

Board Permission to Proceed to Formal Process

Request for Permission to Proceed with Formal Regulatory Process to Adopt Amendments to Regulation Section 18001-1, Addressing the Other State Tax Credit].

INTRODUCTION AND BACKGROUND:

California Revenue and Taxation Code ("RTC") section 18001 allows a credit against the net tax for net income taxes imposed by and paid to another state on specified income. Under RTC section 18001, the payment of tax to another state is generally eligible for the Other State Tax Credit ("OSTC") only where the other state's tax is a net income tax.

The proposed regulatory amendments to Title 18 of the California Code of Regulations ("Proposed Regulation") would clarify the term "net income tax" for purposes of section 18001. The amendments would create a subsection (a)(2) to the Proposed Regulation. Specifically, it would provide that a tax is only considered a net income tax for purposes of the OSTC where the tax is imposed only on net income. A tax that is imposed on items other than net income, as applied to all taxpayers, is not a net income tax.

INTERESTED PARTIES MEETINGS:

Interested Parties Meetings ("IPM") was held on August 7, 2019 and on July 30, 2020, allowing the public an opportunity to raise issues and comment on the proposed regulatory language before you today. We appreciated the discussions and incorporated any changes that were offered that were consistent with the underlying statute and relevant judicial authority.

REQUEST FOR PERMISSION

Staff believes that the Proposed Regulation provides appropriate criteria and guidance in implementing the OSTC as provided in RTC section 18001, and now requests permission to commence the formal regulatory process under the Administrative Procedure Act.

DRAFT PROPOSED REGULATION TEXT
CALIFORNIA CODE OF REGULATIONS TITLE 18, DIVISION 3,
CHAPTER 2.5. SUBCHAPTER 12, SECTION 18001-1,
REGARDING CREDIT FOR TAXES PAID

Proposed language additions are underlined.

Section 18001-1 is amended to read:

(a) (1) Subject to the limitations described in California Code of Regulations, title 18, section 18001-2 respecting residents, and in Revenue and Taxation Code section 18002 respecting nonresidents, resident taxpayers are allowed a credit against “net tax”, as defined in Revenue and Taxation Code section 17039, for net income taxes paid another state, and nonresidents are allowed a credit against “net tax”, as defined in Revenue and Taxation Code section 17039, for net income taxes paid to the state in which they reside. The term “state” as used in the regulations contained in this Group for taxable years beginning before December 31, 1956, includes states, foreign countries, territories and possessions of the United States, and territories, possessions and political subdivisions of foreign countries, but did not include the United States. For taxable years beginning after December 31, 1956, the term “state” includes states of the United States, the District of Columbia and the possessions of the United States, but does not include the United States or foreign countries. The credit is limited to “net tax” and may neither be taken on account of any preference, alternative, or minimum tax comparable to the tax imposed by Revenue and Taxation Code section 17062 paid to another state or interest or penalties paid to another state nor may the credit be applied against interest or penalties due under the law. Since credit may be allowed only for net income taxes or, in the case of shareholders of a S corporation, the shareholders' prorata share of any taxes on, according to or measured by income or profits which were paid by the S corporation and satisfy the requirements of Revenue and Taxation Code section 18006, subdivision (b), no credit may be allowed for taxes imposed on gross receipts, gross income, dividends, etc., which must be paid regardless of whether or not the subject of the tax constitutes net income, even though in particular instances the subject taxed is net income in whole or in part. A taxpayer may also be required to report only the net amount of dividends if a tax is imposed by a foreign country upon the profits of the corporation and the corporation deducts the tax from each dividend payment before remitting the remainder.

(2) For purposes of this section, a tax will be considered a net income tax only where the tax is imposed on only net income. A tax imposed on items that include amounts other than net income, is not a net income tax, even though in particular instances the items taxed include net income in whole or in part. If a tax base includes items other than net income, in whole or in part, as applied to all taxpayers, the tax is not a tax on net income, regardless of whether an individual taxpayer would only be taxed on net income.

(b) The credit may be taken either at the time of filing returns under the law or subsequently and may be applied against the entire “net tax” if it is not paid in installments, or may be applied against each installment until the credit is exhausted. However, no credit will be allowed on account of income taxes imposed by another state or country until such taxes are actually paid. Receipts showing the payment of such taxes, and a certified copy of the return or returns upon the basis of which such taxes are assessed must be filed with the Franchise Tax Board at or prior to the time credit is claimed. If credit is claimed on account of a deficiency assessment, a certified copy of the notice assessing, or proposing, to assess the deficiency, as well as a receipt showing the payment of the deficiency must be filed.

(c) If, for any reason, the “net tax” has been paid before credit is claimed, a refund claim (accompanied by a receipt showing payment of the taxes claimed as a credit and a certified copy of the return or returns upon which the taxes were assessed) in the amount of the credit must be filed (see Part 10.2, Chapter 6 respecting the time and manner of filing refund claims). If the refund claim is approved, the amount of the claim will either be allowed as a credit against “net tax” or refunded to the taxpayer in the manner specified in Part 10.2, Chapter 6.

(d) If a husband and wife file separate returns under the law and also file separate returns in another state, credit on account of taxes paid to the other state may be claimed by each spouse only to the extent the income of each spouse as reported under the law, has been taxed by the other state. If a husband and wife file a joint return under the law, the entire amount of taxes (subject to limitations described in California Code of Regulations, title 18, section 18001-2, and Revenue and Taxation Code section 18002) paid by either or both to another state may be claimed as a credit, regardless of whether the husband and wife filed a joint return or separate returns in such state. If a husband and wife file separate returns under the law but file a joint return in another state, each is entitled to credit (subject to the limitations described in California Code of Regulations, title 18, section 18001-2, and Revenue and Taxation Code section 18002) for that portion of the total tax paid to such other state which the income of each taxed under the law and also taxed by such other state bears to the total income taxed by such other state.

(e) For provisions relating to credit allowed:

- (1) An estate or trust, see Revenue and Taxation Code sections 18003-18004;
- (2) Resident beneficiaries of an estate or trust for taxes paid by the estate or trust on income taxable to the beneficiaries, see Revenue and Taxation Code section 18005;
- (3) Members of a partnership where a net income tax is levied on the partnership, see Revenue and Taxation Code section 18006;
- (4) Shareholders of an S corporation where the S corporation has paid “net income taxes” to another state, which include taxes on, or according to, or measured by, income or profits paid, see Revenue and Taxation Code section 18006; and

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(5) In a case where the taxpayer at any time obtains credit for, or a refund of, taxes paid another state, see Revenue and Taxation Code sections 18007-18009.

Note: Authority cited: Section 19503, Revenue and Taxation Code.

Reference: Sections 18001 and 18002, Revenue and Taxation Code.