REPORT #744

TAX SECTION

New York State Bar Association

AUDIT GUIDELINES AND REGULATIONS
GOVERNING NEW YORK STATE RESIDENCY AUDITS:
REPORT AND SUGGESTIONS FOR CHANGE

December 29, 1992

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TAX SECTION
New York State Bar Association

January 4, 1993

The Honorable James W. Wetzler
Commissioner, New York State Department
of Taxation and Finance
W.A. Harriman Campus, Building 9
Albany, NY 12227

Dear Commissioner Wetzler:

I enclose a report on audit guidelines and regulations governing New York State residency audits, which was prepared by the Tax Section's Committee on New York State Matters. Its principal authors are Paul R. Comeau, Mark S. Klein and Sharon M. Kelly. In addition to listing options with respect to changes in the current audit guidelines and regulations, the report notes the possibility of certain statutory changes.

Either I or the preparers of the report will be happy to discuss it with you and your colleagues at your convenience.

Sincerely yours,

John A. Corry
Chair

cc: William F. Collins, Esq.
New York State Department of
Taxation and Finance
W.A. Harriman Campus, Building 9
Albany, NY 12227

Tax Report #744

AUDIT GUIDELINES AND REGULATIONS GOVERNING NEW YORK STATE RESIDENCY AUDITS: REPORT AND SUGGESTIONS FOR CHANGE

NEW YORK STATE BAR ASSOCIATION TAX SECTION
COMMITTEE ON NEW YORK STATE TAX MATTERS

December 29, 1992

I. INTRODUCTION[1/]

Earlier this year, New York State's Commissioner of Taxation and Finance, James W. Wetzler, asked the Tax Section of the New York State Bar Association to suggest possible audit guidelines and improved administrative procedures relating to the State's Residency audits program.[2/] residency audit[3/] generally involve individuals who maintain living quarters in two or more states. The purpose of the audits is to determine whether individuals with a New York residence are “residents” of New York for income tax purposes. Similar issues are involved in determining whether or not a decedent was a resident of New York and therefore subject to New York's estate tax. However, the estate tax aspects of residency are beyond the scope of this report.

1/ This report was prepared by members of the New York State Bar Association Tax Section Committee on New York State Tax Matters. The principal authors are Paul R. Comeau, Mark S. Klein, and Sharon M. Kelly. Helpful comments were received from Seymour F. Bernstein, E. Parker Brown, II, Joyce Calvin, Eugene Chester, William M. Colby, John A. Corry, Haskell Edelstein, Pamela Ehrenkranz, L. William Fishman, David A. Fruchtman, Carolyn Lee Ichel, James A. Levitan, James A. Locke, Philip C. Pinsky, and David E. Watts

2/ New York State has an audit manual for personal income tax audits. This manual does not contain any guidelines for residency audits. Consequently, each district office has the freedom to develop its own audit methodology.

3/ Beginning in 1989, the Department of Taxation and Finance (“the Department”) began a major audit program that targeted individuals who were filing nonresident personal income tax returns. In 1989, the Department audited 2,400 nonresident returns. Approximately half of those audits resulted in a “no change” determination. The remaining 50% brought in approximately $120 million in additional tax revenues. That success has led the Department to increase substantially the number of residency audits it conducts. In 1992, the Department plans to complete more than 6,000 such audits and expects to assess more than $200 million.

This report is the Tax Section's response to Commissioner Wetzler's request. It discusses current law and audit. procedures, points out various policy-based and practical problems with the current system, and suggests possible changes. Although the Tax Section recognizes serious problems and the need for changes, Section members have different views as to the best ways to improve the current system. The suggestions in this report are, therefore, not necessarily consistent with each other. They are more in the nature of options. The Commissioner can choose one or more of these options, depending on tax and economic policy considerations, revenue effects, administrative burden, and so on.

The Commissioner asked for improvements that could be made by regulation or administrative direction, without statutory amendments, and most of the suggestions in this report conform to that limitation. However, several sections (those relating to the 183-day test and to the specific problems of commuters) suggest options that would require statutory implementation.

II. THE LAW REGARDING RESIDENCY

Under New York's personal income tax law, residents of New York pay tax on their entire income, regardless of whether it is attributable to New York activities or property. Nonresidents pay tax only on income that is “derived from or connected with New York sources.” N.Y. Tax L. S 631(a). This includes items of income, gain, loss and deduction attributable to the ownership of real or tangible personal property in New York, or to a business, trade, profession or occupation carried on in New York. Income from intangible personal property, including annuities, dividends, interest, and gain from the sale of such property, is not New York source income to a nonresident unless the intangible

property was employed in a business, trade, profession or occupation carried on in New York.

To be taxed as a New York State resident, an individual must fall within one o-f two categories:

1. an individual who is domiciled in New York, unless the individual maintains a permanent place of abode outside New York, does not maintain a permanent place of abode in New York, and spends less than 31 days in New York during the taxable year;[4/] or

2. an individual who is not domiciled in New York but maintains a permanent place of abode in the State and spends more than 183 days in the State during the taxable year. (Such an individual is commonly referred to as a statutory resident.) N.Y. Tax L. SS 602(b)(1)(A),(B).

New York's residency audits focus on three issues: domicile, statutory residency, and (for nonresidents) allocation of income to New York.

