

INFORMATION BRIEF

Research Department
Minnesota House of Representatives
600 State Office Building
St. Paul, MN 55155

Nina Manzi, Legislative Analyst
nina.manzi@house.mn
Joel Michael, Legislative Analyst
joel.michael@house.mn

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Individual Income and Estate Taxation

Residence, Domicile, and Taxation

This information brief describes the constitutional, statutory, and administrative rules that govern when individuals are taxable as residents under the Minnesota individual income tax and their estates are taxable under the Minnesota estate tax.

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Executive Summary

Who is a Minnesota resident for income and estate tax purposes?

Minnesota tax law uses two sets of rules or criteria to determine residency:

- Domicile:** Does the individual intend to make his or her permanent home in Minnesota? To determine this intent the Department of Revenue (DOR) and the courts look to the individual’s expressed intent and more importantly to any of his or her actions that help to reveal that intent. DOR has promulgated an administrative rule that enumerates four presumptions and 26 factors (conditions or behaviors relevant to residency status) that DOR and the courts use to determine intent. *See pages 4 to 8.*
- Statutory residency:** Does the individual maintain a permanent abode (a residence with both kitchen and bathing facilities) in Minnesota and was the individual in Minnesota on all or part of more than half of the days in the year? *See pages 8 to 12.*

Both of these tests apply under the individual income tax—that is, an individual can be deemed a Minnesota resident under either the domicile rules or the statutory residency test. Under the estate tax, a decedent is a resident only if he or she was domiciled in Minnesota at the time of death.

What are the tax consequences of residency status under the individual income and estate taxes?

Status as a Minnesota resident is very important under both the individual income tax and the estate tax. The tax consequences are summarized in the table below:

Tax Consequences of Residency Status		
	Resident	Nonresident
Individual income tax <i>See pages 4 to 12</i>	All (worldwide) income subject to tax with credit for taxes paid to other states	Minnesota source income (e.g., from work in Minnesota or from Minnesota property or business operations) only subject to tax
Estate Tax <i>See page 12</i>	Property subject to tax: <ul style="list-style-type: none"> • Minnesota real property • Tangible personal property ordinarily kept in Minnesota • All intangible property 	Property subject to tax: <ul style="list-style-type: none"> • Minnesota real property • Tangible personal property ordinarily kept in Minnesota

Federal law imposes limits on the ability of states to tax the income of certain nonresidents:

- Members of the military (including prohibiting states from treating certain of them as residents even when they live in-state for more than half of the year)
- Nonresidents who receive qualifying retirement income that was earned in-state
- Nonresidents who are employed in various transportation industries (merchant marine, railroads, and trucking)

How does the Constitution restrict states taxation of residents and nonresidents?

Federal constitutional rules also limit the ability of states to tax the income of nonresidents and may limit their ability to tax the income of residents to the extent it is derived from out-of-state sources and is subject to state tax in another state. These limits apply under the Due Process Clause and dormant Commerce Clause doctrine. Application of the constitutional limits to the taxation of residents are particularly unclear under both the income and estate taxes. The U.S. Supreme Court has not decided a case on this issue in over half a century; however, an income tax case is pending in the U.S. Supreme Court this term that may help to clarify the limits that apply. *See pages 20 to 27.*

Have legislative proposals been made to change these tax rules?

Proposals have recently been made in the legislature to modify the tax rules that apply to residents and nonresidents. Governor Dayton's snowbird proposal would have taxed nonresidents with permanent residences in Minnesota and who spend more than 60 days and less than 183 days in Minnesota as part-year residents. This would have resulted in a portion of their non-Minnesota source income being subject to Minnesota tax. A bill passed by the Minnesota Senate in 2014 would have ruled certain types of evidence—use of specified types of Minnesota business—as off-limits to determine domiciliary intent. *See pages 28 to 32.*

Introduction

Under longstanding constitutional principles, states have broad authority to impose taxes on resident individuals. An individual's status as a resident provides legal authority for the state to tax his or her income and transfers of property, such as under an estate or gift tax. For example, a state may apply its income tax to all the income of a resident, including income derived from sources in another state (e.g., real estate, a business, or services performed) and income derived from intangible property (such as stocks, bonds, trademarks, or copyrights that have no clear physical location for their income). By contrast, a state's authority to tax the income of a nonresident is limited to income derived from sources within the state, such as real estate, services performed in the state, or a business located in the state. Similarly, estate, inheritance, and gift taxes can only be applied to transfers of in-state tangible property of nonresidents, but residents are subject to taxation on transfers of in-state tangible property and all intangible property.

As a result, an individual's status as a resident or nonresident is crucial to determining the reach and application of Minnesota's taxes to that individual's income or estate. Moreover, because Minnesota is a relatively high tax state with a top individual income tax rate among the highest in the nation and is one of the few states to retain an estate tax, many individuals who spend considerable time in Minnesota wish to avoid being taxed as residents. These individuals often worked much of their adult lives in Minnesota or owned Minnesota businesses, but now also spent considerable time at homes in other states, often in sunbelt states, many of which do not impose an income or estate tax (e.g., Florida, Nevada, or Texas). To minimize their Minnesota tax obligations, while still maintaining some or even considerable contact with Minnesota, these individuals may attempt to structure their affairs so they are not treated as Minnesota residents for tax purposes. With the recent enactment of a higher top income tax rate and an expanded reach to the estate tax, these efforts are likely to increase.

This information brief describes the statutory and administrative rules that govern determination of residency under the Minnesota individual income and estate taxes. The first section discusses the rules that Minnesota law (statute, administrative rules, and case law) uses to determine residency under the domicile and statutory residency tests. The second section discusses how the income and estate tax rules apply to residents and nonresidents. The third section discusses the constitutional limitations that apply to the state's authority to tax residents and nonresidents. The information brief concludes with observations about proposed legislative changes. The information brief does not discuss the rules under the fiduciary income tax—that is, when and the extent to which trusts and estates are subject to Minnesota's income tax.

Residency: Who Is Considered a Resident

Individual Income Taxation: How Residency Is Established

An individual may be determined to be a Minnesota resident and subject to the Minnesota income tax on all of his or her income, regardless of source, under either of two alternative tests:

- The traditional **domicile test or intent-based test**—i.e., did the individual intend Minnesota to be his or her permanent home?
- The **statutory residency or physical presence test**—i.e., did the individual have a permanent “abode” in Minnesota (a dwelling with both a kitchen and bathing facilities) and was he or she physically present in the state for 183 or more days of the tax year?

This section of the information brief describes each of these tests and their basic rules.

Domicile Test

The taxpayer's intent governs; DOR and the courts determine intent by looking to the taxpayer's expressed intent and, more importantly, to the taxpayer's actions. Since its inception, the Minnesota income tax has defined “resident” by reference to the common law

domicile test.¹ Domicile apparently was such a widely accepted term under the common law that the act did not define it and the statute still does not define it. The Minnesota courts, in applying the act, defined it as “bodily presence in a place coupled with an intent to make such place one’s home.”² Numerous cases have applied this common law test as well as provisions of the Commissioner of Revenue’s administrative rule that specifies in more detail the contours of the domicile test.³ The current version of the administrative rule is reproduced in the Appendix.

[Rule 8001.0300](#) codified and elaborated on the familiar judicial (common law) definition of “domicile” (physical presence plus intent):

The term “domicile” means the bodily presence of an individual person in a place coupled with an intent to make such a place one’s home. The domicile of any person is that place in which that person’s habitation is fixed, without any present intentions of removal therefrom, and to which, whenever absent, that person intends to return.⁴

The rule also codified or specified a variety of rules that had either been recognized by the courts or were administrative practices of the DOR. These include the following:

- **Permanence is crucial:** Because domicile status refers to one’s permanent home, an individual can have only one domicile and temporary absences from the state do not change one’s domicile.
- **Family considerations are important:** A married person is presumed to share his or her spouse’s domicile; minor (unemancipated) children have the same domicile as their custodial parent(s); and where minor children attend school may be relevant to their parents’ domicile.
- **Three additional presumptions are established:** (as well as the presumption that one shares a spouse’s domicile, as noted above). These presumptions shift the burden of proving domicile, implicitly requiring more evidence to overcome the presumption (whether for DOR or the taxpayer).

¹ [1933 Minn. Laws, ch. 405](#), § 1(f) (“The term ‘resident’ shall mean any individual domiciled in Minnesota and any other individual maintaining an abode therein during any portion of a tax year who shall not during the whole of such tax year have been domiciled outside the state.”)

² *Miller’s Estate v. Comm’r of Taxation*, 59 N.W.2d 925, 926 (Minn. 1953) appears to be the first reported case under the individual income tax (upholding taxpayer decedent’s actions and expressed intent to change his Minnesota domicile to Florida).

³ [Minn. R. 8001.0300](#) (2013). A version of the administrative rule has been in place for over 40 years; it appears in the first compilation of Minnesota administrative rules in the early 1980s. Proposals to amend it date back to the first edition of the State Register in 1976.

⁴ *Ibid.*, subp. 2.

1. Once established, one's domicile is presumed to continue, unless proven otherwise; in some ways this is a corollary of the idea of permanence. Moreover, you can only change your domicile by establishing a new one.⁵
2. Accepting a foreign job is presumed to not change one's domicile.
3. One's domicile is presumed to be where he or she lives.⁶

DOR and the courts look at multiple factors in determining intent. Since intent is a key element, the domicile test necessarily involves a subjective element: what was in the mind of the individual (i.e., his or her intent) relative to his or her living arrangements? Inevitably, this creates conflict between DOR and individuals. Individuals may claim they intended to change their domicile to another state for an obvious reason: they wish to avoid paying Minnesota income tax on their non-Minnesota source income. DOR, not surprisingly, cannot simply accept an individual's word regarding his or her intent. Rather, the administrative rule provides:

No positive rule can be adopted with respect to the evidence necessary to prove an intention to change a domicile but such intention may be proved by acts and declarations, and of the two forms of evidence, acts must be given more weight than declarations.⁷

Put another way, the rule essentially says that an individual's expressions of his or her intent matter, but actions are more important. The courts have routinely indicated that they follow a similar practice in applying the statute and rule to specific cases.⁸ The administrative rule provides a list of 26 factors to be considered in determining domiciliary intent.⁹ This list of factors is an attempt by DOR to specify concrete relationships, activity, behavior, or other actions that it considers to be objective evidence of where an individual considers his or her permanent home to be. The list has been in place since 1981, essentially unchanged.¹⁰ In the words of the rule, no one item on the list "determine[s]" domicile, but rather it is DOR's and (if it comes to that) a court's assessment of all the facts in determining the requisite intent. Ultimately, then, it is a fact-intensive, case-by-case determination by (in this order) the individual, DOR, and the courts that decides whether an individual is domiciled in Minnesota or

⁵ *Sanchez v. Comm'r of Revenue*, 770 N.W.2d 523 (Minn. 2009) (taxpayers who began an itinerant life in a motor home without any intent to return to Minnesota failed to overcome presumption because they did not establish a new domicile).

⁶ Joseph E. Cooch, "When Everything Matters, Nothing Matters: Minnesota's Unprincipled Approach for Determining Domicile in Tax Disputes, and a Path Forward," *Hamline Law Review*, vol. 37, pp. 233-238 (2014) criticizes the presumptions. He considers three of the four presumptions to be little different than evidence of intent and recommends eliminating them as presumptions. Under his recommendation, only the presumption of continuing domicile would remain. *Ibid.* p. 249.

⁷ *Ibid.*

⁸ See, e.g., *Sanchez v. Comm'r of Revenue*, 770 N.W.2d 523, 526 (Minn. 2009) (taxpayer and DOR apparently agreed on taxpayer's subjective intent); *Dreyling v. Comm'r of Revenue*, 711 N.W.2d 791 (Minn. 2006).

