June 22, 2001

New York Residency Audits Can Be Intrusive

By: Glenn Newman

The issue of residency for New York tax purposes has long been a contentious issue and has caused much litigation. The audits and cases frequently delve into matters of an extremely personal, as opposed to a financial, nature. Two recent Administrative Law Judge determinations serve to highlight just how intrusive residency audits can be.

The 'Alfano' Case

Matter of Diane Alfano,[1] involved a taxpayer who had lived in New York City with her husband and filed New York State and City resident income tax returns for several years. However, for the years 1993 through 1996, the taxpayer filed nonresident New York returns, claiming to have changed her domicile to Connecticut. The taxpayer continued to work in part in New York (although she traveled extensively on her job) and showed New York source income on her return. The Department audited those returns and claimed that the she had not demonstrated a change in domicile from New York to Connecticut.

New York imposes its resident income tax (a tax on all income as opposed to a nonresident tax only on New York source income) if a taxpayer is domiciled within New York or if a taxpayer is a statutory resident which requires maintenance of a permanent place of abode in New York and spending more than 183 days (or any part of a day) in New York. In the *Alfano* case, the taxpayer established presence in New York far less than 183 days so that the resident tax assessment was based solely upon domicile. The Department argued that the taxpayer did not dispose of her New York dwelling and had not established, by clear and convincing evidence, that she had changed her domicile.

In 1992, the taxpayer and her then husband began experiencing marital difficulties. Since her husband would not leave the marital residence, the taxpayer sought refuge from what she considered a threatening situation near her family in Connecticut, where she was raised,. A home was purchased in December 1992 by the Mary Ann Alfano Family Irrevocable Trust. The taxpayer paid about 25% of the purchase price of the home, her brother contributed a small amount and her parents paid the balance of the $500,000 price. The Trust, for the benefit of the taxpayer and her siblings, was created in order to provide some protection in the event the taxpayer's estranged spouse sought to assert a claim against her assets.

The taxpayer furnished the home and moved all of her valuables, heirlooms, personal documents and items near and dear to her to the Connecticut home in June, 1993. She executed a new will in July 1993 and registered to vote in Connecticut in August 1995. She had a Connecticut driver's license and car registration. The taxpayer received mail at her New York City apartment but arranged with the doorman to

separate her mail so her former husband would not have access to it. Her personal assistant at her job in New York City would handle some mail and make bank deposits for her.

The taxpayer's job required her to spend some time in New York and also required extensive travel throughout the world. The auditor noted that she spent time in the New York City apartment although the taxpayer said she only stayed there when her work required her to be in New York and her estranged husband was away. On other occasions the taxpayer stayed in New York hotels. The audit also showed a pattern of credit card use in New York on weekdays as well as some Connecticut usage on weekends.

The Department also noted that the taxpayer used a New York dentist and physicians, maintained health club memberships in New York and Rome, Italy (where her new husband lived) and did her primary banking with Citibank, a New York headquartered institution. Her safety deposit box was in Connecticut and she received medical treatment in Connecticut as well as New York and Europe. When seeking a divorce, the taxpayer filed the papers in the Connecticut courts.

The Department reviewed the locations in which the taxpayer spent time and found that she had more working days in New York than in any other single location and more total (working and non-working) days in New York than in any other location. In the years at issue, the taxpayer spent between 113 to 142 days in New York and from 50-69 total days in Connecticut. This led the Department to assert that there had been no clear and convincing proof of intent to change domicile because while there was considerable time spent outside New York, the taxpayer spent no more time in any one location than she spent in New York.

In her determination, the Administrative Law Judge reviewed the law on domicile and stated the well-established propositions that a person can have only one domicile and that domicile continues until a new domicile is acquired by an actual change in residence coupled with an intent to abandon the former domicile.[2] The ALJ stated that the "test of intent with respect to a purported new domicile has been stated as 'whether the place of habitation is the permanent home of a person, with the range of sentiment, feeling and permanent association with it."[3]

The ALJ then analyzed the Department's conclusion that the taxpayer had not established a new domicile in Connecticut. The ALJ mentioned the critical factors, in the Department's view, that the taxpayer continued to spend more time in New York than in any other specific location, continued the use of the New York apartment and her business ties in New York and that the Connecticut home was purchased and expenses paid by a trust. The ALJ found that the explanations for using the trust to purchase the Connecticut residence (to insulate it from any claims of the former husband) and for the failure to dispose of the New York residence (due to the inability to force the former husband to agree to the sale) were reasonable.

