

## NH Remote Tax Case Could Upend NY's Income Sourcing Rule

By **Maria Koklanaris**

*Law360 (February 5, 2021, 5:35 PM EST)* -- A U.S. Supreme Court case concerning New Hampshire's complaint against a Massachusetts regulation imposing income tax on remote workers during the coronavirus pandemic could have a profound effect on states with similar income sourcing rules, especially New York.

Massachusetts' temporary rule, put in place to address how it would tax nonresident workers employed by Massachusetts companies who are working from home during the pandemic, is similar in many ways to New York's "convenience of the employer" sourcing rule, as well as rules in a few other states. Under the convenience-of-the-employer rule, days worked remotely can generally be treated as if they were office days.

If the justices agree to consider New Hampshire's complaint and decide to broadly strike down the Massachusetts rule, it would likely mean an end to New York's rule, with huge implications for the state's fisc. The U.S. Supreme Court has invited the acting U.S. solicitor general to weigh in with an opinion on whether the justices should review the case.

"For New York, it's a fight that I don't think they can afford to lose," said Timothy Noonan, state and local tax partner and leader of the tax residency practice at Hodgson Russ LLP.

In comments made Friday afternoon, Democratic New York Gov. Andrew Cuomo indicated that he agreed.

"That lawsuit could have devastating impacts to the state if we're not successful," Cuomo said, indicating what he thought would happen if Massachusetts were to lose. "I believe we will be successful, and we should be successful, but there's no doubt that it would have devastating consequences."

New York brings in billions of dollars of revenue by taxing residents of neighboring states, such as New Jersey and Connecticut, who work in New York City. The U.S. Supreme Court has declined in the past to hear cases on the convenience-of-the-employer rule, under which states include in their tax bases the income earned by out-of-state employees of in-state businesses. But now that many employees are actually working at home, both New Jersey and Connecticut see a new avenue to challenging New York's rule and keeping more tax revenue for themselves.

They have joined New Hampshire in its battle challenging Massachusetts' reach across its border to tax nonresidents. New Jersey took the lead on an amicus brief urging the justices to take the case, which Connecticut, Hawaii and Iowa joined.

As many as 400,000 New Jerseyans are working from home during the COVID-19 period, paying billions to New York — a jurisdiction that is now providing them no services, noted Cosimo Zavaglia, a tax partner at Morgan Lewis & Bockius LLP.

"There's a lot of money at stake," Zavaglia told Law360. "It's not surprising at all that New Jersey and Connecticut decided to draft briefs telling the court that they're losing out on tax revenue as a result of New York's rule."

Besides New York, four other states — Pennsylvania, Delaware, Nebraska and Arkansas — have permanent convenience-of-the-employer rules similar to the temporary Massachusetts policy. But Pennsylvania has a reciprocity agreement with neighboring New Jersey that eliminates the bulk of residency issues in Pennsylvania, and the other states are relatively small. Thus, the convenience-of-the-employer issue has, until the relatively recent fight between New Hampshire and Massachusetts, been squarely centered in the tri-state area.

So far, New Jersey and Connecticut haven't gotten anywhere with their gripe against New York, but now they are jumping back in.

In its brief to the justices, New Jersey said its residents and those of the three other states listed on the brief are paying taxes to the convenience-rule states "that are inconsistent with the Constitution."

New Hampshire has made a similar argument in its complaint against Massachusetts, but there are significant differences, too, the brief noted. New Hampshire does not levy a personal income tax, so it is stepping into the shoes of its residents to tell the justices that residents have chosen to live in a state without an income tax and Massachusetts is violating their rights by imposing one on them. New Jersey and other states, however, do have personal income taxes, and they are providing credits to their residents who pay taxes to states other than their home states.

New Jersey told the justices that it and similarly situated states are thus presented with a Hobson's choice: "doubly tax residents' income or suffer fiscal consequences."

That language sounds a warning, tax professionals told Law360. It makes clear that New Jersey and other states have grown weary of continuing to allow income tax credits while states such as New York take in billions of dollars in taxes. The states were not shy about saying so before the pandemic, but now the situation is far more intense, said Edward Renn, who as a tax partner at Withers LLP practices in both New York and Connecticut. Not only is New York continuing to collect tax from residents of a state such as Connecticut, but it is doing so without providing any services to those Connecticut residents.

"Connecticut's got the obligation to send the ambulance and the fire department. Whose roads is the [worker] wearing out? He's wearing out Connecticut roads more likely than not," Renn said. "The state of Connecticut could have gotten that tax, but for the fact that New York has grabbed it."

New York, which so far has not filed an amicus brief in the New Hampshire v. Massachusetts matter, has long spent considerable resources to enforce the convenience-of-the-employer rule that brings it so much money. It does so administratively with a robust auditing force that focuses primarily on this issue,

Jeffrey Reed, chair of the state and local tax practice at Kilpatrick Townsend & Stockton LLP, told Law360.

Reed said New York routinely checks for residency and also to determine why the employee of a New York company might be elsewhere.

"If they determine [a worker is a] nonresident, they do apply the convenience-of-the-employer rule," Reed said. "It does come up in audits fairly frequently."

New York is also no stranger to litigating in defense of its rule. Edward Zelinsky, tax professor at Yeshiva University's Benjamin N. Cardozo School of Law and a Connecticut resident, sued the state over the rule, saying it violated due process and commerce clauses. In 2003, he lost at the New York Court of Appeals, the state's highest court, after a previous loss at the New York State Tax Appeals Tribunal.

Zelinsky has filed an amicus brief urging the U.S. Supreme Court to take New Hampshire's case and has also written articles on why the case has merit.

The issue isn't simply going to go away, Zelinsky told Law360. He noted that until 2019, Connecticut's position was that it would not grant a credit for taxes paid to New York, but the state then changed its mind.

"That doesn't solve the problem," Zelinsky said, saying that Connecticut could simply reverse itself again. "It's costing a lot of money this year. For 2021, they're going to continue to give the credit. But a future governor, or even this governor, under fiscal stress, could reasonably say, 'I've got to go back to the pre-2019 policy.'"

Despite his strong hopes that the justices will take New Hampshire's case, Zelinsky said he had no predictions to make on whether they would. Other tax professionals noted that even if the U.S. Supreme Court does agree to hear the case, a win by New Hampshire that is broad enough to affect the convenience-of-the-employer rule in New York and other states is by no means assured.

Renn said the court could always cite Congress, saying that it understands New Hampshire's arguments but the issue should be settled through legislation rather than litigation.

Reed said the court could consider that Massachusetts' rule is temporary, according to the Massachusetts Department of Revenue, and therefore say that a temporary rule is OK and has little bearing on rules of other states. But New York would likely be in trouble if the justices were to decide that the location of the employee rather than the location of the office is the basis for income tax, Reed said.

"If the court says there cannot be source income in a state unless the employee is physically working in the state, that to me would mean that New York's convenience-of-the-employer rule has been overturned and is unconstitutional," Reed said.

--Additional reporting by James Nani. Editing by Robert Rudinger and Neil Cohen.