LOUISIANA DEPARTMENT of REVENUE | Policy Services Division
Revenue Information Bulletin

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December 18, 2019
Individual Income Tax

Credit for Taxes Paid to Other States
Resolution Process for 2014-2018 Claims

Louisiana Revised Statute 47:33 provides a nonrefundable individual income tax credit for taxes paid to other states (herein often referred to as "credit") to Louisiana resident individuals.[1] The statute was legislatively amended during the 2015 Regular Session and 2018 Second Extraordinary Session and was declared unconstitutional, in part, by the Louisiana Supreme Court in 2019. The purpose of this comprehensive bulletin is as follows:

1. To provide historical background and effects of the legislative amendments to LA R.S. 47:33 and the *Smith*[2] decision rendered by the Louisiana Supreme Court;

2. To explain the interaction of legislative recoveries on the credit amounts;

3. To issue administrative guidance on the filing of original and amended returns for tax years affected by the multiple changes;

4. To explain the procedural requirements for obtaining a return of tax previously paid following the unconstitutionality declaration within the *Smith* decision;

5. To provide examples based on potential scenarios; and

6. To provide the list of states for which a credit for taxes paid to the state may be claimed.

General Rules for the Credit for Taxes Paid to Other States

LA R.S. 47:31 requires "[e]very person residing within the state…" to pay "…a tax on net income *from whatever sourced derived…*" Louisiana residents are required to pay individual income tax on their income, whether earned within or earned outside the state. To prevent potential double taxation caused by a state taxing the same income, the Louisiana resident may claim a credit for taxes paid to the other state. For example, if a Louisiana resident earns $50 in Louisiana and $50 in Mississippi, the resident generally pays Louisiana income tax on the entire $100 and pays Mississippi income tax on the $50 earned in Mississippi. However, for Louisiana tax purposes, the

[1] LA R.S. 47:300.9 provides the same credit for taxes paid for resident estates and trusts. The bulletin applies to both credits while primarily referring only to individual income tax matters for purposes of clarity.

[2] *Smith v. Robinson*, 18-728 (La. 12/5/18), 265 So. 3d 740, *aff'd as amended on reh'g,* 18-728 at p. 2 (La. 2/27/19), 265 So. 3d at 755 (affirming unconstitutionality but limiting it to LA R.S. 47:33(A)(4))

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resident may claim a credit for taxes paid to Mississippi on the $50 of income. By claiming the credit, the resident's Louisiana tax liability is reduced by the amount of tax paid to Mississippi, thus avoiding double taxation on the same income.

The credit for taxes paid to other states applies to individual income and fiduciary income taxes. As a nonrefundable credit, a taxpayer cannot claim a credit amount in excess of actual tax liability reported on the Louisiana tax return.

<u>Act 109 of the 2015 Regular Session</u>

Act 109 imposed three limitations on the credit:

1. Paragraph (A)(4) provided the credit is only allowed if the other state provides a similar credit for its residents for Louisiana income taxes paid on income derived from property located in, or from services rendered in, or from business transacted in Louisiana ("the reciprocity limitation").

2. Paragraph (A)(5) provided the credit is limited to the amount of Louisiana income tax that would have been imposed if the income earned in the other state had been earned in Louisiana ("the calculation change limitation").

3. Paragraph (A)(6) provided the credit is not allowed for income taxes paid to a state that allows a nonresident a credit against income taxes imposed by that state for taxes paid or payable to the state of residence. This limitation is not at issue or discussed further in this bulletin.

In addition to these substantive changes to LA R.S. 47:33, Act 109 included an applicability section which provided that the reciprocity and calculation change limitations applied to tax returns filed on or after July 1, 2015, regardless of the taxable year. If the tax return was filed after July 1, 2015, but a valid filing extension had been allowed prior to July 1, 2015, then the amount of the credit that was limited may be recovered on the 2017, 2018, and 2019 tax returns ("the legislative recoveries").

