

California FTB Issues Ruling on Credit or Deduction for Taxes Paid to Other State

Overview

On February 22, 2017, the California Franchise Tax Board ("FTB") issued Legal Ruling 2017-01, which provides guidance on the circumstances in which a taxpayer may claim the Other State Tax Credit ("OSTC") or a deduction for taxes paid to another state under the California Revenue and Taxation Code ("CRTC").¹ This ruling applies to taxable years beginning on or after January 1, 2016.

This Tax Alert summarizes the guidance provided in Legal Ruling 2017-01 and provides some taxpayer considerations.

Current California Law

To avoid double taxation, California allows under certain circumstances an OSTC for individuals, estates, and trusts for net income taxes imposed by and paid to another state on income that is also taxed by California.² Depending on the residency and status of the taxpayer, the statutory requirements to claim the credit varies.³ Additionally, subject to certain exceptions, a deduction is allowed for taxes that are not a tax on, or according to, or measured by income or profits and are imposed by and paid to another state by an individual, an entity taxed as a partnership, or a corporation in connection with carrying on a trade or business or for the production of income.⁴

Summary of Legal Ruling 2017-01

The FTB stated that the determination of whether a payment of a tax to a another state qualifies for an OSTC or a deduction for California tax purposes turns on (1) whether the tax is properly characterized as a tax on, or according to, or measured by income (e.g., a measure based on income which includes both gross and net income taxes), and if it is (2) whether the tax is properly characterized as a net income tax. If the first prong is not met, the inquiry ends, and the taxpayer may claim a deduction for the tax provided all other requirements are met,⁵ but may not claim the OSTC.⁶ However, if both the first and second prongs are met, then the next question is whether the tax is imposed by and paid to the other state such that the taxpayer may claim an OSTC. If the tax at issue is not a single, indivisible tax, but instead a multifaceted tax that consists of a combined set of separate and independent taxes, each tax must be analyzed independently under this multi-pronged test.

Notably, citing the United States Supreme Court decision in *Maryland v. Wynne*⁷ in support, the FTB stated that, "[w]hen a tax operates as a tax imposed by and/or collected by a county, city, or other locality, the tax is not imposed by and paid to the other state, so the OSTC is not available for payment of the tax. In contrast, if the tax is imposed by a state statute and paid to the state, the tax is deemed a tax imposed by and paid to the state, even if the tax is labeled a county, city, or other locality tax."

¹ FTB Legal Ruling 2017-01, available [here](#) (effective Jan. 1, 2016).

² Cal. Rev. & Tax Code §§ 18001-18011; Cal. Code of Regs., tit. 18, §§ 18001-1, 18001-2; FTB Schedule S.

³ *Id.*

⁴ Cal. Rev. & Tax Code §§ 17201, 24345.

⁵ Generally, an individual, entity taxed as a partnership, or corporation made claim a deduction for taxes not on, or according to, or measured by income or profits imposed by and paid to another state in connection with carrying on a trade or business or for production of income, subject to certain exceptions. See FTB Legal Ruling 2017-01, p.4; Cal. Rev. & Tax Code §§ 17201, 17220, 17853, 24345.

⁶ Although the FTB did not directly state this in Legal Ruling 2017-01, if the first prong is met, but the second one is not (e.g., in the case where a tax is a gross income tax, but not a net income tax), it appears that neither a deduction nor the OSTC would be allowed.

⁷ In *Maryland v. Wynne*, the United States Supreme Court held that, although Maryland imposed a "so-called 'county' tax" upon its residents, the tax was actually a state tax imposed by and paid to the state of Maryland, "[d]espite the name[]" that Maryland has assigned." *Comptroller of the Treasury of Maryland v. Wynne*, 135 U.S. 1787, 1791 (2015); see also FTB Legal Ruling 2017-01, p.12.

External Multistate Tax Alert

The FTB next applied the multi-pronged test to six factual scenarios analyzing certain taxes paid to California and Arizona, New York (including the Metropolitan Commuter Transportation Mobility Tax ("MCTMT")), Kentucky, Tennessee (franchise and excise tax), and Texas (franchise tax)⁸.

As to the NY MCTMT, the FTB concluded that this tax did not qualify for the OSTC because it was not a tax on, or according to, or measured by income because it was based on payroll expenses paid by the taxpayer and was not a tax that was imposed by and paid to another state because it was imposed on and paid to the Metropolitan Transportation Authority. For the Kentucky Limited Liability Entity Tax credit, the FTB concluded that it did not qualify for the OSTC because that credit was not a tax "paid" to the other state, but instead was a nonrefundable tax credit. For the Tennessee tax, the FTB concluded that the Tennessee excise tax (but not the franchise tax) was a tax measured by income and thus, only the excise tax qualified for the OSTC. As to the Texas franchise tax, the FTB concluded that it was not a tax on, or according to, or measured by income, and thus, did not qualify for the OSTC, but instead could be deducted.⁹

Considerations

Although Legal Ruling 2017-01 provides guidance on whether a taxpayer may claim the OSTC or a deduction for taxes paid to another state, especially in the context of the New York MCTMT, Tennessee excise and franchise tax, and the Texas franchise tax, there is a degree of ambiguity in the language of the Legal Ruling that leaves some open questions on how it could apply. This ruling also provides the FTB's opinion on how, for California tax purposes, the United States Supreme Court's ruling in *Maryland v. Wynne* applies to certain county, city, or other local taxes that are paid by a California taxpayer.

If you have questions regarding Legal Ruling 2017-01 or other California tax matters, please contact any of the following Deloitte Tax professionals:

Christopher Campbell
Principal, California
Technical/Controversy Lead
Deloitte Tax LLP, Los Angeles
+1 213 553 3072
cwcampbell@deloitte.com

Steve West
Managing Director, California
Technical Lead
Deloitte Tax LLP, Los Angeles
+1 213 688 5339
stevewest@deloitte.com

Gregory Bergmann
Partner
Deloitte Tax LLP, Chicago
+1 312 486 9811
gbergmann@deloitte.com

Shirley J. Wei
Senior Manager, California
Technical/Controversy Lead
Deloitte Tax LLP, Los Angeles
+1 213 553 1715
shiwei@deloitte.com

Valerie C. Dickerson
Partner, Washington
National Tax
Deloitte Tax LLP, Washington DC
+1 202 220 2693
vdickerson@deloitte.com

The authors of this alert would like to acknowledge the contributions of Lili Sowlati to the drafting process. Lili is a Tax Consultant working in the Orange County Multistate Tax practice of Deloitte Tax LLP.

For further information, visit our website at www.deloitte.com

Follow [@DeloitteTax](https://twitter.com/DeloitteTax)

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

⁸ The FTB previously issued FTB Notice 2010-02 which addressed the proper treatment of the Revised Texas Franchise Tax for purposes of the OSTC and deductibility under the CRTS. However, FTB Legal Ruling 2017-01 replaced FTB Notice 2010-02 and thus, that Notice is withdrawn.

⁹ Although the FTB explicitly stated in Legal Ruling 2017-01 that the Texas franchise tax was deductible, it did not specifically address the deductibility of the NY MCTMT or the Tennessee franchise tax.

External Multistate Tax Alert

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of which is a legally separate and independent entity. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a detailed description of DTTL and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2017 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited