WILLMS, S.C.

MEMORANDUM

TO: Clients and Friends of Willms, S.C.

FROM: Attorney Maureen L. O'Leary

DATE: April 11, 2016

RE: State of Domicile Considerations

There is no shortage of important personal considerations that go into the decision of where to call home. Proximity to work, family and friends, climate, and lifestyle preferences all influence where we choose to live. However, the state of your legal residence (or "domicile") can also have major legal consequences.

1. Why does Domicile Matter?

The state of your domicile can have a major impact on property rights, the taxes paid by you and your heirs, and a creditor's ability to file claims against you and your heirs. It can also affect how your assets are distributed after you die. The following is an overview of some key legal, tax, and estate planning issues you should evaluate when considering your state of domicile.

a. Income Taxation

State income taxation laws vary greatly by state. For example, Wisconsin imposes an income tax of up to 7.65% on most income of Wisconsin residents. In contrast, several states do not impose any state income taxes at all[1]. Accordingly, a change of residency can result in a significant state income tax savings.[2]

State income tax laws can also affect your heirs after your death. For example, if your estate plan creates trusts for your children that continue for their benefit after your death, then Wisconsin (and several other states) takes the position that these trusts will be

[1] Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Furthermore, New Hampshire and Tennessee do not tax wage income.
[2] However, non-residents of Wisconsin still have to pay Wisconsin income tax on Wisconsin source income (i.e. income derived from property located in Wisconsin, business transacted in Wisconsin or personal services performed in Wisconsin).

permanently subject to state income tax after your death in the state of your residency at the time of your death, regardless of your children's states of residency.[3]

b. Property Ownership by Married Couples

There are two different property law systems in the United States that govern the ownership of property acquired during marriage. The first is known as "common law property" and the second is referred to as "community property".

There are nine community property states (Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin)[4]. Broadly speaking, married couples in community property states are deemed to own all of their assets jointly regardless of how the property is titled, unless the property a) was acquired by the spouse prior to marriage, b) is acquire by gift or inheritance, or c) is classified as individual property by written agreement of both spouses. By comparison, ownership of property by married persons in common law states (or "separate property states") is determined in large measure by how the property is titled.

Whether you live in a community property or common law property state affects the ownership of your property during your lifetime, in the event of a divorce, and upon your death. Some key differences are summarized in the chart below.[5] However, to a large extent, married persons may be able to modify how these rules apply to their marriage by entering into a prenuptial or postnuptial agreement.

	Community Property States	**Common Law Property States**
Lifetime Management:	Community property is generally managed by both spouses.	Common law property is managed by the person(s) titled on each asset.
In the Event of Divorce:	Community property is generally divided 50/50 in the event of a divorce.	Common law property is divided as the court deems appropriates in the event of a divorce.
Distributions At Death:	At death, one half of community property passes as the decedent directs. The other half belongs to the surviving spouse.	At death, common law property passes as directed by the spouse that owned the property at the time of death, subject to "elective rights" of

[3] Recent court decisions have raised serious questions as to whether continued taxation of such trusts by the state of a decedent's domicile is constitutional.
[4] Wisconsin has a unique marital property system, although marital property is a form of community property.
[5] The general rules described in this memorandum can vary significantly from state to state.

		the surviving spouse.
Income Tax Cost Basis Adjustment at Death:	100% of community property receives an income tax basis adjustment to fair market value upon the death of a spouse.	Only the decedent's share of property in common law property states receives an income tax basis adjustment to fair market value upon the death of a spouse.

c. Homestead Laws

Many states have special rules that apply to a resident's home (referred to as a "homestead"). For example, Florida has three unique homestead exemption laws that are favorable to Florida residents.

1. **Homestead Exemption from Forced Sales** – Florida provides no limit to the value of certain real property that can be protected from creditors.

2. **Homestead Exemption from Devise and Alienation** – Florida has restrictions on how homestead property may be alienated and devised at death if the decedent has a spouse or minor children, as well as rules dealing with an improperly devised homestead upon the owner's death.

