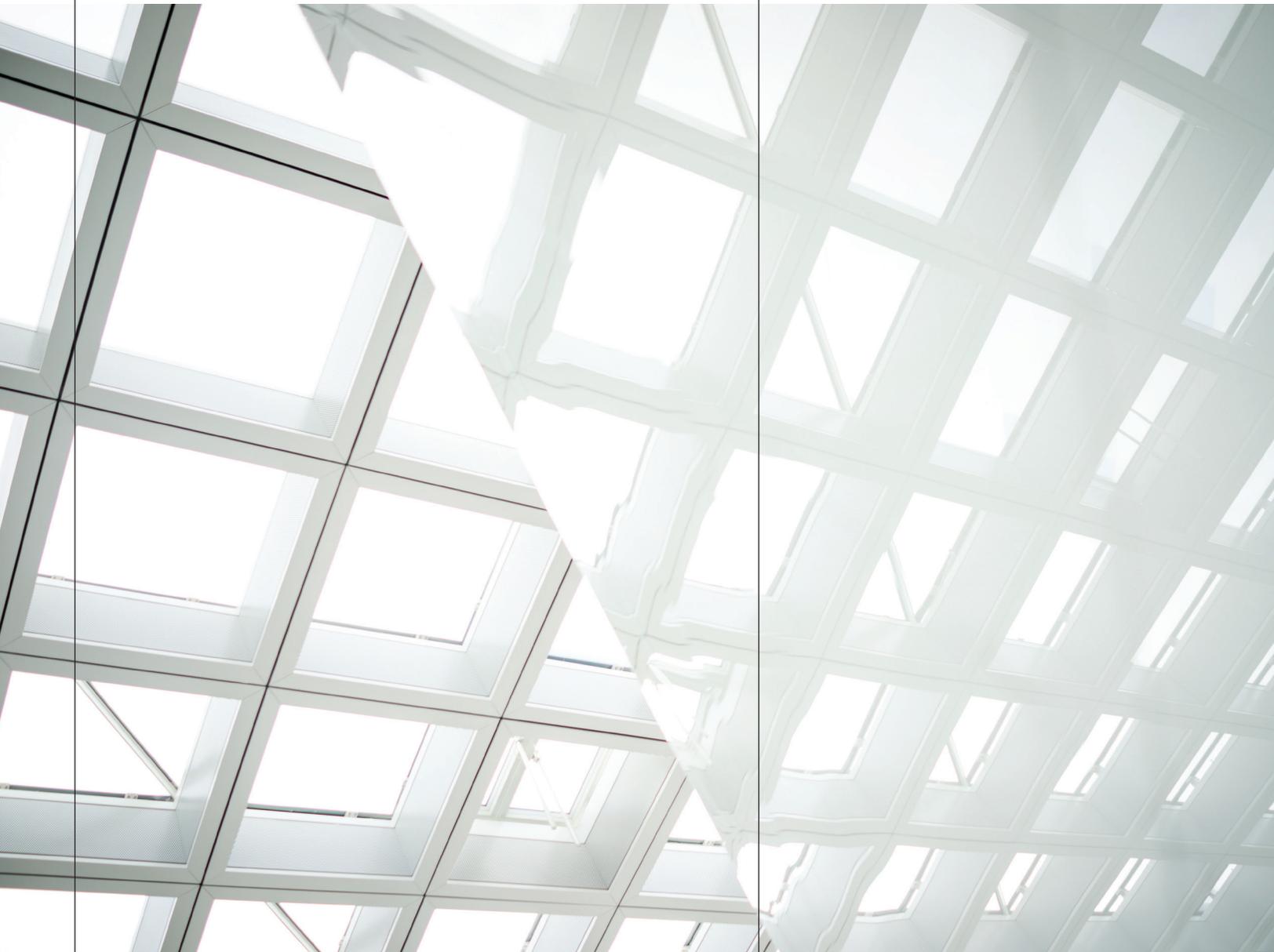


State Residency Changes:
Tax Implications and Rules





State Residency Changes

Many states have significantly increased their state income tax in recent years; meanwhile, seven states do not have a state income tax. As a result of this divergence, more taxpayers are becoming interested in possibly changing their tax residency.

