

ARIZONA DEPARTMENT OF REVENUE

ARIZONA INDIVIDUAL INCOME TAX RULING

ITR 93-4

(On 7/26/2011 the Arizona Administrative Code rule reference was updated to use the rule's new number. 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:

Is an Arizona resident individual who is a shareholder of an S corporation entitled to a tax credit for income taxes paid to another state when the other state's income taxes are imposed upon or paid by the corporation?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-1071 sets forth the conditions under which residents are allowed an Arizona income tax credit for income taxes paid to another state.

Arizona Administrative Code (A.A.C.) rule R15-2C-501 further defines the requirements for an Arizona income tax credit allowed under A.R.S. § 43-1071.

DISCUSSION:

For federal income tax purposes, a qualifying corporation may elect to be taxed as an S corporation. Generally, when this election is made, the income or loss from the business operations is "passed through" to the shareholders and is taxed on each shareholder's return.

For state income tax purposes, the laws governing S corporations vary from state to state. Some states recognize S corporation status and other states do not. Generally, a state that recognizes S corporation status, taxes the shareholder rather than the corporation. However, some states that recognize S corporation status may tax the corporation rather than the shareholder when the shareholder is a nonresident of the

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state imposing the tax. States that do not recognize S corporation status generally tax the corporation rather than the shareholder.

For Arizona income tax purposes, Arizona recognizes a corporation's federal subchapter S election and, to the extent that S corporation income is included in federal adjusted gross income, it will be included in Arizona gross income and subject to Arizona tax.

When an Arizona resident is a shareholder of an S corporation that does business outside of Arizona, that individual may be subject to tax on the S corporation's income in both the state in which the corporation does business and Arizona.

If the state in which the corporation does business recognizes the corporation's S corporation status and allows the income to be passed through to the corporation's shareholders, the Arizona resident will be the taxpayer that is subject to tax in both states. However, if the state in which the S corporation does business does not recognize S corporation status or taxes the S corporation when the shareholder is a nonresident of that state, the Arizona resident will not be subject to tax by both states. In this case, the Arizona resident will be subject to tax in Arizona while the corporation will be subject to tax in the other state.

When another state imposes income taxes on an Arizona resident individual, A.R.S. § 43-1071 will allow that individual a credit against the Arizona taxes for net income taxes imposed upon and paid by that individual to that state if:

1. the income was derived from sources within the other state and is taxable to the other state regardless of the residence of the recipient;
2. the other state does not allow Arizona residents a tax credit against income taxes imposed by the other state; and
3. the tax imposed by the other state is imposed on the same income being taxed by Arizona.

However, if the other state's taxes are imposed on the corporation rather than on the individual shareholder, a credit against the individual's Arizona income tax liability is not allowed for such taxes.

RULING:

The credit for income taxes paid to another state is available only when the taxes paid to the other state are imposed upon and paid directly by the shareholder and all the

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requirements of A.R.S. § 43-1071, as explained above, are met. The credit is not allowed when the taxes are imposed upon and paid by the S corporation. Therefore, an Arizona resident individual who is a shareholder of an S corporation is not entitled to a tax credit for taxes paid to another state when the income taxes are imposed upon or paid by the corporation.

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.