

Breaking Up Is Hard to Do: Ending Your California Residency

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For more than a dozen years now, more people have been moving *from* California to other states than have been moving to California from other states. This trend has been attributed to several factors, including cost of living to politics and highway traffic.

Compounding the problem is the fact that many companies – small business and large corporate enterprises alike – are abandoning California due to the high cost of doing business in the state, including Tesla Motors, Kaiser Aluminum, Wiley X Sunglasses, and Gordon Ramsay North American Restaurants.



Some people – especially high-net-worth individuals – want the best of both worlds. They love living in the Golden State for its weather, scenery, culture, culinary options, outdoor activities, and more. However, they would prefer lower taxes and a more business-friendly environment offered by other states such as Texas, Nevada, Florida, and Tennessee.

In an attempt to build this Shangri-La for themselves, they purchase a condo in Las Vegas, San Antonio, Nashville, or Fort Walton Beach and live there instead of in the house they own in California, in the mistaken belief that's all it takes to reduce or even eliminate their obligation to pay California taxes.

Unfortunately, it's not that easy. Ending your California residency is much more complicated than just moving out of state. And if you fail to meet all the requirements of becoming a non-resident, you're likely to be pursued by the State of California's Franchise Tax Board (FTB) for unpaid taxes and penalties.

In this SWC singlette, we explain the rules that govern residency in California and what you need to do to officially end your State of California residency.

Defining "Residency"

According to the State of California, a *resident* is any individual who meets either of the following criteria:

- Is in California for other than a temporary or transitory purpose
- Has established a primary home in California, but lives outside California for a temporary or transitory purpose

Residency is determined primarily by examining all the facts and circumstances of a specific case, such as where you vote, where you see your doctor and dentist, the state in which your vehicles are registered, and so on. It is *not* determined by your intent.

Residency is important because it determines how your income is taxed:

- If you're a resident of California, you're taxed on all income, regardless of source.
- If you're not a resident of California, taxes apply only to income from sources in California.
- If you're a part-time resident of California, you're taxed on all income while a resident and only on income from California sources while you're a non-resident.

Defining "Domicile"

While many states consider *domicile* and residence to be the same, California views them as distinct concepts that may, at times, overlap:

- *Domicile* is your fixed, permanent home – the place where you have a substantial connection. You can have only one domicile at a given time.
- *Residence* is where you live. It can be your domicile or somewhere else. For example, your domicile can be in California, where you reside for nine months a year, and you can reside in Colorado for the other three months of the year.

You can be a resident of California without being domiciled in California. Conversely, you can be domiciled in California without being a resident of the state.

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You can be domiciled in only one place at any given time. Your domicile is retained in a state until you establish a domicile in another state. A change of domicile requires that you meet all three of the following conditions:

- You abandon your prior domicile.
- You physically move to and reside in the new locality.
- You plan to remain in the new locality permanently or indefinitely.

Voting and military service are often used to determine where a person is domiciled:

- If you vote in California elections, that's a pretty good indication that you are domiciled in that state.
- If you're a military member, you're domiciled in the state of your home of record, in which case you're likely to be taxed by your domiciliary state and not necessarily by the state where you are stationed.

Establishing Non-Resident Status

A *non-resident* is any individual who does not live in California. Non-resident status may be determined by the general rule or the 546-day rule, as explained in the following sections.

The general rule

The general rule applies if you end your California residence and domicile, leave the state with no intention of returning, and then return due to unexpected circumstances. This is the rule that applies to most people who leave California and establish a new domicile and residency in another state without any intent of moving back to California.

546-day rule

If you are domiciled in California but working outside of California, you may be able to use the 546-day rule to establish non-residency status. To qualify, you must meet all of the following three conditions:

- Be outside of California for at least 546 consecutive days under an employment-related contract.
- Spend no more than 45 days in California during the taxable year. The 45-day period includes time spent in California for personal or business purposes.
- Have less than \$200,000 in intangible income (stocks, bonds, etc.) in taxable years in which the employment-related contract is in effect (this test applies to the income of each spouse separately).

A spouse is also considered a non-resident if accompanying the spouse meeting the test and the spouse complies with the 45-day rule.

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Note: The 546-day rule doesn't apply to taxpayers who retire and establish permanent residence in another state.

Temporary or Transitory Purpose

If you come to California for vacation or merely to complete a transaction, or you're simply passing through, your purpose for being in the state is temporary or transitory, in which case your stay does not constitute residency.

Your stay is not temporary or transitory under any of the following conditions:

- You are assigned by an employer to an office in California for a long or indefinite period.
- You return to California with no specific plans to leave.
- You are ill and in California for an indefinite recuperation period.

Here are some good indications that a person is a resident of California:

- Owns real property in California.
- Sends children to California schools.
- Has a California driver's license.
- Has a vehicle registered in California.
- Has family, social, or business interests in California.

Presumption of Residency

If you spend more than nine months of a taxable year in California, you are presumed to be a resident. You can overcome the presumption by providing satisfactory proof that you were in the state for a temporary or transitory purpose.

