

HOTEL CALIFORNIA

You can check out any time you'd like, but you can never leave —
Expatriating the Golden State



San Francisco
Estate Planning Council
March 17, 2021

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Today's Discussion

- Migration out of California / Statistics
- Residency – Why is it Important?
- Domicile
- Change of Residence / Becoming a Non-Resident
- Selling Assets and Leaving California
- Recent Cases
- The Audit Process / Pre-Audit Planning
- Taxation of Remote Workers
- Compensatory Stock Options
- Business Nexus Issues, Private Equity Funds, etc.
- Q&A

Please submit your
questions real time via the
chat window

Leaving California: The Statistics

Is There a CalExodus?

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Wealth

Oracle's Larry Ellison Says He Has Moved to Hawaii, Fleeing California

By [Nico Grant](#) and [Sophie Alexander](#)
December 14, 2020, 12:54 PM PST

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December 8, 2020 3:23 PM PST

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OPINION - Published December 13

Now Oracle's exiting California for Texas. Will the last one in Silicon Valley, please turn out the lights?

Oracle, part of the S&P 100 with 138,000 employees, was founded 43 years ago in Silicon Valley

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Hewlett Packard Enterprise to move headquarters to Texas

December 2, 2020

Is There a CalExodus?

- Recent news reports, preliminary data, and anecdotal evidence suggest the COVID-19 pandemic may be either causing or accelerating an exodus from California
- The pandemic and last year's wildfires provided many reasons for people to move
- Faced with the prospect of indefinite remote work and school, some families have sought additional space or proximity to support family and social networks
- It is not yet clear whether those who moved left permanently or only temporarily

Is There a CalExodus?

University of California Consumer Credit Panel data suggests:

- No evidence of a pronounced exodus from California
- The number of people leaving California historically tracks with the number of people entering California, but this pattern deviated in Q4 2020, when 267,000 people left the state and only 128,000 entered (net migration of -139,000)
- There's little evidence that wealthy Californians are leaving en masse

CalExodus? Not So Fast

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Mass 2020 exodus from California did not happen, study says

March 5, 2021

THE HILL Study shows there was no 'mass exodus' from California last year

BY CELINE CASTRONUOVO - 03/05/21 03:31 PM EST

CNN US Crime + Justice Energy + Environment Extreme Weather Space + Science LIVE TV Edition

No 'mass exodus' in California during the pandemic, study finds

By Kelly Murray and Jessica Myers, CNN
Updated 2348 GMT (0748 HKT) March 5, 2021

Los Angeles Times

Californians aren't leaving the state en masse — but they are leaving San Francisco, study says

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ECONOMY

Bidding wars and overblown fears: The curious case of the California exodus

BY LAUREN HEPLER
MARCH 4, 2021

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Bay Area Exodus?

The pandemic has prompted people to move around within California, but not necessarily to leave the state. The overall rate of exits is not abnormally high, including from California's wealthiest ZIP codes.

However, there *were* net exits from the Bay Area—particularly from San Francisco, which is experiencing “a unique and dramatic exodus”.

- San Francisco exits in Q4 2020 were 31% higher than in Q4 2019, while new entrances were 21% lower
- Net exits from SF increased 649% from the end of March to the end of December compared to the same period in 2019 (from 5,200 to 38,800 net exits)
- However, nearly 80% of those leaving San Francisco remained in California
 - Many counties in Northern California and the Sierra Nevada mountains saw from 50% to 100% more San Francisco in-migrants than in 2019

