

Outside Counsel

Shift of Residence/Domicile From New York to Florida

Part 1

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New York's high income tax rates have prompted some high-income taxpayers to relocate to lower-tax states, such as Florida and Texas. Consequently, fiscal revenues in New York have suffered and, not surprisingly, audits of taxpayers asserting a change in domicile have increased. New York conducts roughly 3,000 nonresidency audits annually and has collected approximately \$1 billion in revenue between 2010 and 2017 as result of these audits. The Tax Cuts and Jobs Act of 2017 capped the federal income tax deduction at \$10,000 for state and local income taxes, which will likely result in an increase in the number of high income taxpayers changing domicile to a low tax state.

This article is intended to provide a legal analysis of change of domicile under New York law and its residency audit process. While this article focuses on relocation to Florida, a state which imposes no personal income tax, issues and analysis are similar in the case of other low-tax destinations.

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Introduction

At the outset, a couple of terms should be distinguished—"domicile" and "residence." Although people often use these terms synonymously, each has a technical meaning. You can have plenty of residences, but only one domicile. Domicile is largely subjective; it is the place to which you always intend to return. Due to the migratory nature of affluent taxpayers—with some maintaining three or more homes and not spending much time in any one place, the determination of domicile has become increasingly complicated.

Taxpayers domiciled in New York are subject to income taxes and estate taxes in New York. There is a statutory

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exception from income tax for a New York domiciliary who is not physically present in New York for more than 30 days in a calendar year, does not have a permanent place of abode in New York and has a permanent place of abode outside of New York during the entire year.

Once established, the presumption is that a taxpayer's domicile continues until it is proven that it has been changed. The burden to prove change of domicile is on the party asserting the change and must be established by "clear and convincing proof." Florida generally



welcomes individuals to become domiciliaries of that state. The challenge in changing domicile for tax purposes is not to have Florida recognize a taxpayer as domiciled in Florida, but rather for New York to recognize that the taxpayer is no longer domiciled in New York. While Florida is a low-tax state, concerns of dual residence may arise if the taxpayer does not complete the necessary steps to effectively change domicile.

New York has published the Nonresident Audit Guidelines (the Guidelines), to provide guidance to its auditors conducting a "residency audit" in determining if the taxpayer is a domiciliary of New York. The Guidelines were last updated in 2014 and can be found on the New York State Department of Taxation and Finance website. In addition to evaluating change of domicile, residency audits are conducted to determine if a taxpayer is subject to tax based on "statutory residence" or if an allocation of income to New York State is required.

A favorable residency audit result has some precedential effect for a future

residency audit. A favorable audit result is formal New York tax authority recognition that the taxpayer is not domiciled in New York. The taxpayer would have to reacquire New York domicile for the tax authorities to prevail in a future audit. The practical effect is that some taxpayers may be willing to agree to a monetary settlement for one year in order to secure a tactical advantage in the case of any future audit, either for income tax or estate tax purposes.

Statutory Residence and Initial Part-Year Residency

A taxpayer who is not a domiciliary of New York can still be taxed as a New York resident if the taxpayer is a “statutory resident.” A statutory resident is someone who maintains a permanent place of abode in New York and spends 184 days or more during the year in New York. A person who meets these criteria will be taxed as a New York resident, even if the person is domiciled in another state. A partial day spent in New York counts as an entire day for purposes of the statutory residence test.

If a taxpayer wishes to change residence from New York to Florida during the calendar year, the same “factor” analysis (discussed below) will apply for the second portion of the year, taken in isolation. This can be important for a taxpayer who has sold a New York closely-held business (particularly if a portion of the sales price is paid post-closing). In planning for a part-year residency election, however, the statutory residence rule (184 days in New York) applies for the entire year, and that may cause a part-year election that might otherwise be successful to fail if the taxpayer is in New York 184 days during the entire calendar year.

Establishing Change Of Domicile

The Guidelines address two basic elements to establish a domiciliary change: (1) residence in a new location; and (2) intention to make the new location their permanent “home.” There must be a good faith intention coupled with overt acts. The Guidelines provide five

“primary” factors to be considered in determining a taxpayer’s domicile: Home; Active Business Involvement; Time; Items Near and Dear; and Family Connections. The Guidelines indicate that no single primary factor is determinative of domicile.

