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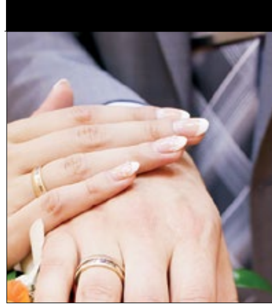

# For Snowbird Tax Savings, Avoid Homing Pigeon Instincts

Retirees relocating to a low-tax state must sufficiently cut ties with their prior home state to achieve intended income tax savings.

TERRY LaBANT

The American Taxpayer Relief Act of 2012 (Tax Act) brought more certainty to estate and income tax discussions for individuals. With a relatively low maximum estate tax rate (40%) and ongoing higher estate tax exemption amount ($5.45 million in 2016, indexed for inflation), only 11,931 estate tax returns were filed in 2014.[1] Not surprisingly, then, taxpayers have shifted their focus to federal income tax planning. The need for this focus is intensified by the creation of four different levels at which someone may be classified as a "wealthy" taxpayer subject to higher rates, loss of exemptions and deductions, and the 3.8% surtax under the Affordable Care Act that can apply to net investment income.

Whether a taxpayer is considered "wealthy" under the Tax Act is set on the first page of a federal income tax return. As a result, it has become more difficult than ever for taxpayers to reduce the tax liability reported on page two of Form 1040 through the use of exemptions and deductions elsewhere on the return. In light of these changes, taxpayers (and their advisors) have shifted their focus and become more sensitive to the cost of state taxes that they may pay over time.

Of course, each state maintains its own laws to calculate income tax (if the state has an income tax). These different laws may have a significant impact on a taxpayer's decision to relocate during retirement. Reducing state income tax payments can help improve cash flow and spending power in a meaningful way during retirement. Consequently, as the "baby boom" generation retires, wealth preservation discussions involve decisions to relocate to another state. A retiree may move to enjoy nicer weather or a change of scenery, but he or she may be motivated by tax savings as well.

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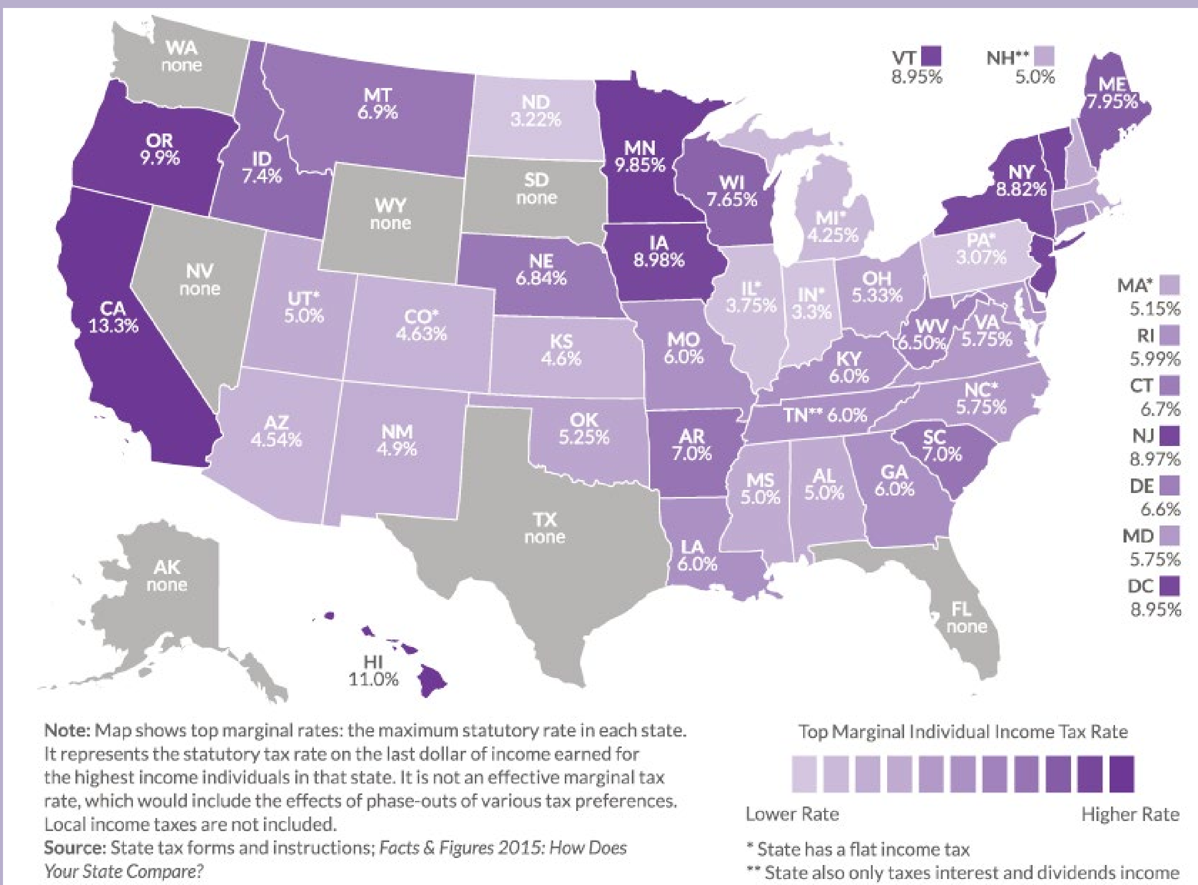
### State income tax focus

