



# Remote workers and COVID-19 in the sports, media, and entertainment industries – Are new tax obligations on the horizon?

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The coronavirus pandemic has forced most studios and many other production companies to accelerate the adoption of remote working. While the process of making creative decisions both before the shoot (such as casting, set, and costume design) and postproduction tasks (such as editing, sound engineering, marketing, and distribution) historically had been in-person work and tended to cluster in Los Angeles and New York, new virtual workspace technologies have already begun to change this thinking. Hollywood has started making progress toward shifting to a remote workforce while still completing preproduction, postproduction, and marketing and promotion. COVID-19 simply accelerated this change to working near 100 percent remotely.<sup>1</sup>

In the case of Los Angeles-based companies, remote workers can often be found in places where they maintain second or vacation homes, such as Arizona, Colorado, Nevada, and Utah. In the case of New York, remote working is commonplace in Connecticut, Massachusetts, New Jersey, Pennsylvania, and Vermont. Further, these states offer robust remote careers in human resources/back-office functions (e.g., legal, administrative, finance), marketing, writing, computer/IT, and editing.<sup>2</sup> Many international remote workers in the film industry are also found in Berlin, London, Paris, and Toronto.<sup>3</sup>

In the world of sports, remote working became the lone option as competition was "ring fenced" in a single "bubble" and players were forced to train away from the team's practice facilities. The 2020 National Basketball Association (NBA) playoffs and a portion of the Major League Soccer (MLS) regular season took place in Orlando, Florida. The later rounds of the 2020 Major League Baseball (MLB) playoffs took place in San Diego, California and Arlington, Texas. The 2020 National Hockey League (NHL) playoffs took place in two hub cities in Canada.<sup>4</sup>

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<sup>1</sup> See Peter Jackson and Kenneth Williams, *Hollywood Must Adapt to Remote Work or Suffer the Consequences*, Fortune Magazine (July 1, 2020).

<sup>2</sup> See *Remote Job Market Map - Trends, Companies, & Facts* by FlexJobs (<https://www.flexjobs.com/remote-job-market-map/state=CA>).

<sup>3</sup> The Pop Blog, *Top 10 International Cities to Live in if you Work in Film* (<https://www.wegotpop.com/pages/2017/06/02/top-10-cities-live-work-film>).

<sup>4</sup> A discussion of the possible Canadian tax consequences is not discussed herein.

For the remote worker, the tax issue is what is the source of the employee's income associated with her work away from the employer's location for personal income tax purposes? The three possible answers to this question are: (1) the employer's location, (2) the place where the services are performed, or (3) the employee's place of tax residence.

For the employer of the remote worker, the tax issues are: (i) does the employee's work away from the employer's location create nexus for the employer in the place where such services are performed, and (ii) does the employee's work away from the employer's location affect the source of the employer's income? The possible answers to these questions vary from state to state and depend most on varying determinations of the geographic location of "economic activity" that has physical and virtual ties to one or more jurisdictions.

### **The employee's concerns**

Most states impose income taxes on both resident and nonresident individuals. State residency exists by virtue of an individual's place of domicile or her physical presence in a state in excess of a defined number of days in a taxable year. Resident taxation is typically levied on worldwide income, with credits provided for income taxes paid to other states on the same income.

Nonresident taxation is typically limited to income from personal services. Such personal service income is often determined by looking to the percentage of an individual's working days in the state compared with her working days everywhere.

New York's "convenience of the employer rule" (discussed below)<sup>5</sup> provides that a nonresident employee does not need to be physically present in the state for her wages to be subject to tax. If the employee's state of residency does not determine the source of personal service income under such a rule, the employee could be subject to double state taxation (as the employee's state of residency may deny a tax credit for the taxes paid to New York under the "convenience of the employer rule").

Employees earning personal service income in the states of Florida, Nevada, and Texas are not subject to personal income taxes whether on a resident or nonresident basis. These states do not tax personal service income. Query, then, whether the choice of Florida and Texas sports "bubbles" was partly motivated by tax considerations of the players and non-player personnel.

### **The employer's concerns**

#### **Nexus**

Regarding the question of nexus, state tax policy may be moving toward the conclusion that the location of a full-time employee's work place rather than the employer's office is the determining factor in the creation of nexus as long as the product of the employee's work contributes to the production of the employer's goods or services. It might be that only a minimum level of "economic activity" is required. A 2012 case in New Jersey, *Telebright Corp. v. Director, New Jersey Division of Taxation*, 38 A.3d 604 (N.J. Super. Ct. App. Div. 2012), best illustrates this conclusion. In *Telebright*, the court held that the activities of a single employee working remotely from her home in New Jersey caused her Maryland-based employer to have nexus with New Jersey. The employee's activities, which amounted to writing software code from her home in New Jersey, was determined sufficient enough to contribute to the "[production of] a portion of the company's web-based product."

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<sup>5</sup> Connecticut and Pennsylvania also apply a similar rule.

New York, Connecticut, and Pennsylvania, on the other hand, may think otherwise. Under New York's "convenience of the employer rule," non-New York resident employees working from home are treated as earning income at their employer's location. This rule, while aimed at determining the taxation of the employee, could be read to mean that such remote worker working, at her convenience, from her home outside of New York, alone does not create "economic activity" in such state.

