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## Viewpoint

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# Congress Must Slam the Brakes On New York's Convenience-of-the-Employer Rule

by Nicole Belson Goluboff

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On March 29, the New York Court of Appeals decided *Huckaby v. New York State Division of Tax Appeals*, upholding the state's "convenience of the employer" rule<sup>1</sup> against challenges raised by a Tennessee telecommuter. The decision brings into sharp focus the national significance of New York's convenience rule. It confirms that New York will not confine its application of the rule to nonresident telecommuters living in neighboring states. Rather, it will tax telecommuters living anywhere in the nation on the income they earn while working at home for their New York employers.

New York's nationwide campaign against interstate teleworkers demands federal intervention. Last September, near the end of Congress's 108th session, Sen. Christopher J. Dodd, D-Conn., and Rep. Christopher Shays, R-Conn., introduced "The Telecommuter Tax Fairness Act," a bill that would prohibit states from applying the convenience of the employer rule. In the wake of *Huckaby*, the 109th Congress must reintroduce and pass this corrective legislation quickly.

### The Facts of Huckaby

Thomas L. Huckaby was a Tennessee resident employed as a computer programmer for a Tennessee firm, Multi-User Computer Solutions (MCS). One of the firm's clients for which Huckaby provided service was the National Organization of Industrial Trade Unions (NOITU), an organization based in Jamaica, N.Y.

In 1991, MCS underwent a reorganization that resulted in Huckaby's termination. Subsequently, NOITU hired him. NOITU and Huckaby agreed that Huckaby would work primarily from his Tennessee home and travel to New York only "as needed." NOITU helped to both establish and maintain Huckaby's Tennessee home office, setting up a long-distance data line to connect the New York and Tennessee offices and reimbursing Huckaby monthly for office expenses.

During each of the two tax years at issue (1994 and 1995), Huckaby spent approximately 75 percent of his work time in Tennessee and 25 percent of his work time in New York. When he filed his nonresident New York income tax returns for those years, he "allocated his income between New York and Tennessee based on the number of days he worked in each state relative to the total number of days he worked in each tax year."<sup>2</sup>

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New York disallowed the allocation and taxed him on his entire income, including the income he earned in Tennessee. Tracking the language of the convenience rule, the Department of Taxation and Finance explained that, "[a]ny allowance claimed for days worked outside of New York must be based on the performance of services which, because of the necessity of the employer, obligate the employee to out-of-state duties in the service of his employer. Such duties are those which, by their very nature, cannot be performed at the employer's place of business."<sup>3</sup>

Huckaby challenged New York's taxation of the income he earned in Tennessee. New York denied his challenges at the administrative level, and the Appellate Division upheld the administrative decision.<sup>4</sup> Huckaby then appealed to the Court of Appeals, New York's highest court.

<sup>2</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005). (For the New York State Court of Appeals' ruling in *Huckaby*, see *Doc 2005-6487* or *2005 STT 62-21*.)

<sup>3</sup> *Id.*

<sup>4</sup> *Huckaby v. New York State Division of Tax Appeals*, 6 A.D.3d 988 (App. Div. 3d Dept., 2004).

<sup>1</sup> 20 N.Y.C.R.R. section 132.18(a) ("If a nonresident employee . . . performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State. . . . However, any allowance claimed for days worked outside New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the services of his employer.").

Before the Court of Appeals, Huckaby conceded that he did not work from home because of employer necessity. He argued, however, that New York's application of the convenience rule to him was contrary to the state's statutory tax law. He also argued that it violated his rights under both the Due Process and Equal Protection clauses of the U.S. Constitution. The Court of Appeals, in a 4-3 decision,<sup>5</sup> rejected his claims.

### Conclusions of Law

#### New York's Tax Law

Under the tax law, nonresidents must pay tax on their New York-source income.<sup>6</sup> That income includes income attributable to "a business, trade, profession or occupation carried on in" New York.<sup>7</sup> Huckaby argued that the tax law does not permit New York to tax him on income attributable to work he carried on in Tennessee.

