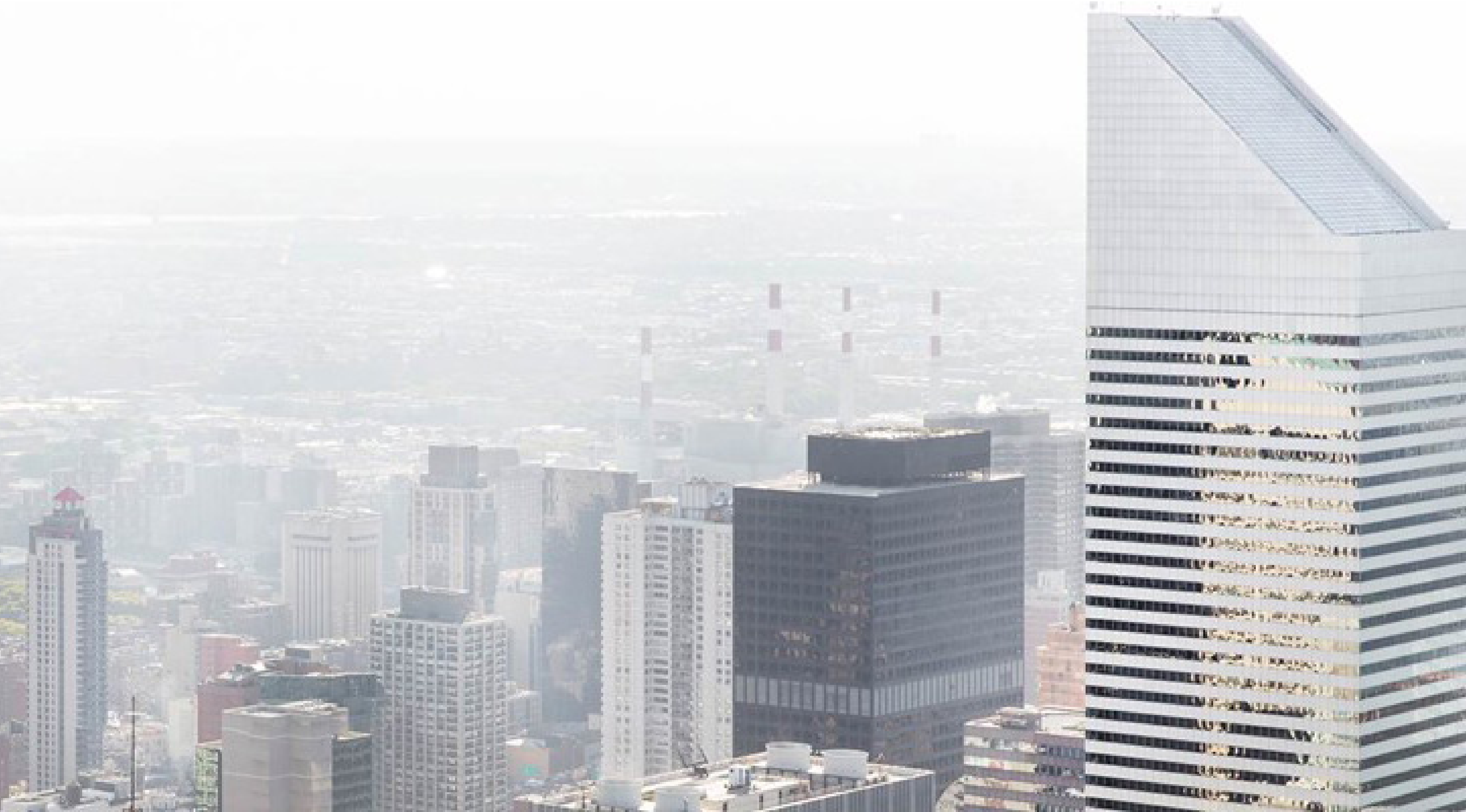
Changing state of residence



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Individuals often change their state of residence and they do so for many reasons, not the least of which is often to minimize state income taxation. A recent report from the Tax Foundation indicates that the states experiencing the largest net inflows of taxpayers during the period from 2020 to 2021, based on returns filed with the IRS during that period were states that had the lowest top marginal state income tax rates.[1] Military obligations, college tuition, employment opportunities, health, and weather can also play into the decision to move from one state to another. For many, taxes can be just an afterthought (albeit, an important afterthought) in the residency change decision process.

