Noonan's Notes on Tax Practice
State Tax Notes, Mar. 19, 2007, p. 815
43 State Tax Notes 815 (Mar. 19, 2007)

A Very Good Knight for Taxpayers

by Timothy P. Noonan

One of the common areas of contention that New York state tax practitioners face in their day-to-day practice involves issues of residency. The New York Department of Taxation and Finance is probably one of the more aggressive state tax departments when it comes to auditing individuals who claim to reside elsewhere. And unlike other areas of tax practice in which practitioners are forced to undertake sophisticated analyses of statutes, regulations, or cases, in residency cases, we are often forced to deal with arguments about subjective intent, moving bills, and the location of someone's teddy bear. Sometimes the practitioner might be able to find residency case law that is helpful or somewhat on point, but that is the exception rather than the rule. So when a new residency case comes along, and when it comes from New York's Tax Appeals Tribunal -- which, if you were paying attention in my last column, is the only administrative body that can issue precedential New York tax decisions[1] -- people like me listen.

A couple of months ago, the tribunal came down with a decision in *In the Matter of Craig F. Knight*,[2] a case that many feel will alter the landscape of some residency audits or, at the very least, will provide practitioners with some additional ammunition in disputed residency cases. In this article, I will discuss *Knight* and how it should generally help practitioners involved in New York residency audits. But practitioners who deal with residency issues in other states shouldn't stop reading here. Connecticut, New Jersey, Massachusetts, and many other states have the same residency rules as New York, so the tribunal's analysis in *Knight* could affect situations arising in other states as well.

Background on Residency Rules

Before getting to the decision, it is helpful to begin with a little background on residency. Under New York's rules, residency can be established through one of two tests. The first test is based on domicile -- that is, if you are domiciled in New York, you are taxable as a New York resident.[3] Domicile refers to one's principal, primary, and permanent home.[4] Under New York's residency audit guidelines, auditors generally focus on comparisons of four primary factors: home, business, time, and location of important possessions.[5] However, non-New York domiciliaries can still be taxable as residents if they meet New York's test for statutory residence. Under the statutory residency test, a person can be taxed as a New York resident if they maintain a permanent place of abode in New York and spend more than 183 full or part days in New York during the year.[6]

The *Knight* Case

In *Knight*, the taxpayer was a cofounder and owner of a successful financial consulting firm based in Manhattan. Throughout his career, he commuted to Manhattan from New Jersey, where he lived with his wife and children. After he separated from his wife in March 1996, Knight moved into his old bedroom in his parents' house (complete with shag carpeting, a twin bed, and possibly "Heroes of the NFL" bed sheets), also in New Jersey, where he had been visiting to assist his father, who was suffering from cancer. Even though Knight worked in Manhattan during the audit period and spent time there visiting a romantic interest, he maintained close ties with New Jersey, including coaching and refereeing soccer games, filling prescriptions and receiving medical care, remaining a registered voter, spending Thanksgiving and Christmas, bringing his children to stay at his parent's home when he had them, and contributing to and volunteering with a local religious organization.

Knight formed his consulting business -- Knight, Tallman & van Tol Capital Partners LLC (KTV) -- in March 1996. Soon after that, the company leased an apartment in Manhattan to be used by Knight, his two partners (who were based out-of-state), and others who came to New York on KTV business. Knight stayed there occasionally, as did the two partners, who each had keys. KTV used the apartment for business meetings as well as overnight stays by Knight and his partners, but there was no written agreement between the partners regarding the use of the apartment between them.

Several years before the audit period, Knight became romantically involved with another woman, who lived in New York City. Knight began visiting her apartment, and eventually his girlfriend gave him a key to one of the apartment's locks, which he could use if she knew he was coming and left the other lock unlocked. Knight and the girlfriend's relationship grew after his separation, and the couple eventually married. During the audit period, Knight often stayed at her apartment. The tax department's investigator reported that the couple had lived there on a daily basis since 1996.

