Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Nguyen	Analyst:	Diane Deatherage	Bill Number:	SB 1449
Related Bills:	See Legislative History	Telephone:	845-4783	Introduced Date:	February 19, 2016
		Attorney:	Bruce Langston	Sponsor	

SUBJECT: Other State Tax Credit Source Rules

SUMMARY

This provision would modify the sourcing rules required to be used by California residents under the Personal Income Tax Law when calculating the other state tax credit (OSTC).

RECOMMENDATION

No position.

REASON FOR THE BILL

The reason for the bill is to reform and modify the current calculation of the OSTC to prevent Californians with income from other states from being double taxed.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on and after January 1, 2016.

PROGRAM BACKGROUND

Residents of California are taxed on all income, including income from sources outside California.

In some instances, taxpayers are taxed by both California and another state on the same income. To prevent the income from being taxed twice, either California or the other state will generally allow a credit to offset the taxes paid to the other state.

California residents may claim a credit for net income taxes imposed by and paid to another state only on income which has a source within the other state. No credit is allowed if the other state allows California residents a credit for net income taxes paid to California.

For purposes of calculating the OSTC, California's sourcing principles apply even though the results may be contrary to the other states' principles. The following describes the sourcing principles of various types of income:

- Compensation for services rendered by employees or independent contractors has a source where the services are performed.
- Income from tangible personal property and real estate has a source where the property is located.

- Income from intangible personal property (such as interest and dividends) generally has a source where the owner resides.
- Business income has a source where the business is conducted.

FEDERAL/STATE LAW

There is no federal credit comparable to the other state tax credit discussed in this bill.

Existing state law imposes tax on the income earned by individuals, partnerships, estates, and trusts. Tax is imposed on the entire taxable income of residents of California and upon the taxable income of nonresidents derived from sources within California.

Existing California law allows a tax credit for net income taxes paid to a state other than California. The credit is based on taxes paid to the other state on income that has a source in the other state, and is also taxable under California law.

California statutes, regulations and case law are used to determine the source of income, regardless of any provision or interpretation of the law of the other state.

THIS BILL

This bill would require California residents to apply the other state's sourcing rules, instead of using the California sourcing rules, as described in the Background Section above, when calculating the OSTC.

This bill specifies that these changes would apply only to the extent that it will either maintain or increase the amount of the credit that a taxpayer is allowed.

IMPLEMENTATION CONSIDERATIONS

This bill uses a phrase that is undefined, i.e., “only to the extent” (page 2, line 7). The absence of a definition to clarify this phrase could lead to disputes with taxpayers and would complicate the administration of this bill. The author may want to amend the bill language to remove the phrase “only to the extent” and replace with the word “if”.

LEGISLATIVE HISTORY

AB 2771 (Irwin, 2015/2016) would, similar to this bill, modify the sourcing rules in determining income derived from sources within another state. AB 2771 is pending before the Assembly Revenue and Taxation Committee.

AB 2979 (Assembly Revenue and Taxation Committee, Chapter 374, Statutes of 2002) among other things, codified the detailed rules regarding sourcing of out-of-state income that were in both case law and regulations.

AB 2980 (Assembly Revenue and Taxation Committee, 2001/2002) among other things, would have codified the nonresident sourcing rules for determining the appropriate amount of other state tax credit that were found in case law and regulations. AB 2980 failed to pass out of the Assembly Appropriations Committee.

OTHER STATES' INFORMATION

The income tax laws of *Florida, Illinois, Massachusetts, Michigan, Minnesota,* and *New York* were reviewed because of their similarities to California's income tax laws.

Illinois allows a credit equal to the lesser of the tax on items of income included in both states, or the amount of the *Illinois* tax multiplied by the gross income taxable in the other state divided by the total gross income for *Illinois*.

Massachusetts allows a credit equal to the lesser of tax due to the other state reduced by interest, penalties, and any federal credit allowable on the federal return, or the amount of the *Massachusetts* tax multiplied by the gross income taxable in the other state divided by the total gross income for *Massachusetts*.

New York allows a credit for taxes paid to other states. The credit cannot reduce the tax below the amount of tax that would have been due had the income from the other state not been included.

Minnesota allows a credit equal to the lesser of the *Minnesota* tax on income taxed by the other state (compared in proportion to adjusted gross income) or the tax imposed by the other state on that income.

Michigan does not have a credit similar to California's other state tax credit.

Florida does not have a personal income tax.

FISCAL IMPACT

The department's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be identified and an appropriation will be requested, if necessary.

ECONOMIC IMPACT

Revenue Estimate

There would be a revenue loss to the general fund, however the amount is unknown.

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

Due to the lack of available data, it is difficult to predict the frequency and amount of credits that would be impacted by this bill. Therefore, the department is unable to provide an annual estimate. However, based on a three-year average for the OSTC, the department estimates that for every one percent of taxpayers impacted there would be a revenue loss of approximately $8.8 million.

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Proponents: Supporters could argue that this bill could benefit taxpayers because the amount of OSTC allowed by California may be increased by using other states' sourcing principles.

Opponents: Some may argue that the bill doesn't fully resolve the issue of income being subject to tax in more than one state.

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