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OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:

**S. MATHER AND
N. MATHER**

OTA Case No. 18093787

OPINION

Representing the Parties:

For Appellants: Jon A. Sperring, Representative
Derick J. Brannan, Representative
Michael Zargari, Representative

For Respondent: Nathan H. Hall, Attorney
Desiree Macedo, Attorney

For Office of Tax Appeals: Mai C. Tran, Attorney

K. GAST, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19331, S. Mather (appellant-husband) and N. Mather (collectively, appellants) appeal deemed denials by respondent Franchise Tax Board (FTB) of their refund claims totaling $217,904, $163,860, and $167,190 for the 2012, 2013, and 2014 tax years, respectively.

Office of Tax Appeals (OTA) Administrative Law Judges Kenneth Gast, Ovsep Akopchikyan, and Cheryl L. Akin held an electronic oral hearing for this matter on September 20, 2023. At the hearing, the record was held open for additional briefing. On November 30, 2023, the record was closed and this matter was submitted for an opinion.

ISSUE[1]

Whether the New York City (NYC) Unincorporated Business Tax (UBT) and the Metropolitan Commuter Transportation Mobility Tax (MCTMT) are eligible for the other state tax credit (OSTC), and if so, the amount, if any, appellants are entitled to claim as the OSTC.

[1] To better reflect the issue in dispute based on the parties' briefing and oral hearing, OTA has revised the issue statement, which is materially the same as the one provided to the parties at the prehearing conference.

FACTUAL FINDINGS

1. During the years at issue, appellants were California residents.
2. Appellant-husband was a partial owner and member of two California-headquartered limited liability companies (LLCs) that were classified as partnerships for federal and California income tax purposes: Pacific Investment Management Company LLC; and PIMCO Partners LLC.[2] Both LLCs were funds that generated income from providing fixed income investment management and other services. They conducted multistate business operations, including in New York state (NYS), where they had office(s) in NYC and the metropolitan commuter transportation district (MCTD), which embraces NYC and certain nearby NYS counties.
3. For the 2012 through 2014 tax years, the LLCs were each subject to the entity-level NYC UBT, and they separately filed UBT returns with, and paid UBT to, the NYC Department of Finance. Appellant-husband's total share of UBT paid by both LLCs was $187,926 for 2012, $140,016 for 2013, and $139,295 for 2014.
4. Also for the 2012 through 2014 tax years, appellant-husband was individually subject to the MCTMT based on his net earnings from self-employment allocated to the MCTD from both LLCs. Appellant-husband filed 2012 and 2013 MCTMT returns with, and purportedly paid MCTMT of $29,978 for 2012 and $23,844 for 2013 to, the NYS Department of Taxation and Finance.[3] For 2014, the LLCs each filed (on behalf of their qualified electing partners, including appellant-husband) group MCTMT returns with, and paid MCTMT to, the NYS Department of Taxation and Finance. Appellant-husband's total share of MCTMT paid by both LLCs for 2014 was $27,895.
5. On their 2012 through 2014 joint California resident income tax returns, appellants reported and paid net income taxes on their entire distributive shares of the LLCs' income on a residence basis, i.e., regardless of the state in which it was earned. Since they paid nonresident net income taxes on this same income in various states, including NYS, they claimed the OSTC for those taxes, which are not in dispute. Appellants, however, did not initially claim the OSTC for the NYC UBT or MCTMT.

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[2] Appellant-husband was employed as the Chief Investment Officer in one, or both, of these LLCs.

[3] FTB disputes whether appellants provided sufficient evidence showing they paid these two amounts.

6. Appellants later filed refund claims for the contested years, claiming the OSTC in the exact amounts paid (or purportedly paid) for the NYC UBT and MCTMT. Appellants considered their claims denied after FTB did not act on them within six months after they were filed. Appellants then filed this timely appeal.[4]

DISCUSSION

I. Introduction

Taxpayers bear the burden of proving entitlement to their refund claims, which means they must not only prove the tax paid was incorrect but must also produce evidence to establish the proper amount of tax due, if any. (*Appeal of Jali, LLC*, 2019-OTA-204P.) Stated differently, taxpayers must affirmatively establish the right to a refund of the taxes by a preponderance of the evidence.[5] (*Gray et al. v. Franchise Tax Bd.* (1991) 235 Cal.App.3d 36, 40 (*Gray*).) It is well settled that tax credits, such as the OSTC, are matters of legislative grace and are to be strictly construed against taxpayers, with any doubts resolved in FTB's favor. (*Appeal of Buehler*, 2023-OTA-215P (*Buehler*); see also *Miller v. McColgan* (1941) 17 Cal.2d 432, 441-442 [the OSTC is in effect an exemption from liability for a tax already determined and admittedly valid and is therefore strictly construed against taxpayers].)

California residents are taxed on their entire taxable income, regardless of whether that income is earned within or without this state. (R&TC, § 17041(a).) If California residents also earn income in states where they are nonresidents, those states can (and often do) impose nonresident net income taxes on income sourced to those states under their tax laws, even when that same income is subject to California's resident tax based on worldwide net income. (*Buehler*, *supra*.) Therefore, to avoid double taxation, R&TC section 18001 provides some relief in the form of an OSTC against California's resident tax for net income taxes imposed by and paid to the nonresident state, provided certain conditions are met, as set forth below. (*Ibid.*; see *Gray*, *supra*, 235 Cal.App.3d at p. 40 ["A tax credit is a direct dollar-for-dollar reduction of the amount of tax owed by a taxpayer"].) California's OSTC allows members of partnerships, such

[4] On appeal, FTB raised, for the first time, an unrelated issue involving whether appellants improperly claimed ordinary business loss deductions, which FTB sought to disallow for purposes of offsetting any potential refund related to appellants' OSTC refund claims. However, FTB no longer disputes this issue.

[5] A preponderance of the evidence means taxpayers must establish by documentation or other evidence the circumstances they assert are more likely than not to be correct. (*Appeal of Black*, 2023-OTA-023P.)

as appellant-husband, to treat their pro rata share of net income taxes paid to another state by the partnerships as if those taxes had been paid directly by the partners themselves. (R&TC, § 18006(a).)

As relevant here, at least five conditions must be satisfied before California residents can claim the OSTC. The first three conditions involve whether the other state's levy is eligible for (i.e., creditable under) the OSTC. They are found in R&TC section 18001(a), which provides, in relevant part, that California residents shall be allowed the OSTC against their California net tax[6] "for net income taxes imposed by and paid to another state" on income taxable under California's Personal Income Tax Law (PITL), found in R&TC section 17001 et seq.[7] Thus, based on this language, one condition is the other state's levy must be "imposed by and paid to another state." A second condition is the levy must be a "tax" and not something other than a tax, such as a fee. Lastly, the other state's tax must be imposed on "net income."[8]

Once it is determined that the other state's net income tax is *eligible* for the OSTC, that does not end the analysis because two more conditions must be met that involve the *amount* of the OSTC that California residents can claim against their California net tax. One condition is the OSTC "shall be allowed only for taxes paid to the other state . . . on income derived from sources within that state . . . ." (R&TC, § 18001(a)(1).) "[I]ncome derived from sources within that state" is determined by applying California's nonresident sourcing rules for determining income from sources within California, which are found in R&TC section 17951 et seq., and the accompanying regulations. (R&TC, § 18001(c); Cal. Code Regs., tit. 18, § 18001-2(a); *Buehler*, *supra*.) The other condition is the OSTC "shall not exceed the proportion of [the California net tax] payable under [the PITL] as the income subject to tax in the other state . . . and also taxable under [the PITL] bears to the taxpayer's entire income upon which the [California net tax] is imposed by [the PITL]." (R&TC, § 18001(a)(3); Cal. Code Regs., tit. 18, § 18001-2(c).)

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[6] R&TC section 18001 looks to R&TC section 17039 for its definition of "net tax." In basic terms, R&TC section 17039(a) provides that, for the purpose of computing tax credits, "net tax" means the tax imposed under R&TC section 17041, less credits allowed by R&TC section 17054 (relating to personal exemption credits).

[7] R&TC section 18001(a) also requires the other state net income taxes not be a preference, alternative, or minimum tax comparable to the tax imposed by R&TC section 17062 (involving the alternative minimum tax). There is no dispute the NYC UBT and the MCTMT's self-employment tax are not these types of taxes.

[8] Another eligibility condition is the OSTC is disallowed if the nonresident state allows California residents the OSTC against taxes imposed by that nonresident state for resident taxes paid to California. (R&TC, § 18001(a)(2); Cal. Code Regs., tit. 18, § 18001-2(b).) This condition is not relevant here because appellants were not entitled to claim the OSTC against their NYC UBT and MCTMT liabilities for California resident taxes paid.

