

2016 Arizona S corporation Income Tax Return

For information or help, call one of the numbers listed:

Phoenix (602) 255-3381
From area codes 520 and 928, toll-free (800) 352-4090

Tax forms, instructions, and other tax information

If you need tax forms, instructions, and other tax information, go to the department's website at www.azdor.gov.

Income Tax Procedures and Rulings

These instructions may refer to the department's income tax procedures and rulings for more information. To view or print these, go to our website and click on *Legal Research* then click on *Procedures* or *Rulings* and select a tax type from the drop down menu.

Publications

To view or print the department's publications, go to our website and click on *Publications*.

General Instructions

Who Must Use Form 120S

Corporations taxed as S corporations under Subchapter S of the Internal Revenue Code (IRC) must file Form 120S. Qualified subchapter S subsidiaries are not treated as entities separate from the parent corporation and would be included on a single Form 120S filed by the parent S corporation.

Entity Classification Under the Federal "Check-the-Box Rules"

The federal tax classification of an entity under the federal "check-the-box rules" determines the entity's classification for Arizona tax purposes.

Limited Liability Companies

Only a limited liability company that makes a valid federal election to be taxed as an S corporation must file Form 120S. A single member limited liability company that is disregarded as an entity is treated as a branch or division of the owner, and is included in the tax return of its owner. Refer to *Corporate Tax Ruling (CTR) 97-2, Limited Liability Companies*, for further information.

A nonprofit medical marijuana dispensary (NMMD) under *Arizona Revised Statutes (A.R.S.) Title 36, Chapter 28.1*, is exempt from Arizona income tax in accordance with *A.R.S. § 43-1201(B)*. If the NMMD makes an election pursuant to subtitle A, chapter 1, subchapter S of the IRC, it must file Arizona Form 120S to meet the filing requirements of *A.R.S. § 43-1126*. However, no Arizona income tax is due from the S corporation, even if the S corporation is subject to tax at the federal level. Shareholders are subject to Arizona income tax on the flow through from the S corporation.

Taxable Year Covered by Return

The S corporation must have the same taxable year for Arizona purposes as it has for federal purposes. Indicate whether the taxable year is a calendar year or a fiscal year; if a fiscal year, indicate the taxable year on the top of page 1 of the return.

Records

Every S corporation should maintain books and records substantiating information reported on the return and keep these documents for inspection. Refer to *General Tax Ruling*

(GTR) 96-1, *Electronic Data Processing* for more information about record retention requirements.

S corporations should complete three copies of Form 120S, Schedule K-1 or Schedule K-1(NR) for each shareholder. File one copy of each shareholder's Schedule K-1 or Schedule K-1(NR) with the S corporation's Form 120S. Provide all shareholders with a copy of their Schedule K-1 or Schedule K-1(NR). Retain a copy of each Schedule K-1 or Schedule K-1(NR) for the S corporation's records.

IRC § 7519 Required Payments

Taxpayers cannot deduct the federal required payments on their Arizona tax returns as an ordinary and necessary business expense or otherwise.

Rounding Dollar Amounts

Taxpayers must round amounts to the nearest whole dollar. If 50 cents or more, round up to the next dollar. If less than 50 cents, round down.

Extension of Time to File a Return:

- A request for an extension of time to file an Arizona corporate income tax return **must** be submitted by the original due date of the return.
 - The extension request can be made by filing a federal extension request, or by filing an Arizona extension request, Form 120EXT.
 - **The department may grant an extension request for a maximum of six months.**
 - The department will accept a valid federal extension for the same period of time covered by the federal extension.
- If the original return is filed under extension, do not include a copy of the extension with your return.
 - However, make sure to check the extension box, 82F, on page 1 of your return.
- Form 120EXT must be used to transmit extension payments by check or money order regardless of how you request an Arizona extension (valid federal extension or Form 120EXT).
 - If you made extension payments over the internet, you are not required to file Form 120EXT unless you are requesting an Arizona filing extension.
- The Arizona extension and the federal extension provide an extension of time to file, they do not provide an extension of time to pay tax.
 - You must pay 90% of your tax liability (including the \$50 minimum tax) by the original due date of your return.
 - The department imposes the extension underpayment penalty on any late or underpaid extension requests.
- See *CTR 01-3, Extensions*, for additional information.
- **Mail the extension request to the address shown on the form.**

Filing Original Returns:

- Returns are due by the 15th day of the third month following the close of the taxable year.
- If the S corporation has a valid federal or Arizona filing extension, the return is due by the extended due date.
 - If the return is filed under extension, check box 82F on page 1 of the return.

- If the due date for the return falls on a Saturday, Sunday, or a legal holiday, the return is considered timely filed if it is postmarked the next business day.
 - See *GTR 16-2, Timely Filing of Income or Withholding Tax Return – Holidays and Weekends*.
- The return must be signed by one or more of the officers of the S corporation (President, Treasurer, or any other principal officer).
- Do not submit a blank Arizona return with a copy of the federal return.
 - S corporations must furnish complete data.
 - Answer all questions on the return.
 - Complete all applicable schedules.
 - Include all appropriate supplementary schedules.
- **Mail the return to the address shown on the form.**

Timely Filing of Returns:

- The department determines the timeliness of a tax return by the postmark or other official mark of the United States mail stamped on the envelope in which the return is mailed.
 - See *GTR 16-1, Timely Filing of Income or Withholding Tax Returns Through the United States Mail*.
- The Department will accept proof of mailing from a private delivery service included in the Internal Revenue Service (IRS) list of designated private delivery services.
 - Contact the private delivery service for information regarding how to obtain written proof of mailing.
- If the due date for the return falls on a Saturday, Sunday, or a legal holiday, the return is considered timely filed if it is postmarked the next business day.
 - See *GTR 16-2, Timely Filing of Income or Withholding Tax Return – Holidays and Weekends*.

Filing Amended Returns:

- Any S corporation who files an amended return with the IRS *must* file an Arizona amended return on Form 120S, for the tax year amended, (i.e. 2016 Form 120S for tax year 2016) within 90 days of final determination of the federal amended return by the IRS.
 - When submitting an amended return, check the box labeled “Amended” in the upper right corner of the return.
- S corporations *must* report changes or corrections of their taxable income by the IRS or as a result of renegotiation of a contract or subcontract with the United States to the department.
- Within 90 days after the final determination of the change or correction, the S corporation must:
 - File a copy of the final determination with the department, concede the accuracy of the determination or state any errors, and request the department recompute the tax owed Arizona, or
 - File an amended return as required by the department.
- The S corporation must provide sufficient information for the department to recompute the S corporation’s Arizona taxable income based on the Revenue Agent Report changes.