The legislative recoveries apply only to the 2014 tax year. For 2013 and previous years, the legislative recoveries generally do not apply because a "valid filing extension" only extends the tax return within the six month extension window. A 2013 or earlier tax return filed in 2015 is untimely and no "valid filing extension" may exist. An exception may exist for a taxpayer filing on a fiscal year basis that does file a 2013 tax return, on extension, during the 2015 calendar year. Additionally, legislative recoveries do not apply to 2015 and subsequent years because the returns for those periods were not due until after July 1, 2015.

Act 109 was signed into law on June 19, 2015, and the limitations were effective beginning July 1, 2015 (after the 2014 tax return due date but before the extended tax return due date). For tax returns filed after July 1, 2015, in which a valid filing extension had been allowed, the taxpayer was entitled to the legislative recoveries.

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The limitations of Act 109 were originally temporary and set to cease on July 1, 2018. Act 6 of the 2018 Second Extraordinary Session extended this cease date to July 1, 2023 (discussed later).

Texas Franchise Tax and the *Smith* Decision

Prior to Act 109, the credit was allowed when a Louisiana resident paid the Texas Franchise Tax ("Texas Tax"). The Texas Tax is an entity level tax on the taxable margins of an entity with limited liability protections. Texas does not levy an individual income tax, so the reciprocity limitation was triggered because Texas does not offer a similar credit for taxes paid to Louisiana residents. Therefore, Act 109 prohibited a credit for Texas Tax paid by Louisiana residents.

In reviewing the constitutionality of Act 109, the Louisiana Supreme Court held, on rehearing, the reciprocity limitation was unconstitutional. The calculation change limitation, legislative recoveries provision, and the remaining provisions of Act 109 remain in effect.

The original decision was issued on December 5, 2018. The rehearing decision was issued on February 27, 2019, during the 2018 tax return filing season. Between the original and rehearing decision, the 2014 tax year was set to prescribe on December 31, 2018. Several taxpayers filed amended returns with the Department and/or claims against the state with the Board of Tax Appeals (herein sometimes referred to as "BTA").

The *Smith* plaintiffs were the only taxpayers to challenge the constitutionality of Act 109 and pay the taxes at issue under protest and file suit for their recovery. As such, the plaintiffs were permitted a refund of the tax paid as a result of the reciprocity limitation. All other taxpayers affected by the reciprocity limitation may receive a return of the tax paid as a result of the reciprocity limitation via the claim against the state (herein sometimes referred to as "CAS") procedure.

Act 6 of the 2018 Second Extraordinary Session

Act 6 changed three provisions related to credits for taxes paid to other states:

First, the calculation change limitation was revised to codify the existing calculation of the credit. The calculation is:

$$\text{LA tax liability} \times \frac{\text{LA tax table income attributable to other states to which net income taxes were paid by a resident individual}}{\text{Total LA tax table income}}$$

Second, Act 6 created a new deduction for another state's entity-level tax that is based solely on net income included in the entity's federal taxable income without any capital component. The deduction applies for taxes paid on or after January 1, 2018. The Louisiana resident's deduction is limited to their proportionate share of the entity-level tax paid. The deduction is only allowed to the extent the entity's income is included in the Louisiana resident's Louisiana income and subject to Louisiana tax.

The deduction for entity level taxes was intended to offer relief to Louisiana residents adversely impacted by Act 109's reciprocity limitation. When the deduction was enacted on June 12, 2018, the *Smith* litigation was ongoing. The effect of *Smith* removed the reciprocity limitation, thus allowing credit for Texas Tax paid again. Without regard to the *Smith* litigation, the Legislature intended to disallow a credit for Texas Tax paid but to offer a deduction for Texas Tax paid in its place. The Legislature did not intend to offer a credit and a deduction for the same Texas Tax paid. However, a taxpayer may claim a deduction for tax paid to another state and claim a credit for Texas Tax paid, provided that a deduction and credit are not both claimed for the tax paid to the same state.

Third, Act 6 extended this cease date of the limitations to July 1, 2023, as mentioned above.

