

810-3-21-.03 Maximum Credit for Tax Paid other Jurisdictions.

(1) The credit for tax paid or incurred to other jurisdictions shall not be used to offset that portion of a taxpayer's income tax liability which is attributable to Alabama sources. The credit for tax paid or incurred to other jurisdictions shall only be utilized against that portion of the taxpayer's income tax liability which is attributable to income from other jurisdictions.

(2) As a general rule, that portion of a taxpayer's income tax liability which is attributable to non-Alabama sources shall be determined by multiplying the taxpayer's Alabama income tax liability before consideration of any credit described in Ala. Code § 40-18-21 by a fraction, the numerator of which is total non-Alabama source adjusted gross income and the denominator of which is total Alabama adjusted gross income.

(a) Example. Taxpayer reports \$120,000 of adjusted gross income on his Alabama income tax return, of which \$80,000 is attributable to another jurisdiction; his Alabama income tax liability before credits is \$4,000. Taxpayer paid the other jurisdiction \$4,000 of income tax on the \$80,000 of income from the other jurisdiction.

Because one-third (\$1,333) of Taxpayer's liability is attributable to Alabama sources, it is not subject to the credit for tax paid to other jurisdictions. The maximum credit that Taxpayer may utilize is \$2,667, which is the portion of his liability attributable to other jurisdictions.

(b) Example. Taxpayer reports \$120,000 of adjusted gross income on his Alabama income tax return, of which \$80,000 is from non-Alabama sources. Of this \$80,000 non-Alabama source income, \$40,000 is attributable to State A and \$40,000 is attributable to State B. Taxpayer's Alabama income tax liability before credit is \$4,000. Taxpayer paid State A \$2,000 of income tax on the \$40,000 of income from State A; Taxpayer paid State B no income tax on the \$40,000 of income from State B.

Because one-third (\$1,333) of Taxpayer's liability is attributable to Alabama sources, it is not subject to the credit for tax paid to other jurisdictions; Taxpayer's remaining income tax liability of \$2,667 is creditable. However, because the total of income tax paid by Taxpayer to both States A and B (\$2,000) is less than the creditable portion of Taxpayer's income tax liability (\$2,667), the maximum credit for tax paid to other jurisdictions does not limit Taxpayer's use of the credit.

(3) As an exception to the general rule described in (2), taxpayers with foreign (non U.S.) source income and federal foreign tax credits may use the following alternative methodology to determine the portion of the Alabama income tax liability attributable to Alabama and non-Alabama sources. The taxpayer may multiply Alabama source income by his or her effective Alabama income tax rate to determine the portion of his or her liability attributable to Alabama and therefore not creditable. For purposes of this calculation: the taxpayer's effective Alabama income tax rate equals the statutory rate of five percent (5%) multiplied by one (1) minus the taxpayer's effective federal income tax rate; the taxpayer's effective federal income tax rate equals the taxpayer's federal income tax liability before foreign

tax credit divided by his or her federal taxable income; and Alabama source income equals total Alabama adjusted gross income less income attributable to non-Alabama sources.

(a) Example. Taxpayer reports \$200,000 of adjusted gross income on his Alabama income tax return, of which \$30,000 is attributable to a foreign (non-U.S.) jurisdiction; his Alabama income tax liability before credit is \$8,500. Taxpayer's federal taxable income is also \$200,000; his federal income tax liability before subtracting any foreign tax credit is \$40,000. Taxpayer paid the foreign jurisdiction \$10,000 of income tax.

In determining the overall limit on the credit available for taxes paid to other jurisdictions, Taxpayer multiplies his Alabama source income of \$170,000 by his effective Alabama income tax rate. Taxpayer determines the effective Alabama income tax rate by multiplying the five percent (5%) statutory Alabama income tax rate by one minus his or her effective federal income tax rate. His effective federal income tax rate before foreign tax credit is twenty percent (20%) or ($\$40,000 / \$200,000$) and his Alabama effective tax rate is four percent (4%) or ($5\% \times (1 - 20\%)$ or 80%). Taxpayer then multiplies his Alabama source income (\$170,000) by his effective Alabama income tax rate (4%), which equals \$6,800. The credit for tax paid to other jurisdictions cannot be used to reduce Taxpayer's liability below \$6,800. Taxpayer's credit for tax paid to other jurisdictions cannot exceed \$1,700 ($\$8,500 - \$6,800$).

(4) In addition to the methodologies described above, the taxpayer may use an alternative methodology by obtaining written approval from the Department before the original due date of the taxpayer's income tax return.

(5) This rule is applicable to tax years beginning on or after January 1, 2013.

Author: Brandee B. Tickle, CPA

Authority: Sections 40-2A-7(a)(5) and 40-18-21, Code of Alabama 1975

History: New rule: Filed November 28, 2012, effective January 2, 2013