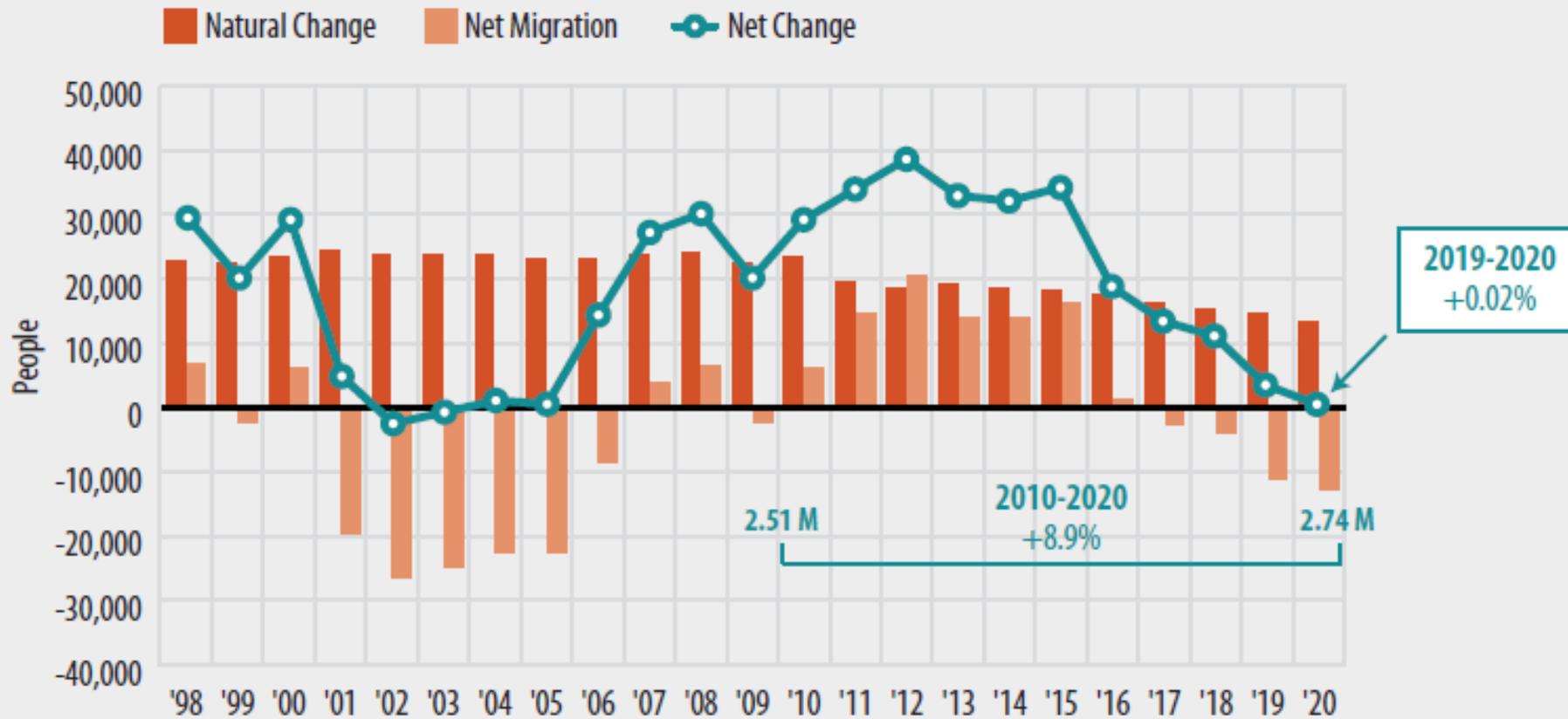
Silicon Valley Exodus?

- Silicon Valley's population grew by just 0.02% from July 2019 to July 2020—the smallest gain since 2005
- Silicon Valley has only experienced a net in-migration from other parts of the state and country during four of the past 30 years
 - Last year, outmigration exceeded in-migration by nearly 12,800 people—more than any year since those following the dot.com bust (2001-2005)
- For the past four years, more people have left Silicon Valley than have moved in
 - The total net loss of Silicon Valley residents between July 2015 and July 2020 was -29,200
- Silicon Valley population growth has halted. While the region continues to attract tech talent from around the world, incoming (primarily foreign born) talent is met with a massive outflow of residents to other parts of the state and nation, and slower natural growth. Tech employment is still rising, but Silicon Valley companies are adding jobs more rapidly elsewhere.

