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# The Tax Implications of Working from Home

*Presented by FourFront Advisors*

In addition to causing countless hardships, the COVID-19 pandemic has created smaller issues that may be easy to overlook during a crisis. With employees working remotely far more often, for example, one such issue is the complexity of a scattered workforce and its various tax implications.

## Office Supplies and Equipment Needed for Remote Work

Because many offices are equipped with supplies and equipment that help employees perform efficiently, it's understandable that working remotely may cause deficiencies. Although many employees can work from home on occasion without a substantial need for equipment, working remotely for extended periods can cause that need to change.

Purchasing supplies and equipment could play out in a few ways, with varying tax implications:

1. The employee purchases the items and is reimbursed by the company.
2. The company purchases the items and provides them to the employee.
3. The employee purchases the items and does not get reimbursed.

**Company reimburses employee.** If a company reimburses an employee for the purchase of office supplies and equipment, it is generally not considered taxable income to the employee. Under most circumstances, therefore, the employee would not have any identifiable financial loss related to the purchase of the equipment.

There are a few important exceptions, however. First, the expense should be "ordinary and necessary." Specifically, as it relates to deductible business expenses, the IRS states in Publication 535, Business Expenses, **"To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in your industry. A necessary expense is one that is helpful and appropriate for your trade or business. An expense does not have to be indispensable to be considered necessary."**

Additionally, the employer must have what is referred to as an "accountable plan" that lays out the policy for expense reimbursement, including the documentation required to substantiate the claim and the timeline for submitting the expense claim. If the employer fails to have an accountable plan, the reimbursement may be deemed taxable income. In the same vein, if the employer has an accountable plan and the employee fails to follow it by substantiating his or her expenses, or is tardy in submitting for reimbursement, the reimbursement may be considered taxable income.

**Employer provides equipment.** Another area of concern is whether the equipment is used exclusively for business purposes or the employee derives personal benefit or entertainment from it. The major issue here is employer-provided computers and cell phones (or employee's reimbursement for these items). Although these items are intended to be used for business, they are sometimes used for personal reasons when an employee works from home. Fortunately, the IRS has issued Notice 2011-72, which says if the equipment is provided to the employee for "non-compensatory business reasons," personal use of the equipment would be deemed a "de minimis fringe benefit" to the employee and not counted as income. Initially, this ruling related to cell phones; however, as part of the Tax Cuts and Jobs Act (TCJA) of 2017, employer-provided computers were included.

If the employee is reimbursed for cell phone bills or for the use of a personal computer, the same concepts may not apply. There would likely be a closer analysis as to whether the item was purchased primarily for business use, as well as how often the employee uses it for business, in assessing to what extent reimbursement of the expense could be considered taxable income to the employee.

**Employee purchases items and isn't reimbursed.** The final way employees may acquire office supplies or equipment is by purchasing them without any expectation of employer reimbursement. Previously, employees could deduct unreimbursed employment expenses, but that deduction was eliminated as part of the TCJA. If employees are paying for office supplies out of pocket, they should not anticipate receiving any federal tax benefit, for the time being. Additionally, under the TCJA, employees can't take a deduction for the business use of their home. These concepts apply only to employees—not to self-employed independent contractors. In many circumstances, a self-employed person can deduct unreimbursed business expenses.

**State Taxation Possibilities**

Many businesses have employees who commute from neighboring states. Although this hasn't been a major issue for employers, having those employees work exclusively from home could have unintended consequences. States have the general ability to tax companies that operate within their borders; however, federal law requires there to be a "nexus" between the company and a state to permit the state to levy a state income tax on the business. Merely soliciting business in the state is typically not a significant enough connection to result in tax liability, but having employees working in that state could create a sufficient tax nexus.

In response to the pandemic, various states have issued guidance indicating they will not enforce their typical rules in creating a nexus between the state and employer or employee. As states are increasingly starved for revenue, however, it is important that businesses are aware of this tax possibility as they adopt work-from-home policies.

**State Income Tax Withholding Requirements**

Having employees exclusively work remotely in a different state than the one in which their company operates (even temporarily) could also affect withholding requirements. Many states impose an income tax on residents regardless of where they work. Typically, employees who commute across state lines would be subject to withholding only in the state in which the company operates. When those employees file their state income tax returns, they would get a credit for taxes paid to their company's state against their own state income tax liability. If an employee has changed to working and living in the same state, the company would be under an obligation, in most circumstances, to withhold state income taxes. Without prior knowledge, this could create complexity for the employee and an unanticipated administrative burden for the employer.

**Stay Aware of Tax Implications**

Because employers and employees have endured many life-altering changes throughout the COVID-19 crisis, it's easy to overlook some of the tax ramifications of an overwhelmingly remote workforce. As many employers have created an infrastructure that permits a more seamless work-from-home operation, however, being aware of the tax implications associated with working remotely is critical to avoiding unintended financial consequences.

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