Residency and state income taxes

For high income earners, the choice of state residence can have a significant impact on after-tax income. State income tax rates vary for individuals from highs of 13.3% and 11.0% in California and Hawaii to a complete absence of an individual income tax in seven states. Alaska, Florida, Nevada, South Dakota, Texas, Tennessee, and Wyoming have no state income tax and no state capital gains tax. Washington has no state income tax but it does have a capital gains tax that applies to certain long term capital gains realized on or after January 1, 2022.[2] New Hampshire has no state income tax on an individual's earned income, but does currently tax certain interest and dividends. New Hampshire's interest and dividends tax is being phased out, however, and it will join the seven states with no personal income tax on January 1, 2025.[3]

In addition, the Tax Cuts and Jobs Act limits the deductibility of state and local taxes on federal income tax returns. This limitation adds fuel to the relocation fire. Through 2025, residents of states with high income tax or property tax rates are now limited to deductions of up to $10,000 in the aggregate for property tax, state income tax and sales tax on their federal income tax return.

Changing state residency, with its concurrent state income tax consequences, is not a new phenomenon. In 1935 Tyrus R. Cobb (more commonly known as the baseball great, Ty Cobb) bought a home (main house with 17 rooms and a guest house) and became a resident of the state of California, just outside of San Francisco. In 1939 he bought another home (five rooms, three baths) in Glenbrook, Nevada. Shortly thereafter he transferred his bank account and safe deposit box from San Francisco to Reno, registered his automobile in Nevada and obtained a Nevada driver's license. He changed his resident memberships in San Francisco clubs to nonresident memberships. He commenced filing Federal income tax returns in Nevada (though the returns were prepared by his Palo Alto accountant). In 1950 he registered to vote in Nevada as well.

[1] Adrey Yushkov and Katherine Loughead, "How Do Taxes Affect Interstate Migration?" Tax Foundation, November 7, 2023 *(taxfoundation.org/data/all/state/taxes-affect-state-migration-trends-2023)*.

[2] See Washington State ESSB 5096, signed May 4, 2021, tax applied as of January 1, 2022.

[3] New Hampshire's tax on interest and dividends ("I&D") is being phased out. The I&D Tax rate is 5% for taxable periods ending before December 31, 2023. That rate is 4% for taxable periods ending on or after December 31, 2023, and 3% for taxable periods ending on or after December 31, 2024. The I&D Tax has been repealed for taxable periods beginning after December 31, 2024 according to the New Hampshire Department of Revenue website, accessed December 7, 2023 at *revenue.nh.gov/faq/interest-dividend.htm*.

For the years 1949 through 1957, Mr. Cobb claimed that he was not a California resident for state income tax purposes. The Franchise Tax Board (California's state income tax collector) disagreed and assessed personal income tax and penalties totaling a whopping $41,000 (about $440,000 in today's dollars). In the end, the Franchise Tax Board won the case. The decision on appeal was based to some extent on the fact that Ty Cobb kept his many baseball awards and trophies at the California residence.

The reasons a person relocates can impact how state taxing authorities view the change from resident to non-resident. State income taxes are generally based upon the taxpayer's residence as well as the geographic source of the income. Potential employers may have a greater focus on the prospective employee's domicile or intention to remain in the new location.

The terms "residence" and "domicile" have very different meanings in the law. Residence typically means a place of abode or where one maintains a home. Accordingly, one can have several residences in several states and an individual can owe income tax as a resident of more than one state.

Domicile, on the other hand, requires physical presence with the intention to permanently remain (or to return after a temporary absence). As such, determining one's domicile is largely a matter of intent. A person can remain domiciled in a state even after they have physically left if they have not demonstrated an intention to permanently live somewhere else.

As was the case with Ty Cobb, one may have several residences, but only one domicile.

The Impact of Domicile Beyond Income Taxes

States subject those domiciled within their borders to different taxes than those domiciled elsewhere. This often includes income taxes, but may also include gift taxes, estate taxes and possibly even inheritance taxes. An individual's domicile also affects the law governing the individual's estate. Trust and estate laws vary from state to state, and certain provisions that may be more favorable to an individual may only be available if the individual is a resident of a particular state. Important variations include the rights of a surviving spouse, the duration permitted under state law with respect to irrevocable trusts, the availability of directed trust statutes, the ease of modifying or decanting irrevocable trusts and the ability to create so-called "silent" trusts that limit a beneficiary's right to information relating to the trust assets. Probate may also differ from state to state. For instance, the time and expense to probate an estate may differ from one state to another, which is why many individuals in certain states try to avoid probate by using a pour-over Will and Revocable Trust structure, while in other states, probate may be inexpensive and less time consuming, so it is more common to use only a Last Will and Testament for estate planning purposes. State laws can also differ when it comes to who may serve as Executor or Personal Representative of an estate, or as guardian of minors and incapacitated persons or even as trustee.

