WRMarketplace
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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

TOPIC: Should I Stay or Should I Go: Changing State Residency – Reasons & Requirements.

MARKET TREND: As the population ages and taxes increase, differences in state laws, including tax laws, may make a compelling case for moving to another state.

SYNOPSIS: States have different tax, asset protection, and property ownership rules that need to be analyzed before a client moves. Changing residency to a new state is complicated if the client intends to retain ties with the old state. Some states base tax residency on an objective test that counts the number of days in the state, which will require the client to minimize the number of days there after a move. Other states impose a subjective test that looks at the individual's connections to each state to determine tax residency. Even if a client successfully establishes tax residency in a new state, wages earned in the old state or income from business or real estate interests located in that state, may still be taxable by the old state.

TAKE AWAYS: For clients moving to new states, advisors can add value by helping the client analyze the move's impact on taxable income, estate taxes, real property taxes, creditor protection, and, if the client is married, possible changes in property ownership if moving to or from a community property state, or rights and entitlements for same-sex married couples moving to a non-recognition state. When clients are looking at life insurance products for tax or liquidity planning or creditor protection, advisors can analyze how a client's anticipated move will affect the coverage amount or type needed and what adjustments, if any, should be made to current protection. Advisors also can assist with developing and implementing a coordinated plan of action to accomplish the move, including steps to sever ties with the old state and establish strong connections with the new state to document the change of residency. If the client is moving before a significant tax event, timing and implementation of the move will be critical. Some states are very aggressive in challenging taxpayers who leave the state just before such an event. A focused move accomplished within a concentrated period of time well before the tax event will help establish a firm move completion date and give the client time to bolster ties to the new state, which may help defeat challenges to the date state residency changed, particularly for state tax purposes.

MAJOR REFERENCES: *Fowler v. North Carolina Dept. of Revenue, N.C. Super. Ct.*, Dkt. No. 13 CVS 10989 (Aug. 6, 2014).

PRIOR REPORTS: 14-28.

Clients migrate from state to state at different stages of their lives, particularly after retirement, for a multitude of reasons –business, to be near family, to live in a warmer climate, to simply live life at a slower pace, and yes, for tax reasons. However, state laws differ as to taxes, property ownership rights, asset protection, and the requirements to disengage from the "old" state and establish residency in the new state. The decision to move to another state, along with where to move and when, and the steps required to establish residency in the new state, is multifaceted and requires advance analysis and planning to avoid unpleasant surprises after relocation.

WHY MOVE? ISSUES & CONSIDERATIONS

Income Taxes. A frequently cited reason for moving to a new state, other than better weather or employment, is to reduce income taxes. As both federal and state income tax rates rise, more clients are considering changing their residency to a low or no income tax state (such as Florida, Texas or Nevada) to reduce the overall tax bite.

When analyzing a move for tax reasons, clients need to look at more than just the difference in rates. They also must examine the source of their taxable income, as moving to a new state may not remove all income from the old state's tax reach. For example, if, after a move, the client will continue to own a business or work in the old state, the income from such business or employment may still be taxable by the old state. Also, if the client will continue to own real property in the old state, rental income and capital gains upon any subsequent disposition of the property will be subject to tax in the old state.

Estate Taxes. High net worth clients should examine the differences in estate tax rates and exemptions before relocating. Moving from a state with an estate tax to a state without an estate tax can reduce such taxes at the client's death, leaving more for the client's family. ***Real property located in the old state, however, still will be subject tax under the old state's estate tax laws.*** Placing the real property in a partnership or corporation as part of the relocation process may remove the property from estate taxation in the old state. Conversely, clients moving ***from a state without an estate tax to one with an estate tax should consider whether they need more liquidity to pay the added tax burden (including the need for additional life insurance coverage to pay or offset the estate taxes)***.

Real Property Taxes. Clients should consider the move's impact on their real property tax liability with regard to their new residence, since some clients could see a ***significant reduction or increase*** in their real property taxes as a result of the move. Many states base real property taxes on a percentage of the property's current fair market value, with the tax increasing annually with that value. Some states, however, may cap the annual tax increase. For example, California bases its real property tax on a percentage of the property's fair market value at the time of purchase but caps how much the property's value may increase annually for real property tax purposes. Over time, this cap creates a significant difference between the fair market value of the residence and the value used for property tax purposes, resulting in a lower property tax. If the client sells the home and buys a residence in a new state that bases the tax on the fair market value of the property, the move could result in higher real property taxes.

