SHERMAN WELLS
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TAX AND TRUSTS & ESTATES UPDATE

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Changing Your State of Residency: What You Need to Know Before You Go

There has been a documented exodus from New Jersey of individuals seeking to unburden themselves of the Garden State's relatively high taxes and cost of living. Nevertheless, New Jersey can, under certain circumstances, continue to treat (and tax) many of these taxpayers as residents. If you are planning on leaving the state, it would be a good idea to examine whether or not you will remain a New Jersey resident for tax purposes.

For income tax purposes, a New Jersey resident taxpayer (defined in N.J.S.A. 54A:1-2(m)) is an individual:

(1) who is domiciled in this State, unless he maintains no permanent abode in this State, maintains a permanent place of abode elsewhere, and spends in the aggregate no more than 30 days of the taxable year in this State; or

(2) who is not domiciled in this State but maintains a permanent place of abode in this State and spends in the aggregate more than 183 days of the taxable year in this State, unless such individual is in the Armed Forces of the United States.

New Jersey defines a resident estate as that of an individual who at his death was domiciled in the state. N.J.S.A. 54A:1-2(o)(1). With respect to New Jersey's estate and inheritance taxes, New Jersey views "residence" to be the same as the common law concept of domicile.

So what exactly is "domicile" and how is it established?

In the December 2014 edition of *Tax Topic: Part-Year Residents*, the New Jersey Division of Taxation put forth the following definition of the word "Domicile":

> Domicile is any place you regard as your permanent home—the place to which you intend to return after a period of absence (e.g., vacation abroad, business assignment, educational leave, etc.). You have only one domicile, although you may have more than one place to live. Once established, your domicile continues until you move to a new location with the intent to establish a fixed and permanent home there. Moving to a new location, even for a long time, does not change your domicile if you intend to remain only for a limited time. Domicile is based on many factors, including your intent, where you register to vote, maintain a driver's license and vehicle registration, have family ties, etc. You can have only one domicile at a time. The burden of proof is upon the person asserting a change of domicile to show that the necessary intention existed to abandon his or her domicile in one location and to establish a fixed and permanent home in another.

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The Division discusses objective steps one can take, such as switching driver's licenses and registrations for cars and voting to your new state, but leaves plenty of room to keep a departed New Jersey resident's domicile (and their tax dollars) in the state. Since the determination of domicile is based on "many factors," including a subjective inquiry into a taxpayer's "intent" to establish a fixed and permanent home elsewhere, that determination has no single definitive and objective criterion. So, with the burden of proof on taxpayers to prove they are no longer domiciled in the New Jersey, what are some recommended steps for demonstrating the necessary intent to change your domicile?

A 2005 case decided by the New Jersey Tax Court is instructive. In *Samuelsson v. Dir., New Jersey Div. of Taxation*, 22 N.J. Tax 243 (2005) the taxpayers, Mr. and Mrs. Samuelson, left New Jersey for Florida in October 1998 and successfully convinced the Court that they had changed domicile when they moved. The Court provided a list of factors supporting the Samuelsson's claim that they had abandoned their New Jersey domicile:

(1) They moved all of their furniture and belongings to Florida.

(2) They listed their New Jersey house for sale.

(3) They did not rent out their New Jersey house.

(4) Mrs. Samuelsson looked for a house to purchase in Florida.

(5) They sadly said farewell to their friends in New Jersey.

(6) They enrolled their children in school in Florida.

(7) They closed their New Jersey bank accounts and opened accounts in Florida.

(8) Mr. Samuelsson got a Florida driver's license and registered his car in Florida.

The Court also provided a list of factors that did not support the Samuelsson's claim that they had abandoned their New Jersey domicile:

(1) They never sold their New Jersey home.

(2) They returned to their New Jersey home within one year of moving to Florida.

(3) They never purchased, but only rented, a home in Florida.

(4) Mr. Samuelsson worked in Florida for less than one year

(5) Mrs. Samuelsson did not change her voter registration or driver's license to Florida.

The takeaway from this case and the guidance promulgated by the Division, is that it is not enough to count days of residence and change your driver's license. The Division is looking for evidence of real intent to abandon New Jersey as the place you regard as your real home. Remember that to change domicile, you must rebut the presumption that your domicile remained in New Jersey. So, if you are planning a move out of New Jersey, talk to your legal adviser about what concrete steps you can take to demonstrate your intent to <u>abandon</u> New Jersey and never return.

We have available a list of factors courts around the country have considered in determining domicile and can make it available to you upon request. Please contact us at info@shermanwells.com if you would like that list.

