Consider State Taxes When Deciding Where to Live in Retirement

When you retire, you may consider moving to another state — say, for the weather or to be closer to loved ones. State taxes also may factor into the equation. Here's what you need to know about establishing residency for state tax purposes — and why the process may be more complicated than it initially appears to be.

Identify and Quantify All Applicable Taxes

It may seem like a no-brainer to simply move to a state that has no personal income tax, such as Nevada, Texas or Florida. But, to make a good decision, you must consider *all* of the taxes that can potentially apply to a state resident, including:

- Income taxes;
- Property taxes;
- Sales taxes; and
- Estate taxes.

For example, suppose you've narrowed your decision down to two states: Texas and Colorado. Texas currently has no individual income tax, and Colorado has a flat 4.63% individual income tax rate. At first glance, Texas might appear to be much less expensive from a state tax perspective. Not necessarily. The average property tax rate in Texas is 1.93% of assessed value, while in Colorado it's only 0.62%.

Within the city limits of Dallas, the property tax rate is a whopping 5.44%. So, a home that's assessed at $500,000 would incur an annual property tax bill of $27,200 if it's located in Dallas, compared to only $3,100 in Colorado. That difference could potentially cancel out any savings in state income taxes between those two states, depending on your income level. Of course, there are other factors to consider in any move, including taxes in the exact locality in the state.

If the states you're considering have an income tax, also look at what types of income they tax. Some states, for example, don't tax wages but do tax interest and dividends. And some states offer tax breaks for pension payments, retirement plan distributions and Social Security payments.

Watch Out for State Estate Tax

Not all states have estate tax, but they can be expensive in states that do. Every dollar you pay in state estate tax is in addition to any federal estate tax owed, except for the federal estate tax savings from the state estate tax deduction. Currently, estate taxes are levied in:

- Connecticut;
- Delaware;
- Hawaii;
- Illinois;
- Maine;
- Maryland;
- Massachusetts;
- Minnesota;
- New Jersey (scheduled to be repealed as of January 1, 2018);
- New York;
- Oregon;
- Rhode Island;
- Tennessee;
- Vermont;
- Washington; and
- Washington, D.C.

Beware — the federal estate tax exemption is $5.49 million in 2017. But some states haven't kept pace with the federal level and, instead, levy estate tax with a much lower exemption. As part of a legislative compromise to fund the New Jersey Transportation Trust Fund, Governor Christie signed a new law on October 14, 2016 that drastically changes the New Jersey estate tax. The legislation raises the New Jersey estate tax exemption amount from $675,000 to $2 million for individuals dying on or after January 1, 2017, and repeals the New Jersey estate tax for individuals dying on or after January 1, 2018.

Also note that some states may levy an inheritance tax in addition to (or in lieu of) an estate tax. The New Jersey Inheritance Tax has not been repealed by the recent estate tax changes mentioned above and will remain in effect. This is a tax on the amount transferred at death to a beneficiary who is not a spouse, parent, child or grandchild of the decedent (for example, Class “C” beneficiaries such as decedent’s siblings and Class”D” beneficiaries such as decedent’s nieces, nephews, cousins and friends). New Jersey Inheritance Tax rates range from 11% to 16%.

Establish Domicile

If you make a permanent move to a new state and want to escape taxes in the state you came from, it's important to establish legal domicile in the new state. The exact definition of legal domicile varies from state to state. In general, your domicile is your fixed and permanent home location and the place where you plan to return, even after periods of residing elsewhere.

Because each state has its own rules regarding domicile, you could wind up in the worst-case scenario: Two states could claim you owe state income taxes if you established domicile in the new state but didn't successfully terminate domicile in the old state. Additionally, if you die without clearly establishing domicile in just one state, both the old and new states may claim that your estate owes income taxes and any state estate tax.

How do you establish domicile in your new state? The more time that elapses after you change states and the more steps you take to establish domicile in the new state, the harder it will be for your old state to claim that you're still domiciled there for tax purposes. Some ways to help lock in domicile in the new state:

- Buy or lease a home in the new state.
- Sell your home in the old state or rent it out at market rates to an unrelated party.
- Change your mailing address with the U.S. Postal Service.
- Change your address on passports, insurance policies, will or living trust documents, and other important documents.
- Get a driver's license and register your vehicle in the new state.
- Register to vote in the new state. (This can probably be done in conjunction with getting a driver's license.)
- Open and use bank accounts in the new state.
- Close bank accounts in the old state.

If an income tax return is required in the new state, file a resident return. File a nonresident return or no return (whichever is appropriate) in the old state. Your tax advisor can help with these returns.

Make an Informed Choice

Before deciding where you want to live in retirement, do some research and contact a tax professional in the new state that you're considering. Taking these steps could avoid making a bad relocation decision when taxes are considered — one that could be difficult and expensive to unwind.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com