

VITA Multi-state tax awareness issues

Normally, an individual taxpayer who works in several states must pay tax in those states, but not in the same way in every state. This is an overview covering the most common situations. Be aware that this is a complex tax area and if you aren't familiar with it, you should seek help. Even those of us who work with it frequently find it requires ongoing research.

A taxpayer can fall into one of three categories in a state:

- **Resident.** The person resides more than 180 days in the state.
- **Nonresident.** The person works in the state but lives elsewhere.
- **Part year resident.** The person is a resident for part of the year.

As a rule, you do not have to pay tax to more than one state on the same income. However, there are many fine points. In most cases, the state income tax applies as follows:

- **Resident.** You pay tax on all your income from all states, but receive credit for taxes you've paid to nonresident states on the income from those states. The maximum credit is the tax you would have paid to your resident state. So if you work in a nonresident state with an 8% tax rate and your resident state rate is 5%, you get credit for the 5%. If the nonresident state rate is 4%, your credit is limited to what you paid: 4%.
- **Nonresident.** You pay tax only on earned income and business income from the state, not on dividends, interest, capital gains, rentals or pensions.

Note: In most states, if you have an overall high income but your income in the state is small, the state uses a formula designed to tax you at a higher bracket.

- **Part year resident.** Normally there are two states: old residence and new residence. You apportion the income for the year between the two states.

In TaxWise, you must access four parts of the system to make multi-state taxes work out:

- **Main Info.** About 2/3 down the form, enter the states where you want to file. Normally, in the input on the left, there is only one primary state. The "foreign" states are on the right.
- **W-2 inputs.** Be sure you have designated the state for allocating the W-2 wages. Make note of the client's W-2 package where an employer covers several states. Some W-2 forms contain the state allocations in a grid at the bottom of the form while others have a separate W-2 for each state.
- **Foreign state returns.** The foreign state return normally contains a calculation of the taxable income and tax as if all income were derived from the state. At the end, there will be a calculation of the tax based on the ratio of foreign state income to total income. Look for inputs that have not carried from the info page.
- **Resident state return.** This contains a calculation of the credit for taxes paid to another state. The calculation is normally based on foreign state earned income divided by total income.