

## RESOURCES

# North Carolina Court of Appeals Affirms How Change of Domicile Saves North Carolina Income Taxes

**The North Carolina Court of Appeals affirms the Business Court’s finding that the Fowlers had changed their domicile from North Carolina to Florida and therefore could avoid substantial North Carolina income tax on the sale of their business.**

On August 4, 2015, in *Fowler v. NC Department of Revenue*, 2015 WL 4622 914 (August 4, 2015), the North Carolina Court of Appeals issued its decision and upheld the August 2014 decision of the North Carolina Superior Court in *Fowler v. NC Department of Revenue*, 2014 NCBC 36, 2014 WL 3870503 (August 6, 2014), that Mr. and Mrs. Fowler had abandoned North Carolina as their domicile and had adopted Florida as their new domicile. As a result, the Fowlers avoided a significant amount of income tax from the sale of their closely-held business by virtue of their attempts to move to Florida.

As discussed further below, the Fowler case demonstrates that, with proper planning, it may be possible to relocate to Florida (or to another no-tax state) before incurring a taxable/liquidating event.

But first, here are the facts of the Fowler case and the Superior Court’s prior conclusions of fact and law – taken almost “verbatim” directly from the Superior Court’s opinion, and reproduced below:

### **I. Events prior to and up to January 20, 2006.**

Previously, in 1984, Mr. Fowler founded Commercial Grading, Inc. (“Commercial Grading”), a North Carolina company, which did business as “Fowler Contracting,” and Mr. Fowler built Commercial Grading into a highly successful enterprise.

In the 1990s, Mr. and Mrs. Fowler began considering Florida as a potential retirement location. However, Mr. Fowler was born and raised in North Carolina and a significant amount of his family lived in North Carolina. Also, Mrs. Fowler was born and raised in North Carolina and had no family in Florida. Up through 2005, Mr. Fowler had spent his entire lifetime as a North Carolina resident. Mrs. Fowler likewise was born and raised in North Carolina and had no family in Florida.

In 1999, while residing in Apex, North Carolina, Mr. and Mrs. Fowler purchased property located at 7801 Old Stage Road, Raleigh, North Carolina, and built a 2,080 square-foot house, with two multi-bay garages of approximately 3,000 square feet each — one equipped with an office, car wash and dog wash — special kennels, and elaborate landscaping and gating.

Over several years, Mr. and Mrs. Fowler visited numerous cities in Florida in search of real estate. In 2002, they purchased a three-bedroom, 3,400 square-foot house in Naples (the “Tiburon House”) for approximately \$1.6 million. In 2003, Mr. and Mrs. Fowler moved furniture to the Tiburon House, including some family heirlooms and valued furniture. At this time, the Tiburon House was Mr. and Mrs. Fowler’s secondary residence.

In 2004, Mr. Fowler was diagnosed with kidney cancer and they accelerated their efforts to sell Commercial Grading and retire to Florida.

In October 2005, Mr. Fowler signed a preliminary letter of intent (“Letter of Intent”) with a private equity firm, Long Point Capital, to sell a majority of his shares in Commercial Grading. Mr. Fowler was further expected to remain the company’s President, and Mrs. Fowler was also expected to remain with the company for a period after

the sale.

After signing the Letter of Intent, Mr. and Mrs. Fowler told various other acquaintances in both Florida and North Carolina of their intent to move to Florida.

Also, shortly after signing this Letter of Intent, Mr. and Mrs. Fowler contracted to buy a four-bedroom, 9,300 square-foot house in Naples, Florida (“the Quail West House”), while retaining the Tiburon House. They closed on their purchase in August 2006, but later sold the Quail West House in April 2009 without having lived in it.

In late 2005, Mr. and Mrs. Fowler consulted their accountant to determine how to accomplish a change of domicile to Florida. As part of this consultation, the accountant informed Mr. and Mrs. Fowler that, if they became Florida residents prior to January 1, 2006, their holdings in Commercial Grading would be subject to Florida’s intangibles tax.

Therefore, the accountant advised Mr. and Mrs. Fowler to change their domicile to Florida after January 1, 2006, but before the close of the sale to Long Point, which would be a taxable event. To effect the transfer, the accountant advised Mr. and Mrs. Fowler to own a home in Florida, hire a Florida attorney, file a Declaration of Domicile in Florida, spend at least 183 days in Florida, and take some “official action” to effect their change of domicile, such as changing their driver’s licenses and registering to vote.

On January 19, 2006, Mr. and Mrs. Fowler signed the binding Securities Purchase Agreement for the sale of the majority interest in Commercial Grading, which was set to close in early February of 2006.