Act 6 became effective on June 12, 2018, and applies to tax returns filed on or after that date.

Claims Against the State for Return for Tax Paid

Prior to the 2019 Regular Session, if a taxpayer believed a tax statute or regulation was unconstitutional or invalid, the taxpayer was required to challenge the validity of the statute or regulation in the Nineteenth Judicial District Court. If successful, the taxpayer would receive a refund of the tax paid with statutory interest on the refund amount.

If a taxpayer did not challenge the statute or regulation, but the statute or regulation was nonetheless declared unconstitutional or invalid, the taxpayer may receive a return of the tax paid via the claim against the state procedure without interest.

In the context of credit for taxes paid and the reciprocity limitation, taxpayers (other than the *Smith* plaintiffs) may receive a return of the tax paid resulting from the reciprocity limitation. In other words, taxpayers may claim credit for the Texas Tax paid, but the reduction of the tax from the application of the credit is returnable to the taxpayer as a claim and not a refund of tax. Claims against the state, once approved by the Board of Tax Appeals, required legislative appropriation for payment of the claim in all cases. The Department lacked authority to pay the claim absent such appropriation by the Legislature.

Act 367 of the 2019 Regular Session changed the above provisions on a prospective basis only. Statutes authorizing refunds of tax are substantive areas of law and Act 367 did not declare a retroactive effect. On June 18, 2019, and going forward, if a tax statute or regulation is declared unconstitutional or invalid, a taxpayer is entitled to a refund of tax paid as a result of the statute or regulation. Importantly for purposes of this bulletin's guidance, credits for taxes paid as limited by Act 109 are unaffected by this legislative change.

However, Act 367 changed the claim against the state procedural provisions. These provisions apply to claims against the state relating to credits for taxes paid as limited by Act 109. The Board of Tax Appeals and Secretary of Revenue may enter into an agreement to allow the filing of claims against the state with the Department on the Department's forms. A claim filed with the

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Department is deemed a claim filed with the BTA. If the claim amount does not exceed $20,000, the Department may issue the return of tax upon receipt of a stipulated judgment from the BTA as to the claim amount. Legislative concurrence or appropriation is not required. Such claims must be paid in the order in which the claims were approved by the BTA. A cap of $2 million dollars per fiscal year is applicable to this level of claims, but may be increased with approval from the Commissioner of Administration and the Joint Legislative Committee on the Budget ("JLCB"). If the claim amount exceeds $20,000, but does not exceed $250,000, the claim must be additionally submitted to the JLCB Litigation Subcommittee for approval prior to any payment. Claims in excess of $250,000 require legislative appropriation. If the Legislature does not approve the claim during the regular session following approval by the BTA, the taxpayer and Secretary may enter into a nonrefundable offset agreement with a 5 year carryforward provision. Claims in excess of $1 million do not qualify for offset agreement treatment. Regardless of value of claim, the statute prohibits the payment of interest on claims.

Return of Taxes Relative to the Reciprocity Limitation

Taxpayers previously subject to the reciprocity limitation are due a return of tax paid resulting from the previously limited credit for taxes paid to other states.

In order to process these claims, several aspects related to the three legislative changes and the *Smith* case must be harmonized.

Focusing first on the 2014 tax year, a common example is as follows:

1. Taxpayer filed a valid timely extension in 2015 for the 2014 tax year. As such, taxpayer earned legislative recoveries with respect to both the reciprocity limitation and calculation change limitation.

2. Taxpayer filed an amended 2014 return with the Department by December 31, 2018 or filed a claim against the state with the BTA by December 31, 2018. Both or either filing will be treated as a claim filed with the Board in accordance with Act 367.