If analysis of the primary factors does not establish a change of domicile by clear and convincing proof, then the Guidelines provide seven “other” factors that an auditor can consider. Information concerning the “other” factors should only be considered by an auditor in cases where the primary factors do not establish a change of domicile. The five primary factors are discussed in detail.

Five Primary Factors

(1) Home. If a taxpayer sells their home, and does not purchase or lease a replacement home in New York, then this factor usually is decided in favor of a change in domicile. Challenges arise when the

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taxpayer has acquired a new home in the place where the taxpayer asserts a new domicile and retains a home in New York, or purchases or leases a replacement home in New York. Auditors will analyze the home and community in each place. The Guidelines indicate that the retention of a home is a strong indication that domicile has not changed; and further, that “‘home’ refers not only to the family residence, which over the years has been clearly established and accepted by everyone as ‘home’ to the taxpayer and/or their immediate family, but also the community to which the individual has established strong and endearing ties.” From the perspective of the Guidelines, a long-time resident of New York usually has a sentimental attachment to the area, as well as the dwelling, in which they reside; and consequently, selling or disposing of that dwelling does not necessarily change the attachment the taxpayer has for the

area if a new residence is acquired within that area. Therefore, retention or replacement of a home is a strong indication that domicile has not been changed. However, the Guidelines specifically emphasize that retention of a home, by itself, is not sufficient evidence that the taxpayer did not change domicile.

Auditors have been instructed to give appropriate weight to facts such as whether the taxpayer has sold and moved possessions from a home or contracted with a real estate firm to sell the property. However, auditors have been alerted to recognize situations in which the taxpayer is not really actively trying to sell their home.

Auditors are also instructed to compare the size and value of the residences in each state. Another aspect considered by auditors is how the taxpayer uses a particular dwelling. For example, the length of time the property is used each year is a fact to be considered. Other aspects of the home factor are employees such as housekeepers, grounds keepers, chauffeurs, etc.

Some taxpayers may be inclined after selling a principal residence in New York to make a clean break and not maintain any residence in New York for a period of time (say, for a period that includes at least one calendar year)—although there can be no assurance of success if a New York residence is later acquired.

For New York taxpayers who are considering selling their primary home in New York and retiring to Florida, who also plan to maintain a home in New York, there is reason to consider making the effective date for Florida relocation to be upon the real estate sale closing (or earlier), with a view towards countering the argument that the taxpayer’s domicile was attached to the new New York home.

This is part one of a two-part article dealing with a taxpayer’s domicile and residence status as it pertains to tax planning. The other four primary factors used in determining a taxpayer’s domicile—the location of an active business, time spent in the states at issue in the audit, the location of items near and dear to the taxpayer, and the location of family connections—are discussed in Part 2 of this article.

Part 2

This is part two of an article that addresses the legal and tax factors involved in shifting a taxpayer's residence or domicile to another state. Part one addressed the New York statutory framework for residency analysis and related matters, as well as the first of five primary factors used in determining an individual's domicile (the location of an individual's home). The other four primary factors are discussed below, as well as other factors and part-year residency.

(2) Active Business Involvement. A taxpayer's employment or active participation in a New York trade, business, occupation or profession, and/or substantial investment in, and management of, any New York closely-held business will usually result in a finding against a change of domicile. It does not matter if the taxpayer's involvement does not actually take place in New York. However, passive investments in New York entities is not indicative of domicile. The Guidelines specifically state that the fact that funds are left on deposit with a New York bank must not enter into the determination of domicile (presumably on account of concern that New York banks and brokerage firms not lose business to out-of-state entities).

For an owner of a New York closely-held business, compensation may be a factor (given New York source income rules) leading to a finding against a change of domicile. If the business (or at least its headquarters) can be relocated out of New York to Florida (or possibly to another state) prior to relocation, the negative impact of this factor may be able to be turned around, or at least neutralized.

The Guidelines provide that the passive activity loss rules may increase the importance of analyzing a taxpayer's business ties. For example, a taxpayer may have provided documentation with his or her federal return to substantiate that he or she materially participates in a New York



business activity. This material participation may permit the taxpayer to exclude the loss from the passive activity loss limitations. This same activity can also be used to show that the taxpayer has significant New York business connections.

