

# Practice

*By Charles P. Rettig*

## A Temporary and Transitory Visit with California Residency

Residency determinations are relevant for purposes of marital dissolutions, education, probate proceedings, property tax determinations, voter's registration and ... income taxes. Individuals often believe they are not California residents for tax purposes simply because they spend significant amounts of time or maintain homes outside California. These individuals are often surprised when facing an adverse determination by the California Franchise Tax Board following a residency examination. The same scenarios apply with individuals throughout the country who believe they live in one state but once they accumulate some degree of wealth, other states begin to inquire about where the individual resides for purposes of determining the individual's tax status.

For tax purposes, residency examinations are designed to identify individuals maintaining a sufficient physical presence within California and/or receiving substantial benefits and protections from its laws and government justifying their contribution to the support of California.<sup>1</sup> Individuals present in California for a mere "temporary or transitory purpose" do not generally avail themselves of the benefits of residency and should not be considered residents for income tax purposes. The administrative examination process involves a deeply personal, factual analysis by a highly trained examiner making after-the-fact determinations regarding an individual's physical presence and intentions that are often not taxpayer friendly.

The Franchise Tax Board will not issue a written opinion on whether an individual is a California resident during a particular tax year because residency is a question of fact, not law. As a result, even individuals without any significant California contacts are often subjected to a highly intrusive examination process. Franchise Tax Board Auditors have canvassed



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neighborhoods in Beverly Hills, Carmel, La Jolla, Lake Tahoe, Rancho Mirage and Palm Springs in an effort to locate some degree of presence within California justifying a residency examination. They also scour neighborhoods in Las Vegas, Seattle and Austin in an effort to later demonstrate some *de minimis* presence in states that do not seem to have an income tax.

Determining whether an individual is a California resident for tax purposes is significant since (1) California residents are taxable on their worldwide income; (2) nonresidents of California are only taxed on income derived from California sources; and (3) part-year residents are taxable on their worldwide income while a resident, and only on income from California sources while a nonresident.<sup>2</sup> There are various guidelines for determining the source, allocation and apportionment of gross income for tax purposes.<sup>3</sup> However, the following generally represent California sources:

- Income and gains from real or tangible personal property physically located in California
- Income from a business, trade or profession conducted entirely within California
- Compensation for personal services performed in California
- Income from intangible personal property having a business or taxable situs in California
- Rents or royalties for the use of, or for the privilege of using patents, copyrights, secret processes, formulas, goodwill, *etc.*, in California with a business or taxable situs in California<sup>4</sup>

If the individual is enjoying the benefits of California, California will not limit itself to the California-source income if the individual has any significant non-California-source income, *e.g.*, interest or dividends from their Nevada business operations. During the California budget crisis, individuals present in California for any significant period of time must be especially careful to avoid inadvertently becoming a “resident” for income tax purposes.

## Resident

In California, the term “resident” was originally defined for income tax purposes in the Personal Income Tax Act of 1935 (effective June 13, 1935),<sup>5</sup> which was the enabling legislation enacted pursuant to Constitutional authority<sup>6</sup> that first established the California Personal Income Tax. Section 2(k) of the Personal Income Tax Act of 1935 defined a “resident” as follows:

The word ‘resident’ includes every natural person domiciled in the State of California and every other natural person who maintains a permanent place of abode within this State or spends in the aggregate more than six months of the taxable year within this State.

Article 2(k)-2 of the Regulations (the California Administrative Code) promulgated by the Franchise Tax Board set forth a definition of “domicile” under the Personal Income Tax Act of 1935, as follows:

Domicile has been defined as 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. It is the place in which a man has voluntarily fixed the habitation of himself and his family, not for a mere special or temporary purpose, but with the present intention of making a permanent home, until some unexpected event shall occur to induce him to adopt some other permanent home ...

As initially enacted, the statutory concept of residency encompassed every individual having a physical residence in California or every individual physically present in California for more than six months during the tax year. The actual purpose of an individual’s presence in California was generally irrelevant.

Based on an increasingly mobile society, the definition of a “resident” for California income tax purposes was substantially modified in 1937 in an attempt to ensure that all persons who are in California, for other than a temporary or transitory purpose, contribute to the support of the state.<sup>7</sup> As amended in 1937, Section 2(k) of the Personal Income Tax Act defined the term “resident” as follows:

Every natural person who is in the State of California for other than a temporary or transitory purpose is a resident and every natural person domiciled within this State is a resident, unless he is a resident within the meaning of that term as herein defined of some other state, territory, or country. ... Every natural person who spends in the aggregate more than nine months of the taxable year within this State or maintains a permanent place of abode within this State shall be presumed to be a resident. The presumption

may be overcome by satisfactory evidence that such person is in the State for a temporary or transitory purpose. ...