Unmarried couples, as well as families that include or may include children who are adopted or conceived through ART ("artificial reproductive technology"), may also find that state laws vary considerably with respect to family planning matters. In some states, unmarried couples are not permitted to adopt jointly. Thus, in these states, only one of the individuals will be legally recognized as the child's parent. A few states allow for second-parent adoptions, wherein a child may be adopted by an additional parent who is not married to the parent of the child.

For a more in-depth discussion of family planning for nontraditional families, see Casey Verst and Joanna Morrison, *Planning for the LGBTQ Family,* (a publication of the UBS Advanced Planning Group).

The nature and extent of the asset protection afforded to an individual and their property may also be affected by the individual's domicile. For instance, forty-eight states exempt at least some portion of the value of your primary personal residence from the claims of creditors (Pennsylvania and New Jersey have no such exemption). The extent of this protection varies by state, and can range from a few thousand dollars to a significant amount of value. Six states—Florida, Iowa, Kansas, Oklahoma, South Dakota, and Texas—and the District of Columbia provide for an unlimited homestead exemption, subject in some cases to certain restrictions regarding acreage and length of ownership. Qualified retirement plans such as 401(k)s, money purchase pension plans, and profit sharing plans are exempt from the claims of most creditors under federal law, but this does not include IRAs. Many states also exempt IRAs, although the amount of this protection will vary based on state law. The cash value or proceeds of life insurance policies payable to named beneficiaries (other than to the insured's estate) may be partially or totally exempt from the claims of the insured's creditors depending on state law. Certain states provide enhanced asset protection for married couples who own assets as tenants by the entireties. In those states, only a creditor of both spouses can attach property owned by a couple as tenants by the entireties. While this form of ownership can provide significant advantages, it is available in only a handful of states, and may not be applicable to all types of assets. Other states permit self-settled asset protection trusts, while others states do not. Whether an individual who is domiciled in a state that does not permit self-settled trusts may benefit from creditor protection by creating a self-settled asset protection trust in a state that does permit such trusts is a matter of debate.

For more information on asset protection, please see *Asset Protection Planning* by Jacqueline Denton, a publication of the Advanced Planning Group.

Changing residency

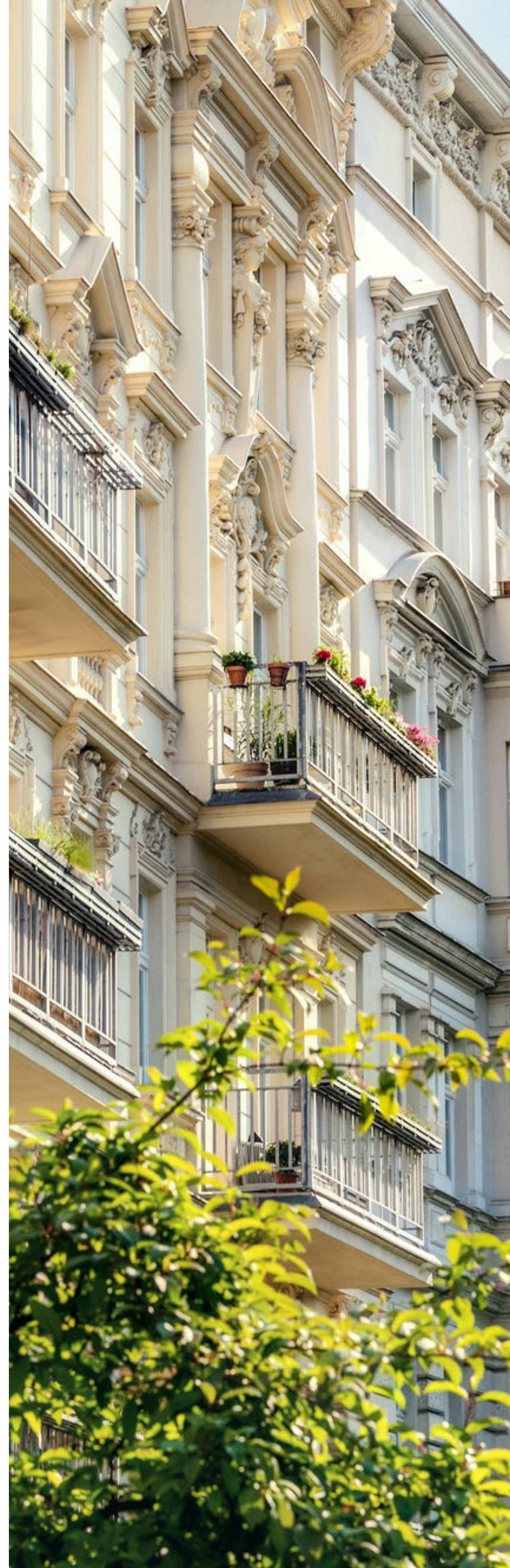
To know how to change residence, it is important to know what the term "residence" means in the law. Each state's statutes provide a definition of residence for tax purposes and those definitions vary considerably. For individuals, physical presence in a state is an important factor. Some states also determine the residency of an individual by reference to a variety of other factors such as the ownership of a home, location of family, access to employment, and financial interests.

