Leaving the Big City: Can You Leave Your Big Tax Bill Behind Too?

by Jennifer S. White

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In this article, White explores the individual income tax implications of leaving metropolitan areas, using New York as the basis for probable scenarios and advising those who move to be prepared.

Americans are fleeing big cities in record numbers. COVID-19 has led many people to trade urban lifestyles for suburban living — more space, fewer people, easier transportation and, in many cases, a more affordable lifestyle. As many businesses continue to operate remotely, generally with success, people are feeling less pressure to live close to their offices. For many, the thought of returning to a densely populated city lacks appeal.

Large cities like New York, Los Angeles, and San Francisco are feeling this trend. To no surprise, these cities also have some of the highest personal income tax rates and the most aggressive tax audit programs in the country.

As individuals pack their bags to relocate, they are faced with the question: "Can I stop paying income tax in my historic place of residence?" The answer is yes: It is certainly possible. However, given the significant budget deficits states and municipalities are projected to face, we can reasonably assume that tax authorities will closely review tax return filing positions of high-income individuals to preserve their income tax bases. It is therefore more important than ever for individuals to understand income tax residency rules and the implications of their actions on their tax return filing positions.

I. Understanding Tax Residency Rules

Determining where an individual must file a resident income tax return begins with understanding the applicable law. For purposes of this article, we will focus on New York's income tax law. While each tax authority has its own rules, the guidelines set forth by New York state and New York City are representative of the laws and analysis imposed by state and local taxing jurisdictions around the country.

New York residents are subject to tax on their worldwide income.[1] An individual is a resident if she is either a (i) domiciliary or (ii) statutory resident of the state or city.[2] A person can only have one domicile, notwithstanding having multiple residences.

Domicile, in general, is the place that an individual intends to be her permanent home — the place to which she intends to return whenever absent. To establish a change of domicile from New York to another jurisdiction, an individual must take up residence in the new location with the intent to remain there indefinitely, and abandon her prior domicile.

[1] N.Y. Tax Law sections 601, 1301. Nonresidents are also subject to New York state tax on New York-source income. Generally, this is income that is generated from work performed in the state. However, New York's "convenience of the employer" doctrine outlines a complex set of rules through which income may be sourced to the state, notwithstanding that the employee performed the work to generate the income outside the state. There is currently no explicit guidance as to how income earned during state-mandated shelter-in-place orders and office closures are implicated by these rules. Accordingly, employees who continue to earn income from New York-based employers should consider the proper sourcing of their income, notwithstanding their resident status.

[2] N.Y. Tax Law sections 605(b)(1)(a), 1305(a)(1).

Determining an individual's domicile is a highly fact-specific inquiry. While the standard is subjective, New York courts and the New York State Department of Taxation and Finance have consistently looked to five primary objective criteria to determine whether an individual has demonstrated the requisite intent to effectuate a change of domicile: (i) home, (ii) active business involvement, (iii) time, (iv) items "near and dear," and (v) family. In the department's view, an individual who has asserted a change of domicile should be able to show that, taken as a whole, these factors point predominantly toward the location purported to be the new domicile. The burden of proof is on the individual to prove by clear and convincing evidence that a change of domicile has occurred.

Alternatively, an individual will be deemed a statutory resident, and therefore subject to income tax as a resident, if she maintains a permanent place of abode in the state or city for substantially all of the tax year and spends more than 183 days in the state or city during the tax year.[3] Permanent place of abode is defined, in part, as "a dwelling place of permanent nature maintained by the taxpayer, whether or not owned by him."[4] A rental, hotel, or corporate housing may be treated as a permanent place of abode. The day count component requires an individual to prove by clear and convincing evidence that she was outside New York for more than half of the year. If an individual steps foot into New York for only a few minutes, it will still be considered a full day. Limited exceptions have been established, including those for travel and specific medical issues.

II. The Importance of the 'Home'

The rise of COVID-19 has led many individuals to make unplanned departures from their historic domiciles. The quick impact of the pandemic means that individuals have not had much time to contemplate and effectuate their moves. These unique realities led many to up and leave their historic residence on a whim. Swift action has led many to rent — as opposed to buy — new homes to move as quickly as possible. Hasty timelines and plummeting real estate markets plaguing big cities have also resulted in people choosing not to sell their historic residences (or, in many instances, simply being unable to).

The size, use, and relationship of an individual's residences is a significant component of both the domicile and statutory resident analysis. Accordingly, it is important to consider how the characteristics of and relationship to that can affect the income tax residency analysis.

A. Maintaining the Home

There is no requirement that an individual must sell her historic residence to successfully change her domicile. New York case law is replete with examples of taxpayers who successfully changed their domiciles without selling their historic family homes.[5] Nonetheless, the relationship to the residence should change when switching domiciles. The home may be converted to an investment property, such that it is rented or not used at all. If maintained for use on a sporadic, part-year basis, such change should be well documented through calendars and logs.