While a change in residency may appear to be a straightforward endeavor, there is no bright line test to guarantee that a taxpayer will be taxed as a resident of the state of his choosing. Instead, changes in residency are evaluated based on a taxpayer's specific facts and circumstances. Additionally, states have become aggressive in challenging residency changes to avoid losing out on tax revenue.

This paper reviews the residency rules for individuals, identifies steps to establish new residency, and addresses residency audits. It also provides an overview of the residency rules for trusts.

2024 Top Income Tax Rates by State (Descending)

State	%	State	%	State	%	State	%	State	%
CA	14.40	WA	7.00 ¹	VA	5.75	AR	4.40	TN	NONE
HI	11.00	CT	6.99	IA	5.70	CO	4.40	FL	NONE
NY	10.90	DE	6.60	KS	5.70	LA	4.25	NV	NONE
DC	10.75	WV	6.50	GA	5.49	MI	4.25	SD	NONE
NJ	10.75	SC	6.40	AL	5.00	KY	4.00	TX	NONE
OR	9.90	RI	5.99	IL	4.95	OH	3.50	WY	NONE
MN	9.85	MT	5.90	UT	4.85	PA	3.07	AK	NONE
MA	9.00	NM	5.90	MO	4.80	IN	3.05		
VT	8.75	NE	5.84	OK	4.75	NH	3.00 ²		
WI	7.65	ID	5.80	MS	4.70	ND	2.90		
ME	7.15	MD	5.75	NC	4.50	AZ	2.50		

Source: Tax Foundation

1 Applies only to capital gains income for those whose income is \$250,000 or more.

2 Applies to interest and dividends only.

State Residency Rules for Individuals

State residency rules vary, often significantly, across the states. But the residency determination usually involves a look at a taxpayer's domicile, which is their permanent home. The following chart summarizes the residency rules for individuals in Illinois, New York and California, three notoriously tax unfriendly states.

State	Considered a Resident if:
Illinois	In Illinois for other than a temporary or transitory purpose, or Domiciled in Illinois, but absent from Illinois for a temporary or transitory purpose
New York	Domiciled in New York, or Domicile is not New York but maintains a permanent place of abode in New York for more than 11 months of the year and spends 184 days or more in New York during the year
California	In California for other than a temporary or transitory purpose, or Domiciled in California, but absent from California for a temporary or transitory purpose

As you can see, New York's residency rules are particularly troublesome for non-residents who maintain a home there. For example, executives who have a vacation home in New York and spend significant time there for work or any other purpose will be considered statutory New York residents even if they are domiciled in and residents of another state. Being a statutory resident of one state does not relieve a taxpayer of residency in the taxpayer's state of domicile. As a result, all of the taxpayer's income would be subject to tax in both states. In some instances, taxpayers who are taxed as dual residents may obtain relief in the form of a tax credit for a portion of the double-taxed income. This credit, however, rarely eliminates the entire additional tax burden.

Presumption of Residency

In addition to the rules above, it is important to know that in California there will be a presumption of residency if a taxpayer spends more than nine months of the year in that state. Illinois presumes residency if a taxpayer receives a homestead exemption for Illinois real estate. It is possible to overcome these presumptions with sufficient relevant, contrary evidence, but taxpayers would be well advised to avoid putting themselves in this predicament.

