TITLE 45 DEPARTMENT OF STATE REVENUE

Proposed Rule
LSA Document #16-491

DIGEST

Adds 45 IAC 3.1-4 concerning administration, tax rates, defining income subject to tax, exemptions, treatment of married individuals, duration of tax, determining the county of residence, determining the principal place of business or employment, reciprocity agreements, and credit for taxes paid to out-of-state local governments. Effective 30 days after filing with the Publisher.

IC 4-22-2.1-5 Statement Concerning Rules Affecting Small Businesses

45 IAC 3.1-4

SECTION 1. 45 IAC 3.1-4 IS ADDED TO READ AS FOLLOWS:

Rule 4. Local Income Tax

45 IAC 3.1-4-1 Persons and income subject to tax; administration

Authority: IC 6-8.1-3-3
Affected: IC 6-3-1-3.5; IC 6-3.6

Sec. 1. (a) The local income tax (LIT) is imposed on individuals who are residents of adopting counties and on individuals who are residents of nonadopting counties but who have their principal place of business or employment in an adopting county.

(b) For residents of adopting counties, the tax is imposed on adjusted gross income as defined in IC 6-3-1-3.5(a).

(c) For residents of nonadopting counties and nonresidents of the state with a principal place of business or employment in an adopting county, the tax is imposed only on the adjusted gross income derived from the principal place of business or employment.

(d) For purposes of determining the adjusted gross income, the adjusted gross income shall be the amount as defined under IC 6-3-1-3.5(a) and shall include all deductions from adjusted gross income permitted under IC 6-3.

(e) For periods ending before January 1, 2017, these rules apply to the county adjusted gross income tax, county option income tax, and county economic development income tax, except as otherwise expressly provided in this rule.

(Department of State Revenue; 45 IAC 3.1-4-1)

45 IAC 3.1-4-2 Tax rates; income subject to tax

Authority: IC 6-8.1-3-3
Affected: IC 6-3.6

Sec. 2. (a) Effective January 1, 2017, the local income tax (LIT) is imposed on residents and nonresidents at the same rate.

(b) Prior to January 1, 2017:
(1) if a county has a county adjusted gross income tax, the nonresident rate is twenty-five hundredths percent (0.25%);
(2) if a county has a county option income tax, the nonresident rate is twenty-five percent (25%) the

rate imposed on residents; and
(3) if a county has a county economic development income tax, the nonresident rate is the same rate imposed on residents.

If a county has a combination of subdivisions (1) and (3) or subdivisions (2) and (3), the resident rates and nonresident rates for each tax type are added together to determine the aggregate resident and nonresident tax rates.

(Department of State Revenue; 45 IAC 3.1-4-2)

45 IAC 3.1-4-3 Income subject to LIT

Authority: IC 6-8.1-3-3
Affected: IC 6-3.5-7; IC 6-3.6

Sec. 3. (a) For a resident of an adopting county, the following applies:
(1) If an individual's county of residence adopts or has adopted the local income tax (LIT), his or her entire adjusted gross income will be subject to the tax rate adopted in the individual's county of residence.
(2) Notwithstanding subdivision (1), Perry County residents are not subject to tax on income earned in a contiguous county outside Indiana and subject to local income tax in that county. Prior to 2017, this exemption only applies to taxes imposed under IC 6-3.5-7.

(b) For a resident of a nonadopting county and out-of-state residents, if an individual resides in a nonadopting county or outside the state of Indiana, but his or her principal place of business or employment is in an Indiana adopting county, only the adjusted gross income derived from his or her principal place of business or employment in Indiana will be subject to LIT.

(c) For purposes of determining what income is subject to LIT, all income derived from an Indiana county in which the principal place of business or employment is located is subject to LIT as follows:
(1) The income subject to tax includes compensation and self-employment income, as well as net income derived from ownership or beneficial interest in a pass-through entity.
(2) In the case of income derived from the operation of a business (profits from a business but not compensation), only such income derived from the conduct of business in the county of principal place of business or employment will be subject to LIT.

(Department of State Revenue; 45 IAC 3.1-4-3)

45 IAC 3.1-4-4 Persons and income subject to tax; exemptions; joint returns

Authority: IC 6-8.1-3-3
Affected: IC 6-3-1-3.5; IC 6-3.6

Sec. 4. (a) An individual is subject to county tax if he or she lives or works in an adopting county on January 1 of the tax year as follows:
(1) A taxpayer's county of residence and principal place of business or employment on this date alone determine whether he or she is subject to local income tax (LIT) for the entire year.
(2) If a taxpayer lives in an adopting county on January 1 and later in the year moves to a nonadopting county, he or she is subject to county tax on his or her adjusted gross income for the entire year.
(3) If a taxpayer lives in a nonadopting county on January 1 and later in the year moves to an adopting county, he or she is not subject to county tax for that year except as provided in subsection (b).

