

Social Distancing From California

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In this article, Shah, Durham, and Fairley examine the basics of California residency law and considerations given by California's various tribunals in situations in which taxpayers have been both successful and unsuccessful in arguing for a California nonresident classification.

Over the last 14 months Californians faced the unpredictable, but were also oftentimes greeted with the predictable from Sacramento. While, unpredictably, the large metropolises came to a grinding halt and citizens stood masked, six feet apart from one another, California's government predictably introduced new taxes and suspended

business-friendly tax credits.¹ All of this, layered with remote working, Zoom meetings, and unprecedented low interest rates, created a perfect storm in which, for the first time, California experienced a net *decrease* in its population in 2020.² Despite the state's gradual reopening, many Californians are continuing to work from home and some are beginning to contemplate whether they, too, should exit the Golden State. While many residents may wish to socially distance themselves from California to escape taxation, physically moving out of the state is only the tip of the iceberg when it comes to terminating California tax residency.

In contrast to many other areas of state tax law, a California residency analysis and determination hinges, to a large extent, on the subjective intent of the individual claiming nonresident status. As a result, a keen understanding of the law and impeccable organization of the facts are critical before one endeavors down the path of severing residency in California. This article discusses the basics of California residency law and considerations given by various tribunals in situations in which taxpayers have been both successful and unsuccessful in arguing for nonresident classification. Finally, this article discusses recent residency decisions from the Office of Tax Appeals (OTA). These decisions are a sign that the Franchise Tax Board has begun to ramp up its audits of California nonresidents.

¹ Reed Smith, "Groundhog Day in California — Tax Attribute Limitations and False Claim Act Expansion Strike Again" (July 6, 2020).

² Shawn Hubler, "A New Demographic Surprise for California: Population Loss," *The New York Times*, May 7, 2021.

The Basics of California Residency/Domicile

California taxes residents upon their entire taxable income, while nonresidents are taxed only on income from California sources.³ A resident includes (1) “every individual who is in this state for other than a temporary or transitory purpose,” or (2) “every individual domiciled in this state who is outside the state for a temporary or transitory purpose.”⁴ These two tests seek to ensure that all individuals who are in California enjoying the benefits and protection of the state contribute to its support.

Domicile Determination

To determine which test to apply, taxpayers must first establish whether they are domiciled in California. An individual can have only one domicile at any given time.⁵ A domicile is “the place where an individual has his true, fixed, permanent home and principal establishment, and to which place he has, whenever he is absent, the intention of returning.”⁶ Thus, the domicile analysis rests largely on where the taxpayer intends to create his permanent home. An individual cannot terminate his California domicile simply by leaving California. Rather, to change domicile, a taxpayer must (1) actually move to a new residence, and (2) intend to remain there permanently or indefinitely.⁷ If there is any doubt regarding a taxpayer’s domicile, it is presumed to remain unchanged.

Temporary or Transitory Purpose Tests

After determining a taxpayer’s domicile, the residency determination shifts to whether an individual is present in or absent from California for a temporary or transitory purpose. If a taxpayer has contacts with multiple states, her residency is where she maintains the closest connections. This determination cannot be based solely on an individual’s subjective intent; instead, this “closeness” analysis is based on objective

facts and does not rely on one specific test. *Appeal of Bragg* establishes that to determine where an individual’s closest connections lie, a court or agency must assess a bevy of factors. These factors are commonly organized into three categories:

- registrations and filings with a state or other agency;⁸
- personal and professional associations;⁹ and
- physical presence and property.¹⁰

While instructive, the *Bragg* factors are simply a tool to help determine where a taxpayer has the closest connections — no factor is dispositive.¹¹

Mazer

In 2020 the OTA issued its first precedential residency opinion, *Appeal of Mazer*.¹² This decision affirms the fact-intensive nature of California residency determinations, as well as the importance of the *Bragg* factors. The issue in *Mazer* was whether the appellant husband was a domiciliary and resident of California for the 2013 tax year. The undisputed facts show that in February 2013, Mazer moved from California to Malaysia to work for a Malaysian-based employer. As part of Mazer’s employment contract, the employer provided Mazer with a leased car, leased apartment, cellular phone, and payments for his phone bill. Mazer’s wife did not accompany him to Malaysia. Instead, during the 2013 tax year she continued to live at their home

⁸ The analysis under this category looks at factors like the state in which a taxpayer: claims a homeowner’s property tax exemption; has cars registered; has a driver’s license; is registered to vote; has voted in the past; and claims residence on federal and state tax returns.