The majority disagreed. According to the Court of Appeals, the Tax Law authorized the promulgation of rules for determining New York-source income in cases in which a business, trade, profession or occupation is carried on partly within and partly outside New York.<sup>8</sup> Under that statutory authorization, the commissioner of taxation and finance developed the convenience of the employer rule. Because the commissioner fulfilled his statutory duty by developing the rule, there was no violation of the statute in concluding that all of Huckaby's income was New York-source income.<sup>9</sup>

The dissent objected. "The majority's sole ground for holding that Huckaby's income is 'New York source income' is that the Commissioner says it is. . . . But the Commissioner's rule is still supposed to make sense," and, as applied to Huckaby, it does not.<sup>10</sup>

According to the dissent, although application of the rule has, in some cases, been justified on the grounds that it prevented employees from working outside New York for the specific purpose of evading New York tax liability, that rationale fails in Huckaby's case. "Huckaby does not work in Tennessee to avoid New York taxes; he works there because that is where he lives. There is no undue difficulty in verifying his claim that three quarters of his working days are spent in Tennessee." Further, the dissent said, "there is no other good reason for attributing the part of Huckaby's income that is

earned in Tennessee to 'a business, trade, profession or occupation carried on in this state.'"<sup>11</sup>

#### Due Process

Huckaby argued that New York's application of the convenience rule to him violated the federal Due Process Clause because it resulted in taxation "out of all proportion to the benefits" he receives from New York.<sup>12</sup> Again, the majority disagreed.

As the majority characterized Huckaby's position, Huckaby asked the Court of Appeals "to engraft a proportionality requirement upon existing due process precedent."<sup>13</sup> However, the court implied, the matter of proportionality is relevant under the Commerce Clause, not the Due Process Clause.

"All that is required to satisfy due process," the Court of Appeals said, "is some 'minimal connection' between the taxpayer and the state, and that the income the state seeks to tax be 'rationally related to values connected with' the state."<sup>14</sup> Huckaby had the requisite "minimal connection," because he "accepted employment from a New York employer and worked in his employer's New York office approximately 25 percent of the time annually."<sup>15</sup> The Court of Appeals also said "the amount of time [Huckaby] spent working in New York — 25 percent — is significant enough to satisfy any rough proportionality requirement called for by due process."<sup>16</sup> Further, taxing 100 percent of Huckaby's income was "rationally related" to values connected with New York, because both he and his employer received benefits from New York every day, regardless of whether he chose to telework.

### ***If the employee works out of state for convenience, the employer is not engaged in interstate commerce, the court of appeals believes.***

The majority further said the convenience rule was "designed to comply" with the Commerce Clause, as well as the Due Process Clause.<sup>17</sup> According to the Court of Appeals, if an employee works out of state due to employer necessity, the employer is engaged in interstate commerce. If the employee works out of state for convenience, the employer is not engaged in interstate commerce, the high court believes.<sup>18</sup> New York

<sup>5</sup> Judge Read wrote the majority opinion, in which Chief Judge Kaye and Judges Rosenblatt and Graffeo concurred. Judge R. S. Smith wrote a dissenting opinion, in which Judges G. B. Smith and Ciparik concurred.

<sup>6</sup> Tax Law section 601(e).

<sup>7</sup> Tax Law section 631(b).

<sup>8</sup> Specifically, the court of appeals discussed tax law section 631(c), which provides:

If a business, trade, profession or occupation is carried on partly within and partly without this state, as determined under regulations of the tax commission, the items of income, gain, loss and deduction derived from or connected with New York sources shall be determined by apportionment and allocation under such regulations.

<sup>9</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005). ("[T]he statute facially evidences the Legislature's intent to tax nonresidents on all New York source income, and to task the Commissioner to develop a workable rule for apportioning and allocating the taxable income of nonresidents who work both within and without the State. The Commissioner has carried out his statutory responsibility by adopting the convenience of the employer test.")

<sup>10</sup> *Id.* (Smith, R. S., J., dissenting).

<sup>11</sup> *Id.* The dissent addressed a second potential rationale for concluding that the convenience rule comports with New York's tax law, *viz.*, the commissioner's argument that Huckaby's income comes from a "business, trade, profession or occupation carried on this state" (and is therefore "New York source income") because the business of Huckaby's employer is "carried on" in New York. The dissent rejected that argument as "untenable." The commissioner's "theory not only contradicts the apparent meaning of the statute and our . . . interpretation of it [in an earlier case]; it is riddled with logical flaws."

<sup>12</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005).

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* (citation omitted).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* ("[N]onresidents do not implicate themselves or their employers in interstate commerce merely by working from home")(citing *Zelinsky v. Tax Appeals Tribunal of New York*, 1 N.Y.3d 85 (2003), *cert. denied*, 541 U.S. 1009 (2004)). (For the New York State Court of Appeals' ruling in *Zelinsky*, see *Doc 2003-25309* or *2003 STT 228-10*.)

will not tax the income earned as a result of the employer's participation in interstate commerce, the high court said, because that income is not New York-source income.<sup>19</sup>

However, the Court of Appeals failed to explain why the New York employer's status as an interstate actor requires the conclusion that the employee's income is not New York-source income. As the dissent observed, "the majority's assumption that the New York company is involved in interstate commerce would if anything support the argument that the company's [nonresident] employees are getting income from a New York source. The word 'interstate' seems to imply a source in one state and a recipient in another."<sup>20</sup>

