Commercial/Bankruptcy/Tax Law

Will COVID-19 Affect Your Clients' New York State Tax Residency?

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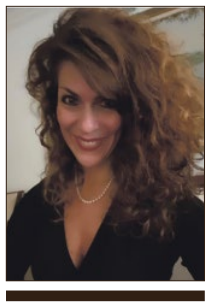

Marisa Friedrich

The shelter-in-place rules imposed by many states, including New York, during the coronavirus pandemic, led many to leave their homes. In New York City, residents exchanged their cramped apartments for suburban summer homes in less densely populated areas with more living space and a backyard.

Others opted to leave New York altogether, moving to second homes owned or rented in other states. Months later, these individuals have grown fond of their new locations (and perhaps their reduced income tax exposure as well). They now do not wish to return to their pre-COVID lifestyles. Can these individuals establish the necessary intent so as to establish their new domicile?

First, it is important to understand how New York taxes its residents. Residents are taxed on all their worldwide income, regardless of where it is sourced. Nonresidents pay tax only on income earned in New York, such as wages or rental income earned in the state.

To be considered a resident of New York for tax purposes, an individual must meet either the Domicile test or the Statutory Residency test. Note that New York City has its own distinct income tax which applies to city residents.

Domicile Test

A person can only have one domicile but many residences. Domicile is defined as the place the taxpayer considers their permanent home. It should be noted that the burden of proof is on the party asserting a change in domicile: in this case, the taxpayer. The domicile test is based on several factors, and looks to determine where the taxpayer's true home lies. How is this intent shown?

A person's intent is objective and difficult to quantify. New York provides five primary factors which must be analyzed to determine a taxpayer's domicile. The five primary factors are home, business involvement, time, family connections, and items near and dear. These factors demonstrate through subjective means the person's objective intent. The phrase "actions speak louder than words" may come to mind. An analysis of all the facts and circumstances is necessary.

The "Home" factor involves a comparative analysis of the use, maintenance, value, and size of each home. Another relevant factor is whether the taxpayer has severed roots in the old community while establishing connections in the new community. However, establishing new ties may be more difficult to prove as a result of the COVID pandemic.

Active participation in the daily management of a business is strong evidence of one's domicile for the "Business Involvement" factor. The location of the taxpayer's primary office or the degree to which the taxpayer remains involved in the day-to-day operations of a New York business could be evidence of the place the taxpayer considers his domicile. As such, if the taxpayer has moved out of New York but is still heavily involved in the operations of a business in New York, the taxpayer may be considered a resident for tax purposes.

The "Time" factor considers the amount of time the taxpayer spends in New York State as against the amount of time spent in the new domicile. New York often focuses on whether there has been a significant shift in time between New York and the new domicile, or in the taxpayer's pattern of life when compared to years prior. If a taxpayer has left either New York City or New York State, the burden of proof falls on the taxpayer to establish that he is spending significantly more time in the new domicile. Producing this evidence can be onerous. It may require reviewing personal calendars, flight records, credit card statements, and cell phone records.

The "Family Connections" factor examines the taxpayer's family structure in order to help determine where he is domiciled. Historically, where the taxpayer's school-aged children were attending school was dispositive. During the shut down and shelter-at-home orders, however, most schools were closed, and remote learning was implemented. As a result, children may still be associated with the old domicile's school district even if the children were physically located elsewhere. Note that auditors will be looking at what taxpayers do once the COVID crisis has ended.

"Items Near and Dear," also referred to as the teddy bear test, examines where the taxpayer keeps sentimental and valuable possessions. Moving items to the new domicile may be indicative of the taxpayer's intention to change domicile. Similarly, leaving possessions in the old residence can be construed as having the intention to remain in, or return to, the old domicile. It may have been difficult during the shutdown to hire a moving company to transfer items to the new domicile. However, smaller items, such as photo albums, easy to transfer collectibles, even one's pets, can provide evidence of one's intent to establish a new domicile.

There are several less significant "other" factors which are also considered. They include obtaining a driver's license, registering to vote, registering one's vehicles, and making a domicile declaration at the new domicile, to name but a few. However, during

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WE CARE ...

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procedures have to be made for the safety of everyone involved, the WE CARE Fund can still remain a beacon of light for those in need.

Looking at the time, effort, and work that go into all that WE CARE does, it would be difficult to find another group of individuals whose passion, dedication, and generosity rivals that of the members involved with WE CARE. Mister Rogers once said, "We live in a world in which we need to share responsibility. It's easy to say 'It's not my child, not my community, not my world, not my problem.' Then there are those who see the need and respond. I consider those people my heroes." The members of WE CARE see the need, and respond. They share the responsibility, put in the extra work, and help, in any way they can.

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Residency ...

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the shelter-in-place timeframe, and depending on the executive orders in place at the new domicile, establishing any of the "other" factors may have been difficult due to government agencies being closed indefinitely.

