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SB 1783: small businesses; alternate income tax

Sponsor: Senator Mesnard, LD 17

Caucus & COW

Overview

Permits, retroactive to January 1, 2021, a tax to be levied, collected and paid for each taxable year (TY) on Arizona small business taxable income in an amount equal to 4.5 percent. Defines *small business taxpayer* and outlines requirements for income tax return filing and tax treatment. Establishes tax credits for a qualifying Arizona small business.

History

Individual income tax is levied on Arizona residents' taxable income and uses a graduated rate structure, based on the taxpayer's income level. Current statute authorizes various amounts to be added or subtracted when computing an individual's Arizona adjusted gross income ([A.R.S. § 43-1021](#), [43-1022](#)).

A small business corporation that makes an election for a TY under the United States Internal Revenue Code (IRC) is not subject to the corporate income tax. The income of these corporations is generally passed through to each shareholder, who is then taxed under Arizona's individual income tax ([A.R.S. § 43-1126](#), [JLBC Tax Handbook](#)).

Current statute applies the individual income tax rates to the income of estates or of any kind of property held in trust. The current brackets and tax rates are:

Single or Married Filing Separately and Estates and Trusts	
Taxable Income	Tax
\$0 - \$26,500	2.59% of taxable income
\$26,501 - \$53,000	\$686, plus 3.34% of the amount over \$26,500
\$53,001 - \$159,000	\$1,571, plus 4.17% of the amount over \$53,000
\$159,001 and over	\$5,991, plus 4.50% of the amount over \$159,000

Statute requires any new individual or corporate income tax credit to include a specific year for the Joint Legislative Income Tax Credit Review Committee (JLITCRC) to review the credit ([A.R.S. § 43-223](#)).

Provisions

Tax Imposed on Estates and Trusts

1. Removes the requirement that the taxable income of estates and trusts is subject to the tax rates imposed on single individuals. (Sec. 7)

<input type="checkbox"/> Prop 105 (45 votes)	<input type="checkbox"/> Prop 108 (40 votes)	<input type="checkbox"/> Emergency (40 votes)	<input checked="" type="checkbox"/> Fiscal Note
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- Establishes new tax brackets for TYs beginning January 1, 2021, which apply to the income of estates, property held in trust, the taxable income of resident trusts and the taxable income of nonresident trusts derived from sources with Arizona (Sec. 7):

Estates and Trusts	
Taxable Income	Tax
\$0 - \$27,272	2.59% of taxable income
\$27,273 - \$54,544	\$686, plus 3.34% of the amount over \$27,272
\$54,545 - \$163,632	\$1,571, plus 4.17% of the amount over \$54,544
\$163,633 and over	\$5,991, plus 4.50% of the amount over \$163,632

- Requires DOR to adjust the income dollar amount for each rate bracket according to the annual change in the metropolitan Phoenix Consumer Price Index published by the U.S. Department of Labor, Bureau of Labor Statistics. (Sec. 7)
- Requires the adjusted income dollar amount to be raised to the nearest whole dollar and prohibits the amounts for each bracket from being revised below the previous year amounts. (Sec. 7)

Arizona Small Business Income

- Establishes a tax to be levied, collected and paid for each TY on Arizona small business taxable income in an amount equal to 4.5% of Arizona small business taxable income, if the Arizona small business taxpayer elects to file an Arizona small business income tax return. (Sec. 8)
- Requires, in computing Arizona small business adjusted gross income (AGI), the additions and subtractions applicable to an individual's Arizona gross income to be made only to the extent that the additions and subtractions directly relate to Arizona small business gross income. (Sec. 8)
- Prohibits, in computing Arizona small business taxable income, deductions from being taken against Arizona small business AGI, unless the deductions are reflected in the net amounts reported on prescribed federal schedules. (Sec. 8)
- Defines *small business taxpayer* as any individual taxpayer who reports income that constitutes *small business gross income* on the taxpayer's federal income tax return. (Sec. 1)
- Defines *Arizona small business gross income* of a resident taxpayer as the sum of the amounts included in a taxpayer's federal adjusted gross income (FAGI) for the TY that are reported on certain IRC schedules and forms. (Sec. 8)

