BY BRADFORD S. COHEN, WALTER R. CALVERT, AND MICHAEL A. BLOOM

Tax Residency Issues for Filmmakers, Actors, and Musicians in California

MOVIES ARE FILMED IN FOREIGN LOCATIONS; musicians go on tour; actors, writers, producers, and directors come to Los Angeles. As a result of all this moving around, people working in entertainment may find themselves treated as California residents for income tax purposes even if they do not intend to live here permanently. Certain tax planning techniques may be available, however, to mitigate the impact of being treated as a California resident, particularly in connection with the sale of substantially appreciated intangible property, for example musical copyrights.

Nevertheless, the consequences of being caught in a state's tax net are significant. A person who is treated as a resident of a state is typically subject to income tax on all income, even if it was earned elsewhere. Further, each state has its own residency test, each of which may be satisfied in multiple ways. An individual may be treated as a resident of two states at the same time.

To illustrate, a New York actor coming to work on a television series in Los Angeles may be treated as a New York income tax resident under New York's income tax laws because he or she intends to return to New York upon completion of the project and as a California income tax resident under California's income tax laws if the work on the television project is for an indefinite duration. In this scenario, both states may seek to tax the actor's worldwide income earned during the period of dual residency. The scenario is not completely dire because relief from double taxation is typically granted in the form of an "other state tax credit" or OSTC. However, this relief may not be complete.[1]

In California, persons who are classified as residents are subject to California income tax on all their income, regardless of where it was earned.[2] Consequently, if a New York actor is treated as a California income tax resident as a result of being present in California while working on a television show in Los Angeles, he or she would become taxed in California on any income received while a California resident. This may include fixed fees, profit participations, and deferred compensation earned from earlier New York projects, as well as passive income such as dividends, interest, rents, and royalties. In contrast, nonresidents of California are only subject to California income tax on income that is derived from California sources.[3] If the New York actor can avoid being treated as a California resident, he or she can limit liability for California income tax to the taxes owed on income from the L.A. television show.

The tax statute for determining who is a California resident or nonresident is Section 17014 of the California Revenue and Taxation Code, which defines a resident as including both 1) "[e]very individual who is in this state for other than a temporary or transitory purpose"[4] and 2) "[e]very individual domiciled in this state who is outside the state for a temporary or transitory purpose."[5] A nonresident is any person who does not meet either of these tests.[6] Not all states apply the same residency test. In fact, California's test is a bit of an outlier. Many states apply a bright-line, 183-day presence test in lieu of an "other than a temporary or transitory purpose" test. There is no bright-line test for determining when a person is considered to be present

RICHARD EWING

in California for other than a temporary or transitory purpose. The evaluation is made on a case-by-case basis.

California's Franchise Tax Board Publication 1013 explains that all relevant facts and circumstances are considered in residency determinations. The goal of the facts-and-circumstances test is to determine "the place where [the taxpayer] has the closest connections."[7] In this respect, the "other than a temporary or transitory purpose" test is similar to the "center of vital interest" test that applies under the tie-breaker residency provisions in U.S. income tax treaties with foreign countries. Publication 1013 lists 13 nonexclusive factors commonly considered when making this determination. They are 1) the amount of time one spends in California versus the amount outside California, 2) the location of one's spouse or registered domestic partner and children, 3) the location of one's principal residence, 4) the state that issued one's driver's license, 5) the state where one's vehicles are registered, 6) the state in which one maintains one's professional licenses, 7) the state in which one is registered to vote, 8) the location of the banks where one maintains accounts, 9) the origination point of one's financial transactions, 10) the location of one's medical professionals and other healthcare providers, accountants, and attorneys, 11) the location of one's social ties, such as one's place of worship, professional associations, or social and country clubs of which one is a member, 12) the location of one's real property and investments, and 13) the permanence of one's work assignments in California.[8]

This facts-and-circumstances test offers little guidance to taxpayers seeking certainty. However, certain rules and presumptions apply

Bradford S. Cohen is a partner at Venable LLP in Los Angeles whose practice focuses on business and tax matters for clients in the entertainment and sports industries. Walter R. Calvert is a Venable partner in Baltimore who focuses his practice on state and local tax planning and controversy matters. Michael A. Bloom is an associate in the firm's New York office who provides tax planning services to many prominent entertainers and professional athletes.

