
Estate and Financial Planning News You Can Use

December 2009

YEARNING FOR SUNNIER DAYS?

Michael D. Gentzle, Esq.

Introduction

For years, retired New Yorkers have migrated south to make Florida their new home. Some move for the weather, while others are motivated by potential tax savings. Florida residency offers the opportunity for significant tax savings for its residents, because, unlike New York, Florida does not impose state income tax or state estate tax.

Establishing residency in Florida is relatively easy; however, terminating residency in New York requires a serious change in lifestyle that not everyone may wish to undertake.

As a result of the migration of snowbirds, many northern states are experiencing a substantial decrease in tax revenues. Consequently, these states may aggressively challenge the residency status of snowbirds for state income and estate tax purposes.

In this article we discuss: (i) how New York imposes its income tax; (ii) how New York imposes its estate tax; (iii) what to expect if you are audited; and (iv) the steps to help establish your domicile in Florida, should that be your desire.

Although this article generally addresses a change in domicile from New York to Florida, the content may be applicable for taxpayers in other states as well. In any case, if considering a change of domicile, you should consult with a professional tax advisor regarding your specific situation and not rely upon the contents of this article.

New York State Income and Estate Taxation

Income Taxation

An individual's residency status determines his or her level of New York State income taxation. New York residents are taxed on 100% of their worldwide income; whereas, nonresidents are only taxed on income "derived or connected with New York sources" (e.g., wages, salaries, stock option income, deferred compensation, rental income).

Generally speaking, New York defines a "resident" for income tax purposes as an individual who:

- (i) is domiciled in New York; or
- (ii) is not domiciled in New York, but maintains a permanent place of abode (owned or rented) in New York for more than 11 months of the year and spends, in the aggregate, more than 183 days of the taxable year in New York (generally referred to as, "statutory residence"). Presence within New York for any part of a day counts as a day for purpose of statutory residence.

What does it mean to be "domiciled in New York"?

You are determined to be domiciled in New York if you maintain a permanent place of abode in the State with the intent to ultimately return. The terms "domicile" and "residence" are often used synonymously, but for New York tax purposes, these two terms have completely different meanings. "Residence" simply means a place you own or rent. You may have multiple residences, but you can have only one "domicile."

YEARNING FOR SUNNIER DAYS? (cont'd)

Your domicile remains the same until you move to a new location with the intent of making the new location your permanent home. Whether there has actually been a change of domicile is a question of fact. Your subjective intent to change your domicile is insufficient to establish the change. The burden of proof is on you to prove your change of domicile by clear and convincing evidence. Clear and convincing evidence can be proven by both actions and statements. New York weighs this information to make an objective determination of your domicile.

Estate Taxation

Tax planning with respect to New York State estate tax can be just as beneficial as tax planning with respect to New York State income tax. New York's estate tax exemption is currently \$1 million. Assuming you have made no taxable gifts during your lifetime, you can transfer up to \$1 million worth of assets at your death without being assessed a New York State estate tax.

New York divides assets into three categories

The question then is, what assets count towards New York's \$1 million exemption? For estate tax purposes, New York divides assets into three categories: (i) real property; (ii) tangible personal property; and (iii) intangible personal property. To determine which assets are includable in an estate, New York looks to a decedent's residency at death:

Residents- New York includes the value of all real and tangible personal property having an actual situs within the State as well as all intangible personal property wherever located.

Nonresidents- New York includes only real and tangible personal property having an actual situs in the State. Intangible personal property is not taxable.

Therefore, even if you are a nonresident, New York will include in your estate the value of all real and tangible property having an actual situs in the State. Actual situs for real property is determined by the property's physical location, whereas, actual situs for tangible personal property is determined by looking at the permanent location of the asset. If the asset is moved between New York and Florida, the actual situs is determined on a case-by-case basis.

