

Vermont Department of Taxes
TECHNICAL BULLETIN

TAX: INCOME TAX - TAXATION OF INDIVIDUALS, TRUSTS AND ESTATES

SUBJECT: CREDIT FOR TAXES PAID TO ANOTHER STATE OR CANADIAN PROVINCE; LIMITATIONS

REFERENCES: 32 V.S.A. §5825

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INTRODUCTION

This Bulletin clarifies the limitations on the Vermont tax credit for income tax paid to another state or Canadian province when a taxpayer's income includes capital gains, income from the taxpayer's business or another business entity, rents or royalties, or the taxpayer made an adjustment to Adjusted Gross Income such as the deduction for alimony paid.

Vermont tax law authorizes the credit under 32 VSA §5825(a) as follows:

A taxpayer of this state who was a resident individual, estate or trust during any portion of a taxable year shall receive credit against the tax imposed, for that taxable year, by section 5822 of this title for income taxes imposed by, and paid to, another state or territory of the United States, the District of Columbia, or a province of Canada, upon the taxpayer's income earned or received from sources within that state, territory, district or province during that portion of that taxable year. *In no case shall the credit allowed by this section exceed the portion of Vermont income tax, otherwise imposed by this chapter, attributable to the adjusted gross income earned or received from sources within such other state, territory, district or province.* (Emphasis provided)

SCOPE OF THE CREDIT

Vermont allows a credit against income tax for income tax paid to another state, territory, district or province on income that is also required to be reported in Vermont provided the other taxing jurisdiction offers a reciprocal credit for Vermont income tax paid. The credit can be no more than the amount of Vermont tax imposed on income also taxed by the other jurisdiction. For purposes of calculating the credit:

“Other jurisdiction” means the state, territory, district or province (other than Vermont) where the taxpayer paid income tax.

“Income tax” means a tax upon the income of the individual and includes the tax imposed on the income of an individual from a partnership, S-corporation, or other pass-through entity where the tax is imposed at the individual level. The following items are not part of income tax:

- 1) Interest, penalties, late filing fees; or similar charges, or
- 2) City or local income taxes of the other jurisdiction, or
- 3) Any surcharge or special assessment by the other jurisdiction applied to their nonresidents.

“Income taxes paid” means the paid tax liability as calculated on the income tax return filed with the other jurisdiction. Having income tax withheld by other jurisdiction does not constitute “income tax paid.” A return must be filed with the other jurisdiction and the income tax paid to the other jurisdiction.

CALCULATION OF THE CREDIT - GENERAL RULE

The credit is the smaller of:

- 1) the amount of tax paid to the other jurisdiction on income also taxed in Vermont or
- 2) the portion of the Vermont tax imposed on the common income.

Generally the amount of income tax paid to another state, territory, district or province is clear.

However, special treatment may be needed for the calculation of the Vermont credit in some circumstances, such as when the other jurisdiction's income tax calculation results in income different than Federal income and the other state income is not taxed in Vermont.

The portion of the Vermont tax on income taxed in the other jurisdiction can never be more than 100% of the Vermont tax. The percentage is determined by dividing the amount of AGI from sources taxed in both Vermont and the other jurisdiction by the total AGI from all sources included in the Vermont return. The credit is the Vermont income tax multiplied by this percentage or the tax paid to the other jurisdiction, whichever is less.

Taxpayers claiming a credit for income taxes paid to other jurisdictions are required to complete a separate claim schedule for each jurisdiction. If the Vermont return is paper, a copy of the return filed with the other jurisdiction must be attached to it. Taxpayers who file electronically may be asked to provide copies of the return filed with the other jurisdiction if the Department requires additional information for processing.

CREDIT LIMITATION ON INCOME FROM BUSINESS, BUSINESS ENTITY, RENTS OR ROYALTY SOURCES

Federal AGI combines income and losses from all sources. Because the Federal AGI aggregates all activity or because some of the income is not taxed in both states, the income taxed in both Vermont and the other jurisdiction may be different than is shown on a particular line on the Federal tax return.