Appellants contend both the NYC UBT and the MCTMT's self-employment tax are NYS-imposed taxes based on net income that are paid to NYS and not a local government, such as NYC. Thus, appellants maintain, these taxes are eligible for the OSTC, and they are properly due refunds in California in the exact amounts paid for these taxes. FTB disagrees, asserting the NYC UBT and MCTMT are locally-imposed levies that are best characterized as fees and not taxes, and in any event, are not based on net income. FTB further asserts that if OTA finds one, or both, of these levies is OSTC-eligible, appellants are still not entitled to refunds because they have not submitted evidence supporting: (1) the alleged double-taxed income has a source, under California's nonresident sourcing rules, in NYC or the MCTD; (2) the claimed OSTC does not exceed the proportion of net tax payable to California as the double-taxed income bears to appellants' entire California income; or (3) actual payment of the MCTMT's self-employment tax for 2012 or 2013.[9]

To resolve this appeal, OTA must first determine whether the NYC UBT and MCTMT are OSTC-eligible. If one, or both, of these levies is eligible, OTA must next determine the OSTC amount, if any, appellants are entitled to claim against their California net taxes. For reasons that follow, OTA holds that appellants are not entitled to their claimed refunds because (1) the NYC UBT is a local levy that is not eligible for the OSTC, and (2) although OTA finds

[9] In its post-hearing brief, FTB states that it "agrees with the OSTC amounts [for the NYC UBT for each disputed year and the MCTMT for 2014] claimed by [a]ppellants from a strictly computational standpoint," but also adds its "position has not changed" in its briefing and at the hearing that these levies are not OSTC-eligible. OTA interprets FTB's post-hearing concession, made in the context of whether appellants have proven payment of the levies, as simply agreeing with their mechanical computation of the claimed OSTC, assuming, without conceding, all conditions required to claim it are met, including the sourcing condition, which involves largely (if not solely) factual and legal determinations rather than merely computational ones. For example, and as discussed later in the Opinion, a factual and legal analysis under the express conditions of R&TC section 18001(a)(1) and (3) must first be undertaken to determine the amount, if any, of the claimed double-taxed income that has a source in the nonresident state under California's nonresident sourcing rules (and the related amounts, if any, employed in the proportion limitation condition) before the OSTC becomes strictly computational (i.e., before entering such amounts on Schedule S, which has line items to perform a mechanical computation of the OSTC). Indeed, in its opening brief, FTB explicitly contests the sourcing and proportion limitation conditions, and at the hearing, FTB clarified that for issues it did not address there (e.g., the tax versus fee or net income issues), it would rest on its briefing but was not conceding these issues. Thus, OTA will address these contested issues, where applicable.

the MCTMT's self-employment tax is eligible for the OSTC, appellants have not shown the amount, if any, they can claim against their California net taxes.[10]

II. Analysis

A. The NYC UBT is a Local Levy that is Not Eligible for the OSTC[11]

1. California Law Controls the Conditions for Claiming the OSTC

As noted above, one of the conditions for OSTC eligibility is the other state's tax must be "imposed by and paid to another state." (R&TC, § 18001(a).) These terms are not defined in R&TC section 18001. However, the term "state" is defined in the accompanying regulation, California Code of Regulations, title 18, (Regulation) section 18001-1(a), which provides that for the tax years at issue, "the term 'state' includes states of the United States, the District of Columbia and the possessions of the United States, but does not include the United States or foreign countries."[12] The parties agree this definition of "state" excludes local levies (e.g., those imposed by U.S. political subdivisions, such as cities, counties, municipalities, etc.). But the crux of appellants' contention is the NYC UBT, despite its name, is actually imposed by and paid to *NYS*, not NYC. Before addressing the merits of this contention, OTA first provides a recitation of other relevant legal authorities.

As a threshold matter, OTA concludes, and the parties appear to agree, that California law controls the determination of whether the other state's levy meets the conditions for claiming the OSTC. (See *Christman et al. v. Franchise Tax Bd.* (1976) 64 Cal.App.3d 751, 755-758 (*Christman*).) While *Christman* specifically held California law governed whether income has a

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[10] At the hearing, appellants called Mr. Glenn Newman, a NYS lawyer and former President of the NYC Tax Commission and Tax Appeals Tribunal, to testify as an expert witness involving the two disputed levies. To the extent his testimony reflects his views on legal questions related to the NYC UBT, MCTMT, and other authorities as they pertain to R&TC section 18001, OTA considers his testimony nonbinding legal argument. OTA is ultimately charged with deciding legal questions, and its analysis and conclusions in this Opinion reflect its independent judgement unimpeded by any legal conclusions Mr. Newman may have reached. (See *Communications Satellite Corp. v. Franchise Tax Bd.* (1984) 156 Cal.App.3d 726, 747.)

[11] OTA broadly refers to the NYC UBT as a "levy" because, as discussed fully below, it concludes the UBT is ineligible for the OSTC on the sole basis that it is "imposed by and paid to" NYC, a local jurisdiction. Therefore, OTA does not need to separately determine whether the UBT constitutes a tax or fee, or whether it is based on net income.

[12] See also R&TC, §§ 17018 [for purposes of the PITL, "'[s]tate' includes the District of Columbia, and the possessions of the United States"], 17017 [for purposes of the PITL, "'United States,' when used in a geographical sense, includes the states, the District of Columbia, and the possessions of the United States"].

source in California or the other state for OSTC purposes, it contains broad language supporting that California law should also govern other conditions under the OSTC. Specifically, the court noted "it would be anomalous indeed to find that the California legislature's bestowal of this tax benefit was intended to depend upon some other state's characterization of a California resident's income." (*Christman*, *supra*, 64 Cal.App.3d at p. 757.) The court concluded R&TC section 18001's goal was of "limited protection against double taxation," as shown in part by the fact that the statute has specific conditions for qualification, rather than an outright allowance of the OSTC for any out-of-state taxes paid. (*Id.* at p. 758.) Indeed, another court also looked to California law to determine a different OSTC issue; i.e., whether the other state's tax was imposed on "net income" for purposes of qualifying for the nonresident OSTC under R&TC section 18002, whose conditions are substantially similar to those for the resident OSTC under R&TC section 18001 at issue here. (*Gray*, *supra*, 235 Cal.App.3d at pp. 42-45.) Accordingly, California law should also govern other OSTC conditions, such as whether the other state tax is "imposed by and paid to another state."

2. To be Eligible for the OSTC, (1) the Other State Must Mandate or Require the Tax's Imposition, and (2) Taxpayers Must Pay that Tax to the State

The only California guidance on the meaning of "imposed by and paid to another state" appears to be from OTA's predecessor, the Board of Equalization (BOE), which issued a precedential decision in *Appeal of Callister* (99-SBE-003) 1999 WL 253126 (*Callister*), that appellants cite as authority to support that the NYC UBT and MCTMT are state levies. In *Callister*, BOE held that Maryland resident taxpayers could claim a nonresident OSTC under R&TC section 18002 against their California nonresident income taxes for resident county income taxes paid to Maryland. (*Callister*, *supra*.) The Maryland resident tax consisted of two elements: a state income tax and a county surcharge equal to between 20 and 50 percent of the state income tax, depending on the location of the taxpayers' residence. (*Callister*, *supra*, at p. *1.) FTB initially viewed the surcharge as a local income tax and denied the taxpayers the OSTC for that tax, but subsequently changed its position by adopting the holding in a Minnesota Tax Court decision, *Meyer v. Commissioner* (1993) Docket No. 6095, 1993 WL 30518 (*Meyer*). (*Ibid.*)

In *Meyer*, the taxpayer was a Minnesota resident who worked in Maryland and paid both the state and local county income taxes to Maryland, which, acting as a collection agent, remitted

the local tax to the county where she worked. (*Meyer*, *supra*, at p. *1.) The taxpayer sought to claim a resident OSTC for both the Maryland and local county taxes against her Minnesota resident tax, but Minnesota's taxing agency denied the local credit. (*Ibid.*) The Minnesota tax court partially reversed the taxing agency's determination and found the central issue in the case was not whether taxes were literally paid to Maryland but rather the proper identity of the taxing agency and whether the tax was state-imposed. (*Id.* at p. *2.) It concluded the taxpayer was entitled to a credit for the local taxes paid but only in the amount of 20 percent of the Maryland state tax because that was the minimum amount that "*Maryland law require[d] each county to impose* . . . ." (*Ibid*., italics added.) The court further concluded that any amount paid above the minimum percentage was not creditable because Maryland counties were "given the *option*" to impose higher taxes up to a ceiling. (*Ibid.*, italics added.)

In *Callister*, BOE reviewed *Meyer*, "accept[ed]" its conclusion," and declined to "completely" follow its previous holding in *Appeal of Bartz* (94-SBE-006) 1994 WL 510127 (*Bartz*), in which BOE concluded the Maryland surcharge was ineligible for the OSTC because it was a local income tax neither imposed by, nor paid to, the state of Maryland. (*Callister*, *supra*, at p. *2.) Thus, consistent with *Meyer*, BOE found that a nonresident OSTC was allowed for local taxes "paid to Maryland, in an amount not to exceed the amount of the 'surcharge' mandated by that state, which is currently in an amount not to exceed 20 percent of a taxpayer's Maryland state income tax liability." (*Ibid.*) BOE further found that any amount in excess of the 20 percent was ineligible because that portion of the local tax was "*discretionary* with the counties." (*Id.* at pp. *1-*2, italics added.)

Indeed, in *Callister*, one of the Maryland tax statutes at issue explicitly provided: "Each county *shall* have a county income tax . . . ." (Md. Tax-Gen. Code, § 10-103(a) (1988), italics added.) The other relevant Maryland tax statute provided the same: "Each county *shall* set, by ordinance or resolution, a county income tax rate *equal to at least* 20% but not more than 50% of the [s]tate income tax for an individual." (Md. Tax-Gen. Code, § 10-106(a)(1) (1988), italics added.) In a case involving a predecessor statute to Md. Tax-Gen. Code section 10-106, Maryland's highest court concluded "[t]here is no discretion in the subdivisions to adopt or refuse to adopt [] a [local] tax; the imposition of the tax is mandatory, and it is only with respect to the establishment of the rate of tax that the local governments retain a modicum of flexibility." (*Stern v. Comptroller of the Treasury* (1974) 271 Md. 310, 314; see also *Frey v. Comptroller of*

the Treasury (2011) 422 Md. 111, 138-142.) The U.S. Supreme Court has also recently observed that "[d]espite the names that Maryland has assigned to these [resident] taxes [i.e., the "state" and so-called "county" income taxes], *both are [s]tate taxes [under state law], and both are collected by the [s]tate's Comptroller of the Treasury*." (*Comptroller of the Treasury of Maryland v. Wynne* (2015) 575 U.S. 542, 546, italics added.) Thus, *Callister* and these other relevant authorities provide useful guidance to determine whether an out-of-state tax is "imposed by and paid to another state," and support the mechanics of the tax, rather than the label attached to it, must be analyzed to make that determination.