On January 20, 2006, the Fowlers left for Naples, Florida, on a chartered plane for the purpose of taking “official action” to evidence their change of domicile. They tried but could not complete certain efforts on this trip because they left certain necessary papers in North Carolina. At the driver’s license office, Mr. and Mrs. Fowler presented their North Carolina licenses and asked for Florida driver’s licenses, but were denied for lack of additional identification. They attempted but were unable to register to vote for the same reason.

At this time, Mr. and Mrs. Fowler had one of their several automobiles in Florida. They registered that single car in Florida, but signed the registration form as non-residents, listing their North Carolina address. Mr. and Mrs. Fowler also unsuccessfully attempted to obtain a post office box and register their dog on January 20, 2006.

## **II. Events After January 20, 2006.**

On February 3, 2006, Mr. Fowler sold a majority stake in his business to a private equity firm and the purchase funds (of around \$70 Million) were wired into his account on that same date. Mr. Fowler retained a 33% ownership interest and continued to manage the day-to-day business operations of the business until February 2009.

Mr. and Mrs. Fowler returned to Florida on March 10, 2006, and successfully completed the matters that they were unable to complete on their January 20, 2006, trip. They signed and filed a Declaration of Domicile in Florida. They obtained a Naples post office box and Florida driver’s licenses, and they registered to vote in Florida.

Thereafter, in 2006, the Fowlers continued to further their attempts at establishing domicile in Florida, obtaining a Florida driver’s license, by signing a Declaration of Domicile in Florida and by changing their records to reflect their Florida address.

On March 10, 2006, Mr. Fowler signed a Florida Homestead Exemption application indicating that he was a Florida resident on March 10, 2006. On March 10, 2006, Mr. and Mrs. Fowler obtained Florida drivers licenses and registered to vote in Florida. Mr. Fowler ultimately signed a Declaration of Domicile on March 10, 2006.

However, the Fowlers retained their Raleigh home so that Mr. Fowler would have a place to stay while in North Carolina. The Fowlers ultimately did not list the Raleigh home for sale until December 2010.

During 2006 and 2007, Mr. and Mrs. Fowler spent a majority of their days during those years in North Carolina.

Neither Mr. Fowler nor Mrs. Fowler spent 183 days in North Carolina in either 2006 or 2007. However, the Fowlers also did not spend at least 183 days in Florida in either 2006 or 2007. In 2006, Mr. Fowler spent 162 and 51 days in North Carolina and Florida respectively. In 2007, Mr. Fowler spent 168 and 27 days in North Carolina and Florida respectively. In 2006, Mrs. Fowler spent 173 and 47 days in North Carolina and Florida respectively. In 2007, Mrs. Fowler spent 180 and 27 days in North Carolina and Florida respectively.

There was also additional evidence, introduced by the Secretary of Revenue, indicating that Mr. and Mrs. Fowler continued to be North Carolina residents. For example, they used their North Carolina residence address on various business license documents; they made charitable contributions to North Carolina charities and they kept North Carolina drivers licenses and vehicle registrations in North Carolina. Also, the Fowlers continued to use their North Carolina physicians.

Mr. and Mrs. Fowler used their Florida address on their North Carolina Individual Income Tax Returns filed in April 2006 and thereafter. Mrs. Fowler continued to use her North Carolina address on her Privilege License Tax Returns from 2006 through 2010, although the checks Mrs. Fowler used to pay the taxes due on her Privilege License Tax Returns displayed her Florida address. Mrs. Fowler retained her North Carolina real estate license and received referral fees for properties in South Carolina and Florida, but never for property sold in North Carolina. During 2006 and 2007, Mrs. Fowler completed her continuing education requirements in North Carolina. Mrs. Fowler did not obtain a Florida real estate license.

Throughout 2006, the Fowlers changed their address from North Carolina to Florida with various businesses. However, throughout 2006 and 2007, they also continued to use the Old Stage Road address in Raleigh for certain correspondence and billing, and on K-1s, 1099s, bills, and bank statements.

In 2006 and 2007, Mrs. Fowler went to church in both Naples and Raleigh, and while she contributed to churches in Naples, the Fowlers made much more significant giving in North Carolina during this period. Mr. and Mrs. Fowler donated cash and property to Westover United Methodist Church in Raleigh in the amounts of \$102,580 and \$24,985 in 2006 and 2007, respectively. During 2006 and 2007, Mr. and Mrs. Fowler further donated to numerous other North Carolina charitable organizations.

In 2006 and 2007, Mr. and Mrs. Fowler were members of the Tiburon Club and the Quail West Club in Florida, but of no club in North Carolina. They obtained the Quail West Club membership to make the Quail West property more attractive to prospective buyers.