⁹ The analysis under this category looks at factors like the state in which a taxpayer: is employed; has children attending school; has bank accounts; is a member in social, religious, and professional organizations; has and uses doctors, dentists, accountants, and attorneys; maintains business interests; has professional licenses; and owns real property.

¹⁰ The analysis under this category looks at factors like the state: in which a taxpayer resides; in which the taxpayer’s spouse and children reside; from which the taxpayer’s phone calls originate; and where the taxpayer’s checking and credit card transactions originate. The analysis in this category also includes a comparison of the number of days the taxpayer spends in California and other states and the reasons taxpayer visits California.

¹¹ While the *Bragg* factors are not dispositive, there is a presumption of residency in California if an individual is present in the state for more than nine months of a tax year. Unfortunately, if an individual is outside California for more than nine months, the presumption does not shift to nonresidency. Cal. Rev. Tax. Code section 17016; and Cal. Code of Regs. tit. 18, section 17014(a).

¹² *Appeal of L. Mazer and M. Mazer*, OTA Case No. 19064883 (July 23, 2020).

³ Cal. Rev. & Tax. Code sections 17041(a), (b), and (i); and 17951.

⁴ Cal. Rev. & Tax. Code section 17014.

⁵ Cal. Code Regs. tit. 18, section 17014(c).

⁶ *Id.*

⁷ *Appeal of Stephen D. Bragg*, 2003-SBE-002 (May 28, 2003).

in California and remained a domiciliary and resident of California. Mazer left his position in Malaysia in March 2014 and returned to live with his wife in California. The Mazers filed a California resident return for 2013 but excluded Mazer's income earned in Malaysia.

The OTA first looked at whether Mazer was domiciled in California during the 2013 tax year. The OTA found that (1) before leaving for Malaysia, Mazer was domiciled in California and (2) he failed to show his domicile had changed to Malaysia. The OTA acknowledged that Mazer's physical presence was in Malaysia; however, his actions did not indicate *an intention* to abandon his old domicile and establish a new one. In making this determination, the OTA pointed to the fact that Mrs. Mazer had remained in California and maintained their family home. Moreover, upon leaving his position in Malaysia, Mazer immediately returned to his California home with his wife.

After determining that Mazer remained a California domiciliary, the OTA next assessed whether Mazer was outside California for other than a "temporary or transitory purpose." Accordingly, the OTA used the *Bragg* factors to examine whether Mazer had closer ties to California or Malaysia during 2013. In reviewing these factors, the OTA found that (1) Mazer's connections to Malaysia were weak and (2) he failed to provide evidence that he severed his California connections. The OTA acknowledged that at a surface level, Mazer had made connections in Malaysia, including having an apartment lease, vehicle, and vehicle registration, and having bills mailed to his Malaysia address. However, his employer provided the apartment, provided the vehicle, and paid his bills. Because Mazer's employer provided these things as a "matter of job convenience," the connections were less significant and of limited duration. Moreover, Mazer made no efforts to sever his California ties, because his wife remained in California maintaining their home — a home that Mazer returned to after leaving his job in Malaysia. As a result, the OTA sustained the FTB's determination that Mazer was a California resident in 2013.

Analysis of the 2021 OTA Residency Opinions

The OTA continues to develop its process for making residency determinations and published two relevant decisions in 2021. The first, *Appeal of Khan*, is a non-precedential decision published in February that found that the appellant, Khan, abandoned his California domicile.¹³ The second, *Appeal of Bracamonte*, is a pending-precedential decision published in May that found that the appellants were still California residents at the time they sold their corporation.¹⁴ Both decisions are based on well-developed facts and provide further insight into the OTA's analysis of residency cases.

Appeal of Khan

Appeal of Khan, one of a few taxpayer wins in the residency arena, looked at whether the appellant established that he was not a resident of California from May 25, 2013, through the end of 2013. The undisputed facts show that Khan is an osteopathic physician who moved to Saudi Arabia on May 25, 2013. Khan, a Muslim, cited that his move was for spiritual reasons and that he had been planning this move for almost a year before his departure. The move occurred shortly after Khan's spouse filed for divorce. Upon his move, Khan's former spouse and three minor children remained in California.