In addition, while R&TC section 18001 et seq. and its regulations do not define the terms "imposed by and paid to" another state, BOE concluded "'imposed by' . . . refers to [the] ultimate tax liability, not [for example] the amount of tax withheld." (*Appeal of Cornman* (84-SBE-034) 1984 WL 16114.) And a California court, involving a local tax issue, cited a dictionary that defined "to impose" to mean "to establish or apply by authority or force." (*Ponderosa Homes, Inc. v. City of San Ramon* (1994) 23 Cal.App.4th 1761, 1770 (*Ponderosa Homes*).) According to the court, the phrase refers to the creation of a tax by the authority of a government, as opposed to compliance with that tax. (*Ibid*.) Similarly, a legal dictionary defines the verb "pay" to mean, in part, "to make satisfaction" or "[t]o transfer money that one owes to a person, company, etc." (Black's Law Dictionary (11th ed. 2019).)

Based upon these authorities, OTA concludes that for a net income tax to be "imposed by and paid to another state" under R&TC section 18001(a), two conditions must be met: (1) the state (rather than a local political subdivision, such as a city, county, municipality, etc.) must mandate or require the tax's imposition; and (2) taxpayers must pay that tax to the state.[13] (*Callister*, *supra*; see also *Appeal of Collamore* (72-SBE-031) 1972 WL 2664 [taxes must actually be paid to another state].) This two-part test is derived from the plain language of R&TC section 18001(a) and is consistent with *Callister*. (See *Microsoft Corp. v. Franchise Tax Bd.* (2006) 39 Cal.4th 750, 758 [statute's plain language governs unless the text is ambiguous].)

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[13] OTA finds that *Callister* supports not only that the state must mandate imposition of the tax but also taxpayers must pay that tax to the state. (See *Callister*, *supra* ["[BOE found] that a[n] [OSTC] may be allowed . . . for county 'surcharge' taxes *paid to Maryland*," italics added].) However, OTA recognizes there may be situations where, in the words of *Meyer*, *supra*, at p. *2, a payment "literally" to the state may not necessarily be required if, for example, the state did not actually collect the state-imposed tax but instead directed the taxpayer to pay someone else (e.g., a locality) on behalf of the state. But OTA need not analyze or conclude on these possibilities because, as discussed below, neither the NYC UBT nor MCTMT has these facts.

Also consistent with these authorities, OTA distills a non-exhaustive list of objective factors to aid in the analysis of whether a tax is imposed by and paid to another state, where an affirmative answer to a factor weighs in favor of a tax more likely resembling a tax imposed by and paid to a state:

- Whether the tax is imposed (rather than merely permitted or authorized) by a state statute (*Callister*, *supra*);
- Whether the state requires (rather than merely permits or authorizes) the imposition of a certain tax rate (*Callister*, *supra*);
- Whether the state (rather than a local jurisdiction) administers and enforces the tax (*Callister*, *supra*), which can include, but is not limited to, whether:
  - tax returns are filed with the state;
  - the tax is paid to the state;
  - the state has authority to examine returns, issue notices of deficiency and assessments, collect amounts owed, and credit or refund overpayments;
  - the state can settle or compromise tax issues;
  - the state has a process for adjudicating appeals of taxpayer-adverse determinations; and
- Whether the tax is imposed *statewide* on all affected taxpayers no matter where in the state they reside, are deriving income, or are conducting business (see *Callister*, *supra* [creditable, mandatory portion of local tax was imposed statewide, while non-creditable, discretionary portion was selectively adopted by the counties and thus not imposed statewide]).[14]

These factors are intended to serve merely as an aid to the analysis required by R&TC section 18001(a). The weight given to a particular factor depends on the facts and circumstances of the out-of-state tax under consideration. More factors weighing for or against a tax being characterized as "imposed by and paid to another state" may not necessarily be dispositive. With this framework, OTA now turns to the NYC UBT.

[14] However, this does not mean a *state-level* tax, which may be imposed only on certain taxpayers in a certain geographical region in the state, cannot still qualify as "imposed by and paid to another state." (See generally *Gray*, *supra*, 235 Cal.App.3d at p. 43, fn. 6 ["a state [does not have to] adopt a comprehensive personal income tax in order for a tax to be creditable against California tax"].)

3. The NYC UBT is Imposed by and Paid to NYC, Not NYS

Applying the above principles, OTA concludes the NYC UBT is a local levy imposed by and paid to *NYC*, not NYS. The NYC UBT is found in Chapter 5 of Title 11 of the NYC Administrative Code (NYC Admin. Code) rather than in a state-level law or statute. Beginning with tax years ending after January 1, 1966, NYC Admin. Code section 11-503(a) "hereby impose[s]" a four percent entity-level levy on the unincorporated business taxable income of every unincorporated business wholly or partly carried on within NYC.[15] Thus, based on the plain language of this NYC-enacted provision, NYC, and not NYS, imposes the NYC UBT. This fact alone appears enough to disqualify the levy from being eligible for the OSTC because it fails R&TC section 18001(a)'s first prong that the state must mandate or require the levy's imposition.

Although the analysis can end there, OTA finds further support of the levy's ineligibility because it is not paid to NYS (thus failing R&TC section 18001(a)'s second prong) and the above-enunciated factors weigh in favor of it being locally-imposed. Specifically, the NYC Department of Finance[16] administers and enforces the UBT and is authorized to make rules and regulations necessary for these purposes. (NYC Admin. Code, § 11-537.) UBT returns are filed with, and UBT is paid to, the NYC Department of Finance, not the NYS Department of Taxation and Finance. (NYC Admin. Code, § 11-515.) The NYC Department of Finance has authority to examine returns, issue notices of deficiency and assessments, collect amounts owed under the UBT, and credit or refund overpayments of UBT. (NYC Admin. Code, §§ 11-537, 11-521, 11-522, 11-532, 11-526.) It can settle contested determinations involving the UBT, and disputes concerning UBT deficiencies and refunds are adjudicated through NYC's, not NYS's, tax appeals tribunal. (NYC Admin. Code, §§ 11-124, 11-529, 11-501(f); NYC Charter, § 168.) Lastly, the NYC UBT is not imposed statewide but rather only on unincorporated businesses conducting operations within NYC. (NYC Admin. Code, § 11-503(a).) Accordingly, the NYC UBT is not imposed by and paid to NYS, which makes it distinguishable from the portion of the

[15] An unincorporated business generally includes, but is not limited to, entities classified as partnerships for federal income tax purposes. (NYC Admin. Code, §§ 11-502(a), 11-501(m).)

[16] For purposes of this discussion, no distinction is made between the NYC Department of Finance and the NYC Commissioner of Finance, as those terms are referenced in Chapter 5 of Title 11 of the NYC Admin. Code. (See NYC Admin. Code, § 11-501(d), (e).)

county income tax in *Callister* that Maryland required its counties to impose and that was paid to a state agency (i.e., the Maryland State Comptroller of the Treasury).

Appellants assert this conclusion is incorrect. They contend that even though the NYS Constitution grants "home-rule" powers to its local governments (NYS Const., art. IX, § 2),[17] the state constitution still prohibits the NYS Legislature from surrendering, suspending, or contracting away (other than exceptions not applicable here) its power of taxation, and any laws that delegate that taxing power shall specify the types of taxes that may be imposed and provide for their review. (NYS Const., art. XVI, § 1.) Appellants argue that aside from establishing rates for real property taxes, NYC lacks discretion to impose the UBT because the NYS Legislature, with the governor's approval, must initiate and approve the levy, including amendments to applicable sections of the NYC Admin. Code. Thus, appellants posit, the NYC UBT is a "city" levy in name only, it is imposed by NYS, and NYC merely administers and collects the UBT as an agent on behalf of NYS. OTA disagrees.

The relevant authorities do not support that NYS required or mandated NYC to impose the UBT. "In [NYS], local governments lack an independent power to tax. The State Constitution vests the taxing power in the [NYS] [L]egislature and authorizes the [L]egislature to delegate that power to local governments." (*Expedia, Inc. v City of N.Y. Dept. of Finance* (2013) 22 N.Y.3d 121, 126 [citing, among other authorities, NYS Const., art. XVI, § 1].) "The State Constitution places fundamental limitations on such delegations," and "[t]he [L]egislature must describe with specificity the taxes authorized by any enabling statute." (*Ibid.*) "In turn, local governments can only levy and collect taxes within the expressed limitations of specific enabling legislation." (*Ibid.* [citing, among other authorities, NYS Const., art. IX, § 2(c)(8)].)

Here, "[i]n 1966, the [NYS] Legislature enacted a statute '*to enable* any city having a population of one million or more to raise tax revenue by *authorizing* the imposition of taxes . . . on unincorporated businesses' (L. 1966, ch. 772)." (*Shapiro v. City of New York* (1973) 32 N.Y.2d 96, 100, italics added; see also City Unincorp. Bus. Tax, § 2 ["any city having a

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[17] For example, every local government shall have power to adopt and amend local laws not inconsistent with the provisions of the NYS Constitution or any general law relating to its property, affairs, or government. (NYS Const., art. IX, § 2(c).) The NYS Legislature, however, "[s]hall enact, and may from time to time amend, a statute of local governments granting to local governments powers including but not limited to those of local legislation and administration in addition to the powers vested in them by this article. A power granted in such statute may be repealed, diminished, impaired or suspended only by enactment of a statute by the [L]egislature with the approval of the governor . . . ." (NYS Const., art. IX, § 2(b)(1).)

population of one million or more, acting through its local legislative body, is hereby *authorized and empowered* to adopt and amend local laws imposing for any such city a tax on unincorporated businesses" that "substantially" follows the Model Local Law established by NYS, italics added].) "Pursuant to this [enabling] legislation, *[NYC] enacted* Local Law No. 22 of 1966 which imposes" the UBT that is patterned after the since-repealed state-level UBT. (*Shapiro v. City of New York*, *supra*, 32 N.Y.2d at p. 100, italics added.)