State Residency Rules for Estates

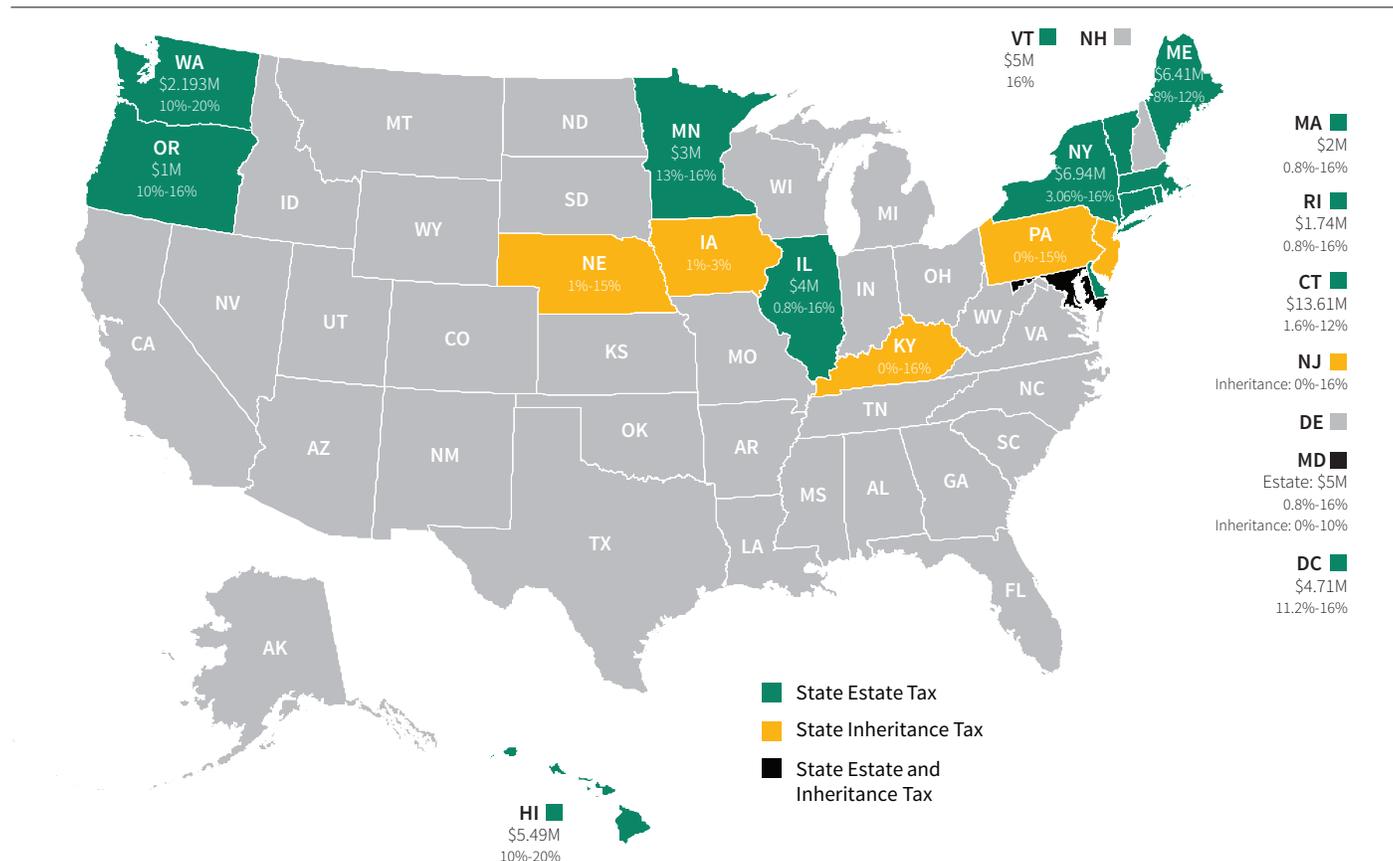
In addition to contemplating the effect of income taxes, taxpayers should also be aware of the estate tax implications associated with a change in residency. The following chart illustrates which states impose an estate tax, inheritance tax, or both, for 2024. Illinois and New York both impose a top estate tax rate of 16%. As the chart shows, California does not impose an estate tax.