The OTA found that Khan abandoned his California domicile on May 25, 2013, because he moved to Saudi Arabia "with the intention of staying indefinitely, not for a temporary or transitory purpose." In addition to testimony from Khan's former wife, brother-in-law, and Saudi Arabian work colleague, the facts showed that Khan broke his ties to California. Khan's marriage to a California resident was irreparably severed before his departure in May 2013, and he sold his California property, leaving nothing in storage. Moreover, Khan started a new life for himself in Saudi Arabia. In reaching this determination, the OTA noted that Khan:

- rented a large apartment in Saudi Arabia under a two-year lease;

¹³ *Appeal of A. Khan*, OTA Case No. 18042861 (Dec. 21, 2020).

¹⁴ *Appeal of J. Bracamonte*, OTA Case No. 18010932 (Mar. 22, 2021).

- joined a mosque;
- obtained suitable employment in Saudi Arabia as a physician;
- became involved in professional and religious organizations;
- purchased a vehicle;
- obtained a Saudi driver's license (valid for 10 years); and
- became engaged to a Saudi woman.

The OTA determined that these facts overcame any lingering connections Khan had to California, including his failure to cancel his California driver's license, voter registration, or license to practice medicine. Thus, the OTA overturned the FTB's determination that Khan was a California resident for part of 2013.

Appeal of Bracamonte

A few months after publishing *Appeal of Khan*, the OTA published its decision in *Appeal of Bracamonte*. The OTA found that the appellants, a married couple, were California residents when they sold their company, Jimsair Aviation Services, on July 18, 2008. Thus, the proceeds of the sales were subject to California tax. The Bracamontes rented an apartment in Henderson, Nevada, on March 6, 2008, and eventually purchased a home in Nevada in September 2008. However, until then, they retained their large California home. Moreover, until September 2008, the appellants left much of their personal property at their California home, and from February 25 through July 18, 2008, they spent most of their time there. The OTA found that the Bracamontes were California domiciliaries at the time of the sale of Jimsair, because, as of that date, they had failed to adopt a permanent home in Nevada. Unlike the appellant in *Khan*, renting the apartment in Nevada "was part of [the appellants'] plan to find a permanent home . . . not the actual move to a new residence with the intent to remain their permanently."

The OTA then assessed whether the Bracamontes were outside California for a temporary or transitory purpose at the time of the Jimsair sale. This fact-intensive inquiry again relied on the *Bragg* factors to determine the appellants' closest connections. The OTA acknowledged that the Bracamontes had increased their contacts with Nevada. (They had

opened a post office box, registered to vote, obtained a Nevada cellphone number, purchased and registered a trailer in Nevada, and so forth.)

However, the Bracamontes' contacts with California remained significant. These contacts included numerous vehicles and vessels registered in California, a California post office box address, numerous California bank accounts, and established care with California healthcare professionals. Also, before the sale of Jimsair, the Bracamontes conducted business in San Diego that ultimately led to the sale of Jimsair. However, the most persuasive factor was the Bracamontes' physical presence in California from February 26, 2008, through the sale of Jimsair on July 18, 2008. During this period, the appellants were in California for 90 days and in Nevada for only 28 days. The OTA found "the sheer amount of time spent in California, and the average length of their stay in the respective homes significant," because "physical presence is a factor of greater significance than mental intent and the formalities that tie one to a particular state." As a result, the OTA sustained the FTB's determination that the Bracamontes were residents in 2008.

Key Take-Aways From the OTA's Opinions

Because of the pandemic and the appearance of more permanent work-from-home policies, individuals no longer need to live near the office. This shift allows current California residents to think about living elsewhere. This flexibility likely means that residency determinations will continue to be a hot-button item over the next few years. Moving out of California does not necessarily mean a person is no longer a California resident. A taxpayer's physical presence in California is one of many factors the FTB looks at when determining residency. Moreover, *Mazer* and *Bracamonte* highlight that the OTA will not automatically apply the *Bragg* factors when assessing taxpayers' closest connections. Instead, the OTA will examine the *Bragg* factors in the context of each case. This fact-intensive inquiry requires taxpayers to meticulously document their efforts to break ties with California.

It is also important for taxpayers to begin severing ties well before they actually plan to leave California. In *Bracamonte*, the appellants

declared residency had been broken before they found a permanent home in Nevada. In contrast, the appellant in *Khan* planned his move to Saudi Arabia for almost a year. His foresight allowed him to sever his California connections before the move and establish multiple new connections in Saudi Arabia. Accordingly, taxpayers planning to leave California should consult their tax advisers as early in the process as possible to ensure they take proper steps to sever their California residency. This is especially true for taxpayers who want to break residency before recognizing specific items of income or gain. The failure to plan and to keep good records can result in huge financial consequences, as demonstrated by the result in *Bracamonte*. ■



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