The IRS Will Know About Your Undisclosed Foreign Accounts Very Soon

Under the Foreign Account Tax Compliance Act ("FATCA"), foreign financial institutions ("FFI") must disclose information about their U.S. customers to the IRS or all of their customers (even non-U.S. customers) will be subject to 30% mandatory withholding on certain transfers of funds from the U.S. to the FFI. FATCA was passed in 2010, but the IRS postponed the beginning date for FFIs to begin filing annual reports about their U.S. customers while it established filing procedures and negotiated agreements with foreign countries. Depending on the type of agreement signed by the foreign country where the FFI is located, FFIs must generally report account information for their U.S. clients directly to the IRS by June 29, 2015 or to their country's own regulatory authorities by September 30, 2015.

"Financial institutions" is broadly defined to include not only banks, but also any entity that functions or holds itself out as a collective investment vehicle, mutual fund, exchange traded fund, private equity fund, hedge fund, venture capital fund, leveraged buyout fund, or any similar investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets. "Financial assets" include securities, partnership interests, commodities, notional principal contracts, insurance contracts or annuity contracts, or any interests (including a futures or forward contract or option) in a security, partnership interest, commodity, notional principal contract, insurance contract, or annuity contract. The definition of a foreign financial institution is so broad it may include entities that are not typically thought of as a financial institution such as trusts.

What You Should Do <u>Now</u> to Avoid Imprisonment if You Have an Undisclosed Foreign Account

If you have foreign accounts that you have not yet disclosed, you should assume that the IRS will be informed of your foreign account, and criminal prosecution for non-disclosure and non-reporting may follow. Successful criminal prosecution will result in a fine of 50% of the highest value of the account or entity, plus an additional $250,000 fine, plus a possible prison sentence. Please contact your attorneys or accountants immediately if you have undisclosed foreign accounts or entities, so that you can enter the OVDP (Off Shore Voluntary Disclosure Program) and avoid criminal prosecution.

If you are the beneficiary or trustee of a foreign trust or have responsibility for an entity that could meet the definition of a FFI, we recommend that you consult with your tax professional to determine if you or the entity has a reporting requirement this year under FATCA.

Trustees of Life Insurance Trusts, Beware of Your Duties

When life insurance policies are owned by trusts, trustees have a responsibility to establish and follow certain protocols for the care and maintenance of the policies, as well as for periodic assessments of the continued appropriateness of such policies for the broader purposes of the trust. Failure to establish, follow, and demonstrate compliance with such protocols could result in a trustee's breach of his or her fiduciary duty. This may be the case even where the terms of a trust explicitly excuse a trustee from any duties pertaining to the policies - a trustee still may have a fiduciary duty to the beneficiaries imposed by statutory or case law to act in their best interests.

The 2015 Nebraska decision in *Rafert v. Meyer* is illustrative of this point. In that case, "[t]he trust instrument provided that the trustee had no duty to pay the insurance premiums, had no duty to notify the beneficiaries of nonpayment of such premiums, and had no liability for any nonpayment." The trustee, among other things, gave a false address to the insurance companies so that notices of overdue premiums were sent to a false address, and the policies lapsed without notice to the beneficiaries. In response to the trustee's argument that the false address was irrelevant, since he had no duty to notify the beneficiaries of any failure to pay premiums based on the language of the trust instrument, the court stated that:

> Such a position is clearly untenable and challenges the most basic understanding of a trustee's duty to act for the benefit of the beneficiaries under the trust. Perhaps the most fundamental aspect of acting for the benefit of the beneficiaries is protecting the trust property. [The terms of the trust instrument] cannot be relied upon to abrogate [the trustee's] duty to act in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries.

Accordingly, even where language to the contrary is present in the trust agreement, a trustee is advised, at the very least, to ensure that he or she receives notice regarding any failure to pay premiums on the policies. The trustee should also consider advising the beneficiaries of any possible lapse. A trustee is also advised to be mindful of the economic performance of the policy, as well as the financial stability of the carrier.

Consultations with independent, qualified, third-party insurance professionals can go a long way towards demonstrating an active, engaged, and compliant trustee who is properly managing the trust's life insurance assets.

Other factors to consider when conducting a review include, but are not limited to:

(1) Changes to federal and state death tax rules;
(2) Whether the grantor or trust can continue to pay the premiums at the necessary levels to continue holding the policies; and
(3) Whether the policy is being supported through high interest policy loans that might be refinanced with other trust assets (funded by additional gifts or loans from the grantor, trust assets or otherwise).
(4) Whether more cost-efficient policies offering comparable benefits could be purchased (or premiums on the current policies could be reduced) as a result of changed circumstances since the policies were first acquired.

Again, the trustee's broader policy analysis should be well-documented in the trust records to include consultations with independent, qualified, third-party insurance professionals. These steps can protect a trustee from liability by demonstrating his or her active attention to the policies held in trust and a robust deliberation process.

If you are the trustee of a trust that owns life insurance, you should talk to your insurance and legal adviser to ensure that you are taking the necessary precautions to avoid any breach of fiduciary duty with respect to the care and maintenance of life insurance policies owned by the trust.

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