A. DOMICILE

"Domicile" is defined in the regulations as "the place which an individual intends to be such individual's permanent home—the place to which such individual intends to return whenever such individual may be absent." 20 NYCRR 105.20(d)(1). According to commonly quoted case law, the test of intent with respect to domicile is "whether the place of habitation -is the

[4/] There is a second exception, which rarely arises in routine audits, for individuals who spend considerable amounts of time in a foreign country. See N.Y. Tax L. S 605(b)(1)(A).

permanent home of a person, with the range of sentiment, feeling and permanent association with it." Bodfish v. Gallman, 378 NYS2d 138 (3d Dept. 1976). A person can have only one domicile, and once a domicile is established it continues until the individual moves to a new location with the bona fide intention of making his fixed and permanent home there. 20 NYCRR SS 105.20(d)(2),(4). To change his domicile, an individual must abandon his old domicile and establish a new domicile in a new location. Aetna National Bank v. Kramer, 126 NYS 970 (3d Dep't 1911). A person who asserts that he changed his domicile from New York to another location must prove the change by clear and convincing evidence. Under existing case law, an individual's motive for changing his domicile is irrelevant. Estate of Newcomb. 192 NY 238, 251. A tax-motivated move is respected, provided there is a real change of domicile.

B. STATUTORY RESIDENCY

To be a statutory resident of New York, a nondomiciliary must maintain a permanent place of abode in New York and spend more than 183 days of the taxable year in New York.

A permanent place of abode is "a dwelling place permanently maintained by the taxpayer, whether or not owned by him, and will generally include a dwelling owned or leased by his or her spouse." 20 NYCRR $105.20(e). An individual maintains a permanent place of abode "by doing whatever is necessary to continue one's living arrangements in a particular dwelling place. This would include making contributions to the household, in money or otherwise." Matter of Evans. 1992-2 NYTC T-730.

A permanent place of abode must be maintained for "substantially all of the taxable year." Eisner, TSB-A-88(16)I. It must be suitable for year-round habitation and must have cooking and bathing facilities. 20 NYCRR S105.20(e). A dwelling place that is maintained for a temporary stay for a particular purpose (e.g. a two year job assignment to an employer's New York branch office) is not a permanent place of abode. Id. A nursing home is not a permanent place of abode. LaBue. TSB-A-91(10)I.

For purposes of the 183-day test (and the 30-day test for excepting domiciliaries from taxation as residents), any part of a day spent in New York is counted as a day. 20 NYCRR § 105.20(c); Leach v. Chu, 540 NYS2d 596 (3d Dep't 1989). An individual must show that he did not spend more than 183 days in New York in each year under audit.

C. ALLOCATION

A nonresident who carries on a business, trade, profession, or occupation partly within and partly without New York must include a portion of the business income as New York source income. 20 NYCRR § 132.12. For an employee or officer who performs services within and without New York, the apportionment of earnings is based on a ratio of the number of days worked in New York compared to the total number of days worked. 20 NYCRR § 132.18. The taxpayer calculates this ratio on Schedule A of Form IT-203 ATT. Days when a taxpayer performs services outside of New York for his or her own convenience rather than the employer's necessity (i.e., when the work could be performed either in or out of New York) are counted as New York days in calculating the apportionment ratio. See 20 NYCRR § 132.18(a); Matter of Churchill v. Gallman, 38 AD2d 631 (3d Dep't 1971).

III. PROBLEMS WITH CURRENT REGULATIONS AND AUDIT PROCEDURES

New York's tax laws are sometimes abused by taxpayers who live primarily in New York but claim a tax “home” elsewhere, and the State's audit initiative is targeted at these people. However, the absence of clear rules regarding residency means that taxpayers who genuinely reside out of state are also caught up in the audit process. At present, there are no specific guidelines for residency audits; audit methodology and results vary among district offices and among auditors. In some cases, auditors, inspired by aggressive tax department statements,[5/] exceed the bounds of established law. This report suggests clearer rules and safe harbors to create a more uniform audit methodology and more consistent audit results.

A second concern expressed by the Commissioner is the inherent conflict between current residency audit positions that encourage former New Yorkers to sever all ties to New York, and the State's desire to encourage investment, tourism, business, and economic development. New York's residency audits have acquired a reputation of being overly aggressive and unreasonable. Individuals who have experienced these audits, or who have heard them described, often react by radically changing their living and business patterns. They withdraw from New York - physically and economically - and they take their businesses and their employees with them. In addition, tax professionals know that auditors will scrutinize all of a taxpayer's contacts with New York, and that some auditors will find that the taxpayer is a New York resident if he retains only a few incidental ties to New York State. Conscientious professionals, therefore, advise their

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5/ For example, according to a statement by Joseph Catalina, head of the Department's Revenue Opportunity Division, New Yorkers who have retired to Florida but “still hold financial and social ties” to New York are still domiciled in New York for tax purposes.

clients who are moving to terminate all New York contacts: to withdraw all cash and investments from New York State, to dispose of all New York property, proprietorships, partnership interests, and closely held or closely controlled corporation stock, to stop using New York State professionals (bankers, brokers, accountants, attorneys, doctors, dentists, counsellors and so forth), stores, airports, museums, theaters, restaurants, and hotels, to stop making donations to New York-based charities, and to refrain from spending any time in New York State.

Clearly, a regimen of this type is not economically advantageous to New York. It is especially disadvantageous when the former New Yorker also moves his business and all of its employees out of New York (which would be a prudent thing to do since an active New York business connection is usually fatal in a residency audit, see, e.g., Matter of Kartiqaner, 1991-2 NYTC T-1181, Matter of Wechsler, 1991-2 NYTC T-611). Many people move out of New York State,[6/] and many of those who leave have considerable wealth. Forcing such people to sever all ties to the State results in reduced economic activity in the State, lost jobs, a reduction of real estate values, an erosion of the real estate, corporate and individual tax bases, and lost tax revenues."

The approach taken by the State with respect to issues of tax domicile is, in our experience, at odds with the promotion of investment, economic development, business opportunity, and tourism in the State. Some of the changes described in this report could help to reduce the conflicts between the State's tax policy and its economic development policy. For example, the

[6/] According to the Business Council of New York State, 700,000 people moved from New York to Florida during the period 1980-1986. New York's net population decrease during that period was 1.4 million people.

report suggests that certain contacts such as New York bank accounts or contributions to New York charities could be excluded from review in a domicile audit. This type of change would be only a partial “fix”, however. Even with such items excluded from audit scrutiny, a former New Yorker would still be well advised to terminate all contacts with New York and to establish businesses and contacts in the state of his new residence. Under the principles that courts apply to determine domicile in both tax and non-tax cases, such changes would be valuable evidence of his intent to change his domicile.

