REPORT #776

TAX SECTION

New York State Bar Association

FEBRUARY 17, 1993 RESIDENCY AUDIT GUIDELINES:

PRACTICAL EXPERIENCE AND SUGGESTED CHANGES

COMMITTEE ON NEW YORK STATE TAX MATTERS

DECEMBER 13, 1993

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TAX SECTION

New York State Bar Association

December 23, 1993

<u>Via Federal Express</u>

Hon. James W. Wetzler
Commissioner of Taxation and Finance
State Campus - Building No. 9
Albany, New York 12227

Dear Commissioner Wetzler:

Enclosed herewith are five copies of a report of the Tax Section's Committee on New York State Tax Matters dealing with practitioners' experiences under the February 17, 1993 New York Nonresidence Audit Guidelines (the “Guidelines”). This Report was prepared at your request, and reflects the results of an informal survey of Tax Section members as well as extensive discussion in the Tax Section's Executive Committee.

The Report concludes that the Guidelines have failed in their attempt to provide taxpayers and their advisors with a reasonable degree of assurance that the residency audit process will be conducted in a fair and balanced way. To the extent that the Guidelines were motivated by a desire to prevent damage to the New York economy from taxpayer response to perceived unfairness in the residency audit process, the Report concludes that they have fallen far short of their objective.

Many practitioners remain highly concerned over the rules contained in the Guidelines relating to issues of domicile, statutory residence and allocation of income. Equally important, many practitioners feel that residency audits are conducted in an arbitrary, burdensome and unfair manner.

The Report addresses the issues of audit standards and procedures in considerable detail. First, specific revisions to the Guidelines are proposed as follows: to reorder the priorities and burden of proof in the “domicile” area; to modify the “day count” and “permanent place of abode” concepts in the statutory residence area; and to make certain changes in allocation of income rules.

Even if these changes were made, however, serious problems would remain because of the widespread perception that the residency audit process is unfairly administered. To deal with this concern, the Report recommends certain procedural changes in the residency audit process, most importantly, the establishment of an <u>ombudsman</u> in the Commissioner's office to whom taxpayers would have direct recourse with respect to residency audits. By short-circuiting the audit and review process and giving taxpayers direct access to a high-level tax administrator, this proposal might be helpful in altering long held and deeply felt taxpayer concerns.

Given the public perception of the problems in this area, there is no assurance that even the substantial changes recommended in the Report would achieve the objectives which motivated the promulgation of the Guidelines. The only alternative we see in such event would be changes in the relevant State and New York City legislation.

If you have any questions, please call me.

Yours truly,

Peter C. Canellos

Tax Report #776

FEBRUARY 17, 1993 RESIDENCY AUDIT GUIDELINES: PRACTICAL EXPERIENCE AND SUGGESTED CHANGES

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

DECEMBER 13, 1993

I. INTRODUCTION

This report[1], prepared at the request of New York State Commissioner of Taxation and Finance James Wetzler, discusses the content of the February 17, 1993 New York Nonresident Audit Guidelines, summarizes the recent experiences of many practitioners representing taxpayers under audit, and recommends various changes to the Guidelines.

At the outset, we commend the Department for recognizing the existence of problems in its residency audit program and for promulgating Guidelines designed to strike a balance between the Department's responsibilities and taxpayers' rights. There is no doubt that the Guidelines are the product of a thoughtful, diligent, well-intentioned work effort. Unfortunately, the preponderance of practitioners who responded to our request for reactions to the Guidelines report that the practical effect of the Guidelines has been quite limited, and that experience in the field continue much the same as before. Indeed, there continues to be considerable vitriol in practitioners' assessments of residency audits. The damage to New York's economy caused by earlier audit techniques continues to reverberate. In our assessment, therefore, the audit Guidelines have not effectively gotten the word out -- to auditors, practitioners or the public -- that things have changed. We believe more decisive administrative or legislative action may well be necessary to

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[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 author was Paul R. Comeau. Helpful comments were received from E. Parker Brown, II, David Sunning, Peter Canellos, John A. Corry, William M. Colby, Peter Faber, Abraham Gutwein, Robert S. Herbst, Robert A. Jacobs, Sharon M. Kelly, Mark S. Klein, Judith E. Lansky, Carolyn Joy Lee, Robert Levinsohn, Joseph Lipari, Robert D. Plattner, Robert Plautz, Arthur R. Rosen, Michael Schler, Michael Schlesinger, James W. Shea, Charles Simmons, Carlton M. Smith and Eugene L. Vogel.

reduce the problems that persist in residency audits.[2]

II. BACKGROUND

New York residents are taxed on all income from all sources, while nonresidents are taxed only on New York source income. New York State Tax Law §605(b)(1) defines the term "resident" as follows:

> A resident individual means an individual:
>
> (A) who is domiciled in this state, unless, (i) he maintains no permanent place of abode, maintains a permanent place of abode elsewhere, and spends in the aggregate not more than thirty days of the taxable year in this state, or...[special rule for domiciliaries living in a foreign country] or
>
> (B) who is not domiciled in this state but maintains a permanent place of abode in this state and spends in the aggregate more than one hundred eighty-three days of the taxable year in this state, unless such individual is in active service in the armed forces of the United States.

A nondomiciliary with a permanent place of abode in New York is a "statutory resident" if s/he spends more than 183 days in New York during the tax year. This is a more or less "mechanical" statutory test, complicated somewhat by definitions of "maintain," "permanent place of abode," and "day," and by the burden of proof regarding a taxpayer's daily presence in or out of New York.

Domicile, by contrast, is a vague concept that is not defined by statute and is susceptible to varied interpretations.

[2] For a discussion of rules prior to the February, 1993 Guidelines, and a detailed discussion of options for change, see New York State Bar Association Tax Section, Committee on New York State Tax Matters, Audit Guidelines and Regulations Governing New York State Residency Audits: Report and Suggestions for Change, Dec. 29, 1992, reprinted in State Tax Notes, January, 1993.

Regulations and case law refer to an individual's permanent home, the place to which an individual intends to return whenever absent. Once established, domicile continues until the person proves, with clear and convincing evidence, that s/he has abandoned the old domicile and established a new domicile. The key element of every definition of domicile is “intent” -- the individual's own intent. “Proof” of domicile consists of statements of intent coupled with acts confirming that intent.

In the past, auditors have cited various theories to challenge purported changes of domicile. In some instances, auditors focused on retained New York contacts, while in others they found insufficient contacts with the new “home” state. Administrative tribunals and judicial courts have often upheld assessments based on these divergent theories, resulting in a growing body of law that imposed an increasingly difficult burden of proof for taxpayers to overcome.

III. FEBRUARY 17, 1993 GUIDELINES

On February 17, 1993, the New York State Department of Finance, Division of Taxation, published residency audit Guidelines -- instructions for auditors who conduct residency audits. These Guidelines, the first adopted for use in personal income tax audits, attempt to balance the rights of taxpayers against the Department's obligation to determine whether an individual is a New York resident and has properly allocated income and deductions to New York.

Unquestionably, New York' has the right to protect and police its revenue base. Individuals may claim nonresident status while maintaining a house in New York, engaging in business in the State, conducting other significant activity in New York, or maintaining other ongoing contacts. If these individuals are, in fact, New York residents, they should pay their fair share of taxes to the State. The audit program is designed to identify these individuals while minimizing the compliance burdens imposed on legitimate nonresidents.

The Guidelines recognize that residency audits may adversely impact the New York economy. First, the factual inquiries underlying the audits focus on whether the individual has sufficiently abandoned New York domicile and established significant ties in the claimed home state. Residency audits thus encouraged the severance of New York economic ties, such as bank accounts, professional relationships, business ownership and operation, and real estate ownership. Auditors, often upheld in their actions by courts with limited powers of review, have granted favorable nonresident treatment only to those individuals who have substantially reduced or eliminated their New York presence and New York activities. Second, the residency audit process is perceived to be highly burdensome and unfair, causing many individuals to avoid all contact with New York to eliminate the costs and risks of an audit.