Presently, the California statutory concept of a “resident” includes any individual who is (1) in California for other than a “temporary or transitory purpose,” or (2) domiciled in California, but physically located outside California for a “temporary or transitory purpose.”<sup>8</sup> The term “temporary or transitory purpose” depends upon the facts and circumstances of each particular case, although it generally encompasses individuals physically present within the state for a particular purpose of a specified duration.<sup>9</sup> A “part-year resident” is any individual who is a California resident for part of the year and a nonresident for part of the year. The term “nonresident” includes every individual other than a resident.<sup>10</sup> A California resident continues to be a resident even though absent from the state on a temporary or transitory basis.<sup>11</sup>

## Domicile

In California, the term “domicile” has remained substantially unchanged as the place where an individual has their true, fixed, permanent home and principal establishment and to which they have the intention of returning whenever they are physically present elsewhere.<sup>12</sup> The concept of domicile requires both physical presence in a particular place and the intention to make that place one’s home. At birth, a child is assigned a domicile of origin,<sup>13</sup> and they retain that domicile until they acquire one elsewhere.<sup>14</sup> An individual can only have one domicile. Once a domicile is acquired, it is retained until another is thereafter acquired. A new domicile is acquired by an actual change of residence accompanied by the intention to either remain permanently or for an indefinite period of time without any fixed or certain purpose to return to the former place of abode and in determining the individual’s intention, their acts and declarations must be considered.<sup>15</sup> An individual’s actions must clearly demonstrate a current intention to abandon an old domicile and establish a new one.<sup>16</sup>

**Residency determinations are relevant for purposes of marital dissolutions, education, probate proceedings, property tax determinations, voter’s registration and ... income taxes.**

The distinction between “domicile” and “residence” is important. An individual may be a resident, although not domiciled in California, and, conversely, may be domiciled in California without being a resident.<sup>17</sup> For example, a Nevada domiciliary accepting a job assignment in California expected to last for a long, indefinite duration will be considered a California resident. Similarly, a California domiciliary accepting a job assignment in Nevada expected to last for a long, indefinite duration will not generally be considered a California resident.

Although residence is frequently construed to mean “domicile,” the terms are not synonymous. The key distinction between residence and domicile is intent. Resi-

dence requires voluntary physical presence as a nontransient inhabitant; domicile requires both physical presence in a certain location and an intent to make that location the individual’s one permanent home. A residence is any place of some permanency where a person is physically present or connected for more than a mere temporary visit.<sup>18</sup> However, domicile is the place where an individual intends to return whenever they are physically present elsewhere.

Domicile requires both general physical presence in a particular location and the intent to remain there indefinitely. If a taxpayer is a California domiciliary, physical presence outside California is generally irrelevant. Accordingly, with respect to domicile, it is the *intention* of the taxpayer that is important. With respect to residency, it is the *actions* of the taxpayer that tend to be the most important.

Issues regarding domicile are often difficult to resolve since they involve a determination of an individual’s subjective intent. As a result, most disputes involve residency issues—whether the individual is present within or absent from California for a “temporary or transitory purpose.” Many residency disputes in high tax states such as California involve individuals claiming to be residents of states that do not have an income tax—Alaska, Florida, Nevada, Texas, *etc.*—even though the contacts with the other state may be severely limited. The California Franchise Tax Board is highly suspicious and encounters often frivolous assertions of nonresident status. (How does one actually reside in a Nevada post office box?)

## Relevant Considerations

The Franchise Tax Board will generally consider a list of nonexclusive factors to aid in determining with which state an individual has the closest connection.<sup>19</sup> These factors are not given individual weight or priority and were not intended to form a checklist from which residency could be determined. It is difficult to enunciate a specific test for determining residency due to the variety of factual contexts from which a residency question can arise. As such, these nonexclusive factors serve merely as a guide in our determination of residency, and the weight given to any particular factor depends upon the totality of the circumstances unique to each taxpayer for each tax year. These factors are generally organized into three categories: (1) registrations and filings; (2) personal and professional associations; and (3) physical presence and property.

### Registrations and Filings

This group of factors includes items that the taxpayer has filed with the state or other agency. These factors represent how the taxpayer portrays himself or herself to government, and generally includes factors that the taxpayer can change merely by filing or cancelling a registration or license with a government agency. These factors include the state wherein the taxpayer claims the homeowner's property tax exemption on a residence; the address the taxpayer uses on his tax returns, both federal and state, and the state of residence claimed by the taxpayer on such returns; the state wherein the taxpayer registers his automobiles; the state wherein the taxpayer maintains a driver's license; and the state wherein the taxpayer maintains voter registration and the taxpayer's voting participation history.

