What You Need to Know Before Switching States to Save on Taxes

Mark Klein
Hodgson Russ LLP

**This article originally appeared in the February 15, 2020 issue of Bottom Line Personal magazine and is reprinted with permission.*

In recent years, several billionaires have changed their official residency from Connecticut, New Jersey or New York to Florida. That includes hedge fund managers David Tepper and Paul Tudor Jones and, the latest transplant, President Donald Trump. The main draw isn't the high temperatures—it's the low taxes. Florida is one of the states that has no state income tax or estate tax and relatively modest property taxes. Billionaires aren't the only ones seeking to escape high taxes, especially since the new federal tax law took effect in 2018. That law capped federal deductions for state and local tax payments at $10,000, increasing the overall tax burden for taxpayers who pay hefty state income tax and/or property taxes. In addition to the Northeastern states that lost billionaires, high-tax states include California, Maryland and Minnesota. Unfortunately, some people who flee to low-tax states (see page 12) find that the high-tax states they're hoping to escape are reluctant to let them say goodbye. These states are aggressively auditing taxpayers who relocate, hoping to prove that they have not completely severed their connection to a former home state and thus still owe taxes.
The rules regarding who owes state taxes where can be complex. There are two separate tests that could come into play. Fail either, and your former home state is likely to demand tax payments.

THE DOMICILE TEST

To no longer officially reside in a state, you must change your "domicile" — permanent, primary home — to an out-of-state location. This might be clear-cut if you sell your home in the old state, buy (or rent) a home in the new state and move yourself and all your possessions there. But what if you own or rent homes in two states? An auditor likely would consider five primary factors when determining which is your domicile...

The homes. The home that is bigger, better and more valuable is likely to be considered your domicile. Minor differences in size or value might not be considered definitive, but expect problems claiming Florida as your home if you have a one-bedroom condo there versus a 3,500-square-foot house in Connecticut.

Your active business interests. It will be more difficult to convince auditors that you truly have moved away if you still own or work for a company in your former state. Be ready to supply a copy of your letter of resignation...or paperwork proving that you sold, closed or moved your business. It is possible to relocate and work remotely for an employer from a different state, but be warned—such arrangements are likely to attract close attention from auditors. Be very cautious about returning to the state to visit the office.

Your time. You might have heard that spending less than 183 days in a state proves you don't live there. There is some truth to this, but it's not the whole story. You also might be asked to prove your "lifestyle" changed significantly and that you spend more time in your new state than your former one. Example: A New Jersey man moves to Florida but still spends 180 days in New Jersey. An auditor is likely to argue that New Jersey remains his true domicile if he spends just 170 days in Florida, with the remaining days spent vacationing elsewhere. It should be beyond question that where you spent your time changed substantially when you officially moved...and you certainly should spend more days in the state that you are claiming as your new home than you do anywhere else.

The burden will be on you to prove how many days you spend in each state. Save receipts, credit card statements and cell-phone records that establish where you were on as many days of the year as possible. Keeping a diary or calendar can help here, too, but only if this is completely accurate. If you expect to take a trip one week and enter this in your calendar—but the trip is canceled and you forget to remove it from the calendar—this incorrect listing could later be seen as evidence that the entire calendar can't be trusted.

Your possessions. The location of the items nearest and dearest to your heart could play a major role in establishing which home is your domicile. "Meaningful" possessions may include family heirlooms...family photo albums...and family pets.

Hire or rent a moving van to relocate at least some items from your old state to your new one —even if you can afford to buy all-new stuff for your second home. If you have a safe-deposit box in your old state, close it and rent one in your new state.

Your family. Where your spouse and minor children spend most of their time can be used as evidence of your true domicile.

Also, change your driver's license, bank accounts, primary physician, voter registration, car registration, passport and insurance policy addresses to your new state and sell any municipal bonds issued by the prior state. Failing to get rid of them could be used as evidence that you haven't moved. Auditors sometimes even consider where people get their teeth cleaned...which airports they most often fly through...and where pets get annual checkups.

Don't claim "resident rates" for anything in your former state. Example: One man ended up with a big New York State tax bill because when he returned to his former home state, he paid the resident rate for a fishing license.

Warning: Beware the January 1 move-date trap. People who switch states often claim to have relocated on January 1 to avoid filing partial-year tax returns in two states. A January 1 move is a huge red flag to state tax auditors—expect to be asked for proof you moved in on New Year's Day. If it turns out you moved on a different day, the auditor will treat you with increased suspicion.

THE RESIDENCY TEST

Even if you prove that your domicile is now in a new state, your former state might insist that you're still a resident if you spend more than a certain number of days there during a year and maintain a "permanent residence" there. Typically, the limit is 183 days, but there are exceptions. Example: The cutoff is 200 days in Oregon.

The rules are confusing, which can lead to expensive missteps. What you need to know...**You might legally have a "permanent residence" in your former state even if you don't own a house or rent an apartment there.** A relative's home or a home owned by your employer that you stay in frequently might be considered your permanent residence — particularly if you have a key to the property and/or keep stuff there. This especially becomes a problem if you might spend more than 183 days in that state. The safest way to avoid being deemed to have a residence in that state is to vary where you stay when you're there.

Partial days count as full days. If you arrive in the state at 11:59 pm, that day counts toward your total. There are a few exceptions, which vary by state. In New York, you can travel through the state on the interstates and/or fly out of the airports without it counting as a day—but if you even stop for a meal in a New York restaurant along the way (other than in the airport), that does count as a day. In many states, days as an in-patient in the hospital do not count—but even with this there are gotchas. Example.• A man was forced to pay New York State income taxes be-cause of days he spent visiting his dying wife in a New York hospital. The wife qualified for the in-patient exception, but her visiting husband did not.

Think you can sneak into a state and no one will know? Don't count on it. State tax auditors have become sophisticated—they often obtain cellular records and toll-monitoring services such as E-ZPass to track people's movements.

Bottom Line Personal interviewed Mark Klein, chairman of Hodgson Russ, LLP, a law firm based in New York State. He is general editor of LexisNexis Tax Practice Insights: New York. HodgsonRuss.com