⁹ [Minn. R. 8001.0300](#), subp. 3. See Appendix for the language of the rule.

¹⁰ The list of 26 factors or considerations was proposed as an amendment to the administrative rule in 1980. 5 Minn. Reg. 277 (August 25, 1980). The list was finally adopted in 1981. 5 Minn. Reg. 2060 (June 22, 1981).

not.¹¹ The statute and rule, however, prohibit DOR and the courts from taking into consideration the individuals' charitable contributions in making domicile determinations.¹² Some of the 26 factors overlap with one another and can be combined into groups of similar factors to simplify and help to understand the relevant concepts:

- **Employment-related factors:** Where was the individual's employment located; was it permanent; did the individual have a professional license in the state or a union membership; and where was any unemployment compensation received from?
- **Homes and living arrangements:** What was the status of current and previous living quarters (rented versus owned, for-sale, homestead property tax status, and so forth) and how much time did the individual spend in-state versus out-of-state?
- **Business relationships:** Where did the individual primarily do business (e.g., with financial institutions, as well as other businesses), own property, and so forth?
- **Social and civic relationships:** Where was the individual registered to vote, drive, hunt, and fish; where were his or her social, athletic, and other memberships; where was his or her place of worship; and so forth?
- **Other factors:** Was the individual a student (implying a temporary presence when a student moves to another state to attend college or other school); where did minor children or a spouse attend school; where were motor vehicles registered; and what was the nature of income and other tax filings (resident versus nonresident)?

The rule does not assign relative weights to any of the 26 factors. Rather, the rule and the court decisions make it clear that no factor is determinative and that it is not a matter of simply counting up the positive and negative factors. Moreover, court decisions make it fairly clear that some factors are more important or carry more weight than others. In particular, permanent employment relationships and the relative amount of time spent in-state both appear to be factors that trump other factors, particularly those that the individual can easily change at little cost to themselves (voting registration, vehicle registration, hunting and fishing licenses, banking and some other business arrangements, and so forth).¹³

¹¹ Most states have similar rules under their statutes or administrative rules for determining domicile, although the details of the list vary. See Aaishah Hashmi, "Is Home Really Where the Heart Is?: State Taxation of Domiciliaries, Statutory Residents, and Nonresidents in the District of Columbia," 65 *Tax Lawyer* 797, 811-12 (2012).

¹² *Minn. Stat. § 290.01*, subd. 7 (c) (2014); *Minn. R. 8001.0300*, subp. 3 (last sentence). Thus, whether contributions are made to in-state or out-of-state charities is irrelevant. This prohibition was added by the legislature in 1999 and was intended to prevent domicile consideration from discouraging individuals seeking to establish their domiciles outside Minnesota from contributing to Minnesota charities. 1999 *Minn. Laws, ch. 243*, art. 2, § 2. The rule also prevents individuals from pointing to contributions to non-Minnesota charities as evidence that their permanent homes are outside Minnesota.

¹³ In two recent cases, the Minnesota Supreme Court has rejected claims that individuals were not domiciled in Minnesota when they spent more time in Minnesota than in the state where they asserted they were domiciled. This was so despite the fact that they probably satisfied more of the 26 considerations than they did not. *Mauer v. Comm'r of Revenue*, 829 N.W.2d 59, 66 (Minn. 2013) (181 days in Minnesota and 64 days in Florida, the asserted state of domicile); *Larsen v. Comm'r of Revenue*, 824 N.W.2d 329, 330 (Minn. 2013) (taxpayer "spent more time in

The reason for this (both on the part of DOR and the courts) seems obvious: many of these disputes involve taxpayers who are consciously attempting to change their domiciles to low or no-tax states, while still maintaining residences in Minnesota at which they spend material amounts of time.¹⁴ Given this, for many of the listed considerations (drivers and motor vehicle licenses, registration to vote, hunting and fishing licenses, changing banks and brokers, and so forth), the individual may, based on advice by a financial planner or lawyer, simply be going through a process of checking as many of the 26 boxes as possible without really significantly changing their living patterns and most important contacts with the state. As a result, DOR and the courts may discount how probative of intent some of these factors are. This is likely so because the factors have two common characteristics: (1) they are under the control of the individual and (2) can be changed (typically at minor cost, relative to the tax savings) without severing an individual's most important ties to Minnesota. By contrast, taking a permanent job in another state, permanently vacating your Minnesota home, and spending most of your time in the new state are likely considered more probative of actual intent for one or two reasons: (1) they require a significant independent decision by someone other than the individual (e.g., an employer hiring and paying the individual to perform a permanent job in another state), or (2) show a real reduction of ties to and important contacts with Minnesota (e.g., abandoning one's Minnesota job, selling or renting a house, spending most of your time in another state).

Summary. Overall, determining residency is a case-by-case, fact-intensive process where DOR and the courts weigh as many factors and considerations that they consider to be relevant to where an individual intends his or her permanent home to be. Their assessment of these factors and the weight they assign to them seems likely to be at least partially influenced by the recognition that some individuals are engaging in domicile planning—that is, they are seeking to change their domiciles to low-tax states, while still maintaining substantial Minnesota contacts, such as spending large shares of their time in-state and maintaining family and social ties with local residents.

Statutory Residency Test

Having a permanent Minnesota residence and being physically present in the state for more than half of the days of the year is determinative. Individuals who are domiciled in another state may still qualify as Minnesota residents under the statutory residency test. This test

Minnesota than he did in Nevada”). By contrast, in a case in which most of the factors would suggest that the taxpayer was domiciled in Minnesota, the tax court was persuaded by the fact that petitioner was transferred out-of-state by his longtime employer (who previously had transferred him to Minnesota) in concluding he intended to move his domicile to the site of the new job location. *Morrissey v. Comm'r of Revenue*, 1988 WL 91653 (Minn. Tax 1988).

¹⁴ The U.S. Supreme Court has regarded tax motivation as coloring the reliability of declarations as to one's domicile. *Texas v. Florida*, 306 U.S. 398, 417-18 (1939). The Court noted:

If declarations were alone sufficient to establish domicile, the record would leave no doubt that Green was domiciled in Texas until the time of his death. But in this connection it should be noted that Green never paid an income tax or a personal property tax on intangibles in any state, and the Special Master was of opinion that the desire to avoid taxation was a controlling motive for Green's repeated declarations that he was a resident of Texas long after he had ceased to have an abiding place or any active connection with affairs in that state.

It ultimately held the decedent was domiciled in Massachusetts contrary to his declarations.

focuses on maintenance of a residence and physical presence in an attempt to provide a standard that can be more objectively verified than domicile.

It provides that an “individual domiciled outside the state who maintains a place of abode in the state and spends in the aggregate more than one-half of the tax year in Minnesota” is a resident.¹⁵ The statutory residency test does not apply to individuals and their spouses who are in the military (discussed in the next section) or who are covered by an income tax reciprocity agreement (i.e., domiciled in North Dakota or Michigan).

The test has two components:

- **Physical presence in the state for more than half a year.** The statute provides that this is calculated on a per-day basis (i.e., the individual has spent 183 or more days in Minnesota in a nonleap year) and any part of a day spent in Minnesota counts.¹⁶ The administrative rule clarifies that days in which the individual is simply in transit (e.g., changing planes) between two points outside of Minnesota do not count as Minnesota days.¹⁷ To avoid being considered a Minnesota resident under the statutory residency test, individuals who maintain a Minnesota residence must keep records that enable them to verify that they were not in Minnesota for more than 182 days.¹⁸ This is typically done with calendars, financial records, and airline tickets. Because any part of a day qualifies, proof can present greater challenges for taxpayers than DOR and disputes over facts can occur.¹⁹ However, because the test is based on simple physical presence in the state, it is more objective and verifiable than the intent-based domicile test.
- **Maintenance of a place of abode.** The statute defines a “place of abode” as a dwelling the individual or spouse maintains. They don’t need to own or occupy the dwelling, just “to maintain” it. Thus, a rented dwelling or one owned by a relative but used by the individual could qualify. The administrative rule clarifies that dwellings do not qualify if they’re unsuitable for year-round use (e.g., a nonwinterized cabin) or if they do not contain cooking and bathing facilities (e.g., a sleeping room).²⁰ Moving one’s personal belongings out and attempting to rent or sell the residence will generally be sufficient to disqualify it.

¹⁵ Minn. Stat. § 290.01, subd. 7(b).

¹⁶ Minn. Stat. § 290.01, subd. 7(b) (“For purposes of this subdivision, presence within the state for any part of a calendar day constitutes a day spent in the state.”).

¹⁷ Minn. R. 8001.0300, subp. 4.

¹⁸ Minn. Stat. § 290.01, subd. 7(b); Minn. R. 8001.0300, subp. 4.

¹⁹ See *Luther v. Comm’r of Revenue*, 588 N.W.2d 502 (Minn.), cert. denied, 528 U.S. 821 (1999) (dispute over 18 days). Taxpayers need to prove they were outside of Minnesota for the entire day (essentially proving a negative), while DOR can show a day is a Minnesota day based on one financial record (e.g., use of a Minnesota ATM). However, taxpayers have the advantage in that they control and can create their records. James B. Stewart, “Tax Me If You Can,” *The New Yorker*, pp. 16-23 (March 19, 2002), describes in great detail the litigation between New York City and billionaire Julian H. Robertson over whether Robertson was in the city for parts of a few days (\$27 million in tax was at stake), as well as similar disputes with other high-profile taxpayers.

²⁰ Minn. R. 8001.0300, subp. 6.

The statutory residence test was enacted by the legislature in 1987.²¹ It seems clear that it was intended to provide a more objective and verifiable test of residency, as well as representing a judgment by the legislature that individuals who spend most of a tax year in Minnesota should pay tax on all their income. Most state income taxes now have analogous statutory residency rules, likely for the same reasons.²² Because the test is more objective than the domicile test, there probably is less litigation under it than under the domicile test. However, it can impose significant administrative burdens on taxpayers who travel in and out of the state frequently and must maintain records to document days when they were in Minnesota.

Under statutory residency tests, an individual may be subjected to income tax as a resident in two different states—that is, on all of their income by each of two states. The statutory residency test likely was partially motivated by a goal of making it easier to prove individuals are Minnesota residents without going through the challenge of showing they intended Minnesota to be their permanent homes. However, unlike the domicile test, it may cause someone to be a resident of two states—the state of domicile and Minnesota.²³ If the domicile state imposes an income tax, that means such an individual’s total income would be taxable by both states. To mitigate that effect, the Minnesota credit for taxes paid to another state allows a credit for income tax paid to the state of domicile to offset or reduce Minnesota tax. However, the credit requires that the state of domicile’s similar credit *not* apply before the Minnesota credit is allowed.²⁴ This reflects an apparent presumption that the state of statutory residency has a higher claim to the tax revenue than the domicile state.²⁵

Special situations and ambiguities are created by (1) Minnesota workers who live in bordering states and own Minnesota vacation homes and (2) part-year residents. The statutory residency test arguably applies in the following situation: An individual lives in

²¹ 1987 Minn. Laws, ch. 268, art. 1, §§ 9 and 10. This was done as part of an act that substantially restructured the Minnesota individual income tax.

²² Edward A. Zelinsky, “Apportioning State Personal Income Taxes to Eliminate the Double Taxation of Dual Residents: Thoughts Provided by the Proposed Minnesota Snowbird Tax,” *Florida Tax Review*, vol. 15, no. 7, pp. 543-554 (2014), describes the various statutory residency rules in state individual income taxes.

²³ Because of problems of proof, this could also occur under the domicile test. It is rare, but occurs most often under estate and inheritance taxes where two states both claim a decedent was domiciled in their state. *Cory v. White*, 457 U.S. 85 (1982), involved a dispute of this nature, involving California and Texas and the estate of Howard Hughes. A uniform law, repealed by Minnesota in 2014, is designed to address these types of disputes over estate and inheritance taxes. *Minn. Stat. §§ 291.41-291.47* (2012), repealed by *2014 Minn. Laws, ch. 308*, art. 9 § 94. DOR staff testified that this law was never used despite being on the books for over 60 years.

