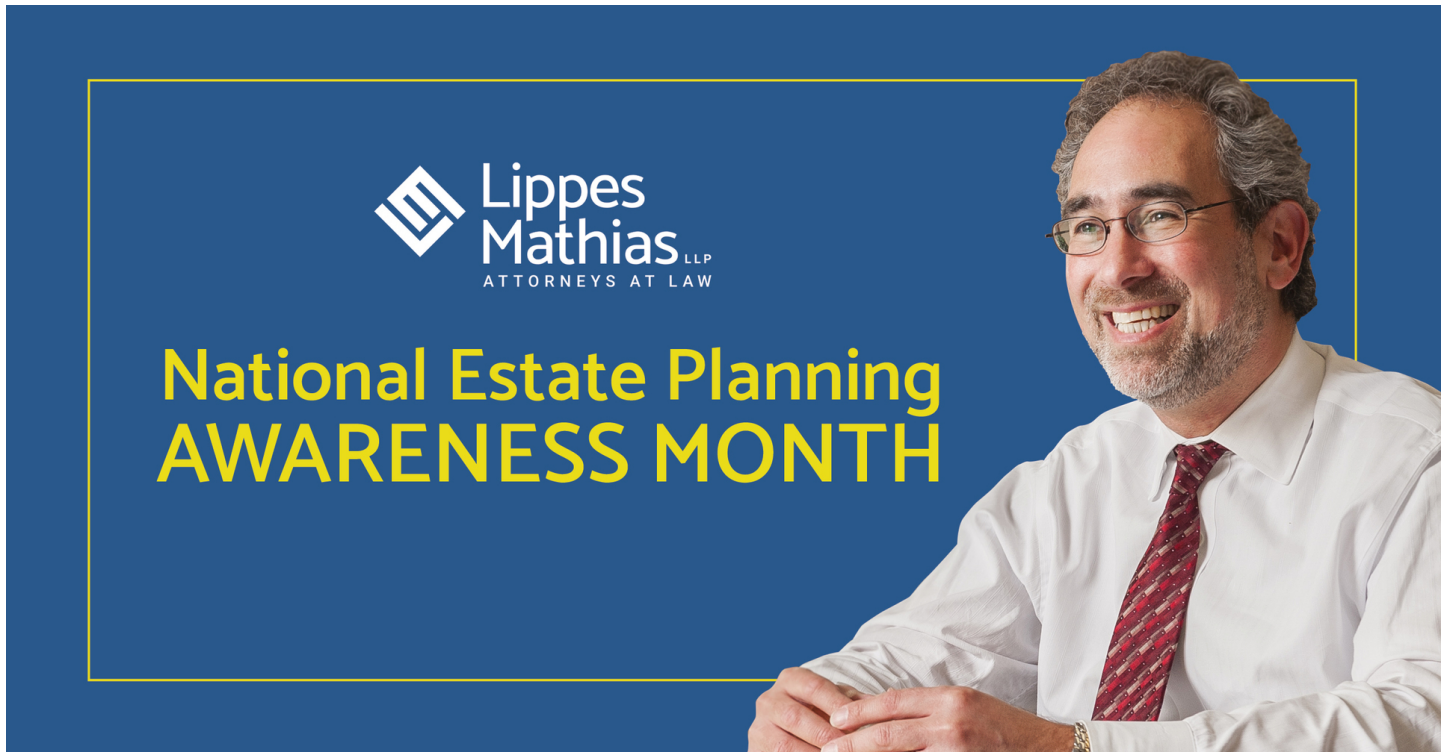


## Breaking Up is Hard to Do, Especially if You Want to Leave New York State



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As the influx of New York residents depart to warmer and sunnier pastures in the South, they may be leaving their homes but not necessarily their obligation to the New York State Tax and Finance Department. There are many factors that determine whether you have indeed cut all ties with the Empire State.

Whether or not someone is considered a “resident” in the State of New York is analyzed based upon the answers to these questions: (i) are you ‘domiciled’ in New York State? or (ii) are you not domiciled in New York but still maintain a permanent place of abode in New York State and spend more than 183 days of the taxable year in the state?

