



Requested By: Dale Isaac  
TAM Author: Bruce R. Langston  
Phone Number: 3337  
Fax Number: 0848

#### QUESTION PRESENTED:

Where a taxpayer has both a Minimum Tax Credit (MTC) carryforward to the year at issue under Revenue and Taxation Code (RTC) §23453, and also has a current year credit that can be carried forward to future years, such as the Manufacturer's Investment Credit (MIC), how should the credits be ordered?

#### CONCLUSION

There are two contradictory statutory provisions. Subdivision (c) of RTC §23036 requires the MTC to be applied after carryover credits, while subdivision (d) of RTC §23036 allows carryover credits that reduce tax below TMT to be applied "only after" the MTC. In addition, RTC §23453(c) appears to contemplate different treatment for different "portions" of credits that can reduce regular tax below tentative minimum tax (TMT).

A strict reading of the statutes always reduces the MTC to zero where there is another credit which reduces regular tax below TMT, requiring the MTC to be carried forward unused indefinitely until it can be used against regular tax. However, this interpretation ignores the phrase "but only after allowance of the [MTC]" in RTC §23036(d).

It appears from an examination of the legislative file's analysis of the amendments to the provisions at issue that a better reading of the statutes is that the MTC should be allowed to reduce regular tax to TMT before carryover credits that reduce regular tax below TMT are allowed. However, a legislative change should be pursued to resolve the contradictory language.

#### ANALYSIS AND DISCUSSION

##### Federal AMT System

The Alternative Minimum Tax (AMT) is an additional tax that is computed as the excess of the TMT over regular tax (tax before application of credits). (IRC §55, RTC §23455<sup>1</sup>.) The taxpayer then pays the sum of regular tax and AMT as the total tax liability for the year. If there are no tax credits, the taxpayer will essentially pay the greater of TMT or regular tax for the year.

---

<sup>1</sup> This TAM refers to the Bank and Corporation Tax Law. The principles involved also apply to corresponding sections of the Personal Income Tax Law.

The primary rule relating to tax credits, in general, is that they may not reduce regular tax below the tentative minimum tax (TMT). (IRC §26, RTC §23036(d).) The purpose of this is to allow the regular tax to be reduced to the TMT, but not below TMT. Mathematically, this rule can only apply where regular tax is greater than TMT (where there is no AMT). If TMT is greater than regular tax (resulting in AMT) then regular tax is already below TMT and no credits are allowed - they all carry forward.

As explained in *Mertins* Law of Federal Taxation §2A.102:

In restructuring the alternative minimum tax under the Tax Reform Act of 1986, Congress sought to recognize that certain minimum tax preferences reflect the deferral, rather than the permanent avoidance of tax liability. \* \* \* The response to this perceived problem ... was the enactment of a "minimum tax credit" available against a taxpayer's regular tax liability under Section 53. The minimum tax credit was enacted because preferences and adjustments used in calculating the alternative minimum tax liability defer but do not prevent the imposition of regular tax liability for those amounts. (Footnotes omitted.)

*Mertins* §2A.104 goes on to explain the IRC §53 MTC credit limitation:

The point is that the minimum tax credit cannot reduce the regular tax liability (as adjusted by certain nonrefundable regular tax credits...) below the potential alternative minimum tax (tentative minimum tax) for the taxable year. In essence, the minimum tax credit cannot be used to reduce minimum tax liability in subsequent years. (Footnotes omitted.)

While this may seem obvious, it is important background in understanding how the California modifications to this federal system apply.

### California Modifications

For California certain credits are allowed to reduce regular tax below TMT. Remember that AMT has already been computed by the time that credits are applied to regular tax. The general rule, and the rule for federal purposes, is that credits can reduce regular tax to TMT, but not below. If regular tax before credits was greater than TMT, then there will be no AMT for the year. If regular tax before credits was less than TMT, then there would be AMT. In that case, the AMT amount for the year is computed first, then the credits are applied to the regular tax, then the AMT is added to any remaining regular tax liability to come up with the total tax due for the year.

The credit ordering provisions of the B&CT require carryover credits to be applied before the MTC.

R&TC §23036(c) states:

“Notwithstanding any other provision of this part, credits shall be allowed against the "tax" in the following order:

- (1) Credits that do not contain carryover provisions.
- (2) Credits that, when the credit exceeds the "tax," allow the excess to be carried over to offset the "tax" in succeeding taxable years. The order of credits within this paragraph shall be determined by the FTB.
- (3) **The minimum tax credit allowed by Section 23453.**
- (4) Credits for taxes withheld under Section 18662.”

On the other hand, R&TC §23036(d) states, in relevant part:

“Notwithstanding any other provision of this part, each of the following shall be applicable:

- (1) No credit shall reduce the [regular] "tax" below the tentative minimum tax (as defined by paragraph (1) of subdivision (a) of Section 23455), except the following credits, but **only after allowance of the credit allowed by Section 23453** [the minimum tax credit]: (list of credits deleted)”

This is an apparent contradiction. In (c) all carryover credits must be applied first before the MTC applies, but in (d) certain credits are allowed to reduce regular tax below TMT, but only after application of the MTC.

AB 802 (Stats. 1989, Ch. 1352) added the "but only after the allowance of the credit" phrase, and also added §23453(c), which provides:

- (c) For purposes of this chapter, the amount determined under Section 53(c) of the Internal Revenue Code shall be the regular tax as defined by subdivision (c) of section 23455, reduced by the sum of credits allowable under this part **other than the portion of any credit which reduces the tax below tentative minimum tax** as provided in paragraph (1) of subdivision (d) of Section 23036. (Emphasis added).

In other words, the general rule is that the amount of the MTC is allowable in any year only after all other credits are exhausted. There is an exception for the "portion" of any credit which reduces tax below TMT. Read literally, this phrase always requires the MTC to be zero where there is a credit that brings regular tax below TMT, because the "portion" of the credit that does not reduce tax below TMT, but only reduces tax to TMT, reduces the MTC.

A review of the legislative file for AB 802 (Memo dated August 11, 1989 from Dan Converse to Debbie Hale) discloses that the amendments above were justified as follows:

"Section 23036 ... This act also specifies that the minimum tax credit, resulting from payment of alternative minimum tax in prior years, must be allowed before any credit is allowed to reduce the regular tax below the tentative minimum tax. [23036(d)(1)]"

"Section 23453 ... This act clarifies that, for purposes of computing the minimum tax credit, the reference to "regular tax" is before the allowance of those credits which, for state purposes only, may reduce the regular tax below the tentative minimum tax."

Given this explanation, it seems clear that the intent of the change was to allow the MTC to be taken after regular credits, but before credits that reduce regular tax below TMT. The "portion of" language in 23453 was evidently intended to ensure that the MTC could not reduce regular tax below TMT<sup>2</sup>, not to prevent the MTC from being applied before the other credit.

Similarly, the explanation of the addition of §23036(d)(1) indicates that the intent was to have the credits that reduce tax below minimum tax be applied after the TMT, despite the existing language of §23036(c).

Because of this ambiguity, a legislative change should be pursued that deletes the "portion of" language from §23453(c) and reconciles §23036(c) and (d) to provide that the MTC applies before credits that reduce regular tax below TMT.

Tax Counsel

---

<sup>2</sup> The drafter apparently did not realize that by specifically excluding the "portion" of the credit that reduced regular tax below TMT (requiring that portion of the MTC to be carried over) the statute by implication could be interpreted to include the "portion" of the other credit that brought regular tax down to TMT.