(3) Time. Another factor in the determination of domicile is where the indi-

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vidual spends his or her time during the year. Auditors may ask for diaries, appointment logs and calendars to substantiate time spent in each location. If none are available, or in order to substantiate what is in the diaries, etc., auditors will look at credit card receipts, utility usage, telephone bills, bank information, etc. Auditors look for overall living patterns that show evidence of intended domicile.

Time spent in places other than New York and Florida is not analyzed. It would be problematic if, for example, an individual spends 150 days in New York but only 125 in Florida.

Auditors may verify location with cell phone records and social media use. Auditors will take into account New York refrigerator contents and location of a social club, wealth manager professional, or dentist, although it is recognized that specialized medicine in New York should not be considered. While charitable contributions are not to be taken into account (discussed below), service as a trustee or director of a New York charitable institution may be viewed as a New York activity separate and apart from a contribution to that charitable institution.

(4) Items Near and Dear. The Guidelines instruct auditors to visit the taxpayer's home in New York and look for items of significant sentimental value, such as family heirlooms, works of art, book collections, stamp and coin collections, and other personal items. These items do not have to be

valuable from a monetary standpoint (e.g., photo albums). Also relevant is where family pets are maintained (including veterinarian location and services). The Guidelines instruct auditors to review insurance policies, to determine actual location of items, and told to look at bills of lading to see if sentimental items were actually moved. Auditors are specifically instructed that they must not only look at the items in both the New York and Florida residence and take into account the transfer of near and dear items from New York to Florida.

(5) Family Connections. If the first four factors are not conclusive in determining domicile, auditors will consider a taxpayer's family connections. Assuming the taxpayer and his or her spouse live together on a year-around basis, this factor often comes into play when there are minor children. For example, if the taxpayer claims to be a Florida domiciliary, but his minor children attend school in New York. A similar issue arises if one spouse relocates to Florida and claims a change in domicile, while the other spouse and family connections remain in New York.

'Other' Factors

While the "other" factors are subordinate to the primary factors, they are nevertheless important because they will be looked into if the primary factors are not determinative or if the primary factors indicate that the taxpayer has not changed domicile. It is recommended, especially if a New York home is retained or replaced with another home in New York, that the taxpayer structure as many as possible of these "other" factors to indicate Florida domicile.

The "other" factors are:

- (a) The address at which bank statements, bills, financial data and correspondence concerning other family business is primarily received.
- (b) Physical location of safe deposit boxes used for family records and valuables.
- (c) Location of auto, boat and

airplane registrations, as well as the individual's personal driver's or operator's license.

(d) Indication as to where the taxpayer is registered to vote and an analysis of the exercise of voting. In this regard, the auditors are instructed not merely to limit the review to the general elections in November, but also to question the taxpayer's participation in primary or other off-season elections, including school board and budget elections.

(e) Possession of the New York City parking tax exemption.

(f) An analysis of telephone services at each residence, including the nature of the listing, the type of service features, and the activity at the location.

(g) The citation in wills, trusts, affidavits and other legal documents that a particular location is the individual's place of domicile.

The auditor is instructed not to consider the following: the place of interment; the location where the taxpayer's will is probated; passive interest in partnerships or small corporations; the location of bank accounts; contributions made to political candidates or causes; and the location where the taxpayer's individual tax returns are prepared and filed. Additionally, two specific "non-factors" that are not to be part of the determination of domicile are charitable contributions and religious organization membership. Nevertheless, since the auditor is human (hopefully), it is typically worthwhile to structure as many of these "non-factors" in a manner so as to leave the auditor with the impression that the taxpayer's life is now focused in Florida, rather than in New York.

Establishing Domicile In Florida

Individuals who wish to become domiciled in Florida should file a Declaration of Domicile with the Clerk of the Court in the county in which the individual resides. Other steps to establish domicile in Florida include

registering to vote in Florida, registering all motor vehicles (including automobiles, boats, airplanes) in Florida and obtaining unrestricted Florida driver's/ boating licenses.

This article is intended as an overview of the challenges of changing domicile from New York to Florida. The determination of domicile is specific to each taxpayer's facts and circumstances; thus, individual guidance is necessary to successfully change domicile from New York to Florida.