Most importantly, it was the testimony from the taxpayer, her personal assistant and the taxpayer's father that turned the tide. The ALJ held that the situation was fully explained and the whole picture was shown in a credible way; an estranged wife moving back to a secure familiar environment and away from an "unhappy and what she considered a threatening situation with her former husband". While we cannot see the transcript of the hearing, we can surmise that the "threatening situation" was described in detail and would have been subject to vigorous cross-examination.

Thus, it appears that to establish a change in domicile from New York a taxpayer has to go to great lengths and may have to expose his or her most personal life experiences to scrutiny by a bunch of tax auditors and tax attorneys and hope that there are others familiar enough with the situation and willing to testify to corroborate the story.

The 'Brush' Case

The Matter of Dr. Charles F. Brush, III and the Estate of Ellen S. Brush,[4] involved Mr. Brush's New York City resident status. Mr. Brush ("taxpayer"), claimed to be domiciled in Shelter Island, NY and filed tax returns as a resident of New York State but not New York City. The definition of who is a resident of the City are the same as that for State residency except the word "city" is substituted for the word "state".

The taxpayer had access to dwellings on Shelter Island and on Park Avenue in Manhattan for the years in issue, 1991, 1992 and 1993. He also lived on a houseboat in Sausalito, California for parts of the winter and had other properties.

The taxpayer's wife passed away in 1999 and it was conceded that she was domiciled in New York City. The taxpayer claimed that notwithstanding his wife's domicile in New York City, he was domiciled in Shelter Island and spent fewer than 184 days (or parts of days) in New York City. He also disputed that the Park Avenue residence was a permanent place of abode maintained by him during the audit years.[5] The taxpayer testified that he disliked all cities including New York City and stayed there only when required for business reasons, if the ferry to Shelter Island was closed or he had a flight to or from a New York City area airport leaving very early or very late.

Most significantly, (and in keeping with the theme of this article), the taxpayer claimed that he rarely stayed in New York City with his wife because his wife had a drinking problem. He introduced testimony from their children that confirmed the taxpayer's infrequent presence in the Park Avenue home.

The Department claimed the taxpayer was domiciled in New York City or, in the alternative, had failed in his burden of proving that he spent no more than 183 days in New York City. In part, this finding was based upon telephone records and utility bills showing extensive use in the Park Avenue apartment, the fact that Mrs. Brush was in New York City frequently and a presumption that husbands and wives have the same domicile. Also, the Department pointed to an article in The New York Times of December 26, 1993, describing the nine-room, four-bedroom apartment with a working fireplace in the living room plus a 3,000-square-foot terrace and greenhouse. The article stated that the Brush family always returned to the Park Avenue apartment after their travels to distant places.

The ALJ started the discussion of the law noting that spouses, "who in fact lead separate lives may have separate and distinct domiciles."[6] The ALJ found that the taxpayer spent a very considerable amount of time at Shelter Island and his life-style was centered there. The ALJ also noted that, on the sale of the Park Avenue apartment, the taxpayer had not taken advantage of the "roll-over" of gain for the purchase of the Fifth Avenue apartment for Federal tax purposes that would have been available if Park Avenue had been the taxpayer's primary residence.

Having found that the taxpayer was not domiciled in New York City for the audit period, the ALJ turned to the issue of statutory residency. The first condition that is required for a finding of statutory residency is the maintenance of a permanent place of abode within the City. The taxpayer claimed that due to his

wife's alcoholism, he was effectively unable to use the apartment. The ALJ rejected this position stating that while "it was certainly reasonable to choose not to stay when his wife was in a very drunken state, his ability to stay was not prohibited, and while staying might have been unpleasant on many occasions, he was not restricted or precluded from doing so." This is contrasted to the *Moed* case in which the estranged husband had to call in advance and receive permission from his wife to stay at the marital apartment.