3. **Homestead Exemption from Property Taxes** – Florida provides a reduction in the assessed value of the homestead, and the year-to-year increases in assessed value of the homestead are limited to the lesser of 3% or the percentage change in the Consumer Price Index for qualifying property owned by Florida residents.

d. Spendthrift Trust Laws

If your estate plan creates irrevocable trusts for your children upon your death, it is important to consider state laws governing spendthrift trusts.

To the extent state law recognizes spendthrift trust provisions and the trust agreement is drafted accordingly, the assets of such irrevocable trusts are largely protected from the trust beneficiary's creditors, unless the creditors are "exception creditors" under state law. For example, Florida Statute § 736.0503(2)(a) says that a beneficiary's "spouse or former spouse who has a judgment or court order against the beneficiary for support or maintenance" is an exception creditor under Florida state law. In contrast, Wisconsin statutes do not list spouses with alimony claims as exception creditors. Wisconsin exception creditors are limited to child-support or public-support claims.

Therefore, if a key objective of establishing an irrevocable trust for your child is protection from potential spousal alimony claims, Wisconsin governing law may be better than Florida governing law. However, it may also be possible to create an irrevocable trust with its governing law being a state of which you are not a resident.

e. Domestic Asset Protection Trusts

A trust created by a person (a "grantor") for their own benefit is a "self settled trust." In most states, the assets of a self settled trust are subject to the claims of the grantor's creditors. However, there are now sixteen states[6] that allow for the creation of a special type of self-settled trust known as a "domestic asset protection trust" or "DAPT". DAPTs are generally irrevocable trusts with an independent trustee that has absolute discretion to make distributions to the trust beneficiaries, which includes the grantor, without subjecting the trust assets to the claims of the grantor's creditors.

In some cases, it is possible to create a DAPT in a state where you do not reside, provided the trust has sufficient other contacts with the state in which it is created (i.e. location of the Trustee and location of trust assets).

f. Administration of your Estate Plan

The state of your residence at the time of your death affects the administration of your estate plan, including issues such as:

1. Whether your Will and any Trusts are properly signed and legally valid.
2. Whether your estate is subject to probate, and if so, the laws and procedures governing that probate proceeding.
3. The reporting and accounting requirements for irrevocable trusts created by your estate.
4. The laws governing the amendment of irrevocable trusts created by your estate plan.

2. How is Domicile Determined?

For individuals who own a single home, their state of domicile is clear. However, if you split your time between multiple states or you desire to change your state of domicile, then it may be possible to adjust you affairs so that you can select the state of your domicile. For example, it is not uncommon for Wisconsin residents to own a second home in Florida and split their time between both states. These "snowbirds" may strategically select

[6] Alaska, Colorado, Delaware, Hawaii, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia and Wyoming.

whether to be Wisconsin residents or Florida residents due to their preference for the laws of one of those states.

Each state has specific rules that must be followed in order to legally qualify for residency. In general, when determining residency, most states look at a variety of factors including how much time you spend in each state, where you vote, where you work, where your driver's license is issued, where you own property, and a host of other factors.

The State of Wisconsin publishes a "Legal Residence (Domicile) Questionnaire" found here: https://www.revenue.wi.gov/forms/2015/Form1NPR_inst.pdf#page=51

The State of Florida summarizes many of its residency requirements on its website here: http://www.stateofflorida.com/residency.aspx

For a more detailed list of various factors to consider, please see our Domicile Checklist found here: Checklist for Determining Domicile

There are a number of very important legal and tax issues that ought to be considered when selecting the state of your legal domicile. It is also very important to update your estate plan anytime you change your state of domicile, especially if you move from a community property state to a Common law property state or vice versa.

Please let us know if you would like to discuss how a change of domicile would impact you and your estate plan. We would also be happy to meet with you if you would like discuss the possibility of changing domicile for strategic reasons.

END OF MEMO

Information contained in this memorandum is not a substitute for professional estate planning advice nor should any information provided in this memorandum be construed as legal advice. Therefore, none of the information being provided should be relied on without seeking the advice of legal counsel or other professionals regarding the tax and non-tax consequences associated with the same.