

Legal Issues, Judicial Analysis, And Domicile Planning To Avoid State Inheritance Tax Using Tennessee As A Case Study

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ABSTRACT

This paper examines the pitfalls and planning opportunities for taxpayers attempting to change domicile from our case study state, Tennessee, to avoid Tennessee inheritance tax to a state that doesn't have such taxes. Various court cases and state tax authority will be examined in order to synthesize the issues and formulate some general guidelines to assist taxpayers and their advisors in successfully using a change of domicile as a tool in state estate tax planning. A leading New Jersey case will be examined as an example of the consequences of unsuccessful state domicile planning causing the taxpayer to be subject to state inheritance tax in multiple states.

Keywords: U.S. State Inheritance Tax; Domicile Planning; Tennessee Estate Tax

INTRODUCTION

Presently, over twenty states impose some form of estate tax or inheritance tax. Tax minimization planning to avoid these types of taxes has become vastly more important to the practitioner since the avoidance of federal estate tax has become somewhat moot, except for the ultra wealthy, due to the present federal unified credit amount of \$5,120,000.00; which is the floor amount below which a decedent's estate is not subject to federal estate tax. However, various states, such as New Jersey, Tennessee, etc. impose state inheritance or estate tax on much lower transfers of wealth; the avoidance of which can result in substantial tax savings.

Tennessee imposes inheritance tax upon beneficiaries who receive property from the estates of decedents who are residents of Tennessee; subject to an exemption presently of \$1 million (\$1.25 million in 2013) dollars.¹

A Tennessee resident is defined as “a person whose legal domicile is in Tennessee.”² “A person's domicile is generally determined by various factors including an intention to abandon an old domicile and acquire a new one, the nature of employment, social and financial connections and voting location.”³

Since domicile is based on a taxpayer's “intent” along with various overt actions, the statutory authority's vagueness on what combination of these a taxpayer must have to successfully change domicile is challenging at best.

The statutory vagueness by implication seems to leave the state with leeway to virtually always claim a taxpayer a domiciliary of Tennessee; and subject to inheritance tax despite any affirmative actions taken by the taxpayer to change domicile.

¹ Tennessee Code Annotated §67-8-316(b)

² Tennessee State Tax Reporter ¶15-260

³ Tennessee State Tax Reporter ¶15-110

To find guidance the tax practitioner may need to consider, we must look at cases and rulings dealing with domicile issues; as the Tennessee statutory authority is mostly devoid of any such detailed rules.

In the *Denny* case the court stated “The question of domicile is often a difficult one; and it is a matter of surprise, considering the number of cases, that questions do not arise more frequently. The difficulty is intrinsic in determining under the various combinations of circumstances, what constitutes habitancy or domicile, which, for most purposes at least, are the same.”⁴

Further, the *Denny* court held “the mere intention to acquire a new domicile without the fact of an actual removal and residence avails nothing; neither does the fact of an actual removal without such intention. The intent is as essential as the fact of actual residence. A mere change in the place of abode, although more than temporary, is not sufficient, unless the intent concur.”⁵

Conversely, “a person who was formerly domiciled in Florida and who moved to Tennessee for business reasons, but intended to return to Florida after he sold his home in Tennessee, was deemed to be domiciled in Tennessee because his return to Florida was contingent on an event that might never happen.”⁶

Although not stating how these various factors relate in comparison to “intention” “The Tennessee Department of Revenue has indicated the following as some factors considered in determining legal domicile – where the individual is registered to vote; where the individual maintains a driver’s license; and where the individual maintains a permanent or principal residence.”⁷

Adding to the confusion is the fact that in the Tennessee Attorney General Opinion, it was found “a person who has been a resident of Tennessee may abandon his legal residence in this State and transfer his domicile to another state even though such person retain a dwelling place in Tennessee and remain here a substantial portion of the time.”⁸

“On the other hand, a person who resides in Tennessee cannot abandon his legal residence here and fix it in another state by a mere declaration of such intention unaccompanied by actual residence in the other state.”⁹

What we can synthesize from the cases and state authority outlined above is that some degree of both intention and overt acts are required in order to effect a change of domicile. The questions still unanswered are: 1) when does a taxpayer need to have the required mental capacity to form the intent to change domicile; and 2) what level of mental capacity is sufficient to form such intent to change domicile? To find guidance in answering these questions we must look to cases dealing with taxpayers of diminished capacity in Tennessee; as well as other states. Such analysis is beyond the scope of this article.

Not only is it confusing at best whether a taxpayer of somewhat diminished mental capacity can effectuate a change of domicile, it is possible for taxpayers of both full mental capacity and diminished mental capacity to be deemed a domiciliary of two states for inheritance tax purposes.

DORRANCE

In the *Dorrance*¹⁰ case, the taxpayer’s fortune at his death in 1930 was estimated at over \$115,000,000.00. He was a domiciliary for most of his life in New Jersey, however, approximately five years before his death he purchased an estate in Bucks County, Pennsylvania. Upon occupying the Pennsylvania estate his “entire personal

⁴ *W.R. Denny v. Sumner County, et. al.* 134 Tenn. 468 (Sup. Ct., December, 1915)

⁵ *Id* at 5

⁶ Tennessee State Tax Reporter ¶15-110.31

⁷ Tennessee State Tax Reporter ¶15-110

⁸ Tennessee State Tax Reporter ¶401-006, Tennessee Attorney General Opinion (July 7th, 1937)

⁹ *Id*

¹⁰ 309 Pa. 151 (Pa. Sup. Ct., Sept. 26th, 1932)

effects were removed”¹¹ from New Jersey to Pennsylvania. The estate’s executors argued that the deceased taxpayer was a domiciliary of New Jersey and he only occasionally occupied the Pennsylvania property.

