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Ask Bob: How Can I Protect Myself from California State Income Taxes?

A reader is wondering if moving out of state will protect him from California's state income tax. Two tax experts explain what he'll need to do to if he doesn't want to be considered a California resident.

ROBERT POWELL, CFP® | June 1, 2021

Question

I have several questions about moving out of California and to a no tax state such as Nevada or Florida. I want to do it this year so that I can sell a large appreciated stock position and save state taxes. I understand California will try and go after me. I intend to keep my home in California. What can I do to protect myself?

Answer

I see a number of issues here, says Mary Kay Foss, a CPA in Walnut Creek, CA. One relates to the source of his appreciated stock position. If the stock was acquired in connection with his employment, California has rules on how these are taxed. Foss explains, “In a Franchise Tax Board (FTB) audit I was involved with, the agent went back to each grant of stock options and RSUs and measured the time period from grant to exercise to sale to determine the California share of the income. In that case, FTB was determining the amount of the compensation income attributable to California when the options and RSUs were exercised and sold after a move from California.”

The other issue is whether FTB will think he has really moved his domicile from CA to the nontax state. “California examines such things as the address on drivers’ licenses, fishing licenses, library cards to determine whether the individual has actually cut ties with the State of California,” Foss adds. In some situations, they have even obtained telephone records to determine how much time the individual spends in California rather than in the new residence state. “In the fact pattern given,” she notes, “the individual intends to maintain his home in California.” That makes it difficult. That’s not to say that someone will forever be taxed by California if they keep real property in the state that they visit a few times but if one is trying to establish that California is no longer their domicile they cannot spend a lot of time within the state.

“In my experience,” Foss says, “FTB auditors do a lot of research in a big residency case. They’ll look at calendars, search for travel documents, examine credit card bills to determine where charges originate, look at cell phone bills – you get the picture. I live in CA and think there are far more important reasons to stay here than to pay income taxes. I advise people not to let the tax tail wag the residency dog.”

Scott Hoppe, founder of Why Blu, a San Francisco accounting firm says, "A lot of our clients are tech employees who can live anywhere. California is very aggressive with enforcing tax liability. You have to cut your ties and demonstrate the intent to permanently move. The keyword is domicile."

Hoppe outlines these key points for avoiding California income tax:

1. If you move to another state and immediately make a big stock sale, it will be a red flag and be more difficult to make the case that you are no longer under California jurisdiction.

2. The operative word is "domicile," the permanent location of your home and where you intend to return when you are away. You can be resident in multiple places but have only one domicile. That's what California is looking at.

3. To establish a non-California domicile, you need to be able to show that your move is permanent and your intent is not to return. It is a gray area but that's the concept.

4. No single item is a show stopper, but it is helpful to own no real estate, have no family, and spend little time in California. You should register to vote at your new domicile, change driver's license and car registration, see a local doctor, etc.

Got questions? Get answers!

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