Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Irwin	Analyst:	Diane Deatherage	Bill Number:	AB 2771
Related Bills:	See Legislative History	Telephone:	845-4783	Introduced Date:	February 19, 2016
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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 this bill is to ensure that taxpayers could use the amount of income taxes they paid to other states as a credit against income taxes owed in California on the same income, reducing the chance of double taxation and creating a more equitable result for California residents.

EFFECTIVE/OPERATIVE DATE

As an urgency measure, this bill would be effective immediately upon enactment and would be operative for taxable years beginning on or 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 for 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 a 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[1], as described in the Background Section above, when calculating the OSTC.

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would occur during the department’s normal annual update.

LEGISLATIVE HISTORY

SB 1449 (Nguyen, 2015/2016) would, similar to this bill, modify the sourcing rules in determining income derived from sources within another state. SB 1449 is pending before the Senate Governance and Finance 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.

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[1] California Revenue and Taxation Code sections 25128-25139, inclusively, and the regulations thereunder, when apportioning business income for purposes of calculating the OSTC.

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 reduce taxpayer burden by simplifying the OSTC calculation.

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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