These factors are often clerical in nature, and can easily be changed by re-registering or using a new address. The nature of these factors is such that the taxpayer may have both in-state and out-of-state ties for that same factor, such as vehicles registered in two states or registering to vote in a new state but not immediately cancelling voter registration in the previous state. Therefore, these factors are indicative of whether the taxpayer exhibited, or at least put forth the appearance of, exhibiting the intent to change residency.<sup>20</sup>

### Personal and Professional Associations

These factors help show where the taxpayer had his or her day-to-day contacts in both his or her occupational life as well as his or her personal life. More

specifically, these factors show where the taxpayer reaped the benefits of occupational endeavors as well as personal relationships and community involvement. These factors include the state wherein the taxpayer's children attend school; the location of the taxpayer's bank and savings accounts; the state wherein the taxpayer maintains memberships in social, religious and professional organizations; the state wherein the taxpayer obtains professional services, such as doctors, dentists, accountants and attorneys; the state wherein the taxpayer is employed; the state wherein the taxpayer maintains or owns business interests; the state wherein the taxpayer holds a professional license or licenses; and the state wherein the taxpayer owns investment real property.<sup>21</sup>

These factors are representative of the taxpayer's financial and community ties. Most of the factors in this group are quantifiable based on the taxpayer's records and pattern of behavior. Unlike the factors in the Registrations and Filings group, however, many of these factors are built on significant life choices that are not easily changed.

### Physical Presence and Property

This group includes the factors showing where the taxpayer was physically located during the time in question, and where his or her tangible and real property were located. Many of the factors in this group attempt to pinpoint the taxpayer's location, and therefore may be redundant or used to corroborate location statistics. These factors include the location of all of the taxpayer's residential real property, and the approximate sizes and values of each of the residences (*i.e.*, indicating the nature of the use of the property) including whether the taxpayer sold or rented any residential property around the time of the alleged residency change; the state wherein the taxpayer's spouse and children reside; the taxpayer's telephone records (*i.e.*, the origination point of taxpayer's telephone calls); the number of days the taxpayer spends in California versus the number of days the taxpayer spends in other states, and the general purpose of such days (*i.e.*, vacation, business, *etc.*); and the origination point of the taxpayer's checking account transactions and credit card transactions.<sup>22</sup>

The residence of the taxpayer's spouse, children and immediate family can provide guidance regarding where the taxpayer resides, as can the location of the taxpayer's real property, including his or her likely home. The number of days the taxpayer spends

in one state and the purpose of those stays can be determined in various ways, including the origination point for financial transactions and telephone calls.

## Presumptions

There is a general presumption that individuals physically present within California for less than six months during the tax year (who are domiciled outside California and maintain their personal residence outside California) will not be considered California residents provided they do not engage in any activity or conduct within California other than that of a seasonable visitor, tourist or guest.<sup>23</sup> Similarly, there is a general presumption that individuals physically present within California for more than nine months during the tax year are California residents.<sup>24</sup>

These presumptions are not conclusive and may be overcome by evidence that physical presence in California, even if for more than nine months during the tax year, was merely for a temporary or transitory purpose.<sup>25</sup> “The language of the statute establishes that the length of time a person is in California does not ... compel a determination that he has acquired residence [in California].”<sup>26</sup> Clearly, a person who stays for more than six months of the year, but less than nine months “may be considered as being in the State for a temporary or transitory purpose.”<sup>27</sup> Further, an individual may be deemed a seasonal visitor, tourist or guest even though they own or maintain a physical residence in California, join local social clubs, or have a bank account in California for the purpose of paying personal expenses.<sup>28</sup>

Actual time spent in California is only one factor to be considered as an indication of the purpose of the visit.<sup>29</sup> For tax purposes, a residency determination depends upon an overall evaluation of the individual’s “closest connections” during the tax year.<sup>30</sup> The state with which an individual has the closest connections during the tax year is typically their state of residence.<sup>31</sup> The contacts/connections that a taxpayer maintains in California and other states are important objective indications of whether presence in or absence from California is for a “temporary or transitory purpose.” Such connections are important

both as a measure of the benefits and protections which the taxpayer received from the laws and government of California, and also as an objective indication of whether the taxpayer entered or left the State for temporary or transitory purposes.<sup>32</sup> It must be determined whether connections with a state were maintained in readiness for the taxpayer’s return.<sup>33</sup> However, retention of certain contacts such as bank accounts, driver’s licenses, professionals, etc., may

only be a reflection of the taxpayer’s past and may not be inconsistent with an absence for other than a temporary or transitory purpose.<sup>34</sup> Retention of the former personal residence often raises the suspicions of the Franchise Tax Board. Indeed, as the residency dispute proceeds thru the

lengthy administrative dispute process, it’s not unusual for the individual to have returned to California as a result of changed circumstances to live in their former personal residence.