Thus, in the words of *Callister*, imposition of the UBT is merely "discretionary" with NYC. Unlike in *Callister*, which involved a state-mandated 20 percent county income tax, NYS neither requires NYC to impose the UBT nor did NYS itself impose the levy.[18] Rather, NYS simply gave NYC the option to impose the UBT, which NYC itself exercised by enacting the levy. (See *Ponderosa Homes*, *supra*, 23 Cal.App.4th at p. 1770 ["to impose" means "to establish or apply by authority or force"].) Indeed, appellants' position with respect to the NYC UBT would characterize all (or nearly all) local net income taxes as state-imposed and eligible for the OSTC, because in every state in the U.S., local governments are generally viewed as creatures of the state that derive their taxing powers either from the state legislature and/or the state constitution. (See *Hunter et al. v. City of Pittsburg* (1907) 207 U.S. 161, 178-179.) But that could not have been the result intended by R&TC section 18001's narrowly conditioning the OSTC on net income taxes imposed by and paid to "another state." (See *Christman*, *supra*, 64 Cal.App.3d at p. 758; *Buehler*, *supra*.)

In addition, while the NYC UBT was required to "substantially" follow the Model Local Law established by NYS, and although the NYS Legislature and governor approve amendments to the NYC UBT, that does not change it from a levy imposed by a local government to a levy imposed by the state. Like in NYS, California's legislative grant of power to local governments to impose local taxes "is an essential prerequisite to all local taxation, because local governments

[18] A city, like NYC, that wishes to impose a UBT must do so at a NYS-mandated rate of 4 percent, which is similar to *Callister* in which Maryland required its counties to impose the surcharge at a minimum rate. (Compare City Unincorp. Bus. Tax, § 101(a) ["A tax at the rate of four percent is hereby imposed . . . ."] and NYC Admin. Code, § 11-503(a) [same] with Md. Tax-Gen. Code, § 10-106(a)(1) (1988) ["Each county shall set, by ordinance or resolution, a county income tax rate equal to at least 20% . . . of the State income tax for an individual"].) However, that fact, standing alone, is not dispositive of the analysis here but simply one factor to consider. *Callister* was not decided on the sole basis of whether the other state set the local tax rate, but rather what was critical was whether the state mandated the imposition of the local tax, which was paid to the state. (See *Callister*, *supra*.) Thus, even though a local government, like NYC, must abide by certain state-level statutory rules if it elects to impose a levy, that does not necessarily mean the levy is mandated by the state.

have no inherent power to tax."[19] (*Santa Clara County Local Transportation Authority v. Guardino* (1995) 11 Cal.4th 220, 247-248.) "The [California] Legislature's authority to grant taxing power to local governments, moreover, includes the authority to prescribe the terms and conditions under which local governments may exercise that power[.]"[20] (*Id.* at p. 248.) "[E]ven when it has been thus granted, the taxing power of a local government does not become a vested right of that entity but remains at all times subject to amendment or repeal by the Legislature." (*Ibid.*) Similarly, while the NYS Legislature may limit a local jurisdiction's power to tax, that limitation does not change the characterization of a tax from a local tax to a state tax. Rather, to the extent the NYS Legislature enacts, and the governor approves, amendments of applicable sections to the NYC Admin. Code, it is merely a limit imposed on the delegated power to NYC if it decides to impose a tax on unincorporated businesses within its local jurisdiction. (See *Expedia, Inc. v City of N.Y. Dept. of Finance*, *supra*, 22 N.Y.3d 121 at p. 126.) Accordingly, the NYC UBT is a local levy that is not eligible for the OSTC.

B. The MCTMT's Self-Employment Tax is Eligible for the OSTC, But Appellants Have Not Shown What OSTC Amount, If Any, They Can Claim

1. The MCTMT is a NYS-Imposed Levy

The MCTMT is found in Article 23 of the New York Tax Law (NYTL), a state-level law.[21] Beginning in 2009, NYTL section 801(a) "hereby impose[s]" the MCTMT on certain employers (based on their payroll expense) and self-employed individuals (based on their net earnings) conducting business within the MCTD.[22] The NYS Department of Taxation and

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[19] Similar to NYS, California employs "home rule" provisions in its constitution. (See, e.g., Cal. Const. art. XI, §§ 3, 5.) "Levying taxes to raise revenue is an archetypal municipal affair, and a power secured by the home rule provision of the state Constitution." (*City and County of San Francisco v. Regents of University of California* (2019) 7 Cal.5th 536, 560.)

[20] For example, California prohibits local jurisdictions, such as a city or county, from imposing an income tax but instead permits them to impose a tax on gross receipts. (R&TC, § 17041.5.) Further, certain local taxes are subject to voter approval. (Gov. Code, § 53720 et. seq.)

[21] Although the MCTMT's statutes have been amended since the tax years at issue, OTA, unless otherwise noted, cites to the most recent version of NYTL section 800 et seq. (2023) because its relevant provisions are materially the same as those in effect for the tax years in this appeal.

[22] The MCTD generally embraces NYC and the counties of Dutchess, Nassau, Orange, Putnam, Rockland, Suffolk, and Westchester. (NYTL, § 800(a); New York Public Authorities Law, § 1262.)

Finance[23] administers, enforces, and collects the MCTMT, and is authorized to make rules and regulations necessary for these purposes. (NYTL, §§ 804, 805, 806(a) [generally incorporating the provisions, including the procedural and administrative rules, of Article 22 of the NYTL, involving NYS's personal income tax].) The NYS Department of Taxation and Finance has authority to examine returns, issue notices of deficiency and assessments, and credit or refund overpayments of MCTMT. (NYTL, § 806(a) [incorporating NYTL sections 681, 682, and 686].) Further, disputes concerning MCTMT deficiencies and refunds are adjudicated through NYS's tax appeals tribunal. (NYTL, § 806(a) [incorporating NYTL section 689]; see also NYTL, § 2(1).)

Based on these provisions, OTA finds the MCTMT is imposed by and paid to NYS. Although, as FTB seems to assert, the MCTMT is limited to activity conducted within the MCTD, a local region, and thus is unlike the local tax in *Callister* because it is not imposed statewide on all NYS taxpayers (see NYTL, § 801(b)(1)), the above-enunciated factors nonetheless weigh in favor of it being characterized as a NYS-imposed levy: it is imposed under the NYTL, a state law; and is administered, enforced, and collected by a NYS taxing agency. Accordingly, the MCTMT is unlike the NYC UBT but rather similar to the OSTC-eligible portion of the county income tax in *Callister* that was mandated by state statute and paid to a state agency.

FTB counters that even though the MCTMT is administered by the NYS Department of Taxation and Finance, proceeds from the levy must be distributed to the Metropolitan Transportation Authority (MTA) and are excluded from NYS's general fund. (See NYTL, § 805(a), (b) [taxes, interest, and penalties imposed by the MCTMT and collected by NYS shall be deposited daily with certain banks in trust for the MTA, and after deducting administrative costs, shall then be paid over into the MTA finance fund established under New York Public Authorities Law (NYPAL) section 1270-h].) FTB also notes the MCTMT's stated purpose as found in the statute: "For the sole purpose of providing an additional stable and reliable dedicated funding source for the [MTA] and its subsidiaries and affiliates to preserve, operate and improve essential transit and transportation services in the [MCTD], [the MCTMT] is hereby imposed . . . ." (NYTL, § 801(a).) Therefore, FTB contends, the "MCTMT is a dedicated use

[23] For purposes of this discussion, no distinction is made between the NYS Department of Taxation and Finance and the NYS Commissioner of Taxation and Finance, as those terms are referenced in the NYTL. (See NYTL, § 2(1).)

levy for a special purpose," and NYS's "participation is better described as an agent and administrator on behalf of the MTA, a local entity, to whom the MCTMT is paid."

However, OTA is not aware of any precedent to support FTB's use-of-funds argument. The plain language of R&TC section 18001(a) contains no such requirement, and *Callister* seems to undercut FTB's position. As noted above, in *Bartz*, BOE held the Maryland county surcharge was an OSTC-ineligible local income tax that was not "paid to" Maryland in part because the state tax agency was merely acting as a collection agent when it collected, earmarked, and returned the funds to the county where the taxpayer resided. But since *Callister* largely declined to follow *Bartz*, it appears this part of the *Bartz* analysis is no longer relevant. Instead, what matters under R&TC section 18001(a) is whether the state mandates or requires the tax's imposition and whether taxpayers must then pay that tax to the state, regardless of whether the state then distributes the funds to its localities.[24] (See *Callister*, *supra*.)

Critically, "the MTA does not have the power to tax." (*Metropolitan Transportation Authority v. County of Nassau* (1971) 28 N.Y.2d 385, 390; see also NYPAL, §§ 1265, 1266 [no indication the MTA has the power to tax, decides whether to impose a tax, or sets the tax rate of the MCTMT].) Created by the NYS Legislature (L. 1965, c. 324), the MTA is "a body corporate and politic constituting a public benefit corporation,"[25] consists of a chairperson and voting and non-voting members, considered a state agency for certain purposes, and generally exempt from taxation. (NYPAL, §§ 1263(1) & (5), 1275.) Thus, the MTA is dependent on NYS to impose the MCTMT to help the MTA raise revenue.[26] Also, the MCTMT benefits not just the MCTD

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[24] Indeed, under FTB's position, a state tax would always turn into a local one simply because the state decides, or is legally obligated, to deposit collected funds with a local entity. But such a position, if adopted, would arguably disqualify an otherwise OSTC-eligible state personal net income tax simply because the state uses or earmarks collected funds for a special purpose outside the general fund. Such a result does not appear to have been intended by the plain language of R&TC section 18001(a), which focuses on a payment obligation by the taxpayer to the state and not on how the state decides to use the funds. And, as noted above, this appeal does not involve a situation in which NYS is not collecting the MCTMT but instead directing the taxpayer to pay it to the MTA on NYS's behalf. There is no dispute that taxpayers must pay the MCTMT directly to the NYS Department of Taxation and Finance.

[25] A "public benefit corporation" means "a corporation organized to construct or operate a public improvement wholly or partly within the state, the profits from which inure to the benefit of this or other states, or to the people thereof." (New York General Construction Law, § 66(4).)