The tax department noted in reviewing Knight's records during the audit period, including American Express receipts from 1996 and 1997, that Knight made numerous purchases at high-end New York dining and retail establishments; that many of the purchases, including furniture, were made on weekends; and that in 1997, there was significantly more money spent on groceries and retail items in New York than in New Jersey.

Following the audit of Knight for the 1996 and 1997 tax years, the tax department concluded that he changed his domicile to New York in April 1996 and that he qualified as a statutory resident in 1997. Following a hearing, an administrative law judge upheld the deficiency, and Knight appealed. On appeal, the tribunal reversed the ALJ on all counts and canceled the assessment.

On the domicile issue, the tribunal noted that Knight had always been a domiciliary of New Jersey before the audit and that during the audit period, his close personal connections remained in New Jersey despite the changes in his life. As for the stays in the city, the tribunal noted that neither the corporate apartment nor the girlfriend's apartment could be said to be actual residences, regardless of whether there was intent to move to New York. Neither apartment allowed unchecked residency, the tribunal said. The girlfriend gave Knight the key to only one lock and thus retained control over his access. Also, Knight was only a minority shareholder in KTV, which owned the corporate apartment, and his access was limited by others' use of the apartment. In so holding, the tribunal distinguished *Knight* from *Aetna National Bank v. Kramer*,[7] in which the appellate department found that a woman who left her New Jersey home with the intention of moving to Brooklyn became a New York domiciliary on the day she arrived at her temporary abode in Brooklyn, even though the residence she intended to permanently occupy was not yet ready. Here, Knight's stays at either the girlfriend's apartment or the KTV apartment could not be said to be steps in changing domicile.

As to the statutory residency issue, because Knight had stipulated that he had spent more than 183 days in New York City in 1997, the question whether he could be considered a statutory resident turned only on whether he maintained a permanent place of abode. The tribunal distinguished *Knight* from *Matter of Evans*,[8] which defined maintaining an abode as "doing whatever is necessary to continue one's living arrangements in a particular dwelling place." In *Evans*, the tribunal found a person had maintained an abode in New York City even though his "abode" was merely a room at a church rectory in which he spent workweeks, leaving the city on weekends. Evans kept clothing and belongings in the room and had free, unfettered access and relied on the room for access to his full-time job.

In contrast, the tribunal noted that Knight did not share expenses with his girlfriend, did not maintain clothing or personal articles in her apartment, did not have free access or a room of his own, and did not use her apartment for daily attendance at his job. Likewise with the KTV apartment, the tribunal said that Knight was only a minority shareholder in the company, and thus the apartment, and also did not keep clothing or belongings there or depend on it for daily life.

The decision in *Knight* represents more than just a taxpayer victory in an isolated case. There are several interesting tidbits in the areas of both domicile and statutory residency that we can take from *Knight* and apply more generally in other audits and cases.

Domicile Insights

The factual circumstances in a domicile case will always be unique, but a few general principles can be gleaned from the tribunal's domicile analysis.

Burden of Proof. We know that taxpayers in tax cases generally will bear the burden of proof to rebut the "presumption of correctness" that attaches to a notice of deficiency or notice of determination.[9] But that general rule has always been unclear in domicile cases in which the tax department asserts that the taxpayer has changed domicile to New York from another location, because the common-law rule of domicile is that a party asserting a change of domicile bears the burden of proof.[10] Well, that rule is not unclear anymore. The tribunal unequivocally stated in its decision that "it is the *burden of the Division* to establish that petitioner had a place of residence in New York and that he intended to establish a new permanent home in New York displacing his New Jersey domicile."[11] So even though a taxpayer would generally bear the burden of proof in tax cases, the tribunal makes it clear that the tax department will bear the burden to prove -- by clear and convincing evidence -- a change of domicile *to* New York. That gives the taxpayer a huge advantage in those of cases, especially now that the tribunal has made it clear that that concept applies also in the Division of Tax Appeals.