If an individual is simply passing through California on his or her way to another state or country, is in California for a brief rest or vacation, to complete a particular transaction, to perform a particular contract, or to fulfill a particular engagement that will require their presence in California for a brief period of limited duration, the individual should be deemed present in California for a “temporary or transitory purpose” and should not be deemed a resident by virtue of their physical presence within California.<sup>35</sup> However, individuals present in California for an indefinite duration, such as to improve their health, or for a business purpose requiring a long period to accomplish, or employed in a position that may last permanently or indefinitely, or individuals arriving in California with no definite intention of departing shortly thereafter, are deemed present in California for other than a temporary or transitory purpose, and will likely be deemed residents taxable upon their world-wide income, even though they may retain their domicile in some other state or country.<sup>36</sup>

## Limited Safe Harbor

Historically, employment-related absences from California of as long as 12, 15, 19 or 22 months were considered “temporary” absences of relatively

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short duration.<sup>37</sup> Taxpayers have even been deemed California residents during overseas employment that lasted as long as three years.<sup>38</sup> Conversely, an individual was determined to be “temporarily” in California even though present for more than nine months during the year since they resided in a hotel on a weekly basis and their departure was delayed because of illness and a labor strike.<sup>39</sup>

California domiciliaries employed outside California have generally been considered absent for other than a temporary or transitory purpose if the job position is expected to last for a long, permanent or indefinite period of substantial duration.<sup>40</sup> The fact that a foreign assignment ended sooner than expected does not require a conclusion that the assignment was for a temporary or transitory purpose.<sup>41</sup> A permanent departure is not required. However, the individual should be able to demonstrate that they were absent for other than a “temporary or transitory purpose.”<sup>42</sup>

A degree of certainty is provided for California domiciliaries and their spouses who are absent from California for an uninterrupted period of at least 18 consecutive months (546 consecutive days) under an employment-related contract as being considered outside California for a purpose that is not “temporary or transitory” (thereby resulting in the individual being a nonresident).<sup>43</sup>

The “safe harbor” specifically excludes individuals (and their spouses) domiciled in California who are required to relocate outside California as a result of receiving certain federal government elective or appointed positions.<sup>44</sup> Under the “safe harbor,” the individual is allowed to return to California for no more than 45 days during any tax year.<sup>45</sup> However, the “safe harbor” exception does not apply if the individual has income from intangibles (stocks, bonds, notes, *etc.*) in excess of \$200,000 during the tax year or if the principal reason for the absence from California is to avoid personal income tax.<sup>46</sup> In the case of an individual who is married, the “safe harbor” is applied to the income of each spouse separately.<sup>47</sup> Finally, the “safe harbor” does not apply to any individual if the principal purpose of the individual’s absence from California is to avoid any California tax.<sup>48</sup>

## Administrative Review

Since 1935, disputes relating to residency and domicile have been extensively contested. The first appeal to the State Board of Equalization was heard in 1942 and pertained to tax year 1935.<sup>49</sup> Determinations

by the Franchise Tax Board regarding a taxpayer’s income tax liability are presumptively correct,<sup>50</sup> and this presumption of correctness also attaches to a Franchise Tax Board determination of residency status.<sup>51</sup> As such, a taxpayer has the burden of proving the erroneous nature of a residency determination.<sup>52</sup> With respect to domicile, the burden of proof is on the party asserting a change of domicile.<sup>53</sup> The presumption of correctness is rebuttable and supports a finding only in the absence of sufficient evidence to the contrary.<sup>54</sup> Once evidence of residency that would support a contrary finding has been submitted, the presumption of correctness disappears.<sup>55</sup> The burden of proof will not generally be satisfied if solely based on unsupported, arguably “self-serving,” assertions by either the taxpayer or the Franchise Tax Board. Credible evidence substantiating the contentions must be presented.<sup>56</sup>

When the issue of residency arises, the Franchise Tax Board will thoroughly review and evaluate what it perceives to be the relevant contacts with the State of California as compared to those with other states—with a special emphasis on California based contacts. It is not sufficient to aggregate contacts with states other than California and then attempt to balance those with the California contacts. California believes an individual must actually be a “resident” of some other state or country. It is not generally sufficient to merely demonstrate that the individual was not physically present in California for a specified period of time. In fact, minor contacts with California may become more significant if the individual is unable to demonstrate more significant contacts with any other particular state or country.

The most significant contacts tend to include actual physical presence of the taxpayer during the tax year, the location of the family home, the location of various business interests, and the location of the individual’s family (although spouses need not have the same residency status). Even though an individual may not be a California resident, their spouse and minor children may be residents, if they are present in California for other than a temporary or transitory purpose. The taxpayer will be asked about where the individual was located and various other potentially relevant contacts during the year(s) under examination.

The Franchise Tax Board will review and determine the employment status of the individual, the location of the individual’s principal residence, the location and activity in California bank and brokerage accounts, whether the individual’s minor children

attend school in California, whether older children are attending school in California universities on the basis of being deemed California residents, voter's registration certificates, whether the individual files resident or nonresident tax returns in another state or country, statements of residence in the individual's estate planning documents, whether the individual claimed the California homeowner's property tax exemption or renter's credit with respect to a California residence, the location of medical, legal, and business professionals engaged on behalf of the individual, registration of vehicles, planes or boats belonging to the individual, the state where the individual's driver's license is issued, the state where the individual's professional and business licenses are issued, the state where the individual belongs to social, athletic or religious organizations, membership in labor unions within the state, a listing in a telephone directory within the state, the location of the individual's cemetery plot, real estate and other similar investments and other relevant contacts. Generally, the state of residence is where the individual maintains his or her closest connections although no single contact is determinative.