To resolve the 2014 tax year, the following factors must be evaluated:

- Whether a valid filing extension for 2014 was timely filed in 2015
- Whether legislative recoveries exist for the reciprocity limitation
- Whether legislative recoveries exist for the calculation change limitation
- Whether the taxpayer filed an amended 2014 return with the Department by December 31, 2018
- Whether the taxpayer filed a claim against the state with the Board of Tax Appeals by December 31, 2018

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Additional considerations include:

- The claim against the state is only with respect to the reciprocity limitation. The increase of tax attributable to the calculation change limitation remains constitutional and cannot form part of the claim against the state.
- The claim against the state amount must be calculated to limit the reciprocity limitation only to the amount of tax liability. The claim against the state cannot cause the taxpayer to receive a return of tax in excess of 2014 tax liability because the credit is nonrefundable.
- If a taxpayer has legislative recoveries with respect to the reciprocity limitation, and the taxpayer claims the entire amount of the credit previously disallowed because of the reciprocity limitation, the 2017 and 2018 returns must be adjusted to remove the legislative recoveries.

Preparation and Submission of Claims Against the State

Step 1:
Taxpayer prepares and files Form R-2214-SM, 2014 Amended Return, and R-10606 with the Department (assuming the 2014 period remains open because the taxpayer filed an amended 2014 return with the Department by December 31, 2018). The purpose of Form R-2214-SM is to serve as the initiation of litigation to claim the return of tax and is only required if the taxpayer did not file a petition directly with the Board of Tax Appeals.

Step 2:
Applicable amount of Texas Tax paid is claimed as part of credit for taxes paid up to the amount of tax liability.[3] To calculate the Texas Tax, taxpayers must review their Schedule K-1 as issued by the entity paying Texas Tax. If the entity operates in multiple states and apportions its income, the apportionment percentage for the Texas Franchise Tax Return must be factored into the calculation to derive the taxpayer's specific portion of Texas Tax paid.[4]

Step 3:
Legislative recoveries are removed from 2017 and 2018 returns if claim seeks recovery of entire amount otherwise limited by reciprocity limitation. The Department[5] will manually adjust the 2017 and 2018 returns to remove these legislative recoveries, if claimed. Taxpayer does not need to

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[3] While this bulletin focuses on the Texas Franchise Tax, taxes paid to the states of Tennessee and New Hampshire are also impacted and subject to this guidance.

[4] *See* "Examples" section below; additional information will be provided in examples for the numerator and denominator of the calculation.

[5] As used in Step 3, "Department" includes multiple divisions within the Department of Revenue. Because a claim against the state is a form of litigation, the Department's Litigation Division will be the primary owner and responsible division for the claims. The Department's Taxpayer Compliance – Income Division will review the returns and determine whether agreement exists as to the claim amounts. The Litigation Division will handle submission of the Stipulated Judgments (if the Department and taxpayer agree to the claim amount) or will litigate the claim (if the Department and taxpayer disagree as to the claim amount.)

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amend these returns. The Department will review the tax returns and documents. If the Department agrees with claim amount submitted by taxpayer, the Department will prepare a Stipulated Judgment as to claim amount for submission to the Board of Tax Appeals.

Once the Stipulated Judgment is approved by Board of Tax Appeals and Department, the claim amount (if under $20,000) is paid to taxpayer without interest. However, because a claim against the state allows a return of tax, the Department must issue a refund denial as a formality for claims initiated by the filing of an amended return. The taxpayer should expect to receive the refund denial after the Stipulated Judgment is issued and return of tax is paid. The refund denial will include language allowing the taxpayer to appeal to the Board of Tax Appeals; however, this refund denial is a necessary formality as taxpayers will have been made whole through the previously issued return of tax. An appeal of the refund denial will not be necessary.

In the Department's integrated tax system, the final version of the return on file does not include the portion of the credit for taxes paid that constitutes part of the claim against the state. Therefore, copies of tax returns requested via Form R-7004, *Tax Information Disclosure Authorization* will not include the portion of the credit for taxes paid.