The ALJ then turned to the day count issue. There are three exceptions to the requirement that any part of a day spent in New York counts as a New York day.[7] The taxpayer had argued that certain days when he was admittedly in New York City should not be counted because he was present only to visit his wife who was hospitalized. The ALJ rejected that argument stating that the exception for in-patient hospital stays only applies to the involuntary presence due to an inability to leave by reason of physical condition.[8] The taxpayer was present voluntarily while his wife was confined to a hospital in the City so the days counted as New York City days, or so held the ALJ.[9]

The ALJ dealt with the Department's claim that the taxpayer had many undocumented days and had not met his burden of proving a negative (i.e., that he was not in New York City for more than 183 days) by looking at patterns of behavior and the credibility of the taxpayer and other witnesses. The ALJ drew an inference from the same facts that led to his conclusion that the taxpayer was domiciled in Shelter Island, to find that the taxpayer spent many of the undocumented days at his domicile and not in New York City. Many hours of testimony of the taxpayer, his personal assistant, bookkeeper and his children, although not specific about particular days, convinced the ALJ that most of the disputed days were non-New York City days.

However, on days for which there was no specific recollection or documentation other than that the taxpayer was in Shelter Island the day before and the day after, the ALJ did not allow those to be non-New York days. The ALJ reasoned that Shelter Island is about a two to three hour drive from New York City and the taxpayer did, on occasion, 'dart' into the City. Therefore, the burden of proving that he did not do the same on those 'interim' or 'sandwich' days had not been met. After applying the standards set forth in the Determination, the ALJ found between forty-six and sixty-nine days disputed days for each of the three-years in the audit period. With the large number of travel days and extensive documentation and testimony, the taxpayer had shown he was in New York City for fewer than 184 days each year and therefore, he was a non-resident.

What Can We Learn?

We can take several lessons from these two cases. First, accurate reliable records are essential to any residency case. Second, ambiguity will be held against the taxpayer; if it is reasonably possible to get to New York from the location in which the taxpayer is claiming to have been, the burden of proving a negative (an almost impossible standard to meet) will be on the taxpayer. Third, certain things will be very likely to trigger an audit; a change in domicile without actually ridding oneself of a New York abode and prominent news articles about your life-style and habitation may lead to an inquiry. Fourth, the whole story must be told and corroborated by others willing to testify in (sometimes gory) detail. Whether it be, as in these cases, spousal abuse or alcohol abuse, or drug abuse, extramarital affairs or other less-than-savory conduct, the whole picture must be displayed to win the residency case. This last factor is especially difficult for taxpayers. If telling the entire story is too painful, embarrassing or opens up other (non-residency tax) issues, taxpayers may be very reluctant to tell an auditor, much less have their personal lives reported in the tax decisions, or for that matter, rehashed in the New York Law Journal.

[1] New York State Tax Appeals Tribunal, Division of Tax Appeals, decided April 12, 2001.
[2] See, *Matter of Newcomb's Estate*, 192 NY 238 (1908); *Matter of Minsky v. Tully*, 78 AD2d 955 (3rd Dept., 1980).
[3] Citing *Matter of Bodfish v. Gallman*, 50 AD2d 457, (3rd Dept., 1976).
[4] New York State Tax Appeals Tribunal Division of Tax Appeals, decided April 12, 2001.
[5] Subsequent to the audit years, the taxpayer and his wife sold the Park Avenue apartment and purchased a smaller apartment on Fifth Avenue.
[6] Citing *Matter of Moed* (NYS Tax Appeals Tribunal, decided January 26, 1995).
[7] The exceptions are for transit days (travelers boarding an airplane, bus or train or traversing New York en route to another destination); military service and in-patient hospital stays.
[8] Citing *Stranahan v. NY State Tax Comm'n.*, 68 AD2d 250(3rd Dept., 1979).
[9] At a recent meeting, the Commissioner of the Department of Taxation and Finance Arthur Roth, much to his credit, stated that a taxpayer who had been in New York during his wife's treatment for what turned out to be terminal cancer were not counted as New York days in that case.