The New York State Audit Process

New York may challenge a decedent's residency status at death resulting in intangible personal property being taxable under its estate tax structure; however, New York State audits are typically income tax driven. The New York State income tax audit process typically begins with an auditor making contact with the taxpayer by letter indicating that the taxpayer's Nonresident Income Tax Return is being reviewed. The auditor's letter is frequently accompanied by a questionnaire. It is advisable that you seek the assistance of a professional tax advisor to ensure that your responses are fully accurate and complete. A second and more detailed questionnaire, as well as either an in-person visit or phone conference with an auditor may follow. As previously stated, the determination of residency for New York State income tax purposes is a question of fact rather than law. A professional tax advisor will be best situated to assist you in this process.

Factors Considered by the Auditors

In 1997, the New York State Department of Taxation and Finance published a manual (the "Manual") with guidelines for its auditors to follow when conducting audits. When exploring the issue of statutory residence, auditors are permitted to consider virtually all facts and circumstances to determine whether a taxpayer was present in New York for more than 183 days during the year in question. It is not uncommon for auditors to request credit card statements, utility bills, travel logs, phone bills, or similar documentation to assist in establishing a taxpayer's presence in New York. These audits can be fairly exhaustive.

YEARNING FOR SUNNIER DAYS? (cont'd)

If you are successful in demonstrating that you did not spend more than 183 days in New York, you will also need to prove your change in domicile. Unlike an audit to determine statutory residence, an audit to determine a taxpayer's domicile is a much more structured analysis. According to the Manual's guidelines, the factors used to determine domicile are divided into two general categories, primary factors and "other" factors.

The five primary factors are: (i) Home; (ii) Active Business Involvement; (iii) Time; (iv) Items Near and Dear; and (v) Family Connections. The following addresses these factors:

Home: This factor is straightforward when an individual has only one residence. However, complications arise when individuals maintain their New York residence despite obtaining an additional residence in Florida. Specifically, the mere fact that a taxpayer maintains a Florida residence is not sufficient in and of itself to establish a basis for domicile. Retaining dual residences can create what some identify as an "insurmountable obstacle," especially where the residence retained in New York is the taxpayer's historical home. In determining whether a basis for New York domicile exists, auditors will compare the size, value, and nature of use of the New York residence to the size, value, and nature of use of the Florida residence.

Active Business Involvement: According to the Manual, a "taxpayer's continued employment, or active participation in New York State sole-proprietorships and partnerships, or the substantial investment in, and management of New York corporations or limited liability companies is a primary factor in determining domicile." Auditors will scrutinize phone records, travel logs and credit card statements to determine the degree and scope of a taxpayer's involvement in the day-to-day operation of a New York business. Material supervision and review of an individual's business interests in New York has been identified as a probative factor.

Time: In determining a basis for domicile, the Manual provides that auditors are instructed to "focus on the overall living pattern of the taxpayer, asking whether the patterns present strong evidence that the new location has become the taxpayer's domicile." If a taxpayer's living pattern changes from spending six months per year in Florida to spending seven months per year, this change alone may not constitute strong evidence of a change of domicile. Whereas, seasonal visits to New York each summer may strengthen the argument that Florida is in fact the taxpayer's domicile.

Items Near and Dear: This factor is sometimes referred to as the "teddy bear" rule. The guidelines encourage auditors to investigate the location of items which an individual holds "near and dear" to his or her heart, or those items which have significant sentimental value, such as family heirlooms, works of art, family photographs, and collections of books.

Family Connections: The Manual suggests that an individual's family connections to New York be analyzed only when the previous four factors are inconclusive in determining an individual's domicile. Furthermore, an analysis of one's family connections should be limited to an individual's immediate family (i.e., spouse and children).

Where the primary factors indicate a basis for New York domicile, the auditors are permitted to consider "other" factors. "Other" factors are not to be weighed as heavily as the primary factors, as they demonstrate relatively superficial changes. "Other" factors include: (i) the address listed on financial documentation; (ii) the location of the safe deposit box; (iii) the location of auto, boat, and airplane registrations, as well as the individual's personal driver's or operator's license; (iv) where the taxpayer is registered to vote; (v) an analysis of utility services at each residence; and (vi) the individual's domicile as cited in wills, trusts and other legal documents.

