Beyond 183 Days: Comparing Tax Residency in California and New York

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Introduction

Many high-net-worth foreign nationals are interested in purchasing residences and spending extended time in the United States but do not want to accidentally become U.S. taxpayers. While the initial inquiry from a foreign national might concern federal income and perhaps estate and gift tax, practitioners planning for high-net-worth foreign nationals should also consider state income and estate taxes in advising such clients.[1]

The rules governing state tax residency differ from federal tax residency and vary by state. This article discusses the general rules of tax residency for income tax and estate tax[2] as applied to non-citizens under federal law as well as under the laws of California[3] and New York,[4] the two most populous U.S. states that impose a state income tax.[5]

Income Tax

U.S. Federal Tax[6]

The United States imposes federal income tax on the worldwide income of individuals who are considered U.S. residents for federal income tax purposes. In contrast, non-residents generally are subject to U.S. federal income tax only on certain U.S.-source income and on income that is (or is deemed) effectively connected with a U.S. trade or business.[7] In general, foreign nationals are considered U.S. tax residents if they are lawful permanent residents (i.e., green card holders) or if they meet the "substantial presence" test.

With respect to each calendar year, "substantial presence" is satisfied if an individual is present[8] in the United States for at least 31 days and has an adjusted day count of at least 183 days. The adjusted day count equals the sum of (i) the number of days present in the United States for the current year, plus (ii) 1/3 of the number of days present in the United States for the preceding year, plus (iii) 1/6 of the number of days present in the United States for the second preceding year.[9]

For any particular tax year, an exception to the substantial presence applies if the foreign national (i) is present in the United States for fewer than 183 days, and (ii) has a "tax home" in and a "closer connection" to a foreign country.[10] A "tax home" is an individual's principal place of business or, if none, his or her regular place of abode.[11] Notably, the "tax home" must be maintained for the entire year.[12] To determine whether the foreign national has a "closer connection" with a foreign country than with the United States, the IRS will consider various factors, including the location of the foreign national's permanent home, family, business activities, social ties and personal belongings.[13]

California

Generally, California residents are taxed on their worldwide income, whereas nonresidents are taxed only on their California-source income. Under California law, an individual is a tax resident if he or she is "in California for other than a temporary or transitory purpose," or "domiciled in California but . . . outside the state for a temporary or transitory purpose."[14] Whether a stay is temporary or transitory depends on the particular facts and circumstances of each case.[15] California will determine residency based on the "closest connection,"[16] looking at factors similar to the federal factors, including the location, size and value of all of the individual's residences, the place where the individual's spouse and children reside, state registration for business licenses, voting, driver's license and automobiles, location of business activities and social connections, and the number of days the individual spends in California as compared to other states, among other factors.[17]

While the day count is an important factor in determining California income tax residency, it is not alone dispositive.[18] In the only published case to consider the California state tax residency status of a non-domiciliary, the court, taking into consideration all factors, found that the taxpayers were nonresidents, notwithstanding that during the audit years they averaged almost six months per year in California and only one to three months in their state of domicile.[19]

An individual who merely passes through California en route to another state or country, or stays in the state for a brief rest or vacation or for specific business purposes (e.g., to complete a transaction, to perform a particular contract, or to fulfill a particular engagement), is in California for a temporary or transitory purpose.[20] Conversely, an individual is not in California for a temporary or transitory purpose if he or she is there "for a business purpose which will require a long or indefinite period to accomplish, or is employed in a position that may last permanently or indefinitely, or has retired from business and moved to California with no definite intention of leaving shortly thereafter."[21] Importantly, there is a presumption of residency where a non-domiciliary spends at least nine months during the year in California.[22] However, spending fewer than nine months in California does not create a presumption of non-residency. Because California residency begins when an individual enters the state for a non-temporary, non-transitory purpose and ends when he or she permanently leaves California, individuals may be part-year tax residents.

