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Leave California, Keep Paying California Taxes...Really

If you leave California, can the state say you really didn't and keep taxing you? Yes, and it happens more than you might think. California taxes have always been high, and for that reason, many people do their best to try to avoid paying them. This is especially true for someone expecting a big spike in income. Some people vote with their feet, although in some cases, California can assess taxes no matter where you live. How high are California taxes? After decades of high taxes, things got worse in 2012, and then worse still in 2018. In 2012, California's Proposition 55 placed a temporary extension (through 2030!) on a 13.3% tax rate on California's high-income earners. It applies to 1.5% of Californians, singles with an income of $263,000, or joint filers with incomes of $526,000. It is still the highest marginal tax rate in the nation. As a result, tax-free states such as Nevada, Texas, Washington, and Florida can hold considerable allure.

Many millionaires fled California after the 2012 tax increase, with one report saying that, "We estimate that California lost 0.04 percent of its top earner population over the two years following the tax change." The 2012 tax change is now old news, and yet there is still talk about its impact. The 2018 tax changes made it worse, since now only $10,000 of state and local taxes can be claimed as deductions on a federal tax return. That can make paying big state taxes smart even more. People may want to move out of state, and then collect big. A good example is founder legal settlements, which might be tax free or tax deferred. But timing and caution in how you document a move are important. After all, many fear being chased by California's Franchise Tax Board.

Fortunately, there is a safe harbor for certain individuals leaving California under employment-related contracts. The safe harbor says that an individual domiciled in California, who is outside California under an employment-related contract for an uninterrupted period of at least 546 consecutive days, will be considered a nonresident unless either: (1) The individual has intangible income exceeding $200,000 in any tax year during which the employment-related contract is in effect; or (2) The principal purpose of the absence from California is to avoid personal income tax.

The spouse of an individual covered by the safe harbor can qualify too. Return visits to California that do not exceed a total of 45 days during any tax year covered by the employment contract are considered temporary. But what happens if you *don't* meet the safe harbor? It becomes more complicated. Individuals not covered by the safe harbor determine their residency status based on facts and circumstances. That's where California's tough [Franchise Tax Board (FTB) comes in, policing the line between residents and non-residents.] 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. It 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 are in California for more than 9 months, there is another presumption: 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. Many innocent facts might not look to be innocent to California's tax agency, and make no mistake, if you are fighting a California tax bill, procedure counts.

You can have only one domicile, and it depends on your intent. Yet objective facts can bear on your intent. Start with where you own a home. Where your spouse and children reside counts, as does 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. The state can have a long memory. Although the IRS can audit 3 or 6 years, California can sometimes audit *forever*. In fact, several things give the FTB an *unlimited* amount of time to audit you. California gets unlimited time if you never file an income tax return. You might claim that you are no longer a resident and have no California filing obligation.

It 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. Some Californians look to flee the state before selling a business. Some get the travel itch right before a public offering, a sale, or settling litigation. Many would-be former Californians have a hard time distancing themselves from California, and they may not plan on California tax authorities chasing them. Plan carefully, and get some professional advice.

Check out my website.