To eliminate the conflicts between tax policy and economic policy, the domicile part of the residency test would have to be eliminated or drastically curtailed. A new definition of domicile is discussed in section IV(A) below. Elimination of the domicile test would require a statutory change and is therefore beyond the scope of this report. However, since elimination would resolve the conflict between the State's taxation policy on the one hand and its efforts to encourage business and economic development on the other, we suggest that the State seriously review the revenue results of current taxation policies in comparison with the State's other economic goals.

III. SPECIFIC PROBLEM AREAS

A. DOMICILE

The Department's Personal Income Tax Audit Manual does not include any guidelines relating to domicile. The Estate Tax Audit Manual does have a section on domicile audits, including a “Check List for Changing Domicile” and a list of possible external information sources (copies attached). Many personal

income tax residency auditors use the factors on these lists, among others, in determining whether taxpayers are domiciled in New York State. The factors include the location of the taxpayer's banks, brokerage houses, safe deposit boxes, churches, doctors, lawyers, accountants, insurance agents, investments, and business involvements. Where a taxpayer's connections in these areas relate to New York, auditors view them as evidence that the taxpayer did not abandon his or her New York domicile. As discussed in Section III above, this approach encourages former New Yorkers to totally sever their ties to New York, which in turn damages the State's economy.

Domicile determinations are based on “facts and circumstances,” and many different factors are considered. There is no uniformity among auditors as to which factors should be reviewed and how much weight each should be given. Public statements made by state officials have also created uncertainty as to which factors truly relate to domicile. For example, the Commissioner has indicated that the use of a New York tax preparer is not a factor to be reviewed in residency audits, yet Department documents list this as a factor that can trigger a residency audit, and auditors routinely cite to it as a tie to New York. The Department issued TSB-M-84(17)I, stating that contributions to New York charities are not to be considered ties to New York, but auditors often cite such contributions as evidence of retained ties to New York. Governor Cuomo, in a televised interview, said that vacation homes in New York are not a factor in residency audits, yet auditors regularly include such homes as factors tying a taxpayer to New York. See Transcript from Larry King Live, July 24, 1990. The Department's recent TSB-M-92(3)I (copy attached) states that the use of New York banks, securities accounts, and other financial institutions does not subject a nonresident to New York State taxes. However, the

ruling does not address the effect of such use in determining whether an individual is or is not a domiciliary. Many auditors consider New York bank accounts, brokerage accounts, and safe-deposit boxes to be contacts that prevent an individual from being treated as a nonresident. Clearly, more consistent guidelines are required to provide greater certainty for the Department and the taxpayer and to give auditor's a more uniform, solid base from which to conduct domicile audits.

OPTIONS

1. “Domicile” is defined by regulation, and could be redefined. The conflicts between the current domicile test and New York's desire to encourage economic development (see Section III) could be eliminated by defining an individual's domicile as the place he declared to be his domicile on voter registrations, wills, and other official documents (which are often signed under penalties of perjury and have separate (nontax) legal consequences, but which are currently dismissed as “self-serving” by most auditors), and perhaps also requiring that he maintain in that place a place of abode at which he resides with some degree of frequency. The statutory resident test could be used to prevent abuse by persons who make such declarations but continue to live primarily in New York State.

2. The Department should consider establishing a procedure under which individuals can request rulings on their domicile change at the time that change occurs. Once an individual requests such a ruling, the Department would have a period of time (e.g., six months) in which to conduct an “exit audit” of the individual's tax returns and of factors relating to the domicile change. A determination that the individual has changed domicile would be a fact-based ruling and would continue

to apply as long as the facts on which the determination was based remain unchanged. The Department would have the burden of showing that the facts have changed and that the individual has re-established New York domicile. An advance ruling of this type, while it might be unusual, would give exiting taxpayers some certainty concerning their tax status.

3. The Department could clarify that the purpose of a domicile audit is to determine the taxpayer's intention concerning his domicile. Currently, many auditors simply look for New York contacts and reach a conclusion based on those contacts, without considering the way those contacts fit into an overall picture including contacts with the new domicile and expressed intentions concerning domicile.

An Adminstrative Law Judge recently summarized current law as follows: “The question is whether the taxpayer's overall conduct contradicts his or her declared intention of abandoning New York domicile and establishing a new domicile elsewhere. ... In making a determination of domicile, the crucial question is not whether the taxpayer continues to maintain some links to New York, but whether the remaining ties to New York demonstrate that New York is, in fact, the taxpayer's permanent home.” Matter of Entenmann, 1992-3 NYTC J-950. Language similar to this could be incorporated into the regulations or audit guidelines relating to domicile determinations.

4. Where a taxpayer who previously filed resident returns retains a residence in New York and consistently (e.g., at least two years in a row) spends more than a certain number of days in New York (e.g., 122 days), there could be a rebuttable presumption that the individual did not abandon his or her New York domicile. This presumption could be rebutted with proof of a

significant change in lifestyle (divorce, job change, retirement, etc.) or even more time spent in the new state, coupled with significant ties in the new state of domicile.

5. The Department could issue guidance on the relative import of various factors considered in a domicile audit. Some contacts (e.g., active business involvements) could be given greater weight than others (e.g., country club memberships). Currently, each auditor weighs such factors differently. The audit division and taxpayers would benefit from a more consistent approach.