Income tax rates vary widely from state to state. Some states do not tax income at all (such as Florida, Nevada, South Dakota, Texas, Washington, and Wyoming). Whereas, other states have tax rates that approach or exceed 10%. (See Exhibit 1 for a handy chart showing top state income tax rates.) Some municipalities within states even maintain additional, regional income taxes.

Certain states distinguish between taxing wage income as compared to investment income (such as New Hampshire and Tennessee). Other jurisdictions have special rules for taxing retirement income that differ from the tax rules for other types of income.

Within the states that do not tax retirement income, some distinguish among Social Security benefits, public and private pensions

**EXHIBIT 1**
**Top State Marginal Individual Income Tax Rates in 2015 (as of 4/15/2015)**




**Note:** This image was originally posted on the Tax Foundation website (http://taxfoundation.org/blog/how-high-are-income-tax-rates-your-state).

benefits, and retirement account distributions when determining exemptions and taxes.

### Snowbird migrations

When taxpayers ask how best to move from one state to another, the answer remains fairly simple: Sell one's current home and move away with no intent to return, and buy a new home in another state with the intent to remain.

Practically speaking, however, migrations are rarely that easy. Snow birds often prefer to retain their home in the state from which they have "moved" after purchasing a home in their new "residence" state.

The state to which individuals move often welcomes them with open arms. The state they left often pursues them for ongoing tax revenue they thought they left behind. Although states differ in how they define residency, some general themes may help snowbirds and their advisors plan for a successful migration from one state to another while owning a former and new home.

### The Illinois example

A case decided a few years ago in Illinois, *Cain v. Hamer*,[2] helps illustrate how snowbird migration may be challenged, reviewed, and resolved. This particular case involved a married couple who spent approximately equal time in the states of Illinois and Florida while maintaining a home and presence in each state. They successfully challenged the approximately $1.8 million of income tax they paid to Illinois from 1996 through 2004 while claiming Florida residency.

This case provided a good roadmap for advisors because each

1 IRS Statistics of income, "Estate Tax Returns Filed for Wealthy Decedents, 2005-2014," available at www.irs.gov/pub/irs-soi/2014EstateTaxOneSheet.pdf (last visited on 1/15/2016).

