

ARIZONA DEPARTMENT OF REVENUE

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ARIZONA INDIVIDUAL INCOME TAX RULING ITR 96-2

(Note: All references to Arizona Revised Statute § 43-1022.6 were updated on August 4, 2020. See footnote 1 on page 1 of this ruling. No substantive change was made to this ruling.)

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:

If a qualified pension plan has income from investments in U.S. Government obligations, can the individual receiving distributions from the plan subtract from his or her Arizona gross income any portion of the distribution as interest income received on obligations of the United States?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-1022¹ provides for the subtraction from Arizona gross income of interest income received on obligations of the United States.

Internal Revenue Code (I.R.C.) § 72 prescribes rules for including annuities in federal gross income.

I.R.C. § 401(a) sets forth the requirements for tax qualification of trusts which form a part of stock bonus, pension, or profit sharing plans created by employers for the benefit of their employees.

I.R.C. § 402(a) provides that any amount distributed from an employees' trust described in I.R.C. § 401(a) which is exempt from tax under I.R.C. § 501(a) shall be included in the gross income of the distributee in the manner provided under the annuity rules prescribed by I.R.C. § 72.

31 United States Code (U.S.C.) § 3124(a) prohibits states from taxing interest on U.S. Government obligations.

¹ The original ruling referenced Arizona Revised Statute § 43-1022.6. Due to statute amendments, paragraph six (6) is no longer applicable for this ruling

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Internal Revenue Service Ruling (Rev. Rul.) 55-61 (1955-1 C.B. 40) addresses the federal tax treatment of distributions from an employees' trust attributable to interest on tax-free securities.

Meunier v. Minnesota Department of Revenue, 503 N.W.2d 125, *cert. denied*, 114 S.Ct. 635, 126 L.Ed.2d 594 (1993) held that the portion of monthly annuity payments to retired federal employees attributable to interest earned by the civil service retirement fund on tax-exempt U.S. obligations was not exempt from Minnesota personal income tax. Interest on tax-exempt securities loses that exemption upon distribution from a pension plan fund.

DISCUSSION:

A.R.S. § 43-1022 provides a subtraction from Arizona gross income for interest income received on obligations of the United States. The question has been raised whether this subtraction applies to pension plan distributions comprised of income earned by the plan from investment in U. S. Government obligations.

31 U.S.C. § 3124(a) provides as follows with respect to state taxation of U.S. Government obligations:

(a) Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax, except-

- (1) a nondiscriminatory franchise tax or another nonproperty tax instead of a franchise tax, imposed on a corporation; and
- (2) an estate or inheritance tax.

State taxation is barred, regardless of its form, if federal obligations or interest on such obligations must be considered, either directly or indirectly, in computing the tax.

I.R.C. § 402(a) provides that any amount distributed from an employees' trust described in I.R.C. § 401(a) which is exempt from tax under I.R.C. § 501(a) shall be included in the gross income of the distributee in the manner provided under the annuity rules prescribed by I.R.C. § 72.

For federal purposes, Rev. Rul. 55-61 provides that a distribution from an employees' trust meeting the requirements of I.R.C. § 401, made in whole or in part from funds received by the trust as interest on tax-free securities, is taxable income to the extent provided by I.R.C. § 402(a). I.R.C. § 402(a) provides that amounts distributed by an exempt employees' trust are taxable to the distributee under I.R.C. § 72. For federal income tax purposes, the type of income earned by the trust bears no relationship to the treatment of the distributions.

The Arizona income tax is computed solely on the amount of the pension plan distribution determined in accordance with I.R.C. § 72. The tax is not computed, either

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directly or indirectly, on the interest income earned by the plan. A.R.S. § 43-1022 provides for the subtraction from Arizona gross income of interest income received on obligations of the United States. Since the distribution amount received from the plan is not interest income, the subtraction is not applicable to qualified pension plan distributions.

RULING:

A distribution amount received from a qualified pension plan is not interest income. If the plan has income from investments in U.S. Government obligations, the individual receiving distributions from the plan cannot subtract any portion of the distribution as interest income received on obligations of the United States. Therefore, the distribution amount included in Arizona gross income is subject to Arizona income tax.

Harold Scott, Director

Signed: May 9, 1996

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 which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the 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 92-1 for more detailed information regarding documents issued by the Department of Revenue.