Based on the information collected during the audit process, the auditor shall make a determination as to whether the individual is a "resident" for New York State tax purposes. Specifically, the auditor shall determine whether: (i) the taxpayer effectively changed his or her domicile from New York to Florida; and/or (ii) whether the taxpayer was present in New York for more than 183 days during the year in question. With two separate ways to qualify as a "resident," you should not consider yourself a nonresident just because you are not physically in New York for more than 183 days in a given year.

YEARNING FOR SUNNIER DAYS? (cont'd)

How to Establish Your Domicile in Florida

Again, domicile refers to your true, fixed and permanent home. You can have only one domicile. To prove a change of domicile to Florida, you must demonstrate your physical presence in Florida coupled with the present intention to remain there for an indefinite period of time. Physical presence may be easily established. Thus, the key issue in establishing a change of domicile is proving your intent to reside in Florida indefinitely.

Although intent is subjective, it may be proven by clear and convincing evidence that demonstrates that you consider Florida to be your primary and permanent home. There is no waiting period to establish Florida residency.

**domicile refers to your true,
fixed and permanent home**

When changing your domicile to Florida, you should take as many of the following steps as possible in order to amass evidence of your intent to change your domicile. As with most states, New York places the burden of proving a change of domicile on the taxpayer; therefore, you should maintain an accurate record of the dates that you perform each of the following steps:

- File a Declaration of Domicile with the Clerk of the Circuit Court in the County of your Florida residence;
- Apply for Florida's Homestead exemption with the Property Appraiser's Office in the County of your Florida residence;
- Execute new estate planning documents, such as wills, revocable trusts, powers of attorney, living wills and health care surrogates, reciting Florida as your state of domicile;
- Consider selling your New York residence;
- Consider selling business interests in New York;
- Obtain a Florida's driver's license;
- Transfer the registration of your motor vehicles, boats and planes to Florida;
- Surrender any New York resident fishing or hunting license(s);
- Register to vote in Florida (and actually vote);
- Register your pets in Florida;
- File your federal income tax returns from Florida, which means filing with the IRS Service Center in Atlanta;
- File an appropriate nonresident return, or part-year resident return, with New York in the year you change your domicile;
- File a nonresident, rather than a resident, New York income tax return if you continue to have New York based income;
- Transfer safe deposit contents to Florida;
- Open a Florida bank account;
- Refer to your Florida residence in all legal documents;
- Make Florida your mailing address in all documents;
- Establish affiliation with Florida social and religious organizations and consider disaffiliation with New York organizations;
- Obtain a Florida public library card;
- Change your address on your passport to Florida residence;
- List the Florida residence on insurance policies;

YEARNING FOR SUNNIER DAYS? (cont'd)

- Transfer near and dear items to Florida residence;
- Keep a diary or log to keep track of your days in New York; and
- Finally, as a general rule, spend more than six months a year in Florida.

Common sense should prevail in following the aforementioned steps. If there is a good reason for not complying with one or more of the items, the taxpayer should document the reasons why he or she did not comply. The Manual states that individuals do not have to eliminate all of their contacts with New York to be determined nonresidents. In fact, taxpayers are encouraged to continue investing in New York by keeping bank accounts open in the State and seeking expert advice from New York professionals.

Because the legal issue focuses on your intent, there is no prescribed method to ensure New York will agree with your change of domicile. The volume and quality of the evidence of your intent is key. You must be able to prove that Florida is your new place of residence, that it is your permanent home, and not just a domicile for tax purposes.

Of course, the above suggestions are merely a general discussion of the steps to be taken in usual circumstances, and different actions may be advisable under each and every unique set of circumstances. Individuals are encouraged to speak with an attorney or other tax professional before changing their domicile. ■■

PLANNING FOR SPECIAL NEEDS

Since the early 1990's, Supplemental Needs Trusts, also known as special needs trusts ("SNTs"), have been sanctioned by statute and have become an invaluable estate planning tool. These Trusts are funded with assets that will enhance a disabled individual's quality of life without affecting eligibility for government benefits.