The new Guidelines attempt to focus the auditor's attention on the audit program's underlying purpose:

> The nonresident...audit program...is designed to...select taxpayers who may owe additional tax. [It]...is not designed (1) to extract taxes from nonresidents which are not due, or to (2) place a heavy burden on taxpayers to prove domicile or to verify their physical location on every single day..or to (3) discourage...former...residents from returning... to visit family, to do shopping and otherwise take actions which bolster the New York economy.

Guidelines §312.1 at page 1.

The Guidelines ask auditors to apply a practical, common-sense approach and to step into the shoes of the taxpayer. For instance, in statutory residence cases where the 183-day rule may be the central focus, the Guidelines offer the following example:

> Take...the individual who maintains a permanent place of abode in New York and is a domiciliary of New Jersey. If the individual works two or three days a week in New York and spends the rest of the time at home in New Jersey, what proof should the auditor expect? Think for a minute of the proof that you as an individual may have that you spent a weekend at home watching T.V., doing gardening or some other activity. Can you provide convincing evidence that you spent that entire weekend at home?

Guidelines §312.1 at page 3. A more general admonition is set forth at the bottom of the same page:

> Audit staff should balance the audit process to insure that the revenues of New York State are protected and at the same time economic activity by non-residents in New York is encouraged and that the burdens placed on taxpayers are minimized.

IV. OPERATING UNDER THE GUIDELINES -- GENERAL COMMENTS

The foregoing policy statements enunciated in the Guidelines thoughtfully articulate the concerns that must be balanced in conducting residency audits. A number of practitioners have reported that the conduct of residency audits has improved since the promulgation of the Guidelines and that the general principles articulated in the opening pages of the Guidelines have had a positive effect.

However, many other practitioners report that much of the favorable “policy” language in the first pages of the Guidelines is effectively countermanded by the specific instructions contained in the next 45 pages. Many practitioners and taxpayers have as a result come to view the Guidelines as a well-intentioned but ineffective effort, an inconsistent combination of beneficial policy statements that are negated by the focus of auditors on the more specific instructions that authorize burdensome and economically disruptive audits. For many practitioners, the net effect has been that most residency audits are as difficult as ever.

Why is this occurring? Practitioners cite several reasons. For one, the Guidelines instruct auditors to examine virtually every document and contact ever identified in a decided case. This creates the impression that auditors are looking for needles in a haystack -- shreds of residual New York contact that may be accumulated to create doubt regarding the taxpayer's claimed status.

With respect to domicile, the most amorphous statutory concept, auditors are told that formal acts, such as declarations of intent and other “self-serving statements” (e.g. voter registration, driver's license), should be accorded less weight than informal acts. With respect to informal acts, auditors are told to focus on the retention of New York ties, not the establishment of ties in the new location. Auditors too often trivialize steps taken in the new location (the purchase of a home, community activities, business interests) while magnifying the importance of remaining New York connections, such as retention of a New York house or business. This lack of balance creates a heavy burden of proof for nonresidents, one that-many practitioners fear cannot be overcome by statements of intent, formal acts or a preponderance of ties or contacts in the new location, but only by the severance of almost all, if not all, New York ties.

Auditors are told to focus first on the six primary indices of domicile (discussed below). If they find one or more of these factors present in New York (and at least one can be found in most cases) they are instructed to proceed with an examination of the seven secondary and seven tertiary factors, even if a majority of the primary factors point to domicile in the new “home” state. Furthermore, they are told that no single factor is controlling, that a ranking of factors within categories does not exist, and that the list of primary, secondary and tertiary factors is not all-inclusive. This lack of clarity regarding the identification and ranking of factors creates tremendous uncertainty. The exclusive focus on retained New York ties (which ignores ties to the new location) reinforces the view that taxpayers should sever New York ties, despite the negative impact of these actions on New York's economy.

The Guidelines imply that domicile should be considered first, then statutory residence, then allocation. In practice, because one of the six primary domicile tests focuses on retention of living quarters in New York and a second requires an analysis of time spent in New York and in the purported home state, domicile and statutory residence (primarily the 183-day test) are examined simultaneously.

The District Office Audit Bureau gives auditors both copies of the Guidelines and copies of selected cases, generally cases that tend to encourage auditors to pursue aggressive policies, even when those policies may not reflect the spirit of the current Guidelines.

Practitioners are frustrated by evolving interpretations of the law that are inconsistent with the Guidelines and serve to encourage a complete severance of New York ties. Practitioners are also frustrated and confused by the recent hardening of audit positions by the difficulties in reaching reasonable settlements with auditors, their supervisors and reviewers, by the perceived misuse of the Guidelines, and by the Division of Taxation's use of cases such as Kornblum, 599 NYS2d 158 (3d Dep't 1993), as a guide or “standard” for use by field auditors and their supervisors.

V. DOMICILE COMMENTS

Most practitioner comments deal with the domicile factors, which are summarized, with commentary, below. According to the Guidelines, “Without one or more of the primary factors evident, the auditor need not explore the secondary and tertiary factors....” Guideline §312.4E(1). As stated previously in this Report, in most cases a former New York resident, especially one who files nonresident returns, “shows positive” with respect to at least one of the “primary” factors, and can therefore be subjected to a review of all 20 primary, secondary and tertiary factors.

A. Primary Factors.

1. Historical Home. The historical home is the traditional family residence that over the years has been clearly established and generally accepted as “home” to the taxpayer and the taxpayer's immediate family. Retention of this house or

apartment is a strong indicator of continued New York domicile, but is not determinative. In the spirit of fairness, the Guidelines state that the sale of the historic home and simultaneous purchase of another residence in a new state is an important indicator that a change of domicile may have occurred.

What if the historic house has been retained? Auditors are told to examine steps taken to sell the New York quarters, move “all possessions from that location”, and so forth. The size and value of retained New York living quarters, if any, should be compared to the size and value of out-of-state accommodations, along with the level of domestic help, groundskeepers and other employees, if any, at both locations.

Auditors have difficulty with the concept of a “historical home.” Is it a particular dwelling? Any dwelling within a particular community? Any dwelling within New York State? The Guidelines seem to refer to a particular dwelling, but auditors, faced with a taxpayer who has moved from Brooklyn to Queens to Manhattan, may conclude (and have concluded) that the taxpayer's historical “home” was “the New York City area,” even though the Manhattan living quarters, for example, do not have a strong sentimental attraction, were never “home” for the taxpayer's school-age children and were never used as the base for daily commutes to work or community activities. In a recent audit, the taxpayers sold their 4,500 sq. ft. historic home and purchased a 1,500 sq. ft. apartment in New York, simultaneously selling their 1,800 sq. ft. Florida apartment and building a 3,500 sq. ft. Florida home. The audit supervisor viewed the New York apartment as the “historic home”, stating that the taxpayer “lived in New York for many years and still has a place there. He lived in New York and still lives in New York, so that is his historic home”.

Practitioners understand the State's need to focus substantial attention on an individual's living quarters. Case law has recognized the propriety of this line of inquiry, and it is difficult to imagine a “domicile” test that would ignore this important factor. At the same time, however, it should be recognized that it is in New York's best interests not to discourage individuals from retaining their expensive New York real estate, especially affluent nonresidents who spend less time in New York and who require fewer services than full-time residents. The Guidelines encourage the auditor to discuss with the taxpayer the reasons for acquiring the new residence and retaining the old. Auditors are allowed to focus on the comparative size and value of the dwellings. We believe auditors should also recognize differences in use, including the possible conversion of a full-time principal home into a vacation residence, used only during the summer or during periodic visits to the state.