### Source

The rules adopted by most states for corporation taxation have changed recently so that states are increasingly attributing to income amounts based on the corporation's "market" for its goods, services, and intangibles without regard to the location of the corporation's capital or labor that produced whatever was sold in that market. Thus, market-based tax levies are the order of the day in most states, including the states of Arizona,<sup>6</sup> California, Colorado, Connecticut, Florida, Massachusetts, New Jersey, New York, Pennsylvania,<sup>7</sup> Utah, and Vermont. Nevada and Texas do not generally impose a corporation income tax and, thus, allocation of receipts is not an issue.<sup>8</sup>

### Employer withholding

Any uncertainty about whether a remote employee can be taxed by a state where her services are performed raises issues about the withholding obligation of the employer. While some states have issued COVID-19 guidance related to withholding, most have not. Thus, employers need to be cognizant of its withholding obligation for payments made to remote service providers. The penalty environment may be richly imposed on non-compliant withholding agents.

### International issues

In the international marketplace, individual tax residency is generally based on the number of days spent in a particular jurisdiction. For those employees stranded in a country because of COVID-19 travel or related restrictions, some countries offer relief from individual taxation if the employee's stay exceeds the prescribed number of residency days. Applicable treaty relief may also be available. For nonresident U.S. individuals, Rev. Proc. 2020-20 (2020-20 IRB 801 (April 2020)) provides some relief for individuals stranded in the United States on or after February 1, 2020.

Regarding the employer of the employee working remotely in a foreign country, nexus is predominantly defined in the context of whether an employer's business activities give rise to a "permanent establishment" (PE) in such foreign country. A PE is generally created where a taxpayer maintains a fixed place of business through which it regularly conducts business. The activities of employees, agents, independent contractors, and the like may also be imputed to a taxpayer in order to find a PE. According to the Organisation for Economic Co-operation and Development (OECD)'s *Analysis of Tax Treaties and the Impact of the COVID-19 Crisis*, the unintended, extended stay of displaced employees, agents, and independent contractors is a force majeure and hence should not give rise to adverse tax consequences. Note also that most tax treaties exempt from the definition of a PE activities that lasts for no more than six or 12 months (depending on the treaty). Thus, under such treaties, the temporary interruption of activities because of COVID-19 may extend the applicable six- or 12-month period.

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<sup>6</sup> Arizona, unlike the other states noted, uses a multifactor formula that also takes account of payroll and property costs incurred in the state.

<sup>7</sup> Not without controversy, Pennsylvania uses a cost-of-performance approach for the allocation of receipts from intangibles.

<sup>8</sup> These states do, however, impose a tax on the allocable gross receipts of a corporation.

If the remote worker is a member of a company's key management personnel or a director of company that is responsible for management decisions, an extended stay can trigger "place of effective management" (POEM) rules and create double residency under domestic laws and tax treaties. The OECD guidance suggests that a temporary change in the location of directors and key management personnel caused by COVID-19 should not alter the POEM of the entity.

In the United States, Rev. Proc. 2020-20 (cited above) provides that during the COVID-19 emergency, services or activities performed by individuals temporarily present in the United States will not be considered to determine if the nonresident or foreign corporation has a PE.

If remote working give rise to a PE, profits attributable to the PE will be taxable in the country in which the PE is located. While an applicable tax treaty may wholly or partially negate the cost of double taxation, the employer would still be faced with the administrative burden of determining allocable profits. In the international context, this determination is often made on the basis of assuming the PE were a separate and independent enterprise, considering the functions performed, assets used, and risks assumed. The risk of potential double taxation is even greater in a non-treaty context.

### **Concerns regarding professional sports "bubble" play**

For the NBA, MLB, and MLS "bubble" play, neither the players nor the non-player personnel should have any concerns for individual taxation in the states of Florida and Texas. Neither of these states impose a personal income tax. However, the story for MLB's play in California may be quite different. For non-California resident players, California treats as one duty day for each day the team member spends in California rendering services for the team in California. Practice days also count as duty days. Managers, coaches, trainers, and other full-time travelling employees are also subject to the same rules. Injured players in attendance in the "bubble," too, may be taxed on the same basis.

Regarding nexus, there is little doubt that "bubble" play created nexus in the states of California, Florida, and Texas. Texas has no state income tax. For California and Florida, the business income of the teams may also have to be apportioned to these states (as well as the team's home state). Because of COVID-19, play in the "bubble" did not produce any material amounts of business receipts from concessions, local merchandising, game and suites tickets, and parking. But business receipts for licensing, sponsorship, and broadcasting rights may be at issue in the "bubble" states.

Business receipts from licensing, sponsorship, and broadcasting arise from the use of intangible property. As discussed in the section titled, "The employer's concern, Source" (above), Florida and California generally use a "market-based" approach in apportioning receipts to the state.<sup>9</sup> However, California generally apportions all of a visiting sports team's<sup>10</sup> revenue (including its intangible revenue) entirely to the team's home jurisdiction. However, if a state requires that a California-based team apportion its income and pay tax to that state, teams based in that state will have to apportion their income and pay tax to California.

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<sup>9</sup> For broadcast receipts, a market-based approach would look at viewership in the state relative to overall U.S. viewership.

<sup>10</sup> In the 2020 MLB "bubble" in California, all teams were visiting teams. The LA Dodgers played all of their playoff games in the Texas bubble.

## Conclusion

While the COVID-19 pandemic has caused a shift to remote working in the sports, media, and entertainment industries that historically operated in-person, new tax obligations likely do not arise in the case of the remote employee and her employer. Although states and foreign countries could look for additional sources of tax revenues from both the remote employee and her employer, states have clearly been addressing these issues for many years. The OECD's recent guidance looks to cut off any aggressive actions of its member states. Still, both remote workers and their employers should be on the lookout for any legislative changes that could give rise to new tax obligations.

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