Time Factor. The time factor is one of the more powerful of the four primary factors used by auditors in domicile cases. The notion is that a person will spend more time at the place where their permanent home is located. The tax department in *Knight* found that to be a compelling factor, because the taxpayer spent a significant amount of time in New York City and more time in the city than he spent anywhere else, including his claimed New Jersey domicile. But in commuter cases like *Knight*, often the time factor can be misleading because of the proximity between the taxpayer's suburban and city residences. The tribunal recognized that, and it noted the distinction between a commuter situation and a situation in which a taxpayer "had substantial residences in New York and a distant city and the issue was which of the two was the taxpayer's domicile." In commuter cases, however, the tribunal found that "a mere sojourner" will not be treated as a domiciliary simply because he spends a lot of time in New York City ("that [sojourner] status will not be elevated to domicile by the frequency of visits"). That is an important distinction, and one that is not always obvious to practitioners or auditors during a residency audit.

Leave and Land. On this point, the tribunal's holding is not earthshaking. It is hornbook law in domicile cases that to establish a change in domicile, it must be shown that the taxpayer left his old location *and* landed in the new location. Thus, even though Knight gave up his historical home and moved in with his parents (an unusual move given his economic status), there was no factual finding that he "landed" in New York City -- that is, there was no finding that he intended to make his permanent residence in New York. However, other cases go just as far. For instance, in *Kaltenbacher-Ross*,[12] the taxpayer was a New Jersey domiciliary who began her medical school training in New York in 1987. She was engaged in her medical school program for the next 10 years (always in New York City) and ultimately, in 1997, purchased a place in the city and lived there ever since. And even though she rented various different apartments in New York City, married a New York City resident, began having children in New York City, and maintained no residence of her own in New Jersey, the ALJ in the case held that she had not established a new domicile in New York City because the testimony showed that she had not made the decision about whether to make her *permanent* residence in New York City. In other words, although she clearly had "left" New Jersey, her domicile still reverted back to New Jersey because she did not formally make the decision to permanently reside in New York.

That "leave and land" concept is not a new one, but it is one that is always important to keep in mind in domicile cases.

Importance of Testimony. One of the other things we can take from the tribunal's decision relates to the importance of testimony and evidence in domicile cases. Again, domicile is all about intent. Often in residency audits, it is difficult for a practitioner to effectively communicate their client's subjective intent to an auditor sitting on the other side of the table. However, in ALJ law judge hearings, in which a taxpayer is able to testify under oath, testimony about intent is paramount. Unlike many tax cases in which the analysis will turn more on a legal issue or on statutory construction, a residency case turns on a taxpayer's intent. And the best evidence of a taxpayer's intent comes directly from the mouth of the taxpayer. So in residency cases, if the judge believes you, you are probably going to win. And although ALJ hearings are time-consuming, difficult, and expensive, they often present the best opportunity for the taxpayer to hit a home run and win the residency case.

Knight is a good example of that (even though the ALJ initially ruled against the taxpayer). Knight's testimony and the testimony of others was convincing enough to establish his subjective intent when, on paper, maybe his case did not look so good, given that he was sleeping in a twin bed in his parents' house. Also, other evidence, such as investigators' reports containing hearsay evidence from third parties -- which often is a big deal at the audit stage, and was so in *Knight* -- is easily discounted and overcome by straightforward testimony from the taxpayer.

Statutory Residency Insights: The Permanent Place of Abode Issue

There is really only one important concept coming from the tribunal's decision in this area, but it's a big one. So many times in statutory residency cases, issues will arise as to whether the taxpayer's place of abode is "permanent" within the meaning of the statute and regulations, or whether the taxpayer actually "maintains" the abode. The tax law does not define the term "permanent place of abode," and the regulations provide a limited definition, referring only to "a dwelling place permanently maintained by the taxpayer, whether or not owned by such taxpayer, and will generally include a dwelling place owned or leased by such taxpayer's spouse."[13] Confusion often arises when taxpayers have use or access to corporate apartments or apartments of friends or acquaintances.