Certain practitioners believe that retention of the historical home should be de-emphasized as a factor. If a taxpayer is not filing as a New York resident and has declared residence in another location, auditors should determine whether the taxpayer has acquired a permanent place of abode in the new location and is actually living in the new location. With respect to the retained New York property, the focus should shift to the purported change of use, a change which converts the residence from a year-round, full time “home,” the principal place of domicile, to a vacation property or hotel substitute. If the taxpayer says that s/he intended a permanent move to another state, the auditor should focus on use of the former New York home to confirm or discredit the taxpayer's stated intent. A dramatic change in use of the New York living quarters, such as a change from full-time to seasonal use, or a change from fulltime use to use (e.g. by a cross-border commuter) one or two nights per week would tend to confirm the stated intent. Mere retention of the residence may be an insignificant incident, especially where the taxpayer owns several properties in and out of New York.

It is certainly understandable that a taxpayer will in many cases prefer to use his former principal residence as his seasonal home or hotel substitute after moving from New York. The expenses and other burdens associated with selling a house and buying another, as well as moving furniture and other belongings, encourage a taxpayer to retain his old house in New York for future seasonal use. In recent years, a primary reason for retaining the historic home has been the inability to sell the home at an acceptable price in a depressed real estate market. Many nonresidents are wealthy -- they have no economic necessity to sell, and have no reason to sell at a quick sale price when experience and intuition tell them to wait for the market to improve. Auditors should recognize this but some expect the taxpayer to sell at all costs, even at fire-sale prices.

2. Business Connections. The Guidelines' focus on business contacts is inconsistent with and detrimental to the State's economic interests. The Guidelines tell auditors that continued employment, active participation in New York partnerships, or a substantial investment in and management of a closely held New York corporation “are major factors in determining domicile”. In certain instances, taxpayers, primarily influential executives of significant New York employers, have been examined and told that they are New York residents because their executive responsibilities create a powerful, nearly insurmountable tie to New York. This policy is especially harsh

for cross-border commuters who, because of their New York employment, spend many full or part work days in New York (paying taxes on their New York earnings) and who also own a New York house or apartment. These commuters may be well advised to sell the New York apartment, or may alter their employment arrangements to minimize their "New York days." Neither of these steps benefits New York's economy.

What happens if the individual succeeds in structuring her employment so that she remains out of New York and closer to her out-of-state home? The Guidelines recognize that a person living and working in New Jersey or Florida, for example, may still have day-to-day involvement in a New York-based business. The Guidelines tell auditors that the long-distance aspect of this management may be largely ignored:

> In today's world of electronic gadgetry and instant communications, it matters little if the involvement with New York businesses takes place from afar or while physically present in New York State.

In other words, under the Guidelines, a long-distance manager may still be viewed as a New York domiciliary, largely because of the location of the New York business. Practitioners find this position puzzling and question its underpinnings. Domicile usually refers to the place a person lives, not where his business is located. If the facts clearly show that the business is being run from an out-of-state location, the taxpayer's out-of-state presence should be viewed as a strong indicator of a move to the new location. The location of the business should be a relatively minimal consideration in determining domicile compared to the taxpayer's physical location. Moreover, it is counterproductive to public policy for New York to compel the relocation of not only the executive but his or her company as well.

What happens if a business owner passes daily operations to his children but remains active in the decision-making process? The Guidelines advise auditors that “this active involvement could be used to demonstrate the taxpayer's strong connection to New York.” What happens if the elderly owner of a New York-based business retires and moves to another state, devoting little (if any) time to the New York business, bringing in younger managers and accepting a reduction of status and compensation? The Guidelines indicate that “this alone does not establish a domicile change, especially when there are other factors to the contrary.”

Apparently, the Guidelines favor employment with an out-of-state employer. Employees are, in effect, encouraged to terminate their New York employment. Owners are encouraged to move their businesses out of New York. Practitioners have described large and successful closely held businesses that have been moved from New York because the State questioned the owners' residency based on the location of the business. In these situations, New York loses the New York-source income of the taxpayer, the business's property and income taxes, and the payroll, income and property taxes of other employees who are terminated or forced to follow the company to its new “home” state. Practitioners question the wisdom of the Division's emphasis on the location of an individual's business interests for New York's long-term economic well-being. They also question its merit as an indicator in determining domicile, noting that modern travel and communications have altered work patterns. Physical presence “at the office” is no longer essential in many businesses.

We believe the Guidelines should ask whether individuals' business or work patterns have changed, and whether individuals have significantly altered their work habits by reducing their duties, transferring day-to-day responsibilities to others, or moving <u>their</u> business locations (not the business's) outside New York. Maintaining the New York location of the business, occasional use of a New York office, and regular telephone, courier or fax communication with a New York business are not appropriately viewed as strong indicators of New York domicile if the individual's work pattern has significantly changed.

3. <u>Items “Near and Dear” to the Taxpayer.</u> Items “near and dear” to the taxpayer include the location of pets, personal items and sentimental possessions. Under the Guidelines, a taxpayer who moves to Florida may leave a mink coat in the New York apartment, but should not leave a rare book collection or other valuable or sentimental items. Auditors regularly ask about the location of wedding photos, art work, collector cars, stamp or coin collections, and so forth.

Practitioners and taxpayers object to the use of this factor, despite its relevance, because it requires an intrusive investigation into the personal life of the taxpayer. In addition, there is some evidence that auditors view items “near and dear” that remain in New York as a strong indicator of continued domicile (a “primary” factor), but dismiss the transfer of all “near and dear” possessions as a self-serving, mechanical act. In the final analysis, it appears that the location of “near and dear” items has rarely if ever been cited as a significant factor influencing a court's decision on domicile, and thus may not warrant the intrusive inquiry required to secure such information. The Guidelines, for example, do not cite a single case in this area.

4. Analysis of Taxpayer's Time During the Year. The Guidelines ask auditors to examine the taxpayer's diary or calendar. If the calendar shows regular visits to the historical home to "carry on business, visit friends or relatives, or attend to personal affairs, then the diary supports an intent to remain domiciled in New York."

In reaction, practitioners ask why a person would return to New York other than for business, family or other personal reasons. A former New Yorker who commutes from New Jersey three days per week has a clear pattern of regular visits. Does this pattern support a finding of domicile? Are these "regular visits to the historical home?" Is the meaning of "historical home" in this context the same as in the Guideline's discussion of the historical home as a primary factor in and of itself (i.e. the traditional family dwelling), or does it refer rather more broadly to the former state of domicile?

The Guidelines refer to "regular visits to the historical home." Many auditors, however, interpret an annual seasonal visit, such as a visit for four months each summer, as a pattern of "regular visits". In a recent meeting, one audit supervisor stated that visits for a few days or weeks are permitted, but that a taxpayer who spends the summer in New York year after year cannot show clear and convincing evidence of a change of domicile. The supervisor cited Kornblum, supra. as authority for this statement.

Many practitioners believe that the language concerning regular visits should be either better defined or eliminated. As presently structured, it requires a finding of regularity, but does not define that term, and requires an examination of the motives for the visits. To a large extent, it overlaps other primary, secondary and tertiary factors that also focus on family visits, business visits, visits to New York professionals and so forth. We believe the Guidelines should focus on the taxpayer's overall living pattern, asking whether the pattern presents strong evidence that the new location has become the taxpayer's primary home. If the taxpayer formerly lived and worked in New York during the entire year but has retired and moved to Florida, seasonal visits to New York, such as annual summer visits, should not be viewed negatively. They are entirely consistent with the taxpayer's new pattern of living and purported change of domicile. By contrast, if the taxpayer merely changes from spending 6 months per year in Florida to spending 6-1/2 months per year, this minimal alteration, by itself, should not constitute strong evidence of a change of domicile.