[26] See generally *Appeal of S&P Global, Inc., f/k/a The McGraw-Hill Companies, Inc.* (N.Y. Div. Tax App. 2017) DTA No. 825598, 2017 WL 6272556, at p. *19 [specifically concluding the MTA surcharge, which is imposed on C corporations within the MCTD under NYTL section 209-B and provides another source of funding to

but the entire NYS. (See *Mangano, et al. v Silver, etc., et al.* (N.Y. App. Div. 2013) 107 A.D.3d 956, 959 (*Mangano*) [upholding the state constitutionality of the MCTMT and noting investment in mass transit provides direct benefits to mass transit users and to the regional and state economies, including creating statewide jobs].) Accordingly, the MCTMT is best characterized as a NYS-imposed levy.[27]

2. The MCTMT is a Tax and Not a Fee

As determined above, California law controls whether the other state's levy meets the conditions for claiming the OSTC, and OTA concludes that principle should also apply for purposes of whether the levy is a creditable tax or non-creditable fee. (See *Christman*, *supra*, 64 Cal.App.3d at pp. 755-758.) FTB asserts the MCTMT is a fee and largely cites to Proposition 13 cases interpreting California constitutional law (Cal. Const., art. XIII A) to aid in the tax versus fee determination. Appellants assert this authority is irrelevant for OSTC purposes because it involves voting requirements to enact a state or local tax. But appellants do not otherwise indicate what specific California law should apply to determine whether the MCTMT is a tax or fee.

Appellants are incorrect that the California Constitution is irrelevant in the context of whether a levy is a tax or fee for OSTC purposes. A California Court of Appeal case concerning a levy imposed under California's PITL is instructive. In analyzing the U.S. constitutionality of former R&TC section 17942's unapportioned levy that was imposed on certain LLCs, the court first decided whether the levy was a tax or fee for purposes of applying the proper constitutional test. (*Northwest Energetic Services, LLC v. Franchise Tax Bd.* (2008) 159 Cal.App.4th 841, 851-861 (*Northwest*).) In doing so, the court, as FTB does here, looked to the distinction between a tax and fee in court cases involving Proposition 13. Those cases dealt with whether the subject levies were passed by the required two-thirds vote of the Legislature or qualified electors for changes in state and local taxes under former section 3 and section 4, respectively, of

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the MTA like the MCTMT, is a NYS-level tax], citing *United Services Automobile Asson. v. Curiale* (1996) 88 N.Y.2d 306.

[27] In its opening brief, FTB provides a discussion of the general law for the OSTC, and as support, cites Legal Ruling 2017-01, which is applicable to tax years after those at issue here and involves circumstances when a taxpayer may claim the OSTC. In hypothetical situation four, the ruling concludes, contrary to the one reached here, that the MCTMT is imposed by and paid to the MTA and not the NYS Department of Taxation and Finance. The ruling does not provide analysis or citation to authority for this conclusion and FTB does not reference or cite the hypothetical in this appeal. Regardless, for reasons just discussed, OTA finds the MCTMT is a NYS levy.

article XIII A of the California Constitution.[28] (*Id.* at pp. 851, fn. 3, & 854.) Since the *Northwest* court applied California constitutional law to analyze whether the income-based LLC levy, which was imposed under California's PITL, was a tax or fee, OTA discerns no reason why such authority cannot also be employed for the OSTC, which is also found in the PITL. Indeed, these authorities (i.e., the California Constitution and applicable law interpreting it) appear to be the only relevant California guidance squarely addressing whether a levy is a tax or fee in various contexts, including those involving income-based levies. Therefore, they are relevant here.

As support that the MCTMT is a non-creditable fee, FTB relies heavily on the California Supreme Court's seminal opinion in *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866 (*Sinclair*), and its progeny. *Sinclair* described the distinction between taxes, which require approval of two-thirds of the Legislature, and regulatory and other fees, which do not, under former section 3 of article III A of the California Constitution. "In general, taxes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted," and "[m]ost taxes are compulsory rather than imposed in response to a voluntary decision to develop or to seek other government benefits or privileges." (*Sinclair*, *supra*, 15 Cal.4th 866 at p. 874.) On the other hand, a fee funds a regulatory program or compensates for services or benefits provided by the government. (*Id.* at pp. 874-875.)

However, FTB's reliance on *Sinclair* is not entirely accurate. About a decade after *Sinclair* was decided, in November 2010, California voters approved Proposition 26, which amended section 3 of article XIII A by providing, for the first time, a definition of "tax" that was intended to be broad, requiring a two-thirds vote of the Legislature to approve laws increasing state taxes on any taxpayers, and shifting to the state government the burden of demonstrating that any charge, levy, or assessment is not a tax. (*Schmeer et al. v. County of Los Angeles et al.* (2013) 213 Cal.App.4th 1310, 1322-1323 (*Schmeer*).)[29] Proposition 26 "was an effort to close

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[28] California voters adopted Proposition 13 in 1978, adding article III A to the California Constitution, which imposed limitations upon the assessment and taxing powers of state and local governments. (See *Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 872-873.)

[29] Prior to adopting Proposition 26 in 2010, California voters adopted Proposition 218 in 1992, which added articles XIII C and XIII D to the California Constitution. (*Schmeer*, *supra*, 213 Cal.App.4th at p. 1319.) In general, Proposition 218 imposed additional voting approval requirements on the imposition of taxes by a local government but did not define the term "tax." (*Id.* at p. 1320.) Proposition 26 also amended section 1 of article XIII C of the California Constitution to, among other things, add a definition of "tax" that was intended to be broad and is similar to the definition under section 3 of article XIII A. (*Id.* at pp. 1322-1326.)

perceived loopholes in Propositions 13 and 218 and was largely a response to [*Sinclair*]." (*Id.* at p. 1322.) It sought "to curb the perceived problem of a proliferation of regulatory fees imposed by the state without a two-thirds vote of the Legislature or imposed by local governments without the voters' approval . . . ." (*Id.* at p. 1326.) Accordingly, OTA looks to Proposition 26 for a relevant definition of "tax" to determine whether the MCTMT is a tax or fee.

For state tax purposes, Proposition 26 provides a broad definition of "tax": "As used in this section, 'tax' means any levy, charge, or exaction of any kind imposed by the State[.]" (Cal. Const., art. XIII A, § 3(b).) However, the following two relevant charges are not taxes: "A charge imposed for a specific benefit conferred or privilege granted directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the State of conferring the benefit or granting the privilege to the payor"; or "[a] charge imposed for a specific government service or product provided directly to the payor that is not provided to those not charged, and which does not exceed the reasonable costs to the State of providing the service or product to the payor."[30] (Cal. Const., art. XIII A, § 3(b)(1)-(2).)

Based on this language and all available guidance on this issue, OTA concludes the MCTMT is best characterized as a "tax" and not a fee. Courts begin by looking at the words of the statute, giving them their usual and ordinary meaning, and are mindful that a levy's label as a tax or fee is not determinative of its nature. (*Northwest*, *supra*, 159 Cal.App.4th at pp. 854-855; see also *Schmeer*, *supra*, 213 Cal.App.4th at p. 1317 [the construction of a statute or an initiative is a question of law].) The MCTMT statute provides that "[f]or the sole purpose of providing an additional stable and reliable dedicated funding source for the [MTA] and its subsidiaries and affiliates to preserve, operate and improve essential transit and transportation services in the [MCTD], a tax is hereby imposed . . . ." (NYTL, § 801(a).) Thus, regardless of being called a "tax," the MCTMT meets California's broad definition of tax because it is "*any* levy, charge, or exaction *of any kind* imposed by" NYS. (Cal. Const., art. XIII A, § 3(b), italics added.) Additionally, it does not meet the relevant exceptions to a tax. It is not a charge imposed for a specific benefit conferred, privileged granted, or service provided directly to the payor that is not provided to those not charged. Specifically, payment of the MCTMT does not grant payors

[30] Section 3(b)(3)-(5) of article XIII A lists three other non-tax charges that appear to be irrelevant here.

access to the MTA's transportation services within the MCTD, and non-payors may use such services without being subject to the MCTMT.[31,32]

FTB contends the MCTMT cannot be a tax under California law because the revenue is not deposited into NYS's general fund for use for general governmental purposes.[33] While such a fact was a relevant consideration prior to Proposition 26 (see *Northwest*, *supra*, 159 Cal.App.4th at p. 857), that may no longer be the case. And even if such a fact were to be considered here, it does not appear to be dispositive because the plain text of section 3(b)(1) and (2) of article XIII A of the California Constitution requires the non-tax charge to at least be imposed for something provided "directly" to the payor that is not provided to those not charged. (See also Cal. Const., art. XIII A, § 3(d) [to be a non-tax, "the manner in which th[e] costs are allocated to a payor bear a fair or reasonable relationship to the payor's burdens on, or benefits received from, the governmental activity"].) For reasons just discussed, the MCTMT payor does not receive anything directly in return that is not provided to those not charged. While the payor's business may benefit from reliable public transportation services, non-payors benefit as

[31] The record does not indicate whether the MCTMT exceeds the reasonable costs to NYS or the MTA of providing transportation services within the MCTD. However, such a determination appears to be unnecessary since the MCTMT does not meet the first prong of either section 3(b)(1) or (b)(2) of article XIII A of the California Constitution to be a non-tax charge.

[32] Even if Proposition 26 did not apply here, the conclusion the MCTMT is a tax is consistent with prior law. (*City of San Buenaventura v. United Water Conservation District* (2017) 3 Cal.5th 1191, 1210 [the language of Proposition 26 is drawn in large part from pre-Proposition 26 case law].) Specifically, like a tax, the MCTMT is compulsory rather than imposed in response to the payor's voluntary decision to seek benefits, and it raises revenue for public transportation rather than in return for a specific service provided to the payor. (See *Sinclair*, *supra*, 15 Cal.4th 866, 874-875.) And it is not like a regulatory fee because there is no indication it funds a regulatory program. (Cf. *Sinclair*, *supra*, 15 Cal.4th 866 [program of evaluation, screening, and follow-up for lead contamination supported by fees paid by certain manufacturers]; *Cal. Assn. of Prof. Scientists v. Department of Fish & Game* (2000) 79 Cal.App.4th 935 [filing fee imposed to defray costs of managing and protecting fish and wildlife trust resources].) Nor is there any indication of a nexus between the MCTMT and the expense of a regulatory program. (See *Northwest*, *supra*, 159 Cal.App.4th 841 at p. 858.)

