MANAGEMENT & *TAX CONCEPTS*

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CONSIDER TAXES WHEN MOVING TO A NEW STATE

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Consider taxes when moving to a new state

One byproduct of the COVID-19 pandemic is that for many jobs, remote work is here to stay. With greater flexibility to work from anywhere, many people are considering moving further away from their jobs, even to a new state. Relocating to another state can create income tax complications, so you'll need to familiarize yourself with potential tax issues before you make a move.

BE AWARE OF THE LONG ARM OF TAX LAW

To get a feel for your potential tax exposure when moving to a new state, you need to understand the concepts of domicile and residency. Domicile is generally defined as the place where you have your "true, fixed, permanent home" or the "principal establishment to which you intend to return whenever absent."

You can have only one domicile at a time. Once you establish domicile in one state, it stays there until you establish domicile in another state. It's important to recognize that domicile, in many respects, is a state of mind. Even if you spend more time in another state, your domicile won't change if it remains the place you *intend* to stay indefinitely and return to when you're away.

Statutory residency, on the other hand, has more to do with where you spend your time. Residency laws vary from state to state, but typically you're considered a resident if you maintain a "permanent place of abode" in a state and spend most of your time there. Again, the law varies from state to state, but a common threshold is 183 days or more.

How to change your domicile

Domicile is based on your *intent* to stay in a state indefinitely and return to it when you're away. Keep in mind that intent can be very subjective, as it's determined largely by the facts and circumstances. There's no magic formula for establishing domicile in a new state, but there are steps you can take to demonstrate your intent. Here are a few actions to take in the new state:

- Buy a home,
- Move your prized personal possessions — such as artwork, furniture and heirlooms,
- Obtain a driver's license and register your car,
- Register to vote, and
- Establish bank accounts and safe deposit boxes.

Generally, states have the power to tax three types of income:

1. Worldwide income of persons domiciled in the state,
2. Worldwide income of persons who are statutory residents of the state, and
3. Income derived from sources within the state, regardless of the location of the recipient's domicile or residence.

State-sourced income typically includes income from real property or tangible property located in the state, income from certain business interests in the state, or income from services performed in the state. For example, even if your domicile and residence is in State A, if you commute across the border for a job in State B, then your wages could be taxable by State B (as well as State A).

AVOID DOUBLE TAXATION

Moving to a new state can trigger double taxation. Let's say you live and work exclusively in State A, which is both your domicile and residence. Your employer allows you to work remotely on a permanent basis, so you decide to relocate to State B. Because you now spend most of the year in State B, it has become your statutory residence and your income is taxable there. However, because you retain significant ties with State A, it considers you to be domiciled there and also taxes your income.

To provide relief from double taxation, some states have reciprocal arrangements with other states under which they agree not to tax each other's residents. Even if reciprocity doesn't apply, states generally provide credits for taxes paid to other states. However, these credits may not completely offset the tax you're paying to the nonresident state. For example, if you live in a state with no income tax but work in a state that has an income tax, the result will be that, at least for that income, you'll pay tax at the rate assessed by the nonresident state.

If you're moving to a state with a lower income tax or no income tax, the most effective way to minimize your tax costs is to shift both your residence and your domicile to the new state. That means spending the majority of your time in the new state and taking steps to establish your domicile there. (See "How to change your domicile" on page 2.)

WATCH OUT FOR "CONVENIENCE OF THE EMPLOYER" RULES

Generally speaking, an employee who works remotely from another state isn't subject to tax in the state where the employer is located, so long as the worker isn't a resident or domiciliary of that state. However, a handful of states have adopted "convenience of the employer" rules.

These rules allow a state to tax income earned by remote workers outside the state from in-state employers, if they're working remotely for their own convenience and not because it's required by the employer.

BE PREPARED

State tax rules are complex, so plan carefully before you relocate to another state. And keep in mind that some states have temporarily changed their tax treatment of remote workers during the pandemic. Also, if you're thinking about moving abroad, be sure to consult with your tax advisors because the tax consequences can be even more complicated. •

Lighting a FIRE under your financial goals

Many people have been rethinking their approach to work and employment, and the COVID-19 pandemic has only accelerated this trend. Among the many strategies some are considering is the idea of retiring early — in fact, some people are striving to be able to leave the workforce as soon as their 30s or 40s. Achieving this goal, known as Financial Independence, Retire Early (FIRE), requires an extreme focus on saving and frugality. But even if you don't want to retire early (or that early), you may gain some useful tips from aspects of the FIRE strategy.

CONSIDER SAVINGS

FIRE strategies start with maximizing retirement savings. It's commonly recommended that individuals set aside at least 10% of their gross income for retirement. But retiring at a younger age could require saving much more than this. For example, some people practicing FIRE are saving 70% or 80% of their income for retirement.