2 975 NE 2d 321, 363 Ill. Dec. 519 (Ill: App. Ct., 1st Dist., 2013).

side agreed there was no factual dispute but rather only a question of law. For this purpose, the legal question revolved around whether the Cains had effectively established a new Florida residence while abandoning their prior Illinois residence.

The Illinois appellate court examined whether the Cains had sufficiently left their Illinois residence by demonstrating a clear intent to land in Florida with no intent to return for other than a "temporary or transitory" purpose. That is, the court examined whether the Cains not only abandoned their Illinois home but established a new permanent residence in Florida with every intent to remain there (even while spending almost equal parts of the year in each state).

As noted above, in a perfect world, the taxpayer would sell the prior home and purchase the new home in another state leaving no remaining ties to the prior state. The Illinois Department of Revenue challenged the Cains' position because they retained a home in each state.

Fortunately, the Cains demonstrated sufficient intent to shift their primary residence from Illinois to Florida. The court concluded that a taxpayer can maintain only one, true permanent residence, so the court needed to review the facts and circumstances to make its legal determination.

The following are "lessons learned" from this case, which provide a useful guide for changing residency:

- The snowbird should "abandon" the prior home and adopt a new residence with intent to remain there. Selling the prior home demonstrates this intent best; however, a snowbird can also indicate the requisite intent by spending enough time in the new home.
- Generally speaking, a snowbird should expect to spend at least six months in the new home to establish new residency in another state. It remains critical for this purpose to check applicable state law first to meet a particular time requirement.
- Maintaining a log of physical presence during the year will help the snow bird prove he or she spends the required number of days in the new home state. Merely counting the days in between plane flights no longer accomplishes this goal.
- Consider making a super-majority of all purchases within the new home state. Local meals and entertainment will help the snowbird toward this goal.
- If the new state has laws that allow a snowbird to declare residency, he or she should comply with them and also obtain a new identification card or driver's license.
- Transfer primary professional and health care provider relationships to the new residence state. Also, the individual should consider making any funeral arrangements there.
- Register to vote and accept future jury summons from the new residence state.
- Enjoy the local conveniences of daily life at the new home—such as local banking, telephone services (including cell phone), mail, and newspaper delivery.
- Join local clubs and purchase any resident sports or recreational licenses when customary. The snowbird should no longer purchase the resident version of these licenses from the prior home state; the former discount will not outweigh any tax savings.
- Be careful not to continue applying for a real estate homestead tax exemption in the state left behind. That exemption could be treated as a presumption that he or she intends to remain a resident there.

These planning concepts may help not only snowbird clients but also clients in other circumstances. For instance, as discussed below, professional athletes and retired executives with deferred compensation can encounter potential state tax conflicts involving the determination of their state of residence.

**Athlete signing bonus**

For many athletes, the excitement of draft day creates a whirlwind of change that includes signing a contract, training, and then playing the first season as a professional athlete. It also can bring a huge tax bill that may catch an athlete off-guard the following spring. This bill will likely be greater than any rookie dinner an athlete hosts for his teammates.

Athletes pay federal income taxes on their entire income, but they also pay state income taxes depending on where they play or reside. The federal income tax rules do not create many planning opportunities for athletes. The state income tax rules may provide great benefits depending on an athlete's facts and circumstances.

Two components of an athlete's contract are subject to income tax, namely salary and signing bonus. The state income tax that applies to salary does not need to apply similarly to a signing bonus. The larger the signing bonus, the more an athlete can save by understanding this distinction.

Athletes pay state income tax on their salary based on where they play. This leads to separate tax bills

from several states, with states fighting over a share of an athlete's salary.

If a signing bonus is taxed like salary, the same approach would apply. But, what if an athlete resides in a state with a lower tax rate? What if an athlete resides in a state with no income tax? The athlete could pay much less income tax on his or her signing bonus if it could be treated different from salary.

In order to take advantage of this tax opportunity, the athlete first needs to understand what qualifies as a "signing" bonus for tax purposes:

- The bonus is not conditional on playing any games for the team.
- It is payable separately from any other compensation.
- It is not refundable.