[33] FTB's general fund argument should be distinguished from its use-of-funds argument related to whether the levy is imposed by and paid to another state. The issue here is whether the levy is a tax to begin with, even if the levy is imposed by the state.

well by, for example, being able to use the MTA's transportation services.[34] (See *Mangano*, *supra*, 107 A.D.3d 956, 959.)

FTB further asserts the MCTMT must be a fee because it does not benefit the entire NYS, but simply funds the provision of specific transportation services in a certain geographical region. However, even assuming that for a levy to be a tax it must benefit an entire state, a stated purpose of the MTA is "the continuance, further development and improvement of commuter transportation and other services related thereto within the [MCTD]," and such purpose is "for *the benefit of the people of [NYS]*." (NYPAL, § 1264(1), (2), italics added.) The MCTMT does not just benefit a specific area but rather "serves a substantial [s]tate concern." (*Mangano*, *supra*, 107 A.D.3d 956, 958-959.)

Lastly, to the extent there is any ambiguity under Proposition 26 as it relates to the MCTMT, the analysis of Proposition 26 by the Legislative Analyst supports the MCTMT is a tax. (See *Schmeer*, *supra*, 213 Cal.App.4th at pp. 1317, 1328 [looking to the official ballot pamphlet as evidence of voter intent for ambiguous language].) According to the Legislative Analyst, "Generally, the types of fees and charges that would become taxes under the measure are ones that government imposes to address health, environmental, or other societal or economic concerns."[35] A chart lists several examples of regulatory fees (oil recycling fee, hazardous materials fee, and fees on alcohol retailers) that could be considered taxes under the measure "because these fees pay for many services that benefit the public broadly, rather than providing services directly to the fee payer." (*Ibid.*) Additionally, "some business assessments could be considered to be taxes because government uses the assessment revenues to improve

[34] FTB's focus on the general fund primarily relates to its assertion the MCTMT is not a "general tax" or "special tax" under section 1 of article XIII C of the California Constitution relating to local levies. That section defines "general tax" as "any tax imposed for general governmental purposes," and "special tax" as "any tax imposed for specific purposes, including a tax imposed for specific purposes, which is placed into a general fund." (Cal. Const., art. XIII C, § 1(a), (d); see also Gov. Code, § 50076 [providing a definition of "special tax" based on what it excludes, which predates the definition of "special tax" and "tax" in section 1(d) and (e) of article XIII C].) However, the definition of "special tax" itself contemplates taxes that may or may not be placed into a general fund. (See *Bay Area Cellular Telephone Co. v. City of Union City* (2008) 162 Cal.App.4th 686, 696 [under section 1(d) of article XIII C, a special tax is when its proceeds are earmarked or dedicated in some manner to a specific project(s) and this applies whether or not the proceeds are placed into a general fund].) Indeed, the MCTMT could be a "special tax" because it is a tax imposed for the specific purpose of providing a source of stable and reliable funding for the MTA. Further, section 1(e) of article XIII C provides similar tax exceptions to those under section 3(b) of article XIII A; i.e., as relevant here, the charge must be imposed for something provided directly to the payor that is not provided to those not charged. For reasons expressed above, the MCTMT does not meet these exceptions.

[35] https://www.lao.ca.gov/ballot/2010/26_11_2010.aspx#:~:text=Proposal,2%20summarizes%20its%20main%20provisions.&text=Classifies%20as%20taxes%20some%20fees,impose%20with%20a%20majority%20vote.

shopping districts (such as providing parking, street lighting, increased security, and marketing), rather than providing a direct and distinct service to the business owner." (*Ibid.*)

Consistent with Proposition 26's intent to broadly define "tax," these statements support the MCTMT is best characterized as a tax under California law. (See *Zolly v. City of Oakland* (2020) 47 Cal.App.5th 73, 83, 87 [noting broad definition of tax].) These statements also do not suggest that placement of the levy's proceeds into a general fund is a dispositive fact. As noted above, the MCTMT provides a funding source for essential transit and transportation services in the MCTD that have substantial implications for the statewide economy. The MTA's services within the MCTD benefit the entire NYS and not just the taxpayer, and revenues from the MCTMT cannot be said to provide direct and distinct transportation services to MCTD business payors when such services are also available to non-payors. Accordingly, the NYS-imposed MCTMT is a tax.

3. The MCTMT's Self-Employment Tax is a Net Income Tax

Appellants assert the MCTMT imposed on individuals with net earnings from self-employment is a "net income tax" for OSTC purposes. FTB seems to argue this portion of the MCTMT cannot be based on net income because California does not conform to Internal Revenue Code (IRC) section 1402, the federal provision defining "net earnings from self-employment" that the MCTMT incorporates into its law, and in any event, the MCTMT is not a "statewide" net income tax. On this issue, OTA finds in favor of appellants.

To restate, under R&TC section 18001(a), residents are allowed the OSTC against California's net tax for "net income taxes" imposed by and paid to another state. Thus, the issue here is whether the MCTMT's self-employment tax is imposed on net income.[36] "Net income tax is not defined for purposes of [the OSTC provisions], or for any other purpose in the [PITL]

[36] FTB does not argue the two components of the MCTMT (i.e., the one imposed on certain employers based on their payroll expense, and the other imposed on certain self-employed individuals based on their net earnings) must be treated as a single, indivisible tax such that because there is a payroll component, the tax cannot be a net income tax. Therefore, OTA treats the MCTMT as multifaceted, which means the self-employment tax component, which is in dispute here, can be bifurcated and analyzed separately from the employer payroll tax component, which is not in dispute here. (See *Robinson et al. v. Franchise Tax Bd.* (1981) 120 Cal.App.3d 72, 80-81; *Appeal of Dayton Hudson* (94-SBE-003) 1994 WL 65935; *Appeal of Kelly Services, Inc.* (97-SBE-010) 1997 WL 466851; *Trinova Corp. v. Mich. Dept. of Treas.* (1991) 498 U.S. 358, 375.)

of the [R&TC]."[37] (*Gray*, *supra*, 235 Cal.App.3d at p. 42.) However, general principles have emerged from California judicial and administrative cases, involving the issue of whether out-of-state taxes paid by taxpayers are deductible (e.g., gross receipts taxes) or nondeductible (e.g., gross income or net income taxes) under California's PITL and Corporation Tax Law (CTL), that guide the OSTC analysis. The proper characterization of the other state's tax is determined by its true nature and labels do not control. (*Beamer et al. v. Franchise Tax Bd.* (1977) 19 Cal.3d 467, 475 (*Beamer*).) General tax law principles are employed in the analysis, including federal and California tax law, and the other state's characterization of the tax is not controlling. (*Id.* at p. 479; *Robinson et al. v. Franchise Tax Bd.* (1981) 120 Cal.App.3d 72, 80-81 (*Robinson*); *MCA, Inc. v. Franchise Tax Bd.* (1981) 115 Cal.App.3d 185, 196-199 (*MCA*); *Gray*, *supra*, 235 Cal.App.3d at p. 42.)

Importantly, the characterization of a tax is analyzed on a universal basis, applicable to all taxpayers subject to the tax, as opposed to on a case-by-case basis. (See *Robinson*, *supra*, 120 Cal.App.3d 72 at p. 80, fn. 9 [the other state's tax law, measured by general tax law, must be analyzed for all taxpayers, regardless of a particular taxpayer's particular facts]; *Appeal of Kelly Services, Inc.* (97-SBE-010) 1997 WL 466851 (*Kelly Services*) [characterization of out-of-state tax is the same for both non-service businesses that incur cost of goods sold and service businesses that do not incur such costs].) When a state's tax base allows a return of capital (e.g., cost of goods sold) to be subtracted, the tax would be imposed on something other than gross receipts, such as a gross income tax, and if the base only allows items of gross income to be included (e.g., royalties, rent, interest, and/or dividends), the tax is not converted into a gross receipts tax even though a taxpayer's gross income equals its gross receipts. (See *Beamer*, *supra*, 19 Cal.3d at p. 479; *MCA*, *supra*, 115 Cal.App.3d 185, 197; *Robinson*, *supra*, 120 Cal.App.3d 72 at p. 82.) Similarly, if a state's tax base contains an element of return of capital (e.g., a full or partial addback for cost of goods sold), the tax would be imposed on something other than gross income, such as a gross receipts tax, and it would not be converted into an income tax even though a taxpayer's gross receipts equal its gross income, such as when a taxpayer is a service provider that does not incur cost of goods sold. (See *Beamer*, *supra*,

[37] Effective January 1, 2024, FTB added subsection (a)(2) to Regulation section 18001-1 to clarify that for purposes of the OSTC, a tax is considered a "net income tax" when the tax is imposed on only net income, and a tax imposed on items other than net income, as applied to all taxpayers, is not a net income tax. Since this amendment appears to apply to tax years after those at issue here, it is inapplicable to this appeal (and even if it were applicable, it would not alter the analysis and conclusions in this Opinion). (See R&TC, § 19503(b).)

19 Cal.3d at p. 479; *Appeal of Dayton Hudson* (94-SBE-003) 1994 WL 65935; *Kelly Services*, *supra*.) In addition, "no [OSTC] may be allowed for taxes imposed on gross receipts, gross income, dividends, etc., which must be paid regardless of whether or not the subject of the tax constitutes net income, even though in particular instances the subject taxed is net income in whole or in part." (Cal. Code Regs., tit. 18, § 18001-1(a).)