²⁴ *Minn. Stat. § 290.06*, subd. 22: “A taxpayer who is a resident of this state pursuant to section 290.01, subdivision 7, paragraph (b) [the statutory residency test], and who is subject to income tax as a resident in the state of the individual’s domicile is not allowed this credit *unless the state of domicile does not allow a similar credit.*” [emphasis added]. DOR, as an administrative practice, requires the taxpayer to attach a statement to the tax return indicating that domicile state’s credit is not available.

²⁵ Minnesota’s credit would apply in such a circumstance—that is, if an individual domiciled in Minnesota was a statutory resident of another state and paid income tax to the other state. See the general discussion of the credit in the text on pages 6 to 8. Many other states’ credits are limited only to taxes that are applied on a source basis. See the discussion in Zelinsky, note 22, p. 546 (“[M]ost states limit their income tax credits to situations where dual taxation results from a second state taxing on the basis of source”).

Wisconsin (or Iowa or South Dakota),²⁶ works at a full-time job in Minnesota, and owns a Minnesota vacation home (e.g., a lake cabin that qualifies as a “place of abode”), which he or she uses for overnight stays for a few days per year. A literal reading of the statute implies that the statutory residency test would treat such an individual as a Minnesota resident, subject to tax on his or her worldwide income. This is so because the full-time job causes the individual to be physically present in Minnesota for more than 183 days, the statute makes it clear that physical presence in Minnesota for any part of a day (no overnight stay required) is a Minnesota day, and the individual owns a qualifying “abode” in Minnesota. It seems unlikely that the legislature intended this result in enacting the statutory residency test and it is unclear if DOR enforces it in that manner (particularly after the repeal of the income tax reciprocity agreement with Wisconsin, after which more individuals could potentially be affected).²⁷

Similarly, the statute is unclear as to whether a part-year resident under the domicile test can be transformed into a full-year resident by the statutory residency test. By its terms, the statutory residency test applies only to individuals who are “domiciled outside the state[.]”²⁸ A literal reading would exclude days from the 183-day test after a part-year resident establishes domicile in Minnesota. DOR, consistent with its administrative rule, takes the position that this does not disqualify individuals who own a Minnesota abode for the entire tax year and who are physically present in Minnesota for 183 or more days. In an October 2014 ruling, the Minnesota Tax Court held that the test does not include days after an individual establishes a Minnesota domicile, following the literal language of the statute.²⁹ It is unclear if DOR will appeal.

Federal law dictates special rules for military personnel and other service members. The Servicemembers Civil Relief Act, to the extent that it is inconsistent with state law, governs whether a member of the military is a resident under either the domicile or statutory residency test.³⁰ The act provides that a service member’s presence or absence in the state under military orders does not affect a state’s determination of domicile or residency for income tax purposes (as well as some other taxes).³¹ This means that days in Minnesota under military orders do not count in applying the statutory residency test. [Rule 8001.0300](#) also provides that the presumption that one’s domicile is where one lives does not apply to individuals covered by the act. The rule also provides that a service member’s domicile is “governed by the facts just prior to becoming a member of the armed forces unless the person takes the necessary steps to

²⁶ North Dakota and Michigan residents would be unaffected because of the income tax reciprocity agreement with those states.

²⁷ Based on reported judicial cases, New York state apparently applies its statutory residency test in this manner. See, e.g., *In the Matter of the Petition of John J. and Laura Barker*, NYS Tax Appeals Tribunal, 2011 WL 198441 (2011) and the discussion in Peter L. Faber, “New York’s Statutory Residency Rule Should be Repealed,” *State Tax Notes* (April 4, 2011), pp. 29-33. The New York Court of Appeals has held that the New York statutory residency test does not apply to an abode that the taxpayer does not personally use as residence. *In the Matter of John Gaied v. N. Y. State Tax Appeals*, 983 N.Y.S.2d 757 (N.Y. 2014) (owned residence used by taxpayer’s parents did not qualify). That, however, would not address the situation in the *Barker* case.

²⁸ [Minn. Stat. § 290.01](#), subd. 7(b).

²⁹ *Marks v. Comm’r of Revenue*, 2014 WL 5426875 (Minn. Tax 2014).

³⁰ [50 U.S.C. App. § 571](#).

³¹ *Ibid.* Service members include member of the Public Health Service and the National Oceanic and Atmospheric Administration (NOAA), as well as the armed forces (including the Coast Guard).

establish a new domicile.”³² Aside from rules governing residence, the act also imposes income tax-base limitations that restrict a state’s power to tax nonresident service members and their nonresident spouse’s income if the service member is in the state under military orders and the spouse is in the state solely to be with the service member.

Estate Taxation: How Residency Is Established

Unlike the individual income tax, there is only one residency test under the estate tax: the domicile of the decedent.³³ The estate tax (similar to the income tax statute) does not define domicile. Its meaning, again, must have been assumed to be so obvious that an explicit definition was unnecessary. Although Administrative [Rule 8001.0300](#) was promulgated as an income tax rule,³⁴ DOR and the courts appear to consider that it applies to the estate tax as well.³⁵ Thus, the above discussion of domicile under the income tax generally also applies to the estate tax. One distinction is that no tax period (similar to a tax year for the income tax) applies to the estate tax, making it less clear how to assess factors that involve time elements. One assumes that the decedent’s intent at or near to death governs, so that evidence of the factors in the period immediately preceding death will be more probative of the relevant intent, adding another potential element to the domicile proof equation.

Fiduciary Income Taxes: Special Rules Apply

The information brief does not discuss the residency rules that govern Minnesota income taxation of trusts and estates (fiduciary income taxes). These rules are governed by special statutory provisions. See, e.g., [Minn. Stat. §§ 290.01](#), subd. 7a, 7b; [290.014](#), subd. 3. Taxability can depend upon the location of some combination of the (1) settlor (creator) of the trust, (2) trustee(s), or (3) beneficiaries. In addition, the constitutional limitations on state taxation of these entities are less clear than those relating to individuals. See, e.g., the discussion in Jeffrey Schoenblum, “Strange Bedfellows: The Federal Constitution, Out-of-State Nongrantor Accumulation Trusts, and the Complete Avoidance of State Income Taxation,” *Vanderbilt Law Review*, vol. 67, no. 6, pp. 1945-1998 (2014).

³² [Minn. R. 8001.0300](#), subp. 2.

³³ [Minn. Stat. § 291.005](#), subd. 1(8). In part, this reflects the reality that estate taxation probably cannot easily be tied to a percentage test of physical presence in the same way the income tax can (e.g., 183 days out of a 365-day tax year under the income tax). The estate tax is based on a point in time (date of death), rather than a time period (tax year), making it somewhat difficult to conceptualize how a percentage test would apply. Moreover, much of the constitutional case law, as discussed later in the information brief, is based on the domicile test of residency and seems premised on the concept that a decedent can have only one state of residence.

³⁴ The Statement of Need for Administrative Rule (SONAR) for the proposed rule amendments adopting the 26 factors characterized the amendments as an income tax rule: “The proposed rule amendment to the definition of “resident” (Income Tax Rule 2001(7)) lists several items which will be considered in determining whether or not a person is domiciled in this state. The amendments also clarify the application of other provisions of the existing rule.” 5 *State Register* 277, 278 (August 25, 1980). In addition, it cited an income tax statute, sections [290.06](#), subdivision 14, and [290.52](#), as the authority for promulgating the rule (nowhere mentioning the estate tax). *Ibid*.

³⁵ See, e.g., *Bradison v. Com’r of Revenue*, 2012 WL 36046, fn. 9 (Minn.Tax 2012), *aff’d* 825 N.W.2d 747 (Minn. 2013) (citing the rule as the authority for the definition of domicile in an estate tax case).

Application of the Minnesota Income and Estate Taxes to Residents and Nonresidents

Individual Income Taxation: Application to Residents and Nonresidents

States can impose income taxes under either of two jurisdictional principles:

- Income received by a resident of the state (**jurisdiction over the person**)
- Income earned in or derived from sources in the state (**jurisdiction over the income or property generating the income**)

The Minnesota individual income tax, similar to most state income taxes, relies on both of these jurisdictional bases to impose tax. Residents are subject to Minnesota tax on all their income, regardless of its source. For a resident whose income is taxed by another state (e.g., because it is derived from sources located in another state), a credit typically applies to prevent that income from being double taxed—by Minnesota and the other state. By contrast, nonresidents are subject to Minnesota income tax only on income that is derived from Minnesota sources. Part-year residents, individuals who move into or out of Minnesota during the tax year, are taxed as residents for part of the year and as nonresidents for part of the year. This section of the information brief describes the rules that determine the income that is subject to tax and the credit for taxes paid to another state for residents, nonresidents, and part-year residents.

Residents are subject to tax on their worldwide income.³⁶ This includes all of their Minnesota-source income, income from intangibles, and income from sources outside Minnesota (e.g., rents from real estate in another state or country or a business operating outside of Minnesota). A resident with income from sources in other states can, therefore, be subject to two levels of state taxation on this income—both by the source state (the state in which the income is earned) and the state of residence (Minnesota, in the case of a Minnesota resident).

To avoid cumulative or double taxation of this income, the Minnesota tax allows a credit for taxes paid to another state.³⁷ Similar credits are a feature of all state income taxes.

Things to note about the Minnesota credit for taxes paid to another state include:

- The credit is limited to the *lesser* of (1) the Minnesota tax on the income taxed by the other state (computed in proportion to adjusted gross income) or (2) the tax imposed by the other state on that income. Thus, if the other state's tax is higher (e.g., because it has higher tax rates or less generous deductions and credits), the full amount of the other state's tax will not be offset by the credit.³⁸

³⁶ [Minn. Stat. §§ 290.014](#), subd. 1 (“All net income of a resident individual is subject to tax under this chapter); [290.17](#), subd. 1 (“The income of resident individuals is not subject to allocation outside this state”).

³⁷ [Minn. Stat. § 290.06](#), subd. 22.

³⁸ It is this limitation that has caused the dispute with Wisconsin over how to calculate Minnesota's revenue loss under reciprocity agreements. Wisconsin's tax is higher than Minnesota's on many Minnesota residents who

- To qualify for the credit, the other state's tax must be imposed on or measured by net income.³⁹
- Other states are defined to include the District of Columbia and Canadian provinces,⁴⁰ but the credit does not apply to taxes imposed by local government units.⁴¹
- If the other state imposes a net income tax on an S corporation or partnership as an entity, rather than on its shareholders or partners on a pass-through basis, the Minnesota shareholder may claim the credit for his or her proportionate share of the entity tax.⁴²

The credit also applies in circumstances where an individual may be treated as a resident both by Minnesota and by another state.

Nonresidents are subject to tax only on their Minnesota-source income. For a nonresident, this income includes compensation for services performed in Minnesota and income from tangible property and businesses located in Minnesota. The geographic source of income depends on what type of income it is:

1. **Earnings from work or provision of services:** Its source is determined by the location of the work or services performed (e.g., wages earned from work done in Minnesota is Minnesota source income). In most circumstances, it will be obvious how to assign earnings based on location—e.g., based on the amount of time worked relative to the rate

work in Wisconsin. As a result of the limitation, the Minnesota credit does not offset fully Wisconsin's tax for these individuals. A reciprocity agreement with Wisconsin would allow the affected Minnesota workers to avoid the portion of Wisconsin's tax that exceeds Minnesota's, since they would no longer be required to file and pay Wisconsin tax and, then, claim a Minnesota credit that is lower than their Wisconsin tax. In the reciprocity agreement negotiations, Minnesota has refused to reimburse Wisconsin for this lost revenue (by accepting a lower reimbursement from Wisconsin for Minnesota's revenue loss resulting from exempting Wisconsin residents who work in Minnesota). Letter from Richard G. Chandler, Wisconsin Secretary of Revenue to Myron Frans, Minnesota Commissioner of Revenue, dated August 9, 2012, p. 2. Wisconsin's credit for taxes paid to another state does not have a similar limitation to Minnesota's for those cases where Minnesota's tax is higher (generally high-income taxpayers). Most state credits have limits like Minnesota's and unlike Wisconsin's. Only two other states beside Wisconsin (Georgia and Louisiana) appear to allow credits that exceed some measure of the in-state tax that is imposed on the income subject to tax by both states.

