A Foreign Language? Residency Rules With an International Spin

by *Timothy P. Noonan and Andrew W. Wright*

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In this article, Noonan and Wright provide a refresher on New York's 548-day rule and outline the changing landscape in the area of foreign domicile changes.

Most of the stuff we cover in this column is, for lack of a better word, reactive. We're reacting to trends in areas of our practice and highlighting issues that we see various tax departments raising both in New York and around the country.

This month is no different. With the growing ease of international travel (nosy TSA agents notwithstanding) and the ability for folks to do business from anywhere, we see lots of taxpayers fleeing not just to places such as Florida, but also London, Singapore, Germany, and, heck, even Canada. And while such moves can raise international tax issues above our pay grade and practice area, we're also seeing a growing interest by state tax departments into income tax issues generally, and residency specifically, for many of these taxpayers. And what do we do when we see such trends? That's right, we tell you about it in a Noonan's Notes article!

So here we go. Numerous new residency audits over the past few years being conducted by the New York State Department of Taxation and Finance (as well as by other Northeastern states such as Connecticut and New Jersey) focus on taxpayers who work in foreign countries — for instance, taxpayers on a foreign assignment. In New York, those audits most typically focus on taxpayers who are domiciliaries of New York but file as nonresidents under New York's 548-day rule. Those audits, like statutory residency audits, focus almost exclusively on objective day-count issues. However, given the 548-day rule's three-pronged test (see below) and some of its other implications (for instance, the ability to shift 548-day periods, the ability to overlap 548-day periods, and so forth), 548-day audits can be a bit more complicated than a straightforward statutory residency audit.

Also, as is sometimes the case in these audits, the department examines taxpayers who claim to have changed their domicile from New York to a foreign country. And in those audits, the department has been using a set of criteria different from those it uses in examining a change of domicile from New York to another state. The department has imposed what appears to be a higher burden of proof on taxpayers attempting to prove a change of domicile to a foreign country, though a recent Division of Tax Appeals determination has called that into question.

In this article, we provide a refresher on New York's 548-day rule and summarize some rulings interpreting that test that have been published by the department since we last visited the topic. Next, we address foreign domicile changes and discuss the potential impact of a recent Division of Tax Appeals determination on audits focusing on foreign domicile changes.

548-Day Rule Refresher and Update

A few years ago, we wrote a primer on New York's 548-day rule.[1] In the last several years, we have observed a marked increase in the amount of audits conducted by New York's tax department of taxpayers who file nonresident returns under the protections of the rule. At any time, our firm represents a handful of taxpayers being audited by New York for this specific issue. That increase in 548-day audits could be the result of more New York taxpayers filing nonresident returns on this basis (maybe folks who read our articles!). Or, it's just as likely that the department's systems, which are excellent, are getting better at targeting these

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[1]Timothy P. Noonan and Andrew W. Wright, "The Nuts and Bolts of New York's 548-Day Rule," *State Tax Notes*, Mar. 7, 2011, p. 725.

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taxpayers for audit. Either way, New York domiciliaries who plan to live abroad and file nonresident tax returns under New York's 548-day rule should expect an audit.

Briefly, New York's 548-day rule is an exception to resident taxation that allows a domiciliary of New York to file as a nonresident if he meets each of three specific tests:

- he is physically present in a foreign country or countries on 450 days during any period of 548 consecutive days;
- his spouse (unless legally separated) and minor children are not present in New York state for more than 90 days during the same 548-day period; and
- during any portion of the 548-day period that is less than a full tax year (the short period), the ratio of the number of days he is present in New York (x) over 90 must not exceed the ratio of the total number of days in the short period (y) over 548.[2]

Taxpayers must be very careful about the short period test. When you run the math on the short period calculation, it basically allows a taxpayer to spend five days in New York for every 30 days in the short period. So if a short period spans two months, the taxpayer cannot spend more than 10 days in New York during those two months. In practice, the short period test prevents taxpayers from spending all their allowable New York days at the beginning or end of a 548-day period.

