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Robert W. Wood
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As Trump Tax Cuts Emerge, High 13.3% California Tax Spells Exodus

The promise of Trump tax cuts excites many, and is already triggering some 'pay me in 2017' requests. Yet voters just passed *higher* California taxes, at least until 2030. California's Proposition 55 extended the "temporary" 13.3% tax rate on California's high-income earners, the highest marginal tax rate in the nation. Well, it's only temporary, through 2030. These personal income tax increases on incomes over $250,000 started in 2012. It hits 1.5% of Californians, those with a single income filing of at least $263,000, or a joint income filing of at least $526,000.

Many of these people must be thinking about *cuts* in federal taxes they might get in 2017. Yet the disproportionately high California tax rates are an increasingly large share of their tax burden. That is causing some to weigh the benefits and burdens of the Golden State. Tax-free Nevada is just across the border. Texas, Washington, and Florida also have beckon.

Many people who live and work in California leave for a lower cost of living, especially lower housing costs. But it should be no surprise that state taxes are also a big reason. Why else would there be such a high probability that Californians become residents of no-tax states like Texas? The IRS reports that between 2013 and 2014, over 250,000 California residents moved away between 2013 and 2014. More than 10% went to Texas alone.

California's tough Franchise Tax Board (FTB) polices the line between residents and non-residents, and does so rigorously. Like other high tax states, California is likely to probe how and when you stopped being a resident. For that reason, even if you think your facts are not controversial, be careful. A California resident is anyone in the state for other than a temporary or transitory purpose. It also includes anyone domiciled in California who is outside the state for a temporary or transitory purpose. The burden is on *you* to show that you are *not* a Californian.

If you're in California for more than 9 months, you are *presumed* to be a resident. Yet if your job requires you to be outside the state, it usually takes 18 months to be presumed no *longer* a resident. Your domicile is your true, fixed permanent home, the place where you intend to return even when you're gone. Many innocent facts might not look to be innocent to California's tax agency. For example, do you maintain a California base in a state of constant readiness for your return?

Year after year, no state has a bigger cadre of would-be tax fugitives than California. Some Californians look to flee the state before selling real estate or a business. Some get the travel itch right before cashing in shares, a public offering, or settling litigation. Some of the carefully orchestrated deals and moves can work just fine. Yet, many would-be former Californians have unrealistic expectations about establishing residency in a new state. They may have a hard time distancing themselves from California, and they may not plan on California tax authorities chasing them.

When fighting California tax bills, procedure counts. You can have only one domicile, and it depends on your intent. Objective facts can bear on your intent. Start with where you own a home. Where your spouse and children reside counts too, as does the location where your children attend school. Your days inside and outside the state are important, as is the purpose of your travels. Where you have bank accounts and belong to social, religious, professional and other organizations is also relevant.

Voter registration, vehicle registration and driver's licenses count. Where you are employed is key. You may be a California resident even if you travel extensively and are rarely in the state. Where you own or operate businesses is relevant, as is the relative income and time you devote to them. Taxpayers with unrealistic expectations can end up with big bills for taxes, interest and penalties.

The state can have a long memory. Although the IRS can audit 3 or 6 years, California can sometimes audit *forever*. In fact, several things give the FTB an *unlimited* amount of time to audit you. California, like the IRS, gets unlimited time if you never file an income tax return. You might claim that you are no longer a resident and have no California filing obligation. The FTB may disagree. That can make filing a non-resident tax return–just reporting your California-source income as a non-resident–a smart move under the right facts. Be careful out there.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.