- The department may require the S corporation to file an amended return if the department does not have this information.
- Mail the amended return to the address shown on the form.

NOTE: *File amended returns for prior taxable years on the respective Form 120S for those taxable years. Use the 2016 Form 120S to amend only the taxable year 2016.*

Do NOT file an amended return until your original return has been processed.

Estimated Tax Payments

S corporations that expect an Arizona income tax liability for the taxable year of \$1,000 or more must make Arizona estimated tax payments. An S corporation that fails to make the required estimated tax payments is subject to a penalty on any estimated tax payment which is late or underpaid.

The Arizona required annual payment of corporate estimated tax for an S corporation is the smaller of:

- Ninety percent of the S corporation's Arizona tax liability (reduced by refundable tax credits and claim of right adjustments, if applicable) for the current taxable year; or
- One hundred percent of the S corporation's Arizona tax liability (reduced by refundable tax credits and claim of right adjustments, if applicable) for the prior taxable year.

Use 2017 Form 120ES, *Corporation Estimated Tax Payment* to make payments by check or money order.

Use 2017 Form 120W, *Estimated Tax Worksheet for Corporations*, to compute the required installments.

For exceptions to the estimated tax requirements, see the instructions for Form 220, *Underpayment of Estimated Tax by Corporations*.

NOTE: *For an S corporation to base its Arizona corporate estimated tax payments on its prior taxable year's tax liability:*

- *The S corporation's return filed for the prior taxable year must have been for a period of twelve months.*

ESTIMATED TAX PAYMENTS BY ELECTRONIC FUNDS TRANSFER (EFT)

S corporations whose Arizona corporate income tax liability for the preceding taxable year was \$20,000 or more must make Arizona corporate estimated tax payments via the EFT program. If the S corporation makes its estimated tax payments by EFT, the S corporation should not submit Form 120ES to the department.

S corporations required to make estimated tax payments via EFT must complete the department's EFT authorization agreement at least 30 days prior to initiation of the first applicable transaction.

S corporations whose Arizona corporate income tax liability for the preceding taxable year was less than \$20,000 may elect voluntary participation in the EFT program. Voluntary participants in the program must complete the department's EFT authorization agreement at least 30 days prior to the first applicable transaction.

NOTE: *S corporations required to make corporate estimated payments via EFT that fail to do so are subject to a penalty of 5% of the amount of the payment not made by EFT. See A.R.S. § 42-1125(O).*

For additional information on EFT, refer to A.R.S. § 42-1129 and the related Arizona Administrative Code rules (A.A.C. R15-10-301 through R15-10-307).

ESTIMATED TAX PAYMENTS VIA THE INTERNET

S corporations must be licensed by the department before they can register to pay taxes online. Visit www.AZTaxes.gov to register and make estimated tax payments over the Internet. If a S corporation makes its estimated tax payments via the Internet, the S corporation should not submit Form 120ES to the department.

Electronic payment from checking or savings account

Estimated tax payments can be made electronically from a checking or savings account. Visit www.AZTaxes.gov and choose the e-check option. There is no fee to use this method. This payment method will debit the amount from the specified checking or savings account on the date specified. If an electronic payment is made from a checking or savings account, a confirmation number will be generated. Please keep this confirmation number as proof of payment.

Credit card payment

Estimated tax payments can be made via American Express, Discover, MasterCard or VISA credit cards. Visit www.AZTaxes.gov and choose the credit card option. This will take you to the website of the credit card payment service provider. The service provider will charge a convenience fee based on the amount of the tax payment. The service provider will disclose the amount of the convenience fee during the transaction and the option to continue or cancel the transaction will be presented. If you accept the convenience fee and complete the credit card transaction, a confirmation number will be generated. Please keep this confirmation number as proof of payment.

Penalties and Interest

A. Late Filing Penalty. A return filed after the original due date is subject to the late filing penalty unless the S corporation has a valid federal or Arizona extension. A return filed after its extended due date is also subject to the late filing penalty. The late filing penalty is 4.5% (.045) of the amount of tax required to be shown on the return. "Amount of tax required to be shown on the return" is the amount of tax imposed less the amount of any part of the tax paid on or before the beginning of the month and the amount of any credit against the tax which may be claimed on the return. The penalty period is each month or fraction of a month between the due date of the return and the date the S corporation filed the return. The maximum penalty is 25% of the tax found to be remaining due.

B. Extension Underpayment Penalty. The S corporation must pay 90% of the tax liability disclosed by the S corporation's return on or before the original due date of the return. The department imposes the extension underpayment penalty on any late or underpaid extension payments. The extension underpayment penalty is 0.5% (.005) of the tax not paid. The penalty period is each 30-day period or fraction thereof

between the original due date of the return and the date the S corporation paid the tax. The maximum penalty is 25% of the unpaid tax. S corporations subject to the extension underpayment penalty are not subject to the late payment penalty described in C below.

C. Late Payment Penalty. The department imposes the late payment penalty on any amount shown as tax on a return that is not paid by the date prescribed for its payment. "Amount of tax shown on the return" is the amount of tax imposed shown on the return less the amount of any part of the tax paid on or before the beginning of the month and the amount of any credit against the tax which may be claimed on the return. The late payment penalty is 0.5% (.005) of the unpaid tax for each month or fraction of a month that the tax remains unpaid, not to exceed 10% of the unpaid tax.

NOTE: *If more than one of the penalties described in A, B, or C apply, the maximum combined penalty is 25%.*

Refer to *CTR 09-1, When do Penalties Apply to an Income Tax Return Filed Under an Extension*, regarding the application of penalties to returns filed under extension.

D. Information Return Penalty. This form is an information return when no tax liability is due. The penalty for failing to file, filing late (including extensions), or filing an incomplete information return is \$100 for each month, or fraction of a month, that the failure continues, up to a maximum penalty of \$500.

E. Interest. The department assesses interest on any portion of the tax, whether determined by the department or the S corporation, not paid by the date prescribed for its payment. The department applies interest, compounded annually, in the same manner and at the same time as prescribed by IRC § 6621, except that the Arizona rate of interest for both underpayments and overpayments for all S corporations is the federal underpayment rate under IRC § 6621(a)(2).

On January 1 of each year, the department adds any interest outstanding as of that date to the principal amount of the tax. It is then a part of the principal amount of the tax and accrues interest until paid.