In particular, although New York defines a New York resident in the tax law as someone who is **domiciled** in the state, the law does not define the term “domiciled.” Under New York NYCRR §105.20(d), *domiciled* is defined as “... the place which an individual intends to be such individual’s permanent home—the place to which such individual intends to return whenever such individual may be absent.”

There are three (3) separate and distinct areas to be examined during the audit of a non-resident individual:

- i. Domicile;
- ii. Statutory Residency; and
- iii. Income Allocation.

It should be noted that the nonresident audit places a heavy **burden on the taxpayer** due to the subjective nature of the areas reviewed.

When evaluating an individual's domicile, the New York State Tax and Finance Department will focus on the individual's **intention** regarding his permanent home and the place he intends to return to whenever he may be absent. In the *Matter of Jack Silverman (deceased) & Frances Silverman (deceased)*, DTA No. 802313, New York State has determined that even if a taxpayer takes several steps to show a change of domicile to Florida, such as filing a Declaration of Domicile, registering to vote and obtaining a driver's license, these formal declarations are **less persuasive** than the informal acts of an individual's general habits of life including that the taxpayer had not changed their domicile. In particular, there are two (2) crucial elements to prove a change of domicile:

- i. An actual change of residence; and
- ii. Abandonment of a former domicile in the acquisition of another.

To affect a change of domicile, there must be an intent to make such a change and actual residence in a new location. On the other hand, a residence without intention to remain does not affect the change of domicile, no matter how long the residence is continued. As discussed above, the burden of proving a change of domicile is upon the party asserting the change. The evidence to affect a change of domicile must be **clear and convincing** by supporting the intentions with unequivocal acts.

In New York, factors determining domicile are divided into two (2) general categories: **primary factors** and **other factors**. The five (5) primary factors, outlined in detail below, are:

- i. Home;
- ii. Active Business Involvement;
- iii. Time;
- iv. Items Near and Dear; and
- v. Family Connections.

### 1. Home.

The individual use and maintenance of a New York residence compared to the nature and use patterns of a non-New York residence are key factors. A home is not necessarily where they live but can be based upon the area/community they view as their home. As such, the home refers not only to the family residence, which over the years has been 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 enduring ties. Giving up the only residence in New York and acquiring another outside of New York is an important signal of intent to change domicile but maintaining two (2) or more homes can complicate the issue, especially where the taxpayer has not moved the family heirlooms, treasured possessions, and other indicia of maintaining a New York residence to the new

location. Just an attempt to sell is not sufficient either. When there are two (2) homes, the IRS could take into account: (i) the size of the residence, (ii) the value of the residence, and (iii) the nature of the use of the residence. However, you should keep in mind that if you do maintain two (2) residences and decide to sell the New York residence in the future, you could be risking the loss of the primary residence capital gain exemption on the first \$500,000 of gain; the limit based upon being married and filing jointly.

## 2. Active Business Involvement.

A taxpayer's continued employment, **active participation** in New York State in sole proprietorships and partnerships (i.e., LLCs), or the **substantial investment in and management of New York corporations or limited liability companies** is a primary factor in determining domicile. Suppose a taxpayer continues active involvement in New York business entities by managing a New York corporation or meaningfully participating in New York partnerships or sole proprietorships. In that case, such actions must be weighed against the individual's involvement in businesses, employment, and business at other locations when determining domicile. The connections in New York will be closely scrutinized to determine the degree of participation. Active participation in the day-to-day operations of a New York business can weigh heavily on deciding an individual's business involvement. Again, the active business involvement test, like the home factor, is only one factor leading to a decision concerning an individual's domicile.

If the facts clearly show that the New York business is operated from an out-of-state location, the individual's control over the company is one factor of the New York domicile. In contrast, an otherwise absent person whose primary factors, other than active business involvement, point toward non-New York domiciliary status should not be treated as a New York domiciliary simply because of long-distance contacts with business activities in New York. One example is that in a family-owned business, the parent passes the daily operation of the New York business to the children but remains active in the decision-making process. This active involvement could demonstrate the taxpayer's continued connection to New York. As the person becomes older and accumulates wealth, they may choose to devote less time to the business and bring in younger individuals who will eventually succeed them, ever reducing their status and compensation. This example alone does not demonstrate a change in domicile, and diminished involvement in the New York business is one element of the "active business involvement factor" that becomes less important as the taxpayer phases out operations. In the end, a New York State auditor must weigh this item against others, such as the individual's involvement in any business venture located outside of New York, before concluding. Again, the conclusion reached on the active business involvement factor is only one component of the five (5) primary factors.