POPULATION CHANGE

Components of Population Change

Santa Clara & San Mateo Counties

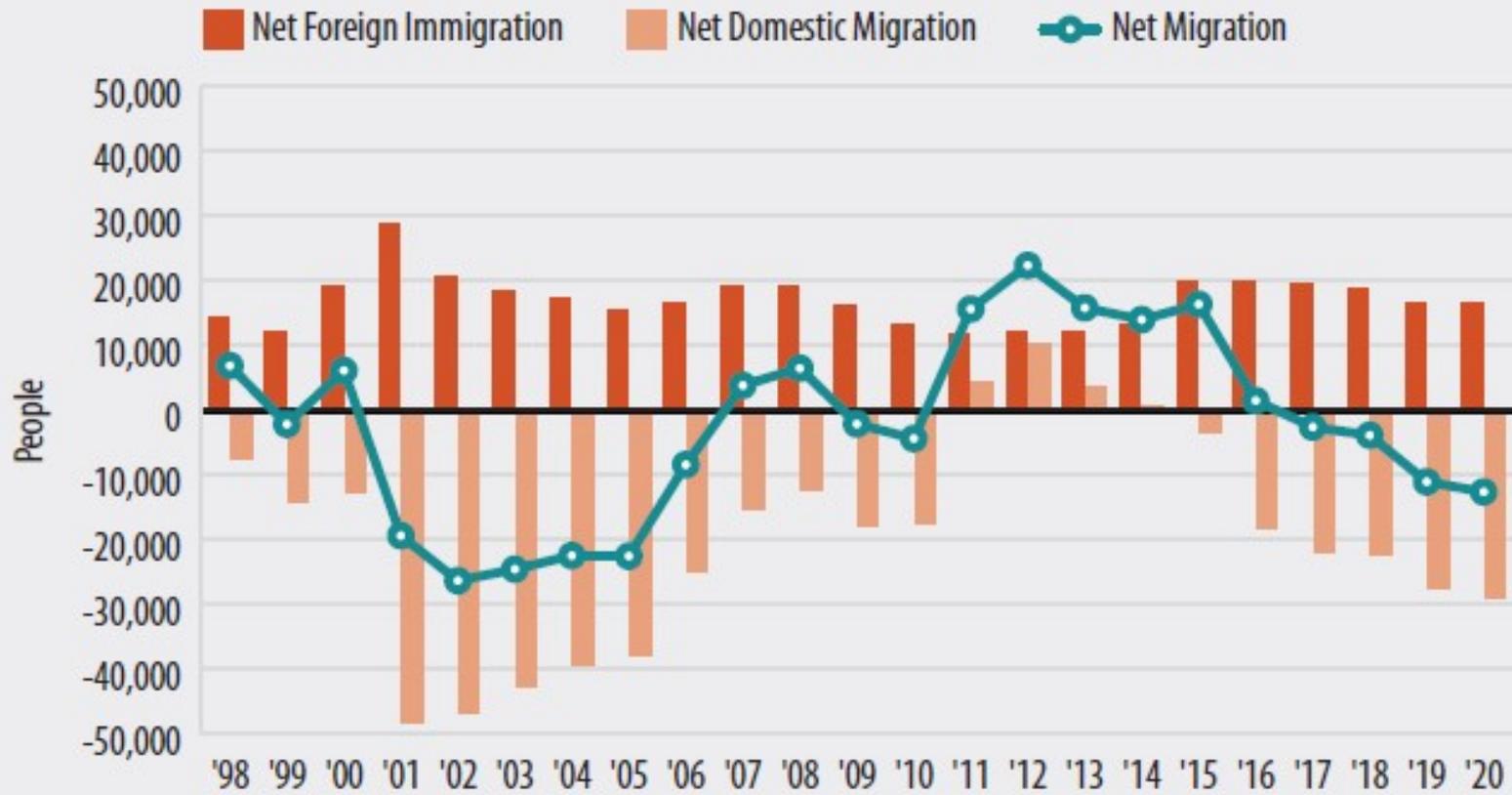


Data Source: California Department of Finance | Analysis: Silicon Valley Institute for Regional Studies

MIGRATION FLOWS

Foreign and Domestic Migration

Santa Clara & San Mateo Counties



Data Source: California Department of Finance | Analysis: Silicon Valley Institute for Regional Studies

Residency

Significance of California Residency

Residency is significant because it determines what income is taxed by California.

- **Residents** of California are taxed on ALL income, including income from sources outside California
- **Nonresidents** of California are taxed only on income from California sources
- **Part-year residents** of California are taxed on all income received while a resident and only on income from California sources while a nonresident

Who is a California Resident?

- A **resident** is any individual who meets any of the following:
 - Present in California for other than a temporary or transitory purpose
 - Domiciled in California, but outside California for a temporary or transitory purpose
- A **nonresident** is any individual who is not a resident
- 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

Who is a California resident?

- The underlying theory of residency is that you are a resident of the place where you have the closest connections
- COVID-19 pandemic
 - If you are impacted by the COVID-19 pandemic, it is one of the factors that the FTB will consider as it applies the general rules for residency and income sourcing provisions

Temporary or Transitory Purpose

Factors that may indicate an individual is a resident and not in California temporarily include:

- Ownership of real property in California;
- Sending children to California schools;
- Obtaining a California driver's license and auto registration; and
- Having family, social, and business interests in California

Temporary or Transitory Purpose

- If an individual comes to California for a vacation, to complete a transaction, or is simply passing through, the individual's purpose is temporary or transitory
- An individual's stay is other than temporary or transitory if the individual:
 - Is assigned by an employer to an office in California for a long or indefinite period;
 - Returns to California with no specific plans to leave; or
 - Is ill and is in California for an indefinite recuperation period

Presumption of Residency

Any individual who spends in the aggregate more than nine months of the taxable year in California is presumed to be a resident.

The presumption may be overcome by satisfactory evidence that the individual is in the state for a temporary or transitory purpose.

Safe Harbor

- Safe harbor is available for certain individuals leaving California under employment-related contracts
- The safe harbor provides that an individual domiciled in California who is outside California under an employment-related contract for an uninterrupted period of at least 546 consecutive days will be considered a nonresident unless any of the following is met:
 - The individual has intangible income exceeding \$200,000 in any taxable year during which the employment-related contract is in effect
 - The principal purpose of the absence from California is to avoid personal income tax

Safe Harbor

- The spouse/RDP of the individual covered by this safe harbor rule will also be considered a nonresident while accompanying the individual outside California for at least 546 consecutive days
- Return visits to California that do not exceed a total of 45 days during any taxable year covered by the employment contract are considered temporary
- Individuals not covered by the safe harbor determine their residency status based on facts and circumstances. The determination of residency status cannot be solely based on an individual's occupation, business, or vocation

Coming into California

When you are in California for other than a temporary or transitory purpose, you are a California resident.

- For instance, if your employer assigns you to an office in California for a long or indefinite period, if you retire and come to California with no specific plans to leave, or if you are ill and are in California for an indefinite recuperation period, your stay is other than temporary or transitory. As a resident, you are taxed on income from all sources
- You will be presumed to be a California resident for any taxable year in which you spend more than nine months in this state
- Although you may have connections with another state, if your stay in California is for other than a temporary or transitory purpose, you are a California resident. As a resident, your income from all sources is taxable by California

Coming into California

Example 1

- You are a business executive and reside in New York with your family. Several times each year you travel to other states for business purposes. Your average stay is one or two weeks and the entire time spent in California for any taxable year does not exceed six weeks. Your family usually remains in New York when you are traveling for business purposes

Determination

- Under these circumstances, you are not a California resident because your stays in California are temporary or transitory in nature. As a nonresident, you are taxed only on your income from California sources, including your income for services performed in California

Coming into California

Example 2

- In December 2019, you moved to California on an indefinite job assignment. You rented an apartment in California and continued to live in the apartment. You retained your home and bank account in Illinois until April 2020, at which time you sold your home and transferred your bank account to California

Determination

- Your assignment in California was for an indefinite period; therefore, your stay in California was not of a temporary or transitory nature. Although you kept ties in Illinois until April 2020, you became a California resident upon entering the state in December 2019. As a resident, you are taxed on your income from all sources

Leaving California

Any individual who is a resident of California continues to be a resident when absent from the state for a temporary or transitory purpose.