³⁹ For example, *Carlson v. Comm'r of Revenue*, 2003 WL 21729573 (Minn. Tax 2003), held that the credit did not apply to the (now repealed) Michigan Single Business Tax, which was imposed on value added. The same rationale would likely apply to the Texas margin tax and to the gross receipts taxes imposed by several states, if they apply to pass-through entities.

⁴⁰ *Minn. Stat. § 290.06*, subd. 22(i). Because foreign taxes qualify for a federal foreign tax credit, the Canadian provincial taxes must first be reduced by the amount of that federal credit before Minnesota's credit applies.

⁴¹ The limitation to state taxes is reflected in the Department of Revenue instructions for claiming the credit. The department's interpretation of the meaning of the statutory language "to another state" has been upheld by the tax court. *Meyer v. Comm'r of Revenue*, 1993 WL 301518 (Minn. Tax 1993).

⁴² *Minn. Stat. § 290.06*, subd. 22(g) (S corporations) and (h) (partnerships). The tax court has also held that the credit may be claimed on both a pass-through tax and entity level tax when a state imposes both types of taxes. *White v. Comm'r of Revenue*, 1995 WL 495912 (Minn. Tax. 1995) (Wisconsin income tax and recycling surcharge). The language of the statute has been modified since *White* was decided, further confirming the result in the case.

of pay.⁴³ Federal law prohibits states from taxing certain categories of wages that were deferred under qualified retirement plans and are paid out to nonresidents.⁴⁴

2. **Income derived from tangible property:** Its source is determined by the location of the property or business operations (e.g., rents paid on a Minnesota apartment or office building is a simple example of Minnesota income).
3. **Income derived from intangible property** (e.g., dividends paid on stock in a C corporation,⁴⁵ interest paid by a bond or bank account, earnings derived from intellectual property such as a patent or copyright, and so forth): The geographic source of this income is typically unclear or would be difficult to determine.⁴⁶ Thus, nonresidents are not subject to tax on this income.

The geographic source of an owner's income from business operations, including pass-through entities, is determined using an apportionment formula.⁴⁷ Starting in tax year 2014, apportionment is done based on the Minnesota percentage of total sales. Prior to 2014, Minnesota apportionment was based on the Minnesota percentage of the business's three-factor formula (property, payroll, and sales with sales weighted more heavily than the other two factors).⁴⁸

Table 1 summarizes the general rules. It is important to keep in mind that these sourcing rules are typically only important for nonresidents; residents are subject to Minnesota tax on all of their income, regardless of whether it is from Minnesota sources or not. This information brief is not intended to provide a detailed discussion of the nuances of the allocation or sourcing of income under Minnesota law. For more information on what constitutes Minnesota source income for nonresidents, readers can consult the information on the Minnesota Department of Revenue (DOR) website⁴⁹ or standard legal treatises on taxation for discussions of the constitutional issues that are involved.⁵⁰

⁴³ Special rules apply in some situations, such as nonresident athletes and entertainers for whom special allocation rules are provided. See, e.g., [Minn. Stat. § 290.17](#), subd. 2.

⁴⁴ [4 U.S.C. § 114\(a\)](#). Thus, an individual earning a qualified pension in Minnesota but who receives it as a nonresident (e.g., because she moved out of state) cannot be taxed by Minnesota on the pension payments.

⁴⁵ As noted below, dividends from S corporations, which are taxed as pass-through entities, are not treated as intangibles that are not taxable to nonresidents, if the business operates in Minnesota.

⁴⁶ [Minn. Stat. § 290.17](#), subd. 2(e) (default rule that assigns types of income not listed in the subdivision to the state of residence or domicile).

⁴⁷ Special rules apply to pass-through entities, such as S corporations and partnerships, owned by nonresidents where state law "looks through" the entity and treats them as if the nonresident individual owned the tangible property owned by the entity or by the business or businesses that the entity owns. Thus, income from pass-through entities, including capital gain realized on the sale of a pass-through entity, are taxable based on the location of the entities' operations or assets. See, e.g., [Minn. Stat. 290.17](#), subd. 2 (allocation of gain on sale of partnership interest based on ratio of the in-state share of original cost).

⁴⁸ [Minn. Stat. §§ 290.17](#), subd. 3; [290.191](#).

⁴⁹ See, e.g., Minnesota Department of Revenue, *Nonresidents*, (Income tax fact sheet 3, Rev. 3/14), http://www.revenue.state.mn.us/individuals/individ_income/factsheets/fact_sheets_fs3.pdf.

⁵⁰ See, e.g., Hellerstein & Hellerstein, *State Taxation* (3rd ed.) ¶ 20.05.

Table 1

Summary of Individual Income Taxation of Nonresident's Income			
Income Type	Examples	Source Determination	Tax Treatment
Current earnings from labor or provision of personal service	<ul style="list-style-type: none"> • Wages • Tips • Commissions • Payments to independent contractors • Gambling winnings 	Location of where the services were performed including where gambling was conducted; special formulas may apply, such as for professional athletes	<ul style="list-style-type: none"> • Taxable when source is Minnesota • May be exempt if subject to special gross income tax on entertainers instead • Federal statutes limit state power to tax employees of certain industries—see box on page 17
Deferred earnings	<ul style="list-style-type: none"> • Distributions from qualified plans 	Not applicable	Exempt under federal law
	<ul style="list-style-type: none"> • Nonqualified deferred compensation • Stock options 	Where services were performed to earn	Taxable when source is Minnesota
Income from tangible property	<ul style="list-style-type: none"> • Rents paid on real estate (e.g., apartment or office building) • Gain on sale of property 	Where property is located	Taxable when property located in Minnesota
Income from business operations	<ul style="list-style-type: none"> • Sole proprietor income • Distributions from pass-through entities (S corps, partnerships, etc.) • Gain on sales of Minnesota business (such as partnership or S corp) 	Formula apportionment—percent of business's total sales that are derived from Minnesota	Taxable based on Minnesota percentage
Income from intangible property	<ul style="list-style-type: none"> • Dividends from C corporation stock • Interest on bonds or bank accounts • Gain on sale of stock • Royalties on intellectual property interests (e.g., copyrights and patents) 	Not applicable	Exempt
Other income	<ul style="list-style-type: none"> • Alimony • Unemployment compensation 	Not applicable	Exempt

Although nonresidents pay tax only on Minnesota-source income, the tax rate is affected by their non-Minnesota income. In general, nonresidents compute their Minnesota income tax in a three-step process. They initially compute the Minnesota tax on their total income, including that from non-Minnesota sources. Then, they re-compute the income and deduction amounts

using only Minnesota source amounts. These computations are done on a two-column form, Schedule M1NR, with one column for total income and deductions and one column for the Minnesota source income and deductions. The final step is to determine a Minnesota percentage (Minnesota net taxable income as a share of total net taxable income); this percentage is multiplied by the tax on their total income to determine their Minnesota tax liability.⁵¹

This method of calculation limits the tax liability to Minnesota source income, but preserves the progressivity of the graduated rate structure by effectively determining where in the rate structure a nonresident's total income places him or her based on income from all sources, including those outside of Minnesota. If the tax were computed solely by applying the rate structure to a nonresident's Minnesota income, the effect of the nonresident's non-Minnesota income on his or her ability to pay would be ignored. To illustrate, assume a nonresident has \$250,000 in total taxable income, but only 10 percent (\$25,000) of it is derived from Minnesota sources (such as a business or real estate located in Minnesota). If the Minnesota tax computation were based only on Minnesota source income, this taxpayer would have all of his or her income taxed in the lowest bracket (5.35 percent). By contrast, the actual method effectively ensures that the width of the brackets is proportionately reduced based on the Minnesota percentage, taxing some income in the higher brackets.⁵⁷

Federal Statutory Limits on State Taxation of Nonresidents

Congress has enacted limits on the ability of states to impose income taxes on the earnings of nonresident employees of certain industries. These employees have the common characteristic of frequently performing services in multiple states, typically because they work in the transportation sector.⁵² They include employees of:

- Railroads ("rail carriers")⁵³
- Trucking companies ("motor carriers")⁵⁴
- Merchant marine⁵⁵
- Airlines ("air carriers")⁵⁶

These statutes do not define residence (e.g., whether it is solely based on domicile), leaving that issue to state law to determine. As discussed in the text, federal statutory limits also apply to the taxation of nonresident members of the military and their spouses. The rules governing members of the military *do include* federal law rules defining residency for state tax purposes.

⁵¹ Tax credits, such as the working family credit, are typically also multiplied by this Minnesota percentage to limit their benefits to the amount of activity in Minnesota.

⁵² The scope of these statutes is not limited to individuals working on vehicles—planes, trains, ships, and trucks—or regularly traveling as part of their duties, but includes employees, such as executives, living in one state and working at a desk job in another state. *See e.g., Fink v. Comm'r of Revenue*, 885 N.E.2d 859 (Mass. App. 2007) (railroad executive lived in New Hampshire working in Massachusetts qualified for exemption).

⁵³ 49 U.S.C. § 11502. The statute also limits a rail carrier's withholding and information filing requirements to the employee's state of residence.

⁵⁴ 49 U.S.C. § 14503(a), limiting employees of a motor carrier regularly performing services in two or more states to income taxation only in the state of residence.

⁵⁵ 46 U.S.C. § 11108(b), limiting taxation of seamen to their state of residence.

⁵⁶ 49 U.S.C. § 40116(f), limiting state income taxation to the employee's state of residence or the state in which the employee earns more than half of his or her pay.

⁵⁷ Taxpayers have argued that this approach results in the state taxing their out-of-state income. All of the courts that have addressed this issue have rejected that argument, but the U.S. Supreme Court has not granted review

Part-year residents, individuals who move into or out of Minnesota during the tax year,⁵⁸ are subject to both taxation as residents and nonresidents for the relevant tax year. This is done by calculating a tentative tax on their total income and apportioning it by the share of income that is derived from the period when they were Minnesota residents.⁵⁹

Estate Taxation: Application to Residents and Nonresidents

The structure of the taxation of resident and nonresident decedents under the Minnesota estate tax differs somewhat from that under the individual income tax. Resident individuals are subject to the Minnesota estate tax on all of their intangible property and on their Minnesota tangible property.⁶⁰ They are not taxed on their non-Minnesota tangible property.⁶¹ Nonresidents are taxed on their transfers of tangible Minnesota property: (1) Minnesota real property, (2) tangible personal property (vehicles, boats, furniture, jewelry, and so forth) that was normally kept or located in Minnesota, and (3) similar tangible property held in pass-through entities (e.g., a trust, S corporation, partnership, or limited liability company).⁶² Table 2 summarizes these rules.

of a case raising the issue. See Hellerstein & Hellerstein, *State Taxation* (3rd ed.) ¶ 20.05[1][b] for a discussion of the issues and cases.

⁵⁸ DOR also considers individuals who spend 183 or more days in Minnesota and maintain an abode (a dwelling with a kitchen and bathroom) for part of the year as part-year residents. See Minn. Revenue, *Part Year Residents*, p. 1, http://www.revenue.state.mn.us/individuals/individ_income/factsheets/fact_sheets_fs2.pdf.

⁵⁹ See *ibid.* for a detailed description of this calculation.