2015 and 2016 Tax Periods:

Legislative recoveries do not exist for these years and the 2014 extension is irrelevant. The 2015 period prescribes on December 31, 2019, and the 2016 period prescribes on December 31, 2020. The taxpayer must file the amended 2015 and 2016 returns within the prescriptive period. However, because the Department will review the returns and documentation per taxpayer, the best practice is to submit amended returns and documentation for all periods at issue at the same time to avoid processing delays. In addition, the taxpayer prepares and files Form R-2214-SM, the 2015 and/or 2016 Amended Return, and R-10606 with the Department. In lieu of filing Form R-2214-SM, the taxpayer may file a petition for a claim against the state directly with the BTA.

2017 Tax Period:

If a 2014 legislative recovery was claimed on the 2017 tax return and the 2014 claim against the state includes the legislative recoveries, the 2017 return will be manually adjusted by the Department to remove the legislative recovery. For 2017, the credit for Texas Tax paid will likely offset the legislative recovery (if applicable). However, if not, the Department will abate interest and waive penalty resulting from additional liability as a result of these changes only, provided the tax balance is paid to the Department within 60 days of notice of additional tax due.

2018 Tax Period:

It is unlikely a claim against the state will be filed because the 2018 return was due in May 2019, over two months after the *Smith* decision. The credit for Texas Tax paid was allowed for the 2018 period. However, the legislative recovery will be manually removed if necessary. If the deduction for Texas Tax was originally claimed on 2018 tax return, the taxpayer may amend to claim credit for Texas Tax paid as an alternative. The credit is likely more beneficial to taxpayer than the deduction, but the taxpayer cannot claim both the credit and deduction for 2018 and subsequent periods, as discussed above.

The Form R-2214-SM (if applicable[6]), amended tax returns, Form R-10606, and applicable documentation should be compiled, year by year, and submitted together via paper filing to:

> Louisiana Department of Revenue
> Litigation Division
> RE: CAS – Credit for Taxes Paid
> PO Box 4064
> Baton Rouge, LA 70821-4064

Applicable documentation includes a copy of the Texas Franchise Tax Return as filed with the Texas Comptroller of Public Accounts, the Schedule K-1, and any calculations used to determine the apportioned amount of the credit claimed. If the taxpayer is unable to produce any documentation, include an explanatory statement to this effect.

Taxpayers, or their tax return preparers, should include a cover letter with contact information (including phone number and email address). For tax return preparers representing taxpayers, Form R-7006, *Power of Attorney and Declaration of Representative* should be included to expedite any necessary follow up discussions with tax return preparers.

Examples

Examples based on the scenarios listed in the "Scenario Table" below will be published via an online presentation recording.

Kimberly Lewis Robinson
Secretary

[6] If a petition has been previously filed with the Board of Tax Appeals, include a copy of the petition in the documentation.

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<u>Scenario Table</u>

Scenario Number	Tax Period	Valid Filing Extension for 2014	CAS or Amended 2014 Tax Return Filed on or before 12/31/2018	Source of Limitation	Legislative Recovery for 2017, 2018, and 2019	Return of Tax Permissible through CAS Procedure
1	2014	No	No	Reciprocity	No	No
				Calculation Change	No	No
2	2014	Yes	No	Reciprocity	Yes	No
				Calculation Change	Yes	No
3	2014	No	Yes	Reciprocity	No	Yes
				Calculation Change	No	No
4	2014	Yes	Yes	Reciprocity	No*	Yes
				Calculation Change	Yes	No
5	2015 and 2016	N/A	N/A	Reciprocity	No	Yes
				Calculation Change	No	No
6	2017	No	No	Reciprocity	No	Yes
				Calculation Change	No	No
7	2017	Yes	No	Reciprocity	No*	Yes
				Calculation Change	Yes	No
8	2017	No	Yes	Reciprocity	No	Yes
				Calculation Change	No	No
9	2017	Yes	Yes	Reciprocity	No*	Yes
				Calculation Change	Yes	No

*While the legislative recovery is allowable, taxpayers are more likely to obtain a return of tax attributable to the legislative recovery in lieu of applying the legislative recovery in 2016 and 2017.

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