

## Louisiana: Court strikes down law limiting tax credits for taxes paid to other states



David M. Kall | Friday, December 14, 2018

The Louisiana Supreme Court recently ruled that its residents holding interests in pass-through entities may take a credit against their Louisiana personal income taxes for business taxes paid to Texas. The case establishes a split on this issue with a recent Supreme Court of Maine decision that we [reported on](#) in August. Other state courts in [Ohio](#), [Oregon](#), [California](#), and [Alabama](#) have similarly held that states may lawfully impose personal income tax on nonresident shareholders of pass-through entities doing business in their state.

In [Smith v. Robinson](#), the Louisiana Supreme Court addressed a refund claim of resident shareholders that owned interests in several LLCs and S Corporations doing business in Louisiana, Texas, and Arkansas. The resident taxpayers paid Texas franchise taxes to Texas for their portion of Texas-sourced income under Texas law and also paid Louisiana personal income tax on all of their personal income. The taxpayers filed refund claims for a tax credit against their Louisiana personal income taxes for the Texas business taxes paid, but the Department of Revenue in Louisiana denied their claims. With the court's ruling, the taxpayers were awarded their refund claims and there may be refund claim opportunities for similarly situated taxpayers.

### **ACT 109**

Louisiana law has always provided a personal income tax credit for income tax paid to other states, as follows:

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A. Subject to the following conditions, resident individuals shall be allowed a credit against the taxes imposed by this Chapter for net income taxes imposed by and paid to another state on income taxable under this Chapter, provided that:

(1) The credit shall be allowed only for taxes paid to the other state on income which is taxable under its law irrespective of the residence or domicile of the recipient.

In 2015 the state legislature passed a law, Act 109 codified as [La.R.S. 47:33](#), that conditioned entitlement to the credit on the availability of a reciprocal tax credit under the law of the state to which taxes were paid. Act 109 provided, in relevant part, the following:

(4) The credit shall be allowed only if the other state provides a similar credit for Louisiana income taxes paid on income derived from property located in, or from services rendered in, or from business transacted in Louisiana.

#### **NATURE OF TEXAS FRANCHISE TAX**

In light of Act 109, the statutory question presented was whether the Texas franchise tax on the taxpayer's businesses should be considered a net income tax for purposes of the Louisiana credit. If the Texas franchise tax was a net income tax for purposes of La.R.S. 47:33 and Act 109, then Louisiana law would deny the taxpayers the tax credit they sought because there was no reciprocal credit in Texas for taxes paid to Louisiana. But if the Texas franchise tax was not a net income tax for purposes of La.R.S. 47:33, then the taxpayers would not be entitled to the claimed credit for business taxes paid to Texas.

The Louisiana Supreme Court resolved this issue in favor of the taxpayer, finding that the Texas franchise tax is a net income tax for purposes of La.R.S. 47:33 and Act 109. The Supreme Court followed a Louisiana Court of Appeals [decision from 1999](#) that similarly found prior to the enactment of Act 109. The Court stated that the Department of Revenue "acquiesced" to that position in the earlier case and conceded that "taxes on net income paid by an S corporation shall be considered taxes on net income paid by shareholders of the S corporation for purposes of computing the credit allowed under La.R.S. 47:33." In the Court's view, the Department's position in the *Smith v. Robinson* was a reversal of a longstanding administrative position.

The Department of Revenue argued that the Texas franchise tax was not the type of income tax that La.R.S. 47:33 contemplated because it was imposed on businesses rather than individuals. But the Supreme Court disagreed and held that "the operational and consequential effect is a tax on the individual taxpayer" because pass-through income is distributed to shareholders or members who actually pay the tax. The Supreme Court further rejected the Department's position that a [Texas appellate court case](#) held that "the Texas franchise tax is not a tax imposed or measured by net income" and therefore not a net income tax. The Court disregarded the case as inapposite to the Louisiana law at issue and non-controlling case law of another jurisdiction.

#### **ACT 109 UNCONSTITUTIONAL**

Having found that Louisiana law disallowed the credit to the resident taxpayers, the Supreme Court next addressed whether the law prohibiting the credit offended the U.S. Constitution. Whereas other state courts have found that the business taxes on pass-through entities and personal income taxes are separate taxes, the high court in Louisiana viewed it as a double tax.

With this double taxation premise, the Court ruled that Act 109 violated the dormant Commerce Clause of

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the U.S. Constitution by failing to afford resident taxpayers a credit against their Louisiana taxes for taxes lawfully paid to other states. Relying on the 2015 U.S. Supreme Court decision in [Comptroller of the Treasury of Maryland v. Wynne](#), the Louisiana Supreme Court ruled that the Act 109 law was not “fairly apportioned” among the states and discriminated against interstate commerce. According to the Court, interstate business suffered a competitive disadvantage to intrastate business wholly within Louisiana because it was taxed twice. The Court thus struck down Act 109 in this situation due to the constitutional infirmities it found.

#### **REFUND CLAIM IMPLICATIONS**

The Supreme Court of Louisiana’s ruling in *Smith v. Robinson* surprised some tax practitioners with its holding that Louisiana must allow a personal income tax credit for business taxes paid to Texas. Ostensibly, the high court in Louisiana found the situation unfair to taxpayers. With this ruling, Louisiana resident taxpayers that similarly paid the Texas franchise tax should consider whether they may too benefit from a refund claim.



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