Changing Domicile for Tax Benefits and Asset Protection

The TCJA and Recent Court Decision Change the Calculus

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When CPAs talk to individuals about moving out of high-tax states such as New York, the focus of the conversation has typically centered on how to reduce or eliminate state income taxes. With the New York State individual income tax rate ranging from 4% to 8.82%, it is no wonder why so many New Yorkers long for the 0% income tax of states such as Florida. The limitation of state and local tax (SALT) deductions in the Tax Cuts and Jobs Act of 2017 (TCJA) further enhanced the attractiveness of a move out of New York for state income tax purposes. Now that most taxpayers will get little or no federal tax benefit for paying state income taxes, many of them may be wondering why they should.

CPAs should also consider another, more pressing concern that may motivate certain individuals to consider changing domicile: asset protection. Wealthy individuals have long sought ways to secure their assets from claims of potential creditors. Approximately 19 states have enacted asset protection legislation that permits individuals to create a trust with themselves as a beneficiary while still removing the trust assets from the reach of their creditors (and, if they wish, estate taxation). These are called self-settled domestic asset protection trusts (DAPT).

Three independent developments make this type of planning different—and perhaps more important—for New York and New Jersey taxpayers. First, the current large estate tax exemption is scheduled to be cut in half in 2026. For individuals who are wealthy but not extremely so, using DAPTs may be a practical way to move assets out of the estate but preserve access to the assets if needed. Bear in mind that the litmus test for having

removed assets from an estate is whether creditors can reach those assets. If, based on the *Rensin* case cited below, the risk of a DAPT created for estate tax purposes by a resident of a non-DAPT jurisdiction (e.g., New York) is greater, then changing domicile to a DAPT jurisdiction (e.g., Connecticut) may enhance the success of this estate tax plan. More significantly, if that change in domicile also provides significant asset protection benefits, more people may be willing to make the change.

Second, *Rensin* highlights the possible risks of DAPTs created by residents of non-DAPT jurisdictions. Specifically, if a non-DAPT state can apply its laws to a self-settled trust created in a state that permits such trusts (e.g., an Alaska self-settled trust created by a New Yorker), that technique may fail for both estate tax and asset protection purposes.

Third, recently enacted legislation in Connecticut will allow qualified dispositions to asset protection trusts, starting on January 1, 2020. Thus, individuals residing in New York and New Jersey, in particular, may change domicile to neighboring Connecticut in order to attain significant asset protection and estate tax benefits.

These three factors provide New York and New Jersey CPA financial advisors with a powerful new planning alternative to offer clients, one that expands the common domicile planning discussion to include the current estate tax planning environment and the desire for enhanced asset protection. This article will explain these developments, outline the factors that CPAs must consider, and offer practical suggestions for advising clients about moving out of New York and into Connecticut for asset protection purposes.

New York Residency for Tax Purposes

Individual 2019 income tax rates in Connecticut range from 3% to 6.99%, which is slightly lower than the New York rates. While this slight savings will not likely motivate many taxpayers to move from New York to Connecticut, especially when factoring in moving costs and other Connecticut taxes, New York's residency taxation rules do provide a framework for individuals who move for asset protection purposes.

New York residents who attempt to relocate to Connecticut must closely adhere to New York's residency rules in order to successfully change domicile. Even if they are changing domicile as part of an estate tax and asset protection plan, and not for income tax purposes, they must still take all steps necessary in order to avoid any application of New York's residency taxation rules. Otherwise, a successful challenge as part of a residency audit may make it more difficult to argue that domicile has been changed for estate tax or liability/asset protection purposes.

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As CPAs and their clients have become more aggressive in using domicile change as a tax strategy, New York has instituted one of the most uncompromising residency audit programs in the country. The New York State Department of Taxation and Finance employs numerous skilled income tax auditors who specialize in examining taxpayers' movements into and out of the state. Careful planning, detailed corroboration, and a real change in domicile are necessary for taxpayers to succeed.