Example: Taxpayer reports Federal AGI of \$40,000 that includes \$5,000 rental income on line 17 of Federal Form 1040. Taxpayer files an income tax return in State Z for \$8,000 wages and rental income. State Z tax calculation results in Taxpayer owing tax on \$10,000 rental income. (The Federal return included rental loss from activity outside of State Z.) Taxpayer pays income tax to State Z. On the Vermont Form IN-112, Schedule B, Taxpayer reports \$18,000 (\$10,000 rental income plus \$8,000 wages) as the AGI taxed in the other jurisdiction.

1a.	□ □ □ , □ 1 8 , 0 0 0 . 0 0	-	1b.	□ □ □ , □ □ □ , □ □ □ . 0 0	=	1c.	□ □ □ , □ 1 8 , 0 0 0 . 0 0	AGI eligible for credit (Line 1a minus Line 1b)
	Adjusted Gross Income taxed in another state or Canadian province and also subject to Vermont tax			Capital Gains Exclusion (40% of long-term capital gains reported to other state or province)				
2a.	□ □ □ , □ 4 0 , 0 0 0 . 0 0	-	2b.	□ □ □ , □ □ □ , □ □ □ . 0 0	=	2c.	□ □ □ , □ 4 0 , 0 0 0 . 0 0	AGI eligible for credit (Line 2a minus Line 2b)
	Adjusted Gross Income (From Form IN-111, Section 2, Line 10)			Capital Gains Exclusion (From Form IN-111, Section 3, Line 14c)				
3.	VT Income Tax (From Form IN-111, Section 4, Line 20)					3.	□ , □ □ , 4 4 2 . 0 0	
4.	Computed tax credit (Divide Line 1c by Line 2c and multiply result by Line 3)					4.	□ , □ □ , 6 4 9 . 0 0	
	Line 1c 18,000	X Line 3 40,000						
5.	Amount of Income TAX paid to other state or Canadian province on income on Line 1c (See instructions on page 10)					5.	□ , □ □ , 3 0 0 . 0 0	
6.	TOTAL OTHER STATES CREDIT: Enter the lesser of Line 4 or Line 5 here and on Form IN-111, Section 5, Line 23					6.	□ , □ □ , 3 0 0 . 0 0	

The credit is the percentage of Vermont income tax or the tax paid to the other jurisdiction, whichever is less.

Example: Taxpayer reports Federal AGI of \$40,000 that includes \$5,000 rental loss on line 17 of Federal Form 1040. Taxpayer files an income tax return in State X for \$15,000 wages and rental income. State X tax calculation results in a \$6,000 rental loss in State X. Taxpayer pays income tax to State X on wages. On the Vermont Form IN-112, Schedule B, Taxpayer reports the \$9,000 for AGI taxed in the other jurisdiction (\$15,000 wages minus \$6,000 rental loss).

1a.	□ □ □, □ □ □, □ □ □ . □ □	-	1b. □ □ □, □ □ □, □ □ □ . □ □	=	1c. □ □ □, □ □ □, □ □ □ . □ □	
	Adjusted Gross Income taxed in another state or Canadian province and also subject to Vermont tax			Capital Gains Exclusion (40% of long-term capital gains reported to other state or province)		
2a.	□ □ □, □ □ □, □ □ □ . □ □	-	2b. □ □ □, □ □ □, □ □ □ . □ □	=	2c. □ □ □, □ □ □, □ □ □ . □ □	
	Adjusted Gross Income (From Form IN-111, Section 2, Line 10)			Capital Gains Exclusion (From Form IN-111, Section 3, Line 14c)		
3.	VT Income Tax (From Form IN-111, Section 4, Line 20)				. □ □ □, □ □ □, □ □ □ . □ □	
4.	Computed tax credit (Divide Line 1c by Line 2c and multiply result by Line 3)					. □ □ □, □ □ □, □ □ □ . □ □
	Line 1c 9,000	X Line 3 1,442				4. □ □ □, □ □ □, □ □ □ . □ □
	Line 2c 40,000					5. □ □ □, □ □ □, □ □ □ . □ □
5.	Amount of Income TAX paid to other state or Canadian province on income on Line 1c (See instructions on page 10)				. □ □ □, □ □ □, □ □ □ . □ □	
6.	TOTAL OTHER STATES CREDIT: Enter the lesser of Line 4 or Line 5 here and on Form IN-111, Section 5, Line 23				. □ □ □, □ □ □, □ □ □ . □ □	