Many disabled individuals receive government benefits such as Supplemental Security Income ("SSI") and Medicaid. In order to be SSI and Medicaid eligible, an individual is permitted to have very little in the way of resources and monthly income. If a disabled individual becomes entitled to money as the recipient of a gift, inheritance, the settlement of a lawsuit, or any other source, he or she will be required to spend that money on medical care and living expenses and will lose government benefits such as SSI and Medicaid in the interim.

Federal and State lawmakers have acknowledged that government benefits provide a very minimal level of support, and that a disabled individual's life could be greatly enhanced through the use of SNT assets which would supplement the benefits paid by SSI, Medicaid, and other sources. For purposes of both SSI and Medicaid, the assets placed in a SNT will not be considered a resource to the disabled beneficiary. Thus, the beneficiary is allowed to retain his or her government benefits, and also reap the benefit of expenditures from the SNT.

The Trustee is required to make distributions from the SNT to **supplement**, but not supplant, the government benefits which the beneficiary is receiving. For example, if the beneficiary is receiving SSI benefits which cover all or a part of the beneficiary's food and shelter costs, distributions from the SNT to pay for the beneficiary's monthly rent will reduce SSI benefits. However, direct payments from the SNT for goods and services other than food and shelter will not reduce SSI benefits.

Should the Trustee determine that the beneficiary's Medicaid coverage is insufficient, the Trustee may distribute trust funds to hire companions and aides, undertake home modifications for the beneficiary (such as the installation of ramps and other handicap-accessible features), or purchase a specialized vehicle for transportation. Some of these expenditures may be subject to court approval. Under certain circumstances, the Trustee has the authority to make distributions to improve the beneficiary's quality of life even if a reduction in government benefits will follow.

PLANNING FOR SPECIAL NEEDS (cont'd)

Distributions of cash made from the SNT directly to the beneficiary will be considered income to the beneficiary. Therefore, the SNT Trustee must endeavor to make in-kind distributions on the beneficiary's behalf whenever possible. Examples of appropriate in-kind distributions include the Trustee's purchase of a laptop computer which is owned by the SNT but may be used by the beneficiary. In addition, the Trustee may pay the beneficiary's cable or cell phone bills, and appropriate travel, entertainment and educational expenses.

There are two basic types of SNTs: The "**Self-Settled SNT**," and the "**Third Party SNT**." A Self-Settled SNT is established with property belonging to a disabled individual, including funds from savings, settlements from a lawsuit, inheritance, pension, or other sources. Self-settled SNTs have a **payback requirement**, requiring that any funds left in the trust after the beneficiary's death must be paid back to the N.Y.S. Department of Social Services up to an amount equal to the total Medicaid assistance paid on behalf of the individual. Once Medicaid benefits have been recovered by the State, the remaining trust assets may be distributed pursuant to the terms of the trust. It should be noted that, with limited exceptions, only disabled individuals under the age of 65 may fund a Self-Settled SNT. Furthermore, due to an arguably paternalistic federal law, a disabled individual must rely upon a parent or grandparent to establish the Self-Settled SNT or petition the court for the establishment of the trust, even though the disabled individual's own assets are being used to fund the Self-Settled SNT.

A Third Party SNT is established with assets belonging to a third party who is not the disabled beneficiary and who does not have any legal duty to support the beneficiary. A Third Party SNT may be established either as a lifetime trust or as a testamentary trust created by the third party's Last Will and Testament. Notably, with respect to a Third Party SNT, there is **no pay-back requirement** for amounts of Medicaid assistance paid on the disabled beneficiary's behalf. Accordingly, upon the disabled beneficiary's death, the remaining SNT assets may be distributed to the trust's remainder beneficiaries without State involvement. Moreover, there are no age restrictions on the ability to create a Third Party SNT, and for this reason the Third Party SNT is very useful when planning for the future needs of elderly parents, grandparents, and friends.