Asset Protection. States differ with respect to the creditor protection provided to residents. For example, Florida and Texas allow residents to exempt the full value of the principal residence from bankruptcy proceeding, meaning that unsecured creditors are unable to access the equity to satisfy the owner's debts. Most states, however, limit the equity in a home that may be exempt from creditors. The following illustrates the disparity between states with respect to the amount of home equity that will be exempt from bankruptcy proceedings.

State	Exemption for Equity in the Principal Home
Florida	Unlimited Value
Texas	Unlimited Value
Nevada	$550,000
California	$75,000-$175,000
New York	$75,000-150,000
Illinois	$15,000
New Jersey	None (but spouse's survivorship interest in property held as tenancy by the entirety is exempt from creditors of a single spouse)

Depending upon the state, other exempted assets may include assets held by spouses as tenants by the entirety, life insurance policies and proceeds, college savings accounts, and IRAs. If asset protection is a primary consideration in making a move, the client and his or her advisors should carefully analyze the protection afforded by the desired state and the length of time the client must be a resident of the state before claiming protection under its bankruptcy laws.

Spousal Property Ownership. Changing residency can impact property ownership rights between spouses. If the couple relocates from a common law property state to a community property state, the move may create unintended community property rights in existing and future assets acquired by the spouses. Moving to a common law state from a community property state also will alter the property ownership rights between spouses in assets acquired in the future and may result in a loss of property ownership by the non-acquiring spouse, a denial of a full step-up in basis on the death of the first spouse for assets previously held as community property, and a change in the surviving spouse's inheritance rights.

Absent an agreement between the spouses, assets acquired through the labor, effort and skill of each spouse while residing in a community property state are community property, in which each spouse owns a 50% undivided community property interest (regardless of how the property is titled). Furthermore, Arizona, California, New Mexico, Texas, and Louisiana have laws which alter the character of certain assets acquired by spouses while married but before moving to the state. In those states, assets acquired while married through the labor, effort and skill of either spouse become "quasi-community property" when the couple moves, giving the non-acquiring spouse the right to one-half of such property if the acquiring spouse dies first. Some community property states also consider income earned on separate property as community property.

In common law states, each spouse owns the assets titled in his or her name – the other spouse does not have an ownership interest unless his or her name is also on the title. For spouses moving to a common law state from a community property state, future assets acquired through the labor, skill and effort of a spouse will no longer be owned equally by the spouses – much to the probable dismay of the non-acquiring spouse.

Thus, before moving, clients and their advisors must carefully analyze how spouses wish to hold their current and future acquired assets and determine whether the separate or community property character of an asset should be preserved or terminated. Properly drafted and executed marital or transmutation agreements can be used to identify or document conversions of community to separate property and vice versa. Clients also may want to establish separate accounts for community and separate property and/or establish a joint revocable trust to hold community property and separate trusts for separate property to avoid commingling.

Same-Sex Marriages. Lawfully married same-sex couples must consider several unique issues if they move to a new state that does not recognize their marriage, including the following:

- The couple may not be able to file joint state income tax returns after the move, even if they file joint federal returns
- The marital deduction may not be available to reduce estate taxes imposed by the new state (if any) on the death of the first spouse.
- State exemptions and protections allowed to heterosexual spouses in bankruptcy proceedings may not be available to same-sex spouses.
- In a common law property state, the couple may not be able to title real property as tenants by the entirety or in similar forms that provide creditor protection for married couples.
- If the couple moves from a community property state to a common law property state, the new state may not recognize the each spouse's interest in assets acquired while married and living in the community property state, or may not grant a full step-up in basis for community property on the death of the first spouse for state estate tax purposes.
- If the couple moves from a common law state to a community property state, they may not be able to acquire assets as community property.

CHANGING RESIDENCY - HOW IT'S DONE

Changing legal residency to a new state isn't just a matter of relocating to a new house in the new state. Clients must evidence that they have truly severed connections with the old state and established strong ties to the new one, particularly as some states, like New York and California, can be very aggressive in challenging state residency changes, especially if the move occurs just before a significant tax event.

Counting Days and Closer Connections. Clients and advisors must carefully analyze the laws of both the old and new states to identify and plan out the steps required to demonstrate the severing of ties with the old state and the creation of sufficient connections to the new state. The analysis should review how each state determines who is a resident and how such residency is extinguished or adopted, including whether the state adopts an objective "day-count test," a subjective "closer connection test," or some other method to determine residency.