⁶⁰ The location or situs of property is defined by where real property is located and for tangible personal property based on “the state or country in which it was normally kept or located at the time of the decedent’s death[.]” *Minn. Stat. § 291.005*, subd. 1 (9). It is unclear whether “at the time of the decedent’s death” modifies both “located” and “normally kept” or only “located.” Under a 2014 legislative change, a special exception is provided for art on loan by a nonresident to a Minnesota nonprofit entity, such as a museum, to ensure this does not trigger Minnesota estate tax.

⁶¹ A structure comparable to the individual income tax would impose tax on all of their property, including non-Minnesota tangible property, and allow a credit for estate or inheritance tax paid to another state on that property. This difference in the structure of the estate tax follows an old U.S. Supreme Court case, which is discussed more fully later in the information brief, holding states could not impose estate and inheritance taxes on out-of-state tangible property owned by residents. See *Frick v. Pennsylvania*, 268 U.S. 473 (1925).

⁶² *Ibid.* Put another way, owning a pass-through entity (e.g., an S corporation) is not treated as owning an intangible asset (i.e., the shares of the S corporation), but rather the entity is ignored or “looked through” and the owner is treated as owning the pass through entity’s Minnesota tangible property directly. This prevents nonresidents from moving Minnesota tangible property (whether personal use property, such as a second residence, or business assets) into an entity, converting ownership to an intangible that avoids Minnesota estate taxation.

Table 2

Property Subject to Minnesota Estate Tax Comparison of Estates of Residents with Nonresidents		
Type of Property	Resident	Nonresident
Minnesota tangible property (real estate and personal property usually kept in Minnesota)	Yes	Yes
Intangibles (e.g., stocks, bonds, mutual funds, retirement plan assets, bank deposits, excluding ownership of pass-through entities)	Yes	No
Pass-through entity ownership interests (stock in S corporation, partnership interests, LLC memberships)	Yes	No
Minnesota tangible property owned by pass-through entities	No (intangible interest is taxed)	Yes (based on fractional ownership of pass-through entity)

To determine the tax, a tentative or initial tax is computed based on the value of the entire estate (including the non-Minnesota property), and then the Minnesota tax is determined by multiplying the result by a fraction:

$$\frac{\text{Minnesota gross estate}}{\text{Federal gross estate}^{63}}$$

Thus, the total value of the estate (including non-Minnesota property) determines the tax rates that apply under the exemption and graduated rate structure for estates of resident decedents with non-Minnesota situs property and for nonresident decedents.⁶⁴

⁶³ Minn. Stat. § 291.03, subd. 3.

⁶⁴ Gross estate, both federal and Minnesota, generally refers to the fair market value of the property owned by the decedent at death, before deductions such as for debts, costs of administration, funeral costs, and charitable contributions. Determining the tax on the entire estate and, then, apportioning the tax based on the Minnesota share of the gross estate avoids the result of a large estate (e.g., \$100,000,000) with a modest amount of Minnesota property (e.g., \$1,000,000) avoiding a Minnesota estate tax because the amount of Minnesota property is less than the exemption amount (\$1,200,000 for deaths in 2014). Similarly, it apportions the benefits of the lower tax brackets based on the total value of the estate. This is similar to the structure of the individual income tax on nonresidents.

Constitutional Restrictions: Rules Limiting Taxation of Residents versus Nonresidents

In general, constitutional restrictions on the ability to tax the income or estates of residents and nonresidents result from application of four provisions of the U.S. Constitution:

- The **Due Process Clause**, generally requiring sufficient contact with the individual, income or property for the state to impose a tax
- The **dormant Commerce Clause**, prohibiting state taxes that unduly burden interstate commerce
- The **Privileges and Immunities Clause**, entitling nonresidents to the same privileges and immunities provided by a state to its own citizens
- The **Equal Protection Clause**, prohibiting differential treatment that is not based on (at least) a rational basis for the differential treatment

This section of the information brief is intended only to point out basic constitutional issues involved with imposing state income and estate tax on residents versus nonresidents. It does not provide a comprehensive or thorough discussion of the constitutional issues. The Equal Protection Clause will generally not come into play, since there typically will be some type of rational basis supporting the tax structure. Tax policies that lack a rational basis typically also violate the dormant Commerce Clause or the Privileges and Immunities Clause. As a result, the discussion does not cover the equal protection.

Income Taxation: Constitutional Restrictions

Due Process Clause

The Due Process Clause requires sufficient contact to provide jurisdiction to tax. The U.S. Supreme Court has held, as noted above, that states have jurisdictional authority to impose their income taxes on two bases—either because the recipient of the income is a resident (is domiciled in the state) or because the income is derived from sources within the state or has a situs in the state.

With regard to residents, in the words of the Court:

That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government. *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312-13 (1937).

It doesn't matter that the income is derived from sources in another state and could be taxed by another state as well. Residency status provides the legal authority to impose the tax. The Court has followed this in upholding taxes on a resident's income from tangible property located in

another state,⁶⁵ from intangible property (stocks and bonds) held in a trust created and administered in another state,⁶⁶ and from a business conducted in another state.⁶⁷

The Court has not directly addressed who qualifies as a resident.⁶⁸ Most of the relevant cases were decided before 1950 and none of the Court's cases on the states' power to tax the income of residents have involved statutory residency tests (i.e., based on the number of days physically present in the state), which were typically enacted in 1980s and later. So far, the Court has refused to hear cases challenging statutory residency tests.⁶⁹ One can speculate as to whether the rationale supporting residency-based taxation—largely the benefits of governmental protections and services provided to residents and the close connection between them and their state and local governments—would extend to a statutory resident (someone whose permanent home is in another state, but who spends substantial time in the state).⁷⁰ Clearly, physical presence in the state for a substantial amount of time and ownership of property implies some level of enjoyment of state-provided benefits, even if it is not as close a connection as likely is the case with domicile. It may be relevant that domicile implies greater consumption or use of services (e.g., minor children attending school) or entitlement to benefits (e.g., resident higher education tuition, resident hunting, fishing, and park licenses are likely not available to statutory residents). However, a statutory resident may actually be physically in the state more than some domiciliaries, possibly implying greater enjoyment of benefits.

⁶⁵ *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937) (rents from real estate).

⁶⁶ *Maguire v. Tefrey*, 253 U.S. 12 (1920) (Massachusetts income tax imposed on distribution of income from trust created and administered in Pennsylvania to Massachusetts resident).

⁶⁷ *Lawrence v. State Tax Commission*, 286 U.S. 276 (1932). The Court in *Lawrence* also rejected the taxpayer claim that the Equal Protection Clause was violated because the Mississippi income tax exempted the similar income of Mississippi corporations. (Like most state corporate income taxes, the Mississippi corporate tax was a territorial tax—it only applied to Mississippi source income—while the Mississippi individual income tax on residents was a worldwide income tax.) The Court easily found a rational basis for the differential treatment, because C corporations were subject to two levels of tax.

⁶⁸ The Court has applied the domicile requirement under the District of Columbia income tax, enacted by Congress. *District of Columbia v. Murphy*, 314 U.S. 441 (1941). However, the case obviously did not involve an issue of the extent of a state's power to tax an individual who was physically present (resident) in a state, but not domiciled there, since resolving the case only required construing the meaning of the District of Columbia statute.

⁶⁹ State courts that have heard these cases have upheld statutory residency tests. See Hellerstein & Hellerstein, *State Taxation* (3rd ed.) ¶ 20.03[2], citing *People ex rel. Ryan v. Lunch*, 186 N.E. 28 (N.Y. 1933). The Court has so far refused to review these decisions, including one Minnesota case. See, e.g., *Luther v. Comm'r of Revenue*, 588 N.W.2d 502, cert. denied 528 U.S. 821 (1999).

⁷⁰ Seth Goldstein, "'Resident' Taxpayers: Internal Consistency, Due Process, and State Income Taxation," *Columbia Law Review*, vol. 91, No. 1, pp. 119–141 (1991), analyzes whether state statutory residency tests (physical presence style) satisfy the requirements of due process and concludes that the more expansive definitions are not consistent with due process. The analysis relies on the Court's resolution of a dispute between two states over the domicile of a decedent in which the Court's opinion focused on "family history" and a sort of special relationship with the state in judging what type of residency is required to justify taxation of a resident's worldwide income. *Ibid.* pp. 134–135, relying on *Texas v. Florida*, 306 U.S. 398 (1939). The article, however, was written before *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), essentially created a division of labor between the Due Process Clause and the dormant Commerce Clause, likely relegating the Due Process Clause to addressing concerns about the minimal level of contacts necessary to permit taxation, rather than concerns about multiple burdens, which are left to the Commerce Clause. The latter is discussed in the text addressing the Commerce Clause. See page 23.

Nor has the Court addressed the due process implications (if any) of two states subjecting an individual to taxation as a resident on his or her total or worldwide income—one based on domicile and the other based on physical presence or statutory residency and whether one (or which) of the two states must give way to the other, for example, by allowing a tax credit for the other state’s tax.⁷¹ The Court generally has not been concerned (under the Due Process Clause) with multiple taxation of the same income or transfer; these concerns are typically addressed under the dormant Commerce Clause.

With regard to nonresidents, the state tax must be limited to sources that are derived from within the state or that have a situs in the state. This allows the state to tax income a nonresident derives from tangible property located in the state or the conduct of a business in the state. The classic case is *Shaffer v. Carter*,⁷² which upheld an Oklahoma income tax on income from in-state oil and gas wells owned and operated by an Illinois resident.⁷³ In some instances, income from intangible property may acquire a tax situs within the state and be taxable to a nonresident.⁷⁴ This allows, for example, a state to impose its income tax on the gain on the sale of interests in pass-through entities that own tangible property or otherwise conduct business in the state.⁷⁵

Dormant Commerce Clause

The “dormant” Commerce Clause limits undue burdens on interstate commerce. The Commerce Clause is a grant of power to Congress to regulate interstate commerce, but the Court has construed that this also, by implication, limits the ability of states to impose regulations or taxes that unduly burden interstate commerce, even if Congress has taken no action.⁷⁶ Because the limits are not dependent upon congressional action, the doctrine is typically characterized or

⁷¹ As discussed below, the Court this term will address whether the dormant Commerce Clause requires a state to allow a resident a credit for taxes paid to another state on the same income. See text on page 23.

⁷² 252 U.S. 37 (1920).

⁷³ The Court used dogmatic language in rejecting the notion that state could only apply a property tax and did not have jurisdiction over the income:

That the State, from whose laws property and business and industry derive the protection and security without which production and gainful occupation would be impossible, is debarred from exacting a share of those gains in the form of income taxes for the support of the government, is a proposition so wholly inconsistent with fundamental principles as to be refuted by its mere statement. That it may tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it, is wholly inadmissible. *Id.* at 50-51.

⁷⁴ *New York ex rel. Whitney v. Graves*, 299 U.S. 366 (1937) upheld imposition of the New York income tax on the gain realized by a nonresident on sale of a seat on the New York Stock Exchange, a transferrable, intangible interest in an unincorporated association. The Court was apparently persuaded by the fact that the constitution and by laws of the exchange required transactions to be conducted at its office in New York City. The nonresident taxpayers, however, never conducted any business in New York or used their memberships to transact business on the exchange (rather it entitled them to discounted rates when other members traded for their account).

⁷⁵ Under the dormant Commerce Clause, as discussed below, this tax must be apportioned appropriately if the pass-through entity has property or conducts business in multiple states.

⁷⁶ U.S. Const. art. I § 8, cl. 3 (“The Congress shall have Power * * * to regulate Commerce * * * among the several States).

referred to as the “dormant” Commerce Clause. In the context of taxation, it most frequently is invoked when a state imposes differential or higher taxes on out-of-state businesses, as compared with local or in-state businesses.