under California law to assist in its application. First, there is a rebuttable presumption that every individual who spends in the aggregate more than nine months of the taxable year in California is a California resident. [9] This presumption may be overcome by satisfactory evidence that the individual is in the state for a temporary or transitory purpose. Note that the converse is not true—spending less than nine months of the taxable year in California does not necessarily avoid California residency. Affidavits or testimony of an individual and of employers or business associates that the individual was in the state to complete a specific business transaction will usually be sufficient to overcome a presumption of residency.[10]

Second, Section 17014 of the California Code of Regulations provides that presence in California for other than a temporary or transitory purpose includes "employment in California that may last permanently or indefinitely."[11] This rule may cause differing tax treatment of film actors versus television actors. Film actors can probably satisfy this test because principal photography lasts for a finite duration. However, television actors may not be able to satisfy this test because television series run for an indefinite duration and, while being made, often represent the actor's primary source of employment.

Third, in apparent acknowledgment of the difficulty in applying this "temporary or transitory purpose" test, the California Legislature created a safe harbor under Revenue and Taxation Code Section 17014(d), which provides:

> For any taxable year beginning on or after January 1, 1994, any individual domiciled in this state who is absent from the state for an uninterrupted period of at least 546 consecutive days under an employment-related contract shall be considered outside this state for other than a temporary or transitory purpose.[12]

For purposes of this safe harbor, returns to California totaling, in the aggregate, not more than 45 days during the taxable year are disregarded. However, the safe harbor does not apply if 1) the taxpayer has income from stocks, bonds, notes, or intangible personal property in excess of $200,000 in any taxable year in which the employment-related contract is in effect, or 2) the principal purpose of the individual's absence from the state is to avoid California income tax.[13] This safe harbor is attractive to entertainers because it allows them to escape the California tax net while retaining domicile in California.

While some may qualify as residents for being in California for other than a temporary or transitory purpose, others may be treated as income tax residents by being domiciled here. The term "domicile" has a special legal definition that is not the same as "residence." While many states consider the terms to be the same, California views them as two separate concepts, even though they may overlap. As discussed in Publication 1013, "[d]omicile is defined for tax purposes as the place where you voluntarily establish yourself and your family, not merely for a special or limited purpose, but with a present intention of making it your true, fixed, permanent home and principal establishment."[14] Stated differently, "it is the place where, whenever you are absent, you intend to return."[15]

Although a taxpayer can be an income tax resident of several states simultaneously, a taxpayer can generally only have one place of domicile. Consequently, once a person has established California as his or her place of domicile, the only way that such person can no longer be treated as a California resident is to be outside of California for "other than a temporary or transitory purpose." Entertainers that come to work in California on a film or television project often intend to leave California upon completion of the project. They usually do not intend to make California their "true, fixed, permanent home and principal establishment" and, therefore, should not satisfy the domicile test for California residency. Once a person establishes California as a place of domicile, it is difficult to change it. To do so, a person must not only leave California but also affirmatively establish a new domicile in a different jurisdiction.

California residency opinions issued by the California State Board of Equalization are not easily reconcilable. The only common thread is that taxpayers seem to lose. One rationale often given in these opinions is that a taxpayer is a resident if he or she receives the benefits and protections of California's laws and government over an extended period of time. Therefore, the more time a taxpayer spends in California, the greater the likelihood that he or she will receive these benefits and protections, and be deemed a California resident.

If a person is not a California resident, only income from California sources is subject to California income tax. California's sourcing rules are set forth under Revenue and Taxation Code Sections 17951 and 17952. Income from California sources includes, without limitation, 1) income from real or tangible property located within California, 2) compensation for services performed within California, and 3) intangible income that has a business situs in California.[16]

These sourcing rules are also important for California income tax residents. This is because California allows its residents a credit against their California income liability for taxes paid to another state on income that is sourced to that state. [17] No credit is allowed for income taxes paid to cities or to foreign countries. The credit is allowed only if the other state does not allow a credit for California taxes paid on the same income. This rule prevents credits from being applied in both states. California, like most other states, limits the amount of the OSTC to the amount of California tax owed on the double-taxed income.

This tax crediting mechanism is unlikely to provide complete relief for any California income tax paid for two reasons. The first reason is that California currently has the highest state income tax rate in the United States (13.3 percent). Therefore, the OSTC allowed in California will almost never equal or exceed the California taxes owed on the same income. Similarly, with respect to California nonresidents, the OSTC allowed in their state of residency will be unlikely to equal or exceed the California income taxes owed on any California source income because California's income tax rate is almost certain to be higher.