New York

Generally, New York residents are taxed on their worldwide income, whereas nonresidents are taxed only on their New York-source income.[23] An individual will be considered a New York State resident if he or she (i) is domiciled in New York,[24] or (ii) maintains a permanent place of abode in New York for substantially all of the taxable year[25] and spends more than 183 days of the taxable year in New York.[26]

Under New York law, "domicile," or an intended permanent home, is established by considering a variety of factors, with no single factor alone determinative. The five primary factors are: (i) one's use and maintenance of a New York residence as compared to the nature and use patterns of other residences outside of New York; (ii) the location of items that one holds "near and dear"; (iii) where one spends time during the year, based on cell phone records, credit card statements, bills, etc.; (iv) one's family connections in New York; and (v) one's active business involvement in New York.[27]

An individual "maintains" a permanent place of abode by "doing whatever is necessary to continue one's living arrangements in a particular dwelling place . . . [including] making contributions to the household, in money or otherwise."[28] A permanent place of abode does not include a "mere camp or cottage," nor does it include "barracks or any construction which does not contain . . . facilities for cooking, bathing, etc."[29] Moreover, the "permanent" nature pertains both to physical aspects and to the individual's relationship to the place.[30]

Estate Tax

U.S. Federal Tax[31]

A U.S. resident is subject to estate tax on the value of his or her worldwide taxable estate at death, whereas a non-resident is subject to estate tax only on the value of his or her U.S. situs assets, including intangibles, at death. For the purposes of the estate and gift taxes, residency is determined based on domicile. The regulations define a "resident" for federal estate tax purposes as follows:

> A "resident" decedent is a decedent who, at the time of his death, had his domicile in the United States . . . A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.[32]

Once domicile has been established, it remains in place until a new domicile is acquired.[33] Where there is doubt, the presumption is that domicile has not changed.[34] Note that a non-citizen can form the requisite intent to remain indefinitely, even where she has not obtained a green card or is here illegally.[35]

New York State Tax

As with the federal estate tax, the New York state estate tax is based on domicile. Tax residence for estate tax purposes is derived from case law.[36] The estate of a New York domiciliary is subject to New York estate tax on the decedent's worldwide assets, reduced by the value of real or tangible personal property having an actual situs outside of New York, and increased by certain taxable gifts that were not otherwise included in the decedent's U.S. federal gross estate.[37]

Conversely, the estate of a non-domiciliary of New York is only subject to New York estate tax on the decedent's New York situs tangible and real property, which is either (i) includible in such decedent's U.S. federal gross estate or (ii) would be includible in such decedent's New York gross estate if the individual had been a resident of New York.[38]

Conclusion

Practitioners advising foreign nationals on estate and tax planning matters should be aware of the potential state tax implications of spending time in a particular state, even if the individual's foreign country of citizenship has entered a bilateral tax treaty with the United States. Although a planning structure may otherwise insulate a foreign national from federal tax liabilities, it is important to remember that the test for residence may differ for state tax purposes. Despite similarities among the U.S. federal and California and New York state tax regimes, there are meaningful differences in how each jurisdiction determines "residence" for tax purposes. As discussed above, (a) U.S. federal income tax residency is based on a day count, with a limited exception for certain closer connections to a foreign country; (b) U.S. federal estate and gift tax residency is based on domicile; (c) California state income tax residency is based on domicile and whether the taxpayer's presence in or out of California is temporary; (d) New York state income tax residency is based either on domicile or on a day count and the maintenance of a permanent home in New York; and (e) New York state estate tax residency is based on domicile. To protect foreign nationals from potential adverse tax consequences in various jurisdictions, practitioners should carefully consider the possible jurisdictions to which clients have ties, how those jurisdictions define residence and domicile, and whether any situs property is involved.

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Endnotes

1 In this regard, we note that U.S. bilateral tax treaties do not apply to state tax.

2 The definitions of "resident" for U.S. federal gift and estate tax purposes are essentially the same.

3 California does not impose an estate or gift tax.

4 New York imposes income and estate taxes. Although New York does not impose a gift tax, gifts made within three years of death can be subject to New York state estate tax.

5 *See, e.g., https://www.census.gov/popclock/.* Texas and Florida do not impose a state income tax on individuals.

6 References to the "IRC" are to the Internal Revenue Code of 1986, as amended, and references to a "Treas. Reg." are to the regulations promulgated thereunder.

7 Generally, an individual who was not a U.S. resident in the preceding year and who becomes a U.S. resident in the current year is considered a U.S. resident as of the first day during the calendar year on which the individual is present in the United States. IRC § 7701(b)(4).

8 With certain exceptions (e.g., for unanticipated medical conditions), an individual is treated as "present" in the United States on any day during which he is physically present for any period of time. Treas. Reg. § 301.7701(b)-1(c)(2)(i).

9 IRC § 7701(b)(3)(A).

10 IRC § 7701(b)(3)(B). To qualify under this exception, the individual must file a statement with the IRS explaining the basis for the claim.

