To Leave or Not to Leave: Determining Minnesota Residency for Tax Purposes[1]

The new tax law significantly affects taxpayers and their estates by enacting a gift tax (and thereby joining Connecticut as the only states to impose a state-level gift tax) and amending the estate tax and income tax. The Minnesota Legislature passed this Omnibus Tax Bill on May 20, 2013 and Governor Dayton signed it into law on May 23, 2013.

Key aspects of the tax bill include the following:

- A new fourth tier income tax rate of 9.85% on single filers with taxable income in excess of $150,000 and married joint filers with taxable income in excess of $250,000;
- The imposition of a state-level gift tax which subjects lifetime gifts of over $1 million to a flat 10% tax; and
- A three-year clawback provision that requires any Minnesota taxable gifts made after June 30, 2013, and made within three years of a taxpayer's death, be added back into the estate when calculating the Minnesota estate tax.

The imposition of a state-level gift tax is particularly significant in light of Minnesota's broad-reaching estate tax. Not every state imposes its own separate estate tax, and of those that do, many tie their exemption amount to the federal exemption amount. Minnesota's estate tax exemption for non-spousal transfers is only $1 million, compared to the federal exemption of $5.25 million (which is indexed for inflation). While the new Minnesota gift tax legislation allows for a $100,000 credit (i.e., 10% of the $1 million exemption amount over a person's lifetime), it also provides for a "clawback" equal to the value of the gifts made (but not the gifts) in the three-year period preceding a person's death. Hence, use of the credit can reduce the value of an estate on death. Any value of the estate in excess of the $1 million exemption is taxed at rates which range from 41% to 9% depending upon the size of the estate, with the rate declining as the value of the estate increases. Additionally, unused portions of the lifetime gift tax exemption amount are not added to the Minnesota estate tax exemption, a difference

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from the Federal law which provides for a unified estate and gift tax lifetime credit and an annual gift tax exclusion amount of $14,000 per recipient. Minnesota also does not provide for portability of any unused estate tax exemption to a surviving spouse. Consequently, a person's assets could be free of Minnesota estate and gift tax up to total of $2,000,000 if one lives three years after a gift and each married person is entitled to both exemptions for a possible aggregate exemption of $4,000,000 in addition to an annual $14,000 per gift per recipient for each married or single person.

In the wake of these new taxes, much has been said and written about whether higher income Minnesotans will migrate to neighboring states with friendlier tax climates. For example, neither South Dakota nor Wisconsin impose state-level estate or gift taxes. South Dakota Governor Dennis Daugaard made a well publicized "visit" to the Mall of America to espouse the benefits of living in his state, and Wisconsin Governor Scott Walker stated that his office "had received calls" from business owners in Minnesota who will be subject to these new taxes.

How difficult, though, is it to change one's domicile from Minnesota to another state in order to avoid paying Minnesota income and/or estate and gift taxes? As two recent Minnesota Supreme Court cases show, the taxpayer must overcome a rebuttable presumption that he/she remains domiciled in Minnesota and carries the burden of proof in rebutting this presumption. Further, while no single factor is dispositive of the issue, the Court has identified certain "key" factors that a taxpayer should demonstrate to rebut the presumption. In short, for individuals willing to cut ties to the state, changing one's domicile from Minnesota to another state may not be difficult. Those individuals seeking to maintain significant ties to Minnesota while at the same time avoiding its seemingly onerous tax system may encounter difficulty in achieving this objective.

Larson v. Commissioner of Revenue

In the case of *Larson v. Commissioner of Revenue*, 824 N.W.2d 329 (2013), the Supreme Court affirmed a decision of the Minnesota Tax Court which held that, although a taxpayer purchased property in Nevada and made efforts to expand his trucking company to Nevada, he maintained enough significant contacts with Minnesota such that it could not be conclusively proven that he had in fact changed his domicile from Minnesota to Nevada (which has no state income tax).

Minnesota Rule 8001.0300 sets out 26 factors that can be used to determine whether an individual is a resident of Minnesota for income tax purposes (NOTE: while nothing in Minnesota Rule 8001.0300 limits its application to the determination of residency for income tax purposes, no Minnesota court decision has addressed whether the factors apply in the context of Minnesota estate tax liability). The following items listed will be considered in determining whether or not a person is domiciled in this state:

