



FEATURE: ESTATE PLANNING & TAXATION

By **David J. Spacht**

Moving Up or Moving Out?

Practical planning for snowbirds pursuing Florida residency

Many retirees, on finding themselves no longer bound by the geographic constraints of a job and with their children off starting families of their own, begin to contemplate moving to another state. While escaping the frigid northeast winters is certainly one benefit, moving to another state can also have distinct economic advantages. Relocating to Florida, for example, a state with sunny winters and without any income or estate tax, can be a simple way for a client to avoid at least two different sets of taxes. With the limitation of the federal income tax deduction for state and local taxes to be promulgated by the Tax Cuts and Jobs Act (the Act), this option is all the more enticing. While completely severing ties with one's long-time home state is a reliable way to avoid its taxes, many snowbirds will inevitably retain some connection that keeps them coming back to the area, whether it be family, a second residence or a closely held business. Retaining ties to a snowbird's state of origin while avoiding its taxes is still possible, but your client must follow the proper roadmap to complete the trip safely.

Case Study 1

Mamma Leone and Captain Jack own a home in Hackensack, N.J., where they've lived for the 25 years of their marriage. They own two other residences, a condominium in Miami Beach, Fla. and a studio apartment in New York City. They started a company soon after they wed and have grown it into a national uniform supplier headquartered in New Jersey. Although Leone has dramatically reduced her involvement in the com-

pany, Jack will work in the business until the sale with his prospective purchaser is finalized. He plans to join Leone in Florida once the business is sold in the next several months.

On Sept. 1, Leone and Jack took their RV for a 4-week long excursion across the country. After the trip, Leone began a 6-month winter residency in Florida, and Jack returned to New Jersey. While Jack spent his winter weekends with Leone in Florida, he remained in New Jersey on weekdays for work. Jack also spent many nights throughout the year in his New York City apartment to assist with the care of his mother, who moved into the apartment two years ago. After Leone purchased the Miami Beach condo, Jack and Leone began filing their income tax returns separately.

New Jersey and New York impose state income tax on resident taxpayers who meet the criteria of either of two independent tests: the statutory residence test or the domicile test.¹ If they're treated as resident taxpayers, Jack and Leone would remain subject to state income tax on all income, regardless of its source.² (See "State Hopping," p. 20.)

Statutory Residence Test

New Jersey and New York may impose income tax on individuals who are statutory residents of that state. Statutory residents are individuals who maintain a permanent place of abode (PPA) in the state for substantially all of the year and spend more than 183 days during the year in the state.³ As a general rule, presence in New York for any part of a day constitutes a full day spent there.⁴ As a result, any part of a day spent in New York will count against Jack, even if he was only present to assist his ill mother.⁵ Auditors will review evidence such as cell phone bills and credit card statements to reconstruct Jack's location on any given day, but Jack should nevertheless maintain contemporaneous records



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to support his daily activities.

The statutory residency test was designed to provide the New York Department of Taxation with an opportunity to tax an individual with an objectifiable connection to the state. To prevent the inequitable consequence of taxing individuals who spent 184 days in New York but didn't reside in their dwelling for much or any of that time, the Tax Appeals Tribunal clarified the legislature's intended definition of PPA in a precedential 2014 taxpayer victory. The Tribunal provided that, for a dwelling to qualify as a PPA, the state must have "some basis to conclude that the dwelling was used as the taxpayer's residence."⁶ This clarification deviated from the Department's historical interpretation by which it taxed individuals who maintained a New York residence so long as it was habitable, even if the taxpayer rarely used it.

To prove that the apartment isn't suitable for his personal residential use, Jack should provide photographic evidence demonstrating that it's being used by his mother and that it lacked space for his own separate living quarters, bed or belongings.

Domicile Test

Although a snowbird may maintain more than one residence, each of which she may consider her "home," the law maintains that a taxpayer may possess only one true domicile. New York and New Jersey categorize a person's domicile as the place where one presently resides and intends to remain indefinitely.⁷

Due to the fact sensitivity of this inquiry, the taxpayer has a significant opportunity to plan ahead. Auditors refer to a series of objective criteria that are suggestive of the taxpayer's motivations. These factors are reviewed in their totality and are assigned varying degrees of weight. If audited, the taxpayer bears the burden of proving the change of domicile by clear and convincing evidence, which requires a demonstration that her ties to the destination state are greater than her origin state. If the circumstances demonstrate that the taxpayer's daily lifestyle has changed, she'll have a better chance of emerging from the audit unscathed.⁸

Home. If the taxpayer owns multiple dwellings, an auditor will compare the properties' physical attributes, including their square footage, market value, usage and

quality of upkeep. An auditor will generally infer that the larger and more luxurious dwelling is the taxpayer's domicile; however, other factors are within the taxpayer's control and can favorably adjust the tenor of the audit. Leone's condo is newly renovated with new kitchen appliances and bathrooms, but it's only half the size of her New Jersey residence and worth only a third of the market value. Additionally, she uses it for only six months out of the year. Leone should strengthen her ties to Florida by declaring the condo as her Florida homestead and by designating the condo as her primary

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residence on her homeowners' insurance policy.

