Extension of California tax rate increases for high-income Taxpayers

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On November 8, 2016, California Proposition 55 was passed in the General Election. This extends the temporary increase in state income tax rates of up to 3% for high-income individuals. The highest marginal tax rate for individuals in California is currently 13.3%. In 2031, the highest rate is scheduled to decrease back to 10.3%, unless the temporary increase is extended again or made permanent.

What you need to know

California's high tax rate, relative to other states, introduces some interesting tax planning opportunities for individuals who are willing to leave the state. Establishing non-residency before selling a business, or receipt of other significant income, can result in *significant tax savings*.

What income is taxable by California?

The income that is taxable by California depends on your residency.

Residents of California are taxed on ALL income, even including income from sources outside California.

Non-residents of California are taxed only on California source income. Income from a California business activity and income from the sale of tangible property in the state is sourced to California. Generally, investment income is sourced to a taxpayer's state of residence. In most cases, gain from the sale of stock or a partnership interest is not sourced to California if the taxpayer is a non-resident when the sale occurs.

Part-year residents of California are taxed on all income received while a resident and only on California source income while a non-resident.

California residents.

A California resident is an individual who meets any of the following:

- Present in California for other than a temporary or transitory purpose.
- Domiciled in California but located outside California for a temporary or transitory purpose.

Note: Establishing a change in domicile requires abandoning your prior domicile, physically moving to and residing in a new locality, and the intent to remain in the new locality permanently or indefinitely as demonstrated by your actions.

Non-residency and part-year residents

In order to plan ahead, consult the California FTB Publication 1031 which lists the primary factors considered when determining state of residency. Residency is based on facts and circumstances and each factor can be significant. California is known for being an aggressive tax collector. Therefore, it is best to have documentation supporting as many factors as possible in order to establish that your move out of state was permanent and that it occurred prior to receipt of income. Also, while not absolutely necessary, it is best to establish non-residency one or more years before the income is received.

Remember, state taxation is based on an individual basis. Please consult your BPM Tax Advisor for personalized advice and solutions.

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