Each state has unique rules for establishing or terminating income tax residency. See below for more information about common residency guidelines and potential obstacles.

We hope you find this information useful. Feel free to contact us if we may be of further assistance.

(Spring 2017) WRM #17-06

TOPIC: Leaving One State for Another? Don't Get Stuck In Between...

The WRMarketplace is created exclusively for Mullin Barens Sanford Financial by experts at Greenberg Traurig and the AALU staff, led by Jonathan M. Forster, Steven B. Lapidus, Martin Kalb, Richard A. Sirus, and Rebecca S. Manicone. WR Marketplace #17-06 was written by Greenberg Traurig Shareholder Karen D. Yardley.

The AALU WRNewswire and WRMarketplace are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members-the nation's most advanced life insurance professionals.

MARKET TREND: As budgets are squeezed, more states are challenging state residency changes for income tax purposes.

SYNOPSIS: Each state has its own unique set of rules for establishing or terminating income tax residency. Some states base tax residency on an objective test that counts the number of days the individual is present in the state, while others impose a subjective test that looks at the individual's state connections.

TAKE AWAYS: State laws differ as to the requirements to disengage from one state and establish residency in another.

The decision to move to a new state, along with the steps required to establish residency, is multifaceted and requires advance analysis and planning by individuals and their advisors to avoid unpleasant surprises. Keeping too many connections to the old state and not creating enough connections in the new one can result in the worst of both states for income tax purposes.

Prior Reports: 14-37

Individuals are increasingly mobile and may relocate to another state for many reasons- business and employment opportunities, lifestyle changes, or family proximity just to name a few. Regardless of the reason, a primary objective when relocating is to avert dual state taxation by establishing a single tax residence in the new state.

When contemplating a change in state residency, individuals must understand both the tax residency requirements of the new state and the rules for terminating tax residency in the old one. Unfortunately, there is no uniform set of laws to determine state tax residency. Consequently, each individual's unique set of circumstances must be analyzed to determine what the individual must do to completely change his state tax residence.

BASIC RULES

Changing legal residency to a new state is far more complicated than just relocating to a new house, obtaining a driver's license, and registering to vote in the new state.

While varying by state, the laws surrounding tax residency generally fall into two main camps: (1) an objective "day-count test" or (2) a subjective "closer connection test."

Day-Count Test.
States that impose a day-count test generally look at the number of days an individual is present in the state to determine residency.

Example: In New York, an individual is a resident for income tax purposes if he spends at least 183 days of the tax year in the state and has a permanent place of abode in the state. Accordingly, to relinquish residency in New York, the individual must limit the amount of time spent in New York after the move.

Day-count tests require the individual to know the number of days present to trigger state residency. The individual will need to minimize the number of days present in the old state and/or maximize the time spent in the new state, depending on where the day-count test applies. Regardless, if the individual is regularly present in the old state he should maintain detailed records to substantiate the number of days spent in each state, including receipts for airline or train tickets, hotel receipts, taxi or rental car service, etc. Even part of a day generally counts as an entire day present in a state. Thus, if the individual arrives in the state at 11:45 pm, he could be considered present for the entire day.

Closer-Connection Test.
Many states determine tax residency by looking at where the individual has the closest connections. This is a subjective test based on objective elements, and state courts and tax authorities will consider a wide variety of factors to determine an individual's tax residency, including the amount of time the individual spends in the new state versus the old state, where the individual is registered to vote, where the individual's spouse and children reside, and the location of the individual's place of business or employment. No one factor is determinative.

If the change of tax residence is challenged, the individual will need to provide evidence that he has truly severed connections with the old state and established strong ties to the new one. Some states, like California, have become very aggressive in challenging residency changes, especially if the move occurs just before a significant tax event. Attached as Appendix A is a list of some (but not all) of the steps an individual can take to help prove a change of tax residence. These steps reflect factors that courts and other agencies have considered.

POTENTIAL OBSTACLES

Severing connections to the old state may not be easy to achieve, especially if family members, property interests, and/or business interests remain there. In such circumstances, the individual will need to take additional precautions.

Keeping the Former Residence.
Some individuals will keep the family residence or a smaller residence in the old state.

Owning (or even leasing) a residence in the old state, however, can be used as evidence that the individual's tax residency hasn't truly changed.

Continuing to have a permanent residence in the old state can be particularly perilous if the old state uses the day-count test to determine residency and the individual continues to spend a significant amount of time there.