F. Underpayment of Estimated Tax Penalty. The department imposes the underpayment of estimated tax penalty on any late payment or underpayment of a required installment of estimated tax. Refer to Form 220 for further details. The penalty imposed is the penalty prescribed by A.R.S. § 43-582, for the applicable period.

The S corporation must complete Form 220, *Underpayment of Estimated Tax by Corporations*, if it made its estimated tax payments based on either the annualized income installment or adjusted seasonal installment methods, or if it is a large corporation that computed its first required installment based on the S corporation's tax liability for the prior taxable year. This is required even if no penalty is due.

The S corporation does not have to complete Form 220 if the S corporation made its estimated tax payments in four equal installments based on an amount equal to either 90% of the current taxable year's tax liability or 100% of the prior year's tax liability. "Tax liability" here means the liability reduced by any refundable tax credits and the claim of right adjustment, if applicable.

The department will compute the estimated tax underpayment penalty based on either of these methods and notify the S corporation of any amount due.

Payment of Tax

The entire amount of any tax for which the S corporation itself is liable is due by the original due date of the return. Payments can be made via check, e-check, money order, or credit card. Visit www.AZTaxes.gov to register and make payments via the internet.

Disaster Relief for Out-of-State Businesses

If an out-of-state business is in Arizona on a temporary basis solely for the purpose of performing disaster recovery from a declared disaster during a disaster period, it may not be required to file, remit, withhold or pay state or local (income) tax. See *Publication 720, Disaster Recovery Tax Relief* to determine if the taxpayer qualifies for this relief.

Arizona Apportionment Methods

There are three apportionment methods for multistate S corporation income tax returns filed to Arizona: (1) air carrier apportionment; (2) standard apportionment; and (3) enhanced apportionment.

Air carriers are required to use revenue miles. All other taxpayers may select either the standard or the enhanced apportionment method.

1. Air Carrier Apportionment

An air carrier is required to use revenue miles to calculate its apportionment ratio. Check the box on line A on page 1, fill out Schedule ACA, and include it with your return. Do not complete Schedule A.

2. Standard Apportionment Formula

All non-air carrier taxpayers are allowed to continue to use Arizona's standard apportionment formula, which double-weights the sales factor. Check the box on line A on page 1 and complete Schedule A using the number on the left-hand side of line A3e, column A, to double-weight the sales factor. Divide the total ratio by four.

3. Enhanced Apportionment Formula

All non-air carrier taxpayers may use Arizona's enhanced apportionment formula, which is determined by adding two and one-half (2.5) times the property factor plus two and one-half (2.5) times the payroll factor plus ninety-five (95) times the sales factor and dividing the total by 100. Check the box on line A on page 1 and complete Schedule A using the numbers on the right-hand side of line A1d, A2b and A3e, column A, to weight each of the three apportionment factors respectively.

MULTISTATE SERVICE PROVIDER

For taxable years beginning from and after December 31, 2013, taxpayers that qualify, may elect to treat sales from service as being sourced to Arizona based on a combination of income producing activity sales and market sales. (See: Part A of Schedule MSP to determine if the taxpayer qualifies.) Multistate taxpayers that qualify to be a Multistate Service Provider (MSP) may use the MSP to source their Arizona sales under either the "Standard" or the "Enhanced" apportionment formulas. Taxpayers that qualify and who want to make the

election, should check the applicable boxes on line B on page 1 of the return and include Schedule MSP with the return. See the specific instructions for the apportionment formula beginning on page 10 of these instructions. Also refer to A.R.S. § 43-1147 and Schedule MSP instructions for more information.

Specific Instructions

For calendar year filers, check the box, "calendar year 2016". For fiscal year filers, check the box, "fiscal year" and enter the beginning and ending dates for the fiscal year.

Type or print the required information in the name, address, and information boxes on the top of page 1. If the taxpayer has a foreign address, enter the information in the following order: city, province or state, and country. Follow the country's practice for entering the postal code. **Do not abbreviate the country's name.**

Enter the S corporation's employer identification number (EIN). Subsidiaries would enter the parent S corporation's Taxpayer Identification Number (TIN).

NOTE:

- All returns, statements, or other documents filed with the department must have the taxpayer's EIN or TIN indicated on them.
- Taxpayers who fail to include their EIN or TIN may be subject to a penalty.
- Paid tax return preparers must include their TIN where requested.
- The TIN for a paid tax return preparer is:
 - The preparer's PTIN
 - The preparer's social security number
 - The EIN of the preparer's employer
- Paid tax return preparers who fail to include their TIN may be subject to a penalty.

Box 68

- If this is the taxpayer's first return filed to Arizona, check the box "This is a first return".
- If the taxpayer changed its name during the tax year, check the box, "Name change".
- If the tax taxpayer changed its address during the tax year, check the box, "Address change".

Box 82F

- Check this box if this return is being filed under extension.

Line A:

- If the S corporation is a multistate S corporation, check the appropriate box indicating its method of apportioning income to Arizona.
 - If the S corporation utilized the Air Carrier apportionment, check the box "AIR CARRIER", complete Form ACA and include Form ACA with this return.
 - If the S corporation utilized the Standard apportionment formula, check the box "Standard".
 - If the S corporation utilized the Enhanced apportionment formula, check the box "Enhanced".
- If the S corporation is not a multistate S corporation, or did not apportion its income to Arizona, do not check any boxes.

Line B:

- Check this box only if the S corporation elected to be treated as a multistate service provider by completing Arizona Schedule MSP and including it with this return. If this box is checked, check the appropriate box, Yr 1 through Yr 5, to indicate the year of the taxpayer's election cycle.
- If the S corporation did not elect multistate service provider treatment, do not check any boxes.

Line C: If this is the S corporation's final Arizona tax return filed under this Employer Identification Number (EIN), check the box labeled "Yes". If not, check the box labeled "No".

- If the "Yes" box is checked, check the box indicating the reason this is the S corporation's final Arizona tax return.
 - The S corporation dissolved
 - The S corporation withdrew from operating in Arizona
 - The S corporation merged or reorganized
 - List the EIN of the successor corporation, if any

Line D: If the S corporation conducts business within and without Arizona, check the box labeled "Yes". If not, check the box labeled "No".

Line E: If a composite return will be filed on Form 140NR, check the box labeled "Yes". If not, check the box labeled, "No".

Line F: Enter the total number of nonresident individual shareholders of the S corporation on this line. If none, enter "0".

Line G: Enter the total number of resident and part-year resident individual shareholders on this line. If none, enter "0".

Line H: Enter the total number of entity shareholders (exempt organizations, trusts, estates). Do not include individual shareholders.

