PERSPECTIVE

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When Are Taxes In California Too Much – Even For Rock Stars?

By Robert W. Wood

Living and paying taxes in California is expensive. If the COVID-19 pandemic has taught us anything, it might just be that it is probably less important where you are on a day to day basis than it used to be. A great deal depends on your business or profession, of course. And even within a business or profession, how you interact and with whom matters a lot.

At a minimum, it is surely true that working from home voluntarily or not has caused some major rethinking about these things. Still, if you are working for a California employer and sitting at your home in Nevada, Texas or Washington, must you pay California taxes anyway? Does it depend on what your employer is willing to do, and whether they withhold California taxes?

Does it help or hurt your exposure to be an independent contractor? The answer to these questions, like so much else in the tax law, is that it depends. These questions are fodder for more than a few columns, and I am adding them to my to-do list. In the meantime, though, what if your facts are more vanilla, and you are moving away to clip coupons and manage your investments, perhaps like a retired rock star?

That may be hard to imagine for many of us, but it is surely simpler from a tax viewpoint. Yet even there, a surprising number of people have trouble. And there can be a kind of deer in the headlights angst too. California's 13.3% tax rate is enough to make almost anyone sick, including rock stars, it appears. Kiss rocker Gene Simmons announced that he would be leaving California for tax-free Washington state, putting his $22 million Beverly Hills California estate on the market.

The listing of his 16,000 square-foot mansion says it has a 40-foot foyer, parking for 35 cars, and a laundry list of amazing features. There is TV history here too, since the A&E show Gene Simmons Family Jewels featured the property. "California and Beverly Hills have been treating folks that create jobs badly and the tax rates are unacceptable," Simmons said. "I work hard and pay my taxes and I don't want to cry the Beverly Hills blues but enough is enough."

Simmons isn't the only one saying that. California may have more millionaires and billionaires, but the tax cost of living in the Golden State is high. It could go higher still, since the 13.3% Tax Rate may be raised to 16.8% retroactive to January 1, 2020. California top 13.3% rate is the highest in the nation, and it applies equally to ordinary income and capital gain. There's even a legislative proposal for a 0.4% wealth tax.

For many people, the fact that California doesn't give you a break on capital gains can be the most painful pill to swallow. The lack of a capital gain rate makes California's among the highest rates in the world when combined with federal. As people look at big sales, it is a common motive for moving away. Federal tax rules play a part too.

It was bad enough paying California taxes when you could deduct your state taxes against your federal taxes. But since 2018, you can deduct a maximum of *$10,000* in state taxes on your IRS tax return, and paying 13.3% in non-deductible state taxes is even more painful. Following Simmons' lead and leaving for tax-free Texas, Washington, Florida, Nevada, New Hampshire, Wyoming or Tennessee makes sense for many people.

In fact, forget thinking no-tax. You don't even have to aim for a no-tax state to improve your tax posture, since states *with* taxes all have lower rates than California. Just be sure to document your exit carefully so you don't end up leaving California but being asked to *still* pay California taxes. California can reach into other states, and in some cases can assess taxes no matter where you live.

California's Franchise Tax Board (FTB) aggressively monitors the line between residents and non-residents. Like other high tax states, California is likely to probe how and when you stopped being a resident. 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. Some Californians flee the state before selling stock, a business or cryptocurrency or before an IPO.

Establishing residency in a new state is key, as is distancing yourself from California. Your true domicile depends on your intent, but objective facts are key. Start with where you own a home, where your spouse and children reside, and the location where your children attend school. Your days inside and outside the state are important, as is the purpose of your travels.

Many points are just common sense. Where you are employed, have bank accounts and belong to social, religious, professional and other organizations is relevant. Voter registration, vehicle registration and driver's licenses also count. You can be a California resident even if you travel extensively and are rarely in the state. Be prepared for an audit, and remember that California tax procedure counts.

Taxpayers with unrealistic expectations can end up with big bills for California taxes, interest and penalties. If you move, watch the clock until you are really in the clear and beyond audit risk. The IRS can generally audit for three years, but California gets four years, and in some cases can audit with no limit. California, like the IRS, gets unlimited time if you never file an income tax return.

Keep in mind that you might claim that you are no longer a resident and have no California filing obligation, but the FTB may disagree. Once you leave, 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. If nothing else, filing a return starts to tick off the FTB's ability to audit you. Four years after filing your return, you should be OK.

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