By substituting "interstate commerce" for "work performed out of state due to employer necessity," and by simply declaring that income is foreign-source income when earned by a nonresident whose employer is participating in interstate commerce, the Court of Appeals contorted the convenience rule into "a surrogate for interstate commerce" — as the commissioner had argued the court should.<sup>21</sup> The dissent objected that this "novel Commerce Clause theory" lacks precedent or reason.<sup>22</sup>

The majority concluded:

Under the [convenience rule], New York taxes a nonresident employee's income from a New York employer except to the extent the income is connected with the employer's participation in interstate commerce. By taxing only income sourced to New York, the convenience test is rationally related to values connected with New York because New York has the right to tax 100 percent of a nonresident employee's income derived from New York sources. . . . [T]he convenience test constitutes an across-the-board standard designed to comply with both due process and the Commerce Clause.<sup>23</sup>

The Court of Appeals' view — a circular one — is, essentially: "The rule used to determine what is New York source income satisfies both the Commerce Clause and the Due Process Clause because it taxes only New York source income and New York has the right to tax all of a nonresident employee's New York source income."

### Equal Protection

Huckaby argued that the convenience rule violated the U.S. Constitution's Equal Protection Clause by discriminating between nonresidents who work outside New York for personal convenience and nonresidents who work outside the state due to employer necessity. In rejecting this claim, the majority explained:

<sup>19</sup> *Id.* ("Where work is performed out of state of necessity for the employer, the employer creates a nexus with the foreign state and essentially establishes itself as a business entity in the foreign state. . . . The convenience test stands for the proposition that New York will not tax a nonresident's income derived from a New York employer's participation in interstate commerce because in such a case, the nonresident's income would not be derived from a New York source.")

<sup>20</sup> *Id.* (Smith, R. S., J., dissenting).

<sup>21</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005).

<sup>22</sup> *Id.* (Smith, R. S., J., dissenting).

<sup>23</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005).

New York distinguishes between these two classes of nonresidents because by doing so, it properly taxes nonresidents only on income sourced to New York, and, concomitantly, avoids taxing income derived from interstate commerce. That classification, which is designed to comply with both the Commerce Clause and the Due Process Clause, is therefore rational in every respect.<sup>24</sup>

Again, however, the court reasoned in circles.

Under the convenience rule, distinguishing between nonresident "convenience telecommuters" and nonresident "necessity telecommuters" is the mechanism for determining New York-source income: Income that "convenience telecommuters" earn at home is New York-source income; income that "necessity telecommuters" earn at home is not. Thus, the Court of Appeals' justification (quoted above) for distinguishing the two classes of telecommuters is, in sum: "New York uses the method it does to determine what is New York-source income because, by doing so, it taxes nonresidents only on New York-source income." Further, the high court implies, New York's mechanism for sourcing income satisfies the Equal Protection Clause because it is designed not to violate either the Commerce Clause or Due Process Clause. The court's analysis defies reason.

### New York's Wide Reach

In addition to straining logic, the decision in *Huckaby* underscores just how far New York is willing to go geographically to collect revenue from interstate telecommuters. The most recent case before *Huckaby* to strike down constitutional challenges to New York's convenience-of-the-employer rule was *Zelinsky v. Tax Appeals Tribunal of New York*<sup>25</sup> — a case concerning a Connecticut telecommuter who arguably lived close enough to New York to commute there on a regular basis. However, *Huckaby* lived and worked 900 miles from New York,<sup>26</sup> far beyond commuting distance.

## ***Huckaby is simply one example of New York's perception that it can march into any state in the country to tax cross-border telecommuters.***

*Huckaby* is not an isolated case in which New York applied the convenience-of-the-employer rule far afield. It is simply one example of New York's gluttonous perception that it can march into any state in the country to tax cross-border telecommuters. In addition to Tennessee, New York has previously targeted telecommuters in such remote locations as Maine,<sup>27</sup>

<sup>24</sup> *Id.*

<sup>25</sup> *Zelinsky v. Tax Appeals Tribunal of New York*, 1 N.Y.3d 85 (2003), cert. denied, 541 U.S. 1009 (2004).

<sup>26</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005).

<sup>27</sup> *In the Matter of Wallace*, DTA No. 817182 (Dec. 21, 2000). (For the New York Division of Tax Appeals' decision in *Matter of Wallace*, see *Doc 2001-666* or *2001 STT 5-28*.)

New Hampshire,<sup>28</sup> North Carolina,<sup>29</sup> and Florida.<sup>30</sup> New York's persistent overreaching poses a national threat.

### National Goals at Risk

The Court of Appeals effectively conceded that New York's convenience rule discourages telework.<sup>31</sup> However, the country cannot afford the burden on interstate employment relationships that the rule imposes.

