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Legal Update

October 2013

FLIGHT OR JUST FRIGHT: THINGS TO CONSIDER FOR YOU AND YOUR BUSINESS BEFORE FLEEING

Part 1 of 2: Illinois' New Tax Regulations

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With daily news stories about the unfunded pension costs facing Illinois taxpayers, a number of successful Illinois business owners and residents have considered fleeing Illinois to avoid income and/or estate taxes. While this may appear to be a tempting idea, upon closer examination, there can be significant challenges to making such a move.

This Legal Update is the first in a two-part series that will discuss issues and present the facts and law relevant to a person or business considering such a move. Part 2 will discuss the three key questions a person or a business should ask before moving out of Illinois.

First, the facts. Illinois currently has a 5% flat income tax rate. Of the states with an income tax, eight states—Arizona, Colorado, Indiana, Kansas, Michigan, New Mexico, North Dakota, and Pennsylvania—have lower rates, and only Indiana, North Dakota, and Pennsylvania are more than 1% lower. Most of these states, though, have significant local income taxes, which bring their rates even with or above the Illinois rate. The corporate rate is a different story. C-Corps in Illinois do pay a higher rate at 9.5%. Even Illinois S-Corps pay 1.5% at the corporate level.

Seven states—Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming—currently have no personal income tax. When it comes to corporate taxes, however, only Nevada, South Dakota, and Wyoming have no corporate income tax (Ohio, Texas, and Washington have a gross receipts tax instead of a corporate income tax).

The estate tax is a more complicated picture. Until last December, the issues of tax rates and the Federal Estate Tax were unsettled. Prior to changes in the early part of the last decade, all states received a share of the Federal Estate Tax through a mechanism referred to as the "pick-up tax" under which each state received an amount that was treated as a credit against the amount owed to the federal government. That all changed in the early 2000s when the credit was eliminated. Many states, including Illinois, then enacted an estate tax. Others did not and took a "wait and see" approach. In most of these states, there are proposals to enact new estate tax laws as well. It seems likely, nonetheless, that Florida will continue to have no estate tax, as it has a large community of the well-to-do elderly.

Finally, each state has numerous other taxes, including sales taxes. Many taxes are at the local level. Before considering a move, those taxes should be taken into account. In addition, some states with low

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taxes for residents have other sources of tax revenue that may not affect someone deciding to move to that state, such as oil severance or gaming taxes.

Individuals who move to another state can effectively change their residency for income tax purposes, but only if they are careful and keep good records to support the change in residency. A business can also move, but a change is more difficult to establish if it maintains operations in the old state. Businesses are taxed in every state in which they maintain a presence, based on a formula that varies from state to state. The formulae usually consider the sales made from the state, the employees in the state, and the assets in the state. The key note of caution here is that an S-Corp or LLC owner in Illinois who moves to another state, but keeps the business in Illinois, will pay Illinois taxes on all of the business income even though he or she has personally moved out of state.

New Tax Regulations in Illinois

Illinois revised its tax regulations this year, providing clear guidance for those who want to leave Illinois—but also making it more difficult to do so. Illinois law requires an individual to pay income tax when earning or receiving income in, or as a resident of, Illinois. Generally, a non-resident does not have to pay Illinois income tax on income from a non-Illinois source.

The new tax regulations create a rebuttable presumption that a person remains an Illinois resident even if the individual has moved out of state in two situations:

(1) An individual who receives a homestead exemption for Illinois property is presumed to be a resident of Illinois.

(2) An individual who is an Illinois resident in one year is presumed to be a resident in the following year if he or she is present in Illinois more days than he or she is present *in any other single state*.

The changes to the regulations indicate that Illinois is seeking to close tax loopholes for individuals who leave Illinois but maintain a residence or some presence in the state. Illinois has been quite cunning in tying the homestead exemption to Illinois residency.

If presumed to be a resident under the new regulations, an individual should file a non-resident tax return even if the individual believes he or she is a non-resident not required to file a return. Unfortunately, the proof required to establish residency or non-residency or to rebut a presumption of residence will depend on the facts and circumstances of each particular case. The regulations state that the type and amount of proof "cannot be specified by a general regulation;" however, a taxpayer may submit any relevant evidence (*e.g.*, voter registration; automobile registration or driver's license; or telephone and/or other utility usage). The newly revised regulations also list new criteria that Illinois will consider when rebutting a presumption of residence. These include: the location of spouse and dependents; the permanent or temporary nature of work assignments in another state; the location of professional licenses; and the location of medical professionals, other healthcare providers, accountants, and attorneys.

The regulations also specifically exclude charitable contributions to Illinois organizations as evidence of residence or non-residence. The regulations do look at the days in Illinois. To set up residence elsewhere, you must be in Illinois for less than 180 days, and in your first year out, you must spend more time in your new home state than in Illinois. Good recordkeeping is essential, including airline boarding

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passes, local gas receipts, and other evidence of presence elsewhere. A daily Starbucks habit could make that easy if you save your receipts.

With the new Illinois tax regulations in mind, next month's Legal Update will discuss the three key questions that a person or a business should ask before making a decision to move out of Illinois. Stay tuned.

FVLD publishes updates on legal issues and summaries of legal topics for its clients and friends. They are merely informational and do not constitute legal advice. We welcome comments or questions. If we can be of assistance, please call or write Jon Vegosen 312.701.6860 jvegosen@fvldlaw.com, Vance Liebman 312.701.6850 vliebman@fvldlaw.com or your regular FVLD contact.

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