Senate Engrossed House Bill

income tax; partnerships; S corporations

State of Arizona
House of Representatives
Fifty-fifth Legislature
First Regular Session
2021

CHAPTER 425

HOUSE BILL 2838

AN ACT

AMENDING SECTIONS 43-222 AND 43-581, ARIZONA REVISED STATUTES; AMENDING TITLE 43, CHAPTER 10, ARTICLE 2, ARIZONA REVISED STATUTES, BY ADDING SECTION 43-1014; AMENDING SECTIONS 43-1021 AND 43-1071, ARIZONA REVISED STATUTES; AMENDING TITLE 43, CHAPTER 10, ARTICLE 5, ARIZONA REVISED STATUTES, BY ADDING SECTION 43-1075; RELATING TO THE TAXATION OF INCOME.

(TEXT OF BILL BEGINS ON NEXT PAGE)
Be it enacted by the Legislature of the State of Arizona:

Section 1. Section 43-222, Arizona Revised Statutes, is amended to read:

43-222. Income tax credit review schedule

The joint legislative income tax credit review committee shall review the following income tax credits:

1. For years ending in 0 and 5, sections 43-1079.01, 43-1087, 43-1088, 43-1089.04, 43-1167.01 and 43-1175.
2. For years ending in 1 and 6, sections 43-1072.02, 43-1074.02, 43-1075, 43-1083, 43-1083.02, 43-1164.03 and 43-1183.
3. For years ending in 2 and 7, sections 43-1073, 43-1085, 43-1086, 43-1089, 43-1089.01, 43-1089.02, 43-1089.03, 43-1164 and 43-1169.
4. For years ending in 3 and 8, sections 43-1074.01, 43-1081, 43-1168, 43-1170 and 43-1178.
5. For years ending in 4 and 9, sections 43-1073.01, 43-1076, 43-1081.01, 43-1083.03, 43-1084, 43-1164.04, 43-1164.05, and 43-1184.

Sec. 2. Section 43-581, Arizona Revised Statutes, is amended to read:

43-581. Payment of estimated tax; penalty; rules; forms

A. An individual who is subject to the tax imposed by this title and whose Arizona gross income, as defined by section 43-1001, or as described by section 43-1091 in the case of nonresidents, for the taxable year exceeds seventy-five thousand dollars $75,000 or one hundred fifty thousand dollars $150,000 if a joint return is filed and whose Arizona gross income was greater than seventy-five thousand dollars $75,000 in the preceding taxable year or one hundred fifty thousand dollars $150,000 if a joint return is filed shall make payments of estimated tax during the individual's taxable year. The amount of the payments of estimated tax shall be an amount that reasonably reflects a taxpayer's Arizona income tax liability that will be unpaid at the end of the taxpayer's taxable year. This amount shall be paid in four installments on or before the due dates established by the internal revenue code and shall total, when combined with the taxpayer's withholding tax, at least ninety percent of the tax due for the current taxable year or one hundred percent of the tax due for the preceding taxable year.

B. Any other individual who is subject to the tax imposed by this title may make payments of estimated tax during the individual's taxable year. The amount of any estimated tax payments for the taxable year shall be an amount that reasonably reflects a taxpayer's Arizona income tax liability that will be unpaid at the end of the taxpayer's taxable year.

C. For taxable years beginning from and after December 31, 2021, an entity that is treated as a partnership or S corporation for federal income tax purposes, that elects to pay the tax under section 43-1014 and whose taxable income for the taxable year exceeds $150,000 in the

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PRECEDING TAXABLE YEAR SHALL MAKE PAYMENTS OF ESTIMATED TAX DURING THE TAXABLE YEAR IN A MANNER THAT IS CONSISTENT WITH THE MANNER PRESCRIBED IN THIS SECTION FOR INDIVIDUALS.

C. The department shall prescribe rules for the payments of estimated tax that shall provide for estimated payments in a manner similar to the manner prescribed in the internal revenue code.

D. If the taxpayer does not pay the estimated tax required by subsection A OR C of this section on or before the prescribed dates, there is assessed and the department shall collect a penalty on the unpaid amount as prescribed by section 42-1125, subsection Q. No Penalties or interest shall NOT be assessed or collected if either of the following applies:

1. The estimated tax payments made pursuant to this section are allowable exceptions under section 6654 of the internal revenue code.

2. The taxpayer's Arizona income tax liability due on the taxpayer's return is less than $1,000. For the purposes of this paragraph, "Arizona income tax liability due on the taxpayer's return" means the amount of tax due on the return minus the amount of Arizona income tax withheld and tax credits claimed by the taxpayer.

