

## COVID-19 relocation: a state income tax savings opportunity or a dual-taxation trap?

16 SEPTEMBER 2020

CATEGORY:  
[ARTICLE](#)



Beginning early this year, COVID-19 started spreading in the United States, with some states hit harder than others. People who had the means and ability left the hard-hit, densely populated states and fled to less affected, less congested states. For a few, the relocation was a permanent move, but for most people, the relocation was meant to be a temporary move until the pandemic subsided. We are now past the halfway point of 2020 and the number of confirmed cases is still substantial. Many of those who initially planned for a few months' stay are now considering extending their stay for the remainder of the year or longer.

If you are one of those who relocated, have you considered the potential impact of your relocation on your tax planning? Will you be able to benefit from the lower state income tax rate of the new state? Is there any risk that you may be subject to taxation in more than one state?

### State Income Tax

If an individual is a resident of a particular state, such individual is subject to that state's income tax on his or her worldwide income, whereas if an individual is a nonresident, the individual is subject to that state's income tax only on income that has its source in that state.

Forty-three states and the District of Columbia impose state income taxes on individuals. New York and California boast the highest state income tax rates in the country, with top marginal rates of 12.696% for New York City and 13.30% for California. Given these high rates, the income tax savings realized by moving to a state that has much lower or no state income tax rate can be substantial. However, such tax savings don't come easy and individuals may be caught in the trap of dual residency and dual taxation instead.

### Residency

Although each state has its own definition of who is a "resident" of its state for income tax purposes, the majority of states define "residency" based on a person's "domicile." Some states also have a day counting residency rule for statutory residency in addition to the domicile test. Most of these states consider an individual to be a "statutory resident" for state income tax purposes if the individual maintains a permanent place of abode in the state and spends more than 183 days in the state during the tax year. For example, under New York law, an individual is a resident if he or she is domiciled in New York, or if the individual is a statutory resident, such that he or she maintains a permanent place of abode in New York for more than 11 months of the year and spends more than 183 days in New York during the tax year. On the other hand, California does not have a statutory residency rule and defines a "resident" as any individual who is in California for other than a temporary or transitory purpose or domiciled in California but outside the state for a temporary or transitory purpose.

### Domicile

Domicile, generally speaking, is the place in which an individual intends to be his or her permanent home and to which such individual intends to return whenever absent.

An individual can only have one domicile at a time. Once an individual acquires a domicile, it is presumed to continue until a new domicile is definitively established. Establishing a new domicile generally requires a change of physical address and presence as well as an intent to abandon the former domicile and acquire a new domicile.

As with the definition of residency and domicile, states vary on the exact elements required for proving the establishment of a new domicile. For example, there are five "primary factors" and eight "other factors" used by the New York taxing authority to determine both a change in residence

and an intention to change domicile. The other factors are examined only if the primary factors fail to provide convincing evidence relating to the individual's domicile or point equally to a domicile in another location. By comparison, there is no bright-line rule for establishing residency under California law; rather it is determined based on the totality of circumstances, taking into consideration all relevant facts and circumstances.

## Risk of Dual Residency

Because the definition of a "resident" varies from state to state, an individual can be a domiciliary of a state and be a statutory resident of another state during the same tax year (i.e., a "dual resident"). Therefore, without careful planning, an individual can be a dual resident for income tax purposes and subject to tax on all of his or her income in two states. Although most states provide tax credits for taxes paid to other states on income earned in that state to prevent double taxation, such tax credits may not be available for certain types of income (e.g., interest, dividends, capital gains, and other intangible income, etc.) and may be subject to certain limitations in some states.

In recent cases<sup>1</sup> involving dual residents who were domiciled in Connecticut but also statutory residents of New York, taxpayers were not allowed a credit for the tax they paid to Connecticut on intangible income (i.e., gains from the sale of a business) because New York does not consider such income as being "sourced" to Connecticut. New York (and Connecticut) permits double taxation on a resident's intangible income based on the taxpayer's dual residency if such income does not derive from activities in either state. Appeals filed by taxpayers in these cases were dismissed by the New York Court of Appeals and the U.S. Supreme Court also declined to consider the cases. As a result, taxpayers had to pay New York taxes on top of Connecticut taxes paid on the same income, with no credit.

## How We Can Help

We expect that state income tax authorities will become more aggressive in their tax audits of high-income individuals in the coming years to address anticipated budget deficits arising from COVID-19.

Dual residents face the prospect of being taxed by both states on the same income. Ill-advised taxpayers may wind up paying taxes in both states without a reasonable credit mechanism to prevent double taxation on the same income. Thoughtful and strategic planning needs to be undertaken to avoid unexpected adverse tax consequences and to increase the likelihood of a successful and uneventful income tax audit. Withers can assist clients in identifying the potential benefits and pitfalls of the relocation and implementing strategic plans to achieve a desired outcome. If you have any questions or concerns regarding the tax and other business consequences of your relocation, please contact your regular Withers attorney or any of the attorneys listed on this page.

### FOOTNOTES

<sup>1</sup> Samuel Edelman, et ux. v. NY State Dept. of Taxn. and Fin., et al., Nos. 156415, 156416, 156970, 15697 (N.Y. S.Ct., App. Div., 1st Jud. Dept., June 26, 2018), motion for leave to appeal denied (N.Y. Ct. App. March 26, 2019), cert. denied, [Dkt. No. 18-1570](#) (U.S. S.Ct. Oct. 1, 2019); Chamberlain v. N.Y. Dept. of Tax. and Fin., No. 525967 (N.Y. S.Ct., App. Div., 3rd Jud. Dept., Nov. 1, 2018), motion for leave to appeal denied (N.Y. Ct. App. March 26, 2019), cert. denied, [Dkt. No. 18-1569](#) (U.S. S.Ct. Oct. 1, 2019)

# Authors

M. Ridgway Barker

PARTNER | GREENWICH

Corporate

 +1 203 302 4084

 [mr.barker@withersworldwide.com](mailto:mr.barker@withersworldwide.com)

Mark G. Holden

PARTNER | NEW YORK

Private client and tax

 +1 212 848 9837

 [mark.holden@withersworldwide.com](mailto:mark.holden@withersworldwide.com)

SoYoung Wang

ASSOCIATE | GREENWICH

Private client and tax

 +1 203 328 2225

 [soyoung.wang@withersworldwide.com](mailto:soyoung.wang@withersworldwide.com)