

Lawyer Insights

New Jersey Strikes Back With New Convenience of the Employer Rule

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By Jason Feingertz, Katherine Gallagher and Zach Roop
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New Jersey employers with remote employees in New York, Alabama, Delaware, or Nebraska should review New Jersey's newly enacted Convenience of the Employer Rule to ensure they are properly withholding state income and payroll taxes for those remote employees. This is a result of a New Jersey withholding tax requirement that was first imposed in 2023 in response to the proliferation of employees that work remotely following COVID-19.

Withholding Tax for Remote Employees

States have long grappled with the question of how to properly source the income of an employee who works at home in one state, for an employer in another state. Some jurisdictions, most famously New York, have long addressed this question by adopting an aggressive Convenience of the Employer Rule. This rule generally sources to an employer's state the income of certain employees that work out-of-state for their own convenience rather than for the necessity of their employer. Employers must generally withhold state personal income and payroll taxes for such employees.

For example, if a resident of New Jersey works for an employer in New York, that employee's income is sourced to New York and subject to New York income taxes. While this rule was always controversial, it received increased attention in 2020 when many of those employees were asked by their employer to work remotely at home in New Jersey. It was unclear how New York would apply its Convenience of the Employer Rule, until October 2020, when New York announced that it would continue to impose the rule and would source the income of any employee who was working in a New York office pre-COVID-19, even if that employee did not return to the New York office during or post-COVID-19.

New Jersey's Convenience of the Employer Rule

In response to this tax burden placed on its residents and the tax revenue it was losing, in 2023 New Jersey passed its own Convenience of the Employer Rule retroactive to Jan. 1, 2023. New Jersey's Convenience of the Employer Rule is applicable only if the state where the nonresident employee is working remotely imposes its own similar Convenience of the Employer Rule on New Jersey residents.

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Based on the current laws imposed across this country, this would only impact employees working remotely for a New Jersey employer in New York, Alabama, Delaware, and Nebraska. Remote workers in Connecticut and Pennsylvania, which have Convenience of the Employer Rules that do not apply to New Jersey residents, will be safe from New Jersey taxation under the rule.

New Jersey's Convenience of the Employer Rule does not apply a consistent test for determining whether compensation earned by a nonresident telecommuting for a New Jersey employer will be deemed New Jersey-sourced income. Rather, New Jersey will apply the rule of the nonresident's state. This means that a New York resident working remotely for a New Jersey employer will find their own state's aggressive Convenience of the Employer Rule turned against them.

New Jersey's Revenge

New Jersey has historically suffered due to the application of a Convenience of the Employer Rule against its residents. New Jersey offers a generous tax credit for income that is taxed by another jurisdiction to avoid subjecting residents to double taxation. Its proximity to New York has long meant that New Jersey has lost out on potential tax revenue from remote employees living and working in New Jersey who fall afoul of New York's Convenience of the Employer rule.

Another part of P.L.2023, c. 125 may shed some light on New Jersey's motivations in passing a retaliatory Convenience of the Employer Rule targeting states that impose such a rule on New Jersey residents. Alongside its adoption of the retaliatory Convenience of the Employer Rule, New Jersey also adopted a new gross income tax credit for taxpayers who successfully win a legal challenge against another state's taxation of their income derived from services rendered while the resident taxpayer was within New Jersey. The credit is for half the amount that would become due to New Jersey after the successful challenge and is fully refundable. This effectively puts a bounty on other states' aggressive sourcing rules, like New York's Convenience of the Employer Rule, which capture the income of New Jersey residents.

How Should Employers Comply?

Whatever the rationale behind the new Convenience of the Employer Rule, it will have state income and payroll tax reporting implications for New Jersey employers with out-of-state remote employees.

New Jersey employers should review whether remote employees will be subject to this new Convenience of the Employer Rule. Not only is this important to ensure nonresident employees have sufficient income sourced to New Jersey, but employers should also ensure that New Jersey income and payroll taxes are withheld from any New Jersey-sourced compensation due to the Convenience of the Employer Rule.

Additionally, for companies that apply special sourcing rules when computing their state corporate income tax liability, there could be major implications in calculating the payroll factor. While New Jersey has generally adopted the single payroll factor, special apportionment rules apply in the case of trucking companies or instances where the standard apportionment provisions do not fairly reflect the level of a company's business activities in New Jersey. If three-factor apportionment is used, New Jersey employers should take care to ensure the payroll factor for apportioning 2023 income reflects the correct amount of compensation sourced to New Jersey under the Convenience of the Employer Rule.

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