In *Gray*, the court held that Connecticut's capital gains tax was imposed on net income and therefore eligible for California's nonresident OSTC. (*Gray*, *supra*, 235 Cal.App.3d at pp. 43-45.) It reasoned that under Connecticut's tax regime, capital losses could be deducted from capital gains, unused capital losses could be carried over for deduction to subsequent tax years, and deductions were allowed for holding periods as well as certain personal exemptions. (*Id.* at pp. 43-44.) In its analysis, the court made several noteworthy observations in the OSTC context. "Generally, a tax is a gross income tax if it is imposed on the excess of the sales price over the cost of goods sold." (*Id.* at p. 42, citing *MCA*, *supra*, 115 Cal.App.3d at p. 197 [foreign (i.e., non-U.S.) taxes imposed on or measured by gross amount of film rentals and record royalties were nondeductible gross income taxes].) "A gross income tax is distinguishable from a gross receipts tax because a return of capital is excluded from gross income, while gross receipts may include income as well as return of capital." (*Id*. at pp. 42-43, citing *Robinson*, *supra*, 120 Cal.App.3d at p. 78 [Hawaii excise tax was deductible in part and nondeductible in part].) "A tax which is not a gross *receipts* tax may be a gross *income* tax," which in turn can be converted into a net income tax under appropriate circumstances. (*Id*. at p. 43, italics in original.) Further, "[a]s a general rule, . . . a net income tax is one which taxes the net income of a taxpayer. Generally, under a net income tax, if a taxpayer has no net income, the taxpayer will suffer no tax." (*Id.* at p. 44.)

Applying these principles, OTA concludes the MCTMT's self-employment tax is based on net income. The MCTMT is imposed at a tax rate of 0.34 percent on "the net earnings from self-employment" of individuals attributable to the MCTD if such earnings exceed a certain dollar threshold amount for the tax year. (NYTL, § 801(a)(2)(A).) "Net earnings from self-employment has the same meaning as in [IRC] section 1402 []." (NYTL, § 800(e).) IRC section 1402(a), in turn, defines "net earnings from self-employment" as "*the gross income derived by an individual from any trade or business carried on by such individual, less the deductions allowed by this subtitle* [i.e., Subtitle A of the IRC involving income taxes] which are

attributable to such trade or business, *plus his [or her] distributive share (whether or not distributed) of income or loss described in [IRC] section 702(a)(8) from any trade or business carried on by a partnership* of which he [or she] is a member[.]" (Italics added.)

The MCTMT's self-employment tax base thus broadly begins the computation with "gross income," which under the general tax law, "means all income from whatever source derived" and allows a deduction for a return of capital or cost of goods sold. (See R&TC, § 17071; IRC, § 61(a); Treas. Reg. § 1.61-3(a); see also R&TC, § 24271(a) [the CTL's definition of "gross income" is also generally tied to IRC section 61].)[38] Deductions under Subtitle A of the IRC—including all ordinary and necessary expenses paid or incurred in the business under IRC section 162, such as wage compensation—are then allowed to reduce gross income. The same is true for partners in partnerships because IRC section 702(a)(8) requires partners to take into account separately their distributive share of the partnership's "taxable income or loss," which is generally computed in the same manner as for individuals and allows gross income to be reduced by all ordinary and necessary business expenses. (IRC, § 703(a).) The MCTMT's self-employment tax base therefore resembles a net income tax. (See *Gray*, *supra*, 235 Cal.App.3d at p. 42 [noting that "net income is defined in [R&TC] section 24341 [of the CTL] as 'gross income . . . less . . . deductions . . . .'"].)

OTA notes the computation of net earnings from self-employment does not consider various items, such as the following: certain rentals from real estate and personal property leased with the real estate, unless received in the course of a trade or business as a real estate dealer (IRC, § 1402(a)(1)); dividends and certain interest, unless received in the course of a trade or business as a dealer in stocks or securities (IRC, § 1402(a)(2)); gain or loss from the sale or exchange of a capital asset, or the sale, exchange, involuntary conversion, or other disposition of property if such property is neither not stock in trade nor primarily held for sale to customers in the ordinary course of the trade or business (IRC, § 1402(a)(3)); the deduction for net operating losses under IRC section 172 (IRC, § 1402(a)(4)); the deduction for personal exemptions in IRC section 151 (IRC, § 1402(a)(7)); the distributive share of any item of income or loss of a limited partner other than guaranteed payments described in IRC section 707(c) (IRC, § 1402(a)(13));

[38] Under both the PITL and CTL, for the 2012, 2013, and 2014 tax years, California generally conformed to the version of the IRC as of a specified date of January 1, 2009. (R&TC, §§ 17024.5(a)(1)(O), 23051.5(a)(1).) California also generally follows Treasury Regulations promulgated under the IRC to the extent they do not conflict with the PITL and CTL. (R&TC, §§ 17024.5(d), 23051.5(d).)

and the deduction provided by former IRC section 199 involving income from domestic production activities (IRC, § 1402(a)(16)).

However, none of these items disallow a deduction for a return of capital, cost of goods sold, wage compensation, or any commonly found ordinary and necessary business expense under IRC section 162. For OSTC purposes, while "a precise and universally acceptable definition of net income may not be possible," "a deduction for the entire cost of wages is a basic requirement in arriving at the net income of a business," which the MCTMT's self-employment tax base allows. (*Appeal of Covert and Robertson* (60-SBE-038) 1960 WL 1416.) Indeed, it appears an individual taxpayer would not be subject to the MCTMT's self-employment tax if the cost of wages, and/or other allowable ordinary and necessary business expenses, were high enough to eliminate gross income from the trade or business (or at least substantially reduce it below the dollar threshold amount). (See *ibid*. [if the other state's tax could apply even if the cost of wages is so high as to eliminate any net income to the taxpayer, the tax cannot be a net income tax]; see also *Gray*, *supra*, 235 Cal.App.3d at p. 44.)

FTB argues that California has not specifically conformed to IRC section 1402 and therefore the MCTMT's self-employment tax cannot be considered a net income tax for OSTC purposes. However, that fact is irrelevant in determining what constitutes a net income tax. In the California authorities discussed above, it did not matter whether California conformed, or had a tax regime similar, to the other state's regime. "[A] state [does not have to] adopt a comprehensive personal income tax [like California's PITL] in order for a tax to be creditable against California tax." (*Gray*, *supra*, 235 Cal.App.3d at p. 43, fn. 6, citing *Robinson*, *supra*, 120 Cal.App.3d at pp. 80-81.) Rather, "[t]he nature of the tax is determined by reference to the nature of the income taxed," which requires the use of general tax law principles. (*Id.* at p. 44.)

FTB further contends the MCTMT involves "selective items subject to [the] levy" such that a taxpayer subject to the MCTMT "may, on an overall statewide basis, actually experience an overall [NYS] loss, or lack of positive net income, yet still be subject to the MCTMT . . . ." Thus, FTB asserts, the MCTMT is not a "state net income tax." However, the relevance of this

contention, even if true, is unclear.[39] In any event, the starting point in computing the MCTMT's self-employment tax base is essentially *worldwide* gross income and deductions from the individual's trade or business, which includes a partner's distributive share of income or loss in IRC section 702(a)(8). (See IRC, § 1402(a).) It is only after this worldwide amount is determined that the net earnings from self-employment are allocated and apportioned to derive the amount attributable to the MCTD to which the tax rate is applied.[40] (See NYTL, § 801(b)(1).) In substance, this is no different from California's nonresident state-imposed personal income tax that starts with worldwide business income that is then apportioned by formula to derive net income from sources within California. (See Cal. Code Regs., tit. 18, § 17951-4.) Thus, the MCTMT's self-employment tax, which is imposed by NYS and based on net income, is OSTC-eligible.

4. Appellants Have Not Shown What OSTC Amount, If Any, They Can Claim for the MCTMT's Self-Employment Tax

The final issue involves the OSTC amount, if any, appellants can claim against their California net tax for the MCTMT's self-employment tax. As noted above, even if a tax is *eligible* for the OSTC, that does not end the matter. Two more conditions must be met that involve the *amount* of the OSTC that California residents can claim. On appeal, appellants submit detailed schedules and computations that they contend show the proper amounts of income taxed by both California and NYS. They assert they are entitled to claim the OSTC for the full amounts paid to NYS for the MCTMT after applying California's statutory OSTC limitation formula. Appellants, however, have not met their burden.

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[39] Even assuming, as FTB asserts, taxpayers could be subject to the MCTMT when they incur an overall NYS-level net loss, that does not mean such a result precludes a conclusion that the MCTMT on net earnings from self-employment is a net income tax. (*Gray*, *supra*, 235 Cal.App.3d at p. 44.) Although the general rule is if a taxpayer has no net income, the taxpayer will suffer no tax, that "does not preclude the establishment of separate taxing procedures . . ., which may result in a tax on one category of income even where the taxpayer has suffered an overall [state-level] net loss for the year. The nature of the tax is determined by reference to the nature of the income taxed. A tax law may be in part a gross receipts tax, in part a gross income tax, and in part a net income tax." (*Ibid.*, citing *Robinson*, *supra*, 120 Cal.App.3d at pp. 80-81.)

[40] Indeed, assuming identical tax bases, apportionment formulas, and tax rates, a nonresident individual, who conducts a multistate business partly in NYS but solely within the MCTD, would be subject to the same tax liability on the same post-apportioned tax base (all apportioned to the MCTD) for both the NYS-level nonresident income tax and the MCTMT's self-employment tax. Therefore, under these circumstances, it is unclear why the NYS-level nonresident income tax, which is based on net income solely within the MCTD, is creditable but the MCTMT's self-employment tax, also based on net income solely within the MCTD, is not, when the MCTMT is properly considered a state-imposed tax on net income under California tax law.