New York tax law establishes three types of individuals whom the state taxes. First, a taxpayer is a resident of New York if she is domiciled in New York. An individual's domicile is her true home, the place she returns to after having been away. Essentially, domicile is where the heart is. A taxpayer may have more than one residence, but she can only have one domicile.

Second, a taxpayer is also considered to be a resident of New York—even if he is domiciled in a different state—if he satisfies the alternative two-pronged test to be treated as a "statutory resident" of New York by 1) maintaining a permanent place of abode in the New York and 2) spending more than 183 days in New York. In other words, if he is domiciled in Connecticut, but also leases an apartment for his personal use in Long Island and travels to Manhattan every weekday for work, he would likely be treated as both a domiciled resident of Connecticut and a statutory—and thus taxable—resident of New York. Note that while a conclusion of statutory residency in New York should not defeat an asset protection plan dependent upon Connecticut residence, it may be preferable to avoid characterization as a New York statutory resident if endeavoring to support domicile in Connecticut to mitigate the risk of a claimant endeavoring to apply New York law to pierce a self-settled Connecticut DAPT.

Third, a taxpayer who is neither domiciled in New York nor considered a statutory resident will still owe income tax to New York on any income sourced to New York (e.g., income earned in New York, rental income on New York property). A taxpayer who successfully demonstrates that she is a Connecticut domiciliary and a nonresident of New York may enhance her protection under Connecticut law for her assets (acknowledging that the test for domicile may differ); however, litigants who bring a claim against her under New York's laws may be able to attach her New York-source income that is not held and earned inside the DAPT.

A Closer Look at Change of Domicile

Achieving status as a Connecticut domiciliary may require a New York residency audit, which is often a grueling experience for taxpayers. In order to change domicile, a taxpayer must demonstrate that she formed the subjective intent to establish domicile in the new location, coupled with actual residence in the new location. Accordingly, a domicile inquiry begins with an examination of the taxpayer's intention.

The New York courts have stated: "The test of intent with respect to a purported new domicile has been stated as 'whether the place of habitation is the permanent home of a person, with the range of sentiment, feeling, and permanent association with it'" [*Matter of Bodfish v. Gallman,* 50 A.D.2d 457 (N.Y. Sup. Ct., App. Div. 1976)]. With respect to asset protection planning, what greater intent is there than an individual's desire to protect her life savings? Nevertheless, any taxpayer must first endeavor to address as many of the historic change in domicile factors as feasible, even if the motive is safeguarding assets or achieving federal estate tax benefits. The courts and auditors examine intent by analyzing five primary factors [for New York, the Nonresident Audit Guidelines (2014) (http://on.ny.gov/2fTnPWa); for Connecticut, Conn. Agencies Regulations section 12-701(a)(1)-1]. First, the auditor will compare the taxpayer's home in each jurisdiction, looking at size, value, and usage. Second, the auditor will compare time spent in each jurisdiction, looking for habits and patterns and examining both the quantity and quality of days spent in each location. Third, the auditor will compare business ties and activities in each location, looking to see how and where the taxpayer earns a living in the old jurisdiction or the new. Fourth, the auditor will compare "near and dear" items in each location, looking to see if the taxpayer has moved his personal effects and belongings to the new location. Fifth, the auditor will compare where family members reside, looking to see if the taxpayer's spouse also moved, or if minor children changed schools.

These five factors are more indicative of intention than, for example, merely changing a driver's license or an auto registration. This does not suggest that driver's licenses and auto registration should not be changed, or that they are not relevant to the analysis, but that these types of actions by themselves will not sway the conclusion.

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A residency audit examines all aspects of a taxpayer's life, including where, how, and with whom he spends his time. Many typical activities, such as withdrawing cash at an ATM, paying for something by credit card, or using a cellphone, create a digital record indicating time spent in a particular location. Not only are the taxpayer's personal and business records fair game, but his digital footprint will also likely be part of the inquiry. While he need not go so far as to change his bank, something as innocuous as using Groupon to find a restaurant discount could become important evidence in determining his view of each physical location and, ultimately, his tax residency.