Statutory Residency Test

An individual who is not domiciled in New York can still be a resident under the Statutory Residency test. It applies when a taxpayer maintains a *Permanent Place of Abode* in New York for substantially all of the year and spends more than 183 days in the state. Snowbirds, who successfully change their domicile to another state but keep a place in New York, can fall into this category. If they spend too many days in New York, they end up being treated as statutory residents and taxed accordingly. It should be noted that statutory residency is only important for income tax purposes, while domicile is relevant to both income and estate taxes.

COVID-19 Problems

The COVID-19 crisis may have led some taxpayers to change their activities in such a way as to affect their residency for tax purposes. Starting in 2021, state auditors are likely to examine the following issues to ascertain residency:

- **How much time was spent in the state?** Many with multiple homes made decisions about where to shelter based on the severity of COVID-19 in the respective areas, which could cause problems under both the domicile and statutory residency tests.
- **Did the taxpayer become more involved in out-of-state business interests?** As businesses struggled, a part-owner may have taken a more active role in a business located outside the state in which he or she resides, which could impact their residency status.
- **Was a move out of state subsequently negated?** When New York was hard hit by COVID-19, people moved elsewhere. However, auditors will examine the taxpayer's move months or years later. They will be on the lookout for taxpayers claiming a move was a permanent change in domicile, but subsequently the taxpayer took actions that indicated it was really a temporary move to get through the COVID-19 crisis. As a result, they will be judged as a state resident retroactively and get hit with a commensurate tax bill.
- **Did the taxpayer work from home out of convenience or necessity?** Where a taxpayer lives and works in different states, he or she may be subject to taxation in more than one state. However, various rules affect when someone is considered to have worked "in-state," such as whether it was for convenience or necessity.

Recently, New York State has quietly issued guidance on telecommuting outside of the state as a result of the COVID-19 pandemic. Essentially, New York State has confirmed its existing rules that if you are a nonresident and your primary business office is located in New York, those telecommuting days are still considered "days worked in the state unless your employer has established a bona fide employer office at your telecommuting location." The usual factors must be applied to determine if the telecommuting location constitutes a bona fide employer office.

Also note that while the taxpayer may be entitled to a tax credit on earned income, there is no tax credit on intangible income such as interest and dividends. State rules vary so it is important for clients to speak with a tax professional. These and other actions can be problematic for many taxpayers who may have inadvertently put themselves at risk of an audit and significant tax liability.

Advising Clients

Attorneys often are in a position to know a great deal about their clients' lives. Therefore, they are able to anticipate when their clients could face a potential tax residency issue. Informing clients about a potential tax problem is an invaluable service that could prevent or limit exposure.

A client with multiple homes should consult a tax professional (tax attorney and/or accountant) as soon as possible to specifically evaluate the risks of a residency audit. While it may be too late in some instances to fix an existing problem, in most cases there are steps which can be taken to minimize the damage or at least prepare for it financially. If an audit does result, a tax professional is essential to help ensure the client puts the strongest case forward to avoid or minimize liability.

New York State is also facing mounting financial pressures due to the pandemic and lost revenue from closed businesses and unemployment. It appears likely that New York will be more assertive than usual in finding sources of tax revenue. Increasing the number of residency audits can satisfy the need for lost revenue in that audits usually target higher income individuals. As a result, clients need to be properly prepared.

Conclusion

In weighing all of the factors involved, asserting a change of domicile involves more than physically moving out of New York City or New York State or obtaining a driver's license at the new domicile. Given the constraints imposed by the shelter-in-place rules as well as the congruent shutdown of many businesses and government agencies, it may be harder to prove a change of domicile than usual.

While a change of domicile may not be shown to have been established at the time the taxpayer left either New York City or New York State in response to the shelter-in-place orders, it may still be shown, perhaps at a later date. The burden that must be met is substantiating the primary factors by clear and convincing evidence. Consulting a tax professional for assistance is the first step in this process.

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Roundup ...

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"cash for keys" deal to vacate the house in exchange for a cash payment.

However, the Judge did not decide the separate and ultimate question of whether the actual sale transaction would be approved under 11 U.S.C. § 363(b) as being in the best interests of the estate.

Patrusky: Attachment of Judicial Liens to Debtor's Property

In *In re Patrusky*, the debtor owned a home worth about $800,000.[8] After incurring significant debt, she transferred the house to her daughter and son-in-law for about $500,000. After that transfer, a creditor entered a judgment for about $480,000 in the county where the home was located.

In an attempt to enforce the judgment, the creditor brought an action to avoid the transfer as a fraudulent conveyance. The house was then transferred back to the debtor for no consideration, and then she filed bankruptcy. The debtor filed a motion to avoid the judicial lien as impairing her homestead exemption under 11 U.S.C. § 522(f), claiming that the total of the judgment, the mortgages on the house, and the homestead exemption exceeded the value of the house.

