DEPARTMENT OF STATE REVENUE
Information Bulletin # 28
Income Tax
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SUBJECT: Application of State and County Income Taxes to Residents with Out-of-State Income and Nonresidents with Indiana Source Income

REFERENCE: IC 6-3-1-3.5; IC 6-3-1-12; IC 6-3-1-13; IC 6-3-2-2; IC 6-3-3-3; IC 6-3-4-15; IC 6-3-5-1

INTRODUCTION

Full-year Indiana residents must report all income that is reported for federal income tax purposes on their Indiana individual income tax return (Form IT-40; Form IT-40EZ). This includes all income, even if it is derived from sources outside Indiana.

Full-year nonresidents who received income from Indiana sources must file an Indiana individual income tax return (Form IT-40PNR). They are subject to tax on that part of their total federal income that is derived from or connected with Indiana sources. If the nonresident's only Indiana source income was from an Indiana partnership or S corporation, they shall be included in the entity's composite return, and are not required to file Form IT-40PNR.

Part-year Indiana residents must file an Indiana individual income tax return (Form IT-40PNR). They are subject to tax on that part of their total federal income that was received while they were residents of Indiana. Also taxable is income from Indiana sources received while they were nonresidents of Indiana.

If a joint federal income tax return is filed, a joint Indiana return is also required. If separate federal income tax returns are filed, separate Indiana returns are also required.

I. INCOME RECEIVED FROM INDIANA SOURCES

Income received from Indiana sources is considered Indiana income to nonresidents, except certain types of Indiana source income that are subject to tax only by the taxpayer's state of legal residence. Interest, dividends, royalties and gains from the sale of capital assets are subject to tax only by the taxpayer's state of legal residence unless such income results from the conduct of a trade or business in Indiana. If a trade or business is conducted in Indiana, the income should be reported as Indiana income.

Income from a qualified pension, annuity, or profit sharing plan is subject to tax by the taxpayer's state of legal residence. Lump sum distributions from qualified plans are subject to tax by the state that, at the time of distribution, is the taxpayer's state of legal residence.

Deferred compensation other than from a qualified retirement plan, accumulated vacation, bonus, severance, sick pay, and income from a stock option plan are directly attributable to services performed, and are taxable by the state where the services were performed.

II. STATE TAX AGREEMENTS

Taxpayers may be subject to individual income tax by both their state of residence and the state from which the income is derived. The State of Indiana has entered into agreements with several states to eliminate the requirement of paying tax to two states on the same income. Tax treatment of out-of-state income depends upon the types of income and the state from which the income is derived.

In the case of tax credits, Indiana only allows credits for individual income tax paid to other states or localities. Other taxes such as property taxes, corporate income taxes and unincorporated business taxes are not allowed

as a basis for claiming such credits. A worksheet indicating how the credit was computed and a copy of the tax return filed with the other state must be attached to the Indiana return. Withholding statements or other evidence of tax payments will not be accepted. A copy of Federal Form 1116, (Computation of Foreign Tax Credit), must be attached if credit is claimed for tax paid to a foreign country.

In computing the credit allowed by Indiana, adjusted gross income that is subject to tax in both states should be used as a basis for calculating the allowable credit. Adjustments that increase or decrease the taxable amount in other states should not be considered in calculating the allowable credit. For example, State A allows a deduction for medical expenses, but Indiana does not; therefore the credit would be based on the income before the medical expense deduction.

III. RECIPROCAL AGREEMENT STATES

There are five states that have a reciprocal agreement with the State of Indiana. They are Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin. All salaries, wages, tips and commissions earned in these states by an Indiana resident must be reported as if they were earned in Indiana. A credit cannot be taken for any taxes withheld by or paid to any of these states in connection with income from salaries, wages, tips and commissions. If taxes have been withheld or paid to any of these states, a claim for refund should be filed with that state by filing that particular state's income tax form for nonresidents.

Residents of Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin who have Indiana income will report and pay tax on that income to their state of residence.

