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Now, California Can Assess Taxes No Matter Where You Live...Really

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. Buy a vacation home in California, and stay a little too long? Come into the state and do some work for your non-California employer? Travel to California trying to sell some products or collect data that you'll use out of state when you get back home?

Any of these things and many others can pique the interest of California's tax collection agency, the Franchise Tax Board. In fact, it can feel like just about *any* connection to California can be enough to at least raise tax issues. Of course, being a California resident and then moving away has its own set of tax issues. The thought of [leaving California over taxes is nothing new.] California's tough [Franchise Tax Board (FTB) polices the line between residents and non-residents], and does so rigorously. If you leave, 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. California is known to chase people who leave, and to disagree about whether they really are non-residents. After all, [California's 13.3% tax on capital gains inspires] plenty of tax moves.

Even where California *agrees* that you moved, they might not agree when you moved. Say you move from California to Texas and then sell your appreciated stock or bitcoin. California might agree that you moved, but might say you didn't actually establish residency in Texas and depart California for tax purposes until several months later. That might be enough to make all your sales California source income. It can make you wonder whether [California will 'let' you move states!] Some people seek to [avoid California taxes with trusts.]

The state's Franchise Tax Board is the state income tax collector, and it has a fearsome reputation. Most tax lawyers will tell you that they would much rather fight the IRS than California's FTB any day of the week. Savvy taxpayers know this too. You can skate for much longer with IRS problems, and you can more easily defeat or compromise IRS bills. But can you *truly* be outside of California and *still* face California taxes? A recent decision says you can.

Now, check out California Office of Tax Appeals decision In the Matter of [Blair S. Bindley,] OTA Case No. 18032402 (May 30, 2019). There, a nonresident sole proprietor performed all of his services *outside* of California. However, some of his customers were located *in* California. Is that enough for the poor guy to attract California tax liability? The California taxing authorities said he was operating a "unitary" business. Therefore, his tiny business was subject to California's apportionment rules. The state's Office of Tax Appeals said this case has precedential effect, so it is clear the Golden State can go after other non-Californians too.

Exactly what was poor Mr. Bindley's tax offense in California? He is a self-employed screenplay writer living in Arizona. He performed services for a few companies headquartered and registered in California. The California Franchise Tax Board matched income records showing that he collected $40,000 of income from California companies. Not surprisingly, Bindley did not file a California tax return. That meant California's statute of limitations would *never* start to run. That itself is a useful lesson. The statute of limitations is a reason that many non-residents of California file a return to report a small amount of California source income.

In Bindley's case, the state noted that whether a nonresident is subject to California's rules for apportioning income depends on : (1) whether the taxpayer is carrying on a trade or business within California, outside of California, or a combination thereof; (2) the type of entity conducting the business; and (3) whether the business is unitary. California ruled that Bindley's screenwriting business was carried on inside and outside of California. He worked as a proprietor, and basically did the same kind of work for non-California and for California companies. That's a useful lesson too. What exactly is unitary anyway?

California's tough tax regulations only describe what is *not* a unitary business. California says that a business is not unitary where the part within the state is so separate and distinct from (and unconnected to) the part outside the state that the businesses are not a unitary business. Here, the Golden State said that this screenwriter ran a unitary operation. After all, the part conducted inside California and the part conducted outside the state were not separate and distinct so as to be separate businesses.

If your business is unitary, the income derived from services is sourced to the place where the *benefit* of the service is received. To determine the place where the benefit of the service is received, California law provides rules looking first to the contract. If the contract does not specify the location where the benefit is received, then California or the taxpayer can try to approximate the location where the benefit is received. For the companies located in California that paid the screenwriter, California said it was reasonable to conclude that the companies received the benefit of the services in California.

Does this screenwriter's unfortunate tax flap mean *other* little businesses that happen to sell into in California could face tax troubles? Yes, it sure seems that way. California can now push even on sole proprietors who might have California customers. They might have to file California returns and pay California taxes. This is so even if all the services are performed *outside* of California, and even if the sole proprietor has no connection to California.

Check out my website.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.