STATE OF CALIFORNIA
Franchise Tax Board

Summary Analysis of Amended Bill

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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).

Recommendation – No position.

Summary of Amendments

The April 22, 2019, amendments modified the operative date, added a definition for "actual method used," and added a reporting requirement.

As a result of the amendments, two of the implementation considerations discussed in the department's analysis of the bill as introduced February 21, 2019, were resolved, and two new implementation considerations were identified. Except for the "Effective/Operative Date," "This Bill," and "Implementation Considerations" sections, the remainder of the department's analysis of the bill as introduced February 21, 2019, still applies. The "Fiscal Impact," "Economic Impact," and "Policy Concerns" sections have been restated below for convenience.

Effective/Operative Date

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

This Bill

This bill, under the PITL, for taxable years beginning on or after January 1, 2020, and before January 1, 2025, would modify 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.

This bill would define “actual method used” to mean the method used by the taxpayer to determine the amount of tax paid to the other state for the taxable year, provided the method is consistent with the laws of the other state.

This bill would specify that in accordance with Revenue and Taxation Code (R&TC) section 41,[1] the OSTC is provided to alleviate the instances of double taxation on residents.

The Franchise Tax Board would be required report to the Legislature with 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.

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.

This bill would create a new standard for the definition of a net income tax that would be in conflict with numerous federal and California courts' decisions[2] and prior Board of Equalization decisions that define net income tax. Thus resulting in conflicting authority between the R&TC and controlling income tax decisions.

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.

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[1] Under R&TC section 41 legislation that would create a new tax credit is required to include specific goals, purposes, objectives, and performance measures to allow the Legislature to evaluate the effectiveness of the credit.

[2] See Beamer v. Franchise Tax Board (1977) 19 Cal. App. 3d 475. MCA, Inc. v. Franchise Tax Board (1981) 115 Cal. App. 3d 185. Robinson v. Franchise Tax Board (1981) 120 Cal. App. 3d 72.

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.

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. 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 $10 million.

Policy Concerns

This bill would result in a departure from longstanding case law precedent that applies California income tax principles as opposed to the other state's characterization of a tax for determining whether a tax paid to another state is a tax based on net income for purposes of California's OSTC.

This bill would create a statutory difference between the OSTC and the deduction for taxes as to what is an income tax. This may cause disparate treatment between taxpayers upon payment of the same tax. Because this bill would change the statutory and judicial determination of an income tax, it would allow for advantageous tax planning opportunities separate from the realities of what the tax actually is.

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