E. The department shall make available suitable forms and instructions to taxpayers who make estimated tax payments pursuant to this article.

Sec. 3. Title 43, chapter 10, article 2, Arizona Revised Statutes, is amended by adding section 43-1014, to read:

43-1014. Entity-level tax election; partnerships; S corporations

A. FOR TAXABLE YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2021, THE PARTNERS OR SHAREHOLDERS OF A BUSINESS THAT IS TREATED AS A PARTNERSHIP OR S CORPORATION FOR FEDERAL INCOME TAX PURPOSES MAY CONSENT TO BE TAXED AT THE ENTITY LEVEL AT A RATE OF FOUR AND ONE-HALF PERCENT OF THE ENTIRE PORTION OF ITS TAXABLE INCOME THAT IS ATTRIBUTABLE TO ITS RESIDENT PARTNERS OR SHAREHOLDERS AND THE PORTION OF ITS TAXABLE INCOME DERIVED FROM SOURCES WITHIN THIS STATE THAT IS ATTRIBUTABLE TO ITS NONRESIDENT PARTNERS OR SHAREHOLDERS FOR THAT TAXABLE YEAR. THE ELECTION UNDER THIS SUBSECTION MUST BE MADE ON OR BEFORE THE DUE DATE OR EXTENDED DUE DATE OF THE BUSINESS'S RETURN UNDER THIS TITLE.

B. IF THE ELECTION IS MADE UNDER SUBSECTION A OF THIS SECTION, ALL OF THE FOLLOWING APPLY:

1. THE TAXABLE INCOME OF THE PARTNERSHIP OR S CORPORATION SHALL BE COMPUTED UNDER THIS CHAPTER OR CHAPTER 14 OF THIS TITLE, AS APPLICABLE.

2. IF THE PARTNERSHIP OR S CORPORATION DOES NOT PAY THE AMOUNT OWED TO THE DEPARTMENT AS A RESULT OF THE ELECTION UNDER THIS SECTION, THE DEPARTMENT MAY COLLECT THE AMOUNT FROM THE PARTNERS OR SHAREHOLDERS BASED
ON THE PROPORTIONATE SHARE OF INCOME THAT IS ATTRIBUTABLE TO EACH PARTNER OR SHAREHOLDER FOR ARIZONA TAX PURPOSES.

3. THE PARTNERSHIP OR S CORPORATION SHALL PAY ESTIMATED TAX PURSUANT TO SECTION 43-581 AS NECESSARY.

C. THE ELECTION UNDER SUBSECTION A OF THIS SECTION DOES NOT APPLY TO THE FOLLOWING:

1. PARTNERS OR SHAREHOLDERS THAT ARE NOT INDIVIDUALS, ESTATES OR TRUSTS. THE PORTION OF THE TAXABLE INCOME ATTRIBUTABLE TO A PARTNER OR SHAREHOLDER THAT IS NOT AN INDIVIDUAL, ESTATE OR TRUST IS NOT INCLUDED IN THE ENTITY-LEVEL TAX UNDER SUBSECTION A OF THIS SECTION.

2. PARTNERS OR SHAREHOLDERS WHO ARE INDIVIDUALS, ESTATES OR TRUSTS AND WHO OPT OUT OR WAIVE THE RIGHT TO OPT OUT OF THE ELECTION PURSUANT TO SUBSECTION D OF THIS SECTION. THE PORTION OF THE TAXABLE INCOME ATTRIBUTABLE TO A PARTNER OR SHAREHOLDER WHO IS AN INDIVIDUAL, ESTATE OR TRUST AND WHO OPTS OUT OR WAIVES THE RIGHT TO OPT OUT OF THE ELECTION PURSUANT TO SUBSECTION D OF THIS SECTION IS NOT INCLUDED IN THE ENTITY-LEVEL TAX UNDER SUBSECTION A OF THIS SECTION.

D. A PARTNERSHIP OR S CORPORATION THAT INTENDS TO MAKE THE ELECTION UNDER SUBSECTION A OF THIS SECTION SHALL NOTIFY ALL PARTNERS OR SHAREHOLDERS WHO ARE INDIVIDUALS, ESTATES OR TRUSTS OF THE INTENT TO MAKE THE ELECTION AND THAT EACH PARTNER OR SHAREHOLDER WHO IS AN INDIVIDUAL, ESTATE OR TRUST HAS THE RIGHT TO OPT OUT OF THE ELECTION. THE NOTICE SHALL ALLOW EACH PARTNER OR SHAREHOLDER WHO IS AN INDIVIDUAL, ESTATE OR TRUST AT LEAST SIXTY DAYS AFTER RECEIVING THE NOTICE TO NOTIFY THE PARTNERSHIP OR S CORPORATION THAT THE PARTNER OR SHAREHOLDER WHO IS AN INDIVIDUAL, ESTATE OR TRUST IS EXERCISING THE PARTNER'S OR SHAREHOLDER'S RIGHT TO OPT OUT OF THE ELECTION. IF THE PARTNER OR SHAREHOLDER WHO IS AN INDIVIDUAL, ESTATE OR TRUST DOES NOT RESPOND WITHIN THE SIXTY-DAY PERIOD OR WAIVES THE RIGHT TO OPT OUT, THE PARTNER OR SHAREHOLDER WILL BE INCLUDED IN THE ELECTION.

