PERSPECTIVE

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Big Gains Could Mean Big Taxes For New Bitcoin Millionaires

By Robert W. Wood

Bitcoin has captured the hearts and wallets of techies everywhere. At the start, it seemed off the grid, a kind of counterculture counterpunch to the banks and financial institutions that had their grip on everyone everywhere. It seemed largely anonymous, although now that the IRS is getting Coinbase customer lists, it turned out not to be entirely under the radar.

Now, it seems practically mainstream, with futures, investment banks and institutional investors. It is so big and so widespread that some might even argue that it is straying from its upstart roots. And other digital currencies might soon follow the same path.

And then there are taxes, which after all, are ever-present. On an individual level, there are many people who have done well, buying low and ready to sell very high. And there's the rub, for big gains mean big taxes. Many a bitcoin millionaire may be thinking like their forefathers did holding low basis stock in Microsoft, Intel or Starbucks.

After all, losing lots of money to taxes is never fun. And if you can avoid some of the sting, why not? Enter the old-fashioned tax move. That's right, this is one of the least high-tech tax moves there is, the caveman of tax moves: You just move.

In general, stocks and other investments are considered intangibles for tax purposes. One effect of that rule is that, for tax purposes, you take them with you. If you live in California and sell your stocks and bonds, they are sourced for tax purposes to California where you reside.

If you (really and truly) move to Nevada or Texas before you sell, your sale should be sourced to Nevada or Texas. Since California has a 13.3 percent income tax — and no tax break for capital gain — paying tax in California would be painful. Alaska, Nevada, Texas, Florida, South Dakota, Washington and Wyoming have no state income tax.

As for bitcoin and other digital currency, the IRS has said it is property, and it sure does seem intangible. So, it is hard to imagine that the IRS or state tax authorities would view it as different from say a share of stock that travels with you when you move. Moving, of course, has its own foibles and rules.

You have to really do it, and it has to be permanent, not a visit. At the federal level, the capital gain rate is 20 percent for higher income taxpayers. Add the 3.8 percent net investment tax under Obamacare, and you have 23.8 percent.

California taxes long term capital gain as ordinary income, so Californian's pay up to 13.3 percent. By paying 23.8 percent plus 13.3 percent, Californians are paying more on capital gain than virtually anyone else in the *world*. Although there may be reductions in federal taxes soon, disproportionately high California taxes are an increasingly large share of the tax burden.

California's tough Franchise Tax Board polices the line between residents and nonresidents, and it does so rigorously. As with other high tax states, California is likely to probe how and when you stopped being a resident. 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. So, if it looks as though you are exiting to sell and then will come back, the state may say you never left. 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. Check out FTB Publication 1031. 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.

It should be no surprise that former Californians often become residents of no-tax states like Texas. The IRS reports that between 2013 and 2014, over 250,000 California residents moved away. More than 10 percent went to Texas. Some people get the travel itch right before cashing in shares, a public offering, settling litigation or selling bitcoin. Some people have unrealistic expectations about establishing residency in a new state. They may have a hard time distancing themselves from California, and may not plan on California tax authorities chasing them.

You can have only one domicile, and objective facts can bear on your intent. Start with where you own a home. Where your spouse and children reside counts, 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.

California, like the IRS, gets unlimited time to audit if you never file an income tax return. You might claim that you are no longer a resident, claiming that you have no California filing obligation. But the FTB may disagree and can audit you forever *unless* you file a return. That can make filing a nonresident tax return — just reporting your California-source income as a nonresident — a smart move.

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