For the reasons set forth above, Supplemental Needs Trusts stand as one of the most efficient ways to enhance the lives of disabled individuals in our community. Supplemental Needs Trusts are subject to a variety of State and Federal laws and regulations, and often require the approval of the local Department of Social Services. Clients are advised to speak with an estate planning attorney about the usefulness of Supplemental Needs Trust planning in their particular circumstance. ■■

ESTATE TAX LEGISLATION UPDATE

Under the current law, the estate tax will be repealed in the year 2010 and be reinstated in 2011 at a \$1 million exemption per person and a top tax rate of 55%. There have been many proposals introduced in the House and the Senate in 2009, but a resolution has been slow in the midst of other more controversial pieces of legislation and reforms.

At least one part of Congress has made an affirmative decision on where they see the future of the estate tax. On December 3, 2009, the House approved a measure making the current estate tax permanent. The bill which passed would cement the top estate tax rate at 45% with an exemption level of \$3.5 million per individual. According to various news sources, the Senate now faces a December 31 deadline to address the issue. However, with the majority of attention being placed on health care reform, it is unlikely that any action will be taken until 2010. In addition, some Washington insiders do not believe that there will be enough votes in the Senate to pass this measure, and we may end up with only a one year patch to avoid repeal in 2010.

A patch on the estate tax law would continue the status quo through 2010. Status quo meaning a continued \$3.5 exemption with the top tax rate of 45%. However, many commentators are starting to wonder if the current administration will favor a return to the pre-2001 levels, set to return in 2011, which only provide for a \$1 million

ESTATE TAX LEGISLATION UPDATE (cont'd)

exemption per individual. Many democrats believe the pre-2001 levels were fair enough and provided the federal government with additional funds. In addition, if there is a permanent extension of the current estate tax rate, it is estimated it will cost almost \$234 billion in revenue over 10 years, as opposed to a “revenue neutral” return to the pre-2001 levels.

There are other proposed changes to the estate tax law which seem to be losing steam in Washington. Rep. Earl Pomeroy introduced a bill on January 1, 2009, which would have imposed restrictions on valuation discounts for intra-family transfers of closely held business interests. On November 19, 2009, Rep. Pomeroy introduced a second piece of legislation, but this time excluded the restrictions on valuation discounts. It can be inferred that Pomeroy's ideas in this regard were not well received.

Another proposed change which seems to be losing steam is the idea of “portability” of the estate tax exemption. The portability would allow a married couple to essentially share a joint estate tax exemption of \$7 million. If some of the exemption went unused at the first spouses death, the remainder could be transferred to the surviving spouse, without the use of sophisticated estate planning techniques. The portability provisions were not included in the bill recently passed by the House, but in a similar bill in the Senate, portability remains on the table.

If you have any concerns regarding how any of the proposed changes to the estate tax may effect you, we encourage you to contact your attorney to arrange a time to review your estate plan. ■■

NEWTON'S THIRD LAW: WHEN THINGS ARE DOWN, WHERE IS THE UP?

Most, if not all, family owned and operated businesses are feeling the effects of the current economic downturn. Business owners are tirelessly working to lower operating costs and find new ways to generate revenue in the face of an ever decreasing profit margin. You may recall that Newton's third law of motion tells us that with every action there is always an equal and opposite reaction. So where the market is moving “down”, where do you find “up”?

One upside generated by the down economy is the lowered cost of transferring or succeeding your business to the next generation of ownership. Valuations of most business operations are at historical lows. In addition, interest rates have fallen and will likely remain that way, at least in the short-term. There are various ways to transfer the operation and management of your business to the next generation and at the same time take advantage of these low values.

For instance, selling an interest in your business when the market value is depressed may result in recognizing less capital gain income, which is currently taxed at 15% (pending legislation may increase the tax rate to 20%). However, in the context of family succession, finding ways to transfer your business interest without imposition of tax may be a preferred course.