1. location of domicile for prior years;
2. where the person votes or is registered to vote, but casting an illegal vote does not establish domicile for income tax purposes;
3. status as a student;
4. classification of employment as temporary or permanent;
5. location of employment;
6. location of newly acquired living quarters whether owned or rented;
7. present status of the former living quarters, i.e., whether it was sold, offered for sale, rented or available for rent to another;
8. whether homestead status has been requested and/or obtained for property tax purposes on newly purchased living quarters and whether the homestead status of the former living quarters has not been renewed;
9. ownership of other real property;
10. jurisdiction in which a valid driver's license was issued;
11. jurisdiction from which any professional licenses were issued;
12. location of the person's union membership;
13. jurisdiction from which any motor vehicle license was issued and the actual physical location of the vehicles;
14. whether resident or nonresident fishing or hunting licenses were purchased;
15. whether an income tax return has been filed as a resident or nonresident;
16. whether the person has fulfilled the tax obligations required of a resident;
17. location of any bank accounts, especially the location of the most active checking account;
18. location of other transactions with financial institutions;
19. location of the place of worship at which the person is a member;
20. location of business relationships and the place where business is transacted;
21. location of social, fraternal or athletic organizations or clubs, including in a lodge or country club, in which the person is a member;
22. address where mail is received;
23. percentage of time (not counting hours of employment) that the person is physically present in Minnesota and the percentage of time (not counting hours

of employment) that the person is physically present in each jurisdiction other than Minnesota;
24. location of jurisdiction from which unemployment compensation benefits are received;
25. location of schools at which the person or the person's spouse or children attend, and whether resident or nonresident tuition was charged; and
26. statements made to an insurance company concerning the person's residence and on which the insurance is based.

Any one of the items listed above will not, by itself, determine domicile.

In *Larson*, the Court found that when weighing these factors, the taxpayer's actions during the time period he claimed to be a Nevada resident provided evidence that Larson did not intend to change his domicile. For example, Larson owned more property, spent more time and registered more vehicles in Minnesota than Nevada. He maintained bank accounts, mail delivery and professional relationships in Minnesota, and his family resided in Minnesota. In addition, Larson returned to Minnesota for continuing medical treatment during the same time period in which he claimed to be a Nevada resident. Additionally, the evidence showed that Larson flew out of Twin Cities International Airport more frequently than any other airport.

What the *Larson* case shows is that if a Minnesota taxpayer wishes to change his/her domicile from Minnesota to another more tax-friendly state, the break with Minnesota must be complete. If the individual leaves family behind, continues to own a business or real estate in Minnesota, continues to utilize professional services of Minnesota law firms and accounting firms, he/she runs the risk that the Minnesota Department of Revenue will challenge the change of domicile and claim that the taxpayer's actions did not evidence an intent to establish a physical presence in a state other than Minnesota.

Mauer v. Commissioner of Revenue

Another 2013 Minnesota Supreme Court decision, *Mauer v. Commissioner of Revenue*, 829 N.W.2d 59 (Minn. 2013), involves facts similar to the Larson case. In *Mauer*, the taxpayer was an NBA referee who traveled frequently as part of his employment. In 2003 he took steps to establish domicile in Florida by purchasing a townhouse, obtaining a Florida drivers license and registering to vote in Florida. However, like the taxpayer in *Larson*, the *Mauer* taxpayer spent more time in Minnesota than in Florida, maintained

significant professional, banking and business relationships in Minnesota, undertook "negligible" efforts to sell his Minnesota home and maintained a significant level of assets (vehicles and personal property) in Minnesota. The Court in Mauer, citing precedent that acts outweigh declarations of intent, found that the taxpayer failed to overcome the rebuttable presumption of Minnesota residency.

In response to claims that there was no clear "roadmap" for taxpayers to change their domicile from Minnesota to another state, the Court's *Mauer* opinion attempts to set forth certain factors that it considers significant to the determination. They are: (1) spending more time in one's new state than in Minnesota; (2) the "physical removal" described in Rule 8001.0300; (3) demonstrating a good-faith effort to sell or rent an existing Minnesota residence; and (4) making significant and credible efforts to move one's life outside of Minnesota.

Non-Residents and Minnesota Estate Tax Liability

A taxpayer who follows the Court's roadmap in *Mauer* is not entirely "out of the woods," so to speak, from Minnesota tax liability. A final wrinkle of the 2013 Omnibus Tax Bill pertains to the broadening of Minnesota estate tax liability for non-residents. Under prior law, Minnesota estate tax was assessed on real and tangible personal property sitused in Minnesota and owned by a non-resident decedent. Ownership interests in "pass-through" entities such as partnerships, S corporations and limited liability companies, however, were deemed "intangible property" not subject to Minnesota estate tax. Effective for decedents dying after December 31, 2012, however, any such ownership interests in pass-through entities which own real or tangible personal property in Minnesota (such as, for example, a limited liability company which owns its own equipment) are subject to Minnesota estate tax.