6. Certain contacts that are currently considered to be ties to New York could be excluded from a domicile audit: location of accountants, brokers, bank accounts, attorneys, medical specialists, passive business investments, use of New York airports for travel. Current residency audits penalize former New Yorkers for using New York professionals and financial institutions and for investing money in New York. This approach encourages nonresidents, especially wealthy individuals, to direct their spending and investment outside of New York -- a result that is economically harmful and in conflict with efforts by other State agencies to encourage investment in New York.

7. The presence of family members in New York State could be excluded as a factor in a domicile audit. Auditors often cite taxpayers' emotional ties to children or grandchildren in New York as a reason for finding that the taxpayers have not abandoned their New York domicile, despite the fact that the taxpayers have no control over the location of their adult relatives and the fact that the taxpayers have chosen to separate themselves from their relatives by living elsewhere. In Matter of Buzzard (1992-3 N.Y.T.C. J-762), the taxpayers were treated as

New York domiciliaries because the Administrative Law Judge found that the taxpayers' strongest tie to New York was their “close relationship with their children and grandchildren.”

8. Audit guidelines could emphasize that retention of a residence in New York is not, by itself, sufficient evidence that the taxpayer did not change domicile. Some auditors take the position that a retained residence proves that the taxpayer did not abandon New York. While retention of the traditional family residence is certainly a strong New York contact to be considered along with all others in determining the taxpayer's true intentions, it is not determinative. This has been made clear by the Tax Appeals Tribunal in cases such as Matter of Sutton (1990-1 NYTC T-737) and Matter of Doman (1992-2 NYTC T-442). There would seem to be no policy reason to encourage or require people to sell their New York residences when they move out of state.

9. The Department could make auditors aware of the policy in TSB-M-84(17)I, which states that it is Department policy that making contributions to a New York charity will not be taken into account in determining domicile, and clarify the type of charities to which the TSB-M applies. Many auditors are unaware of this policy and consider New York charitable contributions as evidence of the taxpayer's ties to New York; this discourages taxpayers from contributing to New York charities. Other auditors who are aware of the ruling take the position that it does not apply to contributions to churches, temples and other religious organizations, to local charities such as volunteer fire departments and police benevolent associations, or to political contributions.

10. An individual who has filed nonresident returns for five or more consecutive years without being audited could be presumed to have changed his domicile, and the burden of proof would then shift to the Department to prove that domicile has changed back to New York. Taxpayers often assume that such a consistent filing pattern without an audit means that the State has accepted their change of residence, and they then discard old documentation that would help them prove their domicile change, such as moving receipts, outdated wills, old vehicle registrations, letters of resignation, old telephone and utility bills and so on. These records are not business or tax return preparation documents and are routinely discarded by most individuals on a periodic basis. It is not appropriate for the State to make such persons prove their domicile change after the State has led them to assume that their nonresident status has been accepted.

B. STATUTORY RESIDENCY

A nondomiciliary who maintains a permanent place of abode in New York must be able to prove, for each taxable year, that he did not spend more than 183 days in the State. He is required to keep “adequate records” to substantiate this (20 NYCRR §105.20(c)), but there are no guidelines as to what constitutes adequate records. Many auditors take the position that every day is a New York day unless the taxpayer proves otherwise, even when this is not logical (e.g., when a taxpayer can prove she was in Florida on a Monday and the following Friday, it is not logical to assume she was in New York on Tuesday, Wednesday and Thursday). When a taxpayer can prove that he was in a state bordering New York on a particular day, auditors sometimes take the position that he could still have come into New York on that day. In these situations, it can be

impossible for a taxpayer to prove that he did not spend some time in New York. There is no statutory basis for this presumption that every partially or fully undocumented day is a New York day.

The rules with respect to a “permanent place of abode” are clearer than those for day count, but there are still gray areas relating to the meaning of “maintain” and “permanent”, and to situations where spouses maintain separate residences.

OPTIONS

Counting and Substantiating Days Spent in New York Note that some of these options, indicated with an *, might require statutory implementation.

1. The Department could clarify the application of the statutory residency rules in a year in which a taxpayer, under the domicile test, is a part-year resident. For example, how, if at all, is the 183-day test applied in the year in which a taxpayer changes his domicile to or out of New York? A taxpayer who spends January through August in New York, changes his domicile out of New York on September 1, remains out of the State until December 31, and retains a permanent place of abode in New York through the end of the year, could be a resident for the entire year if the 183-day test applies without modification. A taxpayer who wants to avoid the uncertainty and who wishes to change residence part way through a year would be forced to dispose of his residence. If he was unable to complete the sale of his residence in the year of his move, he would be taxable as a New Yorker for the entire year. Since the statutory residency rules apply only to nondomiciliaries, a special, transitional rule could be applied in years where a taxpayer is a domiciliary

for part of the year and a nondomiciliary for part of the year. For example, the number of New York days required to establish statutory residency for the nondomiciliary period could be one half of the total number of days in the nondomiciliary period.

2*. Days spent in New York at a location that is not within a reasonable commuting distance (e.g. 100 miles) of an individual's New York house or apartment could be excluded from a count of New York days. For example, if a nondomiciliary who maintains an apartment in New York City vacations in Niagara Falls, the vacation days would not be regarded as New York days for the 183- day test. This would reinforce the linkage between the two parts of the statutory resident definition (permanent place of abode and more than 183 days) and would be compatible with the State's goal of promoting tourism. It would also put taxpayers who maintain a residence in New York but vacation at another location in New York on the same basis as visitors who do not maintain a residence. Under the present law, individuals who do not have a permanent residence in New York can rent a vacation home for almost the entire year without being taxed as residents.

3*. Days worked in New York by an individual who commutes to and from New York each day could be excluded from a count of New York days for the 183-day test. New York wages and other New York source income would still be taxed, but a true “commuter” who happens to own or rent a house or apartment in New York would not be treated as a New York resident.

