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California Taxes Already Prompt Moving Then Selling, No Deduction Could Mean Exodus

Writing off state income taxes is second nature to most high income Californians. One can say the same about a number of other high tax states, including New York, Connecticut, and others. Tens of millions of Americans claim this tax deduction, writing off their state and local taxes to reduce their federal income tax. However, state income tax deductions are itemized deductions. Thus, they are subject to numerous limits and phase-outs. And state income taxes are not deductible at all in computing the dreaded alternative minimum tax (AMT).

In that sense, the mere fact that you *can* write them off doesn't actually mean you get any particular benefit. Some high income Californians might be surprised to find that they actually get *no* benefit at all from their state tax deduction. Still, losing something that you are used to claiming is hard, and California taxes are very high. California taxes income at rates up to a whopping 13.3% on top of IRS rates. To make matters even worse, California does not distinguish between ordinary income and capital gain. Thus, even before the pending tax bill passes, even while California taxes are still a write-off, they *already* seem to invite investors and business people to move away.



Many people want to make money in California, but to move elsewhere before it is taxed by the Golden State. Year after year, no state has a bigger and more persistent group of would-be tax fugitives than California. Some people worry that the outflow will be much worse under GOP proposals. Both the House and the Senate

tax bills would eliminate the state income tax deduction. To an even greater degree, therefore, some people could rethink where they want to live. Some aggressive taxpayers may try to [skip California taxes without moving](#) by setting up a new type of trust in Nevada or Delaware. A 'NING' is a Nevada Incomplete Gift Non-Grantor Trust. A 'DING' is its Delaware sibling. There is even a 'WING,' from Wyoming.

Let's say you can't move quite yet, so you wonder if a trust in another state might work. The usual grantor trust you form for estate planning doesn't help, since the grantor must include the income on his own return. An emerging answer for the adventurous is a Nevada or Delaware Incomplete Gift Non-Grantor Trusts. The donor makes an incomplete gift—with strings attached—to the trust, and the trust has an independent trustee in another state. The idea is to keep the grantor involved, but not technically as the owner.

New York State has changed the law to make the grantor taxable no matter what. California's Franchise Tax Board is studying the issue. Some sellers hold significant assets and move states before they sell. A cleaner plan is an outright move, and some of those may happen if the tax bill passes in its current form. It has been true for many years that some Californians flee the state before a major income event. But, many leavers have unrealistic expectations about establishing residency elsewhere, and have a hard time distancing themselves from California.

The burden is on you to show that you are *not* a Californian. You can have only one domicile, and it depends on your intent. Start with where you own a home. If you own several, compare size and value. Where your spouse and children reside counts, as does the location where your children attend school. 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. If you leave California, sell your residence or rent it out on a long-term lease. Like other high tax states, California is likely to probe how and when you stopped being a resident.

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