The Court’s standard formulation of the doctrine is derived from a 1977 case, *Complete Auto Transit, Inc. v. Brady*,⁷⁷ which permits state taxes that fall on interstate commerce (broadly defined) if four conditions are satisfied, under which the tax:

1. Is applied to an activity with a substantial nexus with the taxing state;
2. Is fairly apportioned;
3. Does not discriminate against interstate commerce; and
4. Is fairly related to the services provided by the state.⁷⁸

As noted above, the vast majority of the dormant Commerce Clause tax cases involve out-of-state businesses challenging taxes that they considered to impose higher burdens on their operations, compared with local businesses. There simply is little, if any, Court precedent that addresses how the dormant Commerce Clause doctrine or its limitations would apply to the state income taxation of residents.⁷⁹ As described in the previous section, the cases upholding states’ power to tax residents have largely focused on whether the state has jurisdiction or authority to tax the income of residents from sources in other states, such as from businesses or assets in another state. They do not address situations where an assertion was made that income from interstate commerce was being taxed more heavily or differentially than in-state or local income.⁸⁰ Thus, it is unclear to what extent (if any) a state individual income tax on a resident (based on domicile or physical presence) must be “fairly apportioned” (prong 2 of the *Complete Auto* test) or cannot discriminate against interstate commerce (prong 3 of the *Complete Auto* test).

***Maryland Comptroller of the Treasury v. Wynne*,⁸¹ to be decided by the Supreme Court in its 2014-15 term, is likely to provide insight on the Court’s views of how Commerce Clause limits apply to state income taxation of residents.** A Maryland tax case, granted review by the Court in 2014, likely will address whether a state’s taxation of a resident’s out-of-state income is

⁷⁷ 430 U.S. 274 (1977). *Complete Auto* overruled a line of cases that prohibited state taxes that were imposed “directly” on interstate commerce in favor of a test that looked more to the practical or economic effects of the tax and that expected interstate businesses to pay their “fair share” of state taxes, along with local businesses.

⁷⁸ *Ibid.*, p. 279.

⁷⁹ This is compounded by the fact that prior to the decision in *Quill* (see discussion in note 70), the Court typically did not carefully distinguish whether it was deciding state income tax cases on Due Process or dormant Commerce Clause bases. The early cases (from the 1920s through the 1940s) setting the rules for states’ power to tax the income of residents, as discussed in the text on pages 21 to 23, appear to be Due Process Clause cases, rather than Commerce Clause cases. But that is not absolutely clear.

⁸⁰ In fact, in some cases the claim, as perceived by the Court, was precisely the opposite: that out-of-state businesses were attempting to use their status to obtain preferential rates. See, e.g., *Shaffer v. Carter*, 252 US 37, 53 (1920) (“[The Privileges and Immunities Clause] protects him against discriminatory taxation, but gives him no right to be favored by discrimination or exemption”).

⁸¹ *Maryland Comptroller of the Treasury v. Wynne*, 64 A.3d 453 (Md. 2013), cert. granted 134 S.Ct. 2660 (2014).

subject either to fair apportionment or to the prohibition on taxes that discriminate against interstate commerce. Maryland's income tax, like most other states' income taxes including Minnesota's, imposes tax on the worldwide income of residents. It mitigates or prevents double taxation by allowing a credit for taxes paid to other states. However, Maryland also allows counties to impose county income taxes (on the state tax base with the state collecting and remitting the tax to the counties) but does not allow the credit for taxes paid to other states to reduce these county taxes. The net result of this arrangement is that a Maryland resident with income subject to tax in another state pays both that state's tax and the applicable Maryland county tax without a credit to offset the other state's tax.

The taxpayers in *Wynne* were Maryland residents who were part owners of an S corporation that did business in other states. They paid state income taxes to those states on the S corporation income that was subject to the applicable Maryland county income tax. Because the credit for taxes paid to other states did not apply to the county tax, this out-of-state income was subject to a higher tax burden than comparable income from Maryland sources: Maryland income would be subject only to the county tax, while non-Maryland source income would be subject to both the other state income tax and the county tax. The taxpayers argued that this arrangement (the failure to extend the credit to the county tax) discriminated against interstate commerce or was not fairly apportioned, contrary to the requirements of the dormant Commerce Clause. The Maryland Court of Appeals agreed with both contentions.

Whether the Supreme Court will agree likely will depend upon whether it considers the usual fair apportionment and anti-discrimination rules to apply to resident income taxation. In particular, what the Court considers to be the potential impact of source state taxation of this income may be key: Is resident taxation sufficiently unique and *sui generis* so that the possible impact of taxes that other states apply or could apply is irrelevant? Does the dormant Commerce Clause apply at all to resident state income taxation? Interstate commerce (i.e., income earned by a Maryland resident in another state) is subject to higher tax, because another state can and does tax that income, and the Maryland county tax does not account or adjust for that. With regard to fair apportionment, the Court has developed an "internal consistency" test as component of its dormant Commerce Clause doctrine.⁸² A tax is internally inconsistent and not fairly apportioned, if it would impose a higher burden under an assumption that all states impose an identical tax. The Maryland tax fails this test because income from out-of-state sources would pay higher taxes than Maryland source income. This results because income from out-of-state sources pays both taxes (the other state's tax and the Maryland county tax), while Maryland income pays only the county tax. Thus, if the fair apportionment requirement applies to resident taxation, the Maryland tax clearly violates it.

⁸² This test originated with *Container Corp. of America v. Franchise Tax Bd*, 463 U.S. 159, 169 (1983). The Court succinctly described the test as follows:

The first, and again obvious, component of fairness in an apportionment formula is what might be called internal consistency—that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed.

In some ways this test is simply a way of saying a tax structure that imposes higher taxes on income derived from sources in multiple states, presumptively discriminates against interstate commerce.

It should be noted that if the Court holds the Maryland tax violates the dormant Commerce Clause, it would likely mean that the restriction on the Minnesota tax credit to only other *state* income taxes is unconstitutional. The restriction on the Minnesota credit for taxes paid to another state is the converse of the Maryland situation—it subjects non-Minnesota source income that is subject to a local income tax in another state to potential multiple or higher Minnesota tax burdens than in-state income, violating internal consistency and arguably discriminating against interstate commerce.

Privileges and Immunities Clause

The Privileges and Immunities Clause prohibits discrimination against nonresidents. [Article IV](#), section 2, of the U.S. Constitution provides:

The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens of the several States.

The Privileges and Immunities Clause entitles a citizen (essentially a nonresident)⁸³ of another state to be accorded equivalent tax treatment to a resident of the state. In the words of the Court, one of the privileges protected by the clause is the ability of a nonresident to do business or earn income in the state on “terms of substantial equality” with residents.⁸⁴ The clause is not an absolute bar to differential treatment if there is “a valid independent reason” for it.⁸⁵ The clause, however, does not protect residents from preferential tax treatment of noncitizens or nonresidents. As a result, it is unclear how it would come into play regarding the tax treatment of individuals who are contesting tax burdens that result from their status or treatment as residents.⁸⁶

Estate Taxation: Constitutional Restrictions

Due Process Clause: Jurisdiction to Tax. A series of cases from the first half of the 20th century establishes the basic authority for states to impose inheritance and estate taxes. The rules under these cases parallel, but deviate slightly, from the rules that apply to income taxation of residents and nonresidents.

There is the usual tension (and lack of clarity) between three potential jurisdictional principles—governmental authority over the person, property, or transactions. Inheritance and estate taxes can theoretically be thought of as having elements of:

⁸³ The Court has generally held that a tax that illegally discriminates against nonresidents has the effect of violating the Privileges and Immunities Clause because it discriminates against citizens of other states. *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920).

⁸⁴ *Toomer v. Witsell*, 334 U.S. 385, 396 (1948). *Toomer* invalidated a state license fee imposed on shrimp boats owned by nonresidents that was 100 times higher than that on residents.

⁸⁵ *Ibid.*

⁸⁶ In that circumstance, the Equal Protection Clause, which under normal circumstances is a lesser bar to differential taxation based on residency than the Privileges and Immunities Clause, could come into play. The state would need to show that there was some rational basis for its residency classification or treatment, a fairly low bar.

- *Personal taxes.* Similar to individual income taxes, estate and inheritance taxes could be viewed as wealth taxes that are tied to the state's jurisdiction over the decedent as a person (or the estate or trust as an entity). The estate tax is measured by the property holdings of the decedent and imposes graduated rates with exemption amounts, making it look much like a wealth tax analogue of an income tax, that is, that it is personal to the owner, not imposed on the property itself. Under this theory, roughly the same jurisdictional rules would apply to estate taxation as apply under the income tax—i.e., all of the holdings of a resident decedent could be subject to tax, perhaps, with a credit for taxes paid on tangible property located in another state required.
- *Property taxes.* By contrast, estate and inheritance taxes could be viewed as property taxes. The estate tax is measured by the value of the decedent's property on the date of death (or alternative valuation date), nearly the same as a typical property tax. It would be natural, then, to conclude that the same jurisdictional rules apply as under the property tax—i.e., the state could only tax tangible property that is located in (or has a legal situs) in the state, regardless of where the owner resides.
- *Transfer taxes.* Estate and inheritance taxes also have elements of transfer taxes. It is the transfer of property from the decedent or the estate to heirs that is being taxed. This could imply that jurisdictional rules applicable to sales and gross receipts tax should apply, allowing taxation of in-state transfers.

Unlike in the personal income tax context, the Court has drawn a clear distinction between tangible and intangible property. The state has authority to impose an estate or inheritance tax on a resident's intangibles, but can only impose death duties on tangible properties located in the state. The classic case limiting the ability of a state to tax a resident's holding of out-of-state tangible property is a 1925 case, *Frick v. Pennsylvania*.⁸⁷ In *Frick*, the decedent was a Pennsylvania resident but owned over \$13 million in art that had a legal situs in New York (it was located in a New York City art gallery and bequeathed to the gallery), along with other tangible property in New York and Massachusetts. Pennsylvania sought to impose its inheritance tax on the transfer of the out-of-state tangible property. The Court concluded that Pennsylvania's jurisdiction did not apply, because both the property and transfer (which the state asserted was the basis for the jurisdiction) were outside of its territorial authority:

The tax which it [Pennsylvania] imposes is not a property tax but one laid on the transfer of property on the death of the owner. This distinction is stressed by counsel for the State. But to impose either tax the State must have jurisdiction over the thing that is taxed, and to impose either without such jurisdiction is mere extortion and in contravention of due process of law. Here the tax was imposed on the transfer of tangible personalty having an actual situs in other States—New York and Massachusetts. This property, by reason of its character and situs, was wholly under the jurisdiction of those States and in no way under the jurisdiction of Pennsylvania. True, its owner was domiciled in Pennsylvania, but this neither

⁸⁷ 268 U.S. 473 (1925).

brought it under the jurisdiction of that State nor subtracted anything from the jurisdiction of New York and Massachusetts.⁸⁸

Nearly a century later, this essential limiting principle remains. That is, the Court has never reversed it, despite the seeming contradictory approach it has taken in individual income tax cases. There may be some reason to question whether, if confronted with a case involving a state estate tax, the Court would reverse it based on the personal income tax cases allowing the income from out-of-state property to be taxed. The rule has been subject to withering criticism from commentators.⁸⁹ Fundamentally, the rule seems inconsistent with the notion that the state has power to tax the individual (the decedent) and that it should be able to measure wealth by all of his or her property, not just in-state and intangible property. A good reason for distinguishing between types of property is not obvious, if the jurisdictional basis derives from the government's relationship with the person, not the property or the transfer/transaction.