If the taxpayer does not have a diary, or the auditor wishes to validate the taxpayer's diary, the auditor may ask to examine extensive third-party documentation, such as credit card receipts, utility bills, bank records, expense accounts, phone bills and other records. In practice, auditors usually ask for this information when the audit commences, and use these records to establish or question the taxpayer's New York day counts The pattern of activity is rarely examined, other than by noting, in a negative fashion, that the taxpayer “still spends money in New York” shopping, having dinner, and paying household bills, such as phone and electric bills. Instead, the auditor focuses on a comparison of New York days and days in the claimed home state, attempting to show a large number of New York days, or more days or activity in New York than in any other location. While the

Guidelines do not call for this inquiry, many practitioners believe it is relevant, though burdensome.

Many auditors use the diary in an unbalanced manner. Any conceded New York day is accepted as a New York day, but every out-of-state day is questioned, particularly days immediately before or after a New York day. Verification of the diary consists of an exhaustive review of third-party records, such as phone bills or credit card slips, focusing only on New York activity (such as a phone call from a dwelling owned by the taxpayer) on non-New York days, and lack of out-of-state documentation on non-New York days.

“False” indicators that can turn non-New York days into New York days include credit card purchases in New York by children and phone calls by housekeepers, children or relatives staying at a New York address as a guest of the taxpayer when the taxpayer is not in New York. An auditor will rarely willingly concede these days as non-New York days.

Dates are listed as New York days (any New York day listed in the diary plus any other day with <u>any</u> possible New York activity), undocumented days (lacking third-party documentary substantiation), and other days, usually broken down by location shown on third-party records. Some auditors treat every undocumented day as a New York day, even if, for example, the taxpayer is in Aspen on Friday and Monday but lacks records for Saturday and Sunday. The Guidelines treat partial New York days, such as cross-border commuting days or weekend dinner or one-hour shopping days, as full New York days. A taxpayer who wakes up in New Jersey, visits a doctor in New York, and returns to New Jersey to spend the rest of the day and to sleep has a full New York domicile day. One practitioner mentioned his client's “gas station" days -- weekends when the taxpayer was at home in a border state, 150 miles away from his New York City apartment, and made the mistake of buying gas for his car at the nearest gas station, one mile from his home but on the New York side of the state line. These inadvertent New York "gas days" were treated as full New York domicile days, even though they do not evidence any "feeling, sentiment or attraction" to New York, and occur many miles away from the taxpayer's New York place of abode but immediately adjacent to the out-of-state abode. The taxpayer's diary listed these as non-New York days. When a similar issue was raised in Moed (Division of Tax Appeals, Nov. 18, 1993), the ALJ concluded that the cross-border shopping days in question were more closely associated with the taxpayer's Connecticut home than with New York. We recommend a similar approach.

Several practitioners have suggested a change in either the statute or regulations. The statute does not define the term "day," but the regulations say that "presence within New York State for any part of a calendar day constitutes a day spent within New York," and this regulation has been upheld because it was not, in the case at issue, "irrational or unreasonable." See, 20 NYCRR §105.20(c) and Leach v. Chu, TSB-H-87 (100.2), 150 AD2d 842 (3d Dep't 1989). Some practitioners believe that the rules should be changed (via changes in the regulations, if necessary). Part and full days should be distinguished, and a day should not be treated as a New York day for domicile purposes unless the taxpayer spends the night in, or at least visits, the taxpayer's permanent place of abode in New York. The "part day" rule definitely discourages casual visits, meetings with professional advisers, banking, shopping, vacations and numerous other activities that would otherwise generate economic activity for the State.

The current rules are also perceived as inherently unfair because, if such rules were adopted by border states, they could easily lead to multiple taxation by two or more states. A person with a house and family in Connecticut but an apartment and employment in New York could easily be treated as a domiciliary by both states, resulting in taxation of all of the taxpayer's income in both states. Credits by Connecticut would partially offset New York taxes on New York earnings, but neither state would provide a credit for taxes paid on dividends, interest, capital gains and certain other types of income, such as income earned in neither state. See §VI(C) of this Report regarding constitutional issues.

5. Family Connections. The Guidelines consider two aspects of family connections. First, where do any minor children live and go to school? Most practitioners believe this is a relevant inquiry. Second, older taxpayers may have retired and moved to another state. Nevertheless, they may have “deep and substantial ties” to children and grandchildren still located in New York. If it is concluded that this quality time in New York is a central part of the taxpayer's lifestyle, then “there is no change in lifestyle or abandonment of the [New York] domicile.” This language, based upon the Tribunal's 1993 decision in Buzzard, (93-2 NYTC T-168), is offensive to many taxpayers and practitioners. Auditors regularly ask taxpayers whether they still have relatives in New York and whether they are close to their relatives. Vacation and holiday periods, especially school and religious holidays, are closely examined to determine whether the taxpayers visit relatives or worship in New York on these important dates. Many practitioners believe this aspect of the Guidelines elevates a fundamentally irrelevant factor -- the home state of one's relatives -- to a stature of substantial

significance in the domicile determination. At the same time, it penalizes ex-New Yorkers who return to visit children or other family in New York, a public policy that runs contrary to family values and discourages travel by ex-New Yorkers into New York while promoting travel out of New York. These practitioners argue for removing this second aspect of family connections from the list of primary factors and perhaps eliminating it as a relevant factor altogether.

6. Social Connections. Under the Guidelines, continuous, regular, active involvement in New York charities, clubs or other organizations, holding office, attending meetings and volunteering services are viewed as strong indicia of continued New York domicile. Active involvement is contrasted with more passive membership “which does not require attendance or participation.”

This primary factor was addressed by recent legislation that passed both the Assembly and Senate but was vetoed by Governor Cuomo. See, Assembly Bill #1019 and July 28, 1993 veto message. Practitioners, taxpayers, charities and other New York civic and social organizations were understandably concerned by this primary factor. New York's tax policy, as expressed in the Guidelines, tries not to discourage monetary contributions to New York charities but makes no such attempt regarding active participation in these same charities. Many people give generously to charities because they also serve on their boards and are committed to helping with time, talent and money. A tax policy that discourages participation will undoubtedly discourage charitable giving as well.

Some practitioners are also concerned about the “brain drain” that might be caused by the Guidelines. New York's social problems and the burdens on its governments are eased by the efforts of New York charities. New York's public policy should generally encourage the best and brightest to serve on boards, giving their time and talent to help these organizations achieve their objectives.

Moreover, auditors are often unable to distinguish time commitments from financial commitments. If an individual attends a fund-raiser, the monetary gift will be ignored but attendance may be cited as an indicator of continued New York domicile. Charitable and community involvement is a relevant inquiry in determining domicile. Nonetheless, New York may, because of competing policy goals, wish to reduce or eliminate the emphasis such involvement receives by removing this area of inquiry from the list of domicile factors.

B. Weighing the Factors. The Guidelines state that the six primary factors are not weighted. An auditor may examine secondary and tertiary factors if “one or more” of the primary factors exist, and may treat an individual as a New York domiciliary based upon an accumulation of factors. Guidelines at §312.4E(1). Is the presence of one primary factor really sufficient to warrant a more complete examination? The discussion of secondary factors states that “without establishing a strong case with primary factors, an auditor need not be concerned with ... secondary factors.” Guidelines at §312.4E(2). Is it possible to build a strong case with a single primary factor? Many auditors seem to think so.

In a typical case, a person with one primary New York factor may well have at least one other primary factor. For example, a person who has retained the historical home in New York or a New York business will usually have at least a family photo or a few other near and dear items in the State. Given the importance of the primary classification, many practitioners believe that “near and dear items” should be removed from the primary list. Others believe that the presence of family and participation in New York organizations should also be removed as primary factors. An individual may leave New York, but cannot force adult children, parents or other relatives to leave. Inquiries concerning an individual's affinity or estrangement from family members are offensive, intrusive and largely irrelevant to the domicile determination. Similarly, club memberships may entail beneficial charitable or community involvement, or appropriate recreational activity. An avid golfer with club memberships in Florida may spend the summers in New York and may retain a club membership in New York. The dues paid benefit this New York business, and the recreational use of the club during the summer months may be logical and reasonable. This membership should not weigh heavily against the taxpayer in a domicile determination. Unfortunately, auditors have difficulty weighing these factors, ignoring or dismissing out-of-state family or club memberships while placing considerable emphasis on New York family and club memberships.

