State personal income tax exposure when working in non-domicile state

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In brief

In response to the COVID-19 pandemic, many states have declared states of emergency and imposed temporary social-distancing measures and other restrictions. Many businesses, in turn, have implemented work-from-home requirements for their employees. In some cases, individuals have opted to work from home in a location other than their primary state of residence, choosing instead to work from a second home or other location in another state. This action could have state tax implications.

At the beginning of the pandemic, the focus was on whether these employees would be required to report wages and other income as nonresidents while temporary telecommuting from these other states. However, as employees continue to remain at these locations, the discussion has started to shift as to whether they could be considered residents in these secondary states — even if they continue to be a resident in their state of domicile — and whether potential dual-residency status could result in double taxation.

In detail

Statutory residency

In a state that imposes a personal income tax on the income of its residents, an individual is considered to be a 'resident' if the individual is 'domiciled' in the state *or* if the individual meets the conditions of a statutory residency test.

Generally, an individual is considered to be domiciled in a state if the individual intends the state to be his or her permanent home. Such intent is evidenced by such factors as (1) the state in which an individual has registered to vote, (2) the state of an individual's driver's license, (3) the size and value of the individual's residence in the state (compared to other owned residences), (4) the individual's business activity in the state, and (5) the individual's family and social connections in the state.

In many states, an individual is considered to be a 'statutory resident' if the individual maintains a permanent place of abode in the state and spends in the aggregate more than 183 days during the year in the state. Although state rules vary in what constitutes a 'permanent place of abode,' a state generally regards a dwelling place that is continually maintained by an individual — whether or not owned by such an individual and including a dwelling place owned or leased by an individual's spouse — to be an individual's permanent place of abode. Further, while state rules often provide an exception to this rule for a temporary stay at a dwelling, such stay generally must be for the accomplishment of a particular documented purpose for a predetermined period of time not to exceed one year. An individual's second home/vacation home could meet the definition of a permanent place of abode.

As for the 'more than 183 days' prong of the statutory resident test that many states follow, states generally treat an individual's presence for any portion of a day as a full day for purposes of the day count. It is recommended that individuals who maintain a permanent place of abode in a non-domiciliary state maintain a calendar to track their days of presence in such state.

Taxation in domiciliary and statutory resident states

An individual treated as a resident in both the individual's state of domicile and state of statutory residency will be subject to tax on all sources of income that such states subject to a personal income tax. While states generally provide a credit for taxes paid to other jurisdictions, the allowance of such credit in dual-resident situations may be limited. For example, states generally allow a credit only for that portion of an individual's income that is sourced to another state (e.g., wage income for performance of services in a state and rental income derived from property located in a state). Since some types of income are unsourced (e.g., dividend income and interest income and capital gain derived from the sale of securities), a credit might not be available for tax imposed on such income.

In addition, an individual's state of statutory residency might impose tax at a higher rate than an individual's state of domicile. When this occurs, the credit that the state of domicile offers on double-taxed income likely is limited to the amount of tax that would have been paid on such income in the state of domicile. In other words, if the state of domicile imposes a 5% tax rate on an employee's salary but the state of statutory residency imposes a 7% tax rate, then the portion of the salary sourced to the state of statutory residency will still be effectively taxed at 7% because the credit functions to reduce the amount of double taxation up to the tax rate of the state of domicile (which, in this example, is only 5%).

Other tests

Some states do not apply the 'more than 183 days' test in determining whether an individual who is domiciled in another state should be taxed as a resident. California, for instance, treats an individual as a resident for personal income tax purposes if the individual is physically present in California for a purpose other than 'a temporary or transitory purpose.' It is recommended that taxpayers consult with their tax advisers to determine the applicable rules in the states where they might be staying for an extended period of time due to COVID-19.

Other considerations

States have issued COVID-19 state of emergency guidance affecting the collection of sales and use tax, the withholding of payroll taxes, and the imposition of the corporate taxes as a result of nonresident employees working from home instead of commuting to work.

The takeaway

Individuals working from a second home or vacation home in a state other than their state of domicile could be exposed to double taxation on their income if the criteria for statutory residency are met. It is recommended that individuals that have been working from a state other than their state of domicile consult their tax advisor to determine the statutory residency rules in these jurisdictions (and whether double taxation could be avoided), as well as how the credit provisions work in both their state of domicile and state of statutory residence, to determine any adverse state tax implications.

Let's talk

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