The second reason that this crediting regime may not provide complete relief is that certain types of income do not have a state of source (e.g., passive investment income such as interest and dividends) and therefore may end up being double taxed in the event the taxpayer is treated as a resident of two states simultaneously. Therefore, one cannot assume that reliance on OSTCs is an adequate substitute for sound tax planning.

Changing Domicile

California domiciliaries looking to reduce their state tax burden may consider a domicile shift—that is, leaving California and establishing a domicile in a state with a lower income tax rate, such as Texas or Florida. This is easier said than done. It requires: 1) abandoning the California domicile, 2) physically moving to and residing in a new locality, and 3) demonstrating by actions an intent to remain in the new locality permanently or indefinitely.[18] Taxpayers generally must sell or lease their current California home, take their children out of California schools, move bank accounts, and change driver's licenses, vehicle registrations, and voting registrations.

Because of the difficulty in accomplishing a domicile shift, the safe harbor alternative under Revenue and Taxation Code Section 17014(d) can be attractive. As discussed above, this safe harbor alternative provides that any person domiciled in California who is absent from the state for an uninterrupted period of at least 546 consecutive days under an employment-related contract shall be treated as a California nonresident (subject to the $200,000 intangible income limitation). This safe harbor provision, therefore, allows a California domiciliary to drop out of the California tax net while retaining his or her California domicile so long as the foreign state activity occurs pursuant to an employment contract. Two examples of how this may be feasible are 1) an actor does back-to-back movies outside of California or 2) a musician goes on an extended non-California concert tour or is conducting extended non-California recording activities.

If the taxpayer qualifies for this rule, it may allow him or her to avoid paying California income tax on his non-California source income, which is paid or accrued while outside of California. This would include compensation for personal services rendered outside of California during the period of nonresidency. Less clear, however, is whether it would apply to profit participations and other forms of contingent compensation earned in connection with the performance of the non-California services because not all events may have occurred to generate the income during this period of nonresidency—e.g., the determination of the amount of the contingent compensation payable to the taxpayer from future sales.[19] Stated differently, such amounts would not have become fixed and determinable during the period of nonresidency.

Taxpayers with significant profit participations and residuals should still be able to take advantage of this safe harbor. Profit participations and residuals are properly characterized as service income and therefore should not count toward the $200,000 intangible income limitation noted above. However, the $200,00 intangible income limitation would include "portfolio" income, such as interest and dividends, and may include any royalties received from film or record profits if the individual owns all or part of the underlying rights.

A planning opportunity may exist when a California resident anticipates selling a highly valuable intangible asset, such as a music catalog. This type of planning is similar to the planning often done for individuals who anticipate selling substantially appreciated closely held business stock. The rationale of these strategies is the same: intangible assets (whether closely held stock or a music catalog) are generally sourced to the state of a taxpayer's domicile under the principle of *mobilia sequuntur personam* (chattels follow the person). Thus, by changing one's domicile, one can often change the state of sourcing of income realized from the sale of intangible property.

Changing one's domicile away from California to reduce the state income taxes owed on the sale of the intangible property is subject to two notable caveats. The first caveat is that the intangible asset cannot have a business situs in California; otherwise, gain from the sale of the intangible will continue to be sourced to California notwithstanding the domicile change.

Under Section 17952(c) of the California Code of Regulations, intangible personal property has a business situs in [California] if it is "employed as capital in this State or the possession and control of the property has been localized in connection with a business, trade or profession in this State so that its substantial use and value attach to and become an asset of the business, trade or profession in this State."[20] This regulation also provides that if intangible personal property of a nonresident has acquired a California business situs, "the entire income from the property including gains from the sale thereof, regardless of where the sale is consummated, is income from sources within this State, taxable to the nonresident."[21] Little guidance exists on the issue of what it takes for a copyright to acquire a "business situs" in California.

In *Holly Sugar Corporation v. McColgan*,[22] the California Board of Equalization held that "[b]usiness situs arises from the act of the owner of the intangibles in employing the wealth represented thereby, as an integral portion of the business activity of the particular place, so that it becomes identified with the economic structure of that place...."[23]

Applying the foregoing standard, the California Franchise Tax Board held in Ruling No. 145 that copyrights relating to course materials did not acquire a "business situs" in California as a result of their being licensed into the state by a California nonresident for use by an unrelated individual in California. According to the Franchise Tax Board, "there must be further 'localization' of the intangible asset" before the intangible acquired business situs in California.