In any residency determination, it is particularly relevant to determine whether the individual substantially severed their contacts upon departure from a state and took steps to establish a significant connection with their new state of residency. It should be anticipated that the Franchise Tax Board will attempt to determine whether an individual arguably departing California maintained their California contacts with a view toward ultimately returning to the state—an issue calculated to lead to an administrative determination that the individual remained a California domiciliary, even though physically present outside the State of California for a significant period of time. However, the mere fact that an individual owns a home, maintains a bank account or is a member in social clubs located in California should not automatically result in a determination of California residency.<sup>57</sup> All relevant contacts will be evaluated to determine the individual's actual domicile and residency status. Unfortunately, there is no clear guidance for this determination.

**Individuals retaining any contacts or having any presence in California remain exposed to a potentially arbitrary residency determination.**

Frequently, administrative determinations that a taxpayer is domiciled in California lead to the conclusion that their absence from California is for a temporary or transitory purpose. Similarly, determinations that an individual is domiciled outside California frequently involve a conclusion that the individual's presence in the State of California is for other than a temporary or transitory purpose. Each conclusion leads to a determination that the individual is subject to taxation by the State of California on their worldwide income. These

conclusions are often based on the fact that the absent individual maintained contacts with California while away and that the individual located in California arrived in California for an indefinite period of time.

To avoid a potentially adverse determination, individuals departing California should attempt to sever all California connections, physically relocate outside California, and clearly set forth their subjective intent to never return. Although it may be unreasonable to expect California domiciliaries to sever all of their California connections, relinquishment of any contacts with California can be anticipated to significantly enhance the risk of being taxed as a resident during the period of their absence from California.

If an audit arises, it should be anticipated that the Franchise Tax Board will contact the individual's neighbors and business associates in an effort to determine the individual's physical presence during the year(s) under examination. Although mere time spent within California is not determinative, significant amounts of time within California significantly influences the ultimate administrative determination of the individual's residency status. A significant amount of information regarding physical presence is often derived from interviews of neighbors and business associates, credit card receipts, cellular phone records and canceled checks. The use of credit cards, checks or a cellular phone within the California typically places an individual at a particular location at a particular point of time.

If an individual claims to have a residence or business located outside California, the Franchise Tax Board will likely visit the out-of-state locations and contact neighbors and business associates at that location. Individuals should anticipate an

analysis of records relating to air travel originating from within California. There may also be a search of courthouse records for information or statements as to an individual's residency status set forth in any proceedings involving a marital dissolution, probate or other litigation.

If the issue concerning a taxpayer's residency status is unclear, to avoid possible penalties, filing of a nonresident return reporting California-source income should be considered even though the taxpayer believes they are not a California resident.<sup>58</sup> Filing of a nonresident return will commence the applicable statute of limitations on assessment of a tax deficiency. If a return is not filed, the individual will remain exposed to the residency issue forever. The return might be accompanied by a brief statement setting forth the reasons why the taxpayer is not a resident and any evidence in support of the taxpayer's assertion of nonresidency.

Residency disputes often are not administratively resolved for an extended period of time. Basic residency audits often take at least a year to conclude while information is being gathered and coordinated. If a dispute remains, the individual must then timely protest the Notice of Proposed Assessment requesting an informal hearing within the Franchise Tax Board. If an issue remains unresolved following a hearing with the Franchise Tax Board, the individual must subsequently file a timely appeal to the State Board of Equalization. Often this lengthy administrative process can be curtailed by submission of a settlement proposal to the Franchise Tax Board Settlement Bureau on the basis of the realistic "hazards of litigation" involved.<sup>59</sup>

Following the exhaustion of the foregoing administrative processes without an acceptable resolution, an individual may timely commence an action in the Superior Court of any county where the California Attorney General maintains an office—including Sacramento, Los Angeles or San Francisco—without first being required to satisfy the disputed liability. No collection action may be taken while this action is pending. This is a statutory exception to the general rule of substantially all other civil tax disputes, where the taxpayer must pay the California tax liability at the conclusion of the administrative process before commencing Superior Court litigation. The economic benefits of proceeding to litigation without having to first satisfy the asserted deficiency must not be overlooked in determining an appropriate administrative resolution—although the uncertainties of litigation

associated with any residency determination will often justify a meaningful administrative resolution.

It is not unusual for the Franchise Tax Board to consider a jeopardy assessment if it is able to determine that an individual is concealing or removing assets from California in the face of a potential adverse residency determination. The Franchise Tax Board is authorized to issue a jeopardy assessment and seek immediate collection of the amount in dispute if it determines that the assessment and collection of the tax may be jeopardized by delay.<sup>60</sup> A finding of jeopardy is presumptively correct in subsequent proceedings. If a jeopardy assessment is involved in a residency dispute, a tax practitioner should consider the motivations behind the jeopardy (was it improperly asserted to circumvent the taxpayer's ability to contest the residency determination without having to satisfy the tax liability?).