Example: Sarah is a photographer for a New York magazine. She recently purchased a home in Connecticut and considers herself to be domiciled there. However, she continues to lease a small apartment in New York, where she stays during the week, returning to her Connecticut home for weekends, holidays, and vacations. She spends at least 183 days of the year in New York. Based on New York residency rules (a day-count test plus a permanent place of abode), Sarah is still a resident of New York for income tax purposes even though she has acquired a home and domicile in Connecticut.

Maintaining a residence in an old state that applies the closer connections test also can indicate that the individual has not created sufficient connections with the new state to shift tax residency. Individuals who wish to change their tax residence but still maintain a home in the old state should consider taking the following additional actions:

- Apply for a homestead exemption for the new residence and terminate any homestead exemption elected for the old residence.
- Arrange to have the property tax bills, mortgage statements, HOA assessments, property insurance premiums, utility bills, etc. for the old residence sent to the new residence.
- If property taxes for the old residence are based on it being used as a principal residence, notify the property tax collector of the changed status.
- Change property insurance coverage to reflect the changed status of the old residence to a vacation home or rental property.
- Move all personal items, such as family photographs, artwork, jewelry, and important personal documents, antiques and other important pieces of furniture, furnishings, and household items to the new residence. Keep only the bare essentials in the old residence.
- If the old state uses a day-count test to determine residency, limit the time spent in the old state. If the individual continues to work in the old state, for example, determine whether the individual can telecommute one or two days a week.
- Use veterinarians, physicians, and other service providers in the new state.

Leaving the Family Behind.
An individual may move to another state while the spouse and children stay behind, for example, to allow the children to continue their education in the old state. Establishing a new tax residence can be difficult in these circumstances. The old state may deem the move to be temporary or not recognize a separation of the marital home, and continue to treat the individual as a resident of the old state. Further, if the individual moves from a community property state to a non-community property state and the spouse continues to work and generate community income, the individual will still have to file income tax returns in the old state to report his or her half of that income. In such circumstances, in addition to taking as many steps as possible to create closer connections to the new state (see Appendix A) and limiting the time spent in and connections to the old state, the individual should consider the following:

- Transfer the old residence to the spouse.
- Acquire a residence in the new state in just the individual's name.
- If the individual is moving from a community property state, execute a post-marital agreement which provides that each spouse's earnings are deemed that spouse's separate property.
- Have the spouse and children spend weekends, holidays, and vacations - as much time as possible - in the new state and limit the time the individual spends in the old state.

Ongoing Business Interests.
Difficulties also can arise when an individual with an active business decides to move to another state. The ongoing business can make it difficult to move the individual's tax residency under both the day-count test and closer connections test.

Even if the individual successfully transfers his individual tax residence to the new state, income generated in the old state will still be subject to tax in that state. Individuals with active business interests in the old state should take the following additional actions:

- If feasible, move the entire business to the new state. If that isn't possible, consider:
  - Moving the "headquarters" or administrative functions to the new state,
  - Establishing an office for the business and employing administrative personnel in the new state, and/or
  - Transferring the financial aspects of the business to the new state, including all investment and bank accounts and professional advisers.
- Update state entity filings as necessary to reflect the individual's new residence (for example, if the business is an LLC and the individual is the manager, update state records for the LLC to reflect the individual's new address).
- Don't maintain a permanent residence in the old state. Sell the prior residence or lease the residence to a third party. Stay in a hotel when conducting business in the old state.
- Limit the amount of time spent in the old state managing the business.

TAKE AWAYS

State laws differ as to the requirements to disengage from one state and establish residency in another. The decision to move to a new state, along with the steps required to establish residency, is multifaceted and requires advance analysis and planning by individuals and their advisors to avoid unpleasant surprises. Keeping too many connections to the old state and not creating enough connections in the new one can result in the worst of both states for income tax purposes.

  

Kristi Barens	John Sanford	Peter Mullin
Principal	**Principal**	**Principal**
Main (310) 473-0060 ext. 700	Main (310) 473-0060 ext. 701	Main (310) 473-0060 ext.703
Mobile (213) 359-8809	Mobile (805) 300-3161	
kristi.barens@mbsfin.com	john.sanford@mbsfin.com	peter.mullin@mbsfin.com

DISCLAIMER

This information is intended solely for information and education and is not intended for use as legal or tax advice. Reference herein to any specific tax or other planning strategy, process, product or service does not constitute promotion, endorsement or recommendation by AALU. Persons should consult with their own legal or tax advisors for specific legal or tax advice.