- An absence from California under an employment-related contract for a period of at least 546 consecutive days may be considered an absence for other than a temporary or transitory purpose

Leaving California

Example 3

- Until September 2020, you were a resident of California. At that time, you declared yourself to be a resident of Nevada, where you have a summer home. You continue to spend six or seven months each year at your home in California, which you have retained. You spend only three to four months in Nevada and the rest of the time traveling in other states or countries. You transferred your bank accounts to Nevada. However, you continue to maintain your social club and business connections in California.

Determination

- Your declaration of residency in Nevada does not establish residency in that state. Your closest connections are to California and your absence from California is for temporary or transitory purposes. You are, therefore, a resident of California and are taxed on your income from all sources

Leaving California

Example 4

- You and your spouse/RDP are California residents. You accept a contract to work in South America for 16 months. You lease an apartment near the job site. Your contract states that your employer will arrange your return back to California when your contract expires. Your spouse/RDP and your children will remain in California residing in the home you own

Determination

- You maintain strong ties with California because your spouse/RDP and children remain in your California home during your absence. Your intent is to return to California, and your absence is temporary and transitory. You remain a California resident during your absence. You are taxed on income from all sources, including income earned in South America

Domicile

Domicile: One's True Home

- California taxation applies to every individual who is **domiciled** in California and who is found to be outside the state only for a temporary or transitory purpose. RTC § 17014(a)(2)
- Domicile where an individual has a “present intention” of making that one geographic location their settled, permanent home and where the person intends to return whenever absent. CCR § 17014(c)
- An individual may have several residences but will only ever have one domicile
- If an individual has a “definite intention” of returning to California, regardless of the length of time or the reasons for the absence, then generally they retain a California domicile

Domicile: Proving a Break

- A domicile in a new state is presumed to continue until it is shown to have changed
- Taxpayer has the burden of proving they acquired a new domicile by showing they:
 - did not retain significant connections to California; and
 - established strong connections with the new domicile including more permanent footprints such as real estate, business, and social commitments
- While a taxpayer can technically be “domiciled” in California and still be a nonresident of California, establishing domicile in another state is a key factor in successfully resolving an audit or prevailing in litigation
- The taxpayer generally has to “clearly show” domicile has changed based on the individual’s acts and declarations (*Appeal of Johnson*, 2019-OTA-127; *Appeal of Mazers*, 2020-OTA-263P)

Domicile: Key Practical Challenges

Preparing to prove a California domicile break should be a painful process, if done right

- Reducing social, professional, and community connections in California can be a difficult emotional and practical challenge
 - Clients and their adult children have a hard time selling (or renting out) the family home even if they have no intention of ever living there again
 - Moving heirlooms and important possessions can be hard during transitional periods
- Franchise Tax Board continues to focus on various factual elements that may seem odd for high-net-worth individuals or those with footprints in many states or countries
- Individuals who do not carefully document various elements showing their “true home” during the move may be forced to later rely upon statements instead of hard evidence
- We never know what evidence may resonate with a particular auditor to show an individual’s “present intention” to establish domicile in a new state
- Individuals can make casual statements to business partners or friends that later can be construed as a “definite intention” to return to California someday

Becoming a Nonresident Leaving California

Becoming a Nonresident

A taxpayer who wishes to become a nonresident must truly move and change residence and domicile. Factors include (but not limited or weighted evenly):

- Sale of the California principal residence
- Retiring from California employment
- Establishing personal and social ties, and spending time in the new state
- Discontinuing business and social ties in California
- E-mails, telephone calls, credit card transactions, mail, automobile registration, voting registration, advisors, physicians, spouse, children, etc.
- Where are the closest ties?

Becoming a Nonresident

In the *Appeal of Stephen D. Bragg* ((May 28, 2003) 2003-SBE-002), the Board included a number of factors, which, while not exhaustive or weighted evenly, inform taxpayers of the type and nature of connections the Board and the FTB find informative when determining residency:

- Amount of time you spend in California versus amount of time you spend outside California
- Location of your spouse/RDP and children
- Location of your principal residence
- State that issued your driver's license
- State where your vehicles are registered
- State where you maintain your professional licenses
- State where you are registered to vote
- Location of banks where you maintain accounts
- The origination point of your financial transactions
- Location of your medical professionals and other healthcare providers (doctors, dentists etc.), accountants, and attorneys
- Location of your social ties, such as your place of worship, professional associations, or social and country clubs of which you are a member
- Location of your real property and investments
- Permanence of your work assignments in California

Selling Assets and Leaving California

If you have business operations in California and you wish to become a nonresident, you must help carefully plan the exit in order to establish the timing of the business disposition.