Despite the math involved, application of the 548-day rule is fairly simple. But always keep in mind that the 548-day period is flexible. It can be shifted forward or backward at the taxpayer's discretion as long as each of the three requirements are met for the 548-day period covered. The ability to shift the period often proves advantageous to taxpayers — for instance, if a short period test is failed, the 548-day period might be shifted to increase the number of New York days allowed in that short period so that the taxpayer passes that part of the test.

Also, and as evidence that this is a hot topic, the department has issued a few advisory opinions (AOs) on various aspects of the test over just the past couple of years. Below is a brief summary of a few:

- TSB-A-11(3)I: This AO request questioned whether you count both full days and part days spent in a foreign country when determining whether the 450-day threshold for part one of the test is met. The department concluded that the same method used for counting days under the test of statutory residency (that is, "any part of a day is a day") applies to the 548-day test. Therefore, when counting days for both parts one and two of the test, *any part of a day* in a foreign country counts toward the 450-day threshold, just as any part of a day in New York counts toward the 90-day limit.
- TSB-A-12(3)I: This AO request asked whether time spent by a taxpayer's minor child in New York with a separated spouse would count toward the 90-day limit under part two of the test.[3] The department concluded that days spent by a taxpayer's minor child in New York state at the residence of a separated spouse do not count in determining whether the taxpayer meets the requirements of the 548-day rule, as long as (1) the taxpayer and his spouse are legally separated and (2) there is a written separation agreement providing that the spouse has physical custody of the minor child. However, days spent by the taxpayer's minor child in New York when the taxpayer is entitled to custody or visitation *do count* toward the 90-day limit under part two of the test.[4]
- TSB-A-12(5)I: This AO request asked how the department would define the term "minor child" for purposes of the 548-day rule. The department concluded, citing section 2(4) of the Tax Law, that a child will be considered a minor for purposes of the 548-day test until the child reaches 18 years of age (in other words, minors are children under the age of 18).

Foreign Domicile Changes

In the most recent versions of its Nonresident Audit Guidelines (2012 and 2014[5]), the department attempted to distinguish changes of domicile between New York and another state from changes of domicile between New York and a foreign country. The department defends that distinction by stating that a foreign change of domicile presents "a unique set of issues unlike those found in the typical nonresident audit," and that "in such cases, a comparison of the domicile factors between New York and the foreign country may not necessarily be a true measure of the taxpayer's intent."[6] The guidelines caution department auditors that the "business" and "time" factors will often favor the foreign country in a claimed change of domicile, even when the foreign employment is of a temporary nature.

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[2]This part of the test is best understood using the following mathematical formula: $x/90 \leq y/548$. Stated another way, the maximum number of days a taxpayer is allowed to spend in New York during any short period (x) can be determined by the following formula: (90 x y) / 548.

[3]Under previous iterations of the 548-day test, a taxpayer's spouse and minor child were able to spend more than 90 days in New York as long as those days weren't spent at the taxpayer's permanent place of abode in New York. New York changed the rule so that a taxpayer could not "avoid being taxed as a resident" by having his spouse and minor children stay with relatives or at a hotel.

[4]Query whether this interpretation of the rule requires that the taxpayer also be present in New York on days when he is entitled to custody or visitation. If a separation agreement entitled the taxpayer to custody of his minor child every weekend (that is, 52 weekends and 104 days per year), would the taxpayer violate part two of the 548-day rule even if he didn't spend a single weekend in New York state?

[5]State of New York Department of Taxation and Finance, Nonresident Audit Guidelines (June 2014).

[6]Nonresident Audit Guidelines, at 45.

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A Higher Standard of Proof?

