(3) By adding an amount equal to the amount of the taxpayer's net tax-exempt income, as defined in paragraph (b) of §301.6362-4, for the taxable year; and

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

The tax may provide for either a single rate or multiple rates which vary with the amount of taxable income, as adjusted.

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

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

(2) A tax is imposed on the amount taxed under section 56 (relating to the minimum tax for tax preferences).

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

(c) Method of making mandatory adjustments. The mandatory adjustments provided in paragraph (a) of this section shall be made directly to taxable income. Except as provided in paragraph (c)(2) of §301.6362-4, no account shall be taken of any reduction or increase in the Federal adjusted gross income which would result from the exclusion from, or inclusion in, gross income of the items which are the subject of the adjustments. Thus, for example, when for purposes of the calculation the taxpayer's Federal taxable income is adjusted to reflect the exclusion from gross income of interest on obligations of the United States, no change shall be made in the amount of the taxpayer's deduction for medical expenses, or in the amount of his charitable contribution base, even though such amounts would ordinarily depend upon the amount of adjusted gross income.

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

(a) Net State income tax deduction. For purposes of section 6362 (b)(1)(B) and (c)(3)(B), and §§ 301.6362–2 and 301.6362–3, the “net State income tax deduction” shall be the excess (if any) of (1) the amount deducted from income under section 164(a)(3) as taxes paid to a State or to a political subdivision thereof, over (2) the amounts included in income as recoveries of prior income taxes which were paid to a State or to a political subdivision thereof and which had been deducted under section 164(a)(3).

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

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

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

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

(c) Credits for taxes of other jurisdictions—(1) In general. A State tax law that provides for a credit, pursuant to section 6362(b)(2)(B) or (c)(4), and paragraph (b)(1) of §§ 301.6362–2 or paragraph (b)(2) of §§ 301.6362–3, for income tax of another State or a political subdivision thereof shall provide that, in the case of each taxpayer, the amount of the credit shall equal the amount of his liability with respect to such other jurisdiction’s tax for the taxable year which runs concurrently with, or which ends in, the taxable year used by the taxpayer for purposes of the State tax which provides for the credit. Such a credit may be allowed with respect to every income tax (whether or not qualified) imposed on the taxpayer by another State or a political subdivision thereof, or only with respect to certain of such taxes. However, for purposes of this paragraph, the amount which is...