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Leaving California? Watch Out For An FTB Audit

By Robert W. Wood

California may have a record number of millionaires and billionaires, but the tax cost of living in the Golden State has always been high. The current top 13.3% rate, which is the same on ordinary income and capital gain, dates from 2012. In some ways, that high capital gain tax rate is even worse than the ordinary rate. If you are about to sell stock, your cash of bitcoin, your out of state real estate holdings, or settle a career lawsuit, you might want to move first.

High state taxes have always been a sore spot with Californians, and an incentive to move or invest in tax shelters. But the issue seems to have reached a fever-pitch now. After all, with the 2018 federal tax law changes, paying 13.3% in non-deductible state taxes (after a $10,000 cap) is even more painful. Californians like to complain about high taxes, and now they seem to be complaining even more. The tax law is causing an exodus of high-tax state residents to no tax or lower tax states.

Yes, you might think of Texas, Nevada, Washington, Florida and a few others that have no state income tax. Of course, lower tax means just about everywhere. So, you can move easily, right? Yes, but if you aren't careful about how you do it, you could end up leaving California and yet being asked to keep paying California taxes. There's also the fact that California has a very broad reach into other states.

In some cases, California can assess taxes no matter where you live. Should this discourage you? No, but it pays to know what you are up against in a fight. If you live in California, you probably know how aggressive California's state tax agency can be. In fact, even if you live somewhere else, you might have heard of the Golden State's aggressive tax rules. California has a 13.3% tax rate on high-income earners, the highest tax rate in the nation.

Even so, this high rate hits only 1.5% of Californians, those with a single income filing of at least $263,000, or joint income of $526,000. But the new federal tax law that limits state and local tax deductions to $10,000 makes it burn even more, especially if you are writing a several hundred-thousand-dollar check to California and cannot deduct it. That makes moving out seem so enticing. California's Franchise Tax Board (FTB) monitors the line between residents and non-residents, and 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. 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, 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. For example, do you maintain a California base in a state of constant readiness for your return?

Year after year, no state has a bigger cadre of would-be tax fugitives than California. Some Californians look to flee the state before selling real estate or a business. Some get the travel itch right before cashing in shares, a public offering, or settling litigation. Some of the carefully orchestrated deals and moves can work just fine. Yet, 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 pursuing them. When fighting California tax bills, procedure counts.

You can have only one domicile. It depends on your intent, but objective facts can bear on it. Start with where you own a home. Where your spouse and children reside counts too, 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. Taxpayers with unrealistic expectations can end up with big bills for taxes, interest and penalties.

How about audit times? 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, like the IRS, 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. The FTB may disagree. 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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