In *Knight*, both issues come up. And regarding both, the tribunal gave taxpayers clear guidance as to the factors that should be considered in determining whether an abode qualifies as a permanent place of abode. That is significant not only because it clarifies the applicable tests, but also because, as a general matter, the tax department has taken a harder line in permanent place of abode cases and has been trying to administratively limit the exceptions to the rules on a case-to-case basis. And to some extent, at least in nonprecedential small claims or ALJ cases, the department has been successful.[14] So it is promising to see the tribunal restore some balance in the permanent place of abode area and broaden some of the possible exceptions that taxpayers can claim.

Turning to the tribunal's specific analysis, it relied on the Third Department's decision in *Evans v. Tribunal*,[15] noting the absence of several factors lacking for permanent place of abode status, including that the taxpayer did not share expenses of the apartments; the taxpayer did not maintain clothing, personal articles, or furniture in the apartments; the taxpayer did not have a dedicated room to which he had free and continuing access; and the taxpayer did not use either apartment for daily attendance at his full-time job. In the case of both Knight's corporate apartment and the apartment maintained by his girlfriend, the existence of those factors demonstrated that neither place constituted a permanent place of abode for him. Therefore, he could not be taxable as a statutory resident.

This analysis should help taxpayers not only in the specific factual circumstances arising in *Knight* but also in other situations in which arguments exist about whether a place of abode constitutes a permanent place of abode for purposes of statutory residency. If some or all of the factors referenced in *Knight* are not present, a taxpayer should be able to make a good case for the inapplicability of the statutory residency test.

Conclusion

All in all, *Knight* should be seen as a pretty big deal in the development of New York residency case law. As I noted in my last column, when the tribunal speaks, people listen. And the tribunal has spoken loudly about the application of New York's residency rules. Everyone should be listening.

* * * * *

FOOTNOTES

[1] "Litigating a New York Case From Start to Finish," *State Tax Notes*, Feb. 19, 2007, p. 487, *2007 STT 35-21*, or *Doc 2007-3662* [**PDF**].

[2] *Matter of Craig F. Knight*, Tax Appeals Tribunal (Nov. 9, 2006). (For the decision, see *Doc 2006-24114* [**PDF**] or *2006 STT 235-13*.)

[3] N.Y. Tax Law section 605(b)(1); 20 NYCRR section 105.20.

[4] 20 NYCRR section 105.20(d).

[5] "New York Nonresident Audit Guidelines," para. 4.E (Nov. 26, 1997).

[6] N.Y. Tax Law section 605(b).

[7] *Aetna National Bank v. Kramer*, 126 N.Y.S. 970 (1st Dept. 1911).

[8] *Matter of Evans*, Tax Appeals Tribunal (June 18, 1992), *confirmed Matter of Evans v. Tribunal*, 606 N.Y.S.2d 404 (Dec. 30, 1993).

[9] *McKee v. Commissioner of Taxation and Finance***,** 768 N.Y.S.2d 677 (3d Dept. 2003); *Matter of Land Transport Corporation*, Tax Appeals Tribunal (June 29, 2000); *Matter of Atlantic & Hudson Ltd. Partnership*, Tax Appeals Tribunal (Jan. 30, 1992).

[10] *Bodfish v. Gallman*, 378 N.Y.S.2d 138 (3d Dept. 1976).

[11] *See Knight*, *supra* note 2 (emphasis added).

[12] *Matter of Kaltenbacher-Ross*, ALJ (May 29, 2003). The author represented the taxpayer in that case. (For the decision, see *Doc 2003-15126* [**PDF**] or *2003 STT 199-27*.)

[13] 20 NYCRR section 105.20(e)(1). The regulation also contains a few examples excluding camps, cottages, barracks, and temporary places of abode.

[14] *Matter of Goldberg*, ALJ (Feb. 2, 2006); *Matter of Hirsch*, ALJ (Dec. 15, 2005); *Matter of Brodman*, ALJ (Nov. 7, 2002). (For the decision in *Goldberg*, see *Doc 2006-2775* [**PDF**] or *2006 STT 32-14*. For the decision in *Brodman*, see *Doc 2002-25937* [**PDF**] or *2002 STT 226-26*.)

[15] *Matter of Evans v. Tribunal*, 606 N.Y.S.2d 404 (Dec. 30, 1993).