<u>Day-Count Test</u>. States that impose a day-count test generally look at the number of days an individual is present in the state to determine residency. For 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 <u>and</u> has a permanent place of abode in the state. Accordingly, to relinquish residency in New York, the client should limit the amount of time spent in New York after the move.

Closer-Connection Test. Many states determine tax residency by looking at a person's domicile or the place where the individual has the closest connections. As a subjective test, state courts and tax authorities will consider a wide variety of factors to determine an individual's tax residency, including:

- The location of the individual's principal residence and whether the individual owns or leases the residence. If the individual has more than one residence, the courts and tax authorities will look at where the individual keeps personal belongings, lives with family, engages in activities which he or she regards as important, and intends to continue indefinitely to do so.
- Time spent in the new state versus the former state.
- Place of employment or business.
- Location of the individual's spouse and children.
- The state issuing the individual's driver's license and vehicle registration.
- The state in which professional licenses are maintained.
- Where the individual is registered to vote.
- The location of the individual's bank and brokerage accounts and the origination point of the individual's financial transactions.
- The location of healthcare providers (doctors, dentists etc.), accountants, attorneys and other advisors.
- Location of the individual's social ties, such as the place of worship, professional associations, or social and country clubs of which the individual is a member.
- The location of real property and investments.
- Where the individual intends to return after any absences.

Note that residency will be in the state where the individual is most intimately associated. Thus, ***it is the strength of the ties created in the new state, not just the number, which will ultimately determine residency.***

PUTTING IT ALL TOGETHER

The Fowler Case. *Fowler v. North Carolina Department of Revenue*,[1] a recent North Carolina case, illustrates the need for advanced planning for changes in state residency, including understanding the specific technical requirements for ending and establishing residency, respectively, in the old state and new state, and the best forms of evidence to demonstrate that the client has severed ties with the old state and created sufficient connections in the new state.

Facts. In *Fowler*, Steve and Elizabeth Fowler, longtime residents of North Carolina, signed a letter of intent in early 2005 to sell their majority interest in a closely held business located in North Carolina. Shortly after signing the letter of intent, the Fowlers purchased a residence in Florida. They consulted with their advisors about moving to Florida but took no further steps in 2005 to change their state residency.

On January 19, 2006, the Fowlers entered into a binding agreement to sell their business interests, and, the next day, went to Florida to take official action to evidence their change of domicile and residency to Florida. While in Florida, the Fowlers went to local government offices to obtain driver's licenses, register to vote, and license their dog, but were unable to do so in each case because they lacked the necessary documentation in the form requested by Florida authorities. The Fowlers were able, however, to register a car they had previously moved to Florida. They returned to North Carolina on January 22, 2006 and later completed these activities on a return trip to Florida in March 2006. The sale of the business closed on February 3, 2006. The Fowlers took the position on their 2006 state income tax returns that they had changed their domicile and residency to Florida on January 20, 2006.

<u>Challenges to Date of Residency Change</u>. Challenging the Fowlers, the North Carolina Department of Revenue ("**DR**") asserted that the Fowlers were still residents of North Carolina when the sale closed and ***assessed additional income taxes, interest and penalties in excess of $10 million***. The DR specifically noted that ***the failed attempts to get new drivers' licenses and to register to vote were because the Fowlers' passports, social security cards and birth certificates (their important papers) were in a personal safe in North Carolina – not at their home in Florida***. The Fowlers were unable to register their dog in Florida for a similar reason – the vaccination records were located in their home in North Carolina. The DR also noted that, after the sale of the business, Mr. Fowler continued working in North Carolina and accepted delivery of a $19 million airplane there, while Mrs. Fowler threw an elaborate birthday party for Mr. Fowler in North Carolina to the tune of $1.8 million.

<u>Decision in Favor of Taxpayers</u>. After prolonged and expensive legal proceedings, the Fowlers finally ***won a determination from the court that they successfully changed their domicile and residency for income tax purposes to Florida on January 20, 2006 and that they did not owe additional taxes, interest and penalties***. In its conclusions of law, the court noted:

- The Fowlers took ***adequate intentional, voluntary and positive actions in Florida on January 20, 2006 to establish their new domicile***. These actions were adequate, even though the Fowlers did not complete certain activities until the return trip in March, 2006.

- The Fowlers were not required to remove all of their possessions and sever all ties with North Carolina to effect a change in domicile.

- The Fowlers' ***intent to change domicile was not improper or rendered ineffective because the change was timed to maximize tax savings***.

- A change of domicile must be determined from the totality of circumstances, and that a ***taxpayer claiming a change in domicile has the burden of proving such change by demonstrating both intent to establish a new domicile and to abandon the old one***.

