The Empire State Strikes Back

Relocation during pandemic creates tax pitfall

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Key Takeaways

- Even though you've relocated to another state, your income may still be taxable in your former one.
- You bear the burden of proof to demonstrate you're not a resident.
- Work with your advisor in advance of any move to minimize the potential tax impact.

The events of 2020 have certainly changed our lives. Plans have been disrupted at best and canceled at worst. Our daily routines and jobs look a little different. And in some cases, we have uprooted and relocated to other cities or states.

As the pandemic stretches on, your decision to move may have unintended tax consequences. Your previous state may not be as eager to let go. More specifically, it can lead to double taxation of your income.

In this article, we'll explore how this can happen, sharing precautions that should serve as a warning for anyone planning a move in 2021. For our purposes, we will use New York as our example, but this issue is not limited to any one state.

Are You Still a Resident?

Like many people, you probably assume that once you cross the border and set up a new home, you're no longer a resident of your former state. Unfortunately, it's not that simple. While every state has its own residency rules, there are two general definitions: "domiciled resident" and "statutory resident." If you meet one of these definitions, you could be considered a resident of your former state for tax purposes. As such, your income could be taxed twice—once in your new state and once in the old.

Here is an overview of New York's rules to give you a sense of how residency is determined.

New York Definition of Domiciled and Statutory Residents (Many states have similar definitions)	
Domiciled Residents	**Statutory Residents**
• Your domicile residence is the location of your permanent home and the place where you return after being away on vacation or business.	• Even if you don't have a domicile in a state, you can be considered a statutory resident for tax purposes.

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Domiciled Residents	Statutory Residents
• New York looks at a variety of facts and circumstances and "general habit of life" to determine if you have abandoned your domicile in favor of a new one: ○ Have you changed your driver's license and voter's registration? ○ Have you filed a formal declaration of residency in another state? ○ Do you still actively work in New York or operate your business there? ○ Where do you spend the majority of your time? ○ Where are your "near and dear" possessions (pets, heirlooms, art collections) located? ○ Where is your children's school? The residence of immediate family members? ○ Are you maintaining a physical structure in New York? ○ Have you severed community ties? • "Deeds and not words" guide auditors' determinations. That means you will need to provide "clear and convincing evidence" that you have abandoned your New York domicile. • Certain exceptions apply to people in the military and living abroad that are beyond the scope of this article. If either of these situations pertains to you, we will help analyze and advise.	• New York uses a two-part test to determine statutory residency. Did you maintain a "permanent place of abode" and spend at least 184 days in New York during the year? • In general, any part of a day you spend in New York counts as a day even if you just go to the city to dine or shop. • Meticulous recordkeeping is vital to avoid being considered a statutory resident. As with the domicile definition, you bear the burden of proof. Examples of records that New York will examine include, but are not limited to: ○ Detailed day-count calendars, including purpose of visit ○ Cell phone records (reveal the cell tower locations for communications) ○ E-Z Pass records ○ Key fob swipes (for entry to a residence or office) ○ Debit and credit card records (corporate and personal) ○ Corporate expense vouchers

What Is the Potential Tax Impact?

Let's look at an example to see how these residency definitions could impact your tax bill. We'll assume the taxpayer owns a home and lives in New York City with their family from January to March 31, 2020. On April 1, they move to their country home in Connecticut (CT).

Assumptions:

- The taxpayer and spouse change their drivers' licenses, voting registrations, mailing address, doctors, club memberships, and children's schools to Connecticut and move all valuables there.
- They keep their New York City home and use it for short trips to the city, with the intention of selling it sometime in the future.
- The taxpayer works in his New York office 50% of the time between April and December but returns home to Connecticut every night. The other 50% of the time, he works on projects in Connecticut.
- By December 31, he has spent 210 days in New York.

Financials

- Total wages = $1,500,000
- Wages earned in NY as NY/NYC resident = $375,000
- Wages earned in CT as CT resident = $562,500
- Wages earned in NY as CT resident = $562,500
- Interest and dividends = $200,000 for the year ($50,000 received while in NY and $150,000 received while in CT)
- Capital gains = $800,000, all received while living in CT
- Standard tax deduction (doesn't itemize)

Tax Implications

Since the taxpayer maintained a home in New York City and spent more than 184 days in New York, they are considered a statutory resident. As such, they are required to file a full-year New York resident tax return plus a part-year return for Connecticut. Their investment income will be taxed by both states. Each state will provide a credit (explained below) for wages earned in the other location.

Tax Liabilities **NY Full-Year Statutory Resident/ CT Part-Year Domiciled Resident** (Including credits for wages sourced to other states)		**Tax Liabilities** **NY Part-Year Resident/CT Part-Year Resident** (Including CT credit for wages sourced in NY)
$179,612	**New York State Tax**	$86,469
$95,976	**New York City Tax**	$14,136
$105,661	**Connecticut Tax**	$105,661
$381,249	**Total State Tax**	$206,266

The cost of being deemed a statutory resident: $174,983 more in taxes.*

Can You Receive a Credit for Taxes Paid to Another State?

In limited circumstances, a state may offer a credit for taxes paid to another state. For example, while New York taxes all income of statutory residents, it does provide credits for:

- Income attributable to a business, trade, profession, or occupation carried on in the other state (e.g., wages, partnership income, S corporation income, rental income)
- Interest or dividends from intangible investments only if received from an asset connected with a trade or business conducted in that other state
- Capital gains on physical assets located in the other state (e.g., rental property, vacation home, land)

Some states are more generous with credits than others. Your advisor can help you understand the rules applicable to your situation and plan accordingly.

How Do States Know?

At this point, you may be wondering, "how will a state know how long I've lived there?" Some states like New York require you to check a box on the tax return indicating whether you maintained a home in the state and/or in New York City and indicate the number of days you were present in the state. In light of the pandemic, we also anticipate that many states may add a similar check box or residency certification clause and ramp up their enforcement efforts (audits) to bolster tax revenues.

Plan Your Next Move With Us

As our example illustrates, an attempted move outside the state of New York can lead to severe and unintended tax consequences. Each taxpayer's situation is unique and requires an analysis of all facts and circumstances to determine the actual impact. Not every case fits into a perfect box, and Cerity Partners is here to assist you. Before you decide to move to/from any state, please be sure to contact us. It is our goal to help you avoid costly surprises.

For more planning ideas, check out Year-End Tax Planning: What to Consider Post-Election.

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* This is a hypothetical example for illustrative purposes only and uses tax rates effective for the 2019 tax year. Recall that the taxpayer earned $1,125,000 of wages while a CT resident, 50% of which was physically earned in CT and the other 50% physically earned in NY. Therefore, a credit was calculated on the NY return for CT sourced wages of $562,500 and a credit was calculated on the CT return for NY sourced wages of $562,500. Actual results will vary based on your unique circumstances. The example also assumes the taxpayer did not receive income from sources in Connecticut during the period of nonresidency. In that case, the taxpayer would report Connecticut-sourced income earned as a nonresident on the part-year return.

Sources:

- https://www.tax.ny.gov/pit/file/pit_definitions.htm#:~:text=In%20general%2C%20your%20domicile%20is,educational%20leave%2C%20or%20military%20assignment)
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