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ARIZONA INDIVIDUAL INCOME TAX RULING ITR 11-2

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:

State Income Taxation and Withholding on Compensation Paid to Employees of Interstate Air Carriers (air carrier).

LEGAL REFERENCES:

49 U.S.C. § 40102(2) defines the term “air carrier” to mean a citizen of the United States undertaking by any means, directly or indirectly, to provide air transportation.

49 U.S.C. § 40102(15) defines the term “citizen of the United States” to mean: (A) an individual who is a citizen of the United States; (B) a partnership each of whose partners is an individual who is a citizen of the United States; or (C) a corporation or association organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States, of which the president and at least two-thirds of the board of directors and other managing officers are citizens of the United States, which is under the actual control of citizens of the United States, and in which at least 75% of the voting interest is owned or controlled by persons that are citizens of the United States.

49 U.S.C. § 40116(f)(1)(A) defines the word “pay” to mean money received by an employee of an air carrier for services.

49 U.S.C. § 40116(f)(1)(C) provides that an employee of an air carrier is deemed to have earned 50% of the employee's pay in a State in which the scheduled flight time of the employee in the State is more than 50% of the total scheduled flight time of the employee when employed during the calendar year.

49 U.S.C. § 40116(f)(2) provides that the pay of an employee of an air carrier having regularly assigned duties on aircraft in at least 2 States is subject to the income tax laws of the State that is the residence of the employee and the State in which the employee earns more than 50% of the pay received by the employee from the carrier.

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A.R.S. § 43-102(A)(4) provides that an Arizona resident is subject to Arizona income tax on all income wherever derived.

A.R.S. § 43-403(A)(1) provides that no Arizona income tax shall be withheld from wages or salary paid to an employee of a common carrier when the employee is a nonresident and regularly performs services both within and without Arizona.

A.R.S. § 43-408 provides that if an Arizona resident is employed outside of Arizona, the person may request the employer to withhold Arizona taxes on wages earned for the services performed outside of Arizona.

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.

A.R.S. § 43-1091 provides that in the case of nonresidents, Arizona gross income includes only that portion of federal adjusted gross income which represents income from sources within Arizona.

A.R.S. § 43-1096 sets forth the conditions under which Arizona nonresidents are allowed an Arizona income tax credit for income taxes paid to another state.

A.A.C. R15-2C-601(D)(4)(g)(v) provides that nonresident individuals who are employed in Arizona at intervals throughout the year are subject to Arizona income tax on a prorated basis.

The term “common carrier” means a person or company in the business of transporting passengers or goods for a fee, at uniform rates available to all persons. See “common carrier,” Webster’s New World College Dictionary (2010), at <http://www.yourdictionary.com>.

DISCUSSION:

Under 49 U.S.C. § 40116(f)(2), the pay of an employee of an air carrier having regularly assigned duties on aircraft in at least 2 States is subject to the income tax laws of the State that is the residence of the employee and the State in which the employee earns more than 50% of the pay received by the employee from the carrier. 49 U.S.C. § 40116(f)(1)(C), provides that an employee of an air carrier is deemed to have earned 50% of the employee's pay in a State in which the scheduled flight time of the employee in the State is more than 50% of the total scheduled flight time of the employee when employed during the calendar year.

A.R.S. § 43-102(A)(4) provides that an Arizona resident is subject to Arizona income tax on all income wherever derived. 49 U.S.C. § 40116(f)(2), provides that the pay of an

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employee of an air carrier having regularly assigned duties on aircraft in at least 2 States is subject to the income tax laws of the State that is the residence of the employee. Therefore, an Arizona resident who is an employee of an air carrier is subject to tax on all pay received from the air carrier while an Arizona resident.

A.R.S. § 43-1091 provides that in the case of nonresidents, Arizona gross income includes only that portion of federal adjusted gross income which represents income from sources within Arizona. 49 U.S.C. § 40116(f)(2) provides that the pay of an employee of an air carrier having regularly assigned duties on aircraft in at least 2 States is subject to the income tax laws of the State in which the employee earns more than 50% of the pay received by the employee from the carrier. Therefore, an Arizona nonresident air carrier employee is subject to Arizona income tax on pay received from the air carrier only if more than 50% of that pay was earned in Arizona.

An air carrier employee who has regularly assigned duties in at least 2 different states may be subject to tax by 2 different states on the same income earned from the air carrier. For Arizona purposes, when an individual is subject to income tax by both Arizona and another state on the same income, the individual may be eligible to claim a credit against the Arizona taxes for taxes paid to the other state.