## 3. Time.

Another primary factor is the quantitative analysis of where the individual spends his time during the taxable year. Again, this is compared to the time spent in New York to the time spent in other locations. A diary, appointment log, or calendar maintained by the individual can be used to support the analysis of the time spent in New York. During an audit, they will focus on the taxpayer's overall living patterns, asking whether the patterns present strong evidence that the new location has been the taxpayer's domicile.

## 4. Near and Dear.

The location of items which an individual “holds near and dear” to their heart, or those items which have significant sentimental value, such as family heirlooms, works of art, collections of books, stamps and coins, and those personal items which enhance the quality of life, can help determine the domiciliary of the individual. Sometimes insurance policies may direct where those items are located. If those items remain in New York, there is an inference that the intent is to remain a New York resident.

## 5. Family Connections.

While analysis of time factor presents us with the most quantitative factor in determining the individual's domicile, analysis of family is a much more subjective factor. Throughout the discussion of the primary factors, it has been stressed that no single factor can be considered a stand-alone indicator of domicile. This statement certainly holds for the analysis of family connections and is mostly true for minor children, where the spouse lives, or where the children may attend school. This factor is focused primarily on an analysis of the living patterns established by the taxpayer. For example, if an individual formerly lived and worked in New York during the entire year but has retired and moved South. Seasonal visits to New York to visit family members such as an annual summer visit should not be viewed as indicative of domicile.

**Other Factors:** Outside the five(5) primary factors, there are *other factors* to be evaluated when determining residence, such as the following:

- i. The addresses at which bank statement, bills, financial data and correspondence concerning other family business is primarily received;
- ii. The physical location of the safe deposit box used for family records and other valuables;
- iii. The location of the auto, boat, and airplane registrations as well as an individual’s drivers or operating license;
- iv. Where the taxpayer is registered to vote and an analysis of the exercise of such privilege;
- v. Possession of specific location parking permits;
- vi. An analysis of telephone services at each residence, including the nature, listing, and the type of services, features, and activity at the location;
- vii. The citation in legal documents as to whether a particular location is the person's place of domicile or a specific residence is considered the primary residence. Examples are school tax relief exemptions (STAR), leases, and other legal documents, including wills.

Again, this list is subordinate to the five (5) primary factors but can also assist in the analysis of domicile.

Suppose a person wants to establish a domicile in another state. In that case, it is an ongoing responsibility –in the sense that New York State can technically audit a person at any time – even years after leaving New York State as there is no statute of limitations on an audit or assessment if no New York tax returns were filed. In other words, establishing domicile is not a “one and done” proposition – it must be based upon continuous actions.

## Statutory Resident.

A statutory resident is an individual who is not domiciled in the State, but maintains a permanent place of abode in New York State, and spends in the aggregate more than 183 days of the taxable year in the state; unless the individual is in active service of armed forces of the United States. This provision is commonly known as the “183-

day rule.”

A permanent place of abode can be any house, co-op, apartment, condo, or other dwellings, including a leased residence located in New York State permanently maintained by the taxpayer. As we discussed, the 183-day rule is absolute in that if you even step foot in New York or have a presence in New York for any part of a day, and included as a full day (with a few exceptions to note).

## Nonresident Income Allocation Rules

The income tax computation for New York residents is simple. Residents are taxable on one thing: **Everything**. Nonresidents, however, can be taxed only on income that is derived from or connected to *New York sources*. The focus in nonresident allocation cases is usually on one thing — whether the taxpayer's income was derived from or related to New York sources. Generally, under Tax Law section 631, the New York-source income of a nonresident individual includes all items of income, gain, loss, and deduction entering into the taxpayer's federal adjusted gross income that are **attributed to the ownership of any interest in real or tangible property located in New York or a business, trade, profession, or occupation carried on in New York**.