While 21st century taxpayers are more mobile, they have also become less anonymous, as digital records are increasingly used to pinpoint days spent in one jurisdiction versus another. This, of course, presents both opportunities and challenges for taxpayers seeking to claim or rebut a claim of a change in residency. CPAs should harness these data points to gather evidence of each of the five primary factors, as well as all of the historically considered factors, in order to establish a change in domicile.

CPAs seeking to advise clients about this important issue must understand the various residency rules and how they might apply to real-world situations. For example, a New York attorney is not required to sit for the Connecticut bar exam and renounce her New York bar license in order to establish domicile in Connecticut. On the other hand, a professional license "parked" in one state would be an important aspect of the business factor, which would certainly be considered as part of a residency review. Can a New York lawyer continue to practice law solely from within Connecticut, or is she also working in New York? If she is also working in New York, how much time does she spend in New York? This might relate more to determining New York source income that remains taxable in New York, even if domicile has changed to Connecticut.

Furthermore, New York employs a restrictive "convenience of the employer" doctrine that can pull telecommuters back into New York for workday count purposes. Essentially, when an individual works for a company located within New York from his Connecticut home, those days may be treated as days in New York unless he worked outside of New York by necessity and not as a matter of his own convenience. Even then, New York will permit an individual to avoid counting days worked from home as New York workdays to the extent that the home office qualifies as a "bona fide employer office" [Technical Services Bureau Memorandum (TSB-M-06(5)I)].

Would the answer change if the attorney does most of her work on her laptop computer from a coffee shop outside New York? Remember, work is but one factor, and there is no rule that a domiciliary of Connecticut cannot work in New York.

Advisors must review and follow these rules in order to ensure that clients with unique circumstances can withstand a residency tax audit.

Should taxpayers seeking to change residence from New York to Connecticut have all their mail delivered to Connecticut? What if the taxpayer's residence in New York has a concierge service to receive packages, whereas deliveries to the house in Connecticut are at risk of being stolen by porch pirates? Without proper explanation, an auditor could view this as an indication of a failure to change residence outside of New York. This illustrates how the changing nature of society, commerce, and the Internet have affected the domicile determination. These changes are not necessarily favorable or detrimental to individuals; rather, they illustrate how analysis and corroboration should keep up with the times.

The manner in which clients live their lives, coupled with how they enjoy the modern conveniences of various technologies, must be carefully considered when evaluating the five primary domicile factors and other historic factors, or when analyzing the two prongs of statutory residency.

Asset Protection Planning

The TCJA completely changed the estate and gift planning landscape. Taxpayers should, however, use the increased exemption levels ($11.4 million per taxpayer in 2019, $22.8 million per married couple) now or possibly lose them forever. A possible change in control of the White House and the Senate following the 2020 elections could result in a rollback of the increased exemption, either by allowing the 2025 sunset to occur as scheduled or by outright repeal of the TCJA. Democratic candidates for president have already proposed a $1 million gift exemption and a $3.5 million estate tax exemption, which would all but eliminate the planning opportunities for both estate tax minimization and asset protection under current law.

Wealthy taxpayers wishing to take advantage of the planning opportunities of this larger exemption should evaluate the benefits of self-settled DAPTs, or variations thereon. Self-settled DAPTs can give individuals access to transferred assets, while still allowing them to use the large lifetime exemptions. DAPTs may be critical for many taxpayers, other than certain ultra–high-net-worth (UHNW) individuals. Many single persons, and even many married couples, will want to be able to access transferred assets. With historically high exemptions, very large transfers (relative to the net worth of moderate-wealth clients, perhaps defined as those having estates between $5 and $40 million) are necessary to make a meaningful impact.