The determination of an individual's residency status (if domiciled outside California) or domicile (if physically present outside California with an established intention of remaining outside California) depends upon application of the phrase "temporary or transitory purpose." Unfortunately, as with other determinations based upon a factual analysis (independent contractor/employee, *etc.*), this phrase has often been interpreted in an inconsistent and arbitrary manner. Whether a taxpayer's purpose in entering or leaving California is temporary or transitory in character is a question of fact to be determined by examining all of the circumstances of each particular case.<sup>61</sup> In situations where the taxpayer has significant contacts with more than one state, the state with the closest connections during the taxable year will be considered the state of their residence.<sup>62</sup> Individuals maintaining a significant personal and business presence in several states, including California, remain exposed to a potentially arbitrary residency determination.

## **Planning for the Future**

Tax practitioners may not realistically provide much comfort to their departing clients unless substantially every contact with California has been relinquished. Similarly, snowbirds migrating to a warmer California climate must limit their California presence and contacts. Merely balancing the relative contacts or time spent outside of California will not be determinative.<sup>63</sup> If an individual accepts out-of-state employment of a limited duration, the Franchise Tax Board may well assert that the individual retained their status as a



California domiciliary and was merely absent from California on a temporary or transitory basis.

Individuals intending to depart from California should do so under circumstances clearly establishing that their departure is for a lengthy or indefinite duration. Individuals retaining any contacts or having any presence in California remain exposed to a potentially arbitrary residency determination. Residency determinations are unpredictable and are may sometimes be perceived as inequitable. An individual in California for a relatively long or indefinite period will likely be deemed a resident by the Franchise Tax Board whether they came to California for health, business, or employment-related purposes. To the contrary, individuals present in California for purposes of completing a particular transaction or engagement should not be deemed residents.

Important factors to consider (no single factor is determinative) include the location of all residential real property and the approximate sizes and values of each of the properties; the state where a spouse and children, if any, reside. However, as stated, spouses can be residents of different states; the state wherein children, if any, attend school; the state wherein the homeowner's property tax exemption is claimed on a residence; telephone records; the number of days spent in California versus the number of days spent in other states and the general purpose of such days (vacation, business, *etc.*)<sup>64</sup>; the location where the tax returns are filed, both federal and state, and the state of residence claimed on such returns; the location of bank and savings accounts; the origination point of checking account transactions and credit card transactions; the state wherein memberships in social, religious and professional organizations are maintained; the state wherein cars are registered and maintained; the state wherein the person maintains a driver's license; the state wherein the person maintains voter registration and their voting history; the state wherein the person obtains professional services, such as doctors, dentists and accountants; the state where the person has business interests and is employed; the state wherein the person maintains or owns business interests; the state wherein the person holds a professional license or licenses; the state wherein the person owns investment real property; indications in affidavits from various individuals discussing the person's residency; statements of residency and domicile in the person's estate planning documents.

Any retained interests with California jeopardize the residency issue. When representing a client relo-

cating outside California, the advisor should consider advising the client to sever all ties to California—if possible (any retained interests are potentially determinative against the taxpayer); sell the California family home—anything less is extremely risky (if the family home is retained for some reason, terminate the claimed homeowners exemption). It is best to not retain any direct or indirect interest in any real estate in California that might somehow be deemed a personal residence. In many situations, the taxpayer has returned to California after an absence, during which there was a financial liquidity event. The FTB uses the return to California as evidence of a temporary absence from the state (and an ongoing domicile in California); buy a home in the new state of residency and move the personal furniture, establish a local presence and actually live there; enroll children, if any, in schools in the new state of residency; promptly obtain a driver's license in the new state of residency; register to vote in the new state of residency; do not maintain a car, plane or boat registered in California; do not spend any significant amount of time working, visiting or conducting personal business in California; file all required tax returns in the new state of residency and file California nonresident returns if there is any California source income. A nonresident California return begins the applicable statute of limitations within which the FTB must reach a determination on residency status; change the estate planning documents to recite their residency in the new state of residency; join social, athletic and religious organizations in the new state of residency; transfer financial and brokerage accounts to the new state of residency; if there is retained California source income, file California nonresident returns; change California professional licenses to an "inactive" status, if possible; maintain a business diary of activities and meetings conducted in the new state of residency; maintain a personal diary of activities and presence in the new state of residency; for at least five years, maintain all documents supporting a change in residency such as moving and storage receipts for the furniture, plane tickets, baggage claim receipts, termination notifications for telephone and utilities, *etc.*; in the event of an examination, the FTB may request the opportunity to review the foregoing information together with copies of bank and credit card statements, cancelled checks, and ATM and debit card transactions, copies of cellular phone records, employment records, utility bills for any home in California (to be compared with utility usage for

any home outside California), and voting records in the new state of residency, if available.