By implementing a gifting program, you can begin to transfer business interests on a tax free basis. Under current law, a person may transfer up to \$1 million during their life tax free. In addition, a person may transfer \$13,000 per year per individual without the transfer counting towards their \$1 million exemption. This increases to \$26,000 for married individuals who elect to “gift split” with their spouse. Accordingly, a business owner with three children could transfer \$78,000 worth of their business each year, without using any of their \$1 million gift exemption. By gifting when values are low, you can transfer a greater portion of your business each year at a lower cost. As the markets recover, any increased value will also be in the hands of the gift recipients.

Gifting portions of your business each year may also allow the use of various discounts, depending on the structure of your business. For instance, if you gift a non-controlling share of your business, you may be able to apply a discount for lack of control. Similarly, as your business is closely-held a discount for lack of marketability may be applicable. These techniques allow you to further leverage low values to transfer more of your business tax free.

NEWTON'S THIRD LAW: WHEN THINGS ARE DOWN, WHERE IS THE UP?

A grantor retained annuity trust (GRAT) is also a tool which can leverage both the low valuation of your business and the current low interest rates. By placing a portion or all of your business into a GRAT, the future appreciation of your business over the term of the GRAT will flow tax free to your named beneficiaries. This technique allows a business owner to maintain control of their business while moving appreciation and/or control to the next generation.

It is important for any owner of a closely-held family business to plan for the eventual succession or transfer of the business to the next generation. Now is a prudent time to reconsider your plan and the benefits of beginning to transfer interests while values are low. You should consult with an attorney and/or tax professional before implementing any of the above strategies. ■■

Featured Author

Michael D. Gentzle is a graduate of Seton Hall University (B.S., *magna cum laude*, 2003) and Syracuse University College of Law (J.D., *magna cum laude*, 2006).



Mr. Gentzle counsels clients on all aspects of estate and financial planning matters and matters concerning real estate. He is admitted to practice in Florida.



Estate and Financial Planning Department

Since its founding in 1897, BS&K has been committed to helping clients transfer their assets to their families and other beneficiaries in a prudent manner with minimal tax costs. We have met this commitment by offering our clients comprehensive estate planning and administration services which reflect our expertise, experience, and sensitivity to the difficult challenges estate planning and administration present to families. Our clients range from individuals of modest wealth to those of significant wealth, from younger clients building a career to older clients who have already amassed their wealth, from clients who are professionals or employees of larger entities to those involved in family businesses. In addition, we represent universities and other charitable and tax-exempt organizations assisting them in the challenges of raising and administering tax deductible charitable gifts.

Times have changed over our Firm's existence - taxes have become a more pervasive force; wealth has grown among a broader spectrum of clients; forms of wealth such as retirement benefits and life insurance have taken on new significance; and the use of trusts for broad or specific purposes, often related to taxes, has expanded. However, what has not changed is our commitment to treat each estate plan or administration uniquely according to our client's needs, and to provide our attention and skills to ensure optimal results and client satisfaction. We consider our role to be more one of counselors than of technicians. While we provide our clients with our experience, skills, and technical knowledge to ensure successful results, we do not lose sight of our responsibility to counsel clients with respect to the comprehensive best interests of the clients and their families. We strive for an ongoing relationship with our clients knowing that family needs change and estate plans evolve.

Contact: Joseph A. Greenman, Department Chair, 315-218-8178, jgreenman@bsk.com

Department Members



John R.
Aldrich



Arthur E.
Bongiovanni



Dennis C.
Brown



Curtis B.
Cassner



James D.
Dati



David L.
Dawson



Scott J.
DelConte



Michael D.
Gentzle



Joseph A.
Greenman



Brian K.
Haynes



Brian K.
Janowsky



Adam C.
Kerlek



James E.
Mackin



Frank C.
Mayer



F. Joseph
McMackin, III



Elizabeth L.
Perry



William J.
Rubenstein



Martin A.
Schwab



James N.
Seeley



David N.
Sexton



Robert C.
Zundel, Jr.

IRS CIRCULAR 230 DISCLOSURE: IRS regulations require us to notify you that any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of avoiding penalties under the Internal Revenue Code. If you want a further description of this requirement, go to <http://www.bsk.com>.