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When evaluating the possible use of a DAPT, CPAs should consider *Toni 1 Trust v. Wacker* [2018 WL 1125033 (Alaska, Mar. 2, 2018)]. While some commentators have concluded that DAPTs are no longer viable in the wake of *Wacker*, others believe it was a "bad fact case" that does not inhibit the use of DAPTs at all. Still others view the case as quite limited, with no impact on the risks of the use of DAPTs, even by those residing in non-DAPT jurisdictions; they view it as addressing jurisdiction, and as another warning that no type of trust, self-settled or otherwise, can protect against a fraudulent conveyance ("Blattmachr, Blattmachr, Shenkman & Gassman on *Toni 1 Trust v. Wacker*—Reports of the Death of DAPTs for Non-DAPT Residents Is Exaggerated," *Steve Leimberg's Asset Protection Planning Email Newsletter Archive Message #362,* Mar. 18, 2018).

The facts in *Wacker* included that, after a Montana state court issued a series of judgments against Donald Tangwall and his family, the family members transferred two pieces of Montana real property to the "Toni 1 Trust," a trust allegedly created under Alaska law. That transfer was found to constitute a fraudulent conveyance. The Supreme Court of Alaska held that Alaska could not mandate that exclusive jurisdiction in the fraud case rest in Alaska; it did not invalidate self-settled trusts created in Alaska. Although courts in other jurisdictions entered a default judgment on the fraudulent transfer allegations, the viability of Alaska self-settled trusts to shield trust assets from the claims of the grantor's creditors was not addressed.

Planning post-*Wacker* and post-TCJA might be somewhat different than under prior law. Even DAPT proponents seem to suggest that a wide array of variants of the traditional DAPT technique can provide more security. One common-sense precaution includes taking proactive steps to corroborate that the trust and transfers to it are not fraudulent conveyances. These might include lien and judgment searches, having the transferor sign a solvency affidavit (whether or not state law requires it), forecasts by the individual's CPA or wealth advisor demonstrating no anticipated need to access the DAPT assets, and other due diligence steps. A balance sheet prepared by a CPA corroborating solvency after any transfers contemplated to the DAPT may also be helpful. Different requirements may be considered in light of larger (percentage-wise) wealth transfers for moderate-wealth clients in order to use the larger portions of their temporary exemptions.

There are also several variants on the traditional DAPT approach that might be

useful to negate some of the perceived risks. A hybrid-DAPT approach provides a person in a nonfiduciary capacity the right to add descendants of the settlor's grandparents as beneficiaries. Some argue, however, that unless that power is actually exercised, the trust is not self-settled, and thus not subject to DAPT risks. Another approach might be to decant an irrevocable trust into a new irrevocable trust and add a limited power of appointment that a beneficiary might exercise in favor of the settlor. A third variant might be not to make the settlor a beneficiary, but rather to give someone in a nonfiduciary capacity the right to appoint trust assets to the settlor. Whether an individual adopts one of these DAPT variations or combines several strategies into a comprehensive plan, being domiciled in a DAPT jurisdiction may be an additional factor in the success of such a plan.

In a recent case, a bankruptcy judge found that a preexisting asset protection trust, formed in the Cook Islands and moved to Belize, was subject to Florida law and therefore not protected from the creditors of a Florida resident who was both the settlor and a beneficiary [*In re Rensin,* 17-11834-EPK, 2019 WL 2004000 (Bankr. S.D. Fla. May 6, 2019)]. While there are questions about the case and how the matter was handled, *Rensin* raises concern that a DAPT created in a DAPT state (e.g., Connecticut) by an individual who resides in a state that has not adopted DAPT legislation (e.g., New York) may be at more risk than before of being tainted and fail to protect the assets owned by the DAPT from the claims of such individual's creditors by operation of the non-DAPT state's less favorable asset protection laws. Without going into the particulars of the case, some of the findings and reasoning of the *Rensin* court may have been flawed. Furthermore, *Rensin* was decided by a lower bankruptcy court and is not binding on other jurisdictions. Indeed, in another recent case, the Tax Court appears to have respected a foreign trust [*Campbell v. Comm'r.,* 117 T.C.M. (CCH) 1018, 1 (Tax 2019)].

