

New Jersey vs. New York: Litigation Efforts on the Convenience Rule

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In this installment of Noonan's Notes, Noonan and Banks analyze how New York's application of its convenience of the employer rule has affected New Jersey remote workers who paid taxes to New York and how New Jersey is dealing with it.

As we've covered several times in this column, New York's convenience of the employer rule has been in the limelight with the explosion of remote work. Most recently, it's been the focus of much of the litigation and controversy regarding COVID-related remote working arrangements that were common — and indeed mandatory — for many employees in 2020 and 2021.

We reported on the *Zelinsky* case, which in part deals with whether the convenience rule can apply in situations in which the employer or the

government forced employees to work remotely.¹ But in addition to negatively affecting employers and employees, applying the convenience rule — especially during COVID — has caused problems for some of New York's neighboring states like New Jersey and Connecticut, since both have been willing to give their residents a credit for taxes paid to New York under the rule. Now it seems like New Jersey (and potentially Connecticut) would like some of that money back. Here, we'll discuss one of the ways New Jersey is trying to fight back.

Background

Given its broad statutory mandate for the allowance of resident tax credits, New Jersey has generally been reasonable in providing credits to its residents for taxes paid to New York on income also taxed in New Jersey.² So New Jersey residents who were required to pay taxes to New York under the convenience rule were generally able to get reimbursed by New Jersey. But enough is enough: New Jersey estimated that New York's taxation of New Jersey residents forced to work from home in 2020 has cost the state hundreds of millions of dollars in credits given to its residents to provide relief from double taxation.³

So in legislation signed into law on July 21, 2023, New Jersey took steps to address this inequity. First, though New Jersey never had a

¹ See *Matter of Zelinsky*, DTA Nos. 830517 and 830681 (N.Y. Div. Tax App. Nov. 30, 2023); and Timothy P. Noonan and Emma M. Savino, "The Convenience Rule: Another Bite at the Big Apple," *Tax Notes State*, June 26, 2023, p. 1083.

² See Noonan and Open Weaver Banks, "New York vs. New Jersey: Sorting Through Post-Pandemic Resident Credits," *Tax Notes State*, Aug. 2, 2021, p. 447.

³ Martin Poethke, "Estimating the Impact on New Jersey's Gross Income Tax of Other States' Taxes on New Jersey Residents Working From Home," New Jersey Department of the Treasury, p. 4 (Dec. 11, 2020).

convenience rule, it created what is essentially a reciprocal convenience rule.⁴ The new provision only applies for sourcing the income of a nonresident whose state of residence imposes the convenience rule on nonresidents, as is the case in New York. Under this new provision, if such a nonresident is employed by a New Jersey employer and performs services outside New Jersey, and if the New Jersey employer did not require that those services be performed outside New Jersey, then compensation for those out-of-state services is subject to New Jersey tax.⁵ As the old adage goes: What's good for the goose is good for the gander.

But the legislation goes further — in a creative way — by offering an incentive for resident taxpayers to fight New York's convenience rule.⁶ The new provision, applicable to the 2020-2023 tax years, provides a refundable credit against New Jersey gross income tax otherwise due in these years equal to 50 percent of the tax owed to the state if the taxpayer successfully challenges New York's convenience rule and obtains a tax refund from New York relating to income derived from services rendered in New Jersey.⁷ To qualify for the 50 percent credit, the New Jersey resident must obtain a final judgment from a New York court or tribunal.⁸

Note that while the focus of all the controversy in this area has been on the New York convenience rule, on its face the incentive statute is not limited to recovering taxes paid to New York. If all the requirements are met, the credit is available for obtaining a final judgment allowing a refund relating to taxes paid to any other state or political subdivision or the District of Columbia.⁹ But practically speaking, if New Jersey is going to recover any tax dollars based on this initiative, those dollars are going to come from New York, one of the only states that has a convenience rule and aggressively enforces it.

Here's How It Works

Many New Jersey residents who worked from home for New York employers during the COVID-19 pandemic continued to pay New York state taxes on their compensation in 2020, even when the employer's office was closed through the end of that year. These taxpayers undoubtedly claimed and received a full resident tax credit from New Jersey for those taxes, since the New Jersey and New York tax rates are comparable. So even if a New Jersey taxpayer challenged New York on the basis that the convenience rule should not apply, most or all of any refund would have to be paid back to New Jersey because the taxpayer would no longer be entitled to New Jersey's resident tax credit for the New York taxes paid.