Because it seems to be more skeptical of foreign changes of domicile than it is of interstate changes of domicile, the department has, in practice, imposed a higher standard of proof in such cases. In doing so, the department points to its own regulations, which state that although domicile is not dependent on citizenship, "a United States citizen will not ordinarily be deemed to have changed [his] domicile by going to a foreign country unless it is clearly shown that such citizen *intends to remain there permanently*."[7]

To determine a taxpayer's intent in matters of foreign domicile, the department suggests that its auditors review the following factors (in addition to the typical domicile factors):

- Whether the taxpayer has been admitted for permanent residence in the foreign country. The act of applying for and obtaining such status in a foreign country, the department concludes, signals an intent that is lacking in taxpayers who only have temporary work visas.
- Whether the taxpayer has retained the New York residence or has made periodic visits. While the department would never suggest that a New York domiciliary needs to sell his New York residence in order to change his domicile to Florida, or that he not be allowed to return to New York once he has moved to Florida, it seemingly suggests that taxpayers who wish to change their domicile to a foreign country must do both of those things to satisfy this higher standard.
- The nature of the taxpayer's business ties. Though business ties are already a primary factor, the department's concern here is arguably more valid. Many taxpayers who "move" overseas do so because of a foreign work assignment. When such assignments are of a temporary nature (that is, limited to a specific term), it is at least understandable that the department would question whether such a taxpayer really abandoned his New York domicile and landed in the foreign country. The retention of business ties in New York would also cut against a foreign domicile change, according to the department's guidelines.
- The filing of tax returns as a resident of the foreign country. In theory, this factor makes sense. Why should the department view a taxpayer as having changed his domicile to a foreign country if the taxpayer doesn't even file tax returns as a "resident" of the foreign country? In practice, many countries have tax laws that define the word "resident" much differently than New York's tax law does. In other words, New York's laws and the laws in foreign countries don't always line up as neatly as the department might like.[8]

So what does all this mean? As we see it, the department has attempted to make the burden of proving a foreign change of domicile higher than the burden of proving a change of domicile from New York to another state.

Tax Department, Take Note!

Earlier this year, the Division of Tax Appeals heard the case of Irenee D. May.[9] In addition to being a member of the prestigious (and infamous) DuPont family, May was also a former New York state domiciliary who claimed a change of domicile to the United Kingdom. He was formerly a successful hedge fund manager at JP Morgan in New York City. In late 2004 May was unexpectedly terminated by JP Morgan. This termination left May jaded by the New York investment world. In early 2005 he was offered an opportunity with the Royal Bank of Scotland (RBS) in London. In September 2005 May signed an at-will employment contract with RBS and left for London. May's wife and children initially stayed behind in New York, but the plan was to have his wife and children join him in London as soon as the children were admitted to U.K. schools. The couple envisioned a U.K. home, U.K. schools for their children, and moving their nanny to the U.K. — the works. Long story short, while May was experiencing great personal and professional success in the United Kingdom, his wife and children remained in New York. After several failed attempts to gain the children admission to the U.K. schools of their choice, Mrs. May decided she didn't want to move to London. May flew to the United States to try to convince her otherwise, but she instead filed for divorce (on the grounds of abandonment). Later, in October 2008, May returned to the United States to be near his children.

At audit, the department determined that petitioner had not met his burden of proving a change of domicile to the United Kingdom. Examining the factors the department laid out in its guidelines, it's easy to see why. First, May was not admitted for permanent residence in the United Kingdom. He was there on a visa. Second, he retained the family's historic residence in Harrison, New York — though exclusive use of the residence was granted to Mrs. May in November 2007 — and, though he spent overwhelmingly more time in the U.K. each year, he returned to New York for some period in each audit year to visit.[10] Third, May's

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[7]See 20 NYCRR 105.20(d)(3). That test arguably requires something more than the one imposed in a typical domicile case. In a typical domicile case, the rules require "no definite period of residency or specified length of time" in the new domicile, and state that "any residence, however short," will suffice as long as the taxpayer demonstrates the requisite intent. See Nonresident Audit Guidelines, at 10.