(b) If, on January 1, a taxpayer's county of residence is a nonadopting county, but his or her county of principal place of business or employment is an adopting county, he or she must pay LIT on the income derived from his or her principal place of business or employment for the entire year. Even though he or she may later begin working in a nonadopting county, he or she must pay county tax for the entire year on the income earned from his or her principal activity, even if the principal activity is later conducted in another county.

(c) However, if an individual neither lived nor maintained his or her principal place of business or

employment in an adopting county on January 1, he or she is not subject to LIT on any part of his or her income even though his or her county of residence or principal place of business or employment changes to an adopting county during the year.

(d) An individual who as of January 1 maintains his or her principal place of business or employment in an adopting county but is a nonresident of Indiana, or is a resident of Indiana on January 1 but moves out of Indiana during the tax year, is subject to LIT only on income derived from Indiana sources. An individual who as of January 1 had his or her county of residence in an adopting Indiana county is not liable for LIT on income earned outside the state while not a resident of the state.

(e) An individual who as of January 1 lives in an adopting county and moves out-of-state to a reciprocal state, while maintaining his or her Indiana principal place of business or employment, will not owe adjusted gross income tax on the wage income earned after moving out of Indiana. However, LIT will be due on the wage income earned after moving out of Indiana. It should be reported in the county tax schedule of the appropriate tax return.

(f) If an individual is subject to LIT on income from his or her principal place of business or employment, the tax rate shall apply to the taxpayer's adjusted gross income derived from his or her principal place of business or employment for the entire year. Adjusted gross income derived from principal place of business or employment is defined as federal adjusted gross income from that activity after modifications required under IC 6-3-1-3.5(a) against such income.

(g) For purposes of determining whether a deduction is allowable against the adjusted gross income from a principal place of business or employment, the deduction shall be allocated in a manner consistent with the allocation used on the state income tax form filed by the individual. In the case of a filer permitted to complete a return reporting only income derived from activities covered by a reciprocal agreement, the allocation of modifications shall be done in a manner consistent with individuals who otherwise would file a nonresident or part-year resident tax return. For purposes of the county tax portion of a return required for a taxpayer with only income derived from activities covered by a reciprocal agreement, no exemptions shall be permitted on the return.

(Department of State Revenue; 45 IAC 3.1-4-4)

45 IAC 3.1-4-5 Treatment of married individuals filing jointly

Authority: IC 6-8.1-3-3
Affected: IC 6-3.6

Sec. 5. (a) Each individual spouse is treated separately under local income tax (LIT). Accordingly, each spouse must determine his or her respective county of residence and county of principal place of business or employment as of January 1 and will compute his or her respective county tax due, based on his or her separate adjusted gross income.

(1) However, for purposes of calculating LIT on a return of a married couple filing jointly, if one (1) spouse has a negative adjusted gross income and the other spouse has a positive adjusted gross income, the negative income may be used to offset the other spouse's positive income.

(2) If one (1) spouse uses the other spouse's negative adjusted gross income to offset the spouse's positive adjusted gross income, the other spouse shall report zero (0) adjusted gross income and shall not be permitted to carry forward any negative adjusted gross income used by the spouse to succeeding tax years.

(b) Except as permitted in subsection (a), if a person files a joint return with his or her spouse and only the person or the person's spouse is taxable for LIT, then the person who is taxable may take all the exemptions claimed on the joint return except the exemptions attributable to the other spouse (for instance, the personal exemption for the spouse and the exemption for taxpayers over sixty-five (65) years of age or blind, or both, for that spouse).

(c) If a person files a joint return and the person is taxable at one (1) rate on his or her income and the person's spouse is taxable at another rate on the spouse's income, then the spouses may allocate each

whole exemption taken on the joint return between themselves except for the exemptions attributable to the other spouse. The other spouse should then use the exemptions attributable to that spouse.

(d) The computation of LIT is to be completed on the county tax schedule, which is an attachment to the individual income tax return. The county tax computed on the county tax schedule is to be carried to the designated area on the applicable state income tax form.

(Department of State Revenue; 45 IAC 3.1-4-5)

45 IAC 3.1-4-6 Duration of tax

Authority: IC 6-8.1-3-3
Affected: IC 6-3.6

Sec. 6. (a) The local income tax (LIT) is in effect until affirmatively changed by the adopting body for the county, the date otherwise specified in the ordinance, or the date mandated by the appropriate provision of Indiana law.

(b) This subsection applies only to a LIT rate change as follows:
(1) If a LIT is changed between January 1 of a calendar year and August 31 of a calendar year, inclusive, the new LIT is effective on October 1 of that same calendar year. For purposes of computing an individual's LIT for that calendar year, the rate shall be equal to seventy-five percent (75%) of the LIT prior to change plus twenty-five percent (25%) of the LIT after the change.
(2) If a LIT is changed between September 1 of a calendar year and October 31 of a calendar year, inclusive, the new LIT is effective on January 1 of the following calendar year.
(3) If a LIT is changed between November 1 of a calendar year and December 31 of a calendar year, inclusive, the new LIT is effective on October 1 of the following calendar year. The LIT for the following calendar year is computed in a manner similar to subdivision (1).