In 2006, Mr. Fowler used doctors in North Carolina and Massachusetts. In 2007, he used doctors in North Carolina, Massachusetts, and Florida. The majority of Mr. and Mrs. Fowler's 2006 and 2007 medical expenses were for treatment at a Massachusetts facility associated with the Cleveland Clinic.

In 2006 and 2007, the Fowlers did everyday "hometown" activities wherever they were.

In 2006, the Fowlers hired Florida counsel to create their first estate plan. In 2006 and 2007, Mr. Fowler obtained legal services from at least two North Carolina firms.

In 2006 and 2007, Mr. Fowler served as the registered agent for several North Carolina business entities. On February 1, 2007, he established Buffaloe Country, LLC, as a North Carolina limited liability company, which held several North Carolina properties not associated with Commercial Grading. On March 12, 2007, Mr. Fowler incorporated and was the sole owner of Leesville Road Ventures, LLC, a North Carolina limited liability company. Mr. Fowler used his Florida address when organizing these companies.

Mr. and Mrs. Fowler bought a homeowners insurance policy for their home at 7801 Old Stage Road in Raleigh for the period of July 31, 2006, through July 31, 2007. The policy included the stipulation that "The described dwelling is not seasonal or secondary." The Fowlers insured the contents of the Old Stage Road property for \$371,000. They did not insure their Florida property.

The Fowlers donated to candidates running for office in North Carolina but did not contribute to Florida candidates.

Mr. Fowler testified that each contribution was tied to candidates whose efforts benefitted business holdings.

Mr. and Mrs. Fowler held an elaborate birthday party for Mr. Fowler in North Carolina at the Old Stage Road property at a cost approximating \$1.3 million, to which customers and employees were invited.

### **III. The Business Court's Decision.**

In August 2014, the North Carolina Business Court concluded that Mr. and Mrs. Fowler intended to retire in Florida one day, and that the facts demonstrated that, as of January 20, 2006, the Fowlers (i) had abandoned North Carolina as their domicile, (ii) had adopted Florida as their new domicile, and (iii) intended to make Florida their permanent home. Therefore, all of the income from the sale of their business in 2006 was exempt from North Carolina income tax.

According to the Business Court, the Fowlers took adequate voluntary and positive actions in Florida on January 20, 2006 to establish their new domicile. These intentional, voluntary, and positive actions were adequate, even though the Fowlers did not complete certain activities until the return trip on March 10, 2006.

Also, the Business Court stated that the Fowlers' intent to change domicile was not improper or rendered ineffective because the change was timed to maximize tax savings. Additionally, Mr. Fowler's unexpected medical condition accelerated the need to carry out a preexisting future intent for this change in domicile. Moreover, according to the Court, the Fowlers were not in Florida for a temporary or transitory purpose on and after January 20, 2006.

The Business Court further ruled that the Fowlers' continued investments through the North Carolina Wachovia account, charitable and political contributions, maintaining personal property in North Carolina, and various other actions concerning North Carolina did not negate that they had abandoned North Carolina as a domicile.

The Court then stated that weighing the non-exclusive list of sixteen (16) factors in 17 N.C. Admin. Code 06B.3901(b) did not lead to a necessary finding that the Fowlers failed to abandon their domicile in North Carolina on January 20, 2006. The Court found that four (4) of the sixteen (16) factors favored a North Carolina domicile (Nos. 1, 3, 6 & 9), one (1) factor favored a Florida domicile (No. 10), six (6) factors were neutral (Nos. 4, 5, 12, 13, 15 & 16), two (2) factors were beyond the Fowlers' control (Nos. 2 & 8), and three (3) factors were inapplicable (Nos. 7, 11, & 14).

Accordingly, the Fowlers had satisfied the three-part test for change of domicile established in *Farnsworth* and thus had satisfied their burden to prove a change of domicile to Florida as of January 20, 2006.

### **IV. Court of Appeals Affirms the Superior Court.**

The North Carolina Department of Revenue then appealed the Fowler case to the North Carolina Court of Appeals. Ultimately, the North Carolina Court of Appeals upheld the Superior Court's decision, and stated that there was "substantial evidence" in the court's record that supported the earlier determination of the Superior Court - "even though the record contained evidence that could have led to contrary findings of fact and conclusions of law."

Accordingly, and based upon the Court of Appeal's limited standard of review, the Court of Appeals found no error in the earlier conclusions of the Superior Court.

### **V. Conclusion.**

The Fowler case demonstrates a viable tax planning opportunity for clients who have decided to relocate to low tax states and who are nearing a liquidation event, such as the sale of a family business or a large block of publicly traded stock. Arguably, however, the Fowlers cut it very close. And indeed, with better planning, the Fowlers may have been able to altogether avoid t

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