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## ARIZONA INDIVIDUAL INCOME TAX RULING ITR 11-7

(Supersedes Arizona Individual Income Tax Ruling ITR 94-11)

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 Arizona's tax treatment of benefits provided under a cafeteria plan created pursuant to Internal Revenue Code § 125?

### **APPLICABLE LAW:**

Arizona Revised Statutes (A.R.S.) § 43-1021 provides for specific additions to Arizona gross income in calculating Arizona taxable income.

A.R.S. § 43-1022 provides for specific subtractions from Arizona gross income in calculating Arizona taxable income.

A.R.S. § 43-401 provides for employer withholding from employee wages, salary, bonuses, or other emolument for services performed by the employee within the state.

Internal Revenue Code (I.R.C.) § 125 defines which arrangements will qualify as a cafeteria plan under federal law and qualified benefits under such a plan.

### **DISCUSSION:**

A cafeteria plan is an employee benefit plan which qualifies under the requirements of I.R.C. § 125. Participating employees may choose among two or more employer-provided benefits, including a taxable cash benefit and non-taxable qualified benefits such as group-term life insurance, accident or health insurance, and dependent care assistance. Generally such plans may not provide for deferred compensation, and the election of benefits must take place before the plan year begins and is thereafter irrevocable.

With respect to income taxation, the starting point for the Arizona income tax computation for the resident individual is the federal adjusted gross income. This amount is then subject to certain additions and subtractions to arrive at Arizona taxable income.

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There is no specific treatment for benefits from cafeteria plans in Arizona's income tax statutes. Therefore, to the extent that such amounts are excluded from or included in federal adjusted gross income, they will likewise be excluded from or included in Arizona gross income.

With respect to Arizona withholding, A.R.S. § 43-401 provides that beginning from and after June 30, 2010, Arizona's income tax withholding shall be prescribed by tables adopted by the department. Pursuant to those tables, Arizona income tax withholding is a percentage of the employee's gross taxable wages. "Gross taxable wages" is the amount that meets the federal definition of "wages" contained in IRC § 3401. Arizona's withholding statutes do not provide for a specific treatment of benefits from cafeteria plans. Therefore, amounts which are included in wages and are subject to federal withholding are subject to Arizona withholding. Amounts excluded from federal withholding are similarly excluded from Arizona withholding.

### **RULING:**

Arizona has no specific income tax provisions relating to benefits from cafeteria plans. Therefore, to the extent that benefits from cafeteria plans are excluded from or included in federal adjusted gross income, they will likewise be excluded from or included in Arizona gross income.

Benefits from cafeteria plans which are excluded from or included in amounts subject to federal withholding will be treated similarly for Arizona withholding purposes.

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

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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.