The renewed California Franchise Tax Board focus on residency-related issues dictates a careful analysis of all potentially relevant issues well before the receipt of an audit notice. If presented with a potential residency issue, it is important to determine whether the relevant contacts have been substantially severed upon the individual's departure from California and to identify the steps taken to establish a significant connection with the new state of residency. The Franchise Tax Board will attempt to determine whether indi-

viduals leaving California maintained their California connections with a view toward ultimately returning to California. However, the mere fact that an individual owns a home, maintains a bank account, or is a member in social clubs located in California does not support a determination of California residency. All relevant contacts must be appropriately evaluated to determine the appropriate residency status. Caution and responsibility must be demonstrated by both the government and the individuals involved ... lest we return to resolving disputes with the rack and screw ...

## ENDNOTES

- <sup>1</sup> Cal. Admin. Code, Title 18, Regulations ("Regulations") §17014(a); *Whittell v. Franchise Tax Board*, 231 Cal. App. 2d 278 (1964).
- <sup>2</sup> Revenue & Taxation Code §§ 17041, 17056, 17301–17303, and 17310; Regulation §§ 17014 and 17951-1, *et seq.*
- <sup>3</sup> Revenue & Taxation Code § 17951, *et seq.*
- <sup>4</sup> Regulation §§ 17951 and 17952.
- <sup>5</sup> 1935 Cal. Stat. Ch. 329, § 1, at 329.
- <sup>6</sup> Cal. Const. art. XVIII, § 26(a). The Personal Income Tax Law is administered by the Franchise Tax Board which has broad powers to issue nonretroactive regulations prescribing the application of the Income Tax Law and is authorized to examine personal income tax returns and to determine the amount of tax due. The Franchise Tax Board is composed of the State Controller, the Director of the Department of Finance, and the Chairmen of the State Board of Equalization. Cal. Gov't Code § 15700, *et seq.*
- <sup>7</sup> Traynor and Keesling, *The Scope and Nature of the California Income Tax*, 29 CAL. L. REV. 706, 719.
- <sup>8</sup> Revenue & Taxation Code § 17014(a); Regulation § 17014.
- <sup>9</sup> Regulation § 17014(b).
- <sup>10</sup> Revenue & Taxation Code § 17015; Regulation § 17014.
- <sup>11</sup> Revenue & Taxation Code § 17014(c); Regulation § 17014(a).
- <sup>12</sup> Regulation § 17014(c).
- <sup>13</sup> *C.C. Gates, Jr.*, CA-10, 52-2 USTC ¶9505, 199 F2d 291, 294.
- <sup>14</sup> Appeal of Jerome James, California State Board of Equality, Feb. 26, 2013 (Case No. 596166); *In re Marriage of Leff*, 25 Cal. App. 3d 630, 102 Cal. Rptr. 195 (1972); Appeal of Joe and Gloria Morgan, 85-SBE-078, July 30, 1985; Appeal of Richard and Carolyn Selma, 77-SBE-124, Sept. 28, 1977; Appeal of Brent L. Berry, 71-SBE-007, Mar. 21, 1971; Appeal of Earl F. and Helen W. Brucker, 61-SBE-045, July 18, 1961; Appeal of Jimmy J. Childs, 83-SBE-128, June 21, 1983.
- <sup>15</sup> Regulation § 17014(c); Estate of Phillips, 269 Cal. App. 2d 656, 659; 75 Cal. Rptr. 301 (1969).
- <sup>16</sup> *Chapman v. Superior Court*, 162 Cal. App. 2d 421, 426–27; 328 P2d 23 (1958).
- <sup>17</sup> Appeal of Harrison, California State Board of Equality, June 25, 1995.
- <sup>18</sup> Regulation § 17014.
- <sup>19</sup> Appeal of Stephen D. Bragg, 2003-SBE-002, May 28, 2003.
- <sup>20</sup> Appeal of Jerome James, California State Board of Equality, Feb. 26, 2013 (Case No. 596166); Appeal of Stephen D. Bragg, 2003-SBE-002, May 28, 2003.
- <sup>21</sup> *Id.*
- <sup>22</sup> *Id.*
- <sup>23</sup> Regulation § 17014(b); *supra* note 20.
- <sup>24</sup> Revenue & Taxation Code § 17016; Regulation § 17014(b).
- <sup>25</sup> *Id.*
- <sup>26</sup> *Klemp v. Franchise Tax Board*, 45 Cal. App. 3d 870, 119 Cal. Rptr. 821 (1975).
- <sup>27</sup> *Klemp, id.*; *supra* note 20.
- <sup>28</sup> *Whittell v. Franchise Tax Board*, 231 Cal. App. 2d 278, 41 Cal. Rptr. 673 (1964).
