EXECUTIVES WITH EQUITY COMPENSATION

California Tax Implications of Equity Compensation Upon Relocation

Sourcing of Stock Option Income for a Departing California Resident — the grant-to-vest workday rule, by award type.

Scenario: Current California resident planning a move to a no-income-tax state (such as Nevada or Florida) in December; equity options vesting in November; exercise planned after establishing residency in the new state.

Executive Summary

California can claim a portion of the option income even if you exercise after establishing residency elsewhere. The critical factor is *not* when you exercise or where you live at exercise — it is where you performed the services associated with the option between the grant date and the vesting date. Establishing Nevada or Florida residency before exercising does not, by itself, shield the California-source portion of the compensation element.

The Governing Principle: Grant-to-Vest Service Period

California sources stock option compensation based on services performed during the period from the grant date to the vesting date, using a workday allocation ratio. The state looks at the number of California workdays during that grant-to-vest window divided by total workdays over the same period. If you were a California resident performing services in California throughout that period, the California-allocated portion approaches 100% — regardless of a later move or a later exercise.

> **Key point**
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> Residency at the time of exercise governs later capital appreciation, but it does not control the compensation element tied to the California service period. Moving before exercise does not undo California's claim on the service-based portion.

Distinction by Option Type

Nonqualified Stock Options (NQSOs)

The spread at exercise (fair market value at exercise minus the strike price) is ordinary compensation income. California sources this spread using the grant-to-vest workday allocation described above. If the entire vesting period was worked in California, essentially the full spread is California-source income, even when exercised years later as a nonresident.

Incentive Stock Options (ISOs)

For regular tax purposes, there is no ordinary income recognized at exercise, so the sourcing question shifts to the eventual sale of the shares. However, the bargain element at exercise is an alternative minimum tax (AMT) preference item. If exercised while a nonresident, California generally does not tax that AMT preference for a nonresident, because California taxes a nonresident only on California-source income. On a later *disqualifying disposition*, the compensation element is sourced back to the grant-to-vest service period in the same manner as NQSOs.

Comparison of Outcomes

Income Component	Sourcing Basis	Effect of Pre-Exercise Move
NQSO spread (compensation)	Grant-to-vest CA workday ratio	No shield; CA taxes the service-based portion
ISO — regular tax at exercise	No income until sale	N/A at exercise
ISO — AMT preference at exercise	CA-source income of nonresident	Generally not taxed by CA if nonresident at exercise
ISO disqualifying disposition (comp element)	Grant-to-vest CA workday ratio	No shield on the service-based portion
Post-vest capital appreciation on sale	Residency at time of sale	Move can shift this away from CA

Factors That Will Drive the Actual Allocation

- **Grant date and vesting schedule.** Options granted several years ago and vesting in November, worked in California throughout, will carry a very high California allocation regardless of a December move.
- **Option type (NQSO vs. ISO).** This changes both the timing of income recognition and the AMT interaction, including the interplay between California and new-state AMT exposure.
- **Post-vest, pre-exercise appreciation.** Any later gain on sale is generally sourced to residency at the time of sale, so that piece can benefit from the move even when the compensation spread does not.

Practical Considerations

California is notably aggressive in this area. Franchise Tax Board Publication 1004 sets out the workday allocation methodology for stock option income, and residency audits tied to equity compensation around a relocation are common. Contemporaneous documentation of the actual move date and a defensible workday history over the grant-to-vest period are important to support the position taken.

> **Correction to a common assumption**
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> Moving and establishing Nevada or Florida residency before exercising will not, by itself, shield the California-source portion of NQSO spread or a disqualifying-disposition compensation element. It can help with post-vest capital appreciation and, for ISOs, potentially the AMT preference — but the core compensation piece follows the service period.

Next Step: Modeling With Specifics

The precise California allocation can be computed with the following inputs: grant date(s) and vesting schedule, option type (NQSO or ISO), share counts, strike price, and current fair market value. With those, the grant-to-vest workday allocation can be applied and the December-move scenario modeled against alternatives such as exercise timing or an earlier move date.

Information to Gather

Award Terms

- What is the option type for each grant — incentive stock options (ISO) or nonqualified stock options (NQSO)?
- What is the grant date for each award?
- What is the vesting schedule, and what specifically vests in November?
- How many shares are covered by each grant, and what is the strike price?
- What is the current fair market value per share, and is the stock publicly traded or privately held?
- Is there an expiration date or a post-termination exercise window that constrains timing?

Service and Residency History

- Over the grant-to-vest period for each award, how many workdays were performed in California versus elsewhere?
- Were any services performed outside California during the vesting period (remote work, out-of-state assignments)?
- What is the intended move date, and to which state (Nevada or Florida)?
- What steps establish residency in the new state, and what is the timeline for each (home, driver's license, voter registration, days present)?
- What ties to California would remain after the move (property, family, professional licenses, business interests)?

Exercise and Sale Planning

- What is the intended exercise date relative to the move and to vesting?
- Is the plan to exercise and hold, or to exercise and sell (cashless / same-day sale)?
- For any ISOs, is a qualifying disposition (holding period met) or a disqualifying disposition anticipated?
- What other income is expected in the year of exercise, in California and in the new state?

AMT and Other Interactions

- For ISOs, what is the projected AMT exposure at exercise, and in which state of residency?
- Are there prior-year AMT credits available to be applied?
- Are there other equity awards (RSUs, additional option tranches) that vest or settle around the same period?

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