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EFFECT ON OTHER TECHNICAL ADVICE MEMORANDUMS

This Technical Advice Memorandum supersedes Technical Advice Memorandum 2017-01, which is hereby withdrawn.

SUBJECT: Eligibility for the Other State Tax Credit (OSTC) when Filing a Composite (Group) Return in a Reverse Credit State

QUESTION PRESENTED

Is a California resident included in a composite (group) return in a reverse credit state entitled to the California OSTC for taxes paid to the reverse credit state?

CONCLUSION

The OSTC will be allowed for taxes paid to a reverse credit state by a California resident that is included in a group return filed in the reverse credit state when the reverse credit state does not allow a credit for taxes paid to California on the group return.

DISCUSSION

California law provides an OSTC for taxes paid to another state on income derived from sources within that other state. (Rev. & Tax. Code § 18001, subd. (a), par. (1).) To prevent the application of duplicate tax credits against the tax attributable to the same income, Revenue and Taxation Code section 18001, subdivision (b), paragraph (2), provides that the credit will not be allowed if the other state “allows residents of [California] a credit against the taxes imposed by that [other] state” for taxes paid or payable in California. Such states

that provide a credit to California residents are referred to as “reverse credit states.” Currently, Arizona, Oregon, Virginia, and Guam are reverse credit states.¹

The policy reason behind the prohibition of the OSTC when the other state allows the credit for taxes paid to California – the prevention of duplicate credits – does not apply when the reverse credit state does not allow a credit for taxes paid to California by a group filing a composite return in the other state. Currently, none of the reverse credit states allow a credit for taxes paid to California on the group nonresident tax return. In the *Appeal of Gregory J. Soukup and Mary Jo Carr*, 94-SBE-014, the Board of Equalization reasoned that although Section 18001(b)(2) of the Revenue and Taxation Code precludes California taxpayers from claiming a credit for taxes paid to another state if the other state allows a credit to the California resident, the provision should be interpreted in a manner that is consistent with “good tax administration [which] mandates a policy of encouraging the filing of composite returns.” Thus, if the election to file a composite return in the reverse credit state makes the California taxpayer ineligible to claim the credit in the reverse credit state, California will allow the credit for the California resident taxpayer's share of income taxes paid to the reverse credit state.

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¹ Indiana was a reverse credit state for tax years beginning prior to January 1, 2017. Indiana's reverse credit agreement with California ended effective for tax years beginning on or after January 1, 2017. (See Indiana Department of Revenue Information Bulletin #28, Income Tax, dated November, 2016.)