The credit is the percentage of Vermont income tax or the tax paid to the other jurisdiction, whichever is less.

Example: Taxpayer reports Federal AGI of \$40,000 that includes \$5,000 rental income on line 17 of Federal Form 1040. Taxpayer files an income tax return in State N reporting a \$10,000 rental loss with no other income in State N. Because Taxpayer's State N return reports a loss, no credit is available for Vermont income tax.

Example: Taxpayer reports Federal AGI of \$40,000 that includes \$5,000 rental loss on line 17 of Federal Form 1040. Taxpayer files an income tax return in State Y for \$35,000 wages earned in Y and \$10,000 rental income in State Y. Taxpayer pays income tax to State Y based on \$45,000 income (\$35,000 wages plus \$10,000 rental income). On the Vermont Form IN-112, Schedule B, Taxpayer reports \$40,000 for AGI taxed in the other jurisdiction, because the AGI taxed in the other jurisdiction cannot be more than the total AGI reported on the Vermont income tax return.

1a.	□ □ □, □ □ □, □ □ □ . □ □	-	1b. □ □ □, □ □ □, □ □ □ . □ □	=	1c. □ □ □, □ □ □, □ □ □ . □ □	
	Adjusted Gross Income taxed in another state or Canadian province and also subject to Vermont tax			Capital Gains Exclusion (40% of long-term capital gains reported to other state or province)		
2a.	□ □ □, □ □ □, □ □ □ . □ □	-	2b. □ □ □, □ □ □, □ □ □ . □ □	=	2c. □ □ □, □ □ □, □ □ □ . □ □	
	Adjusted Gross Income (From Form IN-111, Section 2, Line 10)			Capital Gains Exclusion (From Form IN-111, Section 3, Line 14c)		
3.	VT Income Tax (From Form IN-111, Section 4, Line 20)				. □ □ □, □ □ □, □ □ □ . □ □	
4.	Computed tax credit (Divide Line 1c by Line 2c and multiply result by Line 3)					. □ □ □, □ □ □, □ □ □ . □ □
	Line 1c 40,000	X Line 3 1,442				4. □ □ □, □ □ □, □ □ □ . □ □
	Line 2c 40,000					5. □ □ □, □ □ □, □ □ □ . □ □
5.	Amount of Income TAX paid to other state or Canadian province on income on Line 1c (See instructions on page 10)				. □ □ □, □ □ □, □ □ □ . □ □	
6.	TOTAL OTHER STATES CREDIT: Enter the lesser of Line 4 or Line 5 here and on Form IN-111, Section 5, Line 23				. □ □ □, □ □ □, □ □ □ . □ □	

The credit is 100% of Vermont income tax or the tax paid to the other jurisdiction, whichever is less.

CREDIT LIMITATION ON CAPITAL GAINS (Revised)

The other jurisdiction may tax a capital gain even though the taxpayer's combined transactions in all jurisdictions produce a net capital loss at the Federal level. The credit is limited by the amount of tax on eligible capital gain taxed in Vermont (i.e. adjusted net capital gain income as defined in Section 1(h) of the Internal Revenue Code). Vermont excludes 40% of the capital gain or 40% of the Federal taxable income, whichever is smaller, to compute Vermont taxable income. 32 V.S.A. §5811(21)(B)(ii). Since no Vermont tax is paid on this portion of the gain, it is not eligible for the credit.

