November 2022

Two Homes in Two States:

Residency and Income Tax Principles

Note: This newsletter does not provide tax advice or legal advice. We strongly recommend consulting with a CPA, who will be familiar with these residency rules and their tax implications. Residency rules can be both complex and subject to change due to evolving regulation and changing federal and state legislation.

Hybrid and remote work, both of which accelerated because of the COVID-19 pandemic, are here to stay. According to the U.S. Bureau of Labor Statistics, 34% of private employers expanded remote work options during the pandemic, and of those organizations, 60% plan to keep those policies in place after the pandemic has ended.

With this in mind, it is no surprise that many professionals are looking to work from sunnier locales, especially during our Pacific Northwest winters. But this can introduce some complexity to their tax planning. Although Washington is one of the nine states with no state income tax (the others are Alaska, Florida, Nevada, South Dakota, Tennessee, Texas, and Wyoming, and New Hampshire does not tax wage income), 41 states do have income taxes.

So how can you determine whether you might owe taxes in another state? The bottom line is that residency rules are complicated and some states are aggressive in pursuing residency audits. This newsletter is meant to provide an overview of the general principles, not specific legal advice.

Domicile and Residency

Individuals are taxed in the state in which they have a domicile (a permanent home base, in other words). That state is the one in which you will pay income taxes (if it all). If you are temporarily traveling to another state for an event or a vacation, you usually do not pay income taxes in that state. The general rule is that if you are in the second state for "temporary or transitory" purposes, you are not considered a resident of that state for income tax purposes.

But if you own a home in a second state, and you work remotely from that home regularly for extended periods of time, you may be subject to a residency audit and possibly owe state income taxes in that second state.

The 183 Day Rule is Not All It Seems

The general advice on this topic is: "as long as you are not physically in a state for more than half the year (or 183 days) you are not considered a resident of that state." But this is not always true. Each state sets its own guidelines for what it defines as residency. It is true that you are considered a resident of California if you are in the state longer than 183 days (they are cumulative days, by the way, not consecutive), but the applicable "days rule" is more lenient in other states. It is 200 days in Hawaii, 200 in Oregon, and 270 in Idaho. States also calculate the days differently. Any time spent at all in New York counts as a residency day, whereas in other states, a day may be a full midnight-to-midnight period.

California has been *particularly aggressive* in determining whether you are a resident for tax purposes. Even if you spend a plurality of a given year in California, the state's Franchise Tax Board (FTB) has been known to use this as an argument that you are indeed a California resident. For example, if you spend five months (or about 150 days, less than the 183 day rule) in California, four months in Washington (120 days), and three months (90 days) traveling/elsewhere, California's FTB might use that evidence as an argument that you are a California resident.

We recommend engaging with a CPA who can understand your specific tax and residency situation. The rules differ state by state, are difficult to interpret, and are subject to change. As the saying goes, "an ounce of prevention is worth a pound of cure."

States Want their Tax Revenue

If a state believes you are a resident for income tax purposes, they may audit you. Residency audits can be difficult, intrusive, and time consuming. Auditors can examine your membership in clubs, credit card transactions, origination points for telephone calls, where you have your driver's license, and multiple other aspects. State tax boards are aggressively pursuing high-income and high net worth families who claim they have moved out of high-tax states, but still maintain business connections and spend time in their original home state.

Small business owners with contacts in multiple states are particularly at risk of audit as well. And the use of residency audits is increasing, as state tax authorities look to ensure compliance with their residency rules in an era of increasing remote and hybrid work.

Resources that Can Help

If you are an employee who receives W2 income, you should immediately communicate changes to your residency to your HR/payroll department. It is likely worthwhile to work with a CPA as well, particularly if you are at risk of a residency audit. The onus is on *your employer* to correctly withhold taxes applicable to your state, *not you as* an employee. And if you are a small business owner, it is imperative to work with a qualified CPA.

Together with your Garde Capital Wealth Manager, we will work with you to ensure all aspects of your financial plan (including your assets and trusts, rental income, employee stock options, business ownership interests, and more) meet the objectives of your CPA and do not subject you to unnecessary tax expenses.

If you have any questions about how residency impacts your financial or retirement plan, please reach out to your advisor.

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