To restate, one condition involving the OSTC amount requires that the taxes paid to the other state must have been "on income derived from sources within that state," which is determined by applying California's nonresident sourcing rules (found in R&TC section 17951 et seq., and the accompanying regulations). (R&TC, § 18001(a)(1), (c); see Cal. Code Regs., tit. 18, § 18001-2(a); *Buehler*, *supra*.) Critically, appellants have not provided any documentation or computations showing how their self-employment income would have been sourced to the MCTD *under California's nonresident sourcing rules*. Rather, they only submit computations showing the amount of self-employment income apportioned *to the MCTD using NYS tax law*, as reported on the MCTMT returns, and the amount of such income apportioned *to California using California tax law*, as reported on the LLCs' California partnership returns. Since the apportionment rules in NYS and California are different for each year at issue, the NYS rules do not necessarily produce the same MCTD-sourced amounts under California's nonresident sourcing rules.

Specifically, for the 2012 through 2014 tax years, appellants allocated (i.e., apportioned) their self-employment net earnings to the MCTD using *a three-factor, equally-weighted formula* that consisted of the LLCs' property, payroll, and gross income within the MCTD divided by their worldwide totals of each, *with gross income within the MCTD generally determined by the location where the activities giving rise to the income is performed*. (NYTL, §§ 801(b)(1), 631(c); 20 NYCCR § 132.15(c)-(f).) In contrast, to determine a nonresident's California source income, Regulation section 17951-4(d) essentially requires the business income of a multistate partnership to be apportioned at the partnership level using California's Uniform Division of Income for Tax Purposes Act (the UDITPA) and the regulations thereunder. (Cal. Code Regs., tit. 18, § 17951-4(d)(1); see also *Appeal of Smith*, 2023-OTA-069P.) For the contested tax years, the LLCs apportioned their business income using *a single-sales factor formula that required market-based sourcing* (e.g., sales from services are in California to *the extent the purchaser of the service received the benefit of the services in California, which is not necessarily the location where the taxpayer performed its services*). (Former R&TC, §§ 25128.5, 25136(b); R&TC, §§ 25128.7, 25136.) Thus, because the MCTMT's apportionment rules are different from California's, appellants incorrectly assumed, without performing a proper sourcing analysis, their

apportioned self-employment income under NYS tax law would have been the same under California tax law.[41]

The other condition is the OSTC "shall not exceed the proportion of [the California net tax] payable under [the PITL] as the income subject to tax in the other state . . . and also taxable under [the PITL] bears to the taxpayer's entire income upon which the [California net tax] is imposed by [the PITL]." (R&TC, § 18001(a)(3); Cal. Code Regs., tit. 18, § 18001-2(c).) This can be expressed as a mathematical formula, where the adjusted gross income (AGI) subject to tax in both California and the other state (the numerator) is divided by the entire AGI subject to tax by California (the denominator), with the resulting quotient multiplied by the California net tax payable to derive the maximum OSTC allowable. (See *Appeal of Bishop* (58-SBE-007) 1958 WL 1235; *Appeal of Poole* (63-SBE-111) 1963 WL 1718.) R&TC section 18001(a)(3)'s overall effect "is to give the taxpayer [an OSTC] for the tax paid to [the other state] up to the amount of taxes [the taxpayer] would have to pay to California on the [out-of-state] income." (*Appeal of Hunt* (73-SBE-040) 1973 WL 2773.) "Under this limitation, [an OSTC] of the entire amount of tax imposed by the other state will occur only when the effective tax rate there is equal to or lower than the rate in California." (*Appeal of Mead* (64-SBE-100) 1964 WL 1504.)

Appellants essentially assert they are entitled to the OSTC for the full amount of MCTMT paid to NYS on the self-employment income apportioned to NYS using NYS's nonresident sourcing rules because that amount (i.e., the MCTMT paid) is less than the tax they paid to California on the self-employment income apportioned to California using California's nonresident sourcing rules.[42] However, this is an improper application of the OSTC limitation under R&TC section 18001(a)(3).

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[41] To the extent appellants assert they are entitled to alternative apportionment under R&TC section 25137 (by way of R&TC section 18001(c) and Regulation section 17951-4(d)(1)'s incorporation of the UDITPA) because it would be distortive to use California's nonresident sourcing rules (and not the other state's) to determine the OSTC sourcing limitation, they have not presented argument or evidence that such an option is even available for OSTC purposes. And even if such option were available, they also have not provided evidence establishing that applying the UDITPA to apportion net earnings from self-employment to the MCTD does not fairly represent the extent of their business activities in the MCTD.

[42] This is based on appellants' calculations, which compare the proportion of the California tax paid on the self-employment income (computed by dividing their California-sourced self-employment income using California's nonresident sourcing rules by their California AGI, with the quotient multiplied by their total California liability) and the proportion of MCTMT paid to NYS on the same income (computed by dividing their MCTD-sourced self-employment income using NYS's nonresident sourcing rules by their NYS AGI, with the quotient multiplied by their total MCTMT liability). Since the latter formula (i.e., the proportion of MCTMT paid to NYS) produces the lesser amount, appellants assert they are entitled to claim a full OSTC for the MCTMT they paid.

Specifically, appellants compute the numerator by multiplying their total self-employment income by the LLCs' California apportionment percentages, but the resulting amount only determines the income properly sourced to *California* under California tax law and such income is ineligible for the OSTC since it is not considered double-taxed income. (See R&TC, § 18001(a)(1), (c).) Rather, appellants are required to compute the numerator by determining the portion, if any, of their total self-employment income that has a source *within the MCTD using California's nonresident sourcing rules*. Thus, for example, they were required to determine each LLC's single-sales factor formula, which compares their sales generated in the MCTD (using California's market-based sourcing rules) to their worldwide sales, with the resulting quotient multiplied by their total self-employment income also subject to tax in California. This apportioned AGI relating to amounts sourced to the MCTD, using California's nonresident sourcing rules, is what should have been included in the numerator of the formula, which is also subject to tax in California because it imposes a tax on a resident's worldwide income. (See R&TC, § 18001(a)(3) [the numerator requires that "the income [must be] subject to tax in the other state . . . and also taxable under [the PITL]"].)[43]

After the OSTC limit under R&TC section 18001(a)(3) is computed, that amount is then compared to the tax the taxpayer would have paid, if any, to the other state using California's nonresident sourcing rules, and the lesser of the two amounts is what the taxpayer can claim as the OSTC. (See R&TC, § 18001(a)(1), (c) [the OSTC is only allowed for taxes paid to the other state on income derived from sources within that state using California nonresident sourcing rules], (a)(3) [the otherwise allowable OSTC "shall not exceed" the maximum OSTC computed under the formula].) Here, again, appellants improperly computed the tax they would have paid, if any, to NYS for the MCTMT because they used NYS's nonresident sourcing rules and not

[43] If the other state imposes more than one OSTC-eligible tax, R&TC section 18001(a)(3) essentially requires those taxes to be aggregated when computing the OSTC limit. (See *Appeal of Salant* (67-SBE-031) 1967 WL 1374 [R&TC sections 18001 and 18006 (applicable to partners in partnerships) are construed together so that the total OSTC for taxes imposed by and paid to another state on income also taxed by California will not exceed the California income tax on that income].) OTA notes that in calculating the formula, appellants only considered the MCTMT and not the OSTC-eligible NYS nonresident personal income tax that is not in dispute, but this may not have made a difference since California's tax rate is higher than both of those rates combined.

California's. Accordingly, appellants have not met their burden of proving the OSTC amount, if any, they can claim for the MCTMT for the contested tax years.[44] (See *Appeal of Jali*, *supra*.)

Largely relying on *Comptroller of the Treasury of Maryland v. Wynne*, *supra*, appellants also make numerous arguments that California's failure to provide the OSTC for the NYC UBT and MCTMT and/or limitation on the amount of the OSTC based on California's nonresident sourcing rules in Regulation section 17951-4 violates the dormant commerce clause of the U.S. Constitution. However, OTA does not have jurisdiction to consider this argument because it invites OTA to rule on the constitutionality of R&TC section 18001, and its incorporation of California's nonresident sourcing rules, when no federal or California appellate court has made such a determination. (Cal. Const., art. III, § 3.5; Cal. Code Regs., tit. 18, § 30104(a); *Appeal of Acosta and Castro*, 2022-OTA-235P.)

Appellants further argue FTB violated the California Administrative Procedures Act because FTB amended Regulation section 17951-4 to implement Proposition 39 without complying with applicable rulemaking procedures. (See Cal. Code Regs., tit. 1, § 100(a).) Starting with the 2013 tax year, this amendment requires most businesses to apportion business income based on a single-sales factor formula using market-based sourcing, which appellants assert limits the OSTC amount they would otherwise be entitled to claim without such amendment. But OTA questions whether it has jurisdiction over this issue. In any event, *even if* it were improper to compute the OSTC sourcing condition using a single-sales factor and market-based sourcing, appellants are still not due refunds because they have not performed a proper analysis of what income, if any, would have been sourced to the MCTD under California's nonresident sourcing rules.

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[44] In its post-hearing brief, FTB concedes appellants submitted sufficient evidence proving they paid the MCTMT for the 2014 tax year, but it asserts they failed to substantiate actual payment of the MCTMT for the 2012 or 2013 tax year. OTA need not address this issue because appellants did not show they satisfied the OSTC sourcing and proportion limitation conditions, even if they proved they paid the MCTMT for 2012 and 2013.

HOLDING[45]

The NYC UBT is a local levy that is not eligible for the OSTC. Although the MCTMT's self-employment tax is eligible for the OSTC, appellants have not shown the amount, if any, they can claim against their California net taxes.

DISPOSITION

FTB's deemed denials of appellants' refund claims are sustained.

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Kenneth Gast
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Kenneth Gast
Administrative Law Judge

We concur:

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Ovsep Akopchikyan
Administrative Law Judge

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Cheryl L. Akin
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Cheryl L. Akin
Administrative Law Judge

Date Issued: 2/16/2024

[45] Appellants' request for reimbursement of fees and expenses is premature because their appeal is not yet final and it must also ultimately be granted. (R&TC, § 21013; Cal. Code Regs., tit. 18, § 30702.)