To the extent that there is a future plan to sell the residence, evidence of those plans can serve as compelling proof of intent to relinquish the domicile. Documentation evidencing discussions with real estate brokers and agents, MLS listings, or other similar documentation should all be maintained. Moving furniture, as well as important and personal items out of the home — and specifically to the new home — is also a helpful step to show the change in relationship to the property.

B. Renting a New Home

Ownership of a residence, as compared with a rental, is often considered to help ascertain the intent of occupancy as being fixed and indefinite, or temporary. Existence of a rental does not, however, preclude the changing of a domicile. When comparing the weight of a rental property

[3] N.Y. Tax Law sections 605(b)(1)(b), 1305(a)(2).

[4] 20 NYCRR 105.20(e).

[5] *Matter of Cooke*, DTA No. 823591, Admin. Law Judge (Nov. 15, 2012); *Matter of May*, DTA No. 825173, Admin. Law Judge (Jan. 8, 2015); *Matter of Handal*, DTA No. 821996, Admin. Law Judge (Nov. 25, 2009).

against another property bought and owned, the facts cannot be examined through a myopic lens. Financial capabilities, real estate market consideration, and investment strategies often dictate the decision to either purchase or rent — and cannot be ignored.

The department's own audit guidelines say that it "matters little if the dwelling is owned or rented."[6] More compelling evidence of intent includes the type of rental agreement entered into. For example, a year-to-year or fully furnished lease may not show the same intent as an individual who enters into a long-term lease, and furnishes the residence herself. Still, many situations necessitate the signing of a yearly lease. When a rental takes place every year over a long period, the individual in effect is in a long-term leasing situation. The department is aware of these situations, and has been instructed to consider the circumstances as a whole.

C. Permanent Place of Abode

The home is important not only in the context of a domicile analysis, but when determining if an individual is subject to income tax as a statutory resident. A statutory resident must maintain a permanent place of abode. Permanence encompasses the physical aspects of the dwelling, as well as the individual's relationship to it.[7] An understanding of the requisite relationship needed to satisfy this standard was recently developed by the New York Court of Appeals in *Gaied*, in which a determination was made that an individual must have a "residential interest" in the dwelling for it to be considered a permanent place of abode.[8] Specifically, "there must be some basis to conclude that the dwelling was utilized as the taxpayer's residence."[9]

Accordingly, to escape taxation as a statutory resident, an individual should consider severing her residential interest in a New York property, notwithstanding maintaining ownership. While there is no definitive, binding guidance as to what would qualify, there are actions that may likely be sufficient: (i) removing all furniture; (ii) granting exclusive use of the residence to a friend or family member; or (iii) ceasing all use of the residence during the period at issue.

III. Must the Move Be Forever?

Domicile is a question of intent: Does the individual intend for the residence to be her true, fixed, permanent home? However, the intention required does not rise to the level of forever. New York courts have held:

> The intention necessary for the acquisition of a domicile may not be an intention of living in the locality as a matter of temporary expediency. It must be an intention to live permanently or indefinitely in that place. *But it need not be an intention to remain for all time; it is sufficient if the intention is to remain for an indefinite period*.
>
> When a person has actually moved to another place, which is his fixed present residence, with an intention of remaining there for an indefinite time, it becomes his place of domicile, *notwithstanding he may have a floating intention to return to his former domicile at some future and indefinite time*.
>
> Though the idea of permanency is sometimes involved in the domicile concept, the term 'domicile' is more safely defined in the negative rather than the affirmative. A person's domicile is the place he is making his home *not 'with' a present intention to remain there forever, but 'without' a present intention of leaving at some particular future time*.[10]

Accordingly, a change in domicile does not require an individual to establish an intention of permanency.

Changes of domicile predicated by the shifting realities caused by COVID-19 need not result in a forever change. However, the intent

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

[7] *Matter of Evans v. New York State Tax Appeals Tribunal*, 199 A.D.2d 840 (3rd Dept. 1993).

[8] *Matter of Gaied v. New York State Tax Appeals Tribunal*, 22 N.Y.3d 592 (2014).

[9] *Id.*

[10] *Matter of McKone v. State Tax Commission*, 490 N.Y.S.2d 628 (3d. Dept. 1985) (internal citations omitted) (emphasis added).

needed to effectuate a change of domicile requires that the relocation have no definitive ending point. For example, a seasonal — or even year-long — move from New York City to Florida or the Hamptons will present challenges in this domicile analysis. However, a move to Florida with no definitive end in sight, even if it may not be forever, has support in New York's income tax guidance.

IV. Conclusion

A determination of an individual's income tax residence location requires a complex, fact-specific analysis. The exceptional set of circumstances afflicting our country has led to changes in lifestyles and plans that have yet to be specifically contemplated by our income tax laws. Also, each individual has a unique story and set of circumstances that dictates her life decisions and intentions, and no two situations are perfectly alike. Yes, on the heels of impromptu moves out of big cities, it is certainly possible for taxpayers to stop paying income tax in their historic places of residence. Nevertheless, they should be well prepared for a fight. ■