Business. Auditors will investigate a taxpayer's sources of income to determine whether she remains actively involved in a business requiring her presence within the state. The amount and frequency of her compensation from the business may indicate whether she continues to play a significant role in the company. Auditors may also assume the taxpayer's physical presence in the state by examining whether she maintains a permanent parking space or personal secretary at the office.

Although Jack is likely to prevail in his New York audit, he should consider postponing any agreements obligating him to sell his business until after the resolution of his audit or until he's relocated to Florida, whichever occurs first. New York requires taxpayers who change domicile to report any income for the year

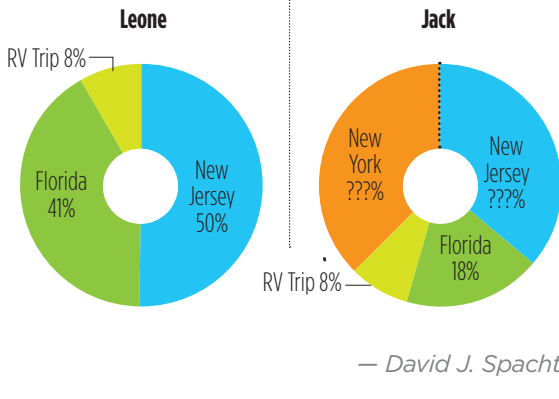


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State Hopping

Here are the day counts for the taxpayers in Case 1

Location	Day count	Location	Day count
New Jersey	183/365	New Jersey	??/365
Florida	151/365	Florida	67/365
RV Trip	31/365	RV Trip	31/365
		New York	??/365



of change using the accrual method of accounting. This “accrual rule” may subject otherwise nontaxable income to New York income tax despite that, as a cash basis taxpayer, the taxpayer wouldn’t actually receive payment until after moving out of the state.⁹ If he’s deemed a New York domiciliary through the audit, the accrual rule would require Jack, as a New York taxpayer changing residency, to include in his taxable income any income that has accrued before the date of his change of residence. This would include income payable pursuant to a contract of sale, even if payment isn’t made until after Jack has already moved to Florida. In any case, if Jack waits to sell the company until after he moves to Florida, Jack will likely also elude New Jersey income tax on the sale of his company.¹⁰

Time. An auditor will presume that a taxpayer spends more time in her domicile than in any other place. Although the domicile test doesn’t require a rigid day count, the time a taxpayer spends in Florida after relocating should exceed the time spent in her state of origin or even anywhere else. Auditors will also generally presume that a taxpayer will return to her domicile after a long and exhausting trip away. Therefore, the more

time a taxpayer spends in her state of origin, the harder it will be for her to prove that she abandoned it.

The quality of time spent in each state is also weighed in the audit. Auditors will generally presume that the taxpayer spends many of her most important family holidays in her state of domicile. If Leone and Jack gather for holidays in Florida with their children and their family, this fact will further support a strong connection to Florida. Leone’s immediate return to Florida after completing her RV trip is also supportive of her change of domicile.¹¹

Near and dear. An auditor will presume that the taxpayer keeps her most sentimental and precious property in her place of domicile. Perhaps the most straightforward way for Leone to influence her audit is to move her family pet, heirlooms, artwork and photographs to Florida and to keep photographic evidence of the location of these items. Additionally, Leone should transfer all of her valuable items from her New Jersey homeowner’s insurance policy personal property rider to her Florida policy.

Family. Although auditors will generally presume that married individuals reside together with their minor children in their place of domicile, both New York and New Jersey permit spouses to file separate income tax returns in different jurisdictions with independent tax attributes. Consequently, the auditor must conduct his review notwithstanding a taxpayer’s unconventional living arrangements or motivations for making a move. Even a tax-motivated move will be respected, provided that there’s a successful change in domicile.

By filing separately, Leone may avoid state income tax on interest, dividends and capital gains income attributable to her intangible stock portfolio. As such, Jack may consider transferring a portion of his investment portfolio to Leone to avoid New Jersey income tax and, further, to remove the transferred assets from the reach of New Jersey and New York wealth transfer taxes.

Trust Residency Planning

Any domicile change should be accompanied by a comprehensive estate plan review, including an analysis of any trusts that the taxpayer previously created or of which the taxpayer is a trustee or beneficiary. Without additional planning, such trusts may continue to be subject to state income tax, even after the taxpayer’s change of domicile.