The following example quantifies the potential estate tax savings from a change in residency. Assume that married taxpayers who have utilized all of their estate tax exemption via lifetime gifting pass away with a \$30 million taxable estate. As Illinois residents, this estate would be subject to state estate tax of approximately \$4.8 million. As Florida residents, the state estate tax obligation is eliminated, resulting in significant state estate tax savings.

States that levy estate tax typically do so based on the value of all of the decedent's in-state property. Tangible personal property and real estate physically located outside a taxpayer's resident state are usually only subject to estate tax by the state in which they are located.

2024 Estate and Inheritance Tax: Does Your State Have an Estate or Inheritance Tax?

State Estate and Inheritance Tax Rates and Exemptions in 2024



State Residency Rules for Trusts

The criteria for determining which state's tax laws a trust is subject to vary significantly.

There are, however, generally five basic ways a trust can become subject to a state's income tax:

1. The trust was created or became irrevocable when the settlor was domiciled in that state
2. The trust was created under the will of a decedent who was domiciled in that state at the time of their death
3. The trust is administered in that state
4. A trustee lives in that state
5. A beneficiary lives in that state

Illinois and New York treat trusts as residents based on where the settlor or decedent is domiciled. For a trust created during the settlor's life, Illinois and New York look at where the settlor was domiciled when the trust was created. For a trust created by a decedent's will, these states look at where the decedent was domiciled at the time of their death. New York does have an exception providing that a New York resident trust is not subject to New York state income tax if none of the trustees are domiciled in New York, none of the trust assets are located in New York, and the trust does not have New York source income.

California takes a different approach and taxes trusts not based on the settlor's domicile, but rather on the domicile of the beneficiaries and trustees.



Establishing New Residency For Individuals

Once domicile is established in a particular state, it is presumed to continue until a person can show that a change in domicile has occurred.

To change domicile and thus, residency, an individual must not only terminate it in their existing state but also establish a new domicile. To terminate domicile a taxpayer must abandon their original domicile without any intention of returning. To establish a new domicile a taxpayer needs to physically locate there with the intent of remaining there indefinitely.

Termination of domicile is often more difficult to prove than the establishment of a new domicile. The reason for this is that the existing state usually stands to lose significant tax revenue if an individual relocates. For example, an Illinois resident with \$200,000 of annual investment income generates approximately \$10,000 in annual tax revenue to Illinois. Upon a residency change, Illinois stands to lose this annual revenue stream indefinitely.

Establishing Residency in a Different State

Terminate Domicile in Current State

Abandon original domicile

No intention of returning

Establish Domicile in New State

Physically relocate to new state

Intent to remain there permanently

Florida Residency

Florida is one of the most common states where taxpayers look to establish new residency. Florida's income and estate tax landscape is viewed as extremely favorable: the state does not impose an income tax on individuals or trusts and does not levy an estate tax. Florida used to impose an intangible personal property tax, but this was abolished in 2006.

Property appraisers are given the authority to determine whether a taxpayer has intended to establish a permanent residence in Florida. While no single factor is conclusive, there are several relevant factors that a property appraiser will consider in determining residency, including:

- A formal declaration of domicile by the applicant
- The place of employment of the applicant
- The previous permanent residency by the applicant in a state other than Florida or in another country and the date non-Florida residency is terminated
- Proof of voter registration in this state
- A valid Florida driver's license or Florida identification card and evidence of relinquishment of driver's licenses from any other states
- Issuance of a Florida license tag on any motor vehicle owned by the applicant
- The address as listed on federal income tax returns filed by the applicant
- The location where the applicant's bank statements and checking accounts are registered
- Proof of payment for utilities at the property for which permanent residency is being claimed
- Evidence of the location where the applicant's dependent children are registered for school

To establish Florida residency, an individual needs to not only reside in Florida, but also to make it clear that the individual intends to remain there indefinitely. To this end, the individual must spend considerable time in Florida each year. As previously mentioned, there is no specific time test that one must pass, but the more time spent in Florida—particularly relative to the time spent in the prior domicile—the better.

