California Residency - Traps for the Unwary

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There are many misconceptions about the rules governing whether someone is taxed as a California resident. This article provides more information as a follow up to my August 20, 2012 article.

BASIC TEST. A very common misconception is that someone can avoid being taxed as a California resident by relying on mechanical tests, such as staying out of California for certain periods of time. This is not necessarily true.

The ultimate test for determining whether or not you are a California resident is whether you have a "closer connection" to California than to any other state during a taxable year. This means it is possible that someone can be taxed as a California resident even if they spend very little time in California during a tax year.

California describes the test as being whether someone is in California "for other than a temporary or transitory purpose." Someone who visits California for an extended vacation of 3 months and who does not engage in any business activity in California will generally be accepted as being in California for only a "temporary or transitory purpose." The more difficult situations arise when someone who historically was in California for other than a "temporary or transitory purpose" attempts to terminate their California residency.

Another misconception is that California residency presumptions can be determinative. At least at the audit level, experience dictates that a favorable residency presumption (one that treats someone as a non-resident) will be ignored. An unfavorable residency presumption will not. It is therefore very important to avoid the unfavorable residency presumption.

UNFAVORABLE PRESUMPTION. Anyone who, in the aggregate, spends more than 9 months of a tax year in California is presumed to be a California resident. The presumption can be rebutted, but anyone who desires to avoid California residency should therefore make sure they do not spend more than 9 months in the state of California.

This does not mean that you are safe if you only spend 8 months in California. It merely assures that you will not trigger an even higher burden of proof than you already face.

6 MONTH PRESUMPTION. Another presumption is that an individual whose presence in California does not exceed 6 months within a tax year, and who maintains a permanent home outside of California, is considered as being in California for temporary or transitory purposes. This presumption applies only if the taxpayer does not engage in any activity or any business within California "other than as a seasonal visitor, tourist, or guest."

You can see that this test is much more difficult to satisfy than merely staying out of California for 6 months. You cannot conduct business here, and you must be able to prove you have a "permanent home outside of California." If you own a large, expensive home in California and try to claim that your Las Vegas condo is your "permanent home," you can expect a fight with the Franchise Tax Board.

EXAMPLE. Assume Mr. and Mrs. Lee are in California for only 4 months out of the taxable year and that they do not conduct business in California. Mr. and Mrs. Lee rent an apartment in California. They spend the rest of the year traveling throughout the world, and they spend 3 months a year in Las Vegas, where they own a large home. Are Mr. and Mrs. Lee safe because they spend only 4 months a year in California?

No. Remember that the basic test of residency is that state to which Mr. and Mrs. Lee have "the closest connection." This means that if the Franchise Tax Board decides Mr. and Mrs. Lee have a closer connection to California, they can claim Mr. and Mrs. Lee are California residents ***for the entire year***. Mr. and Mrs. Lee's travel outside of California is considered a neutral factor, because it is not tied to a specific state. That means California can look to the proportion of time Mr. and Mrs. Lee spend in Nevada as compared to California, and conclude that despite being in California for only 4 months and conducting no business here, Mr. and Mrs. Lee are still residents of California because they have a closer connection to California than Nevada.

How might the Franchise Tax Board come to this conclusion? One factor might be whether or not Mr. and Mrs. Lee historically had ties to California. If, for example, their children and grandchildren lived in California and their social contacts were in California, it might be hard for Mr. and Mrs. Lee to convince the Franchise Tax Board that they had a closer connection to Nevada, even though they owned a home there. Alternatively, the Franchise Tax Board could argue that despite their limited presence in California, Mr. and Mrs. Lee still maintained their "domicile" in California. One's "domicile" is that place in which they intend to either maintain a permanent residence, or intend to return to. "Domicile" is a commonly overlooked factor, and will be addressed in a separate article.

FACTORS CAN BE IGNORED. In my August 20, 2012 article, I listed the 29 residency factors that were set forth by the California Supreme Court in Corbett v. Franchise Tax Board. This means that, for example, even if the taxpayers have Nevada driver's licenses, are registered to vote in Nevada, attend church in Nevada, and have bank accounts in Nevada, California can still claim they have a "closer connection" to California because they spend more time in California than anywhere else.

MORAL. California residency can be avoided. It is simple, but hard, to do. It means drastically limiting the amount of time you spend in California, limiting your activities in California, and making sure that you in fact have a "closer connection" to another state.

FUTURE ARTICLES. There will be future articles discussing the issue of "domicile" as well as the practicalities of fighting the Franchise Tax Board on residency issues.