Here are some strategies that can help you maximize your savings and retire on your timeline, whatever it is:

Set (and prioritize) aggressive savings goals. It's one thing to set aggressive goals such as saving half of your income for retirement. For many people, the challenge lies in following through and making these goals a priority.

Start by putting your savings goals in writing. For example, if you want to save half of your income for retirement, determine exactly how much money this is and write it down. Then set benchmarks for how much money you should have saved by the time you reach certain ages so you can monitor your progress toward your long-term retirement goal.

Slash your expenses. When they look carefully at their expenses, many people are surprised at how much money they spend on nonessential items. Scrutinize your monthly budget in search of wasteful and unnecessary expenses.

For example, can you cut the cable TV cord or downgrade your cable or satellite package? Cut way back on entertainment, eating out and expensive cups of coffee? Keep your vehicles well maintained so you can drive them for 10 years or longer instead of getting a new car every few years?

Set benchmarks for how much money you should have saved by the time you reach certain ages so you can monitor your progress toward your long-term retirement goal.

Save and invest with discipline. A good way to accomplish this is to sign up for automatic investing into a retirement plan, such as a 401(k) plan at your place of work. This way, funds will be automatically transferred into your retirement account each pay period with no action required on your part. Consider contributing a fixed percentage of your earnings rather than a fixed dollar amount. By doing so, with each raise or bonus a portion will go to your retirement, presuming you're not at the maximum allowed. At minimum, be sure to contribute enough to get the maximum match offered by your employer.

Boost your income. There are many ways to earn extra income in today's "gig" economy. For example, can you start an online retail business by selling merchandise on sites like Amazon, eBay or Etsy? Drive for a ride-sharing service like Uber or Lyft? Or offer pet-sitting services to friends and neighbors when they travel?

Eliminate your debt. Carrying excessive consumer debt is one of the biggest obstacles to retirement for many people. Strive to eliminate your nonmortgage debt as soon as possible, starting with high-interest credit cards. Many FIRE devotees also put extra money toward their mortgage principal each month in an effort to be mortgage-free by the time they retire, thus eliminating their largest monthly expense.

USE WHAT'S USEFUL

Looking at FIRE can be useful in helping you rethink how you handle your financial assets and ensure they grow over time. Whether that time is shorter or longer, it can't hurt to implement some of the suggestions noted above — and possibly retire sooner than you thought you would. Get in touch with your financial advisor for more specific strategies suited to your particular situation. •

Now may be the time for a cost segregation study

If you're a business owner, this might be an ideal time to conduct a cost segregation study. During the COVID-19 pandemic, many businesses made improvements to their workspaces to make them safer for workers. A cost segregation study can help maximize the tax benefits associated with these improvements.

Such a study can help you increase depreciation deductions, reduce your tax bills and boost your business's cash flow. These studies examine the costs associated with purchasing, constructing or substantially improving a building and identify opportunities to allocate a portion of these costs to assets with shorter useful lives.

ACCELERATING DEPRECIATION

Commercial buildings are generally depreciable over 39 years (27.5 years for residential rental properties). Often, when building owners make improvements, they assume that these assets are part of the real property, so the costs would be recovered over a similar period. But in many cases, building improvements can be depreciated

over much shorter periods, such as five, seven or 15 years. A cost segregation study ensures that improvements are classified properly.

Many items that appear at first glance to be part of the real property are properly treated as personal property, typically depreciable over five or seven years. Examples include removable carpeting or tile floor coverings, decorative light fixtures, and movable partitions.

Also, some items that would otherwise be considered real property may be treated as personal property if they're more closely related to a business function than to a building function. For example, reinforced foundations or specialized electrical, plumbing, cooling or ventilation systems required by a technology, health care or manufacturing business might be depreciable over five or seven years.

THE ROLE OF QIP

Some improvements to nonresidential building interiors — known as qualified improvement property (QIP) — are entitled to accelerated depreciation over a 15-year period. These improvements also qualify for bonus depreciation, which currently allows you to deduct 100% of the cost in Year 1.

QIP generally refers to improvements to the interior of an existing nonresidential building, such as installation or replacement of drywall, ceilings, interior lighting, fixtures, interior doors, ductwork and other interior HVAC components, fire protection, mechanical, electrical, and plumbing. However, QIP doesn't include improvements to elevators or escalators or to a building's internal structural framework — or enlargement of the building.

Improvements designed to protect workers' health also may qualify as QIP. For example, many businesses have reconfigured their spaces to make it easier for workers to maintain a safe distance from each other. Some have upgraded their HVAC systems or installed antimicrobial building materials or UV lighting to prevent the spread of infectious disease. Others have installed doors with motion sensors, self-flushing toilets, motion-activated lighting and other touchless technologies.