4. The Department has already recognized that certain days spent in New York “involuntarily” do not count as days in New York State for purposes of the 183-day test: days on active military service (20 NYCRR 105.20); inpatient days in a hospital

(Stranahan v. New York State Tax Commission, 416 NYS2d 836 (3d Dep't 1979); days spent in a nursing home (LaBue, TSB-A-91(10)I). The Department could create a general rule that “involuntary” days will not be counted as New York days. In addition to those described above, these might include days when a taxpayer was present in New York to care for a sick parent or child, attend a funeral, appear in court or at administrative hearings, or receive hospital care as an outpatient, days spent in jail or prison, and days spent in New York because of flight cancellations or other travel problems beyond the taxpayer's control.

5. The Department has stated that an individual's presence in New York will be disregarded, for purposes of the 183-day test, where her presence is solely for purposes of boarding a plane, ship, train or bus for travel to a destination outside New York, or while traveling through the State to a destination outside the State. 20 NYCRR § 105.20(c). The Department could clarify that individuals are in New York solely for such travel purposes even if they make telephone calls or purchase meals or other items at airports or terminals, conduct automatic teller machine (ATM) transactions, stop for gas or a meal while driving through the State, are inadvertently detained because of flight cancellations or similar problems, stop to pick up a travelling companion en route to the airport or terminal, park their car in New York in order to meet a limousine or other conveyance that takes them to the airport or terminal or to a destination outside of New York, or perform other activities that are incidental to their travel. The travel exception could also be reworded so it applies to disembarking from a plane, ship, train or bus, as well as boarding such conveyances.

6. The Department could specify what types of documentation constitute “adequate records” for establishing day count. Where entries in a contemporaneous diary or appointment calendar are substantiated, at least in part, by external documentation such as telephone bills, credit card receipts and travel itineraries, and the entries are not contradicted by external documentation, the entire diary or calendar could be presumed to be an accurate record of the taxpayer's location. In determining whether diary entries are contradicted by external evidence, a few inconsistencies would not negate a general conclusion that the diary entries are accurate. This “de minimis” rule is necessary because individuals do not always follow through on plans that they diary, and because external documentation may be inaccurate (e.g., the dates on credit card receipts are often incorrect because the establishment accepting the card fails to adjust the date mechanism on credit card equipment).

7. When a taxpayer's diary or other evidence shows that he was out of New York on a particular date, and there is no evidence that he was in New York on that date, this could create a rebuttable presumption that the day was not spent in New York. Currently, auditors often discount evidence that an individual was in a state bordering New York (e.g., Connecticut or New Jersey) and insist that the individual prove he did not come into New York at some other time during that day. This places an impossible burden of proof on taxpayers.

8. When a taxpayer's diary or other evidence shows that she was out of New York on non-consecutive days, and there is no evidence that she was in New York on the intervening days, this could create a rebuttable presumption that the intervening

days are not days spent in New York. Currently, some auditors allow this type of “blocking,” but others do not.

9. When a taxpayer's typical travel pattern or general lifestyle indicates that weekends are normally spent outside New York, this could create a rebuttable presumption that Saturdays, Sundays and holidays are not days spent in New York.

10. The fact that a taxpayer indicates a certain number of New York work days on a nonresident return for allocation purposes should not automatically be treated as an admission that she was physically present in New York on those days. Different rules (e.g., the employee's convenience rule) apply for purposes of calculating days for allocation purposes.

11. The Department could redefine “day” so that a day is a day in New York only if the taxpayer stays overnight in New York.

12. The Department could redefine “day” so that part days in New York would be counted fractionally rather than as full days.

(Although “day” is defined by regulation and not by statute, the Department may feel that options 11 and 12 above should be enacted by legislation rather than administratively.)

Permanent Place of Abode

1. A New York residence that is listed for sale by a taxpayer who has moved out of the State could be deemed not to be a permanent place of abode unless the taxpayer actually used the residence as a place of abode after moving out of state.

2. In divorce situations, a residence used by one former spouse could be deemed not to be a permanent place of abode for the other former spouse, even if the residence is owned jointly or by the nonresident spouse and the nonresident spouse pays the mortgage or other expenses.

3. Where spouses are separated in fact, even without a legal separation order, a residence used by one spouse could be deemed not to be a permanent place of abode for the other spouse unless the nonresident spouse treated the residence as his or her abode during the separation period.

4. A residence that is maintained by one individual but used exclusively by others (e.g., a parent or a child), could be deemed not to be a permanent place of abode for the individual who maintains it. This situation arises, for example, where parents maintain a residence for a child who is attending college in New York.

C. ALLOCATION

Under the current rules for allocating personal service income, an out-of-state work day is counted as a New York day if the work was performed out of state because of employee convenience rather than employer necessity. 20 NYCRR § 132.18(a); Matter of Churchill v. Gallman, supra. If the state where the

services are performed also taxes these services, double taxation could result.

The United States government taxes the personal service income of nonresidents based on the location where the service was performed. Internal Revenue Code (IRC) §§ 861(a)(3), 862(a)(3). Work performed outside the United States is not included in United States source income, even if the work was performed outside of the country for the convenience of the taxpayer. Where work is performed both within and without the United States, income is generally allocated to the United States based on the ratio of days worked in the U.S. to total days worked. However, regulations allow taxpayers to use other allocation methods to correctly reflect the proper source of the income, depending on the facts and circumstances of each case. Treas. Reg. §.861-4(b).

OPTIONS

1. The Department could, to the extent possible, bring its allocation rules into conformity with federal rules.

2. Where the “days worked” allocation is used, part days could be used to calculate the allocation fraction. For example, an individual who worked half a day in New York and half a day in New Jersey would include “0.5” in the numerator (for the half-day worked in New York), and “1” in the denominator. This provides a more equitable allocation that treats part-days worked outside New York the same way as part-days worked in New York.