NOTE: *The total of the amounts entered for information questions F, G, and H should equal the total number of S corporation shareholders.*

Use Schedule K-1 for resident or part-year resident individual shareholders, resident estate shareholders, and resident trust shareholders. Use Schedule K-1(NR) for all other shareholders.

Nonprofit Medical Marijuana Dispensary

Only a nonprofit medical marijuana dispensary (NMMD) under A.R.S. Title 36, Chapter 28.1, should fill out line I.

All other S corporations, go to line 1.

Line I: Check the box to indicate that the S corporation is a NMMD and enter the registry identification number issued by the Arizona Department of Health Services.

Arizona Income Computation

Line 1 - Total Distributive Income (Loss)

Enter the net total of the pro rata share items of nonseparately computed income (loss) and separately stated income (loss) and deductions (from federal Form 1120-S, Schedule K).

NOTE for NMMDs: *A nonprofit medical marijuana dispensary should skip lines 2 through 25. Only fill out line 26 (Information Return Penalty), if applicable. Complete Schedule A (if a multistate NMMD) and Schedule B. Also include Schedule C, as directed on page 3 of Form 120S.*

Income Subject to Federal and Arizona Corporate Income Taxes

Lines 2 through 4 - Excess Net Passive Income and Capital Gains/Built-in Gains

If the S corporation was subject to the federal excess net passive income, capital gains tax, or built-in gains tax on its federal Form 1120-A, it is subject to Arizona corporate income tax on the total of this income. Use the federal worksheet included in the instructions for Form 1120-S to calculate the amount of excess net passive income and capital gains/built in gains that was subject to federal taxation.

Line 2 – Excessive Net Passive Income

Enter the amount of excess net passive income that was subject to federal corporate income tax.

Line 3 – Capital Gains/Built In Gains

Enter the amount of capital gains/built in gains that was subject to federal corporate income tax.

Line 4 – Total Federal Income Subject to Corporate Income Tax

Add line 2 and line 3. Enter the total.

- Multistate S corporations, continue to line 5.
- Wholly Arizona S corporations, skip to line 11.

Lines 5 through 10 - Apportionment Computation (Multistate S corporations Only)

An S corporation that has income from business activity taxable in more than one state is a multistate S corporation. An S corporation that has income from business activity that is taxable entirely within Arizona is a wholly Arizona S corporation.

Wholly Arizona S corporations should skip lines 5 through 10 and go directly to line 11.

Any S corporation that has income from business activity that is taxable both within and without Arizona must allocate and apportion its net income according to the Uniform Division of Income for Tax Purposes Act (UDITPA), A.R.S. §§ 43-1131 through 43-1150. See the instructions beginning on page 11 for more detailed information regarding apportionment of income.

Line 5 - Nonapportionable or Allocable Income (Multistate S corporations Only)

Nonbusiness income is nonapportionable and specifically allocable to a particular state. "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business, and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. (A.R.S. § 43-1131(1)).

"Nonbusiness income" means all income other than business income. (A.R.S. § 43-1131(4)). Refer to A.R.S. §§ 43-1134

through 43-1138 for the methods of allocating certain types of nonbusiness income.

Enter the total amount of all income (loss) which is nonapportionable or specifically allocable to Arizona. Include a schedule that details the amount of nonapportionable income subtracted on page 1, line 5.

Line 7 - Arizona Apportionment Ratio (Multistate S corporations Only)

Compute the apportionment factors according to the instructions for Schedule ACA or A. Enter on page 1, line 7, the average apportionment ratio from Schedule ACA, line 3, or from Schedule A, line A5, column C. Carry out the decimal to six places.

Line 9 - Other Income Allocated to Arizona (Multistate S corporations Only)

Enter the total amount of all income (loss) that is specifically allocable to Arizona. DO NOT include the amount of any nonbusiness income which is allocable to another state on this line. Include a schedule that details the amount of income that is allocable to Arizona.

Arizona Tax Liability Computation

Is the S corporation subject to federal and Arizona corporate income tax? If so, the S corporation must complete lines 2 through 25. Is the S corporation subject to Arizona corporate income tax from the recapture of the Arizona credits for environmental technology facilities, healthy forest enterprises, renewable energy industry or qualified facilities? If so, the S corporation must complete lines 13 through 25, even if not required to complete lines 2 through 12.

Line 12 - Arizona Tax

The S corporation is subject to the tax computed on line 12 only if it has income subject to tax at the corporate level on the federal Form 1120-S, even if line 11 is zero or a negative amount. Pursuant to A.R.S. § 43-1111, the amount of the tax is the greater of \$50 or 5.5% of the net income subject to Arizona corporate income tax (line 11).

Line 13 - Tax From Recapture of Tax Credits

Enter the amount of tax due from the recapture of tax credits from Form 300, Part 2, line 31.

Line 14 - Subtotal

Add lines 12 and 13. This is the amount of tax to which the total amount of tax credits claimed by the taxpayer may be applied.

Line 15 - Nonrefundable Tax Credits

Enter the allowable nonrefundable tax credit amount from Form 300, Part 2, line 56. This amount cannot be larger than the amount on line 14. Include the completed credit forms and Form 300 with the tax return.

- **Enterprise Zone Credit.** The enterprise zone credit has been repealed. The repeal did not affect carryforwards of properly established credits. Complete Form 304 to claim carryforwards established in prior years.
- **Environmental Technology Facility Credit.** This tax credit is for costs incurred in constructing a qualified environmental technology manufacturing, producing, or

processing facility as described in A.R.S. § 41-1514.02. Complete Form 305 to claim this tax credit.

