

shall be taken of any reduction or increase in the Federal adjusted gross income which would result from the exclusion from, or inclusion in, gross income of the items which are the subject of the adjustments. Thus, for example, when for purposes of the calculation the taxpayer's Federal taxable income is adjusted to reflect the exclusion from gross income of interest on obligations of the United States, no change shall be made in the amount of the taxpayer's deduction for medical expenses, or in the amount of his charitable contribution base, even though such amounts would ordinarily depend upon the amount of adjusted gross income.

[T.D. 7577, 43 FR 59366, Dec. 20, 1978]

§ 301.6362-3 Qualified resident tax which is a percentage of Federal tax.

(a) *In general.* A tax meets the requirements of section 6362(c) and this section only if:

(1) The tax is imposed as a single specified percentage of the excess of the taxes imposed by chapter 1 over the sum of the credits allowable under part IV of subchapter A of chapter 1 (other than the credits allowable under sections 31 and 39), and

(2) The amount of the tax is decreased by the amount of the decrease in such liability which would result from excluding from the taxpayer's gross income an amount equal to the amount of interest on obligations of the United States which was included in his gross income for the taxable year.

(b) *Permitted adjustments.* A tax which otherwise meets the requirements of paragraph (a) of this section shall not be deemed to fail to meet such requirements solely because it provides for one or more of the following three adjustments:

(1) The amount of a taxpayer's liability for tax is increased by the amount of the increase in such liability which would result from including in such taxpayer's gross income all of the following:

(i) An amount equal to the amount of his net State income tax deduction, as defined in paragraph (a) of § 301.6362-4, for the taxable year,

(ii) An amount equal to the amount of his net tax-exempt income, as defined in paragraph (b) of § 301.6362-4, for the taxable year, and

(iii) If a credit is allowed against the tax under paragraph (b)(3) of this section for sales tax imposed by the State or a political subdivision thereof, an amount equal to the amount of his deduction under section 164(a)(4) for such sales tax.

(2) A credit meeting the requirements of paragraph (c) of § 301.6362-4 is allowed against the tax for the income tax of another State or a political subdivision thereof.

(3) A credit is allowed against the tax for all or a portion of any general sales tax imposed by the State or a political subdivision thereof with respect to sales either to the taxpayer or to one or more of his dependents.

(c) *Method of making adjustments.* Except as specifically provided in paragraphs (a)(2) and (b)(1) of this section and in paragraph (c)(2) of § 301.6362-4, no account shall be taken of any reduction or increase in the Federal adjusted gross income which would result from the exclusion from, or inclusion in, gross income of the items which are the subject of the adjustments provided in those paragraphs. Thus, for example, when for purposes of the calculation the taxpayer's Federal income tax liability is adjusted to reflect the exclusion from gross income of interest on obligations of the United States, no change shall be made in the amount of the taxpayer's deduction for medical expenses, or in the amount of his charitable contribution base, even though such amounts would ordinarily depend upon the amount of adjusted gross income. Also, when calculating the adjusted Federal tax liability to which the rate of the State tax is to be applied, no adjustment shall be made in the amount of any credit against Federal tax to which a taxpayer is entitled.

[T.D. 7577, 43 FR 59366, Dec. 20, 1978]

§ 301.6362-4 Rules for adjustments relating to qualified resident taxes.

(a) *Net State income tax deduction.* For purposes of section 6362 (b)(1)(B) and (c)(3)(B), and §§ 301.6362-2 and 301.6362-3, the "net State income tax deduction"

shall be the excess (if any) of (1) the amount deducted from income under section 164(a)(3) as taxes paid to a State or to a political subdivision thereof, over (2) the amounts included in income as recoveries of prior income taxes which were paid to a State or to a political subdivision thereof and which had been deducted under section 164(a)(3).

