PERSPECTIVE

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California's 13.3 Percent Tax Rate Can Encourage Wanderlust

By Robert W. Wood

Living in California has many perks, but the state's 13.3 percent rate is the highest marginal tax rate in the nation. With up to 39.6 percent federal taxes, it can hurt a lot, especially for those who cannot deduct their state taxes against their federal ones. The high 13.3 percent was supposed to be only temporary.

However, California's Proposition 55 extended the "temporary" 13.3 percent tax rate. How temporary is it? Just until 2030. Personal income tax increases on incomes over $250,000 started in 2012. This impacts only about 1.5 percent of Californians, those with a single income filing of at least $263,000, or a joint income filing of at least $526,000.

But some of those people are mobile and may think twice whether there is something they should do about it. In some cases, California taxes are causing migrations out of state. In some cases, it is (especially) the absence of a capital gain rate in California that can be the straw that breaks the proverbial camel's back.

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. President Trump vowed to repeal Obamacare and its taxes, but that effort failed so far. California does not tax long term capital gain at any lower rate, so Californian's pay up to 13.3 percent on capital gains too.

Paying 23.8 percent plus 13.3 percent means Californians are paying more on their capital gains than virtually anyone else in the *world*. Plus, as talk turns to possible reductions in *federal* taxes, the disproportionately high California tax rates can seem even worse. At a minimum, California taxes are taking on an increasingly large share of the overall tax burden.

Some Californians weigh the benefits and burdens of tax-free Nevada just across the border. Other no-tax states including Texas, Washington, and Florida may also beckon. Yet California's tough Franchise Tax Board (FTB) polices the line between residents and non-residents. Make no mistake, it 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.

A California resident 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. Check out FTB Publication 1031, *Guidelines for Determining Resident Status*.

Yet, it doesn't always work both ways. In fact, if your job requires you to be outside of California, it usually takes 18 months to be presumed no *longer* to be a resident. Your domicile is your true, fixed permanent home, the place where you intend to return even when you're gone. California likes to probe about one's true domicile, and many innocent facts might not look so innocent to California's tax agency.

For example, do you maintain a California base in a state of constant readiness for your return? If so, you might look like a resident and domiciliary. In the meantime, many people who live and work in California leave for a lower cost of living, especially lower housing costs. Californians often become residents of no-tax states like Nevada, Washington, Florida or Texas.

In fact, the IRS reports that between 2013 and 2014, over 250,000 California residents moved away. More than 10 percent went to Texas alone. Some Californians flee the state before selling real estate or a business. Warning: California real estate is taxed by California even if you are a non-resident.

Some people get the travel itch right before cashing in shares, a public offering, or settling litigation. Some carefully orchestrated deals and moves can work just fine. But 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. So does documentation and timing. 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.

Some people are surprised to find that they might be California residents even if they 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. And the state can have a long memory.

Some people think there is a statute of limitations that protects them from California. If you file a California tax return, the FTB generally has four years to audit. This is one year longer than the main IRS audit rule of three years. Yet, California, like the IRS, gets *unlimited* time to audit if you never file an income tax return.

You might think that you are no longer a resident and have no California filing obligation. But the FTB may disagree. And if you have not filed a California tax return, the statute of limitations on the Golden State coming after you is unlimited. 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.

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