- **Military Reuse Zone Credit.** This tax credit is for net increases in employment of full-time employees working in a military reuse zone established under Arizona law. Complete Form 306 to claim this tax credit.
- **Credit for Increased Research Activities.** This tax credit is for taxpayers who incur qualified research expenses for research conducted in Arizona. A portion of the excess credit claimed for taxable years beginning from and after December 31, 2009, may be refundable with approval from the Arizona Commerce Authority. Be sure to include only the nonrefundable portion on line 15. Complete Form 308 to claim this tax credit.
- **Pollution Control Credit.** This tax credit is for expenses incurred during the taxable year to purchase real or personal property used in the taxpayer's trade or business in Arizona to control or prevent pollution. Complete Form 315 to claim this tax credit.
- **Credit for Taxes Paid for Coal Consumed in Generating Electrical Power.** This tax credit is for a percentage of the amount paid by the seller or purchaser as transaction privilege tax or use tax for coal sold to the taxpayer that is consumed in the generation of electrical power in Arizona. Complete Form 318 to claim this tax credit.
- **Credit for Solar Hot Water Heater Plumbing Stub Outs and Electric Vehicle Recharge Outlets.** This tax credit is for the installation of solar hot water heater plumbing stub outs and electric vehicle recharge outlets in houses or dwelling units constructed by the taxpayer. The houses or dwelling units must be located in Arizona. Complete Form 319 to claim this tax credit.
- **Credit for Employment of TANF Recipients.** This tax credit is for net increases in qualified employment for recipients of temporary assistance for needy families (TANF) who are residents of Arizona. Complete Form 320 to claim this tax credit.
- **Agricultural Pollution Control Equipment Credit.** This tax credit is for expenses incurred during the taxable year to purchase tangible personal property that is primarily used in the taxpayer's business in Arizona to control or prevent agricultural pollution. Complete Form 325 to claim this tax credit.
- **Credit for Donation of School Site.** This tax credit is for the donation of real property and improvements to an Arizona school district or Arizona charter school for use as a school or as a site for the construction of a school. Complete Form 331 to claim this tax credit.
- **Credits for Healthy Forest Enterprises.** These tax credits are for net increases in qualified employment positions in a healthy forest enterprise and net training and certifying costs. Use Form 332 to claim these tax credits.
- **Credit for Employing National Guard Members.** This tax credit is for an employer who has an employee that is

a member of the Arizona National Guard and the employee was placed on active duty. Use Form 333 to claim this tax credit.

- **Credit for Corporate Contributions to School Tuition Organizations.** This credit is for corporations who make contributions to school tuition organizations which provide scholarships and tuition grants to children attending qualified nongovernmental schools. Use Form 335 to claim this tax credit.
- **Credit for Solar Energy Devices - Commercial and Industrial Applications.** This credit is available to taxpayers that install solar energy devices for commercial, industrial, or any other nonresidential purpose in the taxpayer's trade or business located in Arizona. The taxpayer or an exempt organization may transfer the credit to a third party that either financed, installed, or manufactured the qualifying solar energy device. Use Form 336 to figure this tax credit.
- **Credit for Water Conservation System Plumbing Stub Outs.** The credit for water conservation system plumbing stub outs has expired. This credit may not be claimed for taxable years ending after December 31, 2011. However, any credit carryover established in calendar year 2011 and prior will be allowed for not more than five consecutive taxable years. Use Form 337 to figure any allowable credit carryover. Taxable year 2016 is the last year a taxpayer may claim a carryforward of this credit.
- **Credit for Corporate Contributions to School Tuition Organizations for Displaced Students or Students with Disabilities.** This tax credit is for corporations who make contributions to school tuition organizations that provide scholarships and tuition grants to qualifying children attending qualified nongovernmental schools. Use Form 341 to claim this tax credit.
- **Renewable Energy Production Tax Credit.** This tax credit is for taxpayers that produce electricity using qualified energy resources. Approval by the Arizona Department of Revenue is required prior to claiming this tax credit. Use Form 343 to claim this tax credit.
- **Solar Liquid Fuel Credit.** This credit is for taxpayers in the solar liquid fuel industry. Credits are allowed for taxpayers who:
 - Have increased research and development activities in Arizona related to solar liquid fuel.
 - Produce solar liquid fuel in Arizona in commercial quantities.
 - Incur costs to convert or modify existing motor vehicle service stations for the retail sale of solar liquid fuel to customers in Arizona.
 Use Form 344 to claim this tax credit.
- **Credit for New Employment.** This tax credit is for taxpayers that have net increases in employment. The credit limit is administered by the Arizona Commerce Authority. Use Form 345 to claim this tax credit.
- **Additional Credit for Increased Research Activities for Basic Research Payments.** This tax credit is for taxpayers that make qualified basic research payments for research conducted in Arizona. Approval by the Arizona

Department of Revenue is required prior to claiming this tax credit. Use Form 346 to claim this tax credit.

- **Credit for Qualified Health Insurance Plans.** The credit for qualified health insurance plans has been repealed. All credits for qualified health insurance plans that were properly established can be carried forward for the respective three year carry forward period. Use Form 347 to claim this carry-forward tax credit.
- **Credit for Renewable Energy Investment and Production for Self-Consumption by Manufacturers and International Operations Centers.** This tax credit is for investment in new renewable energy facilities that produce energy for self-consumption using renewable energy resources if the power will be used primarily for manufacturing or for International Operations Centers. Use Form 351 to claim this tax credit.

Complete the appropriate credit form for each tax credit. Include the completed credit form and Form 300 with the tax return.

Amended Returns: Include the completed credit form(s) and Arizona Form 300 with the amended Form 120S, whether or not the amount claimed on line 15 has changed.

Line 16 - Credit Type

Indicate which nonrefundable tax credits were used on line 15 by entering the applicable form number(s) in the space provided.

| Nonrefundable Income Tax Credit | Form |
|--|------|
| Enterprise Zone Credit | 304 |
| Environmental Technology Facility Credit | 305 |
| Military Reuse Zone Credit | 306 |
| Credit for Increased Research Activities | 308 |
| Pollution Control Credit | 315 |
| Credit for Taxes Paid for Coal Consumed in Generating Electrical Power | 318 |
| Credit for Solar Hot Water Heater Plumbing Stub Outs and Electric Vehicle Recharge Outlets | 319 |
| Credit for Employment of TANF Recipients | 320 |
| Agricultural Pollution Control Equipment Credit | 325 |
| Credit for Donation of School Site | 331 |
| Credits for Healthy Forest Enterprises | 332 |
| Credit for Employing National Guard Members | 333 |
| Credit for Corporate Contributions to School Tuition Organizations | 335 |
| Credit for Solar Energy Devices - Commercial and Industrial Applications | 336 |
| Credit for Water Conservation System Plumbing Stub Outs | 337 |
| Credit for Corporate Contributions to School Tuition Organizations for Displaced Students or Students With Disabilities | 341 |
| Renewable Energy Production Tax Credit | 343 |
| Solar Liquid Fuel Credit | 344 |
| Credit for New Employment | 345 |
| Additional Credit for Increased Research Activities for Basic Research Payments | 346 |
| Credit for Qualified Health Insurance Plans | 347 |
| Credit for Renewable Energy Investment and Production for Self-Consumption by Manufacturers and International Operations Centers | 351 |

Line 17 - Arizona Tax Liability

Subtract line 15 from line 14. If line 15 is more than line 14, enter zero (0). Line 17 cannot be a negative amount.