[8]Note that New York's guidelines state that the acquisition of citizenship in a foreign country is generally a non-factor when it comes to examining a foreign change of domicile. See Nonresident Audit Guidelines, at 49.

[9]*Matter of May*, No. 825173 (N.Y. Div. Tax App. 2015). The tax department did not file a tribunal exception to the administrative law judge's determination in *Matter of May*.

[10]Remember the guidelines' warning that the "business" and "time" factor will often favor the foreign country in a claimed change of domicile.

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move to the United Kingdom was driven by an offer of employment, though it was not a contractually temporary assignment. Finally, May filed U.K. tax returns indicating that he was not domiciled in the U.K. So on paper, there were clearly a lot of weaknesses in the case.

Based on detailed testimony offered by both of the Mays at the hearing, however, the administrative law judge concluded that May's actions and general habit of life supported his claimed change of domicile to the United Kingdom. The ALJ made several points in his ruling worth highlighting here:

- A taxpayer may change his or her domicile *without severing all ties* with the prior domicile. The guidelines suggest that moving to a foreign country requires more New York ties be severed than in other changes of domicile.
- The department placed *undue weight* on its regulation, which required that a taxpayer show his intent to remain in a foreign country permanently in order to change his domicile. The department described this regulation as creating a "stronger than general" regulatory presumption. The ALJ disagreed and concluded that the same standard must be used in both interstate and international changes of domicile.
- Despite factors that might mitigate against May's claimed change of domicile (that is, his U.S. and U.K. tax returns, his retention of a New York driver's license, etc.), May's conduct clearly demonstrated an intent to move the focus of his life from New York to London. Credible testimony offered by both Mr. and Mrs. May at the hearing certainly helped bolster his position.

So this case should be an important one for taxpayers facing the prospect of an audit on a claimed foreign domicile change. This case should also be Exhibit A for the notion that testimony can make all the difference in a domicile case. In *May*, we see how powerful testimony can be used to overcome a parade of terrible domicile facts that ordinarily would sink a taxpayer. It's really quite amazing, and should be a warning signal for residency auditors who often push too hard in these cases.

Remember, these domicile cases are all about intent. That's the key fact. If a taxpayer gets up on the stand and credibly testifies about what he was thinking, more often than not he will win. We've seen this in other cases, too, including *Knight*, *Handal*, *Bostwick*, *Kaltenbacher-Ross*, and *Cooke*.[11] But *May* is particularly interesting, because it comes up in the context of a foreign domicile change. In this context the department has historically made it more difficult for a taxpayer to prove his cases by claiming that the burden of proof on the taxpayer claiming the change is higher than normal.

Conclusion

To borrow a line from the department, residency issues involving foreign countries involve a "unique set of circumstances." In 548-day audits, the intricacies of that rule often trip up taxpayers seeking its protections. In foreign domicile cases, the department's attempts to impose a higher standard of proof often make it impossible for a taxpayer to prove his case. However, as the ALJ in *May* made clear, the unique set of circumstances presented in foreign residency cases does not implicate a different standard for proving a change of domicile. That determination should force the department to reevaluate the way it analyzes claimed changes of domicile to foreign countries. At a minimum, the department should take note of this determination and ask itself whether the factors it examines and the standard of proof it applies to a claimed foreign domicile change should be any different from those applied in a typical change of domicile. ✰

[11] *Matter of Knight*, No. 819485 (N.Y. Div. Tax App. 2006); *Matter of Handal*, 821996 (N.Y. Div. Tax App. 2009); *Matter of Bostwick*, No. 820637 (N.Y. Div. Tax App. 2007); *Matter of Kaltenbacher-Ross*, No. 818499 (N.Y. Div. Tax App. 2003); *Matter of Cooke*, No. 823591 (N.Y. Div. Tax App. 2012).

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