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As More People Leave California Over Taxes, They May Face Tax Audits

According to the Wall Street Journal, the blue-state wealth exodus continues. The IRS has confirmed its annual data on the migration of taxpayers and adjusted gross incomes (AGI) between states. Which is the number one state that is losing high-income residents? You guessed it, California is the biggest income loser at $23.8 billion.

If you live in California, you likely pay plenty of state income tax to the California Franchise Tax Board. The top California income tax rate was 13.3% for a decade, but effective on January 1, 2024, the *new* top rate became 14.4%. The new 14.4% rate is the result of no limit on California's 1.1% employee payroll tax for State Disability Insurance. It translates to a top 14.4% rate for those earning over $1 million. There been several proposals in Sacramento to increase the top rate as high as 16.8%, though those bills failed to pass.

California's 13.3% rate still applies to capital gain, which hardly sounds like a tax break. The 13.3% on capital gain has long been an irritant to California investors. At the federal level, the capital gain rate is 20% for higher income taxpayers. Add the 3.8% net investment tax under Obamacare, and you have 23.8%. By paying 23.8% plus 13.3%, Californians are paying more on capital gain than virtually anyone else in the *world*. Moves before big stock sales, sales of a company, a lawsuit settlement, etc., are common.

But if you aren't careful, you could end up being asked to keep paying California taxes. In some cases, California can assess taxes no matter where you live. California's tough Franchise Tax Board (FTB) monitors the line between residents and non-residents, and can probe how and when you left. The burden is on *you* to show that you are *not* a Californian.

If you are in California for more than nine months, you are *presumed* to be a resident, and more than six months usually means that too. Moving sounds easy, but if you aren't careful how you do it, you could end up in a residency audit. The IRS can audit 3 or 6 years, and California can sometimes audit *forever*. That is, California, like the IRS, gets unlimited time if you never file an income tax return. That can make filing a non-resident tax return—just reporting your California-source income as a non-resident after you leave—a smart move.

California looks to objective factors, and your time in California versus time outside counts. California uses a comparative analysis to see if you have closer connections to another state. Many people who leave have a hard time distancing themselves from California. And make no mistake, in California tax disputes, procedure can be critical. In some cases, California can even assess taxes no matter where you live.

Many factors are relevant in assessing who is a California resident, but physical presence is the biggest issue. There are important presumptions too. For example, if you spend more than 9 months in California, you are presumed to be a resident. If you spend 6 months or less in California, you may qualify as a seasonal visitor, but that rule applies only if you *don't work* while you are here and if you meet other rigorous tests. As to moving, if you leave California over taxes, avoid these 10 costly mistakes.

Check out my website.