Tax Payments and Refundable Credits

Line 18 - Refundable Tax Credits

Check the box(es) marked 308, 342 and/or 349 to indicate which of these tax credits the taxpayer is claiming. Enter the total amount of the credits claimed on line 18.

Credit for Increased Research Activities. A portion of this tax credit is refundable for qualified taxpayers. The refund is limited to 75% of the excess credit, which is the current year's credit less the current year's tax liability, not to exceed the amount approved by the Arizona Commerce Authority. Include a copy of your "Certificate of Qualification" from the Arizona Commerce Authority, Form 300, and Form 308 with your tax return. Enter the amount from Form 308, Part 7, line 44.

Credit for Renewable Energy Industry. This tax credit is for expanding or locating qualified renewable energy operations in Arizona and is refundable in five equal installments. Pre-approval and post-approval are required through the Arizona Commerce Authority. Include a copy of your "Certification of Qualification" from the Arizona Commerce Authority and Form 342 with your tax return to claim this credit. Enter the amount from Form 342, Part 6, line 18.

Credit for Qualified Facilities. This tax credit is for expanding or locating a qualified facility in Arizona and is refundable in five equal installments. Pre-approval and post-approval are required through the Arizona Commerce Authority. Include a copy of your "Certification of Qualification" from the Arizona Commerce Authority and Form 349 with your tax return to claim this credit. Enter the amount from Form 349, Part 8, line 18.

If you are claiming more than one of the refundable tax credits, check the appropriate boxes and add the amounts from the credit forms together and enter the total on line 18, or use the following worksheet to figure the amount to enter on line 18.

| Refundable Credit Worksheet | |
|--|--|
| 1. Enter the refundable credit from Form 308, Part 7, line 44. | |
| 2. Enter the apportioned credit from Form 342, Part 6, line 18. | |
| 3. Enter the apportioned credit from Form 349, Part 8, line 18. | |
| 4. Add the amounts on lines 1, 2, and 3. Enter the total here and on Form 120S, line 18. | |

Amended Returns: Include the completed credit form(s) with the amended Form 120S, with Form 300, if applicable, whether or not the amount claimed on line 18 has changed.

Line 19 - Extension Payments

Original Returns: Enter any payment made with the request for extension of time to file the income tax return or made online by the original due date.

Amended Returns: Enter any payment made with the request for an extension of time to file the original return or made online by the original due date. DO NOT include or enter the amount of any penalties or interest paid.

Line 20 - Estimated Payments

Original Returns: Enter the total amount paid by the S corporation for the taxable year. Include a schedule listing dates and payments made.

Amended Returns: Enter the total amount of estimated tax payments made by the S corporation for the taxable year. Do not include the amount of any penalties paid, or any reduction for the amount of an overpayment that was designated as an estimated tax payment for 2016 on a prior return.

Line 21 - Total Payments

Original Returns: Add lines 18, 19 and 20. Enter the total.

Amended Returns: Enter the total amount of tax payments made for the taxable year. Compute the total as follows:

- Add the amounts entered on lines 18, 19 and 20.
- Add the amount of a payment sent with the original return (if any);
- Add the amount of any payments made after the original return was filed; and
- Subtract the amount of any overpayment of tax (from the original return, line 23) and the total amount of any overpayments from an Arizona Department of Revenue correction notice, a prior amended return, or an audit.
- Do not include or enter the amount of any penalties or interest paid.

Computation of Total Due or Overpayment

Line 22 - Balance of Tax Due

If the amount on line 17 is **larger** than the amount on line 21, there is a balance of tax due. Subtract line 21 from line 17, and enter the difference. Skip line 23.

Line 23 - Overpayment of Tax

If the amount on line 21 is **larger** than the amount on line 17, there is an overpayment of tax. Subtract line 17 from line 21, and enter the difference.

Line 24 - Penalty and Interest

The S corporation may choose to calculate any penalty and interest due as a result of late filing, late payment of tax, or extension underpayment of tax. Interest is calculated on the amount shown on line 22 at the prevailing rate. The interest period is from the original due date of the return to the payment date. See the "Penalties and Interest" section beginning on page 3 of these instructions.

Do not include or enter the amount from the Estimated Tax Underpayment Penalty.

If the S corporation chooses not to calculate interest and penalties, the department will calculate them, and include that amount in any refund, or bill the taxpayer, as appropriate.

Line 25 - Estimated Tax Underpayment Penalty

Original returns: The S corporation DOES NOT HAVE TO COMPLETE Form 220, *Underpayment of Estimated Tax by Corporations*, if the S corporation made estimated tax payments equal to 90% of the current taxable year's tax liability, and paid in four equal installments. The department will compute the underpayment of estimated tax penalty based on this method and notify the S corporation of any amount due.

If the S corporation elects to have the department compute the penalty, do not check box **25A** or enter an amount on line 25.

The S corporation **MUST COMPLETE** Form 220, even though no penalty is due, if it made its estimated tax payments based on any of the following methods:

- The annualized income installment method;
- The adjusted seasonal installment method; or
- An amount, paid in four equal installments, that is equal to the sum of:

Ninety percent of the portion of the current taxable year's Arizona tax liability that is attributable to built-in gains income or certain capital gains income; **plus**

One hundred percent of the portion of the prior taxable year's Arizona tax liability that is attributable to excess net passive income.

Enter the total penalty from Form 220, Part C, line 37. Include the completed Form 220 with the return **and** check box **25A**.

Amended returns: Do not recompute the estimated tax underpayment penalty. Enter the amount from line 25 of the original return or the amount from an Arizona Department of Revenue correction notice.

Line 26 - Information Return Penalty

Original Returns: If no tax liability is due, and this return is filed late (including extension) or incomplete, enter the amount of the information return penalty on this line. The information return penalty is \$100 for each month, or fraction of a month, that the failure continues, up to a maximum penalty of \$500.

Amended Returns: Do not recompute the information return penalty. Enter the amount from line 26 of the original return or the amount from an Arizona Department of Revenue correction notice.

Line 27 - Total Due

If the taxpayer had a balance of tax due on line 22, add line 22, line 24 and line 25. Enter the total on line 27. S corporations that do not have a tax liability, enter the amount from line 26. This is the total amount due. Payments can be made via check, electronic check, money order, or credit card.

Check or Money Order

Make checks payable to Arizona Department of Revenue. Include the taxpayer's EIN on the front of the check or money order. Include the check or money order with the return.

Internet Payments

Corporate taxpayers must be licensed by the department before they can register to pay taxes online. Visit www.AZTaxes.gov to register and make payments over the internet.

