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Rev. Rul. 65-19

Advice has been requested concerning the deductibility, for Federal income tax purposes, of the "adjusted gross income tax" imposed by House Enrolled Act No. 1509, enacted by the General Assembly of the State of Indiana in 1963, known as the Adjusted Gross Income Tax Act of 1963.

Section 1.62-1(d) of the Income Tax Regulations provides, in part, that to be deductible for purposes of determining adjusted gross income, expenses must be directly, and not merely remotely, connected with the conduct of a trade or business. For example, taxes are deductible in arriving at adjusted gross income only if they constitute expenditures directly attributable to a trade or business or to property from which rents or royalties are derived. Thus, property taxes paid or incurred on real property used in a trade or business are deductible, but State taxes on net income are not deductible in determining adjusted gross income even though the taxpayer's income is derived from the conduct of a trade or business.

The tax imposed by the Adjusted Gross Income Tax Act of 1963, enacted by the General Assembly of the State of Indiana in 1963, is a net income tax within the meaning of the regulation and is not directly connected with the conduct of a trade or business.

Accordingly, it is held that the Indiana adjusted gross income tax paid by an individual taxpayer is not deductible from gross income in computing "adjusted gross income" under section 62 of the Internal Revenue Code of 1954. Such tax is deductible, however, in arriving at taxable income under section 63 of the Code provided the taxpayer does not elect to use the standard deduction.