While a taxpayer isn't required to sell their former residence, doing so would be prudent and a strong factor towards establishing new residency. If a residence is retained in the former state, to the extent possible, it should be modest and conservatively furnished as compared to the Florida residence.

Additionally, individuals should consider the following steps to strengthen their case for Florida residency:

- Apply for the Florida homestead exemption; do not apply for the homestead exemption in your former resident state.
- Register to vote in Florida and vote in as many elections as possible; write to your prior election office to request that your old registration be canceled.
- Obtain a Florida driver's license and surrender your old license.
- Use the Florida address on all future federal and state tax returns.
- Change the title and registration of automobiles to Florida except for any automobile that is left behind; if you lease cars, lease from a Florida firm.
- Declare Florida as your residence on all forms that request it such as passports, credit applications, and hotel registration slips.
- Update your estate planning documents to reflect Florida residency.
- Reflect the Florida address on any partnership or corporate interests, as well as on all insurance policies.
- Notify your old post office of the change of address. Have the bulk of your mail, especially magazines and periodicals, delivered to the new address.
- Transfer your personal checking and savings accounts to Florida and close your old accounts.
- Open safety deposit boxes in Florida and close old ones.
- To the extent possible, maintain memberships in Florida based social, religious, and professional organizations. Send letters of resignation to these organizations in the former state.
- Consider using Florida-based professionals, such as doctors, dentists, accountants and attorneys.

In addition to Florida, the following states are generally considered tax-friendly as they do not impose an income tax on individuals and trusts, or levy an estate tax: Alaska, Nevada, South Dakota, Texas, and Wyoming.

Surviving residency audits

As a result of the increasing number of taxpayers changing residency (and the amount of tax revenue at stake), states have ramped up the frequency and severity of their residency audit efforts. Audits have become more sophisticated, and auditors are requesting more information to corroborate residency claims.

To determine the number of days a taxpayer has spent in a particular state, auditors can request the following records:

Personal Records

Personal calendars and diaries

Credit card statements and receipts

Bank records including ATM receipts

Freeway fast-lane pass charges

Records of airline frequent-flier miles

Cell phone records and telephone records for residences

Business Records

Business calendars

Corporate credit card statements

Expense reports

Corporate minutes

Employment contracts

To be able to successfully challenge an audit, taxpayers should consider maintaining a calendar or log to record the number of days spent in each state. Additionally, they should be prepared to furnish documents reflecting their change in residency and be cognizant of the aforementioned personal and professional records that may demonstrate the amount of time a person spends in their previous and new states of residency.

Establishing New Residency For Trusts

Some trusts also have the ability to change their state residency. An increasingly popular technique for accomplishing this is through the use of a trust's decanting provisions.