Some practitioners believe that there should be, at most, three primary factors: retention and regular use of the historical home, ownership of an active business or employment (to the extent the taxpayer's services are actually rendered in New York), and the amount of time spent in New York. Family ties, social connections and “near and dear” items should be removed from the “primary” list.

C. Secondary Factors. Under the Guidelines, secondary factors may be examined where the auditor, having examined the primary factors, has developed a strong case for New York domicile. Guidelines at §312.4(E)(2). This language is somewhat inconsistent with §312.4(E)(1) of the Guidelines, which tells the auditor to examine secondary and tertiary factors if “one or more of the primary factors [is] evident.” We believe these instructions should be reconciled in favor of the guidance offered at §312.4(E)(2).

Secondary factors include the primary address used on bills and correspondence; the location of safe deposit boxes; the location of car and boat registrations and licenses; voter registration and voting patterns; frequency and nature of New York and non-New York use of attorneys, doctors and other professionals; possession of a New York City Parking Tax Exemption; and an analysis of telephone use at various addresses.

Despite the priorities called for in the Guidelines, auditors do not necessarily review primary factors first. Instead, they examine all issues simultaneously. This is especially true regarding telephone usage, which is often reviewed as part of the “time in New York” test. Auditors may also examine and compare the level of utility use at each dwelling at this time.[3]

Generally, an absence of secondary factors is deemed largely irrelevant, while the presence of one or more of these factors, such as voting in New York, retention of a New York driver's license or the use of a New York mailing address, is

[3] This comparison may be irrelevant or misleading. For example, in one case a New York home was an old stone structure, unoccupied and up for sale, that had to be heated all winter to avoid permanent structural damage. The New York gas bill was substantially larger than the Florida utility bill, but such usage offered no insight at all into the issue of domicile.

given great weight. This lack of balance creates confusion, anxiety and frustration for both practitioners and taxpayers.

Practitioners are understandably concerned about the “use of professionals” factor. Under the Guidelines, taxpayers are clearly told that use of New York attorneys, accountants and doctors are indicia of domicile in New York. The Guidelines thus encourage ex-New Yorkers to reduce or terminate these contacts, once again creating a chilling effect on economic activity in New York. The fine points of the Guidelines' structure -- that use of New York professionals is a secondary factor and not in itself fatal -- are frequently lost on taxpayers who feel a strong need to eliminate as many risks as possible. We recommend elimination of this factor.

D. Tertiary Factors. Tertiary factors in the Guidelines include incidental items such as the place of interment; the location where the will is prepared and executed; the location where tax returns are prepared and executed; passive business interests; the mere location of bank accounts; passive club memberships; and political contributions. Preparation of a New York nonresident return by a New York accountant is a tertiary indicator of New York domicile under this scheme.

Listing these activities as indicia of domicile deters taxpayers from engaging in them. All of these items benefit New York's economy and are insignificant as measures of “domicile”; all should be removed from the Guidelines.

E. General Observation. Auditors should be aware that the domicile issue turns on the taxpayer's own intent, not on his activity, and that the reason for a change in domicile is not relevant to this determination. The taxpayer's formal declarations of his intention should not be ignored. Informal activities are relevant only to the extent that they are inconsistent with the stated intention. If a taxpayer's formal declarations of intention as to domicile, e.g., voter registration, driver's license, automobile registration, passport, tax filings, and the like, are consistent with domicile elsewhere, that should be sufficient to create at least a rebuttable presumption that the taxpayer has changed his domicile. Residency audits could be much less painful for all concerned if a taxpayer's formal declarations of domicile were accepted in the typical case, and the statutory residence test was used to prevent abuses. The statutory residence test can be difficult for dual-residence taxpayers to meet because of the heavy burden of proof they face. Because it is objective, however, it is much easier for taxpayers to understand and for the Department to administer.

VI. STATUTORY RESIDENCE COMMENTS

Statutory residence applies if a nondomiciliary has a permanent place of abode in New York and spends more than 183 full or part days in New York. Section V(A)(4) of this report discussed day count at length, and many of these comments are applicable here. A cross-border commuter with a house and family in New Jersey but an occasionally used apartment and full-time employment in New York City could easily be treated as a statutory resident. A person in this category will usually have a day count close to 183 days because of the part-day rule. Assuming 45 work weeks and an average of four full or partial New York work days per week, this person will have 180 full or partial New York work days, even if he or she never visits the New York apartment. This person has a serious statutory residency problem, and cannot safely vacation in upstate New York, shop or attend plays in the City on weekends or visit a New York doctor or dentist on a weekend.

This is unfortunate. The person may be a New Jersey domiciliary and statutory resident, but could still be taxed as a New York statutory resident. Serious consideration should be given to whether this result is appropriate or desirable.

A. Day Count. New York could administratively change the definition of "day" since the term is defined only in regulations, not in statute. Part days could be excluded, or commuter work days (when the person wakes up in and, at the end of the work day, returns to his or her principal residence located in the state of domicile) could be excluded. New York could also exclude vacation days spent away from the New York house or apartment.

Medical recuperation days are excluded under §312.5(0(2) of the Guidelines, but only if the presence is "totally involuntary." An incompetent placed in a New York institution may exclude institutional days, and a person who suffers a medical emergency while visiting New York for other purposes and who cannot be removed from the state may exclude the hospital days. What about a person who, while living in Florida, discovers cancer or a heart problem? If the person chooses New York hospital care, will New York include these days? This type of distinction (voluntary v. involuntary medical care) makes little sense, and we recommend a simpler rule that excludes all in-patient hospital days.

B. Permanent Place of Abode. Generally, the Guidelines track the regulations and cases. With respect to a "vacation home," New York should change its focus from the structure (suitable...only for vacations) to the use. This would require a change in the regulations. A ski chalet or beach house may be suitable for year-round use. Many vacation properties are townhouses or condominiums, maintained year-round but used only on a seasonal basis. These properties, possibly located 100 miles or more from the New York work location (such as a summer house on Lake George in upstate New York), should not be treated as a permanent place of abode, and should not create statutory residence issues for New Jersey or other cross-border commuters.

C. Constitutional Issues. In Complete Auto Transit. Inc. v. Brady, 430 U.S. 274 (1977), the United State Supreme Court established a four-prong test to determine the validity of a state tax under the Commerce Clause of the Federal Constitution. A state tax does not violate the Commerce Clause if it (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly-related to the services provided by the state. The Court held in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983), that in order for a tax to be fairly apportioned (the second prong), it must be both internally and externally consistent. Internal consistency requires that the apportionment formula of the state taxing scheme be such that, if applied by every jurisdiction, it would result in no more than 100% of a taxpayer's income being taxed. In order for the tax to be externally consistent, the factor or factors used in the apportionment formula must reflect a reasonable sense of how the income is generated.

Aspects of the State's residency determination may be subject to challenge on constitutional grounds based on Complete Auto Transit and Container. For example, New York taxes both a domiciliary spending 150 days in New York and a nondomiciliary spending 185 days in New York as residents. If State X had the same rules as New York, there would clearly be circumstances in which the New York domiciliary would be taxed as a resident by both New York and State X (e.g., the New York domiciliary spent 215 days in State X). In addition, State X would tax its domiciliary spending 185 days in New York as a resident; so would New York. New York and State X might both provide a credit for taxes paid on income sourced in the other state, but this credit does not prevent the double taxation of income from intangibles, sourced to the state of residence, and thus claimed by both states. As such, New York's taxing scheme could be held to run afoul of the internal consistency test set out in Container. To avoid this problem, New York could give a credit to its domiciliaries for taxes on income on intangibles paid by such persons to other states taxing such persons based on their presence in those other states.