Based on the forgoing guidance, it would seem that merely licensing a song catalog into California for use in television commercials and movie trailers would not give rise to "business situs" in California because it would not arise from the act of the owner thereof (the songwriter) using the musical copyright as part of an integral portion of its business activity in California.

The second caveat to this type of planning is that the property sold must represent an intangible (e.g., a musical copyright) as opposed to a form of deferred compensation. The label given to the property is not determinative, and the contract giving rise to such rights must be carefully analyzed in making this determination. The relevant analysis is illustrated by California and federal income tax authorities.

For example, in its Ruling Number 345, the California Franchise Tax Board ruled that amounts titled "royalties" received by an author from a New York publishing company for textbooks written in California were actually compensation for services because they were earned "under a continuing contract with the publisher."[24] In IRS Program Manager Technical Assistance Memorandum 2007-0007, IRS counsel advised that payments made in respect of a "writer's share" interest in a musical copyright were royalty income (not compensation income) because the music publishing contract under which the songs were made: 1) did not obligate the taxpayer to write any music and 2) granted the music publisher only a limited copyright in the music—i.e., the right to use the songs in U.S. markets. In Revenue Ruling 74-555, the IRS held that amounts received by a foreign author under a contract granting a U.S. company the U.S. serial rights in his exclusive output of both long and short stories were royalty income because the contract "did not prescribe in any manner what the taxpayer was to write or when it was to be written."[25]

As these authorities illustrate, making the determination between compensation and income derived from the ownership of an intangible requires a careful analysis of the contract giving rise to such income.

In general, if the income is paid under a contract to provide services, pursuant to which the service provider did not retain any interest in the copyright produced from the engagement, such income should be treated as deferred compensation. In contrast, if the income relates to a "publishing" contract without any specific output requirements, the income payable to the service provider thereunder will likely be treated as royalty income as opposed to deferred compensation. In the latter scenario, if the taxpayer anticipates selling this income stream, the taxpayer could consider undertaking a domicile shift to a lower tax jurisdiction to minimize the state income taxes owed on the gain from the sale of this "intangible." As discussed above, accomplishing a domicile shift requires 1) abandoning your California domicile, 2) physically moving to and residing in a new locality, and 3) intending to remain in the new locality permanently or indefinitely.

In conclusion, it is worthwhile for individuals working in the entertainment industry to pay attention to California's rules regarding residency and domicile. With awareness of these rules, one can structure one's affairs as best as possible to avoid being treated as a California resident altogether. However, even if this cannot be done, steps can be taken to mitigate the negative effects of being treated as a California resident (e.g., acceleration or deferral of income). Thus, for those who enter, all is not lost. ■

---

[1] States are not bound by and generally do not follow U.S. tax treaties insofar as residency determinations are concerned. Therefore, it is possible for an individual to be considered a nonresident for U.S. federal income tax purposes (either under U.S. law or under the relevant foreign income tax treaty) but a resident of California.

[2] REV. & TAX. CODE §17041(a)(1).

[3] REV. & TAX. CODE §17014(b).

[4] REV. & TAX. CODE §17014(a)(1).

[5] REV. & TAX. CODE §17014(a)(2).

[6] REV. & TAX. CODE §17015.

[7] California Franchise Tax Board, Guidelines for Determining Resident Status—2011, at 4, *available at* https://www.ftb.ca.gov.

[8] *Id.*

[9] REV. & TAX. CODE §17016.

[10] CAL. CODE REGS. §17014(d).

[11] CAL. CODE REGS. §17014(b).

[12] REV. & TAX. CODE §17014(d).

[13] CAL. CODE REGS. §17014(d)(1)-(4).

[14] California Franchise Tax Board, Guidelines for Determining Resident Status—2011, at 7.

[15] *Id.*

[16] CAL. CODE REGS. §17951-2.

[17] *See* REV. & TAX. CODE §175951(a).

[18] CAL. CODE REGS. §17014.

[19] *See* REV. & TAX. CODE §17554; *see also* Cal. Franchise Tax Board Legal Ruling No. 132 (June 23, 1958) *and* Cal. Franchise Tax Board Legal Ruling No. 340 (Oct. 5, 1970).

[20] CAL. CODE REGS. §17952(c).

[21] *Id.*

[22] Holly Sugar Corp. v. McColgan, 115 P. 2d 8 (Cal. 1941).

[23] *Id.* at 11.

[24] Cal. Franchise Tax Board Legal Ruling No. 345 (Sept. 15, 1970).

[25] Rev. Rul. 74-555, 1974-2 C.B. 202 (1974).