Because this exceeds the 30 percent threshold, the professor may allocate his income between New York and Connecticut, as long as he provides evidence of his hours worked in Connecticut.

Under the alternate rule, the New York State Department of Taxation and Finance would provide an attachment for the personal income tax return that would indicate what evidence Professor Ed would have to provide to overcome the presumption that he worked in Connecticut solely to reduce his New York income tax. This evidence might include a statement of reasons why Ed chose to work at his home in Connecticut. Sufficient reasons might be to reduce transportation costs and to save commuting time. The professor might also be required to provide proof of the costs and duration of his commute and the total commuting time saved each year by telecommuting or working outside New York. However, if NYU paid Ed's commuting costs or if Ed regularly drove to a seaside retreat in Connecticut or Rhode Island to perform his work, the Department could use these facts to reject his nontax reasons as insufficient to rebut the presumption. In any case, the professor would have the opportunity to present his case for allocation rather than automatically be forced to pay tax on all of his income to New York State and New York City.

Example B:

Professor Ed works 50 percent of his time in New York and 50 percent in Connecticut. This amount of time spent working outside New York is sufficient to permit Ed to allocate his income under the alternate rule. However, because NYU requires the professor to lecture at its Connecticut satellite campus, the convenience-of-the-employer rule does not kick in. Therefore, the alternate rules under the convenience-of-the-employer rule do not apply. Ed may allocate to Connecticut all his income earned while working in Connecticut. The remainder of his salary is allocated to New York

If Professor Ed also worked at his Connecticut home three hours each week, the additional income for that work would be tested under the convenience-of-the-employer rule. Because the professor works 23 of his 43 working hours each week in Connecticut, he spends 53.5 percent of his work time outside New York. This amount is sufficient to exceed the 30 percent floor but not the 60 percent ceiling. Therefore, Ed would still have to provide proof of the hours he voluntarily worked outside New York to be allowed to allocate those hours to Connecticut. The professor may find that this reporting burden is not worth the anticipated tax savings.

Having arbitrary floor and ceiling rates can make a significant difference to a telecommuter who is within a few hours of reaching the next threshold. As shown by this example, however, it is not easy to manipulate one's life and work schedule for the sole purpose of meeting a particular threshold. Because Professor Ed is required to work at least 20 hours in New York, he would need to add even more hours at his Connecticut office or home to increase his percentage of non-New York work time to reach the 60 percent ceiling. He would have to work seven more hours each week, for a total of 10 hours of work in Connecticut each week, for an entire year to reach the next threshold. If he is paid a salary, then he does not receive additional pay for the additional work hours. It is unlikely he will work an additional 500 hours per year for free simply to avoid having to comply with the proof requirements for using the alternate rule.

If Ed pushed his Connecticut work hours to 60 percent of his total hours, he would also be able to increase the amount of income allocated outside New York. To gain the extra 500 hours, he would have to work an additional 25 percent above his required 40-hour work week, an effort worth approximately $40,000. Meanwhile, his total potential income tax liability in New York is only $4,800.

While the alternate rule clearly protects the interests of telecommuters, it also helps employees with multi-state jobs or careers. The real Professor Edward Zelinsky, and his counterpart in Example B, may not be true telecommuters if they are not using computers and other technology to work and interact with distant colleagues. Nevertheless, they work in two states and perform substantial work in each state. Therefore, the alternate rule permits them to allocate their fair share of income to each state.

Example C:

Tom, the Tennessee computer programmer, spends 75 percent of his work hours outside New York, an amount sufficient for him to meet the 60 percent ceiling. Thus, a rebuttable presumption arises that Tom is not working from his Tennessee home solely for the purpose of reducing his New York income tax and that his allocation of income is proper. Unless audited, Tom would not be required to provide proof of his hours worked outside New York or provide reasons for choosing to work in Tennessee.

New York would still receive tax based on the 25 percent of Tom's income allocated to New York. The Department would also be able, if appropriate, to overcome the presumption of allocation, but only if it can show that Tom's primary reason for working in Tennessee was income tax reduction.

Conclusion

The courts have upheld the New York State Department of Taxation and Finance's aggressive and expansive application of its convenience-of-the-employer rule. Even though the Department's application has been deemed constitutional and legal, it does not reasonably accommodate telecommuters and workers who work in multiple states. Moreover, it constitutes bad public policy. The proposed alternate construction, with its bright-line thresholds, should be considered because it: (1) presents more equitable treatment of nonresident employees and their employers who do contribute to the taxing state, (2) permits New York to receive its fair share of income from employees who work in the state, and (3) respects the interests of other states where workers live and work. The alternate rule prevents abuses, but it also limits the amount of additional administrative burdens of any new reporting regime. It permits New York to keep the protective convenience-of-the-employer rule in place, removes some of the more extreme inequities and much of the arbitrary impact of the Department's interpretation. Finally, the proposed floor and ceiling permit true telecommuters to enjoy the benefits of both their state of residence and their employer's state, allow them to pay their way without undue burdens, and reduce a significant roadblock to a beneficial workplace trend that governments, employers, and taxpayers would like to encourage.[32]■

[32] David A. Lieb, *Supreme Court Hears Case On Telephone Tax Refund, Again*, News Tribune, Feb. 3, 2006, *available at* www.newstribune.com.