> *In many cases, building improvements can be depreciated over much shorter periods, such as five, seven or 15 years.*

GETTING A FIX ON FIXED ASSETS

If you've made improvements to your commercial building as a result of the pandemic or for other reasons, consider a cost segregation study to make the most of depreciation deductions. Even if you haven't made improvements recently, it's a good idea to conduct a fixed-asset study periodically to ensure that you're recovering the costs of those assets over their appropriate depreciable lives. •

Got crypto?

Pay attention to new reporting requirements for digital assets

If you've invested in specific digital assets — including most cryptocurrencies and some nonfungible tokens (NFTs) — be aware that new tax reporting rules will take effect starting with the 2023 tax year. The rules were added by the Infrastructure Investment and Jobs Act (IIJA) enacted in November 2021.

EXISTING TAX RULES

For tax purposes, cryptocurrency is treated as property rather than currency. This means you'll recognize capital gains or losses when you sell these assets in exchange for traditional currency.

Like other capital assets, such as stocks and bonds, your gain or loss is the difference between the sale price and your cost basis in the asset (typically the amount you paid for it). Gains and losses may be short-term or long-term, depending on whether you've held the asset for more than one year.

NEW REQUIREMENTS

The rules don't change the way digital assets are treated for tax purposes. But they impose new informational reporting requirements designed to help the IRS crack down on unreported virtual currency transactions:

Digital assets treated as securities. The IIJA treats digital assets as securities. Brokers are required to provide investors with Form 1099-B for sales of securities during the year and to file the form with the IRS. The form provides details of each transaction, including sale proceeds, purchase and sale dates, cost basis, and the character of gains or losses (for example, short- or long-term). These reporting rules now apply to digital assets. The IIJA also expands the definition of "broker" for 1099-B reporting purposes to include all platforms on which you can buy or sell cryptocurrency or other digital assets.

Digital assets treated as cash. The IIJA also treats digital assets as cash for purposes of cash transaction reporting. Generally, businesses that receive $10,000 or more in cash in a transaction must report the transaction — and the identity of the person making the payment — to the IRS. The new rules will require businesses to file similar reports for transactions involving $10,000 or more in cryptocurrency or other digital assets.

IMPACT ON INVESTORS

In addition to raising privacy concerns, the new reporting rules are likely to result in inaccurate 1099-Bs in many cases. That's because cryptocurrency exchanges often lack access to information they need to report a customer's cost basis. As a result, these forms may overstate investors' gains or turn losses into gains. It will be important, therefore, for investors to keep thorough records of their cryptocurrency transactions to ensure they report their gains and losses accurately.

The new rules apply to transactions on or after January 1, 2023, which means cryptocurrency investors should expect to begin receiving 1099-Bs for cryptocurrency transactions in early 2024. Note, however, that regardless of broker reporting requirements, investors are currently required to report cryptocurrency gains or losses on their tax returns and have been for several years. •

TAX PLANNING AND PREPARATION

Taxes are a part of life, and at Martin Hood we can help you find ways to minimize the impact that taxes have on you and your family. We work with our clients year-round to develop and implement effective tax planning strategies to reduce year-end tax bills. Our state and international tax team performs extensive research in areas that reach beyond our local community. In addition to income tax preparation, we can prepare gift and estate tax returns, sales and payroll tax returns, and informational tax returns for not-for-profit organizations. We also assist clients with IRS audits and notices from tax authorities.

BUSINESS ADVISORY SERVICES

We provide accounting assistance and a comprehensive approach to helping with whatever keeps you up at night. We can help set up an accounting system to help you cover your accounting needs on your own in a more efficient manner, fill a temporary need for accounting staff, or fill a more permanent role in basic accounting or acting as an outsourced controller — all while keeping the bigger picture in mind and pulling in our tax, assurance, and planning expertise to serve as a well-rounded business advisor in nearly all tax, accounting, and financial matters.

ESTATE AND RETIREMENT PLANNING

The Estate and Retirement Planning team at Martin Hood helps our clients recognize the importance of proper planning for business succession, education, retirement, and wealth accumulation. This process is presented in an open and candid manner, placing family and retirement needs at the forefront of every plan. Our team strives to help you build a plan that minimizes the estate tax burden and helps you achieve your financial goals.

Tax Specialty Areas

- State and Local Taxation
- International Tax Issues
- Trusts and Estates
- Partnerships
- C corporations
- S corporations
- Individual tax compliance
- Tax planning
- Construction and Manufacturing
- Non-profits