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25 Years Later - Where's Your Domicile? Still a Vexing Question.

It was just over 25 years ago, in October 1996, that 11 states and the District of Columbia entered into a historic cooperative agreement known as the Northeastern States Tax Officials Association (NESTOA) Cooperative Agreement on Determination of Domicile (the NESTOA Agreement). The agreement was the result of a multistate effort to reduce or eliminate double taxation of income by the 11 signatory states and the District of Columbia. The agreement proposed to administer the issue of a taxpayer's domicile in a fair and consistent manner in order to enhance compliance with the tax laws and to reduce the potential for multiple taxation of a taxpayer who might have a presence in more than one state.

To be complete, we should point out at the onset that state tax residency is based on concepts of domicile as discussed here, but in quite a number of states, it also is based on a concept called "statutory residency," often referred to as the "183 day test." We'll take a deep dive into that concept in a later piece.

With respect to the NESTOA Agreement, the policy goals were essentially:

- Individuals should be determined to be domiciliaries by only one state for a specific period of time.
- Individuals should not pay tax on identical income to multiple states.
- Criteria used should be uniform in order to increase voluntary compliance and to allow for the easy exchange of information among the NESTOA states.

As the tax officials well said, the problems associated with domicile and residency are difficult to address because of the subjective nature of this area. It is therefore critical that any parameters selected to determine the individual's domicile be of a nature that would not be changeable at will or insignificant in nature. It is also important that the parameters be readily identifiable for ease of administration and increased voluntary compliance. Essentially, the agreement attempts to bring certainty to the subjective intent of a taxpayer through a review of objective factors by individuals unfamiliar with the taxpayer's true intention.

The states ultimately agreed to five most important factors to review in the investigation of determining one's true domicile: (1) the taxpayer's HOME situation; (2) the amount of TIME the taxpayer spent in each jurisdiction; (3) the location of items NEAR AND DEAR to the taxpayer; (4) the location of taxpayers' ACTIVE BUSINESS; and finally, but only as necessary, (5) the location of FAMILY CONNECTIONS. It is for the state and the taxpayer to weigh and balance the evidence with respect to each of these factors in order to ultimately come to a conclusion.

These five factors represented a huge step forward in an effort to clarify the definition of domicile. Each factor can also raise many questions. The agreement, however, does not prioritize the factors and continues to permit a review of OTHER lesser factors, but only as appropriate. Despite what many taxpayers and practitioners (and, frankly, many courts) believe, the inquiry should not be focused on these less-influential factors, such as to where the taxpayer is registered to vote, maintains a driver's license, or registers his or her cars. Taxpayers tend to want to focus on these "checklist" items because they are easy to control. However, the appropriate analysis requires a much deeper, esoteric inquiry as to whether the place of habitation is based on the permanent home of a person and the place to which the taxpayer intends always to return, with the range of sentiment, feeling and permanence associated with it.

Home – This factor considers what residences are owned or rented by the taxpayer. Where are they located? How are they used? What is the size and value of each residence? To a fair degree, it matters little if the dwelling is owned or rented, but it must represent a "residence" in the eyes of the taxpayer.

Time – Where and how the individual spends time during the tax year shall be considered. This is the factor on which taxpayers most often stumble, believing that if they successfully navigate the other factors, this one becomes less important. Consideration should also be given to whether the taxpayer is retired or actively involved in a business or profession and, if so, where the business is located. How much travel the individual does, and the nature of the travel, should be considered. Even the place from which the travel is originating can be important. The overall living pattern or lifestyle of the individual should also be examined.

Items Near and Dear – The location of the items or possessions that the individual considers near and dear to his or her heart – things of significant sentimental value, family heirlooms, collections of valuables or possessions that enhance the quality of one's lifestyle—all should be reviewed.

Active Business Involvement – How the taxpayer earns a living, whether the taxpayer is actively involved in any business ownership or profession and to what degree the individual is involved are important factors. Also, how that involvement compares to the involvement in business outside the state the taxpayer is leaving or has left should be examined.

Family Connections – This factor is generally to be reviewed, but only when the first four factors are not conclusive. These family connections include where the individual's minor children attend school and, in certain unique and discrete situations, the residence of the individual's immediate family.

Other – Although not actually one of the five factors, the courts do often look at other factors in weighing whether the balance of factors sways one way or the other. These factors can be "useful," but they are quite substantially less important. Nonetheless, they are more typically what everyone thinks about in any conversation on the subject, e.g., where one votes; where one has a driver's license; the location of one's bank, social club, friends, church or temple; etc. These essentially are a hodgepodge of factors. Although these factors are often the focus of most "cocktail hour" discussions on the issue because they are easily manipulated, in the end, depending on the jurisdiction and the court, they may count for fairly little.

Layer on the above what could be called a number of simple truths, applicable in quite a number of states, that help put the issue in perspective.

Clear and Convincing Evidence

Generally, the party asserting a change of domicile typically has the burden of proof, by clear and convincing evidence, to show that the taxpayer abandoned his or her historic domicile and moved to the new location with the intent to remain there. This essentially puts the entire burden on the taxpayer to prove his or her case with substantial facts—typically not an easy task, as the facts are seldom so clear or one-sided. In addition, the taxpayer has to continue to work at maintaining domicile in the new jurisdiction in years subsequent to the original change of domicile.

Leave and Land

It is not only important that a taxpayer "leave" the state with an intent not to return, but the taxpayer also must "land" in the new state, based on facts and circumstances supporting the taxpayer's intention of living in the new state on a permanent basis. This concept of leave and land is germane to "the story" supporting one's reason to change one's domicile.

30-Day Safe Harbor

Many states adopt a safe harbor providing that taxpayers domiciled in the state are nonetheless not considered a resident of the state if:

- they did not maintain a home in the state during the tax year;
- they maintained a home outside the state during the entire tax year; and
- they spent 30 days or less in the state during the tax year.

Many taxpayers are disappointed to learn that if they owned a permanent place of abode in the state, they cannot qualify for this exemption even if they only spent a handful of days there in any given year.

The World Today Is Complex

Also layer on top of this the world pandemic and all the related travel restrictions, business closures, remote work and life events that impact us on a daily basis.

Domicile Audits Are Tremendously Intrusive

Domicile audits are tremendously intrusive, requiring the production of a substantial number of records, including credit card bills, travel records and tickets, cellphone records, etc. Such audits also typically take a fairly long time—somewhere between 18 and 24 months or more. Also remember that audits can be initiated long after the taxpayer believes the change in domicile is complete.

Consistent with the idea that the best defense is a good offense, if you are planning to change your domicile, the bottom line is **have a plan and stick with it**. The key takeaway is that if you indeed have changed or seek to change your domicile, (1) make a plan supported by each of the five factors, (2) stick to it and (3) monitor the plan by keeping meticulous records. Remember, the facts must be clearly and convincingly on your side to win, so don't wait until the state asks the question. Do your homework beforehand.

Authors

Tasha K. Dickinson

Partner

West Palm Beach, FL | (561) 803-3515

tdickinson@daypitney.com