3. The Department could abandon the regulatory rule that days worked out-of-state for a New York employer count as days worked in New York if the taxpayer works out-of-state for her own convenience. This test is needlessly complex, requiring proof of not only the location of services but also the reason the services where performed outside New York. This adds subjectivity and ambiguity to an area that requires more objectivity and clarity. In addition, the New York employer requirement can be easily avoided by establishing a new corporation in the state where the services are performed so that the employee is then working for an out-of-state employer. The application of the “convenience” rule has caused closely held businesses to move out of New York State to the state of their CEOs’ residence, a result that is at odds with the State's efforts to attract businesses.

D. PROOF

A taxpayer has the burden of proving that she changed her domicile and, if she retained a residence in New York, that she did not spend more than 183 days in New York. Early cases required that taxpayers meet the domicile burden of proof with “clear and convincing” evidence, and that standard is often applied to both domicile and day count issues. The meaning of “clear and convincing” is not clear. Each judge seems to have a different view, including “preponderance of the evidence” and “beyond a reasonable doubt.” As it is currently applied, the “clear and convincing” standard seems excessive, since it can seriously impair an individual's right to move from one state to another.

OPTIONS

1. Regulations could provide that the burden of proof for domicile change and days spent in New York be “preponderance of the evidence.” As applied, the clear and convincing standard often requires taxpayers to show that they severed all their ties to New York. Any continuing contacts with the State can mean that the taxpayer's abandonment of New York is not “clear and convincing”.

2. Auditors could be empowered to accept, as evidence with some weight, written or oral sworn statements by taxpayers. Where such testimony is not contradicted by other evidence, it could be accepted as truthful. In residency cases that reach the Administrative Law Judge level, the determinative factor with respect to domicile change and day count is often credible testimony from the taxpayer. See, e.g., Matter of Fiore, 1992-3 NYTC J-802. However, there is no mechanism for the taxpayer's testimony to be taken into account at the audit level. Auditors typically require third party, written evidence and give no weight to statements by taxpayers concerning their intentions when they moved or their whereabouts on specific dates. In addition to creating an extremely difficult burden for taxpayers, this approach often results in taxpayers becoming angry and uncooperative because they see the auditor's refusal to accept their word as an accusation of lying and abuse of the audit function.

E. SETTLEMENT

Residency audits can be very involved and time consuming. They are especially distressful for taxpayers because they are concerned more with lifestyle than with tax reporting; some auditors are uncomfortable with residency audits for the same reason.

Residency cases are often settled on a compromise basis at the audit level or at a conciliation conference, and the Department should encourage auditors to settle cases on a reasonable basis whenever possible. Taxpayers may agree to be taxed as residents for some, but not all, of the years under audit. Alternatively, taxpayers may agree be taxed as residents for all years under audit provided they receive a determination that they changed their domicile by the end of the last year being audited. Auditors are generally reluctant to settle a case by splitting one year into resident and nonresident parts.

OPTIONS

1. In settling domicile cases, auditors could be allowed to agree that domicile changed part way through a year, so that the taxpayer would be taxable as a resident for part of that year and as a nonresident for the remainder of the year.

2. To assist in reaching settlements, the Audit Division could be empowered to affirmatively state, in writing, that a taxpayer's domicile changed as of a specific date.

3. In settling residency cases, an auditor could be allowed to include in the settlement a determination with respect to other open years. For example, a settlement of an audit

dealing with 1988-1990 could include a determination that the taxpayer was or was not a resident in 1991, even though 1991 was not one of the years covered by the original audit.

F. PROCEDURE

In most cases, the first communication a taxpayer receives from the Department with respect to a residency audit is a letter stating which years are being reviewed, and a questionnaire requesting information on domicile and number of days spent in New York. Auditors then follow up with additional questions and document requests. Taxpayers and their representatives are not always responsive to auditors' requests for information, and do not always respond promptly to such requests. If it appears that an audit cannot be completed before a statute of limitations runs out, the auditor may send the taxpayer a request to extend the statute.

In some cases, this orderly procedure is not followed. An audit is commenced near the end of a statute of limitations period, and the first communication the taxpayer receives includes a request for voluminous documentation and a statement that the taxpayer will be assessed as a resident unless all the requested material is produced within two or three weeks and the taxpayer agrees to extend the assessment limitations period. Such requests can be unreasonable, and assessing additional taxes automatically unless the taxpayer agrees to extend the assessment limitation period is an abuse of New York Tax Law §683, which requires that assessments be made within three years of the filing date of a return.

The binding effect of a determination that a taxpayer did change his domicile is unclear. Taxpayers who have been audited and who have received a determination from the Department that they did change their domicile out of New York are sometimes audited again for subsequent years, and the previous determinations concerning their domicile change are not always respected.

The imposition of penalties in residency audits is also an area that lacks uniformity. Currently, some district offices appear to impose penalties automatically, while other offices rarely impose penalties. The penalties that are imposed are usually those under §§685(b)(1) and (2) (negligence) and §685(p) (substantial understatement of liability).

OPTIONS

1. Because residency audits may require auditors to review large amounts of documentation, and taxpayers may have to obtain records from other sources (e.g., an attorney, an accountant, airlines, banks, credit card or utility companies, or a residence in another state), a reasonable period of time should be allowed to conduct a thorough audit. The Department could rule that audits cannot be started unless the parties would have at least 90 days (without extending the assessment limitation period) to present and review materials.

2. The Department could authorize the issuance of written closing agreements relating to a taxpayer's liability, and such agreements would be final and conclusive with respect to the matters covered by the agreement, including a determination that the taxpayer changed his domicile. Under the current system, many taxpayers whose audits result in a “no change” do not

receive any written determination concerning domicile, permanent place of abode, or days spent in the State. Such taxpayers are sometimes reaudited for later years and forced to prove their change of domicile a second time. Section 171 of the Tax Law authorizes the Commissioner to enter into written agreements relating to tax liabilities, and such agreements are to be final and conclusive as to the matters agreed upon. One of the matters agreed upon in such an agreement could be a change of domicile, since this relates directly to the individual's tax liability.