New Jersey and New York tax trustees on the income of resident trusts. Resident trusts are defined either as inter vivos trusts created by a domiciliary grantor or testamentary trusts of a grantor who was a domiciliary of the state at death.¹² Trusts created by out-of-state grantors or certain resident trusts that qualify for the exemption from resident trust status, often referred to as “exempt resident trusts,” are only taxed by New Jersey and New York on their in-state source income.¹³ As long as a resident trust relinquishes its in-state trustees, assets and state-sourced income, it will become an exempt resident trust.¹⁴ Therefore, by reducing a resident trust’s contacts with the taxing state, a taxpayer may eliminate or reduce state income taxes on accumulated income and certain capital gains.

Case Study 2

Thirty years ago, while a resident of New York, Jack created and funded an irrevocable grantor trust for the benefit of his children. He named Leone and the family’s local accountant as the co-trustees of the trust and funded it with cash, marketable securities and a Brooklyn, N.Y. apartment building. Jack’s children don’t reside in New York.¹⁵

Because the trust is taxed as a grantor trust, Jack must report all of its income on his individual state and federal income tax returns, regardless of any distributions made to beneficiaries during the tax year that would have otherwise carried out taxable income.¹⁶ Jack should renounce any and all of his retained powers that would cause the trust to qualify as a grantor trust. If any would-be grantor trust power is still desirable, for example a power to swap assets to plan for maximization of tax basis, Jack should consider decanting the trust to require the consent of an adverse party to exercise the power. Renouncing or modifying such powers will ensure that the trust, rather than Jack, will be taxed on accumulated income.

Although Leone changed her domicile to Florida, the remaining New York resident trustee will prevent the trust from qualifying as an exempt resident trust. Jack should request that the trustee resign, or he should remove and replace the trustee with an independent co-trustee. It’s important that the successor co-trustee not maintain a New York domicile or a residence in any other state that could expose the trust to another unanticipated state income tax based on the

residence of the trustee, even if the trust has no other connections with that state.¹⁷

Furthermore, the trustee may not maintain any New York situs assets. Intangible property held by a trust is deemed to be located in the domicile of the trustee.¹⁸ Therefore, if the trustee remains invested only in securities, cash or other intangibles, a shift in the trustee’s domicile to another jurisdiction would avoid New York income tax. The trust’s ownership of the New York rental real estate, a tangible asset with a situs within the state, however, will cause all of the trust income, not just the rental income, to be taxed by New York.¹⁹ Leone should convert the real estate into an intangible asset by transferring title into a limited liability company

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(LLC). Doing this would generally shift the situs of the real estate to the state where the trustee has established domicile, as is the case with other intangibles, except as described below.²⁰


Source income generated by any single trust asset will prevent the trust from qualifying as an exempt resident trust.²¹ Source income includes income from ownership of real or tangible personal property located in the state,²² income from a trade or business carried on in the state²³ and gain from the sale of an apartment or cooperative unit located in the state.²⁴ Although the building is no longer a New York situs asset, it’s possible that retitling it into an LLC wouldn’t shift the building’s rental income to the trustee’s new state of domicile.²⁵ To avoid the risk of tainting all of the income generated by the trust assets, Leone could bifurcate the trust into two separate trusts, one funded with the LLC interest and any individual investments that produce New York source income and the other trust with all other assets. Although the trust that owns the LLC interest may be



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taxed on its New York source income, the other trust will escape New York state income tax entirely.

Tipping the Scales

Although a taxpayer's decision to permanently move to another state will depend in large part on her level of affluence and her home state policies, the scales will be tipping for more taxpayers, since the enactment of the Act, in favor of a move to a state with a more favorable state tax regime. Some analysts predict that the limitation on the deductibility of state and local taxes will increase the effective tax rate for some taxpayers in high tax states by up to 5 percent.²⁶ In states like New Jersey and New York, currently ranked among the top 10 in highest effective income tax rates, this could result in an estimated 2.5 percent of high income taxpayers relocating to a state without a state income tax.²⁷ This migration of high income taxpayers may not only have a snowball effect on the tax revenue generated by evacuated jurisdictions, but also will affect the needs and objectives of many clients' estate plans. 