The State's day count rules are subject to possible attack on similar grounds. If any part of a day spent in New York is a New York day and any part of a day spent in State X is a State X day, it is easy to imagine a taxpayer whose day count exceeds 183 days in each state, and who is thus subject to double taxation.

The aggressive taxation of taxpayers in “borderline” domicile cases may also raise State constitutional issues under Article 16, §3, which requires that intangible personal property not employed in carrying on any business in New York be deemed to be located at the domicile of the owner for purposes of taxation.

It is beyond the scope of this report to examine these constitutional questions in depth. Suffice it to say that, according to some practitioners, there is an issue as to whether the State's scheme may be constitutionally flawed on the ground that it seeks to claim for New York more than a fairly apportioned share.

VII. ALLOCATION OF INCOME

Nonresidents have the obligation to allocate New York source income to New York.

A. Convenience Days. Guideline 312.6(B)(1) states that days worked out of New York may be treated as New York work days for allocation purposes unless the work was performed out of state due to employer necessity. This rule raises several concerns.

1. Day Count. Guideline 312.5(E) states that days counted as New York work days under Guideline 312.6(B)(1) should not be treated as New York days for day count purposes. In many cases, auditors do not seem to understand or follow this guideline. The nonresident return and instructions should be revised to require separate identification of these “home” days. Otherwise, auditors commonly assume that the work day count represents a minimum New York day count.

2. Convenience. All out-of-state work days are treated as New York work days unless the out-of-state services could not be performed in New York. Nonresidents must prove not only where they were but what they were doing and the reason they did the work at a particular location. The Guidelines cite Simms and Speno (Simms v. Procaccino, 47 AD2d 149; Speno v. Gallman, 35 NY2d 256, 259) as authority for New York's rule, but we question

the wisdom of these decisions. According to the Guidelines, the convenience test is appropriate.

> [S]ince a New York resident would not be entitled to a special tax benefit for work done at home, neither should a nonresident.

Practitioners question the validity of this reasoning. A person who lives and works in New Jersey pays taxes to New Jersey for the work performed there, and will pay taxes to New York as well for work performed in New York. Is it appropriate for each state to ask whether the person could have performed the services in some other location? If a nonresident employee, employed primarily by a New Jersey company, works from time to time in New York because it is convenient (but not absolutely necessary), will New York refrain from taxing the New York wages or salary? Can New York impose a one-way rule that never benefits nonresidents but only “penalizes” them?

Many companies have offices in several states, and many individuals, for family, child-care, health or other personal reasons, or for employer-related reasons, work at “home”, consistent with modern technology, advanced communication systems, and more flexible work patterns. New York's rule is seen as unfair in this context. It also poses reporting and administrative problems. New York should reexamine its policy, particularly in light of changing national work patterns. We recommend elimination of the convenience test, with taxation based upon the place the services are actually performed.

New York's aggressive position with respect to days worked outside of New York by nonresidents for the convenience of the employee or employer (rather than out of necessity) also raises constitutional concerns. (See Section VI(C)). If New York used a “one-way rule” as described above, New York's scheme might fail the “internal consistency” test set out in Container, supra. Further, even if its rule is applied evenhandedly, there remains the question of whether New York has a sufficient connection to impose its tax with respect to wages paid to a New Jersey resident for work done in New Jersey for the convenience of the employer or employee. Again, a more detailed discussion of these constitutional issues is beyond the scope of this report.

B. Allocation for Salesmen. Guideline 312.6(C) states that earnings of salesmen may be allocated based on business transacted rather than days in and days out. This language follows the regulations, but its meaning is unclear. Auditors tend to focus only on days worked, not on the addresses of customers, or the amount of business done on a given day for a given customer, or other factors. A better definition of “business transacted” is needed.

The Guidelines say this method is available only if compensation is based solely on commissions. Many salesmen, however, receive a combination of salary and commissions or receive commissions with a fixed “floor” amount. It would appear more reasonable to focus on the services provided, not the method of compensation. Alternatively, a salesman's salary (which may often merely be an advance) might be allocated based on days, while commissions or contingent income based solely on sales might be allocated according to the business that generated the contingent income.

VIII. HANDLING THE AUDIT

A. Impact of Prior Audits. Guideline §312.7 states that the results of an audit should be clearly stated so that they can be used as the starting point for subsequent audits. Unfortunately, it appears that since the Guidelines were published auditors have become increasingly reluctant to formalize decisions in a taxpayer's favor. A three-year audit may take years to conclude and may be resolved favorably for the taxpayer, but auditors, supervisors and even Law Bureau personnel are concluding cases with closing agreements or stipulations which state that the issue of domicile has not been resolved. In other instances, domicile simply goes unmentioned. This trend, at odds with the Guidelines, should be reversed. A taxpayer who cooperates with auditors and spends considerable time and money presenting extensive material deserves written confirmation of all conclusions regarding domicile, statutory residence and allocation. Merely “dropping the case,” or “allowing the statute to expire,” or issuing a one-sentence “no change” letter or DTF-50 Form is not sufficient.

B. Timeliness of the Audit. Guideline §312.8(A)(1) states that audits should not start unless four months remain under the statute of limitations. Many auditors, and even some conciliation conferees, ignore this rule or argue that the guideline is “only a guide,” not a rule or requirement. Others maintain that at least four months must remain at all times. These auditors may start an audit with five months remaining and request an extension of the statute almost immediately, threatening to assess if the extension is not granted. This is inconsistent with the spirit of the Guidelines, which may require further clarification to ensure that their purpose is achieved.

C. Lack of an Evenhanded Approach. Several references in the Guidelines give the impression that this audit program is designed to collect taxes rather than to fairly evaluate evidence and apply an evenhanded approach. Many examples have been cited by practitioners:

1. Cases Cited. Guideline 312.10(G) states that auditors may enhance their cases by citing parallel cases, and refers to Appendix #4 for a “synopsis of the more relevant court cases involving Domicile or Residency.” Twenty-eight cases are summarized. The Tax Department won 24 of these cases, while taxpayers won only four. Only one of the taxpayer victories, Sutton, is a fairly straightforward taxpayer victory; the other three are all odd cases, and the Guidelines seem to make an extra effort to distinguish them. Stranahan is described as a 3-2 Appellate Division opinion, implying that it could have easily gone the other way. Doman is described as a taxpayer victory on domicile, but a remand on statutory residency (which was raised by the Division of Taxation for the first time at the ALJ hearing). Trowbridge is an estate tax case, in which the taxpayer's wife and family lived in Connecticut and the New York residence was, for seven years, “boarded up [with] telephone service discontinued and furnishings and silver transferred to Connecticut.” These are not representative cases. Reading the 28 case summaries could easily lead one to believe the taxpayer has a nearly insurmountable burden of proof, and that taxpayers win only the most extreme cases. We believe a more reasonable attitude would be fostered if some of the more “mainstream” taxpayer victories were cited (e.g. Langfan, Stevens, Friedberg, Burke, Langsam, Karlin, Entenmann, Hellman), and if the Guidelines attempted to identify as “marginal” cases won by the Division such as Kornblum, Kartiganer and Getz, that it might not pursue (or might attempt to conclude) under the new Guidelines.

2. Auditors’ Narrative Report. Guideline 312.10(G) also states that the auditor's report should be written in the

form of an advocate's brief, especially for disagreed cases. This guideline promotes a one-sided point of view that fails to recognize factors favoring the taxpayer's position. As the case ascends through the conciliation conference and to the ALJ level, this lack of objectivity may cause the Division to litigate cases that should be resolved.