Presumption of Non-Residency

You are presumed to be a non-resident in a taxable year if you meet all of the following conditions:

- You are domiciled outside of California and maintain a permanent home there.
- Your stay in California did not exceed six months in a taxable year.
- During your stay, you did not engage in any activity or conduct within California other than that of a seasonal visitor, tourist, or guest.

Community Property and Income

In community property states such as California, all property acquired during a marriage, except by gift or will, belongs jointly to the married couple, and all income generated by that

property is community income. In the absence of a separate agreement, community income also includes compensation for services if the spouse earning the compensation is domiciled in a community property state.

If you are married and one of you is domiciled in California while the other is a resident of and domiciled in another state, half of the California-source income of the spouse residing in California is attributed to the non-resident spouse. In this situation, you and your spouse would need to file a joint California tax return.

However, if one of you is domiciled in a separate-property state, the spouse with the California-source income may file a separate California tax return.

Changing Your State of Residence

More and more high-net-worth individuals are moving out of California to avoid its high taxes. This trend is often ascribed to the “Tiger Woods effect,” named for the famous golfer who moved from California to Florida to save \$5.8 million in taxes.

You too can change your residency from California to another state, perhaps even a “tax-free” state, but you need to relocate and sever your ties with California.

To become a non-resident, you must move out of California and change both residence and domicile. Here are the do’s and don’ts for changing residency from California to another state:

Do:

- Move to another state and truly sever ties with California.
- Be sure your change in residence is established before the date on which a major tax event is to occur, such as the sale of a valuable asset.
- Don’t plan to return to California for at least a few years.
- Document everything related to the date of your residency change and be sure it’s the date you enter on your tax return. Keep this documentation for at least five years. Keep it longer if you return to California after that time.
- Sell your home in California.
- End your employment in California.
- Establish and spend time in a residence located in your new state, ideally in a home of equal size, cost, and amenities as your California home. Move your furniture to your new home on or before the stated move date.
- File all required tax returns in the new state.
- Discontinue your business and social ties in California.

- Establish business and social ties in your new state. Don't spread your business and social ties across several states. If you become the target of a residency audit, the FTB will be analyzing residency in California versus the new state in which you are claiming residency.
- Keep a record of e-mail and telephone calls to California from the other state to take care of business and personal transactions.
- Use registered or certified mail to mail important documents to attorneys, accountants, and others in California and save the paperwork you receive from the post office.
- Expect to be audited, especially if changing residency results in significant tax savings. If you're not audited, that's great, but be prepared for the worst.

Do not:

- Keep your home in California and let your children live there.
- Keep your car registration in California.
- Keep your children in California schools.
- Vote in California's local elections.
- Have your mail sent to California.
- Spend a lot of time working, visiting, or conducting personal business in California. Every day you spend in California counts against you in your residency audit.
- Continue to obtain services from professionals in California, including your physician, dentist, and mechanic.

The only way we are aware of to end California residency while maintaining ties in the state is by using the 546-day rule discussed earlier in this singlette.

Consider California-Source Income Issues

Changing residency is not likely to free you from your tax obligation on any income you receive from sources in California. Obviously, wages from an employer operating in California constitutes California-sourced income. However, an income's source can be difficult to determine. Here are a couple examples:

- **Intangible property:** Income from intangible property is generally sourced to the taxpayer's state of residence. This includes income from the sale of stocks, bonds, notes, or other intangible property; dividends received from a publicly traded company; and capital

gains derived from the sale of a publicly traded company's stock. However, anything that can tie those assets back to California may complicate the situation. For example, if you have vested stock options representing a considerable amount of income, moving out of California probably will not free you from having to pay California taxes on proceeds from the sale of your shares.

- **S corporation:** If an S corporation established in California sells its assets, the gains will flow through to the shareholder as taxable to California regardless of the shareholder's state of residence.

Timing and Structuring the Sale of Assets

If you are planning to sell a business or other asset, be careful about the timing of the sale. You want the sale to happen *after* you have established residence in another state. Structuring the sale of an asset too soon can make the gain taxable to California.

Also, beware of structuring a transaction as an installment sale. California taxes non-residents on installment gains from the sale of an intangible asset sold while a resident.

The Audit Process

Filing a part-year resident return with a large amount of income received after your change of residence is likely to trigger an audit. Months before you receive notification of the audit, the FTB will start combing through multiple databases looking for the following information:

- Bank accounts in California and other states
- Sources of wages and 1099 income
- Property owned in California and other states
- Returns filed in other states
- Credit card transactions
- Utility bills
- Where you have driver's licenses, business licenses, or professional licenses
- Other business entities or trusts you own that may be operating in or own property in California
- When you obtained a new driver's license
- If and when you purchased property in another state
- Where you claimed a homeowner's exemption

Remember, if it looks like you moved out of state for the sole purpose of avoiding California tax, you're likely to be on the losing end of a residency audit.

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If you're planning to move from California to a low- or no-tax state, we strongly encourage you to plan carefully and in consultation with your tax planning partner. Poor planning, poor timing, and incomplete record-keeping can result in an audit that's likely to cost you thousands of dollars in legal and professional fees. Not to mention having to pay taxes that could have been avoided – along with penalties.

If you are one of our clients or are considering becoming one, [contact us](#) to schedule a meeting to discuss your situation.

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