E. THE DEPARTMENT SHALL ADOPT RULES AND PRESCRIBE FORMS AND PROCEDURES AS NECESSARY TO ADMINISTER THIS SECTION.

Sec. 4. Section 43-1021, Arizona Revised Statutes, is amended to read:

43-1021. Addition to Arizona gross income

In computing Arizona adjusted gross income, the following amounts shall be added to Arizona gross income:

1. A beneficiary's share of the fiduciary adjustment to the extent that the amount determined by section 43-1333 increases the beneficiary's Arizona gross income.

2. An amount equal to the ordinary income portion of a lump sum distribution that was excluded from federal adjusted gross income pursuant to the special rule for individuals who attained fifty years of age before January 1, 1986 under Public Law 99-514, section 1122(h)(3).

3. The amount of interest income received on obligations of any state, territory or possession of the United States, or any political
subdivision thereof, located outside the state of Arizona, reduced, for taxable years beginning from and after December 31, 1996, by the amount of any interest on indebtedness and other related expenses that were incurred or continued to purchase or carry those obligations and that are not otherwise deducted or subtracted in arriving at Arizona gross income.

4. The excess of a partner's share of partnership taxable income required to be included under chapter 14, article 2 of this title over the income required to be reported under section 702(a)(8) of the internal revenue code.

5. The excess of a partner's share of partnership losses determined pursuant to section 702(a)(8) of the internal revenue code over the losses allowable under chapter 14, article 2 of this title.

6. Any amount of agricultural water conservation expenses that were deducted pursuant to the internal revenue code for which a credit is claimed under section 43-1084.

7. The amount by which the depreciation or amortization computed under the internal revenue code with respect to property for which a credit was taken under either section 43-1081 or 43-1081.01 exceeds the amount of depreciation or amortization computed pursuant to the internal revenue code on the Arizona adjusted basis of the property.

8. The amount by which the adjusted basis computed under the internal revenue code with respect to property for which a credit was claimed under section 43-1074.02, 43-1081 or 43-1081.01 and that is sold or otherwise disposed of during the taxable year exceeds the adjusted basis of the property computed under section 43-1074.02, 43-1081 or 43-1081.01, as applicable.

9. The deduction referred to in section 1341(a)(4) of the internal revenue code for restoration of a substantial amount held under a claim of right.

10. The amount by which a net operating loss carryover or capital loss carryover allowable pursuant to section 1341(b)(5) of the internal revenue code exceeds the net operating loss carryover or capital loss carryover allowable pursuant to section 43-1029, subsection F.

11. Any wage expenses deducted pursuant to the internal revenue code for which a credit is claimed under section 43-1087 and representing net increases in qualified employment positions for employment of temporary assistance for needy families recipients.

12. The amount of any depreciation allowance allowed pursuant to section 167(a) of the internal revenue code to the extent not previously added.

13. The amount of a nonqualified withdrawal, as defined in section 15-1871, from a college savings plan established pursuant to section 529 of the internal revenue code that is made to a distributee to the extent the amount is not included in computing federal adjusted gross income, except that the amount added under this paragraph shall not exceed the
difference between the amount subtracted under section 43-1022 in prior taxable years and the amount added under this section in any prior taxable years.

14. If a subtraction is or has been taken by the taxpayer under section 43-1024, in the current or a prior taxable year for the full amount of eligible access expenditures paid or incurred to comply with the requirements of the Americans with disabilities act of 1990 (P.L. 101-336) or title 41, chapter 9, article 8, any amount of eligible access expenditures that is recognized under the internal revenue code, including any amount that is amortized according to federal amortization schedules, and that is included in computing taxable income for the current taxable year.

15. For taxable years beginning from and after December 31, 2017, the amount of any net capital loss included in Arizona gross income for the taxable year that is derived from the exchange of one kind of legal tender for another kind of legal tender. For the purposes of this paragraph:

(a) "Legal tender" means a medium of exchange, including specie, that is authorized by the United States Constitution or Congress to pay debts, public charges, taxes and dues.