- <sup>29</sup> *Klemp, supra* note 26.
- <sup>30</sup> Regulation § 17014(b).
- <sup>31</sup> Appeal of Hardman, California State Board of Equality, Aug. 19, 1975.
- <sup>32</sup> *Supra* note 20; Appeal of Zupanovich, California State Board of Equality, Jan. 6, 1976; Appeal of Broadhurst, California State Board of Equality, Apr. 4, 1976.
- <sup>33</sup> Appeal of Hardman, California State Board of Equality, Aug. 19, 1975.
- <sup>34</sup> Appeal of Hardman, *id.*
- <sup>35</sup> Regulation § 17014(b).
- <sup>36</sup> Regulation § 17014(b).
- <sup>37</sup> Appeal of Tarring, 4 SBE 51, Nov. 18, 1987; Appeal of Hauber, California State Board of Equality, Nov. 6, 1985; Appeal of Harding, California State Board of Equality, Feb. 4, 1986; Appeal of Boehme, California State Board of Equality, Nov. 6, 1985.
- <sup>38</sup> Appeal of Huran, California State Board of Equality, Jan. 8, 1968; Appeal of Zupanovich, California State Board of Equality, Jan. 6, 1976.
- <sup>39</sup> Appeal of Woolley, California State Board of Equality, July 19, 1951.
- <sup>40</sup> Appeal of Zupanovich, *supra* note 38.
- <sup>41</sup> Appeal of Egeberg, California State Board of Equality, July 30, 1985.
- <sup>42</sup> Appeal of Fox, California State Board of Equality, Apr. 9, 1986.
- <sup>43</sup> Revenue & Taxation Code § 17014(d).
- <sup>44</sup> *Id.*
- <sup>45</sup> *Id.*
- <sup>46</sup> *Id.*
- <sup>47</sup> *Id.*
- <sup>48</sup> *Id.*
- <sup>49</sup> Appeal of W.S. Charnley, California State Board of Equality, Dec. 2, 1942.
- <sup>50</sup> *Todd v. McColgan*, 89 Cal. App. 2d 509, 201 P2d 414 (1949); Appeal of Morgan, California State Board of Equality, July 30, 1985.
- <sup>51</sup> Appeal of Misskelley, California State Board of Equality, May 8, 1984.
- <sup>52</sup> Appeal of Robert F. and Helen R. Adickes, 90-SBE-012, Nov. 17, 1990; Appeal of Robert J. Addington, Jr., California State Board of Equality, Jan. 5, 1982; *Todd v. McColgan, supra* note 50.
- <sup>53</sup> *Sheeham v. Scott*, 145 Cal. 684, 79 P 350 (1905); Appeal of Terance and Brenda Harrison, California State Board of Equality, June 25, 1985.
- <sup>54</sup> Appeal of Fox, California State Board of Equality, Apr. 9, 1986; *M.L. Rockwell, CA-9*, 75-1 USTC ¶9324, 512 F2d 882.
- <sup>55</sup> Appeal of Jerome James, California State Board of Equality, Feb. 26, 2013 (Case No. 596166); Appeal of Stephen D. Bragg, 2003-SBE-002, May 28, 2003; Appeal of Misskelley, Cal. St. Bd of Equality, May 8, 1984; Appeal of Webber, California State Board of Equality, Oct. 6, 1976.
- <sup>56</sup> Appeal of Gum, California State Board of Equality, Mar. 31, 1982; Appeal of Jerome James, California State Board of Equality, Feb. 26, 2013 (Case No. 596166); Appeal of Stephen D. Bragg, 2003-SBE-002, May 28, 2003.
- <sup>57</sup> Regulation § 17014(b); See also FTB Publication 1031—Guidelines for Determining Residency Status.
- <sup>58</sup> Regulation § 17014(d)(2); Appeal of

## ENDNOTES

- Jerome James, California State Board of Equality, Feb. 26, 2013 (Case No. 596166); Appeal of Stephen D. Bragg, 2003-SBE-002, May 28, 2003.
- <sup>59</sup> Revenue & Taxation Code § 19442.
- <sup>60</sup> Revenue & Taxation Code § 19081; Cal. Code of Civ. Proc. § 1060.5.
- <sup>61</sup> Appeal of Gabrik, California State Board of Equality, Feb. 4, 1986; Appeal of Jerome James, California State Board of Equality, Feb. 26, 2013 (Case No. 596166); Appeal of Stephen D. Bragg, 2003-SBE-002, May 28, 2003.
- <sup>62</sup> Regulation § 17014(b).
- <sup>63</sup> Appeal of Thomas, California State Board of Equality, Apr. 5, 1983; Appeal of Loebner, California State Board of Equality, Feb. 28, 1984; Appeal of Stefani, California State Board of Equality, 1984.
- <sup>64</sup> There is an app that a person can acquire that actually tracks their location, which could prove beneficial in a later residency examination. See [www.monaeo.com](http://www.monaeo.com).

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