Forbes

Robert W. Wood

THE TAX LAWYER

TAXES 03/07/22

California Proposes Tax Increases Again With Wealth Tax

California proposed a new tax to take effect in 2023 that could collect billions in taxes. The bill was introduced by Assemblymember Alex Lee of San Jose. This isn't an income tax at all, it would be America's first *bona fide* wealth tax. It would tax households worth more than $50 million with a 1% annual wealth tax. And if you are worth over $1 billion, the rate would be 1.5%. Again, that's every year. Do you get out of income tax? No, of course, not, you pay California's 13.3% state income tax rate too. The new tax would raise more than $22 billion a year in state revenue if passed, according to one study. As proposed, the bill would come into effect in 2023 for billionaires. Setting its sights even wider, it could impact those with a net worth of more than $50 million starting in 2025. California's aggressive wealth tax move was born in 2020, when the law was proposed for the first time. They tried again in 2021, so this 2022 effort makes it a third time.

As in the case of the 2020 and 2021 wealth tax bills, this one would first need to pass. And that's not all, it would also require a constitutional amendment to increase the state's current wealth tax cap. The wealth tax bill in 2020 was different, starting the tax at $30 million in assets, so the 2022 version is less drastic. There's no question that California is a tax pioneer—remember the property tax revolution of Proposition 13? But pioneer or not, the administrative nightmare that the nation's first wealth tax would bring seems large indeed. Remember, this is not about income, but about accumulated wealth. And it's not about a discreet event such as death, where estate tax kicks in. This would be an annual tax, which is and that's where valuation comes into play. Taxing assets rather than income means major valuation and line-drawing exercises. Critics have noted how vastly difficult a wealth tax would be to administer. How do you value assets, and who decides? The amount of compliance and administration would be a nightmare.

And then there is fairness. When you haven't sold anything, is it fair to tax it? Perhaps the theory is a little like property tax, but there one is arguably paying for certain services. In any case, one other topic of debate concerns people who dip into and out of California. Would they be caught by the wealth tax too? It appears that in some cases they would, which could make the Golden State a very expensive place to visit. Of course, it isn't only wealth tax that legislators have been considering. Not long ago, California proposed raising the state's already stratospheric top income tax rate by up to 3.5% for very high incomes. That would mean an income tax rate of to 16.8%, but that bill failed to pass.

Currently, the income tax rate on individuals tops out at 13.3%, but Assembly Bill 1253 would have raise the top tax rate to 14.3% for those making more than $1 million. For some time, California has been losing citizens for no-tax states like Texas, Nevada, Washington, Wyoming and Florida, and not just the likes of Elon Musk. And many states tax capital gains more favorably, like the IRS. California taxes ordinary income and capital gain the same, up to 13.3%—unless the rate goes up. That prompts sellers of stock, Bitcoin, and other assets facing California's 13.3% tax on capital gains to move then sell. The same for litigants settling big suits who move before they settle. Although moving sounds easy, you need to be thorough and careful so you are not asked to keep paying California taxes.

Timing matters too. California audit exposure can be frightening, and in some cases California can assess taxes no matter where you live. The IRS can generally audit 3 or 6 years depending on the issue, but California can sometimes audit *forever*. Like the IRS, California has an unlimited number of years to audit if you never file an income tax return. That can make continuing to file in California—as a nonresident—a smart play. That way you are just reporting your California source income, but not everything else. California source income would include rental income from California property, Schedule K-1s that you might receive from California partnerships or LLCs could reflect some California source income too. Whether you start filing as a nonresident or not, of course, many people worry that saying goodbye to California taxes can mean hello residency audit. Yet the fact that the top tax rate could go up again may put some people on the move. It's not just income taxes driving the reverse immigration either. The repeated talks of a wealth tax are worrisome, even for those who only aspire to be wealthy.

Check out my website.