Although the Fowlers eventually won, the victory required significant litigation, time, and expense. Thus, the case illustrates that scrutiny that will be given to moves that take place shortly before a significant tax event, and that significant and specific advance planning, including a clear understanding of the requirements and laws to establish residence in the new state, is required. Attached is a checklist of steps clients should consider as part of a coordinated plan to change state residency. The list contains a number of facts tax authorities and courts review when evaluating whether a taxpayer has successfully changed residency. The list, however, is not exclusive – each state and each client will have specific facts and circumstances that must be analyzed to successfully adopt residency in a new state.

TAKE AWAYS

- For clients moving to new states, advisors can add value by helping the client analyze the move's impact on taxable income, estate taxes, real property taxes, creditor protection, and, if the client is married, possible changes in property ownership if moving to or from a community property state, or rights and entitlements for same-sex married couples moving to a non-recognition state.

- When clients are looking at life insurance products for tax or liquidity planning or creditor protection, advisors can analyze how a client's anticipated move will affect the coverage amount or type needed and what adjustments, if any, should be made to current protection.

- Advisors also can assist with developing and implementing a coordinated plan of action to accomplish the move, including steps to sever ties with the old state and establish strong connections with the new state to document the change of residency.

- If the client is moving before a significant tax event, timing and implementation of the move will be critical. Some states are very aggressive in challenging taxpayers who leave the state just before such an event. A focused move accomplished within a concentrated period of time well before the tax event will help establish a firm move completion date and give the client time to bolster ties to the new state, which may help defeat challenges to the date state residency changed, particularly for state tax purposes.

NOTES

[1] *Fowler v. North Carolina Dept. of Revenue*, N.C. Super. Ct., Dkt. No. 13 CVS 10989 (Aug. 6, 2014).

Changing State Residency

Client Action Plan Checklist

- Purchase (or lease) a residence in the new state.
- Preferably sell, or at least lease to a third party, the residence in the former (old) state.
- Move furniture, furnishings and other household and personal items to the new residence, particularly family photographs, artwork, jewelry, and important personal documents.
- Apply for homestead exemption for the new residence and terminate any homestead exemption elected for the old residence.
- If the new state allows residents to file a declaration of domicile or residency, file the form as soon as the physical move to the new state is completed. Similarly, if the old state has a declaration of non-domicile or residency, file the form as soon as possible after the move.
- If actively engaged in the conduct of a business in the old state, consider transferring at least the administration and financial aspects of the business to the new state.
- Become a member of local clubs and social/professional organizations in the new state and cancel or change to nonresident status any memberships in the old state.
- If charitably inclined, make contributions to organizations in the new state (or to local branches of national charitable organizations based out of the new state, if possible).
- Register to vote in the new state, and actually vote – even if by absentee ballot. Revoke the voter registration in the old state and do not vote there - even by absentee ballot.
- Consider limiting political affiliations to national organizations and local organizations in the new state.
- File all personal tax returns from the home address in the new state and send to the IRS office that covers the new state.
- Apply for a new driver's license and register personal automobiles in the new state.
- Change the address used for financial, business and personal matters to the new residence, including:
    - Life insurance and other insurance companies.
    - Banks and other financial institutions.
    - Social Security Administration.
    - Employers.
    - Corporations issuing securities which the client owns.
    - Brokers.
    - Department stores and other retailers.
    - Credit card companies.
    - Partnerships or organizations of which the client is a member.
    - Magazine subscriptions, newspapers and other publications.
- Change tax withholding on retirement and other accounts to direct that withholding, if any, to the tax authority in the new state.
- Establish charge accounts with merchants and department stores in the new state.
- Change the address used in a current passport to the new address and use this address when applying for a new or replacement passport.

- Establish personal and business banking relationships in the new state and pay personal bills through a bank account located in the new state.
- Close any safe deposit boxes in the old state and open one in the new state.
- Close the post office box in the old state and file a permanent forwarding address in the new state with the postal service.
- Use attorneys, accountants, and other professional advisors located in the new state.
- Use health providers in the new state and transfer medical records to the new providers.
- If there are pets, use veterinarians in the new state and transfer medical records to the new veterinarians. Register and license any pets in the new state.
- Update estate planning documents to conform to the laws of the new state and include statements in the documents regarding residency in the state. Execute new powers of attorney under the laws of the new state.
- Spend more time in the new state than any other location – particularly the old state. Maintain records to substantiate the number of days spent in each state.

DISCLAIMER

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