Arizona Small Business Tax Return

- Allows a small business taxpayer, beginning January 1, 2021, to elect to file a tax return with the Arizona Department of Revenue (DOR) to report the taxpayer's share of Arizona small business gross income. (Sec. 3)
- Requires the election to be made separately for each TY and is effective by reporting Arizona small business AGI on a timely filed Arizona small business tax return. (Sec. 3)
- Allows the election to be revoked on a timely filed amended Arizona small business tax return and a corresponding Arizona individual income tax return. (Sec. 3)

Credit for Income Taxes Paid to Other States

13. Establishes the Credit for Income Taxes Paid to Other States, allowed against Arizona small business income tax liability, for net income taxes imposed by and paid to another state or country on Arizona small business taxable income. (Sec. 8)
14. Subjects the Credit for Income Taxes Paid to Other States to the following conditions:
 - a) The credit is allowed only for taxes paid to the other state or country on income derived from sources within that state or country and that is taxable under its laws, regardless of residency;
 - b) The credit is not allowed if the other state or country allows Arizona residents a credit against the taxes imposed by that state or country for Arizona small business taxes; and
 - c) The credit may not exceed the proportion of the payable Arizona small business income tax as the small business income subject to tax in the other state or country and bears to the taxpayer's entire small business income on which the tax is imposed. (Sec. 8)
15. Allows an Arizona resident who is also considered to be a resident of another state to claim the Credit for Income Taxes Paid to Other States, subject to the following conditions:
 - a) The credit is allowed only if the other state taxes the income to the Arizona resident 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 the Arizona small business tax;
 - b) The credit is allowed only for the proportion of the taxes paid to the other state as Arizona small business taxable income 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; and
 - c) May not exceed the proportion of the payable Arizona small business tax and also subject to tax in the other state bears to the entire Arizona small business taxable income. (Sec. 8)
16. Allows a small business taxpayer who participates in a composite income tax return in another state to claim a credit for taxes paid to the other state if the taxes paid to the other state are imposed on — and paid directly — by the small business taxpayer and not the entity and if the:
 - a) Small business taxpayer makes direct payment to the other state;
 - b) Small business taxpayer makes direct payment to the entity filing the composite income tax return;
 - c) Entity charges the small business taxpayer's loan account for the amount of the tax; and
 - d) Entity reduces the small business taxpayer's capital account. (Sec. 8)
17. Allows a taxpayer to apply the allowable credit only against Arizona income tax for the same TY in which the income is subject to tax in the other state. (Sec. 8)
18. Requires a taxpayer, if the taxpayer claims the credit for taxes paid to a foreign country, to use the conversion rate in effect on the date the taxpayer paid the taxes to the foreign country. (Sec. 8)
19. Requires a taxpayer, if any taxes paid to another state or country are credited or refunded and the taxpayer has been allowed a credit, to immediately report that fact to DOR. (Sec. 8)
20. Requires, if any taxes paid to another state or country are credited or refunded, a tax — equal to the credit allowed for the taxes credited or refunded by the other state or country — to be paid by the taxpayer on notice and demand from DOR. (Sec. 8)
21. Requires interest to be added to and collected as a part of the tax at a statutorily determined rate from the date the credit was allowed to the date of the notice and demand, if any taxes paid to another state or country are credited or refunded and the taxpayer has been allowed a credit. (Sec. 8)

22. Requires, if the tax and interest are not paid within 10 days after the date of notice and demand, a rate of 12 percent a year to be collected as part of the tax interest on the unpaid amount of tax and interest from the date of the notice and demand until the amount is paid. (Sec. 8)
23. Disallows the Credit for Income Taxes Paid to Other States 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. (Sec. 8)