(Department of State Revenue; 45 IAC 3.1-4-6)

45 IAC 3.1-4-7 Determination of county of residence

Authority: IC 6-8.1-3-3
Affected: IC 6-3.6

Sec. 7. (a) A person's county of residence is determined based on the following criteria:
(1) The county in which he or she maintains his or her home, if he or she has one (1) and only one (1).
(2) If subdivision (1) does not apply, the county in which he or she is registered to vote.
(3) If subdivisions (1) and (2) do not apply, the county in which he or she registers his or her personal automobile.
(4) If subdivisions (1), (2), and (3) do not apply, the county in which he or she spends the majority of his or her time during the taxable year.

(b) The local income tax (LIT) applies against the entire adjusted gross income of an employee whose county of residence adopts the LIT. If the employee resides in a nonadopting county but has his or her principal place of business or employment in an adopting county, the LIT applies only to that adjusted gross income earned from the principal place of business or employment.

(Department of State Revenue; 45 IAC 3.1-4-7)

45 IAC 3.1-4-8 Determination of county of principal place of business or employment

Authority: IC 6-8.1-3-3
Affected: IC 6-3.6

Sec. 8. (a) An individual's county of principal (nontemporary) place of business or employment is that county where the taxpayer receives the greatest percentage of his or her gross income from salaries, wages, commissions, fees, and similar income.

(b) If an individual is self-employed, the county of principal place of business or employment is that county where the individual's principal place of business is located as follows:
(1) If an individual has two (2) or more sources of income from two (2) or more different counties, the principal source is the location from which the individual receives the greatest percentage of income.
(2) If an individual resides outside Indiana, but his or her principal place of business or employment is in an Indiana adopting county, only the adjusted gross income derived from the principal place of business or employment is subject to local income tax (LIT). Reciprocal agreements between Indiana and other states do not affect a taxpayer's liability under LIT.

(c) An individual is not considered to have a principal place of business or employment in an Indiana county solely based on ownership of a partnership or corporation or beneficial interest in a trust that conducts business in Indiana.

(Department of State Revenue; 45 IAC 3.1-4-8)

45 IAC 3.1-4-9 Reciprocity agreements with out-of-state authorities

Authority: IC 6-8.1-3-3
Affected: IC 6-3.6

Sec. 9. County fiscal bodies of adopting counties may enter into reciprocity agreements with taxing authorities outside Indiana to exempt the income from the residents of out-of-state localities from local income tax (LIT) and likewise exempt county residents from that locality's local income tax. Reciprocity agreements must coincide with calendar years, and a certified copy of the agreement must be sent to the department. To be valid, the agreement must be approved by the other government entity and must have been previously approved by the department.

(Department of State Revenue; 45 IAC 3.1-4-9)

45 IAC 3.1-4-10 Credit for taxes paid to out-of-state local governments

Authority: IC 6-8.1-3-3
Affected: IC 6-3-3-3; IC 6-3.6

Sec. 10. (a) Taxpayers subject to county tax at the resident rate may take a credit against local income tax (LIT) liability for taxes paid to localities outside of Indiana.

(b) The credit is limited to:
(1) the amount of tax paid to the out-of-state locality;
(2) the county rate times the amount of adjusted gross income that was taxed by the other locality; or
(3) the amount of LIT due, whichever is the least. This does not apply to income taxed by any state but only to income taxed by any subdivision of any state, such as a city or county, outside of Indiana.

(c) For each locality, the credit and the limitations under subsection (b) shall be computed separately.

(d) To claim the credit under subsection (b), the tax must actually be paid. If the tax is reduced by any credit, other than a credit for taxes withheld, the tax paid will be reduced by such credit.

(e) The credit is limited only to taxes for which the individual is personally liable or for taxes reported by a pass-through entity on behalf of the individual by inclusion in a composite tax return filed by the entity. If the individual owns an interest in a partnership, S corporation, trust, or similar entity for which the entity is subject to a local income tax but the individual is not subject to local income tax on that income, the tax paid by the entity is not eligible for this credit. To claim the credit, the taxpayer must provide evidence of payment of the claimed tax to the out-of-state subdivision. A copy of the tax return filed with the other locality or a tax statement indicating such payment, such as a Form W-2 or Form 1099, must be attached to the Indiana return.

(f) The credit will not be allowed if the laws of such city or county provide for a credit to the taxpayer for the amount of LIT payable.

(g) The credit is not permitted for any state-level taxes paid in excess of the amount permitted under IC 6-3-3-3.

(Department of State Revenue; 45 IAC 3.1-4-10)

Notice of Public Hearing

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