
S&P: Massachusetts And New York State Could Lose Billions Of Income Tax Dollars If Lawsuit Challenging Remote Work Succeeds

NEW YORK (S&P Global Ratings) Jan. 22, 2021–S&P Global Ratings believes a pending U.S. Supreme Court case, New Hampshire v. Massachusetts, could result in the reallocation of billions of income tax dollars between certain states. New York and Massachusetts in particular could potentially lose significant amounts of income tax, while New Jersey and Connecticut could gain revenue.

The case considers whether Massachusetts may impose income tax on New Hampshire residents who are teleworking from home for employers with primary offices in Massachusetts. New Hampshire argues the Massachusetts tax violates its state sovereignty (that is, only New Hampshire has the authority to tax its residents' income). Massachusetts argues that the COVID-19 pandemic is temporary, and ultimately those New Hampshire residents will go back to work at their offices in Massachusetts where the tax is valid. More broadly, the lawsuit could clarify the allocation among the states of taxable personal income generated from teleworking. A decision as to whether the U.S. Supreme Court (SCOTUS) will accept the case should be forthcoming. If SCOTUS declines to take up the case, we expect similar challenges to reappear.

The Pandemic Prompted The New Hampshire v. Massachusetts Dispute, But The Issue Is Not New Or Unique To These Two States

Massachusetts' tax was in response to the COVID-19 pandemic, which prompted many companies to require employees to work from home. Nevertheless, a small number of states have imposed income taxes on out-of-state telecommuters for some time, such as New York. Connecticut or New Jersey residents telecommuting for a New York City-based company have historically paid income tax to New York State regardless of whether or not they worked in New York City or worked remotely from their homes. While New York City levies a local income tax, its city income tax applies only to residents and not commuters. New Jersey and Connecticut have had to enact income tax credits to residents for income taxes paid to New York to avoid double taxing their residents. New York State has defended its tax on the theory that as long as a company does not require workers to telecommute from a specific out-of-state location, telecommuting out of state was at the convenience of the employee and that income should be attributed to the home office of the company, unless telecommuting was "deemed necessary" by the employer. But in light of COVID-19, many companies are requiring their workers to telecommute. Furthermore, as New Jersey argues, in an amicus curiae brief supporting New Hampshire's position in the case, the threshold of "deemed necessary" may not be the appropriate standard any longer given that technology has all but eliminated the need for many employees to be physically present at the employer's location.

A win for New Hampshire would benefit states with a large number of residents commuting out of state to work, such as New Jersey, Connecticut, Hawaii, and Iowa

The credit impact of the case for New Hampshire is not immediately significant because New

Hampshire doesn’t levy a personal income tax. Nevertheless, the state estimates approximately 300,000 of its residents stand to benefit because they would avoid paying Massachusetts tax on approximately $6.04 billion of their collective income. Other states, New Jersey and Connecticut among them, with a significant number of residents commuting out of state to work, where income tax collections have gone to the state of employment, could also benefit if New Hampshire prevails against Massachusetts. Since the filing of the original New Hampshire lawsuit on Oct. 19, 2020, New Jersey, Connecticut, Hawaii, and Iowa have filed amicus briefs supporting New Hampshire’s position.

New Jersey estimates in its amicus brief that 400,000 state residents commuted to jobs in New York City before the pandemic, while Connecticut estimates 78,000 of its residents did. New Jersey calculates that in 2018 it credited more than $2 billion to resident taxpayers who worked for out-o--state employers, virtually all of which is attributable to New York City employers, and of which $100 million-$400 million of the credit was for work performed by New Jersey residents working remotely. Once the pandemic began, New Jersey estimates the work-from-home rates ranged from 44% to 58%, indicating a loss of tax revenue of $928.7 million-$1.2 billion to New York for the 12-month period beginning March 2020. The potential new revenue from a favorable ruling could be significant compared with the $36 billion of 12-month operating revenue New Jersey has budgeted for fiscal 2021. Using a similar analysis, Connecticut estimates it will lose $339.0 million-$444.5 million of 2020 income tax revenue to New York State.

On the other hand, a win for New Hampshire could reduce revenue for some states with large employment centers–New York, Arkansas, Delaware, Massachusetts, Nebraska, and Pennsylvania Potential tax losers could include states with large employment centers on the other side of the state line, with New York State of particular importance because of the large number of high-income Connecticut and New Jersey residents who work in New York City. The amicus brief identifies six states–Arkansas, Delaware, Massachusetts, Nebraska, New York, and Pennsylvania–that tax out-o--state residents for income earned working from home.

New York State stands to lose $1.27 billion-$1.64 billion of tax revenue in New Hampshire were to prevail, compared to its budgeted general fund tax receipts of $62 billion in fiscal 2021. New Hampshire’s amicus brief does not estimate Massachusetts’ potential tax loss, although a separate analysis by New Hampshire’s economic advisor estimates up to $1.2 billion of earnings are attributable to New Hampshire residents who work remotely but are employed by an organization located in Massachusetts. The New Jersey amicus brief estimates Massachusetts could also lose about $3.2 million-$4.2 million to New Jersey alone. Taxes on out-of-state residents tend to be popular with the state imposing them and will likely not disappear without an adverse ruling from SCOTUS.

This report does not constitute a rating action.

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