PERSPECTIVE

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At 48th, Is California Still Golden?

By Robert W. Wood

California has the 48th best tax climate of 50 states, says the new State Business Tax Climate Index from the nonpartisan Tax Foundation. Put differently, the Golden State is almost at the bottom of the barrel. This index measures how well structured each state's code is by analyzing over 100 tax variables including corporate tax, individual income tax, sales tax, property tax, and unemployment insurance.

Overly complex, burdensome and economically harmful tax codes hurt the rank, while transparent and neutral tax codes help. California's ranking is a composite of:

- California's overall State Business Tax Climate ranking: 48th
- Corporate tax structure: 34th
- Individual income tax structure: 50th
- Sales tax structure: 42nd
- Property tax structure: 14th
- Unemployment insurance tax structure: 14th

What should California aspire to fix? Look at these also-rans and victors in what amounts to a tax beauty contest among the states. The 10 *most* competitive states are: Wyoming (#1), South Dakota (#2), Nevada (#3), Alaska (#4), Florida (#5), Montana (#6), New Hampshire (#7), Indiana (#8), Utah (#9) and Texas (#10).

The 10 *least* competitive states are: New Jersey (#50), New York (#49), California (#48), Minnesota (#47), Vermont (#46), Rhode Island (#45), Ohio (#44), Wisconsin (#43), Connecticut (#42) and Iowa (#41). The full report is called 2015 State Business Tax Climate Index.

Perhaps this report will make you want to become a policy wonk. Alternatively, it may make you think about moving. Living in California has many perks, but tax rates are not among them. Taxes were already high in California, but in 2012 went up steeply and remain high today.

Californians earning $250,000 to $300,000 a year now pay 10.3 percent in state income taxes. For $1 million-plus-earners, California's rate is 13.3 percent. Capital gains are even more problematic.

We are used to paying lower federal taxes on long term capital gains compared with ordinary income. At the federal level, the capital gain rate remains 15 percent for some, but rose to 20 percent for higher income taxpayers. Add the 3.8 percent investment tax that results from Obamacare, and you have a federal capital gain rate of 23.8 percent.

What about Californians? California taxes capital gain like ordinary income. And that means adding state taxes on capital gains as high as 13.3 percent. It is one thing to compare states, but the comparisons can be even more depressing when one looks around the world.

If you are paying up to a 33 percent combined federal and state tax on capital gains, you might be in California. And that means you are paying more than virtually anyone else in the world, with only Denmark having a higher long-term capital gains rate — a whopping 42 percent. (France and Finland are close behind California, at 32.5 and 32 percent, respectively.)

Some Californians head for the exits before selling real estate or a business, taking a company public or winning a large legal settlement. The burden is on you to show you're not a Californian. A California resident is anyone in the state for other than a temporary or transitory purpose. See FTB Publication 1031.

Plus, it includes anyone domiciled in California who is outside the state for a temporary or transitory purpose. If you're in California for over 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. Do you maintain a California base in a state of constant readiness for your return? You can have only one domicile, and it depends on your intent.

How do you measure intent? Objective facts, and many are relevant. Start with where you own a home. If you own several, compare size and value. Consider if you claim a homeowner's property tax exemption as a resident.

Where your spouse and children reside count too, as does where your children attend school. If you claim not to be a California resident, make sure you are paying nonresident tuition for college students.

Your days inside and outside the state are important, as is the purpose of your travels. Where do you have bank accounts and belong to social, religious, professional and other organizations? 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 counts, as does the relative income and time you devote to them. You can own investments far and wide, but you can expect them to be compared.

Where you obtain professional services matters, including doctors, dentists, accountants and attorneys. Fortunately for California tax advisers, the mere fact that you hire a California tax lawyer to advise you about your California tax exposure doesn't mean you're a resident.

Many of these points are probably not too significant one-by-one. Yet they have a cumulative effect pro or con. If you leave California, it is best to sell your residence or at least to rent it out on a long-term lease.

Do not think for a minute that getting a post office box in Nevada is enough to count you as a nonresident. That doesn't work and you will end up with bills for taxes, interest and penalties, or conceivably criminal charges. If you're going to move, you need to actually do it.

Like other high tax states, California is likely to pursue you and probe how and when you stopped being a resident. Get some legal advice and plan carefully.

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