(b) "Specie" means coins having precious metal content.

16. For taxable years beginning from and after December 31, 2021, the amount deducted by the partnership or S corporation pursuant to the internal revenue code for the amount paid to this state under section 43-1014 and for taxes that the department determines are substantially similar to the tax imposed under section 43-1014. This amount shall be reflected in the partner's or shareholder's Arizona gross income and the partnership's or S corporation's Arizona taxable income.

Sec. 5. Section 43-1071, Arizona Revised Statutes, is amended to read:

43-1071. Credit for income taxes paid to other states; definitions

A. Subject to the following conditions, residents shall be allowed a credit against the taxes imposed by this chapter for net income taxes imposed by and paid to another state or country on income taxable under this chapter:

1. The credit shall be allowed only for taxes paid to the other state or country on income that is derived from sources within that state or country and that is taxable under its laws irrespective of the residence or domicile of the recipient.

2. The credit shall not be allowed if the other state or country allows residents of this state a credit against the taxes imposed by that state or country for taxes paid or payable under this chapter.

3. The credit shall not exceed the proportion of the tax payable under this chapter as the income subject to tax in the other state or
country and also taxable under this title bears to the taxpayer's entire income on which the tax is imposed by this chapter.

B. If any taxes paid to another state or country for which a taxpayer has been allowed a credit under this section are at any time credited or refunded to the taxpayer:

1. The taxpayer shall immediately report that fact to the department.

2. A tax equal to the credit allowed for the taxes credited or refunded by the other state or country is due and payable from the taxpayer on notice and demand from the department.

3. Interest shall be added to and collected as a part of the tax at the rate determined pursuant to section 42-1123 from the date the credit was allowed under this chapter to the date of the notice and demand.

4. If the tax and interest are not paid within ten days from the date of notice and demand, there shall be collected as a part of the tax interest on the unpaid amount of tax and interest at the rate of twelve percent a year from the date of the notice and demand until the amount is paid.

C. The credit against the taxes imposed by this chapter for net income taxes paid to another state or country shall not be allowed to any taxpayer or any class of taxpayers if the allowances of the credit will result in any invalid or illegal discrimination against another taxpayer or another class of taxpayers.

D. For taxable years beginning on or after January 1, 2002 and subject to the following conditions, a resident of this state, who is also considered to be a resident of another state under the laws of the other state, is allowed a credit against the taxes imposed by this title for net income taxes imposed by and paid to that state on income taxable under this title as follows:

1. The credit is allowed only if the other state taxes the income to the resident of this state and does not allow the taxpayer a credit against taxes imposed by that state on that income for taxes paid or payable on that income under this title.

2. The credit is allowed only for the proportion of the taxes paid to the other state as the income taxable under this title and also subject to tax in the other state bears to the entire income on which the taxes paid to the other state are imposed.

3. The credit may not exceed the proportion of the tax payable under this title as the income taxable under this title and also subject to tax in the other state bears to the entire income taxable under this title.

4. For the purpose of the credit allowed under this subsection, "income taxable under this title and also subject to tax in the other state" means income that would be sourced to the other state if the other
state were imposing its income tax on the taxpayer as if the taxpayer was
a nonresident of that other state.

E. The taxpayer may apply the allowable credit only against Arizona
income tax for the same taxable year in which the income is subject to tax
in the other state.

F. An individual who participates in a composite income tax return
in another state may claim a credit for taxes paid to the other state if
the taxpayer meets all of the requirements of this section and the taxes
paid to the other state are imposed on and paid directly by the individual
taxpayer and not the entity. For the purposes of this subsection, taxes
are considered to be imposed on and paid directly by the individual under
one or more of the following circumstances:

1. The individual makes direct payment to the other state.
2. The individual makes direct payment to the entity filing the
composite income tax return.
3. The entity charges the individual's loan account for the amount
of the tax.
4. The entity reduces the individual's capital account.