Credit for Arizona Small Business Excess Credit Amount

24. Establishes the Credit for Arizona Small Business Excess Credit Amount, allowed against individual income tax liability, in an amount equal to the excess amount of credits claimed by an Arizona small business. (Sec. 6, 8)
25. Allows the amount of the credit not used to offset individual income tax to be carried forward as a credit to the following TY — as a credit that is first available to offset Arizona small business taxable income, if any portion of the allowable credit exceeds taxes due. (Sec. 6)
26. Requires the JLITCRC to review the Credit for Arizona Small Business Excess Credit Amount in years ending in 1 and 6. (Sec. 2)

Individual Income Tax Credits

27. Allows individual income tax credits to be allowed against the Arizona small business income tax to the extent that the credit is derived from items otherwise included in computing Arizona small business gross income. (Sec. 8)
28. Allows the excess amount of credits claimed by an Arizona small business — to the extent that the credits exceed the Arizona small business income tax due for the TY — to be used as a credit against the tax imposed on the small business taxpayer for individual income tax purposes. (Sec. 8)

Estimated Tax Payments

29. Requires a small business taxpayer to pay estimated tax in four installments during the TY if the taxpayer's tax liability is at least \$1,000. (Sec. 4)
30. States that a taxpayer's tax liability is the excess of the tax imposed on an Arizona small business over any tax credits for income taxes paid to another state. (Sec. 4)
31. Sets the amount of the required annual estimated tax payment as the lesser of:
 - a) 90% of the tax shown on the return for the TY or, if no return is filed, 90 percent of the tax for that year;
 - b) 100% of the tax shown on the small business income tax return for the preceding TY — unless the preceding TY was not 12 months; or the small business did not file a return for the preceding TY that indicated a liability; or
 - c) Zero, for TYs before December 31, 2021. (Sec. 4)
32. Aligns the due dates for estimated tax installments with the IRC and requires each installment to equal 25% of the required annual estimated tax payment. (Sec. 4)
33. Stipulates that if a TY begins on a date other than January 1, the installment payments are due during months of the fiscal year that correspond to the prescribed months of a calendar year. (Sec. 4)
34. Subjects a taxpayer to a statutorily set civil penalty if the taxpayer fails to pay the full amount of estimated tax or any required installment payments. (Sec. 4)

35. Requires DOR to adopt rules necessary to administer and enforce estimated tax payments and to make available suitable forms and instructions to taxpayers who make estimated tax payments. (Sec. 4)

Miscellaneous

36. Allows, for TYs beginning January 1, 2021, Arizona small business AGI to be subtracted when computing an individual's Arizona gross income, but only if an individual taxpayer has elected to separately report and pay tax on the taxpayer's Arizona small business AGI on the Arizona small business income tax return. (Sec. 5)

37. Prohibits the individual income tax subtraction from being included as a subtraction under the Arizona small business income tax. (Sec. 8)

38. Specifies that Arizona small business gross income, in the case of nonresidents, includes only that portion of FAGI that represents income from sources within Arizona. (Sec. 8)

39. Allows DOR to adopt rules and to publish and prescribe forms necessary to administer the Arizona small business statutes. (Sec. 8)

40. Defines:

- a) *Arizona small business*;
- b) *Arizona small business adjusted gross income*;
- c) *Arizona small business taxable income*;
- d) *income taxable under this chapter and also subject to tax in the other state*;
- e) *composite income tax return*;
- f) *entire small business income on which the tax is imposed by this chapter*;
- g) *income subject to tax in the other state or country and also taxable under this chapter, net income tax*;
- h) *small business income on which the other state's or country's tax is imposed*; and
- i) *tax payable under this chapter*. (Sec. 8)

41. Contains an intent clause. (Sec. 9)

42. Makes technical and conforming changes. (Sec. 1)

43. Contains a retroactivity clause to TYs beginning January 1, 2021. (Sec. 10)