Telework is a vital tool for achieving a wide variety of national objectives. As I have previously argued,<sup>32</sup> telework can increase the productivity of American businesses; facilitate emergency management and disaster recovery for both business and government; help contain gas and oil prices; reduce vehicular traffic; and help preserve the environment. Telework can strengthen the economies of our rural communities; reduce the incentives to move American jobs offshore; and help the disabled and elderly contribute to our economy. Telework can help Americans improve the balance between their work and personal lives. It can also provide career continuity for frequently relocating military spouses, while improving retention rates for their employers. Individual states should not be permitted to thwart the country's efforts to use telework for those and other important ends.

### ***Telework is a vital tool for achieving a wide variety of national objectives.***

In addition, federal law requires federal agencies to make telework available to 100 percent of their eligible employees,<sup>33</sup> and New York's convenience rule compromises the ability of agencies to comply with that mandate. Suppose a New York nonresident works for a federal agency located in New York. Trying to satisfy federal law, the agency establishes a telework program and offers the employee the opportunity to participate. However, by obligating the telecommuter to pay New York taxes on the income earned outside New York, the convenience rule may render participation in the telework program too expensive for the nonresident employee. (Indeed, if the telecommuter lives in a state that does not provide a credit for taxes paid to New York on income earned at home, the telecommuter may owe taxes to both New York and the home state.<sup>34</sup>)

If an agency's telework program is unaffordable for nonresident employees, it is not truly available to them. Individual states should not be permitted to obstruct agencies' efforts to meet federal statutory requirements.

### A Federal Remedy

Because New York has made clear that it intends to ignore state lines when taxing telecommuters, Congress must get involved. Dodd and Shays recognized the need for a federal remedy when, in September, they introduced the Telecommuter Tax Fairness Act. Upon introducing the bill, Dodd spelled out the national impact of New York's punitive tax: "[T]his is an issue which affects workers all over the country. It will only grow more pressing as people and businesses continue to seek to take advantage of new technologies that affect the way we live and work."<sup>35</sup>

### ***Perhaps the New York Court of Appeals can dismiss the deterrent effect the convenience rule has on the growth of telework in this nation, but Congress must not.***

As originally introduced, the Dodd/Shays bill provided that, when applying its income tax laws to nonresidents, a state (1) may treat a nonresident as working in the state only if he or she is physically present in that state; (2) may not tax a nonresident on income he or she earns when physically outside the state; and (3) may not treat a nonresident as if he or she is physically working in the state on the grounds that the nonresident is working at home for personal convenience.<sup>36</sup>

The Telework Coalition (Telcoa), a telework advocacy group in Washington, continues to press for the reintroduction and passage of that legislation. On its Web site, <http://www.telcoa.org>, Telcoa offers a sample letter that telecommuters, employers, and other stakeholders can send their congressional representatives urging enactment of the bill. Perhaps the New York Court of Appeals can dismiss the deterrent effect the convenience rule has on the growth of telework in this nation, but Congress must not. ☆

<sup>28</sup> *In the Matter of Gray*, DTA No. 819457 (Feb. 24, 2005). (For the Division of Tax Appeals' decision in *Matter of Gray*, see *Doc 2005-4339* or *2005 STT 44-27*.)

<sup>29</sup> *In the Matter of King* (State Tax Commission, Apr. 6, 1987).

<sup>30</sup> *In the Matter of Estate of Roemer*, DTA No. 815734 (Sept. 3, 1998). (For the New York Division of Tax Appeals' decision in *Matter of Estate of Roemer*, see *Doc 98-28088* or *98 STN 181-13*.)

<sup>31</sup> *Huckaby v. New York State Division of Tax Appeals* (New York, Mar. 29, 2005) ("Petitioner criticizes the convenience test as unfair and unsound as a matter of tax policy and a discouragement to telecommuting. Maybe so.")

<sup>32</sup> Nicole Belson Goluboff, "Put the Telecommuter Tax Fairness Act in the Passing Lane," *State Tax Notes*, Nov. 1, 2004, p. 319, *2004 STT 211-2*, or *Doc 2004-19727*.

<sup>33</sup> Public Law 106-346. See also Public Law 108-447 (requiring that \$5 million be withheld from the budgets of certain federal agencies and departments until they certify their compliance with Public Law 106-346).

<sup>34</sup> See *Zelinsky v. Tax Appeals Tribunal of New York*, 1 N.Y.3d 85 (2003), *cert. denied*, 541 U.S. 1009 (2004).

<sup>35</sup> 150 Cong. Rec. S. 9033 (Sept. 9, 2004).

<sup>36</sup> S. 2785; H.R. 5067 (108th Cong.).