



## New York Business, Federal Tax Return and New York Domicile

By Louis Vlahos

We all know the story. A New Yorker builds a successful business and attains a level of financial security. His kids are grown, and have moved to the West Coast. The New Yorker decides that it is time to enjoy the fruits of his labor, preferably in a warmer climate. He buys a condominium, and joins a club, in Florida. He moves many of his favorite items to Florida, including some jewelry and photo albums, golf clubs and fishing gear. He buys a new car in Florida. He spends most of his time in Florida.

He keeps his NYC apartment, his intention being to stay there when he visits NY during the warmer months. He keeps his old car in NYC. He retains his membership at a NYC club. He keeps his art and coin collections in the NYC apartment. He retains a safe deposit box in NY.

He formally declares Florida his domicile and claims the state's homestead exemption. He registers to vote in Florida, obtains a Florida driving license, executes a Florida will, and opens an account at a Florida bank. He finds a Florida physician with a general practice, though he plans an annual visit to the NY specialist who has been treating him for years. He retains his NY accounting firm.

He directs that all financial statements business correspondence be sent to his Florida address. He enters the Florida address on his tax returns.

He starts to maintain a diary, and retains copies of credit card charges and other receipts, in order to keep track of his days in Florida and in NY, in order to avoid being treated as a NY statutory resident for income tax purposes.

Although he has significant investments in marketable securities his business remains an important source of income, on which he continues to rely to maintain his lifestyle.

Based on the foregoing, can the New Yorker rest assured that he will be subject to NY income tax only as to his NY source income; that all his other income will be beyond the reach of such tax? At his passing, will his estate be free of NY's estate tax, other than as to his NY real estate? In other words, though he may succeed in avoiding statutory residence in NY, has he effectively abandoned his NY domicile and established Florida as his new domicile?

Based on the foregoing, it would appear to be a close call.

Domicile is defined as the place an individual intends to be his permanent home. Intention is a decisive factor in the determination of whether a particular residence is one's domicile. This

is a subjective inquiry; it goes to one's state of mind.

Once a taxpayer's domicile has been established, it continues until the taxpayer abandons the old domicile and moves to a new one with the bona fide intention of making his permanent home there.

Whether or not one domicile has been replaced by another depends on an evaluation of the circumstances of the person in question. Certain "primary" factors must be considered, but the evidence to support a change must be "clear and convincing". Thus, a taxpayer who has been historically domiciled in NY, and who is claiming to have changed his domicile, must be able to support his intention with unequivocal acts.

Each primary factor must be analyzed to determine if it points toward proving a NY or other domicile. In conducting this analysis, the taxpayer's NY ties must be explored in relationship to the taxpayer's connection to the new domicile claimed. Each factor is weighed individually, and then collectively.

The primary factors are as follows: the individual's use and maintenance of a NY residence, his active business involvement, where he spends time during the year, the location of items which he holds near and dear, and the location of family connections.

In the case of our New Yorker, his NY and Florida residences are comparable; he spends most of his time in Florida; his near and dear items are in both locations. What about his business activity?

A taxpayer's continued employment, or active participation, in a NY business (whether a sole proprietorship, partnership, LLC or corporation), or his substantial investment in or management of such a business or entity, is a primary factor in determining domicile. If a taxpayer continues active involvement or participation in NY business entities, without comparable or greater business activities outside NY, then the business factor will support continued NY domicile.

The extent of an individual's control and supervision over a NY business can be such that his active involvement continues even when he is not physically present in NY. Active participation in the day-to-day operation or management of a NY business points to continued NY domicile even if it is being run from an out-of-state location.

On the other hand, a taxpayer's pas-



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sive investment in a NY business is not indicative of domicile.

In considering the nature and extent of the taxpayer's involvement with a NY business, one must consider the taxpayer's federal income tax returns, as well as those of the business entity, be that a corporation or a partnership/LLC.

Start with the taxpayer's federal individual income tax return, on IRS Form 1040. Has the taxpayer completed the lines relating to business income and income from partnerships and S corporations? Has the taxpayer identified a NY business on Schedule C (sole proprietorship, including a single member LLC) or on Schedule E (an S corporation or a partnership)? Is the taxpayer's participation in these businesses described on the returns and schedules as active or passive? This same designation can be used to show that the taxpayer has significant NY business connections.

Although it remains to be seen how the newly effective 3.8 percent surtax on net investment income will be administered, any "former" NY taxpayer who claims an exemption with respect to his share of S corporation or partnership income, on the basis of having materially participated in the business, will have to reconcile the exemption with his claimed change of domicile.

Similarly, the completion of the line on Form 1040 relating to wages, and the issuance of a W-2 to the taxpayer by a NY employer, reflecting significant compensation, perhaps even an amount of compensation approximating what the taxpayer had earned prior to the purported change of domicile, may also point to continued active participation in the NY business.

In the case of an S corporation, the Form 1120-S should be reviewed for wages paid to officers. In the case of a C corporation, Forms 1120 and 1125-E (Compensation of Officers) should be reviewed; the latter identifies officers of the corporation, their time devoted to the business and their stock ownership. The same may be said as to "guaranteed payments" made to the taxpayer for services rendered by the taxpayer to a partnership or LLC, as reflected on the Form 1065, Schedule K-1 issued to the taxpayer. Does the Schedule K-1 identify the taxpayer as a general partner or managing member? Did the taxpayer complete Schedule SE, Self-Employment Tax, to Form 1040, with

respect to any of the allocations made or any of the payments received from the NY business? Did the taxpayer execute these business entity returns and, if so, in what capacity?

It is not uncommon for the "retired" taxpayer to retain a board seat and to continue to hold the position of president. This is not necessarily fatal, provided the positions are ceremonial, or provided the taxpayer does not, in fact, materially participate in the business.

The issue to which these inquiries are directed is the following: is the level of involvement in a NY business, as reflected on the taxpayer's federal income tax returns, consistent with the taxpayer's assertion that the taxpayer has abandoned his NY domicile?

Can the taxpayer reconcile his purported status as a Florida domiciliary with the federal returns reflecting his continued active participation in a NY business? In too many situations, the answer is no, notwithstanding the taxpayer's protestations to the contrary. Indeed, it is often the case that the taxpayer has stepped away from his business, and has successfully transitioned the day-to-day operation and management to his children or to a key and trusted employee. Why, then, would the taxpayer's return contradict his actions? A number of reasons may be given: for example, the taxpayer needs a continued income stream from the business; or the taxpayer wants to reduce the corporation's tax exposure (this could be federal and state taxes in the case of a C corporation; NYC taxes as to any corporation).

Unfortunately, as the song goes, "you can't always get what you want." NY will use the taxpayer's federal business tax filings against him, either in rejecting entirely his claim of non-NY domicile, or in extracting an expensive settlement from him.

Fortunately, "if you try sometimes... you might just find, you get what you need." In the case of our taxpayer, corporate dividends and/or partnership distributions may provide the cash flow required by the taxpayer to maintain his lifestyle. In the end, the taxpayer needs to decide whether he can afford to present the strongest set of facts possible to support the abandonment of his NY domicile for both NY income and estate tax purposes. With appropriate planning, the decision need not be an all-or-nothing proposition.

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