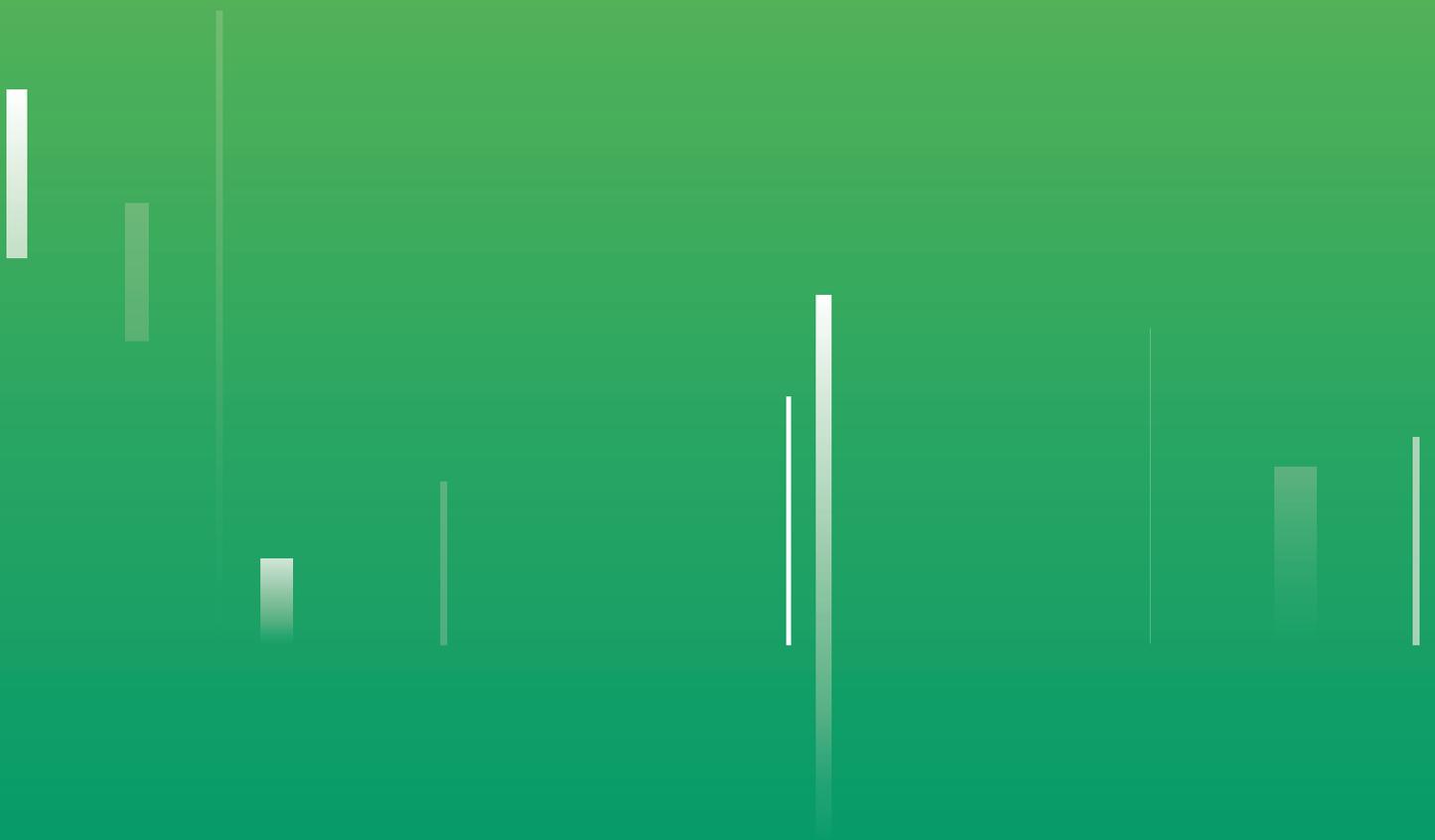
The power to decant essentially gives the trustee the ability to “pour” assets from the existing trust into a new trust with different terms and conditions. Broadly, if the new trust provides for administration under a new state's laws, the trust can benefit from that state's more favorable tax treatment. Currently, approximately thirty states have adopted decanting statutes, including Illinois, New York, and California.

It is important to note that decanting provisions are complex, vary by state, and often have profound tax and non-tax implications that need to be considered. Additionally, since the enactment of decanting statutes is recent for many states, this is an area that is likely to receive increased scrutiny by state taxing authorities.

Summary

Changing tax residency has become an intriguing topic for high-income taxpayers as the disparity in tax rates among the states has widened in recent years. Decanting statutes have also provided trusts with the ability to change their residency with more ease and certainty. But states have responded to the increased activity in residency changes by stepping up their scrutiny through the form of residency audits.

Establishing residency in a state with lower tax rates can result in significant tax savings for some individuals and trusts. But changing residency is not as straightforward as it might seem. In addition, any residency decisions should be made in the context of your overall personal, financial, and tax circumstances. If you are contemplating a change in residency, talk to your William Blair wealth advisor, as well as your estate planning attorney and tax advisor or accountant, about the opportunities and risks involved in these decisions.



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