(b) *Net tax-exempt income.* For purposes of section 6362 (b)(1)(C) and (c)(3)(A) and §§ 301.6362-2 and 301.6362-3, the “net tax-exempt income” shall be the excess (if any) of:

(1) The sum of (i) the interest on obligations described in section 103 (a)(1) other than obligations of the State imposing the tax and the political subdivisions thereof, and (ii) the interest on obligations described in such section of such State and the political subdivisions thereof which under the law of the State is subject to the tax; over

(2) The sum of (i) the amount of deductions allocable to the interest described in subparagraph (1) (i) or (ii) of this paragraph (b), which is disallowed pursuant to section 265 and the regulations thereunder, and (ii) the amount of the adjustment to basis allocable to such obligations which is required to be made for the taxable year under section 1016(a) (5) or (6).

For purposes of subparagraph (1)(ii) of this paragraph (b), a State may, at its option, subject to the tax the interest from all, none, or some of its section 103(a)(1) obligations and those of its political subdivisions. For example, a State may subject to tax all of such obligations other than those which it or its political subdivisions issued prior to a specified date, which may be the date that subchapter E became applicable to the State.

(c) *Credits for taxes of other jurisdictions—(1) In general.* A State tax law that provides for a credit, pursuant to section 6362(b)(2) (B) or (C) or section 6362(c)(4), and paragraph (b)(1) of § 301.6362-2 or paragraph (b)(2) of § 301.6362-3, for income tax of another State or a political subdivision thereof shall provide that, in the case of each taxpayer, the amount of the credit shall equal the amount of his liability with respect to such other jurisdic-

tion’s tax for the taxable year which runs concurrently with, or which ends in, the taxable year used by the taxpayer for purposes of the State tax which provides for the credit. Such a credit may be allowed with respect to every income tax (whether or not qualified) imposed on the taxpayer by another State or a political subdivision thereof, or only with respect to certain of such taxes. However, for purposes of this paragraph, the amount which is treated as being the amount of the taxpayer’s liability with respect to any such tax imposed by another jurisdiction shall not exceed the amount of liability for such tax which is both—

(A) Reported to the taxing authorities responsible for collecting such other jurisdiction’s tax, and

(B) Substantiated pursuant to the requirements of paragraph (c)(1)(ii) of § 301.6361-1.

(2) *Limitation.* The amount of any credit allowed for the taxable year pursuant to this paragraph shall not exceed the product of the amount of the resident tax against which the credit is allowed, as computed without subtracting any such credit, multiplied by a fraction the numerator of which is the amount of income subject to tax by both the State imposing the resident tax against which the credit is allowed and the other jurisdiction whose tax is being credited, and the denominator of which is the amount of income subject to tax by the State imposing the resident tax against which the credit is allowed. For purposes of the preceding sentence, “income subject to tax” means the amount of the taxpayer’s adjusted gross income which is taken into account for purposes of computing tax liability; in the case of a qualified resident tax, an appropriate modification shall be made to take into account any adjustments which are made pursuant to paragraph (a)(1) and (3) of § 301.6362-2, or pursuant to paragraph (a)(2) or (b)(1)(ii) of § 301.6362-3.

(3) *Examples.* The application of this paragraph may be illustrated by the following examples:

Example 1. (i) A, a calendar-year, cash-basis taxpayer, is a resident of State X throughout the taxable year. For such year, his adjusted gross income for Federal income tax purposes consists of \$24,000, consisting of \$3,000

derived from employment in State X, \$5,000 derived from employment in State Y, \$15,000 derived from employment in State Z, and \$1,000 in interest income from United States savings bonds. In addition, he received net tax-exempt income in the amount of \$2,000. For the taxable year, he incurs liabilities of \$200 for the State Y nonresident income tax, and \$1,400 for the State Z nonresident income tax. State X, which has in effect a State agreement for the taxable year, imposes a resident tax against which credits are allowed for the nonresident taxes imposed by States Y and Z. Without taking any such credits into account, however, the amount of A's liability for such resident tax would be \$1,500. A properly reports his nonresident income tax liabilities to States Y and Z at the same time that he files his return with respect to the State X tax, and he substantiates on such return his liabilities to States Y and Z.