11 Treas. Reg. § 301.7701(b)-2(c)(1).

12 Treas. Reg. § 301.7701(b)-2(c)(2).

13 *See* Treas. Reg. § 301.7701(b)-2(d) (listing all factors relevant to determining a "closer connection").

14 Cal. Rev. & Tax. Code § 17014(a). Domicile is "the one location with which for legal purposes a person is considered to have the most settled and permanent connection, the place where he intends to remain and to which, whenever he is absent, he has the intention of returning . . .," and a change of domicile requires "clear proof of a concurrent intention to abandon the old domicile and establish a new one." Appeal of Salinger, 80-SBE-080 (internal citations removed).

15 *See* Cal. Rev. & Tax. Code § 17014(b).

16 *Id.* ("The underlying theory of Sections 17014-17016 is that the state with which a person has the closest connection during the taxable year is the state of residence").

17 *See* Appeal of Bragg, 2003-SBE-002 (May 28, 2003).

18 *See, e.g.,* Appeal of Whittell, 62-SBE-042 ("The time element, however, is one of the most important factors in determining residence").

19 *Klemp v. FTB*, 45 Cal.App.3d 870 (1975).

20 Cal. Rev. & Tax. Code § 17014(b).

21 *Id.*

22 Cal. Rev. & Tax. Code § 17016.

23 A part-year resident pays taxes on all income during the residency period and any New York-source income during the non-resident period. NYS Tax Law § 638.

24 Under an exception, a taxpayer will not be treated as a resident based on domicile if (i) he does not maintain a permanent place of abode in New York, maintains a permanent place of abode elsewhere, and spends no more than 30 days of the taxable year in New York, or (ii) (a) within any period of 548 consecutive days, he is present in one or more foreign countries for at least 450 days, (b) during such 548 day period, the taxpayer, his spouse (unless legally separated), and his minor children are not present in New York for more than 90 days and (c) during the non-resident portion of the taxable year in which the period of 548 consecutive days begins and the non-resident portion of the taxable year in which the period ends, the taxpayer is present in New York for a number of days not exceeding an amount that bears the same ratio to 90 as the number of days contained in that portion of the taxable year bears to 548. NYS Tax Law § 605(b)(1)(A).

25 *See* State of New York – Department of Taxation and Finance, Income Franchise Field Audit Bureau (December 2021, Section VI.D) (defining "substantially all of the taxable year" as a period exceeding 10 months).

26 NYS Tax Law § 638. Any part of any day spent physically in New York, including days in transit, counts as a day of presence in New York. N.Y.C.R.R. 105.20(c). Because residency is determined in part by day count (183-day rule), generally a part-year resident is a person whose domicile changes to or from New York State during a tax year.

27 Nonresident Audit Guidelines, State of New York – Department of Taxation and Finance, Income Franchise Field Audit Bureau (December 2021). The Guidelines have no legal force or effect, but the factors set forth therein are drawn from case law. *See* N.Y.C.R.R. 2375.12.

28 Matter of Evans, Tax Appeals Tribunal (June 18, 1992, *confirmed* 199 AD2d 840, 606 NYS2d 404).

29 N.Y.C.R.R. 105.20(e).

30 *Evans*, *supra* note 28.

31 The tests for residency and domicile under the U.S. federal gift tax are virtually the same as those for the estate tax. U.S. residents are subject to gift tax on all completed gifts made to any person, including a trust. IRC § 2501(a)(1); IRC § 2511(a). Non-residents are subject to gift tax only on completed gifts of U.S. real property and U.S. situs tangible personal property. IRC § 2501(a)(2); IRC § 2511(a). Neither New York nor California imposes a gift tax.

32 Treas. Reg. § 20.0-1(b)(1).

33 *Mitchell v. United States*, 88 U.S. 350, 353 (1974); *Estate of Nienhuys v. Commissioner*, 17 T.C. 1149, 159-61 (1952); *Estate of Kahn*, 75 T.C.M (CCH) 1597, 1604 (1998) ("Domicile is not changed even by long continued absence if there is any intention of returning.").

34 *Kahn* at 1602.

35 *See*, *e.g.*, Rev. Rul 80-363, 1980-2 C.B. 249.

36 *See*, *e.g.*, In re Woodward's Estate, 123 N.Y.S.2d 765 (Sur. Ct. 1953), *order aff'd*, 283 A.D. 846, 128 N.Y.S.2d 587 (4th Dep't 1954).

37 NYS Tax Law § 954(a).

38 NYS Tax Law § 960(a).