Example: Taxpayer reports a Federal AGI of \$60,000 that includes \$15,000 in Vermont-eligible capital gain income on line 13 of Federal Form 1040. Taxpayer excludes 40% of the \$15,000 from Vermont income. The Taxpayer files an income tax return in State M for \$25,000 wages earned in State M and capital gain of \$30,000 in State M. In computing the credit, the capital gain taxed in both states is limited to the \$15,000 Federal capital gain as there is no Vermont tax on the additional gain. Taxpayer reports \$40,000 for AGI taxed in the other jurisdiction. Taxpayer excludes 40% of the \$15,000 capital gain and enters \$6,000 for the capital gains exclusion. The total AGI eligible for credit is \$34,000.

1a. <input type="text"/> 4 0 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0	-	1b. <input type="text"/> 6 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0	=	1c. <input type="text"/> 3 4 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0
Adjusted Gross Income taxed in another state or Canadian province and also subject to Vermont tax		Capital Gains Exclusion (40% of long-term capital gains reported to other state or province)		AGI eligible for credit (Line 1a minus Line 1b)
2a. <input type="text"/> 6 0 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0	-	2b. <input type="text"/> 6 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0	=	2c. <input type="text"/> 5 4 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0
Adjusted Gross Income (From Form IN-111, Section 2, Line 10)		Capital Gains Exclusion (From Form IN-111, Section 3, Line 14c)		AGI eligible for credit (Line 2a minus Line 2b)
3. VT Income Tax (From Form IN-111, Section 4, Line 20) <input type="text"/> 2 , <input type="text"/> 4 8 0 . <input type="text"/> 0 0				
4. Computed tax credit (Divide Line 1c by Line 2c and multiply result by Line 3)				
Line 1c <input type="text"/> 3 4 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0		X Line 3 <input type="text"/> 2 , <input type="text"/> 4 8 0	4. <input type="text"/> 1 , <input type="text"/> 5 6 1 . <input type="text"/> 0 0	
Line 2c <input type="text"/> 5 4 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0			5. <input type="text"/> 1 , <input type="text"/> 5 0 0 . <input type="text"/> 0 0	
5. Amount of Income TAX paid to other state or Canadian province on income on Line 1c (See instructions on page 10) <input type="text"/> 1 , <input type="text"/> 5 0 0 . <input type="text"/> 0 0				
6. TOTAL OTHER STATES CREDIT: Enter the lesser of Line 4 or Line 5 here and on Form IN-111, Section 5, Line 23 <input type="text"/> 1 , <input type="text"/> 5 0 0 . <input type="text"/> 0 0				

The credit is the *pro rata share* of Vermont income tax or the actual tax paid to the other jurisdiction, whichever is less.

A taxpayer must have a Federal capital gain to qualify for a credit based on capital gain taxed by another jurisdiction.

Example: Taxpayer reports a Federal AGI of \$60,000 that includes a net \$3,000 capital loss on line 13 of Federal Form 1040. Taxpayer files an income tax return in State S for \$25,000 wages and capital gain in State S of \$30,000. Taxpayer pays income tax to State S. Taxpayer is not entitled to a credit for income tax paid to the other jurisdiction on the capital gain as the capital gain was not taxed by Vermont. Taxpayer uses only the \$25,000 for AGI taxed in the other jurisdiction.