While a change in state residence may appear to be a simple matter of buying a home in another state, there is no clear test to guarantee that a taxpayer will be taxed as a resident of the state of his choosing. Changes in residency are evaluated based on a taxpayer's specific facts and circumstances.

The question of whether or not you have ceased to be a resident of your former state and have changed residency is determined by facts and circumstances. The longer you can show a lack of strong association with your former state, the more likely that the former state will fail if it attempts to treat you as a resident. Here is a list of tasks that will help create new ties and establish residence in the state of your choosing (and complete your move from the state you are leaving):

- Buy or rent a residence in the new state
- Sell or transfer any real estate in the former state
- Focus social, economic, and other activities in the new state of residence
- Enroll children in school in the new state
- Direct that all financial related mail go to the new state address
- Have all federal tax returns and correspondence directed to the new address
- Move religious affiliations to the new residence
- Make contributions to the local organizations
- Engage a local doctor, dentist, and chiropractor and have medical records moved to their new offices
- Have new estate planning documents (wills, trusts, powers of attorney) prepared in the new state and in accordance with that state's laws
- Terminate old voter registrations, register in the new state and vote
- Change social and service club affiliations and volunteer in the new state
- Obtain a new library card
- Change vehicle registration and insurance
- Change all bank accounts to the new state, close old accounts, and rent a safety deposit box
- Change driver's license to the new state
- Stay away from the former state for more than 183 days (half a year)

There is no requirement that all of these items must be completed before one is considered a resident of a new state. However, the more of these tasks that are accomplished, the stronger the case for the establishment of a new state residence.



Residency audits

Former states are not so quick to let their tax-paying residents go. Just ask Ty Cobb! As a result of the large number of taxpayers changing residency, states have increased the frequency and detail of their residency audit efforts. Auditors have become more sophisticated and are requesting more information to support residency claims. If the number of days a taxpayer spends in a particular state is part of the determinative process, auditors can request the following records:

- Calendars and diaries
- Statements from neighbors, friends, and acquaintances
- Credit card statements and receipts
- Bank records, including ATM receipts
- Freeway fast-lane pass and toll road charges
- Records of airline frequent flyer miles
- Telephone records
- Employment records
- Location of treasured personal property

Further, state income tax auditors are most skeptical of those who change residence merely for income tax purposes. Mr. Cobb attempted to avoid this skepticism by stating that he changed his residence to Nevada because he felt that the climate would help provide relief for a sinus infection and because he felt that living in a thinly populated area would provide an atmosphere in which he could best work out his personal problems. He stated that while the California income tax was not a predominant reason for the change, it was considered.

Plan carefully

Ty Cobb felt the effort to change residency was worthwhile back in the 1930s. Changing tax residency has become an even more important consideration for high-income taxpayers as the disparity in tax rates among the states has widened. States have responded to the increased activity in residency changes by increasing their scrutiny through residency audits.

Changing residency or domicile is not as straightforward as it might at first seem. Any residency change decisions should be made in the context of one’s overall personal, financial, and tax circumstances. While the benefits of a successful move can be material, taxes, interest, and penalties can be assessed on those who are less than thorough in their planning. Those contemplating a change in residency would be wise to carefully consider and document all the relevant circumstances involved in making the change.

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