With regard to intangibles, the Court has long held that the state of residence of the decedent may tax the transfer or value. However, it has vacillated as to whether other states with connections to the intangibles (e.g., a state where a trust holding the assets is being administered or the commercial domicile of a corporation for shares of stock) may also tax the transfer of the property. In 1939, the Court resolved this, allowing the other state (in addition to the decedent's state of residence) to tax this property and rejecting the notion that the Due Process Clause protects against multiple taxation in this context.⁹⁰ This creates the potential for multiple taxation of the same property under estate and inheritance taxes by more than one state. The same result obtains (perhaps more commonly now) if two or more states claim an individual was domiciled in their state.⁹¹

Dormant Commerce and Privileges and Immunities Clauses. Traditionally, dormant Commerce Clause doctrine and the protections under the Privileges and Immunities Clause are not thought to be implicated by state estate and inheritance taxes.

⁸⁸ *Ibid.* p. 492. The Court's opinion implies that taxes that take into account the value of out-of-state tangible property in determining the applicable rate under a graduated rate tax are permissible. *Ibid.* pp. 494-496 (distinguishing *Maxwell v. Bugbee*, 250 U.S. 525 (1919) on that basis). That, of course, is the arrangement that Minnesota and most state estate taxes adopt by computing a tentative tax on the value of the decedent's entire estate, including out-of-state tangible property, and then determining tax by multiplying the tentative tax by the percentage that in-state tangible property and all intangible property comprise of the total value.

⁸⁹ The classic article is Boris I. Bittker, "The Taxation of Out-of-State Tangible Property," *Yale Law Journal*, vol. 56, pp. 640-669 (1947).

⁹⁰ *Curry v. McCannless*, 307 U.S. 357 (1939). It is this case (in addition to the income tax cases) that makes the limitations on the state of residence taxing out-of-state tangible property so perplexing.

⁹¹ In rare circumstances the Supreme Court has taken cases to resolve these disputes over which state is the domiciliary state. *Texas v. Florida*, 306 U.S. 398 (1939), is the classic case where the Court took original jurisdiction under interpleader procedure. It involved four states (Florida, Massachusetts, New York, and Texas) all claiming to be the domicile of the decedent. In aggregate the taxes would have exceeded the value of the estate, if all had applied. In the typical case, the Court does not allow interpleader to resolve domicile disputes. *Cory v. White*, 457 U.S. 85 (1982) (two states disputing reclusive billionaire Howard Hughes' state of domicile).

Potential Modifications to the Domicile Test

Minnesota's residency rules under the income tax have remained largely unchanged since enactment of the tax in 1933 (and DOR's adoption of the 26-factor test in 1982). Their only major change was the adoption of the statutory residency rule, as part of a major restructuring of the tax in 1987. Legislation in 1999 prohibited DOR and the courts from considering charitable contributions in determining whether an individual is domiciled in Minnesota. But this was a modest change, since DOR contended that it did not consider contributions in its residency audits and the location of contributions had never been cited as a factor in published court decisions. However, starting in 2011, proposals to change the rules have become more frequent including:

- Governor Dayton's 2011 snowbird proposal, and
- Modifications to the 26 factors to exclude location of service providers such as accountants and financial planners.

Governor Dayton's 2011 snowbird tax proposal

In his 2011 budget, Governor Mark Dayton proposed a new statutory residency rule. Under the proposal, individuals who maintained Minnesota abodes for over half of the year and who were physically in Minnesota for more than 60 but fewer than 183 days would be taxed as part-year residents.⁹² These individuals would pay Minnesota tax on their worldwide income in proportion to the number of days that they were in Minnesota. The legislature did not adopt this unprecedented proposal (no other state has a similar provision) for restructuring the taxation of nonresidents. However, at least one commentator has suggested that the approach has merit and could help mitigate the problem of individuals being simultaneously subject to taxation as residents in two states.⁹³

The proposal raises interesting issues on least two levels:

- Is the provision constitutional? In particular, does maintenance of a Minnesota residence and physical presence in the state (for between two and six months) justify proportionate taxation of income from intangibles and out-of-state tangible assets (in proportion to time spent in the state) under the Due Process Clause? It is difficult to assess this issue, since the Court's cases, which give states extraordinary taxing authority over residents, all involved individuals domiciled in their states with their close and unique ties to the states. Given the apportionment (relative to time present) and the allowance of a credit for taxes paid to the state of domicile, it seems unlikely the provision will, on its face, run afoul of dormant Commerce Clause doctrine. A perhaps unintended effect could be to lead to a claim that all statutory residents (including those present in the state more than 183 days) should also be afforded the opportunity to apportion their tax liability based on the percentage of their time in the state under Commerce Clause limitations. The Court's

⁹² H.F. No. 1231, art. 1, §§ 9, 19, 31-33 (2011). However, days in Minnesota to obtain medical treatment would not count.

⁹³ See Zelinsky, footnote 22.

decision in *Wynne* could provide some insight into the constitutional viability of the governor's snowbird tax proposal or variants of it.

- The proposal, if implemented, would likely lead to some serious tax administration and compliance issues—in particular, the challenge of tracking by taxpayers and verifying by DOR of the number of days that a fair number of taxpayers are in the state.⁹⁴ While the stakes would be lower than the all-or-nothing decisions under the current 183-day rule (resident or not), many more taxpayers would be affected and auditing even a sample of them could be time consuming and expensive for all affected.

Protecting Minnesota businesses and service providers who sell services to individuals attempting to change their Minnesota domiciles

The 2013 increase in the top individual income tax rate and the demise of many other states' inheritance and estate taxes have increased the incentive for Minnesotans, particularly affluent retired taxpayers who are relatively footloose and may already have second homes in sunbelt states, to change their residences to states with low or no income taxes and no estate or inheritance taxes. This has led to concerns that the 26-factor test, particularly its focus on business and social relationships, may disadvantage local businesses and other organizations in competing for the patronage and participation by individuals who split their time between Minnesota and low-tax, sunbelt states. Specifically, individuals may sever ties with local banks, brokers, and legal and financial advisors to look less like Minnesota residents under the 26-factor test. They may also sever ties with social and political organizations, and athletic and country clubs for similar reasons. This has led to proposals (including changes passed by the full Senate in 2014) to rule some of these relationships (use of legal, accounting, and financial advisors) off limits under the domicile test.⁹⁵ Thus, it would be irrelevant whether the individual used in- or out-of-state providers for these services. Similar requests by financial institutions, brokers, insurance agents, and social and civic organizations could be expected.

In evaluating these proposals, legislators will likely need to balance two competing sets of interests.

- On the one hand is an economic or business development interest: the domicile test's consideration of these business and community relationships may cause local (Minnesota) providers to lose business. Individuals seeking to change their domicile may

⁹⁴ See the discussion of the difficulties of verifying in-state presence in note 19.

⁹⁵ Senate amendments to [H.F. No. 3167](#), art. 3, § 8 (second unofficial engrossment) would have amended the domicile test to treat the location of lawyers, accountants, and financial advisors similarly to charitable contributions. The statute ([section 290.01](#), subdivision 7) would have been amended, in relevant part, as follows:

(c) In determining if an individual is domiciled in Minnesota, neither the commissioner nor any court shall consider:

(1) charitable contributions made by an the individual within or without the state ~~in determining if the individual is domiciled in Minnesota;~~ or

(2) the location of the individual's attorneys, certified public accountants, or financial advisors within or without the state.

terminate their use of Minnesota providers (lawyers, accountants, financial advisors, banks, brokers, and so forth). That will hurt these Minnesota firms (and the state generally) as more expenditures for these services are made in other states rather than in Minnesota.

- On the other hand is a policy or goal of allowing DOR and the courts to use any relevant or probative evidence of intent to determine where an individual is domiciled. Preventing certain categories or types of evidence from being used may degrade the quality of the decisions and result in decisions contrary to the individuals' actual intent.

In balancing these interests, some considerations seem relevant:

- The amount of revenue at stake—both for the affected Minnesota businesses and the state—is likely to be relatively modest. Although the potential for large numbers of older affluent Minnesotans to change their domiciles has garnered media attention, the number of individuals involved is likely small. It may be that a large number of people are considering moving out of state because of Minnesota's high taxes, but the relevant group of taxpayers are the individuals who are considering changing their domicile while still maintaining sufficient contacts with Minnesota that their domicile status could be contested by DOR. This number is likely to be much smaller and the affected number of billings by lawyers, accountants, financial advisors and so forth correspondingly would also be smaller, as well as the potential lost state tax revenue.⁹⁶ In some instances, though, a very large amount of state tax revenue can be at stake in one case.⁹⁷
- As discussed earlier in the information brief, use of local lawyers, accountants, and financial advisors is probably not very probative of whether one is domiciled in Minnesota.
- Ruling certain types of Minnesota contacts as irrelevant to determining domicile, even though they may shed light on an individual's intent, could undermine respect for the integrity of the tax system. This would be a minor issue if only a few types of businesses are given preferred status, but could become more serious if the list grows and more relevant contacts are excluded. A long list of exceptions could lead to perceptions that some *de facto* residents (i.e., individuals who are in Minnesota for much of the year, benefit from Minnesota public services, and have extensive local business and social contacts) are exempt from income taxation. This concern would not arise, if the legislature minimizes the number of exempt factors.

⁹⁶ The stakes for an individual firm (e.g., a law firm or investment advisor) may be very large if it loses a few very large clients that generate substantial billings.

⁹⁷ See, e.g., *Bicknell v. Jordan*, 321 P.3d 37 (2014). This case involved a challenge to the Kansas Department of Revenue's promulgation of an administrative rule on domicile. The amount of Kansas tax, penalty, and interest for two tax years was in excess of \$42.5 million on one capital gain transaction. The top Kansas tax rate is considerably lower than Minnesota's top rate.

Potential “technical” changes

Should the statutory residency test be modified to address “technical” issues relative to part-year residents and/or Minnesota workers domiciled in neighboring states with Minnesota vacation homes? These two issues are outlined on page 28.

To address the issue of Minnesota workers who live in bordering states and have Minnesota vacation homes,⁹⁸ the definition of a day could be modified to require an overnight stay or to require that the individual spent the entire day in Minnesota. This would avoid counting days when individuals cross the border to work in Minnesota, but return to their principal homes. The rule now results in more individuals with dual residencies who are potentially subject to double taxation.⁹⁹ The option would make it more difficult for DOR to prove days were Minnesota days, since they would need evidence that an overnight stay occurred. Conversely, it would make it easier for the taxpayer to prove a day was a non-Minnesota day, if the test required presence in Minnesota for the entire day: evidence of any presence outside Minnesota could resolve that is not a Minnesota day.

The ambiguity in the law regarding part-year residents who have permanent abodes in Minnesota could be resolved either in favor of taxpayers or the state. The preferable policy is not clear. In part, how one resolves the issue likely depends upon how one views the function of the statutory residency test. If the test is intended to ensure that anyone with a permanent Minnesota residence for the full year and who spends more than 183 days in Minnesota should be taxed as a full-year resident, then the statute probably should be clarified to be consistent with DOR’s interpretation. However, if the statutory residency test is largely intended as a backstop to (or more easily verifiable version of) domicile, then it likely should not be used to trump the part year domicile rule.

⁹⁸ Cancellation of Minnesota’s income tax reciprocity agreement with Wisconsin means that this could affect Wisconsin residents who work in Minnesota and have Minnesota vacation homes. According to DOR, over 55,000 Wisconsin residents worked in Minnesota and filed Minnesota tax returns. DOR, *Income Tax Benchmark Study*, p. 3 (March 2013). It seems likely that some of these individuals have Minnesota vacation homes and work in Minnesota more than 183 days per year.

⁹⁹ This will depend upon the number of Wisconsin and Iowa domiciliaries who both work in Minnesota and have Minnesota vacation homes.