Electronic payment from checking or savings account

Payments can be made electronically from a checking or savings account. Visit www.aztaxes.gov and choose the e-check option. There is no fee to use this method. This payment method will debit the amount from the specified checking or savings account on the date specified. If an electronic payment is made from a checking or savings account, a confirmation number will be generated. Please keep this confirmation number as proof of payment.

Credit card payment

Payments can be made via American Express, Discover, MasterCard or VISA credit cards. Visit www.aztaxes.gov and choose the credit card option. This will take you to the website of the credit card payment service provider. The service provider will charge a convenience fee based on the amount of the tax payment. The service provider will disclose the amount of the convenience fee during the transaction and the option to continue or cancel the transaction will be presented. If you accept the convenience fee and complete the credit card transaction, a confirmation number will be generated. Please keep this confirmation number as proof of payment.

Line 28 - Overpayment

If the taxpayer had an overpayment of tax on line 23, subtract the total of line 24 and line 25 from line 23. Enter a positive difference on line 28. This is the total overpayment. If the difference is negative, enter the difference as a positive number on line 27.

Line 29 - Overpayment Applied to Estimated Tax

Original Returns: The taxpayer may apply part or all of an overpayment reported on line 28 as a 2017 estimated tax payment. Enter the applicable amount on line 29.

Amended Returns: The taxpayer may apply part or all of an overpayment reported on line 28 as a 2017 estimated tax payment, if this amended return is filed during the taxpayer's taxable year 2017. Enter the applicable amount on line 29.

Line 30 - Refund

Subtract line 29 from line 28. Enter the difference. This is the net refund amount.

APPORTIONMENT OF INCOME

A.R.S. §§ 43-1131 through 43-1150 govern the apportionment of income. A corporation that engages in activities both within and without Arizona must apportion its business income based on property, payroll, and sales in Arizona as compared with everywhere. "Everywhere" means the property, payroll, and sales factors related to the whole combined or consolidated business.

NON-APPORTIONABLE INCOME

Apportionment factors generating non-apportionable or non-taxable (i.e. U.S. Interest) income are not to be included in the calculation of the apportionment ratio.

ADMINISTRATIVE RELIEF REQUESTS

A.R.S. § 43-1148 provides administrative relief if the allocation and apportionment provisions of UDITPA do not fairly represent the extent of the taxpayer's business activity in this state. The taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- Separate accounting, except with respect to an Arizona affiliated group, as defined in A.R.S. § 43-947.
- The exclusion of any one or more of the factors.
- The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state.
- The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income, other than disallowance of a properly elected consolidated return.

This section permits a departure from the allocation and apportionment provisions only in limited cases. A.R.S. § 43-1148 may be invoked only if unusual fact situations produce incongruous results under the apportionment and allocation provisions. Taxpayers seeking such relief should submit a letter to the Corporate Income Tax Audit Section 60 days prior to the filing of the return setting forth the relief that is requested and the justification for the relief.

The department normally makes such determinations only upon audit of the taxpayer. Such a detailed examination of the specific facts and circumstances reveals whether such unusual fact situations and incongruous results exist.

COMPUTING THE APPORTIONMENT RATIO

When computing the factors of the apportionment ratio, carry the result out to six (6) places after the decimal. If the seventh (7th) place after the decimal is five (5) or more, round the sixth (6th) decimal place up to the next higher digit. If the seventh (7th) place after the decimal is less than five (5), leave the sixth (6th) place decimal as it is.

Example #1:

| | |
|-------------------|----------------|
| Arizona Factor | <u>123,456</u> |
| Everywhere Factor | 789,654 |
| Factor | .1563418 |

The seventh (7th) digit after the decimal is “8”. Since “8” is greater than “5”, the sixth (6th) digit after the decimal is increased to the next higher digit, “2”.

The factor rounded to six (6) decimal places is .156342.

Example #2:

| | |
|---------------------|----------------|
| Total Ratio | <u>.179865</u> |
| Divided by | 4 |
| Apportionment Ratio | .0449662 |

The seventh (7th) digit after the decimal is “2”. Since “2” is less than “5”, the sixth (6th) digit after the decimal remains “6”. No increase to the sixth (6th) digit after the decimal is made.

The apportionment ratio rounded to six (6) decimal places is .044966.

Schedule ACA - AIR CARRIER Apportionment Formula
(Multistate S corporation Air Carriers Only)

A.R.S. § 43-1139(B) requires a taxpayer that is a qualifying air carrier to use revenue miles to apportion its business income to Arizona. The taxpayer must be engaged in air commerce. “Air commerce” means transporting persons or property for hire by aircraft in interstate, intrastate or international transportation.

The taxpayer must complete Schedule ACA. Schedule ACA is available on the department’s website. Check the box on line A on page 1. Do not complete Schedule A.

NON-AIR CARRIER APPORTIONMENT FORMULA
(NON-AIR CARRIER MULTISTATE S CORPORATIONS ONLY)

Non-air carrier multistate S corporations have the opportunity to choose one of two apportionment formulas for calculating the apportionment ratio:

- The enhanced apportionment formula, or
- The standard apportionment formula.

Check the box on line A of page 1 of the return to indicate which apportionment formula, “Standard” or “Enhanced”, will be used to calculate the apportionment ratio on the S corporation’s return. Whichever apportionment method is indicated, the taxpayer must complete the apportionment ratio using that formula. (The taxpayer cannot use “Standard” to calculate one factor of the ratio, and “Enhanced” to calculate another factor of the ratio.)

For the standard apportionment ratio, the numerator of the fraction of the standard apportionment formula is the property factor plus the payroll factor plus two times the sales factor. The denominator of the fraction is four. Use the numbers located on the left-hand side of Schedule A, column A, to weight the property, payroll, and sales factors respectively.

For the enhanced apportionment ratios, the numerator of the fraction is two and one-half (2.5) times the property factor plus two and one-half (2.5) times the payroll factor plus ninety-five (95) times the sales factor. The denominator of the fraction is 100. Use the numbers located on the right-hand side of Schedule A, column A to weight the property, payroll, and sales factors respectively.

Taxpayers apportioning income or (loss) must complete lines 5 through 10 on page 1.

Line A1 - Property Factor

The Property Factor is a fraction that represents the average value of the taxpayer’s property owned or rented and used in Arizona to the total average value of the taxpayer’s property owned or rented and used during the tax period.

The value of tangible personal property and real property owned by the taxpayer is its original cost. The taxpayer normally determines the average value of its owned property by averaging the values at the beginning and ending of the tax period. Property used to generate non-apportionable or non-taxable income is not included in the property factor.