1a. <input type="text"/> 2 5 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0	-	1b. <input type="text"/> , <input type="text"/> , <input type="text"/> . <input type="text"/> 0 0	=	1c. <input type="text"/> 2 5 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0
Adjusted Gross Income taxed in another state or Canadian province and also subject to Vermont tax		Capital Gains Exclusion (40% of long-term capital gains reported to other state or province)		AGI eligible for credit (Line 1a minus Line 1b)
2a. <input type="text"/> 6 0 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0	-	2b. <input type="text"/> , <input type="text"/> , <input type="text"/> . <input type="text"/> 0 0	=	2c. <input type="text"/> 6 0 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0
Adjusted Gross Income (From Form IN-111, Section 2, Line 10)		Capital Gains Exclusion (From Form IN-111, Section 3, Line 14c)		AGI eligible for credit (Line 2a minus Line 2b)
3. VT Income Tax (From Form IN-111, Section 4, Line 20) <input type="text"/> 2 , <input type="text"/> 4 8 0 . <input type="text"/> 0 0				
4. Computed tax credit (Divide Line 1c by Line 2c and multiply result by Line 3)				
Line 1c <input type="text"/> 2 5 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0		X Line 3 <input type="text"/> 2 , <input type="text"/> 4 8 0	4. <input type="text"/> 1 , <input type="text"/> 0 3 2 . <input type="text"/> 0 0	
Line 2c <input type="text"/> 6 0 , <input type="text"/> 0 0 0 . <input type="text"/> 0 0			5. <input type="text"/> 1 , <input type="text"/> 0 2 5 . <input type="text"/> 0 0	
5. Amount of Income TAX paid to other state or Canadian province on income on Line 1c (See instructions on page 10) <input type="text"/> 1 , <input type="text"/> 0 2 5 . <input type="text"/> 0 0				
6. TOTAL OTHER STATES CREDIT: Enter the lesser of Line 4 or Line 5 here and on Form IN-111, Section 5, Line 23 <input type="text"/> 1 , <input type="text"/> 0 2 5 . <input type="text"/> 0 0				

The credit is the percentage of Vermont income tax or the tax paid to the other jurisdiction, whichever is less.

CREDIT LIMITATION WHEN THERE IS AN ALIMONY PAID DEDUCTION

Alimony will be prorated based on the ratio of the positive income taxed by the other jurisdiction to the Federal positive income. Losses are ignored in determining the ratio.

Example: Taxpayer reports wages of \$100,000 with no other income. Taxpayer earned \$30,000 of the wages in State P. Taxpayer deducts \$15,000 alimony paid to arrive at Federal AGI. To determine the portion of alimony allocable to State P wages, the taxpayer must divide the \$30,000 State P wages by total wages of \$100,000; then multiply the \$15,000 alimony deduction by that percentage:

$$\$30,000 / \$100,000 = .30 \times \$15,000 = \$4,500$$

Taxpayer reduces State P wages by \$4,500 for alimony. Taxpayer uses \$25,500 (\$30,000 - \$4,500) for AGI taxed in the other jurisdiction.

Example: Taxpayer reports wages of \$45,000, interest income of \$5,000, rental loss of \$8,000 (from Vermont activity). Taxpayer deducts \$12,000 alimony paid to arrive at Federal AGI. Taxpayer earned \$10,000 of wages in State Q. To determine the portion of alimony allocable to his State Q wages, Taxpayer must divide \$10,000 State Q wages by \$50,000 positive federal income (\$45,000 wages + \$5,000 interest income) and then multiply the \$12,000 alimony by the resulting percentages:

$$\$10,000 / \$50,000 = .20 \times \$12,000 = \$2,400$$

Taxpayer reduces his State Q wages by \$2,400 for alimony. Taxpayer uses \$7,600 (\$10,000 - \$2,400) for AGI taxed in the other jurisdiction.

CREDIT LIMITATION CALCULATIONS WITH OTHER DEDUCTIONS TO ARRIVE AT FEDERAL ADJUSTED GROSS INCOME

Other deductions to arrive at Federal AGI follow the same proration as the alimony examples above unless the deduction is limited to a particular source of income. For instance, IRA deductions are prorated on earned income in the other jurisdiction to total earned income included in AGI and self-employment tax deductions or SEP are based on the taxpayer's self-employment income.

USE OF TECHNICAL BULLETINS

A technical bulletin supplies general information to the public and does not replace the need for competent legal or accounting advice. This technical bulletin supersedes all prior department pronouncements on this subject.

Signed:

Molly Bachman
General Counsel

Approved:

Tom Pelham
Commissioner