3. Ombudsman. One potential administrative response to perceived or actual lack of evenhandedness by auditors would be the creation of a high level “ombudsman” or equivalent position, perhaps in the Commissioner's office itself, to deal with residency cases where taxpayers believe front-line auditors and their supervisors have lost sight of the underpinnings of the audit guidelines and have continued to pursue a case against a taxpayer that should not go forward. While permitting taxpayers to go over the heads of auditors and reviewers may raise some issues as to proper administrative practice, it would be the one step that could dispel the common perceptions of biased interpretation and application of the audit guidelines. As we have noted, it is this perception which must be changed if adverse economic consequences for the State are to be minimized or avoided. If a separate “ombudsman” position were not created, the Audit Division could, as an alternative, provide a more formal mechanism for seeking review of residency audits by someone further up the chain of command. Such a mechanism might serve as a useful “safety valve” to prevent taxpayer harassment and improve the perception that the Department is carrying out its responsibilities in an evenhanded manner.

D. Penalties. The Guidelines state that the auditor has the burden to justify penalties. Mere lack of records or a high day count will not suffice. While some district offices follow the Guidelines, other district offices impose penalties automatically. In certain cases, auditors (and even district office managers) cite a high day count as evidence of negligence. The Division of Taxation should reinforce to auditors that penalties are seldom appropriate in these cases, and are rarely, if ever, appropriate in borderline domicile or close statutory residency cases.

IX. BURDEN OF PROOF

Perhaps the greatest hurdle for taxpayers and the main factor encouraging a complete severance of New York ties is the burden of proof in residency cases, a burden that becomes more difficult as a case progresses. Initially, an auditor must have a rational basis for issuing an assessment. The auditor may cite a lack of records, a place of abode in New York or other items to carry this burden of proof. Cases demonstrate that the auditor's burden is truly minimal. An assessment, once rationally based, is presumed correct, but the presumption can be overcome. In domicile cases, the party asserting a change of domicile must prove, by “clear and convincing” evidence, that s/he has abandoned the old domicile and moved to the new location with the intent of making a fixed and permanent home there. Guidelines at §312.4(B). The “clear and convincing” proof consists of stated intent and “unequivocal” acts supporting the intent. Guidelines at §312.4(D).

In the past, wealthy taxpayers who moved from New York often kept New York living quarters, but obtained quarters in the new location, registered to vote, paid taxes and took other steps consistent with the move. They may have visited New York on a regular basis, possibly for summers or holidays, but they lived primarily in the new location, and New York seemed to accept their status as nonresidents, even if they had New York source income and regularly filed nonresident returns. New York's recent residency audit program has questioned the status of many of these people, asking them to retrieve old (often discarded) records and expecting "clear and convincing" proof of domicile and day count issues. As the cases have advanced, ALJs have -often upheld audit positions, treating individuals as New York residents because they failed to retain voluminous records or because they retained New York ties. The Tribunal usually sustains the ALJs in these cases, and the Third Department has never reversed a Tribunal residency determination, even in cases such as Kornblum where the Third Department implied that it would have found a change of domicile if it had been the fact-finder.

The Guidelines state New York's desire to encourage beneficial economic activity in New York by ex-residents. It cannot do so, however, while simultaneously applying a "clear and convincing" standard of proof and focusing exclusively on retained New York ties, including items "which standing alone may be of slight importance, [but which] may create high evidence of intent when grouped together." Guidelines at §312.9(C)(6).

We believe New York should abandon the "clear and convincing" standard and should adopt a preponderance of the evidence test - a "51%" standard.[4] When deciding whether a person has changed domicile, the rules should take into account formal declarations (declarations of domicile, homestead exemptions, wills, voting registrations, tax returns, drivers licenses, and other filed documents) and the acquisition of ties in the new location, not just the abandonment of New York ties. A change requires an abandonment of New York domicile, not an

[4] This change would require legislative or regulatory action.

abandonment of all contact with New York State. In fairly close cases, the taxpayer's declaration should be respected, not rejected as under current audit practice.

X. CONCILIATION CONFERENCE–USE OF GUIDELINES

Conciliation conferees do not necessarily follow the audit Guidelines; some take the position that they are merely a guide for auditors and do not apply at the conference level. Because the Guidelines represent the Audit Division's own interpretation of the rules, conferees should not countenance actions by auditors that treat taxpayers less favorably than Audits' own Guidelines dictate. It would not be inappropriate, however, for a conferee to take a position more pro-taxpayer than that espoused by the Guidelines where the conferee believes the Audit Guidelines do not reflect a correct interpretation of relevant laws, regulations, or court decisions.

XI. AMENDING TAXPAYER INSTRUCTIONS. PUBLICATIONS AND THE REGULATIONS TO INCLUDE PORTIONS OF THE GUIDELINES

The Division of Taxation should consider amending the IT-203 instructions, Publication 88 and the regulations to incorporate important portions of the Guidelines. Amending the regulations would elevate the status of the Guidelines, increase the likelihood that auditors, conferees and the Division of Tax Appeals would follow them, increase tax practitioner awareness, and help sift through and resolve cases on a more uniform basis.

The Guidelines, as such, are not publicized as a ruling, opinion of counsel, publication, or list of taxpayer instructions. Widely disseminated publications, such as the instructions for Form IT-203 (the nonresident tax return) and Publication 88 (additional guidance for nonresidents) are woefully lacking. Publication 88, for example, does not even mention the concept of or tests for statutory residence, focusing only on a minimal discussion of domicile, place of abode and allocation issues. Yet this publication is cited in the IT-203 instructions as the source for “more detailed information”. It is not surprising that many nonresidents are unaware of the 183-day test, the domicile test, or both.

XII. MULTI-STATE AGREEMENTS OR COMPETENT AUTHORITY FOR MULTI-STATE ISSUES

Guideline 312.5D reads, in part, as follows:

> As soon as it appears a case is heading toward holding the taxpayer a resident of New York by virtue of the Statutory Resident rules, the taxpayer...should be advised to consider filing a protective claim with the...state of domicile before a statute expires, in order to recover any credits s/he may rightfully be entitled to.

The guideline does not refer to domicile cases, where the taxpayer is being treated as a New York domiciliary.

Regularly, taxpayers who have filed as residents of another state are audited and treated as New York residents. When they claim refunds from their “home” state, many are surprised to learn that the home state is not bound by New York's determination. Refunds are often denied, either because the statute of limitations for the refund claim has expired or because the “home” state refuses to follow the results of the New York audit.

This is especially troublesome for cross-border commuters in the tri-state area, who could be double or triple taxed under certain circumstances, without any offsetting credits.

The Personal Income Tax Committee of the Association of the Bar of the City of New York issued a report titled “Individual Double Taxation in the Tri-State Region.” This report, reprinted in a January, 1993 edition of “State Tax Notes”, suggests coordination by New York, Connecticut and New Jersey “to tax each item of taxable income only once.”

Practitioners are understandably concerned about the prospect of multiple taxation, with two or more states claiming full taxes from the same taxpayer. This could happen, for example, if a retiree received only interest, dividends and capital gains and was deemed to be a domiciliary of one state and a statutory resident of a second state. Each state could claim full taxes, and neither state would allow a credit for taxes paid to the other.[5] In the estate tax area, multi-state agreements permit states to resolve competing claims, but New York is not a party to similar agreements for personal income taxes. Perhaps the Federation of Tax Administrators, Multi-State Tax Commission or others could be used as a vehicle for achieving multi-state agreements.

Some Tax Department officials believe that legislative authorization is needed to permit New York's participation in a multi-state income tax dispute resolution agreement. If so, we urge the Division of Taxation to seek the necessary legislative change. The Commissioner should then work with other states-to develop common definitions and procedures for resolving competing state claims. In the meantime, on a case-by-case basis, New York

[5] As discussed in Section VI(C) of this report, this multiple taxation raises potential constitutional concerns.

should work with other affected states to fairly resolve these disputes.