3. Once the Department recognizes that a taxpayer changed her domicile out of New York (e.g. in a “no change” determination, an audit settlement, a conciliation agreement, a Division of Tax Appeals determination, or a written closing agreement as described above), a regulation could specify that the Department should have the burden of proving, in any subsequent audit, that the taxpayer changed her domicile back to New York. This is consistent with the regulation that puts the burden of proof concerning a change of domicile on the party asserting the change. 20 NYCRR § 105.20(d)(2). A taxpayer with a permanent place of abode in New York would continue to have the burden of proof concerning day count.

4. The Department could clarify the use of penalties in residency audits and clearly describe the necessary elements for waiving such penalties.

G. COMMUTER ISSUES

The residency rules can be particularly onerous for taxpayers who commute to or from New York. Under existing rules, such taxpayers may be taxed by more than one state, with no credit for taxes paid to other jurisdictions. Note that the following options would require statutory implementation.

OPTIONS

1. A taxpayer who has paid income tax as a resident of a state other than New York and who is subsequently treated as a New York resident for the same tax year could be allowed a credit, on her recalculated New York tax liability, for income taxes paid to the other state, provided the period during which she can claim a tax refund from the other state has expired prior to New York's determination of residency. At present, such a credit is allowed only for income tax relating to income derived from the other state. Taxpayers who are found to have been residents of New York, therefore, may pay tax to two states on the same income, with no credit for taxes paid to the other jurisdiction. See e.g., Leach v. Chu, 540 N.Y.S.2d 596 (3d Dep't 1989).

2. The State should consider entering into a personal income tax compact with neighboring states to establish a common definition of residency and a system for determining residency so that a taxpayer will be taxed as a resident in only one state. The current system, which allows multiple taxation, encourages neighboring states to take inconsistent positions with respect to residency.

3. The State should consider working with neighboring states to develop a multi-state tax return so that taxpayers with taxable income from more than one state can file a single return that correctly allocates income and tax liability among the different states.

Attachments:

Estate Tax Audit Manual: Check List for Changing Domicile and list of information sources
TS3-M-92(3)I

State of New York - Department of Taxation & Finance

Estate Tax – Audit Guidelines

DOMICILE AUDIT AND INVESTIGATION PROCEDURE

10/27/89

AU-94 (2/88)

Department of Texation and Finance – Audit Division

Transaction and Transfer Tax Burssu

Home Cir and Transfer Tax Season

Check List For Changing Domicile

(a season unread change must)

Name of estate_____ Date of death_____

Country_____ Social Security number_____

Yes	No.		Remarks.
☐	☐	1. Register to vote – Did the Decedent vote in the state of the old domicile? Under no circumstances should the individual have Voted in the state of the old domicile.	_____
☐	☐	2. Certificates of Dimicile – if the new state issue a corthless of domicile (Florida for example), did the decodent apply for such a cortilicum?	_____
☐	☐	3. Banking – Did the decedent Close all checking accounts And savings accounts in the old open them in the new store?	_____

☐ ☐ 4. Brombarage – if the decendent Used a brombarage lims to purchase securities Was a local bromrage form of local branch of a national film used? Were new securities purchased using the address of the new domicile? Were securities hold by a bromarage film trasfered to the new domiciles? _____

☐ ☐ 5. Croft cards – were credit card Companies notified of the new Address of the decedent and were All comepondenes and bills mailed to the new address? _____

☐ ☐ 6. Other's License – Did the decedent Apply for a drther's hones in the New state of domiciles? _____

☐ ☐ 7. Car Registrastion – Did the Decedent Surrender all car registrations to the old state of domiciles and register the vehicles in the new state of domiciles? _____

☐ ☐ 8. safe deposit – Did the decedent Cancel arty homes in the old state and open new safe deposit homes in the new state? Did the decedent transfer Stacis and bonds and other securities From old states to new stats? _____

☐ ☐ 9. Charches – Did the decedent join join a local church, synagogus etc? Car Registration – Did the decedent local arty homes in the old state and Open new safe deposit homes in the New states? Did the decedent transfer Stais and bonds and other securities From old states to new stats? _____

☐ ☐ 10. Asther in community – Did the Decedent became active in the New community or in local Politics? _____

☐ ☐ 11. Social Security – if the decedent Was receiving Social security Checks, were the checks mailed to The new domicile or a local Bank? _____

☐ ☐ 12. Will –Did the decedent retain a lawyer in the new domicile and have a new will proposed, stating that the new address was the domicile of the decedent? _____

Exhibit c

State of New York - Department of Taxation & Finance

Estate Tax – Audit Guidelines

DOMICILE AUDIT AND INVESTIGATION PROCEDURE

10/27/89

All-005 (3/88)

Department of Taxations and Finance – Audit Division

Transaction and Transfer Tax Bureau

Home Cir and Transfer Tax Season

Case investigation Plan – External Source Check List

Name of estate_____ Tis as resident_____

Country_____ Tis a non-resident_____

Date of death_____ Absent in Depute_____

Roof Codes		Roof Codes	
_____	AARP	_____	Insurance companies
_____	Accountant	_____	Laundry
_____	Airport Security	_____	License and Regulation Bureau
_____	Alcoholic Beverage Central	_____	Liquor Startles
_____	Asimey	_____	Lyeds Register of Shipping
_____	Banks	_____	Lyeds Register of Yechte
_____	Board of Elections	_____	Local Yacht and ship Brolmr’s association
_____	Brokers (Investors)	_____	Megatons and papers
_____	Clubs	_____	Medical Service Companies
_____	Country Asesor’s Office	_____	Motor Vehicles-Department of
_____	Country alert’s Office	_____	Moving Companies