G. FOR TAXABLE YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2021, A
RESIDENT TAXPAYER IS ALLOWED A CREDIT AGAINST THE TAX OTHERWISE DUE UNDER
THIS TITLE FOR THE AMOUNT OF ANY TAX THAT THE DEPARTMENT DETERMINES IS
SUBSTANTIALLY SIMILAR TO THE TAX IMPOSED UNDER SECTION 43-1014 FOR THE
TAXABLE YEAR AND THAT IS IMPOSED BY ANOTHER STATE OF THE UNITED STATES OR
A POLITICAL SUBDIVISION OF SUCH A STATE, OR BY THE DISTRICT OF COLUMBIA,
WITH RESPECT TO THE DIRECT AND INDIRECT TAXABLE INCOME ATTRIBUTABLE TO THE
RESIDENT TAXPAYER FROM A PASS-THROUGH ENTITY THAT IS ALSO SUBJECT TO TAX
UNDER THIS TITLE. A CREDIT ALLOWED PURSUANT TO THIS SUBSECTION MAY NOT
EXCEED THE AMOUNT THAT WOULD HAVE BEEN ALLOWED IF THE INCOME WERE TAXED AT
THE INDIVIDUAL LEVEL AND NOT TAXED AT THE ENTITY LEVEL.

H. If the taxpayer claims the credit for taxes paid to a
foreign country, the taxpayer shall use the conversion rate in effect on
the date the taxpayer paid the taxes to the foreign country.

I. For the purposes of this section:

1. "Composite income tax return" means a single income tax return
that is filed with another state on behalf of a group of individuals who
are partners or shareholders of the partnership or S corporation that
filed the return on their behalf.

2. "Entire income on which the other state's or country's tax is
imposed" means the other state's or country's income computed under the
equivalent of section 43-1094 but does not include any exemption allowable
under the equivalent of section 43-1023.

3. "Entire income on which the tax is imposed by this chapter"
means Arizona adjusted gross income as defined and computed under section
43-1001 but does not include any exemption allowed under section 43-1023.
4. "Income subject to tax in the other state or country and also taxable under this title" means the portion of income that is included in the entire income on which the tax is imposed by this chapter that is also included in the entire income on which the other state's or country's tax is imposed. The taxpayer shall increase or reduce the portion of income that is included in the entire income on which the tax is imposed by this chapter by any related additions under section 43-1021 and by any related subtractions under section 43-1022. The taxpayer shall increase or reduce the portion of income that is included in the entire income on which the other state's or country's tax is imposed by any related additions and subtractions under the other state's equivalent of sections 43-1021 and 43-1022, as applicable.

5. "Net income tax":
   (a) Means:
      (i) A tax that grants deductions or exemptions from gross income.
      (ii) Any tax imposed by another country that qualifies for a credit under sections 901 and 903 of the internal revenue code and the regulations under those sections, even if withheld from income.
   (b) Except as specifically included in subdivision (a) of this paragraph, does not include:
      (i) A system of taxation that assesses taxes on gross income, gross receipts or gross dividends.
      (ii) Taxes withheld from income.

6. "Tax payable under this chapter" means the income tax imposed by this state on the taxpayer's taxable income as defined under section 43-1001 minus any tax credit amount claimed for the taxable year under this article but not including the credit amount allowed under this section.

Sec. 6. Title 43, chapter 10, article 5, Arizona Revised Statutes, is amended by adding section 43-1075, to read:

43-1075. Credit for entity-level income tax

A. FOR TAXABLE YEARS BEGINNING FROM AND AFTER DECEMBER 31, 2021, A CREDIT IS ALLOWED AGAINST THE TAXES IMPOSED BY THIS TITLE FOR A TAXPAYER WHO IS A PARTNER IN A PARTNERSHIP OR A SHAREHOLDER OF AN S CORPORATION THAT ELECTS TO PAY THE TAX UNDER SECTION 43-1014.

B. THE AMOUNT OF THE CREDIT IS THE PORTION OF THE TAX PAID BY THE PARTNERSHIP OR S CORPORATION UNDER SECTION 43-1014 THAT IS ATTRIBUTABLE TO THE PARTNER'S OR SHAREHOLDER'S SHARE OF INCOME TAXABLE IN THIS STATE.

C. IF THE ALLOWABLE CREDIT EXCEEDS THE TAXES OTHERWISE DUE UNDER THIS TITLE ON THE CLAIMANT'S INCOME, OR IF THERE ARE NO TAXES DUE UNDER THIS TITLE, THE AMOUNT OF THE CLAIM NOT USED TO OFFSET TAXES UNDER THIS TITLE MAY BE CARRIED FORWARD FOR NOT MORE THAN FIVE CONSECUTIVE TAXABLE YEARS AS A CREDIT AGAINST SUBSEQUENT YEARS' INCOME TAX LIABILITY.
Sec. 7. **Purpose**

Pursuant to section 43-223, Arizona Revised Statutes, the legislature enacts section 43-1075, Arizona Revised Statutes, as added by this act, to restore the ability for partnerships and S corporations in this state to deduct state income taxes.

Sec. 8. **Effective date; retroactivity**

This act is effective from and after December 31, 2021.

APPROVED BY THE GOVERNOR JULY 9, 2021.