Judge Trust denied the motion and was affirmed by the District Court. On appeal to the Second Circuit, the ruling was affirmed again, relying on the U.S. Supreme Court ruling in *Farrey v. Sanderfoot*[9] and the Second Circuit's ruling in *In re Scarpino*[10] The Court found that a judicial lien can be avoided under Section 522(f) only if the lien attached to property the debtor already owned. Here, the judgment lien became fixed simultaneously upon the debtor's reacquiring title to the home.

Finally, the debtor argued that by virtue of the fraudulent transfer being void (as opposed to voidable) she still retained an equitable interest in the property. The Second Circuit concluded that since such transfers are voidable, and not void, the judicial lien in question attached simultaneously with the debtor's acquisition.

Jeff Morgenstern maintains an office in Carle Place, where he concentrates in bankruptcy, creditors rights, and commercial and real estate transactions and litigation.

1. *Plaza v. Heilbron*, No. 1-18-01055-ess, 2020 Bankr. LEXIS 106 (Bankr. E.D.N.Y. Jan. 15, 2020).
2. *Hlady v. Key Bank N.A.*, 616 B.R. 257 (Bankr. E.D.N.Y. 2020); *see also Brunner v. New York State Higher Educ. Svcs. Corp.*, 831 F.2d 395 (2d Cir. 1987).
3. *In re Telles*, 2020 Bankr. LEXIS 1167 (Apr. 30, 2020).
4. *Id.* (citing *Roman Catholic Archdiocese of San Juan v. Acevedo*, 140 S. Ct. 696 (2020)).
5. *In re Ventura*, 615 B.R. 1 (Bankr. E.D.N.Y. 2020).
6. 11 U.S.C. § 1190(3).
7. Case No. 20-10948 (Bankr. E.D.N.Y. Sept. 25, 2020).
8. 8-16-75552-ast (Bankr. E.D.N.Y. Apr. 25, 2018), *aff'd, Patrusky v. Jungle Treats, Inc.*, 599 B.R. 202 (E.D.N.Y. 2019), *aff'd, In re Patrusky*, 797 Fed.Appx. 653 (2d Cir. 2020).
9. *Farrey v. Sanderfoot*, 500 U.S. 291 (1991).
10. *In re Scarpino*, 113 F. 3d 338 (2d Cir. 1997).

Experts ...

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Rules of the Commercial Division expressly provides for the "identification of experts, exchange of reports, and depositions of testifying experts."[11]

While expert disclosure under the CPLR is limited, the disclosure should identify the documents the expert relied on in forming his/her opinion, the theories of liability that will be relied upon, and the nature and relevance of the expert's testimony.[12]

It is essential to comply with all applicable expert disclosure requirements and procedures to avoid the preclusion of expert testimony. Further, even if not required, an early, meaningful exchange of expert information, including reports, may lead to a favorable settlement.

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1. This article does not discuss the rules and procedures that are specific to experts in medical malpractice cases.
2. *Santariga v. McCann*, 161 A.D.2d 320, 321 (1st Dept. 1990); *see also Oakwood Realty Corp. v. HRH Const. Corp.*, 51 A.D.3d 747 (2d Dept. 2008).
3. 2 N.Y. Practice, Com. Litig. in New York State Courts § 5:19 (5th ed.).
4. *Coleman v. Richards*, 138 A.D.2d 556 (2d Dept. 1988).
5. *Rowan v. Cross Cty. Ski & Skate, Inc.*, 42 A.D.3d 563, 564 (2d Dept. 2007) (trial court properly denied motion to preclude expert from testifying, where defendant served expert disclosure two weeks before trial).
6 .*Id.*
7. *Caccioppoli v. City of New York*, 50 A.D.3d 1079, 1080 (2d Dept. 2008),
8. *See Kassis v. Teacher's Ins. & Annuity Ass'n*, 258 A.D.2d 271, 272 (1st Dept. 1999).
9. *See Cela v. Goodyear Tire & Rubber Co.*, 286 A.D.2d 640, 640 (1st Dept. 2001) (despite evidence of intentional withholding of expert disclosure until after note of issue was filed, it was appropriate to give plaintiff "a final opportunity to comply" with CPLR 3101(d)(1) demand, "in view of [defendant's] failure to demonstrate any actual prejudice").
10. 22 NYCRR §202.70.
11. *Id.*
12. *Inwood Sec. Alarm, Inc v. 606 Rest., Inc.*, 35 A.D.3d 194 (1st Dept. 2006); *Durant v. Shuren*, 33 A.D.3d 843 (2d Dept. 2006).

Judge ...

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ation of the Pro Bono Mediation Program and the formation of the E.D.N.Y. Consumer Lawyer Advisory Committee.

The bankruptcy bar of the Eastern District of New York congratulates Judge Trust in being appointed to Chief Judge and has no doubt that the Court will continue to flourish under his stewardship.

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