_____ Country Department of Naturalization

_____ Country tax collector's Offices

_____ Credit card companies

_____ Credit supporting agencies

_____ Doctors

_____ Domestic help

_____ Drug stores

_____ Dun and Bradstreet

_____ Electric and gas company

_____ Employer – prior

_____ Federal Aviation Administration

_____ Federal Immigration and Naturalization service

_____ Gasbag

_____ Hair stylist

_____ Harbor Petrol

_____ Hospitals

_____ New York Social Register

_____ Nursing homes

_____ Passport Div. U.S. State Department

_____ Post office

_____ Racing Commission – State

_____ Real estate

_____ Restaurant Stands

_____ Restaurant

_____ Tax resumes (federal Safe)

_____ Income

_____ Corporation

_____ Other

_____ Telephone Company

_____ T.V. Cable Company

_____ Water Company

_____ Other External Securities as required

_____ _____

_____ _____

_____ _____

_____ _____

Exhibits

New York State Department of Taxation and Finance
Taxpayer Services division
Technical Services Bureau

THIS COPY IS SENT TO YOU
FOR YOUR INFORMATION FROM
MARK S. KLEIN

TSB-M-92
(3) Income Tax
(1) Estate and Gift Tax
October 9, 1992

New York's Tax Policy Relating to the Taxation of Intangible Personal Property of Nonresidents

The New York State Tax Department periodically receives inquiries from nonresidents or their representatives and from financial institutions as to what, if any, New York tax consequences may result if a nonresident individual, estate or trust maintains bank accounts or keeps securities or other intangible property with financial institutions in New York State. An explanation of this issue follows.

General

New York State has long maintained a tax policy that encourages nonresidents to keep their money, securities and other intangible property in New York State. In 1938, the continuation of this policy was firmly established in section 3 of Article XVI of the New York State Constitution, which provides, in pertinent part, that:

> "Moneys, credits, securities and other intangible personal property within the state not employed in carrying on any business therein by the owner shall be deemed to be located at the domicile of the owner for purposes of taxation, and, if held in trust, shall not be deemed to be located in this

> state for purposes of taxation because of the trustee being domiciled in this state... Intangible personal property shall not be taxed ad valorem nor shall any excise tax be levied solely because of the ownership or possession thereof, except that the income therefrom may be taken into consideration in computing any excise tax measured by income generally."

The application of this constitutional provision to the various taxes administered by the New York State Tax Department is described below.

New York State Personal income Tax

The New York State Personal Income Tax is imposed upon the New York source income, as defined in section 631 of the Tax Law, of every nonresident individual, estate or trust. Section 631(b)(2) provides that income from intangible personal property, including annuities, dividends, interest and gains from the

constitute New York source income only to the extent it is attributable to property employed in a business, trade, profession or occupation carried on in New York by the estate, trust, or partnership.

Estate and Sift Taxes

Section 960 of the Tax Law imposes an estate tax on the net estate of nonresident decedents only to the extent of real and tangible personal property having an actual situs in New York

State. The Tax Commission ruled on June 15, 1939, that a nonresident may maintain a bank account and keep his or her bonds, shares of stock and other intangible personal property in a safe deposit box, or in safe-keeping custodial or trust accounts in New York, or establish a trust in New York with a New York trustee without fear that the state of New York will assert a death tax on the transfer of the intangibles even though the administrator, executor or trustee is a New York resident or corporation. In addition, on August 12, 1942, the Tax Commission ruled that neither under the New York State Estate Tax Law nor under the New York State Constitution may intangibles of nonresident decedents be subject to the New York estate tax.

Section 1003 of the Tax Law provides that the New York taxable gifts of a nonresident are limited to transfers of real and tangible personal property having an actual situs in this state and to transfers of moneys, credits, securities and other intangible personal property within the state employed in carrying on any business therein by the donor. Accordingly, unless the intangible property has a business situs in this state, no gift tax liability would be incurred by a donor who is not domiciled in this state, even if the transfer was effected by the creation of a trust.

Generation-Skipping Transfer Tax

Section 1022 of Article 26-B of the Tax Law imposes a generation-skipping transfer tax upon every generation-skipping transfer that includes New York property. Section 1021 defines New York property as real and tangible personal property having an actual situs in this state, intangible property within this state that is employed in a business, trade, profession or occupation carried on in this state and intangible property where the

original transferor was a resident of this state at the time of the original transfer.

assets upon the death of the owner. (Section 13-3.4 of the Estates, Powers and Trusts Law.) This section provides that a New York custodian of personal property might deliver it to a foreign fiduciary without ancillary proceedings in New York State.

Summary

In summary, a nonresident may maintain a bank account, and keep bonds, shares of stock and other intangibles in a safe deposit box, or in safe-keeping, custodial or trustee accounts, or establish a trust (of intangibles) with a trustee in New York State, without the fear that New York State, New York City or Yonkers will assert:

(1) a property tax;

(2) a personal income tax on the interest, dividends, gains or other income therefrom, except to the extent the intangibles are employed in a business, trade, profession or occupation carried on in this state;

(3) a death or estate tax upon death, even though the administrator, executor or trustee is a New York resident or corporation;

(4) a personal income tax against a trust created by

a nonresident or a nonresident beneficiary of any such trust, except to the extent the intangibles are employed in a business, trade, profession or occupation carried on in this state;

(5) a gift tax other than on the transfer of intangibles employed in a business carried on in this state by the donor; or

(6) a tax on generation-skipping transfers against a trust created by a nonresident, except to the extent that the transfer consists of intangibles within this state employed in a trade, business or occupation carried on in this state, or where the original transferor was a resident at the time of the original transfer.

Furthermore, the domicile of the trustee, beneficiary or donee is not a factor in determining the imposition of the estate tax, gift tax or generation-skipping transfer tax.