If a resident of one of the above states has wages, salaries, tips, or commissions from Indiana sources where Indiana state or county tax has been withheld, Form IT-40 RNR must be filed. A credit for Indiana state and county tax withholding amounts will be allowed, plus any Indiana county tax liability will be figured. If a resident of one of the above states has income from Indiana other than wages, salaries, tips, or commissions, Form IT-40 PNR must be filed.

IV. REVERSE CREDIT AGREEMENT STATES

The reverse credit agreement applies to Indiana residents who have income from the following jurisdictions, and to residents of those jurisdictions who have income from Indiana. Included are:

Arizona
California
Oregon
Washington D.C.

For example, a resident of Indiana, with rental income from property owned in a reverse credit state, will file a resident Indiana return and include the rental income on the Indiana return. The taxpayer will file a nonresident return for the state where the income was earned and claim a credit for the taxes paid to Indiana on the rental income.

A resident of a reverse credit state with income from Indiana will file a resident return with his state of residence and include the Indiana income. The taxpayer will then file an Indiana Form IT-40PNR and claim a credit for taxes paid to the state of residence for the Indiana source income.

V. STATES WITH NO AGREEMENT WITH INDIANA

When a person receives income from any state, possession, or foreign country other than those covered in Sections III and IV, the taxpayer might be required to pay income taxes to both entities. The taxpayer may take a credit for taxes paid to other states against the taxpayer's Indiana adjusted gross income tax liability.

The credit is equal to the lesser of:

1. The amount of income tax actually paid to the other state, possession, or foreign country on income from that entity;
2. An amount equal to the Indiana income tax rate multiplied by the adjusted gross income taxed by both Indiana and the entity; or
3. The amount of Indiana adjusted gross income tax due to Indiana for the tax year.

List of States With No Agreement

Alabama	Arkansas	Colorado	Connecticut

Delaware	Georgia	Hawaii	Idaho
Illinois	Iowa	Kansas	Louisiana
Maine	Maryland	Massachusetts	Minnesota
Mississippi	Missouri	Montana	Nebraska
New Hampshire	New Jersey	New Mexico	New York
North Carolina	North Dakota	Oklahoma	Rhode Island
South Carolina	Tennessee	Utah	Vermont
Virginia	West Virginia		

VI. NON-INDIANA LOCALITY EARNINGS DEDUCTION

A non-Indiana locality earnings deduction is available to those who pay income tax to a locality outside Indiana. The term "locality" refers to a city, county, or other political subdivision, but not other state taxes paid or withheld.

The deduction is limited to the lesser of:
1. The amount of income taxed by the out-of-state locality; or
2. $2,000

Claim the deduction on the annual income tax return, Form IT-40 or Form IT-40PNR.

VII. COUNTY INCOME TAX CREDIT

All Indiana residents who are subject to a county income tax and are also required to pay income taxes to a locality outside Indiana are allowed a credit against their Indiana county tax liability. However, this credit is not allowed against the county economic development income tax (CEDIT).

The credit for taxes paid to a locality outside Indiana must be supported by a separate calculation of the credit. If the taxpayer is required to file a return with the locality in another state, a copy of the return must be submitted with the claim for credit. Withholding statements or other evidence of tax payment will be acceptable if no return is required to be filed with the locality outside Indiana.

Persons claiming a county credit for taxes paid to out-of-state localities must add the deduction taken for non-Indiana locality earnings back to their state taxable income after arriving at their county taxable income.

The allowable credit is equal to the lesser of:
1. The amount of income tax actually paid to a locality in another state;
2. The amount of adjusted gross income taxed by the locality outside of the State of Indiana multiplied by the county rate* which the taxpayer is subject to; or
3. The amounts of county tax due on the Indiana return.

**See the Rate Conversion Chart in the annual IT-40 Full-Year Resident or IT-40PNR Part-Year Nonresident individual income tax booklets for the appropriate rate to use to figure the credit.*

On a joint return, the credit should be calculated separately for the husband and wife. Any unused credit attributable to one spouse cannot be used to reduce the other spouse's county tax liability.

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Commissioner

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