The athlete's contract must be structured properly to meet this test. The contract also cannot be treated differently under the league's collective bargaining agreement for these purposes.[3] If these requirements are satisfied, an athlete's signing bonus could be taxed in the state where the client resides instead of the various other states where the athlete performs. Of course, an athlete would need to pass applicable state residency tests to shift this income appropriately. So, careful planning would be required.

The planning concepts considered in the snowbird example could help professional athletes save state income tax when receiving a signing bonus. The law is clear in many states that signing bonuses are taxable in an athlete's state of residence when structured as noted above, so advisors can provide great benefits to these clients from a tax perspective.[4]

### Retired executive with deferred compensation

Fortune 500 executives often have significant stock options and deferred compensation that they continue to earn post retirement. These executives also may need to diversify their investments over time (e.g., by selling their company stock). Yet, they remain extremely income-tax sensitive because their ongoing options and deferred compensation benefits may continue to place them in the highest income tax brackets well past the year of retirement.

For this purpose, assume that an executive can present his or her tax planning professional with a spreadsheet that details sources of income and benefits (including options and deferred compensation) along with a timeline of when the executive would receive them.

Advisors then may inquire whether the executive's benefits could be paid over more than ten years in the form of (1) deferred compensation or (2) deferred stock options. If so, the executive may benefit for two reasons.

First, the executive could "smooth" his or her income tax liability over more years by taking second-look deferrals of the stock options. This would help him or her time the income to recognize less income over more years (and thereby reduce his or her income tax bracket). Some state tax savings could be obtained if the executive would become a snowbird or otherwise move from one state to another if the options could be taxed in that new state (depending on factors such as vesting).

Second, the executive could move from a higher to lower (or no) income tax state and change the state to which he or she pays state income on the deferred compensation once the executive retires there. This result stems from the fact that deferred compensation is taxed in the state where earned when paid out over less than ten years; however, it is taxed in the state where received when paid out over ten years or longer.[5]

### Conclusion

The Tax Act brought great income tax pain by finding four different ways to define individuals as wealthy taxpayers who would pay more tax going forward. At the same time, taxpayers also receive less benefit from their exemptions and deductions that are designed to lower their tax liability.

Taxpayers therefore have become more focused on state tax planning. This is not surprising because it provides the greatest well from which to draw income tax savings. A snowbird who decides to maintain homes in separate states must "tax migrate" effectively or risk getting pulled back into a colder tax climate unexpectedly. ■

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[3] Article 4, section 9, NFL Collective Bargaining Agreement dated 8/4/2011.

[4] Cal. Code Regs. 18, § 18662-6(f)(2); Wis. Admin. Code Tax 2.31(3)(c)(2); Minn. Stat. § 290.17; Maryland Admin. Release No. 24 (9/1/ 2008); Mich. Rev. Bulletin 1988-48 (9/27/1988); Ohio State Tax Report, No. 80 (6/1/2006); See also, Hillenmeyer v. Cleveland Bd. of Rev., slip op. 2015-Ohio-1623 (4/30/2015); and Saturday v. Cleveland Bd. of Rev. slip op. 2015-Ohio-1625 (4/30/2015); Ariz. Admin. Code § R15-2C-604(c)(6); 17 N.C. Admin. Code 6B.3905(a)(3); Ind. Code § 6-3-2- 2.7(a) and 3.2; Penn. Personal Income Tax Guide, Chapter 7 (2014); 35 ILCS § § 5/302(c)(1) and 5/304(a)(2); Utah Amin. R. R865-91-44(1)(d); La. Admin. Code 61:I.1304(1); N.J. Admin. Code § 18:35-5.1(b)(4); Noonan and Kelly, "Pay to Play? How States Handle Signing Bonuses for Athletes," State Tax Notes, June 2015.

[5] 4 U.S.C. section 114.

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