(ii) The amount of A's income subject to tax in State X is \$25,000 (his adjusted gross income of \$24,000, minus the United States savings bond income of \$1,000, plus the net tax-exempt income of \$2,000). The amount of the credit allowable against the State X resident tax for the amount of A's liability with respect to the State Y nonresident tax is calculated as follows: The maximum amount of credit is the actual amount of his liability to Y, or \$200. Under subparagraph (2) of this paragraph, the amount of the credit is limited to \$300 ($\$1,500 \times \$5,000/\$25,000$). Thus, such limit has no effect, and the full \$200 is allowable as a credit against A's liability for the resident tax of State X. The amount of the credit allowable against the State X resident tax for the amount of A's liability with respect to the State Z nonresident tax is calculated as follows: The maximum amount of the credit is the actual amount of his liability to Z, or \$1,400. Under subparagraph (2) of this paragraph, the amount of the credit is limited to \$900 ($1,500 \times \$15,000/\$25,000$). Thus, such limit has the effect of reducing to \$900 the amount of the credit allowable for tax of State Z against A's liability for the resident tax of State X.

Example 2. (i) B, a calendar-year, cash-basis taxpayer, is a resident of State X employed in State Y through March 14, 1977. On March 15, 1977, B becomes a resident of State Z and remains a resident of such State through the remainder of 1977. For 1977, the amount of B's adjusted gross income for Federal income tax purposes is \$20,000, consisting of \$6,000 derived from employment in State Y which B held during the period of his residence in State X, \$12,000 derived from employment in State Z which B held during the period of his residence in State Z, and \$2,000 in interest income from various bank accounts. During 1977, B has no interest income from United States obligations, and no tax-exempt income. For 1977, B incurs a liability of \$200 to

State Y on account of its nonresident income tax imposed with respect to his \$6,000 of income derived from sources within that State. State Z, which has in effect a State agreement for 1977, imposes a resident income tax on B which, if B had been a resident of State Z for all 1977, would amount to \$1,200 prior to the allowance of any credits under this paragraph. However, by reason of paragraph (e)(1) of § 301.6362-6, B's liability for the resident tax of State Z, before taking into account credits allowed under this paragraph, is reduced to \$960 ($\$1,200 \times \frac{292}{365}$, or $\frac{4}{5}$). Furthermore, State Z allows a credit for the nonresident tax imposed by State Y.

(ii) The amount of the credit allowable against the State Z resident tax for the amount of B's liability with respect to the State Y nonresident tax is calculated as follows: The maximum amount of the credit is the amount of his actual liability to State Y, or \$200. Under subparagraph (2) of this paragraph, the amount of the credit is limited to \$288 ($\$960 \times \$6,000/\$20,000$). Thus, such limit has no effect, and the full \$200 is allowable as a credit for tax of State Y against B's liability for the resident tax of State Z.

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§ 301.6362-5 Qualified nonresident tax.

(a) *In general.* A tax meets the requirements of section 6362(d) and this section only if:

(1) The tax is imposed by a State which simultaneously imposes a resident tax meeting the requirements of section 6362(b) and § 301.6362-2 or of section 6362(c) and § 301.6362-3;

(2) The tax is required to be computed in accordance with either the method prescribed in paragraph (b) of this section or another method of which the Secretary or his delegate approves upon submission by the State of the laws pertaining to the tax;

(3) The tax is imposed only on the wage and other business income derived from sources within such State (as defined in paragraph (d) of this section), of all individuals each of whom derives 25 percent or more of his aggregate wage and other business income for the taxable year from sources within such State while he is neither (i) a resident of such State within the meaning of section 6362(e) and § 301.6362-6, nor (ii) exempt from liability for the tax by reason of a reciprocal agreement between such State and the State of which he is a resident within the meaning of those provisions;