Structuring a sale too soon can make the gain taxable to California. Waiting until the client is a nonresident might save tax.

- Any taxpayer who wants to move to a nontax state prior to selling a business or other asset not sourced to California must make the move and become a nonresident before the sale
- These transactions are scrutinized by the FTB

Selling Assets and Leaving California

The gain or loss from the sale of stocks or bonds has a source where you are a resident at the time of the sale.

Example 5

- You are a resident of Oregon and sell stock of a California corporation at a gain

Determination

- Because you are an Oregon resident, the gain has an Oregon source. The gain is not taxable by California

Selling Assets and Leaving California

Structuring the sale before or after change of residency.

- To qualify, the sale must take place after the taxpayer establishes residency in another state
- When a sale takes place might be scrutinized by the FTB, who may assert that the actual sale took place before the escrow closing date if all of the incidences of a sale are in place. (See *Comm. v. Court Holding Co.* (1945) 324 U.S. 331)
- A taxpayer might wish to move to the other state before the sale is conceived
- Sale of c corporate stock, s corporate stock and LLC/partnership interests are taxed differently

Recent Cases

Recent Cases: *Mazer*

- *Appeal of L. Mazer and M. Mazer*, 2020-OTA-263P, is the only “precedential” residency opinion released by the Office of Tax Appeals (OTA) since it started in 2018. It involved the following situation:
 - Husband moved from California to Malaysia in February 2013 under a two-year, renewable employment contract where the company provided his housing, car, and utilities
 - Wife remained in California
 - Husband returned to California in March 2014, after his employment abroad ended (for reasons unknown)
 - Couple incorrectly filed jointly as California residents (using their California address) and simply subtracted Husband’s one-half community share of income (~\$60K) earned while in Malaysia
- OTA determined that Husband remained a California domicile and his presence in Malaysia was for a temporary or transitory purpose because his “connections with Malaysia were only those provided by his employer as a matter of job convenience and not significant, and he made no attempt to sever his substantial connections with California”
- OTA emphasized that such connections to California “constitute an important measure of the benefits and protections the taxpayer has received from the laws and government of California”

Recent Cases: *Bracamonte*

- *Appeal of J. Bracamonte and J. Bracamonte*, OTA No. 18010932, is a more detailed case argued in December 2020 (over Zoom) with an opinion expected as early as next week. It involves the following situation:
 - Couple moved from California to Nevada shortly before the sale of their aviation services business based in San Diego, and the dispute focused on timing of residency break:
 - **January 1, 2008:** Date taxpayers claimed they broke California residency on their original tax return
 - **February 27, 2008:** Taxpayers' revised residency break date in OTA hearing (date of NV driver's license, voter registration, and soon before taxpayers rented a Nevada apartment)
 - **May 2008:** Initial discussions about sale of company began
 - **July 18, 2008:** Sold business through family trust via installment stock purchase agreement
 - **September 29, 2008:** Date FTB agreed taxpayers broke residency (also the month taxpayers bought a Nevada house)
 - Public OTA hearing transcript provides key insights into how the FTB approaches residency matters in recent years including both the most fundamental residency elements and the “minutiae of where people are and what they do when they move places”

Recent Cases: *Bracamonte (cont'd)*

Matter involves the most fundamental issues in residency disputes:

- Days spent in California and Nevada
 - Taxpayers allegedly spent less than 30 days in NV in 2008 before the July 2008 sale
 - Taxpayers testified they “had a lot of things to wrap up on a personal level and a business level” but their counsel admitted “the number of days is FTB's best case here . . . I’m worried about that.”
- Comparison of residential real estate interests in California and Nevada
 - FTB argued that in California, it was a “beautiful home, multiple lots for mobile homes . . . compare that to a one-bedroom utilitarian-decorated apartment in Nevada” on a 6-month lease
 - Taxpayers emphasized the true “issue here is whether the State of Nevada was a permanent home,” not whether the original Nevada apartment was a permanent home
- Business and capital event factors
 - FTB was concerned with where the sale transaction agreements were signed, and whether “business relationships required taxpayer's physical presence in California through July 2008”
 - FTB also argued that taxpayers knew a sale of the company was likely imminent in late 2007 (because of a relevant lease expiration) and the pre-sale actions were made in anticipation of a future move after the sale
 - Taxpayers countered “[t]his isn't a situation where they say, oh, we’re doing a transaction. Let's get out of Dodge.”

Recent Cases: *Bracamonte (cont'd)*

- Disputed importance of ministerial factors
 - FTB argued that “[c]onnections like voter registration, mail forwarding, location of banks where investments are held, vehicle registrations, and driver's licenses are less significant because of taxpayer's ability to manipulate these factors”
 - Taxpayers argued this is a double-edged sword: “Under FTB’s theory, if we hadn't done it, they would say, look, they didn't get all those things. If we did it, they would say . . . It's a total fake.”
- Representations in unrelated litigation
 - FTB argued that taxpayer represented in federal litigation involving the sale of the company, that during 2008 tax year, taxpayer was a San Diego resident (because California law was more favorable for the taxpayer in the case)
- Other classic residency points arose
 - Taxpayers initially moved their own belongings and thus did not have clear moving records
 - Taxpayer’s parent needed on-the-ground help with senior care in CA
 - Mail forwarding didn’t track where the taxpayers were located
 - Timing of driver’s license and voting registration (here, both came a few days before apartment lease was effective)
 - Cell phone and credit card records were scrutinized
 - Medical, ear and eye treatments and purchases in California was held against taxpayers by FTB
 - FTB asked about location of heirlooms and cherished furnishings
 - FTB asked about location of “toys” like motorcycles, boats, and RVs