Endnotes

1. Connecticut and Massachusetts employ similar tests.
2. N.Y. Tax Law Section 601(a); N.J.S.A. Section 54A:2-1.
3. N.Y. Tax Law Section 605(b)(1); N.J.S.A. Section 54A:1-2(m).
4. 20 N.Y.C.R.R. Section 105.20(c); *Zanetti v. NYS Tax Appeals Tribunal*, 8 N.Y.S.3d 733 (3d Dept. 2015). Note that there are a few exceptions to the rule, including time spent by a nonresident confined in a hospital or other medical facility for an illness; presence in the state solely for boarding a means of transport; and time spent in active service of the U.S. Armed Forces.
5. See *In Matter of David J. and Laurie Knoebel*, DTA No. 824117 (N.Y.S. Div. of Tax App., Sept. 19, 2013).
6. See *Galed v. N.Y. Tax App. Trib.*, 101 A.D.3d 1492 (N.Y. App. Div. 3d Dept. 2012), 2014 Slip op. 1101, at p. 2.
7. See *Matter of Newcomb*, 192 N.Y. 238 (1908); see also *In re Estate of Gillmore*, 101 N.J. Super. 77 (App.Div.), cert. denied, 244 A.2d 304 (1968).
8. See *In re Blatt*, N.Y. Tax App. Trib., No. 826504, (Feb. 2, 2017); See also *Matter of Stephen C. Patrick, et al.*, DTA Nos. 826838 and 826839 (N.Y.S. Div. of Tax App., June 15, 2017).
9. N.Y. Tax Law Section 639(a).
10. The sale or disposition of S corporation (S corp) stock is a transaction involving the sale of an intangible asset that isn't taxable for a nonresident for gross income tax purposes under N.J.S.A. Section 54A:5-8. Note, however, that if Jack elects to treat the sale as a deemed asset sale under Internal Revenue Code Section 338(h)(10), gains from the sale will be treated as non-operational income that must be sourced to the principal place of business of the

S corp. N.J.S.A. Section 54:10A-6.1; See *Xylem Dewatering Solutions, Inc. v. Director*, Div. of Taxation, Dkt. Nos. 011704-2015, 000056-2016, 000057-2016 (N.J. Tax Ct. April 7, 2017) (slip op.).

11. See *Matter of Craig F. Knight*, N.Y. Tax App. Trib. (Nov. 9, 2006).
12. N.Y. Tax Law Section 605(b)(3)(B), (C); 20 N.Y.C.R.R. Section 105.23(c); N.J.S.A. Section 54A:1-2(o). Alabama, Arkansas, Connecticut, Delaware, Illinois, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, Ohio, Oklahoma, Pennsylvania, Rhode Island, Vermont, Virginia, Washington, D.C., West Virginia and Wisconsin employ similar tests.
13. N.Y. Tax Law Sections 631, 633; N.J.S.A. Sections 54A:2-1.1; 54A:5-8.
14. N.Y. Tax Law Section 605(b)(3)(D)(i); 2016 Instructions to Form NJ-1041.
15. Had the children remained domiciled in New York or moved back to New York after a period of absence, distributions to them of accumulated trust income (other than capital gains) would be subject to New York's throwback income tax, regardless of the trust's qualification as an exempt resident trust. N.Y. Tax Law Section 612(b)(40).
16. 26 U.S.C. Section 671. Treasury Regulations Section 1.671-2(d).
17. Arizona, California and Kentucky, for example, may impose a state income tax on income from trusts with no contacts other than maintaining trustees who reside in such respective states.
18. N.Y. Tax Law Section 605(b)(3)(D)(ii); see also *Petition of Charles B. Mass Trust*, Income Tax Advisory Opinion, TSB-A-94(7) I (April 8, 1994).
19. See New York Department of Taxation Technical Memorandum TSB-M-09(5) (May 5, 2009).
20. See *supra* note 15.
21. N.Y. Tax Law Section 605(b)(3)(D)(iii); N.Y. Tax Law Sections 631, 633; However, New Jersey trusts that would qualify as exempt resident trusts but for source income will only be taxable on the portion of the trust income constituting source income. See *Residuary Trust A U/W/O Kassner v. Director, Div. of Taxation*, 2015 N.J. Tax Lexis 11 (N.J. Super. Ct. App. Div. 2015).
22. N.Y. Tax Law Section 631(b)(1)(A).
23. N.Y. Tax Law Section 631(b)(1)(B).
24. N.Y. Tax Law Section 631(b)(1)(E).
25. However, New York law is clear that if the fair market value of the real estate exceeds 50 percent of total value of the limited liability company (LLC) assets when the real estate is eventually sold, any capital gains from the sale will be treated as New York source income. See N.Y. Tax Law Section 631(b)(1)(A)(1). For estate tax purposes, the situs of property held by a single member LLC is determined by looking through to the situs of the underlying property.
26. See Ray Dalio, "Watch Out for the Effects of Tax Reform on Tax Migration, the Fiscal Conditions of Affected States and Cities, and Polarity in America" (Dec. 5, 2017), www.linkedin.com/pulse/watch-out-effects-tax-reform-migration-fiscal-conditions-ray-dalio/?published=t
27. See Federation of Tax Administrators State Individual Income Tax Rates Rankings (2017), www.taxadmin.org/assets/docs/Research/Rates/ind_inc.pdf; see also *ibid.*