

STATE OF ARIZONA

Department of Revenue



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ARIZONA INDIVIDUAL INCOME TAX PROCEDURE ITP 20-01

Procedure for Claiming Credit for Taxes Paid to Another Country
by Arizona Resident Individuals

This procedure is intended to complement Arizona Form 309 and provide guidance with respect to determining the amounts required to be entered on Arizona Form 309.

ISSUE:

Will the Arizona Department of Revenue accept a single Form 309 for purposes of claiming the income tax credit for net income taxes paid to multiple countries on income subject to income tax by Arizona and other countries?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-1071, as amended by Laws 2008, Ch 220, sets forth the conditions under which residents are allowed an Arizona income tax credit for income taxes paid to another state or country.

Arizona Revised Statutes (A.R.S.) § 43-1071(D) sets forth the conditions under which an Arizona resident who is also considered to be a resident of another state is allowed an Arizona income tax credit for income taxes paid to that other state.

Arizona Revised Statutes (A.R.S.) § 43-1071(H)(5) provides the meaning of "net income tax" for the purpose of claiming the Arizona income tax credit for income taxes paid to another country.

Shaffer v. Carter, 252 U.S. 37, 40 S.Ct. 221 (1920) held that states can only tax nonresidents on income sourced within that state.

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DISCUSSION:

A.R.S. § 43-1071(H)(5)(ii) specifically defines “net income tax” to mean any tax imposed by another country that qualifies for a credit under sections 901 and 903 of the internal revenue code and the regulations under those sections, even if withheld from income.

Arizona resident taxpayers are permitted a credit against Arizona income taxes for net income taxes imposed by and paid to another country when all of the following criteria are met:

1. The income is derived from sources within the other country and is taxable to the other country regardless of the residence of the recipient.
2. The other country does not allow Arizona residents a tax credit against income taxes which are imposed by the foreign country.
3. The tax imposed by the other country is on the same income which is also taxed by Arizona

The credit is limited to the lesser of the Arizona tax imposed on income taxed by both Arizona and the other country or the other country's tax imposed on income sourced to the other country that is also taxed by Arizona.

Federal Publication 514, *Foreign Tax Credit for Individuals*, sets forth requirements for completing federal Form 1116, *Foreign Tax Credit (Individuals, Estate, or Trust)*. Generally, a taxpayer completes Form 1116 identifying each country and separately reporting income received from the foreign country and taxes paid to the foreign country. However, the publication provides an alternative method of completing Form 1116 for a taxpayer who receives income passed through from a regulated investment company (RIC). The taxpayer is not required to report such income on a country-by-country basis. In this case the taxpayer totals **all** income received passed through and reports the total on a single line on Form 1116. Similar treatment is allowed for reporting foreign taxes passed through from the RIC and paid by the taxpayer.

PROCEDURE:

If an Arizona resident claimed the federal credit for taxes paid to foreign countries and was not required to report income passed through from a mutual fund or other regulated investment company (RIC) on a country-by-country basis, then the Arizona resident is likewise not required to complete a separate Form 309 to separately report income passed through on a country-by-country basis (including taxes paid to foreign countries), for the purpose of claiming the Arizona tax credit.

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Example: The resident earned foreign income from an investment in a regulated investment company (RIC) including, but not limited to, mutual funds, exchange trade funds (ETF), and real estate investment trusts (REITS). The Fund administrator provided the resident a brokerage statement listing countries as “Various” and reports; (1) a combined total of all investment income earned by the resident from the various countries; and (2) a combined total of all net income taxes paid by the resident to the various countries.

1. Complete one Credit Form 309 to claim a credit for net income taxes paid to all foreign countries. The resident must complete this form even if the resident did not have to complete federal Form 1116 to claim a tax credit on the federal return.
 - a. Enter the term “Various” as the country name in the space provided on page 1 of the form.
 - b. Describe the income source on line 1, in column(a).
 - c. Enter the total income shown on the brokerage statement on line 2, column (a).
 - d. Complete the form, as instructed.
2. Keep a copy of the brokerage statement. Upon request by the department, the taxpayer shall provide the copy as proof for claiming the credit.

If an Arizona resident claimed the federal credit for taxes paid to foreign countries and was required to identify each country and separately report the foreign income earned from **unrelated sources**, along with taxes paid to each country, the taxpayer is also required to complete a separate Form 309 identifying each source of foreign income and related net income taxes paid.

Example: Employees or independent contractors (e.g., traveling US consultants), earning foreign income from more than one country for services performed within each country, must complete a separate Form 309 identifying the foreign income source and related net income tax paid to each foreign country.

1. Complete a separate Credit Form 309, as instructed, to claim a credit for net income taxes paid to each foreign country. The Arizona resident must complete this form even if the resident did not have to complete federal Form 1116 to claim a tax credit on the federal return.
 2. Keep a copy of the other country’s tax return. If the other country does not require the taxpayer to file a foreign income tax return, keep a copy of the documentation showing the amount of tax imposed and paid. Upon request by the department, the taxpayer shall provide a copy as proof for claiming the credit.
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Grant Nülle, Deputy Director

Signed: October 29, 2020

Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to Department personnel. A tax procedure is a written statement issued by the Department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.