The Audit Process / Pre-Audit Planning

Pre-Audit Planning: Proactive Residency Advice

1. Define goals
 - Residency is not an area to “toe the line” without a stomach for litigation when high dollar amounts are at stake
2. Emphasize the comprehensive nature of the task and guide the client through framework
 - Residency audits can become very personal in California, and even in states with 183-day residency tests
3. Identify risk factors in particular client’s business and personal lives
 - Given the comprehensive nature of residency analysis, each client will typically have areas in which their facts are better or worse than average

Pre-Audit Planning: Define Goals

- Goal is a straightforward resolution at the audit stage (not testing the bounds in litigation)
- Key evidence is easier to gather when it's fresh, and failure to produce evidence in taxpayer's control gives rise to presumption that it's unfavorable to the taxpayer
- Statute of limitations can remain open for a number of years (Four years from return filing in California; indefinitely if no part-year or nonresident return is filed)
- We want to ensure clients understand that peace of mind is important and can come from careful preparation
- Otherwise, it can feel like potential tax, interest, and penalties are hanging over their heads for a number of years and dictating life choices
- California (and other state) tax authorities can (and do) track out-of-state income in later years through nonresident return filings

Pre-Audit Planning: Comprehensive Fact Gathering

- Key areas (all emphasized in the recent *Mazer* opinion)
 - Days spent in physical location in particular state, and nature of stay
 - Real and personal property
 - Administrative actions including registrations and filings with a state
 - Community and family connections
 - Business and financial ties
- Other considerations (e.g., do not localize intangible stock interests by pledging the stocks as security for debt incurred in connection with a California business)
- Timing of large capital events and structure of equity

Pre-Audit Planning: Identifying Risk Factors

- Top and most common risk factor is continuing to spend significant time in previous home state
- Establishing a new domicile can be critical, rather than shopping around for a new place to land during COVID or waiting for real estate prices to drop in the preferred locale
- Clients with private equity funds and asset management income must carefully manage their business structuring to avoid large unexpected California tax hits
- Likelihood that clients will want to return to California or re-purchase California real estate (e.g., if kids go to college in California two years later or parents need senior care)

Audit and Litigation Process Considerations

Audits

- Audits implicating residency are not always triggered by the residency question itself
- Auditors have all levels of experience with the relevant legal standards, as well as with understanding the lifestyles or businesses of high-net-worth individuals
- Hindsight can be an effective tool for the FTB if a taxpayer (unexpectedly) returns to California before an audit of an earlier year is concluded

Appeals

- The internal FTB appeals process can be a challenging stage in which to resolve disputes
- The next step – Office of Tax Appeals – in front of three administrative judges has thus far appeared to follow Board of Equalization authorities
- While the OTA generally issues a written opinion within 100 days of hearing, appealing these matters can drag out for years
- Publicly released OTA opinions and hearing transcripts may involve personal and otherwise private details about taxpayers
- There is no guarantee that requests to close hearings or seal records will be granted

Litigation

- Litigating tax issues in state court is referred to by some as the “wild west”

Taxation of Remote Workers

Taxation of Remote Workers

During COVID-19 and the shelter-in-place ordinances, many employees have moved to other homes in other locations, many in different states. The work-from-home periods have now stretched beyond the regulations in many states.

- The pandemic has 43% of workforce working remotely full time (Source: Topia)
- Employers and employees are faced with nebulous cross-border tax complications.
- This problem impacts both the employee and the employer's income taxes, including the employer obligations to withhold in particular jurisdictions
- Employees working from locations beyond the employer's home state might become subject to the state and local income taxes in the second state

Taxation of Remote Workers

Companies are also concerned that the mere presence of employees working in new states might create a “tax nexus” that would subject a company to taxes in those states.

- Employees working in new states might disrupt the protections provided under Public Law 86-272, a federal law that bars states from imposing income taxes on an outside business if its activities are limited to “mere solicitation of orders” for the sale of tangible personal property

Taxation of Remote Workers

The AICPA has issued recommendations to resolve these matters, including permitting businesses to adhere to work locations for state and local tax purposes during the pandemic and to allow businesses the option to use these employees' work locations for payroll withholding, nexus and apportionment purposes while such telework requirements are in place

Taxation of Remote Workers

Over the past months, a number of state tax agencies have issued guidance establishing that nexus will not arise for income and/or sales tax purposes during the COVID-19 pandemic. Many tax agencies have not yet addressed the issue, however, and in some cases, the guidance is tied to emergency orders which may or have not been lifted.

