ARIZONA CORPORATE TAX RULING

CTR 94-6

(This Ruling Applies Only To Tax Years Beginning Prior To January 1, 1990)

ISSUES:

1. What is the application of the federal foreign tax credit limitation provisions to the computation of the amount of foreign tax credit allowable as a subtraction from Arizona gross income?

2. What is the application of the federal foreign tax credit carryover/carryback provisions to the computation of the amount of foreign tax credit allowable as a subtraction from Arizona gross income?

APPLICABLE LAW:

Former Arizona Revised Statutes (A.R.S.) § 43-1122.4 governed the subtraction from Arizona gross income for the federal foreign tax credit. *Note*: This statute was repealed effective for taxable years beginning from and after December 31, 1989.

Internal Revenue Code (I.R.C.) § 901(a) provided for the allowance of the foreign tax credit in the amount allowed by I.R.C. § 901(b).

I.R.C. § 904(a) prescribed the limitations on the foreign tax credit and the amount allowed to be claimed under I.R.C. § 901(a).

I.R.C. § 904(c) and the accompanying Treasury regulations set forth the carryover and carryback provisions for the foreign tax credit.

DISCUSSION:

Former A.R.S. § 43-1122.4 provided that the amount of foreign tax credit used to offset federal income tax liability pursuant to I.R.C. §§ 901 through 908 was an allowable subtraction from Arizona gross income unless the credits were attributable to nontaxable income or nonapportionable income not allocated to Arizona.

The Arizona subtraction was determined by federal law inclusive of any limitation imposed by the Internal Revenue Code or any carryover/carryback permitted by the Internal Revenue Code. In addition, Arizona law imposed two other conditions on the allowable subtraction from Arizona gross income:

> 1. The amount of the Arizona subtraction was based on the federal foreign tax credits actually used to offset federal income tax liability; **and**
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> 2. The federal foreign tax credits used to offset federal income tax liability must have been attributable to income that was taxable income apportioned to Arizona or nonapportionable income allocated to Arizona.

DISCUSSION (Issue 1):

What is the application of the federal foreign tax credit limitation provisions to the computation of the amount of foreign tax credit allowable as a subtraction from Arizona gross income?

> *Example:*
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> Corporation A has a federal foreign tax credit attributable to a withholding tax imposed by Country X on royalty income. Corporation A cannot claim the full amount of the foreign tax credit in the current taxable year on its federal corporate income tax return due to the foreign tax credit limitation provisions.
>
> The royalty income is taxable income apportioned to Arizona. The allowable foreign tax credit subtraction in the current taxable year on the Arizona corporate income tax return would be the amount of the foreign tax credit, inclusive of the limitation, that is used to offset Corporation A's federal income tax liability.
>
> The amount of the foreign tax credit not used to offset Corporation A's federal income tax liability in the current taxable year is available for carryover to a succeeding taxable year or carryback to a preceding taxable year.

RULING (Issue 1):

The allowable subtraction from Arizona gross income is the amount of the foreign tax credit used to offset federal income tax liability, **inclusive of the limitations imposed by the Internal Revenue Code**, providing that the credits are attributable to taxable income apportioned to Arizona or nonapportionable income allocated to Arizona.

DISCUSSION (Issue 2):

What is the application of the federal foreign tax credit carryover/carryback provisions to the computation of the amount of foreign tax credit allowable as a subtraction from Arizona gross income?

> *Example:*
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> Corporation B is a multistate corporation that begins doing business in Arizona during the current taxable year. Corporation B claims a foreign tax credit on its federal corporate income tax return filed for the current taxable year. The entire amount of the foreign tax credit claimed by Corporation B is attributable to a carryover of a previous taxable year's foreign tax credit that was subject to limitation. The income to which the foreign tax credit carryover is attributable would not be taxable in Arizona since it was reported on Corporation B's federal corporate income tax return for a taxable year prior to the taxable year in which Corporation B began doing business in Arizona.
>
> The foreign tax credit carryover used to offset federal income tax liability in the current taxable year is not allowable as a subtraction from Arizona gross income.

RULING (Issue 2):

The allowable subtraction from Arizona gross income is the amount of the foreign tax credit used to offset federal income tax liability, **inclusive of any carryovers or carrybacks permitted by the Internal Revenue Code**, providing that the credits are attributable to taxable income apportioned to Arizona or nonapportionable income allocated to Arizona.

Harold Scott, Director
Signed April 26, 1994

Explanatory Notice
The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling**.

See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.