STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Petrie-Norris	Sponsor:	Bill Number: AB 2254
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Attorney: Shane Hofeling	Related Bills: See Legislative History	

SUBJECT

Other State Tax Credit

SUMMARY

This bill, under the Personal Income Tax Law (PITL), would modify the rules used by California residents for determining the other state tax credit (OSTC) by specifically allowing the credit for taxes paid by an S Corporation for certain taxes imposed by the state of Texas.

The Franchise Tax Board (FTB) would be required to report to the Legislature specified information regarding the OSTC.

RECOMMENDATION

No position

SUMMARY OF AMENDMENTS

None noted.

REASON FOR THE BILL

The reason for this bill is to alleviate the instances of double taxation on California residents in certain situations.

ANALYSIS

This bill, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, would modify the OSTC, by specifically allowing the taxes paid by an S Corporation that were calculated using the Cost of Goods Sold Method as specified in the Revised Texas Franchise Tax imposed by the state of Texas (pursuant to Section 171.101(B)(ii)(a)(1) of Chapter 171 of Subtitle F of Title 2 of the Texas Tax Code) to be eligible amounts for the purpose of claiming the OSTC.

This bill would specify that in accordance with Revenue and Taxation Code (R&TC) section 41, the OSTC is provided to alleviate the instances of double taxation on residents.

The FTB would be required to report to the Legislature the amount of credit claimed for each state by taxable year pursuant to this section for 2009 to 2015, inclusive, for 2016 to 2019, inclusive, and biannually thereafter from 2020 and beyond. The report would be required to be submitted pursuant to Government Code section 9795.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment, and specifically operative for taxable years beginning on or after January 1, 2020, and before January 1, 2025.

Federal/State Law

Federal Law

There is no federal credit comparable to the OSTC discussed in this bill.

State Law

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 net income 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.

California law (Section 24345 of the R&TC) currently allows a deduction for taxes other than an income tax, paid by a taxpayer during the taxable year.

Implementation Considerations

The department has identified the following implementation concerns. Department staff is available to work with the author's office to resolve these and other concerns that may be identified.

It is unclear how the department would determine that taxes paid to the state of Texas were calculated using the Cost of Goods Sold Method for the Revised Texas Franchise Tax.

This bill would require the department to report on the amount of OSTC claimed for each state by taxable year for specified periods and biannually from 2020 and beyond. The department lacks data for other states for taxable years prior to 2013, and the available data may be incomplete. The changes proposed by this bill would first be effective for taxable years beginning on or after January 1, 2020. Thus, the department would not have specific data on tax year 2020, until 2022 at the earliest. Additionally, the phrase “and beyond” would mean the reporting requirement would extend in perpetuity.

For clarity it is recommended that the phrase “for each state” be replaced with “by taxpayers in each state.”

Technical Considerations

None noted.

Policy Concerns

This bill could create a statutory difference between the OSTC and the deduction for taxes other than an income tax, paid by a taxpayer during the taxable year. Because this bill would allow a credit for certain “taxes paid,” it would allow for advantageous tax planning opportunities if those same amounts qualify for a deduction under existing law. This concern could be alleviated by specifying that no deduction would be allowed for any taxes for which the OSTC is claimed.

This bill would provide a tax benefit for S Corporations that would not be provided to other taxpayers. Thus, this bill would provide differing treatment based solely on classification.

LEGISLATIVE HISTORY

AB 978 (Petrie-Norris, 2019/2020) would have, under the PITL, modified the determination of whether another state’s tax is a tax on net income for purposes of the OSTC, by specifying that the actual method used by a taxpayer to calculate the tax they paid to another state without regard to other methods allowed by the other state would be controlling. AB 978 failed to pass by the constitutional deadline.

AB 2771 (Irwin, 2015/2016) would have, under the PITL, modified the sourcing rules required to be used by California residents when calculating the OSTC. AB 2771 failed to pass by the constitutional deadline.

SB 1449 (Nguyen, 2015/2016) would have modified the sourcing rules in determining income derived from sources within another state. SB 1449 failed to pass by the constitutional deadline.

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.

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 net 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.

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.

ECONOMIC IMPACT

Revenue Estimate

There would be a revenue impact to the general fund, but 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 or for the net final payment method of accrual.

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, we cannot provide an annual estimate. The amount of credit allowed is equal to the amount of taxes paid. For every $10 million of specified taxes paid by S Corporations to Texas, the revenue loss would be $10 million.

LEGAL IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

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