- Several states have provided a specific end date to their temporary tax withholding guidance and/or nexus and apportionment waivers, with many states beginning to extend the end dates out through the middle of 2021
- Other states have specified that the guidance would remain in effect for the duration of their state of emergency declarations, some allowing for a grace period after the emergency declaration is lifted

Taxation of Remote Workers

- However, many states have not provided any guidance addressing the tax treatment of remote workers, creating a lack of consistency and further confusion for employers that will continue to be faced with important tax decisions as remote work is expected to continue well into 2021
- With respect to income tax withholding, many states released guidance indicating that employer state withholding obligations would not change during the time that employees are working remotely due to the pandemic, meaning that wages paid to nonresident employees normally working in one state before the pandemic are considered to be income earned in that state and subject to withholding

Taxation of Remote Workers

The Franchise Tax Board posted a statement on September 11, 2020, that out-of-state companies will not face state income tax if they have employees teleworking from California during the pandemic, who are complying with Gov. Gavin Newsom's March 19 executive order for Californians to stay home. The FTB and the governor's stay-home order refer specifically to California residents, giving some concern that a company with non-California residents who are sheltering in California may not be able to rely upon this guidance.

- Other states, including New York, Delaware, Pennsylvania, and Nebraska, had regulations in effect that effectively subjected the income of remote workers to taxation in the states before COVID-19
- However most states are not requiring withholding payroll taxes from checks issued to employees who normally work outside its state but who are working in the state during the pandemic, even though the employee is performing the services in that state

Taxation of Remote Workers

The law might not be so gracious for an employee's income tax.

- For income tax purposes, if a nonresident has come to California and performs the work in California, it is California-source income and taxable to California. The “nonresident” employee is subject to California tax on all California-source income. However, the out-of-state employer will likely not be required to withhold California income tax if the employer is not doing business in California. This means that not only will the telecommuting employee have to pay tax on the California-source income, the employee's California tax liability come April 15 will be much larger because no taxes were withheld

Taxation of Remote Workers

Example of nonresident employee working in California

- Samuel is a tech worker employed in New York, but temporarily living and working out of his parents' California home so he is able to care for them during the pandemic. The New York employer that he works for has continued to withhold New York income taxes, rather than California taxes, from his paycheck. Samuel has California-source income and should file a California return to report his California-source income. As he will be taxable to New York on the income because he is a resident of New York, he will claim a credit for tax paid to California on his New York resident return.
 - So someone who lives in one state and works in another may have to file two state tax returns: one in their homestate and a “nonresident” return in the state where they work.

Taxation of Remote Workers

Conversely, if a California worker is telecommuting from another state and has not abandoned their California residency, California will continue to tax that income because California residents are taxed on their worldwide income.

- However, the taxpayer will likely be able to claim an Other State Tax Credit on the California return (or the nonresident return if the taxpayer is telecommuting from Arizona, Oregon, or Virginia). Other states have similar rules
- Whether a person establishes residency in California while telecommuting from California may become a big issue, especially as the period of the pandemic continues to lengthen. Google, for example, has announced that they will extend the work-at-home period until at least September 2021

Taxation of Remote Workers

The U.S. Supreme Court is currently reviewing a challenge to Massachusetts's telework tax rule initiated by the state of New Hampshire.

- New Jersey – joined by Connecticut, Hawaii, and Iowa – have filed an amicus brief in support of New Hampshire's position that the rule is an "unconstitutional double- and over-taxation of interstate remote workers."
- In January, the Supreme Court held a conference call on the case, *State of New Hampshire v. Commonwealth of Massachusetts*, and asked the solicitor general to weigh in on the matter.
- A date for argument before the Supreme Court has not yet been set.

Compensatory Stock Options

Taxation of Equity-Based Compensation

Equity-based compensation, or noncash compensation, represents a form of ownership interest in a company.

- The most common form is stock options and RSUs; however, employers also issue restricted stock and employee stock purchase plans (ESPP)

Taxation of Equity-Based Compensation

Nonstatutory Stock Options

- Generally, you recognize taxable wage income upon the exercise of a nonstatutory stock option. The difference between the fair market value of the stock on the exercise date and the option price is the taxable wage income

California Resident on Exercise Date

- If you exercise your nonstatutory stock options while a California resident, California will tax the difference between the fair market value of the shares on the exercise date and the option price because you are a California resident when the income is recognized

Taxation of Equity-Based Compensation

Nonresident of California on Exercise Date

- If you exercise your nonstatutory stock options while a nonresident, the character of the stock option income recognized is compensation for services rendered. California will tax the wage income you receive to the extent you performed services in this state, whether you were always a nonresident or were formerly a California resident

Services performed within and outside of California

- If you performed services for the corporation both within and outside California, you must allocate to California that portion of total compensation reasonably attributed to services performed in this state

Taxation of Equity-Based Compensation

One reasonable method is an allocation based on the time worked. The period of time you performed services includes the total amount of time from the grant date to the exercise date (or the date your employment ended, if earlier).