The trial court held that the taxpayer was a domiciliary of New Jersey based on the taxpayer’s declarations of being a domiciliary of New Jersey; and the Commonwealth of Pennsylvania appealed.

The Pennsylvania appellate court found the taxpayer “was anxious to give color to his asserted intention to retain New Jersey.”¹² as his place of domicile. The court reversed the trial court holding that the trial court judge “gave too much weight to the declarations of intent contained in his will and other documents.”¹³

The appellate court’s reversal was based on finding “a number of facts which in our opinion, establish beyond question that continually since 1925 the true home of Dorrance and his family was in Pennsylvania, and that the New Jersey residence was maintained by him merely to lend weight to the fiction that he was domiciled there.”¹⁴

The Pennsylvania appellate court reviewed such factors as the number of servants at each locale, the comparative size of the respective property expenses, the relative time spent at each location by the taxpayer; and the fact that a wedding reception held by the taxpayer at the Pennsylvania residence was indicative of where the family’s social events took place.

The taxpayer was found to be a domiciliary of Pennsylvania despite the fact that “on many occasions and in various formal documents after 1925 he stated his residence”¹⁵ was New Jersey. Simultaneously, the New Jersey courts held the taxpayer to be a domiciliary of New Jersey and subject to New Jersey Inheritance Tax.

Thereafter, the taxpayer appealed to the United States Supreme Court which denied entertaining his appeal. The consequence was that Dorrance was deemed a domiciliary of two states for inheritance tax purposes; quite clearly not what the taxpayer had “intended” and proof of how domicile planning can go awry.

TENNESSEE’S MULTIPLE DOMICILE PROCESS

Tennessee recognizes the possibility of multiple domiciles being claimed by Tennessee and other state(s) and has a process to settle such domicile disputes if elected; although it is far from foolproof.

“In any case in which this state and (1) or more other states each claims that it was the domicile of a decedent at the time of his death, and no judicial determination of domicile for inheritance tax purposes has been made in any such states.... any executor may elect....”¹⁶ The domicile dispute can be settled by the commissioner entering “into a written agreement with the other taxing officials involved and with the executors, to accept a certain sum in full payment of any inheritance tax.”¹⁷

If such an agreement cannot be reached “the domicile of the decedent at the time of this death shall be determined solely for inheritance tax purposes”¹⁸ through arbitration based on the states involved in the dispute picking the members of the arbitration panel “which by a majority vote, determine the domicile of the decedent at the time of his death.”¹⁹

¹¹ *Id. at 4*

¹² *Id at 5*

¹³ *Id at 8*

¹⁴ *Id at 5*

¹⁵ *Id at 6*

¹⁶ Tennessee Code Annotated §67-8-502

¹⁷ Tennessee Code Annotated §67-8-503(a)

¹⁸ Tennessee Code Annotated §67-8-504 (1)–(7)

¹⁹ Tennessee Code Annotated §67-8-504(5)

Query: What happens with a wealthy taxpayer such as Dorrance where Tennessee's informal domicile resolution process isn't workable?

CONCLUSION

When the former co-founder of Facebook, Eduardo Saverin, relinquishes his American citizenship in advance of Facebook's initial public offering, for residence in Singapore, we can see that among his tax minimization strategies was changing domicile.

Domicile planning as a tax minimization strategy is available to the tax practitioner in state income tax planning, state inheritance tax planning and state estate tax planning as well. The general principles outlined above indicate that some combination of intent and overt action are required by a taxpayer to successfully change domicile from one state to another; although the specific percentages of each that are required to be successful remain hard to quantify.

In terms of specific steps the tax practitioner may contemplate when advising taxpayers to change domicile are: 1) reviewing the statutory authority of both jurisdictions and attempting to correlate the requirements of each; 2) filing income tax returns, if applicable, as a non-resident of the taxpayer's former jurisdiction; 3) having written declarations of the taxpayer's new domicile set forth in as many documents as possible, including the taxpayer's estate planning documents; 4) transferring all assets from the old jurisdiction to the new jurisdiction; 5) having all the taxpayer's mail sent to the residence in the new jurisdiction; 6) procuring funeral arrangements and/or a safe deposit box in the new state; and 7) registering to vote in the new state and removing the taxpayer from the voting rolls of the old state.

Further, although no domicile planning can be foolproof due to the "intent" component, especially with taxpayers of diminished mental capacity, the practitioner can insulate the taxpayer's change of domicile to the greatest degree possible by taking as many proactive steps as possible; some of which are outlined above. In addition, possibly considering using as a planning tool an approach akin to Massachusetts which has a Nonresident Decedent Affidavit that lists twenty six questions used by Massachusetts to evaluate a taxpayer's domicile.

Finally, a change of domicile could result in substantial tax savings when successful, especially when Tennessee's Inheritance Tax has a highest marginal tax rate of 9.5%, but due diligence needs to be exercised to prevent numerous states from claiming the taxpayer as a domiciliary; resulting in potentially worsening the original issue.

AUTHOR INFORMATION

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