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## ARIZONA INDIVIDUAL INCOME TAX RULING ITR 11-6

(Supersedes Arizona Individual Income Tax Ruling ITR 91-2)

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:**

Taxation of Income of and Income from Real Estate Mortgage Investment Conduits (REMICs)

### **DISCUSSION:**

The Tax Reform Act of 1986 created a new entity called a Real Estate Mortgage Investment Conduit (REMIC). A REMIC is a fixed pool of real estate mortgages with multiple classes of interests held by investors. A REMIC, which is a flow-through entity, is treated basically like a partnership. Its income or loss is allocated to and taken into account by the holders of the interests. A REMIC is generally not taxed on its income; instead the income is taxed to the holders. A REMIC has two types of interest holders: regular interest holders and residual interest holders. Holders of regular interests are taxed as if their regular interests were a debt instrument. The rules of taxation generally applicable to debt instruments apply, except that the holder of a regular interest is required to account for income relating to such interest on the accrual method of accounting.

A residual interest in a REMIC is any interest other than a regular interest, and which is so designated by the REMIC. There can be only one class of residual interests, and all distributions (if any) must be directly related to the residual holder's percentage of ownership. In general, at the end of each calendar quarter the holder of a residual interest takes into account its daily portion of the taxable income or net loss of the REMIC for each day during the holder's taxable year in which the interest was held. The residual interest holders are similar to partners in a partnership since they are the interest holders which share in a REMIC's profit or loss.

A REMIC must annually file to the Internal Revenue Service federal Form 1066. Regular interest holders receive a federal 1099-INT or 1099-OID, as appropriate, and residual interest holders receive a quarterly federal Schedule Q from the REMIC.

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### **CONCLUSION AND RULING:**

The following determinations regarding Arizona's income tax treatment of a REMIC, which has a valid federal election, have been made:

1. A REMIC, as a separate entity for tax purposes, is not engaged in a trade or business and its investment assets do not have a business situs in Arizona even if the REMIC is managed or administered in Arizona.
2. A REMIC, which is managed or administered in Arizona, will be required to report annually to Arizona. This will be accomplished by the REMIC submitting a copy of its federal Form 1066 marked "For State Use Only" to the department.
3. All federal schedules are required to be attached to the state copy, including all of the federal Schedule Q's which were filed during the tax year.
4. The Arizona due date for a REMIC's return is the due date of the REMIC's federal return for the tax year (including federal extensions).
5. Arizona will not consider a REMIC to have income from Arizona sources if its only connections with Arizona are:

That it owns mortgages in which debtors are Arizona residents,

That it owns mortgages secured by property located in Arizona, and

That holders of its regular or residual interests are Arizona residents.

Therefore, the income received by a holder of a residual interest will be considered income from Arizona sources if:

The REMIC owns any real property located in Arizona at any time during the taxable year, including foreclosure property, or

The holder carries on a business, trade, profession, or occupation in Arizona and the REMIC investment is employed in such business.

In the case of a REMIC which is managed or administered in Arizona and which does not own any real property in Arizona, the income received by a holder of a residual interest will be treated as intangible income which is not income from Arizona sources. A nonresident holder whose only connection with Arizona is the receipt of income from such a REMIC

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would not be subject to Arizona income tax. If the holder receives income from such a REMIC and is otherwise required to file an Arizona income tax return, then in computing Arizona taxable income, the following applies:

Nonresidents will exclude the REMIC income,

Part-time residents will include a portion of the REMIC income based on the number of days of residence in Arizona,

Residents will include all of the REMIC income, and

Corporations will include all of the REMIC income, which will be apportioned if the corporation is subject to tax in at least one other state.

John A. Greene, Director

Signed: August 17, 2011

### 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 that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning 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 96-1 for more detailed information regarding documents issued by the Department of Revenue.