- The allocation ratio is:
 - California workdays from grant date to exercise date \div total workdays from grant date to exercise date
 - Income taxable by California = total stock option income \times allocation ratio
- The income is effectively sourced to where the employee performed services between the grant date and the exercise date

Taxation of Equity-Based Compensation

Type	If You're a California Resident	If You're a California Nonresident
Incentive stock option (ISO)	on date of ISO exercise: <ul style="list-style-type: none"> If the stock is not sold in the year of exercise, make an AMT adjustment Increase AMT basis by the AMT adjustment 	on date of ISO exercise: <ul style="list-style-type: none"> If the stock is not sold in the year of exercise, make an AMT adjustment Include AMT adjustment to the extent services were performed in California from the grant date to the exercise date Increase AMT basis by the AMT adjustment
	on date stock is sold in a qualifying disposition at a gain: <ul style="list-style-type: none"> California will tax the capital gain Possible AMT credit 	on date stock is sold in a qualifying disposition at a gain: <ul style="list-style-type: none"> California will not tax the capital gain Possible AMT credit
	on date stock is sold in a disqualifying disposition: <ul style="list-style-type: none"> California will tax the wage income and the capital gain (if any) Possible other state tax credit Possible AMT credit 	on date stock is sold in a disqualifying disposition: <ul style="list-style-type: none"> California will tax the wage income to the extent services were performed in California from the grant date to the exercise date California will not tax the capital gain (if any) Possible other state tax credit Possible AMT Credit

Taxation of Equity-Based Compensation

Type	If You're a California Resident	If You're a California Nonresident
Nonstatutory stock option (NSO)	on date of NSO exercise: <ul style="list-style-type: none"> California will tax the wage income Possible other state tax credit 	on date of NSO exercise: <ul style="list-style-type: none"> California will tax the wage income to the extent services were performed in California from the grant date to the exercise date Possible other state tax credit
	on date of stock sale: <ul style="list-style-type: none"> California will tax the capital gain 	on date of stock sale: <ul style="list-style-type: none"> California will not tax the capital gain
Restricted stock unit (RSU)	on vesting date: <ul style="list-style-type: none"> California will tax the wage income Possible other state tax credit 	on vesting date: <ul style="list-style-type: none"> California will tax the wage income to the extent services were performed in California from the grant date to the vesting date Possible other state tax credit

Taxation of Equity-Based Compensation

N. Prince (OTA Case No. 19024304, 2021-OTA-088, 1/5/2021, Nonprecedential)

Appellant's compensation from Facebook, Inc. included six grants of RSUs that all required appellant to continue working for Facebook in order to receive the stock. These RSUs were granted on six dates ranging from 2007 to 2010 and they all vested in the 2012 tax year while appellant was a California nonresident, as shown below:

Shares	Grant Date	Vesting Date
70,000	12/18/2007	10/25/2012
21,420	8/26/2009	10/25/2012
550	8/26/2009	11/01/2012
545	8/26/2009	12/01/2012
3,130	8/26/2010	10/25/2012
390	8/26/2010	11/15/2012

Taxation of Equity-Based Compensation

N. Prince (OTA Case No. 19024304, 2021-OTA-088, 1/5/2021, Nonprecedential)

California allocated that portion of the compensation income from Prince's Facebook employee's company stock (RSUs) which was reasonable attributable to personal services performed in the state, by multiplying appellant's total income from each of the RSUs by the ratio of appellant's California workdays from the grant date to the vesting date over the total number of workdays during that period.

Prince argued that this method was unreasonable in this instance because the restricted stock "sky-rocketed" in value after the employee left California. He proposed using an annual stock appreciation method to allocated the gain, capping the value of the stock on his last day of in-stock work.

Taxation of Equity-Based Compensation

N. Prince (OTA Case No. 19024304, 2021-OTA-088, 1/5/2021, Nonprecedential)

The appeals panel argued that the increased value of the stock after Prince left the state did not make them less attributable to work he performed in state and that Prince failed to show the stock growth was specifically tied to services he performed for Facebook out-of-state.

California's method was more appropriate, the panel said, because its formula evenly attributes value growth that is recognized on the vesting date across the entire duration of the employees service to Facebook rather than disproportionately attributing income for services provided in state or out of state.

Taxation of Equity-Based Compensation

N. Prince (OTA Case No. 19024304, 2021-OTA-088, 1/5/2021, Nonprecedential)

Following an audit of appellant's 2012 taxable year, respondent determined that appellant's total taxable California source income was \$1,012,081 in 2012 by multiplying appellant's total income from each of the RSUs by the ratio of appellant's California workdays from the grant date to the vesting date over the total number of workdays during that period (as shown in the chart below):

Grant Date	Vesting Date	CA Workdays	Total Workdays	CA %	Total Taxable Income	Total Taxable CA Source Income
12/18/2007	10/25/2012	648	1,219	53.16%	\$1,624,700	\$863,691
8/26/2009	10/25/2012	223	794	28.09%	\$497,158	\$139,652
8/26/2009	11/01/2012	223	799	27.91%	\$11,613	\$3,241
8/26/2009	12/01/2012	223	820	27.20%	\$15,260	\$4,151
8/26/2010	10/25/2012	9	543	1.66%	\$72,647	\$1,206
8/26/2010	11/15/2012	9	558	1.61%	\$8,717	\$140

Business Nexus Issues / Private Equity Funds

General Business Nexus and Fund Considerations

- Certain smaller private equity, hedge, or family investment funds may have historically had solely California investors and managers
- Thus, it can be important to consider potential California-source income risks after a client breaks California residency including income earned as a member of a California-based management company and/or as a partner in a fund
- Can put pressure if the funds are not clearly “qualified investment partnerships”
- May also require careful sourcing allocations and adherence to potentially evolving FTB rules around sourcing

Thank You



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