XIII. PROPOSED NEW GUIDELINES

Problems under the current Guidelines can be addressed in a number of ways, both administratively and legislatively. The following example illustrates one administrative approach that merits consideration.

A. The domicile tests could be altered, as described below.

B. When a taxpayer maintains two or more dwellings, the person's domicile is the one the person regards and uses as the principal home. Generally, this will be the dwelling where the person spends the greatest amount of time. See, New York's Estate Tax Audit Guidelines, §102.7(H)(2).

C. When a person claims a change of domicile, auditors may examine certain facts to determine whether a bona- fide change has occurred. The focus of domicile audits should include acquired ties in the new location as well as retained New York ties.

D. Auditors should first determine whether the taxpayer has formally declared domicile in the new location. Voting registration for state and federal elections should be given great weight. Other proof may consist of a declaration of domicile, filing resident tax returns in the new state, obtaining homestead exemptions or taking other formal acts or filing formal statements of intent.

E. If the auditor finds that the taxpayer has formally claimed domicile outside New York, the auditor should ask the taxpayer to prove, by a preponderance of the evidence, that the taxpayer's other actions confirm the stated intent. A change of domicile should be found if the person establishes that he or she acquired and regularly used a permanent place of abode in the new location, and

(a) sleeps primarily in the new location, and

(b) works (if at all) primarily in the new location.

F. A change of domicile cannot occur unless the taxpayer proves the acquisition of living quarters in the new location. Some of the remaining factors may not apply to a taxpayer. The auditor should first determine which of the additional factors apply. If all of the applicable factors confirm the taxpayer's stated intent, the change of domicile should be accepted.

G. If one or more of the two factors (sleep or work) point to New York rather than the purported state of domicile, auditors should ask whether the taxpayer has maintained living quarters in New York, and should determine whether the taxpayer's overnight use of the New York living quarters is approximately equal to or greater than overnight use of the out-of-state abode.

H. If so, the auditor should presume that the taxpayer is a New York domiciliary. If the taxpayer works primarily in New York and regularly spends three or more nights per week in the New York abode, the auditor should presume that the taxpayer is a New York domiciliary.

I. The taxpayer may overcome these presumptions by submitting other evidence which explains the New York living and working patterns and demonstrates, by a preponderance of the evidence, that a change of domicile has occurred.

J. If the taxpayer cites out-of-state factors such as clubs, bank accounts or other factors, the auditor may inquire concerning the extent of comparable New York items.

K. When the auditors examine the day count issue for domicile purposes, and the taxpayer has a permanent place of abode in New York for substantially all of the year (more than 11 months during the calendar year), the auditor should also examine whether the taxpayer spent more than 183 days in New York during the tax year, focusing on days or part days in New York rather than merely nights in New York.

L. For purposes of all day count tests, in-transit travel, in-patient medical, and vacation and shopping, theater and similar days (spent entirely away from the taxpayer's New York living quarters) should be excluded.

M. Contemporaneous taxpayer diaries and affidavits from the taxpayer and others should be accepted as evidence of location, except to the extent that they are contradicted by other documentary evidence.

N. When testing a diary, auditors should randomly select no more than 50 days per calendar year, and should examine the taxpayer's available records for those dates. These records may consist of telephone bills, credit card receipts, cancelled checks, expense reports, time sheets or other records. The auditor cannot expect the taxpayer to provide third-party documentary evidence of location on every single day. However, if specific contradictions are found, and they are not adequately explained by the taxpayer, the auditors should determine an error factor applicable to the taxpayer's diary. If this error factor, applied to the entire tax year, alters the taxpayer's claimed status, the taxpayer may be asked to present records for the entire year to support the taxpayer's claimed day count and carry the taxpayer's burden of proof.

XIV. NEW YORK STATE LEGISLATIVE SOLUTIONS

Letters, memoranda and calls from various practitioners are divergent. Some believe the current ambiguity is either necessary or desirable and beneficial. Others seek administrative simplification and clarification, both through amendment of the Guidelines and through the publication of appropriate regulations. Many others are very discouraged, contending that the Division of Taxation's interpretations, reinforced by administrative and judicial decisions, create an impossible situation that cannot be rectified administratively. According to one writer:

> Domicile is so subjective and conducive to different interpretation by...reasonable persons, that a statutory resolution may be necessary....[I]n light of...the fact that the audit process as currently constituted is such a mess, perhaps the [Tax Section] should think about suggesting a radical [statutory] change in the State's approach to taxation on this issue.

Section XII of this report discussed competent authority legislation. Other specific suggestions are set forth in the Tax Section's December 29, 1992 report (reprinted in full in January 1993 issue of State Tax Notes), which listed several legislative avenues, including the elimination of the domicile test, elimination of the statutory residency test, or both. We urge the reader to review the options contained in our December 19, 1992 report.

When examining legislative options, it is important to recognize the interesting history of New York's current law.

The 183-day test was enacted in 1954 as a replacement for the “more than seven months” test, which was enacted in 1922 as New York's first attempt to impose full resident taxation based on quantity of time spent in New York. The legislative history of the 1922 amendment demonstrates that even the seven-month test was merely intended to provide a means of ensuring that domiciliaries were fully taxed. The memorandum from the Tax Bureau noted that the reason for the amendment was to tax those “who, while really and [for] all intents and purposes [are] residents of the state, have maintained voting residence elsewhere and insist on paying taxes to us as nonresidents.”

The memoranda in the Bill Jacket for the 1954 amendment demonstrate that the change was primarily intended to remove confusion engendered by the relatively vague term “seven months” and to impose a more administrable standard. Most significantly, the memorandum from the Department of Taxation and Finance states that the amendment will address the case where “individuals who really are residents nevertheless manage to comply with the present seven months rule by spending long weekends, holidays, and vacations outside the State.” The amendment was designed to prevent an individual whose sole business interest is in New York from avoiding New York resident status and, therefore, the imposition of New York taxation by manipulating the quantity of time spent in New York.

This history suggests that domicile, or “heart,” has always been the focus, and day count has been used as a more objective indication of domicile. New York could consider using the domicile concept, but defining domicile as maintenance of a place of abode in the state and spending more time in the state than in any other location. Taxpayers with a place of abode in the state would have a day count burden of proof, and the law could define the term “day” as, for example, any part of a New York work day or a night in the New York abode. Another approach might impose proportionate taxation, taxing 30% (e.g.) of all non-New York or intangibles income if a person spends 30% of his time in the state and has an abode in New York. This could be a safe harbor, elected by nonresidents who want to avoid a more burdensome full-blown residency audit. Some practitioners have questioned the State's ability to tax intangible income received by nonresidents, citing New York's constitutional limitations.[6]

We believe legislation should be considered, and we offer our services to work with the Division of Taxation and the legislature to develop audit standards which protect New York's revenues while establishing more objective and less economically damaging residency tests.[7]

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6 Any kind of proportional taxation of a nonresident's intangible income by New York may, however, be prohibited by Article 16 §3 of the State Constitution which states 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...”

7 The Ohio Tax Department has proposed residency rules intended to clarify and improve its administration of residency cases by establishing certain presumptions and eliminating various factors from consideration. A summary of the proposed rules is set out in Appendix A. These rules, to an extent, resemble the “bright line” tests described in our December 29, 1992 residency report. See State Tax Notes, Highlights & Documents, Nov. 4, 1993, p. 1874.

XV. FEDERAL LEGISLATIVE SOLUTIONS

Currently, Congress is considering legislation limiting the ability of states to tax pensions received by nonresidents. See S. 235 (introduced January 27, 1993), H.R. 546 and H.R. 702. This legislation does not contain a federal definition of "resident," but language could be added and states and their subdivisions could be encouraged or required to adopt the federal definition for purposes of any state or local tax law. A uniform, federal definition, which indicates that a person can have only one "tax home," and which creates a mechanism to resolve claims by competing states, would add considerable certainty and uniformity to this difficult area.