Under A.R.S. § 43-1071, an Arizona resident may claim a credit against Arizona income taxes for net income taxes imposed by and paid to another state if:

1. Income taxed in Arizona is from sources within another state;
2. The other state subjects the income to a net income tax, regardless of the residence of the taxpayer; and
3. The other state does not allow a credit to Arizona residents against the net income tax imposed on income subject to tax in Arizona and the other state.

Under A.R.S. § 43-1096, Arizona nonresident taxpayers are permitted a credit against Arizona income taxes if the nonresident is not allowed a credit by the state of residence for taxes paid to Arizona and either of the following criteria apply:

1. The other state does not tax Arizona residents on income derived from sources within the other state, or
2. The other state allows Arizona residents credit for taxes paid on income subject to tax by the other state and Arizona.

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CONCLUSION AND RULING:

Arizona Nonresident Air Carrier Employees

Arizona Nonresident Air Carrier Employees Whose Scheduled Flight Time in Arizona is 50% or **Less** than the Employee's Total Scheduled Flight Time When Employed by the Carrier During the Taxable Year

Pursuant to 49 U.S.C. § 40116(f)(2), employees of air carriers who are nonresidents of Arizona whose scheduled flight time in Arizona is 50% or less than the employee's total scheduled flight time when employed by the carrier during the taxable year are not subject to Arizona income tax on the pay received from the air carrier. Additionally, pay received by those employees from the air carrier is not subject to Arizona withholding. Therefore, A.R.S. § 43-1091 and A.A.C. R15-2C-601, which provides that nonresident individuals who are employed in Arizona at intervals throughout the year are subject to Arizona income tax on a prorated basis, are preempted by federal law with respect to those individuals to which 49 U.S.C. § 40116(f)(2) applies.

Income earned by nonresident employees of an air carrier from other Arizona sources is not affected by 49 U.S.C. § 40116 and is subject to applicable Arizona income tax provisions.

Arizona Nonresident Air Carrier Employees Whose Scheduled Flight Time in Arizona is **More** Than 50% of the Employee's Total Scheduled Flight Time When Employed by the Carrier During the Taxable Year

Pursuant to 49 U.S.C. § 40116(f)(2), employees of air carriers who are nonresidents of Arizona whose scheduled flight time in Arizona is more than 50% of the employee's total scheduled flight time when employed by the carrier during the taxable year are subject to Arizona income tax on the pay received from the air carrier. Additionally, A.A.C. R15-2C-601(D)(4)(g)(v), provides that nonresident individuals who are employed in Arizona at intervals throughout the year are subject to Arizona income tax on a prorated basis. Therefore, when an Arizona nonresident employee is subject to Arizona income tax on pay earned from the air carrier, the taxpayer shall use the following formula to determine the amount of air carrier pay sourced to Arizona for the taxable year:

$$\frac{\text{Employee flight time scheduled in AZ during taxable year}}{\text{Total employee flight time scheduled during taxable year}} \times \text{Total employee air carrier pay for the tax year}$$

With respect to Arizona withholding, A.R.S. § 43-403(A)(1) provides that no Arizona income tax shall be withheld from wages or salary paid to an employee of a common carrier when the employee is a nonresident and regularly performs services both within and without Arizona. Because an air carrier meets the definition of a common carrier (a person or company in the business of transporting passengers or goods for a fee, at uniform rates available to all persons), Arizona income tax may not be withheld from wages paid by an

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air carrier to a nonresident of Arizona for services performed in Arizona. Therefore, even though the employee may be subject to Arizona income tax on those wages, no Arizona income tax may be withheld from those wages.

If the nonresident individual is subject to tax in the individual's state of residence and also in Arizona on the same pay received from the air carrier, the taxpayer may claim a credit against the taxes paid to Arizona for taxes paid to the individual's state of residence if the taxpayer meets all of the criteria set forth in A.R.S. § 43-1096.

Income earned by nonresident employees of an air carrier from other Arizona sources is not affected by 49 U.S.C. § 40116 and is subject to applicable Arizona income tax provisions.

Arizona Resident Air Carrier Employees

Employees of air carriers who are residents of Arizona and who perform duties in more than one state are subject to Arizona income tax on all pay for services performed both within and without Arizona. Resident employees of air carriers are subject to Arizona withholding to the extent the compensation is paid for services performed within Arizona. Resident employees of air carriers may also request the air carrier to withhold Arizona tax on compensation paid for services performed outside of Arizona.

If the resident air carrier employee is subject to tax by both Arizona and another state on the same pay received from the air carrier, the taxpayer may claim a credit against the taxes paid to Arizona for taxes paid to the other state on the income taxed by both Arizona and the other state if the taxpayer meets all of the criteria set forth in A.R.S. § 43-1071.

Gale Garriott, Director

Signed: May 3, 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.