Staying One Step Ahead of Multistate Residency Audits

By Jonathan Mariner and Karen Tenenbaum, Esq. – January 24, 2017

With many state budgets facing potential deficits, and elected officials reluctant to raise taxes, state taxing authorities are under increased pressure to find new revenue sources.

To help bridge those funding gaps, many have now targeted one potential revenue source that doesn't have the same political backlash as raising taxes: Unpaid taxes owed by non-domiciled taxpayers subject to multistate-residency taxation.

Unfortunately, many individuals do not appreciate how easily they may find themselves subject to multistate-residency taxation, and so they fail to maintain and provide pertinent tax and financial information to their CPAs. Therefore, it's crucial for CPAs to proactively request information in order to protect themselves and their clients. When it comes to residency issues, a few questions today can go a long way towards ensuring taxpayers are not at risk of an audit after filing their returns.

"Do You Have Multiple Residences?"

Clients may not realize the problems that can arise from that vacation home in another state, a convenience apartment in Manhattan, or snowbird lifestyle in New Jersey and Florida. Second homes offer convenience and luxury. Unfortunately, they can also cause significant tax issues when more than one state considers your client a resident for income tax purposes.

Clients who are found to be domiciled in a state other than their declared home state, or who have met certain thresholds based on their travel and time spent in that additional state, are at risk of being taxed on all of their income. That also includes passive income (interest and dividends), capital gains and other income — regardless of whether they are derived from activities in their declared home state.

Accordingly, if a client does have a second home out of state, CPAs should ask them to memorialize and provide additional information about how and where they spend their time.

In most states there are two general tests for residency: The first test looks at the taxpayer's domicile — that is, the location of the one place the individual intends to have as a permanent home. States will look at a range of factors, such as where the individual's family resides, where he/she conducts business activities, and the relative use and size of each home.

"How Many 'Days' Do You Spend in the State?"

Even if your client is not considered a domicile of a particular state, they could still be considered a resident for income tax purposes under day- or month-count thresholds for determining residency, which vary from state to state. Of the 43 states with an income tax, there are only 11 different thresholds that determine permanent residency. These include those that count more than 183 days (the most common), more than 270 days, or more than six months, seven months or nine months. It is crucial to know the applicable day count to avoid inadvertently crossing the threshold and being subject to taxation in that state.

Along with the day count, many states also have a requirement that the taxpayer have an "abode," or may require that the taxpayer stay overnight before the day counts as a day for residency purposes. For example, in New York, your client must maintain a "permanent place of abode" and spend more than 183 days of the year in New York. A "permanent place of abode" is defined as a residence (building or structure in which a person can live) that is maintained by the taxpayer for substantially all of the year and is suitable for year-round use. Even if others are using the place (relatives, renters, etc.), it could still be considered your client's abode under certain circumstances.

New Jersey generally provides that a place of abode is not "permanent" if it is maintained only during a temporary stay for the accomplishment of a particular purpose (e.g., a temporary job assignment). However, depending on the length of a temporary stay (e.g., does it span more than one year?), and other related factors, a taxpayer could subsequently be deemed to be a resident. Also, New Jersey does not consider a home used only for vacations to be a permanent one. When it comes to the day count, in New Jersey, there are no temporary or transitory exceptions other than for certain aliens temporarily in New Jersey. Therefore, any time your client is physically present in New Jersey, it is treated as a day for statutory residency purposes.

"Do You Have Documentation of How Much Time You Spend in Each State?"

Residency audits are very document-intensive and personally invasive. Your clients have the burden to prove their whereabouts. This means they must prove a negative: that they were not in the state. Auditors can look at their appointment calendars, credit cards, passports, phone bills, and other documents, as well as smartphone applications that track and record location, to determine whether your client has met either of the tests for residency.

As a CPA, if you think your client is at risk of an audit, the best practice is to advise them to keep careful records of their whereabouts. There are various travel-tracking apps that can help keep accurate records, but regardless of the method they use, the key point to stress is that their documentation can be the deciding factor in whether or not they face a large tax bill.

If your client has received a residency questionnaire or is being audited, there are a number of options available for resolving the tax dispute. Contact a qualified attorney or CPA to assist you.

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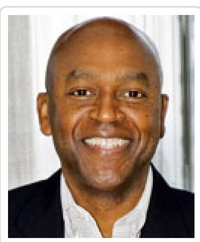

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Jonathan Mariner is the former EVP and CFO of Major League Baseball, and is currently the Founder and President of TaxDay, a travel-tracking mobile app that makes it easy for individuals who maintain residences in multiple U.S. states (or travel frequently between states for business) to securely document their travel and protect themselves from residency-related tax penalties.

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