

General Information Letter: Computation of Iowa double-taxed income explained.

October 5, 2009

Dear:

This is in response to your letter dated May 27, 2009, and your subsequent inquiries. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www. tax.illinois.gov](http://www.tax.illinois.gov).

In your letter you have stated the following:

The Illinois base income for 2008 taxed by other state (Iowa) is \$129,912.00. The Income Tax we paid to Iowa is \$5,734.00. The amount of \$103,546 that is indicated on the Return Correction Notice is incorrect. Pages 1, 2 & 3 of the Return Correction Notice are enclosed as requested.

We are enclosing a copy of the Iowa IA 1040 Tax Return we filed with Iowa for the year 2008.

In this 2008 IA 1040 Tax Return you will find on Schedule 2008 IA 126 that Iowa Net income on line 26 is \$73,187.00 for column "Spouse" and \$56,725.00 for column "You" for a total of \$129,912.00.

The income was derived from investments in Iowa as follows:

The sale of a rental dwelling	\$98,958.00
Ordinary income derived in this sale	1,080.00
Farm rental income	37,125.00
Adjustments:	
Bonus Depreciation Deduction	-207.00
Health Insurance Deduction	<u>-7,044.00</u>
Total Iowa Net Income	\$129,912.00

These amounts of income were divided between columns "Spouse" and "You" on Schedule 2008 IA 126.

We are due a refund of \$552.00, of which \$300 is to be applied to our 2009 estimated tax and the balance of \$252.00 sent to our bank account.

## **Response**

The foreign tax credit computed on Schedule CR of the Form IL-1040 is allowed under Section 601(b)(3) of the Illinois Income Tax Act (35 ILCS 5/601), which states, in part:

The aggregate amount of tax which is imposed upon or measured by income and which is paid by a resident for a taxable year to another state or states on income which is also subject to the tax imposed by subsections 201(a) and (b) of this Act shall be

credited against the tax imposed by subsections 201(a) and (b) otherwise due under this Act for such taxable year. The aggregate credit provided under this paragraph shall not exceed that amount which bears the same ratio to the tax imposed by subsections 201(a) and (b) otherwise due under this Act as the amount of the taxpayer's base income subject to tax both by such other state or states and by this State bears to his total base income subject to tax by this State for the taxable year. (emphasis added)

Guidance on computing the limitation imposed by the underlined language is provided in the Department's regulation at 86 Ill. Adm. Code Section 100.2197. In computing the amount of base income subject to tax by both Illinois and another state (referred to as "double-taxed income" in the regulation), Section 100.2197(b)(4) generally provides that double-taxed income includes all items of income that are taxed by both states, minus deductions that are allowed by both states. Section 100.2197(b)(4)(G) provides:

Some states compute the tax liability of a nonresident by first computing the tax on all income of the nonresident from whatever source derived, and then multiplying the resulting amount by a percentage equal to in-state sources of income divided by total sources of income or by allowing a credit based on the percentage of total income from sources outside the state. Other states determine the tax base of a nonresident by computing the tax base as if the person were a resident and multiplying the result by the percentage equal to in-state sources of income divided by total sources of income. The use of either of these methods of computing tax does not mean that income from all sources is included in double-taxed income. See *Comptroller of the Treasury v. Hickey*, 114 Md. App. 388, 689 A.2d 1316 (1997); *Chin v. Director, Division of Taxation*, 14 N.J. Tax 304 (T.C. N.J. 1994). When a state uses either of these methods of computation, double-taxed income shall be the base income of the taxpayer from all sources subject to tax in that state, as computed in accordance with the rest of this subsection (b)(4), multiplied by the percentage of income from sources in that state, as computed under that state's law

Pursuant to these provisions, Publication 131 gives very specific instructions on the computation of double-taxed income in your circumstances. As stated in that publication, the computation of double taxed income of each spouse starts with the "net income" reported on Line 26 of the Form IA-1040, which is then adjusted by

- Adding back the deduction for health insurance on Line 18 of the Form IA-1040 (except to the extent the deduction is for self-employed health insurance allowed in computing federal adjusted gross income), because Illinois allows the federal deduction for self-employed health insurance.
- Subtracting taxable IRA distributions, retirement income and Social Security benefits reported on Lines 8, 9 and 13 of the Form IA-1040, because Illinois does not tax any of those benefits.
- Adding back the pension/retirement income exclusion on Line 21 of the Form IA-1040, to avoid double-counting this exemption and the broader Illinois exemption for retirement income.

The resulting amount is then multiplied by the percentage of that spouse's taxable income that is from Iowa sources, as reported on Line 28 of the Form IA 126. This computation reflects the fact that Iowa is not taxing you on your Iowa-sourced income, but on a percentage of your income from all sources,

computed as if you were an Iowa resident. This amount includes some items that Illinois does not tax. No credit is allowable for taxes paid to Iowa on the items Illinois does not tax.

The initial Return Correction Notice sent to you included computations based on the wrong section of the Publication 131. When the correct section is used, the total of items of income taxed by both states, minus deductions allowed by both states, is \$85,367 for "Spouse" and \$65,833 for "You," which, when multiplied by the percentage of income from Iowa sources (85.4% for "Spouse" and 65.5% for "You"), yields double-taxed income of \$72,903 for "Spouse" and \$43,121 for "You," for a total double-taxed income of \$116,024. Using this amount, the maximum allowable credit is \$3,343, rather than the \$3,743 you computed on your return.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton  
Deputy General Counsel – Income Tax