Clarifying the domicile test

The 26-factor test has been criticized as not providing enough guidance as to which of the factors are important, while overemphasizing the importance of factors that the administrative rule treats as presumptions.¹⁰⁰ At one level, the concern is that the 26 factors simply give too much discretion to DOR and the courts to decide what is determinative. In essence, the criticism is that the statute (or administrative rule) should provide more guidance and DOR and the court-developed interpretations should not be relied on to sort this out. By contrast, the administrative rule has also been criticized for elevating the presumptions to too high a level, suggesting that three of the four should simply be factors to consider. To address these types of criticisms, the legislature could codify all or part of the administrative rule in the statute, adding or deleting one or more factors and/or putting them into categories based on the legislature's assessment of their importance. This would reduce DOR's and the court's flexibility, while perhaps not adding much predictive power to a test or set of criteria that almost inevitably must include a great deal of uncertainty and lack of clarity for affected individuals.

Providing a clear test that would provide some certainty to taxpayers could have undesirable or unintended consequences. For example, a typical approach to provide certainty would be to establish a "safe harbor" type of arrangement—e.g., spending at least 200 days outside of Minnesota and having some set of legal arrangements in the domicile state could be deemed to qualify the individual as a nonresident. As another example, Ohio law provides that a taxpayer's affidavit attesting to his or her domicile and residency in another state creates a legal presumption that the individual is not an Ohio resident.¹⁰¹ Such a rule or similar standard that allows individuals to be certain that their domicile decisions are unlikely to be successfully challenged by DOR could encourage more Minnesotans to change their domiciles, particularly if the rule allowed them to largely maintain their existing living patterns (e.g., requiring them to spend some additional time outside of Minnesota and make specified legal arrangements or file an affidavit that creates a protective legal presumption). This could have some undeterminable effect on revenues, and, as could occur with extensive exceptions to the 26 factors, could compromise taxpayer respect for the integrity of the tax system.

For more information about income and estate taxation, visit the taxation area of our website, www.house.mn/hrd/.

¹⁰⁰ See the discussion in note 6.

¹⁰¹ Ohio Rev. Code § 5747.24.

Appendix: Minnesota Administrative Rule

8001.0300 RESIDENT AND DOMICILE DEFINED; CONSIDERATIONS.

Subpart 1. **Resident.**

The term “resident” means:

A. any individual person who is domiciled in Minnesota, subject to the exception set forth in subpart 9; and

B. any individual person (other than an individual deemed a nonresident under the Servicemembers Civil Relief Act, [United States Code, title 50 appendix, section 574](#), or an individual eligible for reciprocity under [Minnesota Statutes, section 290.081](#)) who is not domiciled in Minnesota but who maintains a place of abode in Minnesota and spends in the aggregate more than one-half of the taxable year in Minnesota.

A person may be a resident of Minnesota for income tax purposes, and taxable as a resident, even though the person is not deemed a resident for other purposes.

Subp. 2. **Domicile; definition and presumptions.**

The term “domicile” means the bodily presence of an individual person in a place coupled with an intent to make such a place one’s home. The domicile of any person is that place in which that person’s habitation is fixed, without any present intentions of removal therefrom, and to which, whenever absent, that person intends to return.

A person who leaves home to go into another jurisdiction for temporary purposes only is not considered to have lost that person’s domicile. But if a person moves to another jurisdiction with the intention of remaining there permanently or for an indefinite time as a home, that person has lost that person’s domicile in this state. The presumption is that a person who leaves this state to accept a job assignment in a foreign nation has not lost that person’s domicile in this state.

Except for a person covered by the provisions of the Servicemembers Civil Relief Act, [United States Code, title 50 appendix, section 574](#), the presumption is that the place where a person’s family is domiciled is that person’s domicile. The domicile of a spouse is the same as the other spouse unless there is affirmative evidence to the contrary or unless the husband and wife are legally separated or the marriage has been dissolved. When a person has made a home at any place with the intention of remaining there and the person’s family neither lives there nor intends to do so, then that person has established a domicile separate from that person’s family.

The domicile of a single person is that person’s usual home. In a case of a minor child who is not emancipated, the domicile of the child’s parents is the domicile of the child. The domicile of the parent who has legal custody of the child is the domicile of the child. A person who is a permanent resident alien in the United States may have a domicile in this state. The domicile of a member of the armed forces will be governed by the facts just prior to becoming a member of the armed forces unless the person takes the necessary steps to establish a new domicile.

The mere intention to acquire a new domicile, without the fact of physical removal, does not change the status of the taxpayer, nor does the fact of physical removal, without the intention to remain, change the person’s status. The presumption is that one’s domicile is the place where one lives. An individual can have only one domicile at any particular time. A domicile once shown to exist is presumed to continue until the contrary is shown. An absence of intention to abandon a domicile is equivalent to an intention to retain the existing one. No positive rule can be adopted with respect to the evidence necessary to prove an intention to change a domicile but such intention may be proved by acts and declarations, and of the two forms of evidence, acts must be given more weight than declarations. A person who is temporarily

employed within this state does not acquire a domicile in this state if during that period the person is domiciled outside of this state.

Subp. 3. Considerations.

The following items listed will be considered in determining whether or not a person is domiciled in this state:

- A. location of domicile for prior years;
- B. where the person votes or is registered to vote, but casting an illegal vote does not establish domicile for income tax purposes;
- C. status as a student;
- D. classification of employment as temporary or permanent;
- E. location of employment;
- F. location of newly acquired living quarters whether owned or rented;
- G. present status of the former living quarters, i.e., whether it was sold, offered for sale, rented, or available for rent to another;
- H. whether homestead status has been requested and/or obtained for property tax purposes on newly purchased living quarters and whether the homestead status of the former living quarters has not been renewed;
- I. ownership of other real property;
- J. jurisdiction in which a valid driver's license was issued;
- K. jurisdiction from which any professional licenses were issued;
- L. location of the person's union membership;
- M. jurisdiction from which any motor vehicle license was issued and the actual physical location of the vehicles;
- N. whether resident or nonresident fishing or hunting licenses purchased;
- O. whether an income tax return has been filed as a resident or nonresident;
- P. whether the person has fulfilled the tax obligations required of a resident;
- Q. location of any bank accounts, especially the location of the most active checking account;
- R. location of other transactions with financial institutions;
- S. location of the place of worship at which the person is a member;
- T. location of business relationships and the place where business is transacted;
- U. location of social, fraternal, or athletic organizations or clubs or in a lodge or country club, in which the person is a member;
- V. address where mail is received;
- W. percentage of time (not counting hours of employment) that the person is physically present in Minnesota and the percentage of time (not counting hours of employment) that the person is physically present in each jurisdiction other than Minnesota;
- X. location of jurisdiction from which unemployment compensation benefits are received;
- Y. location of schools at which the person or the person's spouse or children attend, and whether resident or nonresident tuition was charged; and
- Z. statements made to an insurance company, concerning the person's residence, and on which the insurance is based.

Any one of the items listed above will not, by itself, determine domicile.

Charitable contributions made by a person will not be considered in determining whether that person is domiciled in Minnesota.

Subp. 4. Days within and days without Minnesota.

In counting the number of days spent within and without Minnesota, a person shall be treated as present in Minnesota on any day if the person is physically present in Minnesota at any time during that day. However, a person in transit between two points outside Minnesota who is physically present in Minnesota less than 24 hours, will not be treated as present in Minnesota on any day during transit.

Items A and B are examples of the application of this subpart:

A. T is flying from New York to California and must change flights in Minnesota. T is scheduled to arrive in Minnesota at 7:00 P.M. on March 1, and is scheduled to depart at 1:00 P.M. on March 2. Since T is in transit between two points outside Minnesota and is present instate less than 24 hours, neither March 1 nor March 2 is treated as a day within Minnesota.

B. T has been in Minnesota from March 1 to April 15. On April 15, T departed from Minnesota at 6:00 A.M. T is treated as present in Minnesota on April 15.

Subp. 5. Records.

Any person domiciled outside Minnesota who maintains a place of abode within Minnesota and claims to be a nonresident of the state must have available for examination adequate records to substantiate that more than one-half of the tax year was spent outside Minnesota.

Adequate records means any contemporaneously kept records that establish the places of physical presence of the person on particular dates. Adequate records include, but are not limited to, calendars, diaries, canceled checks, credit card receipts, and airline tickets.

Subp. 6. Definition of abode.

An abode is a dwelling place permanently maintained by a person, whether or not owned and whether or not occupied by the person. It does not need to be permanent in the sense that the person does not intend to abandon it at some future time. However, a cabin or cottage not suitable for year round use and used only for vacations is not an abode. Additionally, quarters which contain sleeping arrangements but do not contain facilities for cooking or bathing will not generally be considered an abode.

A person who moves a domicile outside Minnesota is not considered to be maintaining an abode in Minnesota even though the person continues to own or rent a dwelling in Minnesota if the person has moved personal furnishings and belongings from the dwelling and is making a good faith effort to sell, lease, or sublease the dwelling.

Subp. 7. Domiciliary residents.

The physical presence test does not apply to persons who are domiciled in Minnesota throughout the tax year. There is no presumption that a person domiciled in Minnesota has lost that domicile if the person is absent from Minnesota over one-half of the tax year.

Subp. 8. Part year domiciliaries.

Persons domiciled in Minnesota who move their domiciles outside Minnesota during the tax year and persons domiciled outside Minnesota who move their domiciles to Minnesota during the tax year are part year residents of Minnesota. The physical presence test does not apply to such persons unless a Minnesota abode is maintained during the period domiciled outside of Minnesota.

Subp. 9. Certain persons deemed nonresidents.

A person domiciled in Minnesota is deemed a nonresident for the period of time that the person is a qualified individual under the Internal Revenue Code, section 911. For a person who has homesteaded the person's principal residence in Minnesota prior to leaving the country, this subpart applies only if the person notifies the county within three months of moving out of the country that homestead status should be revoked and does not file a Minnesota homestead application for any property in which the person has an interest during the period the person is a qualified individual.

Subp. 10. Examples.

Items A to E contain examples of the application of this part:

A. T was domiciled in Minnesota from January 1, 1987, through September 1, 1987, and did not leave the state during that period. On September 2, 1987, T sold the Minnesota dwelling and changed domicile to Texas.

T was a part year resident of Minnesota in 1987. Although T was physically present in Minnesota over 183 days, the physical presence test does not apply because T did not maintain an abode in Minnesota during the part of the year T was not domiciled in Minnesota.

B. Same facts as item A, but T decided not to sell the Minnesota abode.

T was a full year resident of Minnesota in 1987. T was physically present in Minnesota over one-half of the year and maintained an abode in Minnesota.

C. Same facts as item A, but T did not sell the Minnesota dwelling although T listed it for sale with a real estate broker at fair market value from September 1 through December 31, 1987.

T was a part year resident of Minnesota in 1987, assuming T removed personal belongings and furnishings from the Minnesota abode when T changed domicile. Although T was physically present over one-half of the year and continued to own a dwelling in Minnesota, T will not be considered to have maintained an abode in Minnesota because T moved belongings from the dwelling and made a good faith effort to sell the dwelling.

D. T moved from Minnesota to Florida on February 1, 1987. T maintained an abode in Minnesota and lived in that abode May 1, 1987 to September 1, 1987.

T was not a full year resident of Minnesota under the physical presence test. Although T maintained a Minnesota abode, T was not physically present in Minnesota over one-half of the year.

However, the department could review the steps T took to change domicile and could consider T a full year resident if it were determined T remained domiciled in Minnesota.

E. T moved domicile to Minnesota on June 1, 1987. T did not have an abode in Minnesota prior to June 1, 1987. T was physically present in Minnesota throughout the period of June 1, 1987 to December 31, 1987.

T was a part year resident of Minnesota in 1987. Although T was physically present in Minnesota over one-half of the year, T did not have a Minnesota abode during the part of the year T was domiciled outside the state. Therefore, the physical presence test does not apply.

Statutory Authority:

MS s 270.06; 270C.06; 290.52

History:

12 SR 2746; 17 SR 1279; 27 SR 1664; L 2005 c 151 art 1 s

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