That's why New Jersey changed its law to encourage residents to file refund claims in New York. Under this new program, if a New Jersey resident is successful in obtaining a refund from New York through the New York tax appeals process, she will only have to pay 50 percent of the resident tax credit adjustment back to New Jersey. The way the math works out, the New Jersey resident will get to keep about half of any tax refund from New York (as opposed to having to pay it all back to New Jersey).¹⁰

The New Jersey Division of Taxation issued helpful guidance¹¹ explaining that to qualify for the credit (which is only available for 2020-2023), a taxpayer must:

- be a New Jersey resident;
- pay income tax or wage tax to New York;
- apply for *and be denied* a refund from New York on income earned while working remotely (for example, from home) in New Jersey;
- file an appeal of the New York refund denial in a New York court or tribunal;
- obtain a final judgment in their favor from the court or tribunal; and
- receive a refund from New York as a result.

⁴N.J.S.A. 54A-5.8(e).

⁵*Id.*

⁶N.J.S.A. 54A:4-1.1.

⁷N.J.S.A. 54A:4-1.1(a).

⁸*Id.*

⁹*Id.*

¹⁰The credit amount could be offset by interest owed New Jersey, but we're hopeful New Jersey would not impose or abate the interest given that the state wants to encourage residents to pursue claims against New York.

¹¹New Jersey Division of Taxation, "Refundable Gross Income Tax Credit for New Jersey Residents Who Successfully Challenge Another State's Imposition of the Convenience of the Employer Rule" (last updated Dec. 4, 2023).

Is This Credit Worth the Work?

These steps may sound like a lot of work, especially if the New Jersey resident has to file a refund claim, go through an audit, get denied, and then file an appeal at the New York Division of Tax Appeals and pursue that appeal to get a winning decision. But all that work may not be required because New York law allows taxpayers to deem a refund claim denied six months after the claim is filed. Specifically, the Division of Tax Appeals has jurisdiction to review a petition challenging a refund denial if the taxpayer has filed a timely claim for refund and six months have elapsed since the claim was filed.¹² Of course, if the claim is denied quickly, it is not necessary for the taxpayer to deem the claim denied.

That still leaves the taxpayers with an appeal that must be pursued in the New York Division of Tax Appeals. But according to New Jersey's division, the "final judgment" in the taxpayer's favor from the New York Division of Tax Appeals can include an order of discontinuance by the Division of Tax Appeals and a corresponding joint stipulation of discontinuance to verify that a final judgment was obtained by the taxpayer.¹³ That is, in New Jersey's view it is unnecessary for the taxpayer to get an opinion from a New York judge that says, "You win."

But Didn't Zelinsky Lose?

Yes, it is true that professor Edward Zelinsky did not prevail in his challenge of the convenience rule for the 2020 tax year at the Division of Tax Appeals.¹⁴ But as we've reported, that loss is only the first step in a series of appeals that will be playing out in 2024 and beyond. And Zelinsky's case is not the only challenge to the convenience rule in 2020. We predict that one of these cases will make it to the appellate division or the New York Court of Appeals, and there is a reasonable chance the reviewing court will reject the state's position that the convenience rule permits New York to tax nonresidents who worked from home because

their New York offices were shut down during the pandemic.

Time Is Running Short

However, none of this can happen if New Jersey residents do not amend their 2020 New York returns to challenge the convenience rule. For taxpayers who did not file on extension, the deadline to file a claim for the New York refund would likely be sometime in April 2024. Taxpayers who filed on extension will have a little more time to get their ducks in a row and submit their refund claims.¹⁵ Obviously, for 2021 refunds, taxpayers have an extra year, but participants in this program will want to maximize any potential New York refund to make the New Jersey credit worthwhile.

What About Connecticut?

Connecticut, also betting against New York, is proposing similar credit legislation to encourage its residents to pursue New York refund claims and bring some of these tax dollars back to Connecticut. Connecticut Democratic Gov. Ned Lamont's recommended fiscal 2025 budget adjustments include an incentive to challenge New York's convenience rule.¹⁶ Modeled after New Jersey's credit, the governor is proposing a new income tax credit to individuals who successfully challenge the remote worker tax equal to 50 percent of the additional tax owed to Connecticut.¹⁷ Even though Connecticut's proposal has not been finalized, residents should get their New York refund claims filed in anticipation of that credit becoming available. ■

¹² N.Y. Tax Law section 689(c)(1)-(3).

¹³ See New Jersey Division of Taxation, *supra* note 11.

¹⁴ See *Matter of Zelinsky*, DTA Nos. 830517 and 830681; Noonan and Christopher L. Doyle, "Strike One in Zelinsky II: New York ALJ Upholds the Convenience Rule in Office Closure Case," Noonan's Notes blog, Dec. 12, 2023.

¹⁵ Under N.Y. Tax Law section 687(a), a personal income tax refund claim must be filed by the taxpayer within (i) three years from the time the return was filed or (ii) two years from the time the tax was paid, whichever of those periods expires the latest.

¹⁶ Connecticut Office of Policy and Management, "FY 2025 Recommended Budget Adjustments" (Feb. 7, 2024).

¹⁷ *Id.*