BALLENTINE PARTNERS

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All That Glitters is not in The Golden State

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Executive Summary

Two tax bills in the California State Assembly propose to increase income taxes and add wealth tax on affluent California residents. If passed, this legislation would have major implications for our California-based clients.

Two bills, referred to as AB-1253 and AB-2088, have recently been introduced in the California State Assembly and, if passed, would dramatically increase taxes on wealthy California residents.

Despite California already having the highest income tax rate in the nation, AB-1253, "the millionaire tax," would increase income tax rates on taxpayers earning more than $1M. Where the highest marginal rate is currently 13.3%, this would increase the rate by 1% for income over $1M, by 3% for income over $2M, and by 3.5% for income over $5M. The more dramatic of the two bills, AB-2088 "the wealth tax," would implement an annual tax of 0.4% on a resident's *worldwide* wealth exceeding $30M. This threshold is reduced to $15M only for married taxpayers filing separately.

"Wait, they're going to tax my wealth?! I'm packing up and leaving the state!" Not so fast. The wealth tax actually seeks to tax California residents who leave the state for <u>the next 10 years</u>. The 0.4% tax will be levied against wealth at a ratio of the number of years over these coming 10 years that a taxpayer was a resident of California. For example, if a married taxpayer with worldwide net worth of $100M leaves the state in January 2021, 3 years later they will pay a wealth tax of approximately $196,000 ($70M [$100M less the $30M exclusion threshold] * 0.4%[the tax rate] * 7/10[7 comes from 10 total possible taxable years less the 3 years they have now been removed from the state]) to California, despite having no current ties to the state.

I reached out to multiple tax litigators, CPAs, and estate attorneys in California for their insight on this matter. Here is what I learned:

Looking back at recent history, there have been several proposals to increase taxes on wealthy California residents that did not gain traction. Last year, there was a proposal to implement an estate tax on the value of assets between the federal exemption amount and $3.5M, which was defeated. Similarly, there was a carried interest tax bill that was also defeated. Seemingly, each year there is at least one new tax proposal that has the potential to dramatically impact our clients.

Both AB-1253 and AB-2088 require approval by 2/3 of the membership of each house of the legislature.

Currently, Democrats have a super majority in both the Assembly and State Senate, though it is unclear at this time whether the bills will gain the traction needed to be passed into law. If passed, there remains a long road ahead for AB-2088, as there are a lot of unanswered questions on how a new wealth tax would be implemented. The state's current statutory framework is wholly unprepared to address how certain trusts will be included or excluded from calculating a taxpayer's net worth. Complexities around how real estate is held or how stock options are valued represent just a few of the myriad issues that further regulations would need to clarify. Additionally, the constitutionality of a 10-year exit tax is already being called into question for violating the freedom of movement.

Regardless of the outcome of these bills, it is symptomatic of the climate nationwide towards increasing tax rates. As the financial condition of certain states continues to deteriorate, pressure will mount to increase, or in some cases implement new, taxes in an attempt to maintain solvency. In fact, in Arizona, voters just approved a measure increasing the top income tax rate from 4.5% to 8%. And, in CA, the same politicians behind AB-1253 and AB-2088 are already floating the idea of a capital gains tax on unrealized capital gains!

Impact on our clients

The continued push to increase taxes in California has already helped to inspire a number of our clients to leave the state permanently before year-end. If these bills were to pass, I think we can expect wealthy Californians to flee the state in large proportions. As we have observed, states often neglect to take into consideration that the people they are seeking to tax are the very people who are the most mobile. We will continue to monitor the situation as it unfolds in CA and reach out to our clients as befits their individual circumstances.

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David is a Wealth Planner at the firm. Prior to joining Ballentine Partners, David was a Financial Advisor with Cambridge Investment Research where he provided individuals and business owners with comprehensive financial planning services and advised on Defined Contribution plans. Prior to this, he worked as an Associate Financial Analyst for Citizens Bank. David graduated summa cum laude from Bryant University with a Bachelor of Science in Business Administration concentrating in Financial Services and minoring in Economics. He received the Jack H. Rubens Leadership in Financial Services Commencement Award, given to one member of each graduating class. During his time at Bryant, David was actively involved in the Archway Investment Fund. in 2019 David earned the CERTIFIED FINANCIAL PLANNER™ designation. David lives in the Boston MetroWest region, is a car enthusiast, and in his free time enjoys traveling and spending time with his fiancée, family, and friends.