1. Employee Wages. Employees' wages likely constitute the most common form of income in allocation audits. And for the most part, the rules are straightforward. If all the employee's services are performed in New York, all compensation is allocated to New York. When a nonresident performs services within and outside New York State, the non-resident's income must be allocated to New York according to a fraction, the numerator of the number of days worked in New York, and the denominator of the total number of days worked everywhere.

*According to New York's Allocation guidelines, a taxpayer doesn't have to work an entire day for it to count as a "workday" in New York. Although, in many cases, our firm takes the position that taxpayers can work half-days. Taxpayers should also keep in mind the convenience of the employer rule, which says if a taxpayer employed by a New York employer works outside of New York for his or her convenience, the non-resident taxpayer must count it as a New York workday.*

2. Bonuses. Bonuses are generally allocated in the same way as regular compensation. If a bonus is received during the tax year in which it was earned, the allocation fraction is simply based on the same wage allocation fraction used for a regular salary. However, if a bonus is paid for work performed in a different year, the workday allocation fraction applicable for the year in which the bonus was earned is used. Thus, a bonus paid in February 2010 for work performed in 2009 would be allocated based on the workday allocation fraction applicable to the 2009 year.

3. Pensions and Retirement Income. The general rule: Compensation for services rendered in New York State is subject to tax even if it is received in a year when no services are performed. So, a former New Yorker who gets some form of deferred compensation generally — and emphasis on the word “generally” — will be required to pay New York taxes on that compensation. The allocation formula for that type of income is based on a fraction, the numerator of New York compensation for the year of retirement plus the preceding three years, and the denominator of which is total compensation for the same period.

But there are several exclusions in New York and federal law that can apply to exclude some forms of

compensation paid after termination of employment. There are also special federal rules applicable in this area that are not covered or addressed in New York's laws or regulations.

4. Other Postemployment Compensation. Other forms of deferred compensation receive special treatment. For instance, under prior law, some forms of termination pay escaped New York taxation, such as payments under a covenant non-compete contract. The tax law changed in 2009 to ensure that New York could tax all forms of post-employment compensation to the extent the taxpayer worked in New York in prior years.

Stock options are another form of deferred compensation that has received much coverage in practitioner circles and publications. The rules for income from stock options exercised in 2006 and later years are straightforward. Stock options income must be allocated based on the taxpayer's workday allocation factors between the date on which the options were granted and the date on which the options vested.

5. Director's Fees. According to the allocation guidelines, a nonresident board member who works in New York for a corporation doing business in New York has to allocate board compensation based on the location of board meetings. For those purposes, a board meeting counts as a workday. The guidelines also seem to permit the allocation of other board-related work, but they do NOT reference the application of the convenience rule in making that determination.

6. Gains or Losses from Real Property. In the past, the rules in this area were evident. Under current legislation, the phrase "real property located in this state" as defined in Tax Law Section 631 is redefined to include interests in a partnership, limited liability company, S corporation, or closely held C corporation (that is, with 100 or fewer shareholders) owning real property located in New York State if the value of the real property exceeds fifty (50%) percent of the value of all of the assets in the entity. There is a two-year lookback rule to avoid taxpayers' "stuffing" assets into an existing entity before a sale. For sales of entity interests occurring on and after May 7, 2009, any gain recognized on the sale of an interest in that entity will be allocated among the assets in the entity, and the amount allocated to New York real property will be treated as New York source income.

7. Business Income. The taxation of business income varies based on the vehicles through which it is earned. The regulations direct that sole proprietors and partners must establish that items of income, gain, loss, and deduction attributable to that business, trade, profession, or occupation be apportioned and allocated to New York State on a fair and equitable basis following approved methods of accounting. According to the regulations, that "fair and equitable" allocation must be done using two methods. First, is an "actual" method, if the book and records disclose the in-state and out-of-state income "to the satisfaction of the Tax Commission." Absent that, the second method reflects a three-factor formula comprising of property, payroll, and receipts of the business or partnership from in-state and out-of-state sources. That same allocation would apply to nonresident members of LLCs.

## **Conclusion.**

As you can see from this analysis, there is no simple answer when evaluating the residency test, especially when you continue to be actively involved in a trade or businesses within the state. A detailed analysis with one's legal and tax professionals is warranted if you truly desire to determine whether you have separated from the Empire State.

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