

## STATE TAXATION OF FEDERAL TAX REBATES

---

JUNE 5, 1975.—Ordered to be printed

---

Mr. LONG, from the Committee on Finance,  
submitted the following

### REPORT

[To accompany S. Res. 158]

The Committee on Finance, to which was referred the resolution (S. Res. 158) to clarify that the individual income tax rebate provided by the Tax Reduction Act of 1975, Public Law 94-12, is intended not to be subject to State income taxes, having considered the same, reports favorably thereon without amendment and recommends that the resolution do pass.

#### PURPOSE OF THE RESOLUTION

The purpose of the resolution is to express the Senate's intention that the tax rebates provided under the Tax Reduction Act of 1975 are not to be subject to State income tax.

#### GENERAL STATEMENT

The Tax Reduction Act of 1975 (Public Law 94-12) provides for a refund on 1974 tax liability to be paid in one installment beginning in May 1975. The refund is generally equal to 10 percent of tax liability up to a maximum of \$200. However, each taxpayer will receive a refund of at least \$100 (or the full amount of the tax liability if less than \$100). The refund is to be phased down from the maximum \$200 to \$100 as the taxpayer's income rises from \$20,000 to \$30,000.

The Act provides that the taxpayer will be treated as if he had made an additional payment to the Treasury against his 1974 income tax liability. This constructive payment is treated as if made on the due date of the taxpayer's 1974 return. In effect, this constructive payment will in most cases be processed by the Internal Revenue Service as an overpayment of tax by the taxpayer and, as such, will be paid to him in the form of a refund of tax. In accord with the general rule that Federal income tax refunds do not constitute income, refunds received under the act will likewise not constitute income for Federal income tax purposes to the taxpayers who receive them.

In the case of the treatment of the refunds for State income tax purposes, the committee report of the Senate Finance Committee on the Tax Reduction Act contains the following statement (and the House report on the bill also contains this statement) :

By deeming the amount of 1974 tax which is to be refunded under the bill as a payment of 1974 Federal income tax by the taxpayer on the due date of his return, the committee expects that for State income tax purposes, States will treat the Federal refund of this deemed payment as a refund of an overpayment of Federal income tax. Such treatment would also reflect the committee's view that the refunds under the bill do not involve any reduction in the taxpayer's Federal income tax liability as such for 1974. (S. Rept. 94-36, p. 27)

The committee intended this statement to mean that the special refund of Federal income tax for 1974 should not operate to increase, or to decrease, income tax collections by the States. Some States, for example, impose their tax as a flat percentage of the taxpayer's Federal income tax liability. In such jurisdictions, if the special Federal refunds could be interpreted as reflecting a reduction in the taxpayer's Federal income tax liability for 1974, the effect would be to reduce the taxpayer's State income tax liability and, in turn, State revenues. Congress intended that such a result should not occur.

Some States, by contrast, allow a taxpayer, in computing his State taxable income, to deduct Federal taxes paid by him during the year. In such jurisdictions, Congress intended that the special Federal refund should also not be interpreted as reducing the taxpayer's 1974 Federal tax liability so as to reduce his deduction (on his State return) for 1974 Federal income taxes paid. Such a reduction would, in effect, subject the special Federal refund to tax by the State. However, as indicated above, Congress intended that the procedures for making the special refund should neither increase nor decrease a taxpayer's State income tax liability.

The committee has been advised that 15 States permit the deduction of Federal taxes paid to arrive at State taxable income:

Alaska	Kansas	North Dakota
Arizona	Louisiana	Oklahoma
Colorado	Minnesota	Oregon
Delaware	Missouri	Tennessee
Iowa	Montana	Vermont

The committee has also been advised that the attorney general of Oregon has recently concluded that the rebate of Federal income tax will be treated, for State tax purposes, as a reduction of Federal income taxes paid for 1974. That determination would mean that taxpayers in that State would only be permitted to deduct Federal income taxes paid for 1974 minus the amount of their rebate.

The Committee on Finance does not seek in any way to impinge upon or alter the authority of the States to establish their own income tax laws or systems. It does, however, wish to clearly express the view that such State action runs counter to the intent of the Tax Reduction Act and is at cross purposes with the underlying economic basis for the Act.