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Income Taxation of Residents and Nonresidents

How does Minnesota individual income taxation of residents and nonresidents differ?

States have broader constitutional power to tax residents than nonresidents. Minnesota, like most states, has chosen to exercise that authority and imposes more extensive or higher income taxes on its residents:

- **Residents** are subject to tax on all of their income—both that earned from Minnesota and non-Minnesota sources. Since another state may also tax non-Minnesota source income, a credit applies for taxes paid on that income to another state to avoid double taxation.
- **Nonresidents**, by contrast, are subject to tax only on the income they earn from Minnesota sources, such as from working in Minnesota or income derived from property and businesses located in Minnesota.
- **Part-year residents** pay tax under residency rules for the time they are residents and as nonresidents for the time they are nonresidents.

Who is a resident for income tax purposes?

Minnesota law provides two alternative tests or methods to determine if an individual is subject to tax as a resident:

- The **domicile test:** Does the individual intend to make Minnesota his or her permanent home?
- The **statutory or physical presence test:** Does the taxpayer have a Minnesota home and was he or she physically present in the state for more than half of the tax year?

What is domicile?

Domicile is the traditional or common law test that is widely used to determine residence for many legal purposes. It is determined by case law and focuses on intent: Does the taxpayer intend Minnesota to be his or her permanent home? If so, the taxpayer is a resident.

What evidence is used to show Minnesota is an individual's domicile?

Since the domicile test relies on the taxpayer's intent, the key question is what evidence the Department of Revenue (DOR), in its role as tax enforcement agency, and the courts will use to determine that intent. Since residency typically will result in higher taxes, DOR and the courts cannot simply accept taxpayers' assertions of their intent. A series of court decisions and a DOR administrative rule set out relevant factors used to determine taxpayer intent. The administrative rule lists 26 factors that are relevant to determining intent. These can be grouped into several categories:

- **Employment:** Where was the individual employed; was it permanent; in what state were they licensed; and so forth?

- **Homes and living arrangements:** Where was the individual's home; was it homesteaded; how long did he or she spend in the state; and so forth?
- **Business relationships:** Where did the individual primarily do business, own property, conduct other business, and so forth?
- **Social and civic relationships:** Where was the individual registered to vote, drive, hunt, and fish; did he or she maintain memberships and participate in social clubs and religious organizations; and so forth?
- **Miscellaneous factors:** Where did children attend school; was the individual a student; and so forth?

A law enacted in 2017 prohibits DOR and the courts from considering the location of one's lawyer, certified public accountant, or financial adviser in determining domicile, as well as where certain banking relationships were initiated. A 1999 law similarly prohibits considering where an individual makes charitable donations.

What is the statutory residency test?

Since 1987 Minnesota law has provided an alternative test in statute to determine the residency of taxpayers who are not domiciled in Minnesota. This test is based on physical presence in the state and has two elements:

- The individual must "maintain" a "place of abode" in Minnesota—i.e., a dwelling or home that he or she owns or occupies (e.g., he or she can rent it or share quarters with someone else, such as a relative).
- The individual is physically present in Minnesota for more than half of the tax year. This test is calculated or applied on a per-day basis.

What days count under the statutory residency test?

In general, any day in which the individual is physically present in Minnesota, for any part of the day counts as a Minnesota day. The administrative rule provides, however, that days in transit (e.g., changing planes or passing through in a train, bus, or car) between two points outside Minnesota do not count. Taxpayers with Minnesota residences, thus, need to maintain records (e.g., calendars, financial records, airline tickets, and so forth) to be able to demonstrate the number of days that do not count as Minnesota days.

What special rules apply under federal law?

Federal law provides special rules for certain categories of individuals—particularly members of the military and nonresident employees of various transportation sector businesses. For service members, federal law prohibits states from taking into account presence in the state under military orders in determining domicile or residency. Taxation of employees of various transport sectors (air, rail, and motor carriers and the merchant marine) is limited to the employees' states of residence. Federal law also prohibits states from taxing the qualified retirement income of nonresidents. These federal law rules preempt state law.

For more information: Contact legislative analyst Nina Manzi at 651-296-5204 or Joel Michael at 651-296-5057. Also see the House Research publication *Individual Income and Estate Taxation: Residence, Domicile, and Taxation*, September 2017.

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