

ARIZONA DEPARTMENT OF REVENUE

ARIZONA INDIVIDUAL INCOME TAX RULING

ITR 93-7

(On 7/26/2011 the reference to A.R.S. § 43-1021.12 was updated to A.R.S. § 43-1021.10 due to renumbering of the paragraphs. No substantive changes were made.)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

What is the proper Arizona income tax treatment of amounts withdrawn from the Arizona state retirement system and other Arizona governmental retirement plans upon termination of employment before retirement?

APPLICABLE LAW:

Arizona Revised Statute (A.R.S.) § 43-1021.10 provides that amounts withdrawn by an employee from the Arizona state retirement system, the corrections officer retirement plan, the public safety personnel retirement system, the elected officials' retirement plan, or a county or city retirement plan upon termination of employment before retirement are to be added to the employee's Arizona gross income to the extent that such amounts were deducted in arriving at Arizona taxable income in any year.

Former A.R.S. § 43-1022.2 provided that employee contributions to the specified Arizona governmental retirement plans are to be subtracted from the employee's Arizona gross income in computing Arizona adjusted gross income.

DISCUSSION:

Early withdrawals from the Arizona state retirement system and other Arizona governmental retirement plans are comprised of the employee's contributions and accrued interest on such contributions.

Pursuant to A.R.S. § 43-1021.10 amounts withdrawn from the Arizona state retirement system and other specified Arizona governmental retirement plans, upon termination of employment prior to retirement, are required to be added to the individual's Arizona gross income to the extent that such amounts were deducted in arriving at Arizona taxable income in any year. The Arizona tax treatment of early withdrawals of employee

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contributions from these plans is, therefore, determined by the Arizona tax treatment of such amounts at the time the contributions were made.

Employee contributions to the corrections officer retirement plan and the public safety personnel retirement system are, for federal purposes, "after tax" contributions. In addition, prior to July 1, 1986, employee contributions to the Arizona state retirement system and the elected officials' retirement plan were, for federal purposes, "after tax" contributions.

"After tax" contributions would be includible in an employee's federal adjusted gross income and, therefore, in the employee's Arizona gross income. However, former A.R.S. § 43-1022.2 provided that employee contributions to the Arizona state retirement system, the elected officials' retirement plan, the corrections officer retirement plan, and the public safety personnel retirement system were subtracted from Arizona gross income in computing the employee's Arizona adjusted gross income. As a result, these contributions were subject to federal income tax but not subject to Arizona income tax.

When "after tax" contributions are withdrawn, they are not reported as income for federal purposes since these amounts have already been subject to federal tax. For Arizona purposes, the amount of "after tax" contributions withdrawn which were previously subtracted from Arizona gross income must be added to Arizona gross income in the year of withdrawal pursuant to A.R.S. § 43-1021.10.

Since federal taxes will have already been paid on the "after tax" portion of the withdrawal, such amounts may not be rolled over for federal purposes. If such a rollover does occur, it will have no effect on the Arizona tax treatment.

The Arizona tax treatment with respect to early withdrawals from the corrections officer retirement plan and the public safety personnel retirement system remain unchanged. However, as of July 1, 1986, the Arizona state retirement system and the elected officials' retirement plan became federally qualified plans. After this date employee contributions to these plans are "pretax" contributions which are excluded from federal and Arizona income tax. When "pretax" contributions are withdrawn, they should be included in the taxpayer's federal adjusted gross income (less any amounts which may have been rolled over) and, accordingly, flow through and be subject to Arizona income tax without adjustment.

The interest portion of an early withdrawal, whether the interest has accrued on "after tax" or "pretax" contributions, should be included in a resident taxpayer's federal adjusted gross income (less any amounts rolled over with a rollover of "pretax" contributions) and, accordingly, flow through and be subject to Arizona income tax without adjustment. If the taxpayer is a nonresident of Arizona at the time of the early withdrawal, interest earned while the individual was a nonresident will generally not be

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subject to Arizona tax (unless such interest income had acquired an Arizona business situs).

RULING:

The Arizona income tax treatment of early withdrawals from the subject retirement plans is as follows:

1. The interest portion will flow through from federal adjusted gross income and be subject to Arizona income tax without adjustment. Nonresidents will generally exclude any interest earned while a nonresident.
2. The portion comprised of "pretax" contributions will flow through from federal adjusted gross income and be subject to Arizona income tax without adjustment.
3. The portion comprised of "after tax" contributions will not be included in federal adjusted gross income and must be added back to Arizona gross income to the extent previously deducted in any year.

Harold Scott, Acting Director

Signed: March 29, 1993

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.