Notwithstanding the above caveats, the importance of the ruling in *Rensin* should not be ignored by cautious advisors or taxpayers. DAPT naysayers have warned financial advisors for years that DAPTs have an inherent weakness for individuals who reside in non-DAPT states, and the *Rensin* case might be argued to support such a weakness.

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Moving from New York to Connecticut

Given the above, the following example concerns a hypothetical husband and wife who decide to relocate from New York to Connecticut. The couple are longtime New York residents; the husband is an attorney, and the wife is a retired surgeon. They own a home in New York and have also owned a home in Connecticut for the past five years, where they typically spend weekends. Their children are grown and live in California and Virginia. Looking to the future, the couple wishes to move to Connecticut to take advantage of its favorable asset protection rules, as well as a more relaxed lifestyle. The husband will continue to work in New York on a reduced basis as he plans for retirement, and they intend to keep their New York home for visits—essentially, the houses would switch roles. How can these taxpayers navigate the residency rules to successfully change their domicile?

First and foremost, the couple will need to demonstrate a clear change in their lifestyles. Domicile is about intention, which they clearly have, but a residency audit is an exercise in persuading an auditor today about what happened two or three years ago. They will need to carefully walk through New York's five domicile factors to create a dramatic change in their lifestyles, and should also address the historic residency factors. Most importantly, they will need written evidence to demonstrate this change. Furthermore, they will have to be in New York for fewer than 183 days per year, or they will be caught by the statutory residence rule, regardless of what other steps they take.

Accordingly, the couple should move as many "near and dear" items from New York to Connecticut as practical. Furthermore, they will need to spend more time in Connecticut than New York. There are numerous other actions they can take, like changing their driver's licenses to Connecticut, registering their cars in Connecticut, registering to vote in Connecticut, resigning from memberships and organizations in New York, and joining similar memberships and organizations in Connecticut. It is critical to remember that while domicile is an intent-based test, it is established through objective evidence. Mere changes in registrations and memberships, while helpful, will be stronger if accompanied by intangible factors that show a change in lifestyle. Where does the couple shop? What are the relative value, size, and amenities of each residence? Have they established emotional ties to the new home state, including social ties? These factors are often important, but more difficult to document. The couple should endeavor to save objective proof of the increase of social engagements in Connecticut and the decrease of social and other ties to New York.

Furthermore, because the couple plans to retain their New York home, they need to be cautious about New York's statutory test for residency. As noted above, this is a two-part test. The first prong is maintenance of an abode in New York; they will retain their former home for their use, so this prong is satisfied. Accordingly, both of them will need to carefully count their days to ensure they are under the 183-day count threshold. The key, of course, is proving this to an auditor's satisfaction. Day count analysis in and of itself can be a grueling and difficult task, involving burdensome review of calendars, travel records, cellphone records, bank records, E-ZPass records, and other documentation pinpointing a taxpayer's whereabouts. Some taxpayers may find residency smartphone apps (e.g., Monaeo, TaxDay, Taxbird) helpful. These apps use the phone's location to automatically track time spent in each state.

While the couple can certainly move from New York to Connecticut successfully, careful attention to these rules will be essential to successfully defend against a residency audit and ensure that the DAPT planning under Connecticut's favorable rules provides the estate tax and asset protection benefits sought.

Easier Moved than Proved

While it may be less expensive to pack up a New York residence and set up a new home in Connecticut than to move all the way to Florida, the proximity between the states does offer challenges. It may actually be harder for a taxpayer to document a move in closer proximity to the original jurisdiction. It is generally not possible to wake up in Florida and go to sleep in New York without a plane ticket or several gas station receipts to document the travel; the same cannot be said of traveling between New York and Connecticut. Accordingly, planning and documentation take on a heightened importance.

Connecticut offers various incentives for asset protection that may be a leading motivation in a change of residence. Nevertheless, careful attention must be paid to New York's income tax rules in order to establish a new residency before a move to Connecticut will be respected by New York. CPAs and other advisors should understand the basics in order to assist individuals affected by these issues.❑

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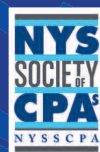

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