**New York State Department of Taxation and Finance**
**Taxpayer Services Division**
**Technical Services Bureau**

TSB-A-90 (13) I
Income Tax
November 30, 1990

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION PETITION NO. I891204B

On December 4, 1989, a Petition for Advisory Opinion was received from Robert Spielman c/o Mahoney Cohen Paul & Company PC, 111 West 40th Street, New York, New York 10018.

The issue raised by Petitioner, Robert Spielman, is whether a New York State resident is allowed a resident tax credit for corporate tax paid to another state by his wholly owned "S" corporation where the other state's corporate tax is termed a "franchise" tax although it is actually computed and based on net income.

A taxpayer who is a New York State resident is the sole shareholder of ABC, a New York State and federal S corporation. ABC does business and pays taxes in States X and Y. State X imposes a corporation business tax described as a "franchise" or "privilege" tax which is measured by net income allocated to the state. State X imposes a direct corporate income tax that is also based on net income allocated to the state. Net income in both states is generally determined by federal taxable income with modifications.

Section 620(a) of the Tax Law provides that a resident shall be allowed a credit against the tax otherwise due under Article 22 for any income tax imposed for the taxable year by another state of the United States, a political subdivision of such state, the District of Columbia or a province of Canada, upon income both derived therefrom and subject to tax under Article 22 of the Tax Law.

Section 601 of the Tax Law imposes the personal income tax on the New York taxable income of resident individuals. Section 611 of the Tax Law provides that the New York taxable income of a resident individual is computed by subtracting from the individual's New York adjusted gross income, the individual's New York deduction and New York exemptions. The New York adjusted gross income of a resident individual is the individual's federal adjusted gross income with the modifications required by section 612 of the Tax Law. An individual's federal adjusted gross income includes a shareholder's pro rata share of a S corporation's income, loss, deduction and reduction for taxes, described in section 1366(f)(2) and (3) of the Internal Revenue Code.

Section 617(a) of the Tax Law provides that when computing New York adjusted gross income and New York taxable income of a resident shareholder of an S corporation not subject to tax under Article 9-A, any modification described in section 612(b), (c) or (d) or section 615 (c) or (d)(2) or (3) of the Tax Law which relates to an item of S corporation income, loss or deduction shall be made in accordance with the shareholder's pro rata share, for federal income tax purposes, of the item to which the modification relates. Section 617(b) of the Tax Law provides that each item of S corporation income, loss or deduction shall have the same character for a shareholder under Article 22 as for federal income tax purposes.

Section 612(b)(3) of the Tax Law contains a modification increasing federal adjusted gross income for income taxes imposed by New York State or any other taxing jurisdiction, to the extent deductible in determining federal adjusted gross income and not credited against federal income tax.

When computing federal adjusted gross income, the taxpayer must include his pro rata share of ABC's income, loss, deduction and reduction for taxes, described in section 1366(f)(2) and (3) of the Internal Revenue Code. When ABC computes ordinary income from trade or business activities, ABC is allowed a deduction for the taxes ABC paid to States X & Y. State X imposes a corporate franchise or privilege tax, and State Y imposes a direct corporate income tax.

In an Advisory Opinion issued to James F. Matthews, it was held that a resident shareholder of an S corporation is eligible for a resident tax credit for tax paid by the corporation in another state, provided that such tax is an "income" tax. (James F. Matthews, Adv Op Comm T & F, June 14, 1989, TSB-A-89(5)I)

In the Matter of William A. Baker, Jr. and Lucelle D. Baker, (Dec Tax App Trib, October 11, 1990) the Tax Appeals Tribunal agreed with the Matthews Advisory Opinion. The Tribunal found that in characterizing a tax for the limited purpose of the resident tax credit, the label of the tax is not conclusive, but rather the nature and practical effect of the tax is determinative. This approach was adopted because it furthers the legislative purpose behind the enactment of the resident tax credit, that is, to avoid double taxation on the same income. The Tribunal concluded that a tax is an "income" tax within the meaning of the resident tax credit to the extent the tax is imposed on an income base.

In the Baker decision, the Tribunal turned to federal law for guidance in determining what is an income tax for purposes of the resident tax credit. The Tribunal found that the most relevant authority on point is provided by the comparable provision in the Internal Revenue Code, the foreign tax credit. Pursuant to section 901(b)(1) of the Internal Revenue Code, a citizen of the United States is entitled to a credit for "the amount of any income, war profits, and excess profit taxes paid or accrued during the taxable year to any foreign country" (emphasis added). Like the resident tax credit provided under New York law, the primary objective of the foreign tax credit is to prevent double taxation on the same income.

The Tribunal also found that in determining whether a foreign tax is an income tax for purposes of the foreign tax credit, the label of the tax is not determinative. The Tribunal noted that it is further well settled that a court is not bound by the classification of the tax in question by the imposing country. A foreign tax qualifies as a creditable income tax if the tax is "the substantial equivalent of an income tax as that term is understood in the United States" (See Treas. Reg. §l.901-2[a][1][ii] Ia foreign levy is an income tax if "the predominant character of that tax is that of an income tax in the U.S. sense"]). The predominant character of a tax is that of an income tax in the United States sense if it is likely to reach net gain in the normal circumstances

in which the tax applies. Where the foreign law imposes a tax that is the sum of two or more separately computed amounts, then each component is tested to determine if it qualifies as an income tax.

The Tribunal held in Baker that the Connecticut Corporation Business Tax, imposed on companies carrying on, or authorized to carry on, business in the State at ll.5% of entire net income attributable to Connecticut, is an income tax for purposes of section 620 of the Tax Law. The Tribunal also held that the New Jersey Business Tax, imposed on corporations for the privilege of having or exercising its corporate franchise, or for the privilege of doing business, employing or owning capital or property, or maintaining an office in the state and based on 9% of entire net income allocated to the state, is an income tax for purposes of section 620 of the Tax Law. However, the tax imposed by the New Jersey Business Tax computed on entire net worth allocated to the state was not considered an income tax because it bore no relation to the income or profits of the corporation.

Herein, the tax that ABC paid to State Y is an income tax for purposes of section 620 of the Tax Law. In addition, pursuant to the Baker decision, the "franchise" or "privilege" tax that ABC paid to State X is an income tax for purposes of section 620 of the Tax Law, to the extent that the tax is based on net income.

Pursuant to the Baker decision, consistency of treatment between the Internal Revenue Code and sections 620(a) and 612(b)(3) of the Tax Law requires that, before a taxpayer may claim a resident tax credit, the amount of taxes paid by ABC to States X and Y be added back to arrive at New York adjusted gross income to the extent such taxes were deducted in arriving at federal adjusted gross income.

Accordingly, herein the taxpayer may claim a resident tax credit under section 620 of the Tax Law for income taxes paid by ABC to States X & Y, when such taxes are included in the taxpayer's New York taxable income pursuant to the modification contained in section 612(b)(3) of the Tax Law. The amount of resident tax credit allowed must be computed pursuant to section 620 of the Tax Law.

DATED: November 30, 1990

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory 0pinions are limited to the facts set forth therein.