The value of tangible personal property and real property rented by the taxpayer is eight (8) times its net annual rental rate. The net annual rental rate is the annual rental rate paid by the taxpayer for rented property, less the aggregate annual subrental rates paid by subtenants of the taxpayer. The taxpayer automatically achieves averaging for rented property by the method of determining the net annual rental rate of such property.

For a discussion of the treatment of computer software in the property factor, refer to *CTR 01-2, How Does a Taxpayer Filing an Arizona Corporate Income Tax Return Determine Whether Computer Software is Included in the Property Factor*.

Report real property situated and tangible personal property permanently located in Arizona as property within Arizona. Attribute the value of mobile property to Arizona based on the total time that the property was within Arizona.

Taxpayers Electing “STANDARD APPORTIONMENT”

- Check the box labeled “STANDARD” on line A of the return.
- Divide the numerator of the property factor by the denominator. The result is the “Standard” property factor. Express the ratio as a decimal carried out to six (6) places. The property factor will not exceed 1.0.

Taxpayers Electing "ENHANCED APPORTIONMENT"

- Check the box labeled "ENHANCED" on line A of the return.
- Multiply the numerator of the property factor by two and one-half (2.5). Divide that result by the denominator. The result is the "Enhanced" property factor. Express the ratio as a decimal carried out to six (6) places. The property factor may exceed 1.0 but may not exceed 2.5.

For additional information on the property factor, refer to: A.R.S. §§ 43-1140 through 43-1142
A.A.C. R15-2D-601 through R15-2D-607 and R15-2D-902
CTR 01-2, *How Does a Taxpayer Filing an Arizona Corporate Income Tax Return Determine Whether Computer Software is Included in the Property Factor*

Line A2 - Payroll Factor

The Payroll Factor is a fraction that represents the compensation paid in Arizona by the taxpayer to the total compensation paid by the taxpayer during the tax period.

Report the salaries, wages, or other compensation of officers, employees, etc., as within Arizona if the performance of their services occurs entirely in Arizona. This rule applies regardless of where payment is made or control exercised. This rule also applies regardless of whether the performance of the services is partly or wholly in connection with the apportionable business carried on outside the state or in interstate or foreign commerce. Payroll used to generate non-apportionable or non-taxable income is not included in the payroll factor.

Allocate the compensation of officers and employees who perform services partly within and partly without Arizona to this state when:

- The services performed outside of Arizona are incidental to the employee's service within Arizona; or
- The employee's base of operation is in Arizona; or
- The employee has no base of operation in any state but the direction or control of the employee is from Arizona; or
- The employee has no base of operation in any state, and there is no direction or control from a state in which the employee performs some part of his services, but the employee's residence is in Arizona.

Taxpayers Electing "STANDARD APPORTIONMENT"

- Check the box labeled "STANDARD" on line A of the return is checked
- Divide the numerator of the payroll factor by the denominator. The result is the "Standard" payroll factor. Express the ratio as a decimal carried out to six (6) places. The payroll factor will not exceed 1.0.

Taxpayers Electing "ENHANCED APPORTIONMENT"

- Check the box labeled "ENHANCED" on line A of the return.
- Multiply the numerator of the payroll factor by two and one-half (2.5). Divide that result by the denominator. The result is the "Enhanced" payroll factor. Express the ratio as a decimal carried out to six (6) places. The payroll factor may exceed 1.0 but may not exceed 2.5.

For additional information on the payroll factor, refer to: A.R.S. §§ 43-1143, 43-1144
A.A.C. R15-2D-701 through R15-2D-705

Line A3 - Sales Factor

The Sales Factor is a fraction that represents the total sales of the taxpayer in Arizona to the total sales of the taxpayer during the tax period.

"Sales" includes all gross receipts from transactions and activities in the course of the regular trade or business that produce income. (Gross receipts from non-apportionable or non-taxable income are not included in the sales factor.)

Sales of tangible personal property are sourced on a destination sales basis. Sales of real property is determined based on the location of the property. Generally, sales of other than tangible personal property is determined based on the location where the income producing activity occurs. Service income is determined based on the location of the income producing activity, *unless* the taxpayer elected to be treated as a Multistate Service Provider (MSP). (See the box below for a description of an MSP.)

TAXPAYERS THAT QUALIFY AS MULTISTATE SERVICE PROVIDERS ELECTING TO SOURCE SALES OF SERVICES TO ARIZONA USING A COMBINATION OF INCOME PRODUCING ACTIVITY SALES AND MARKET SALES

*For taxable years beginning from and after December 31, 2013, taxpayers that qualify as a MSP may elect to treat sales from service as being sourced to Arizona based on a combination of income producing activity sales and market sales. Multistate taxpayers complete Schedule MSP to determine if they qualify as a MSP. If the taxpayer qualifies, and wishes to make the election, the completed Schedule MSP must be included with the taxpayer's original, timely-filed tax return. (The election to be treated as a MSP **cannot** be made on an amended return.) Once made, the election is binding for five (5) years. For each year of the election period, Schedule MSP must be completed by the taxpayer to source sales from services to Arizona. Once Schedule MSP is completed, the taxpayer can compute the sales factor.*

Taxpayers that qualify, and who want to make the election, should:

- *Ensure the completed Schedule MSP is included with the return*
- *Ensure the box on Line B of the return is checked*
- *Ensure the box indicating the year of the election cycle is checked*
- *Enter on line A3b, column A, the Arizona sales from services from the completed Schedule MSP, line B5.*
- *Complete the calculation of the sales factor following the instructions for the taxpayer's choice of the "STANDARD" or "ENHANCED" apportionment formula.*

Taxpayers qualifying as an MSP, and electing to be treated as an MSP:

- Enter the Arizona sales from services on line A3b from the completed Schedule MSP, line B5.

Taxpayers not making the election to be treated as an MSP:

- Include Arizona sales from services on line A3c.
- Leave line A3b blank.

Taxpayers Electing "STANDARD APPORTIONMENT"

- Check the box labeled "STANDARD" on line A of the return.
- Multiply the numerator of the sales factor by two (2). Divide that result by the denominator. The result is the "Standard" sales factor. Express the ratio as a decimal carried out to six (6) places. The sales factor will not exceed 2.0.

Taxpayers Electing "ENHANCED APPORTIONMENT"

- Check the box labeled "ENHANCED" on line A of the return.
- Multiply the numerator of the sales factor by ninety-five (95). Divide that result by the denominator. The result is the "Enhanced" sales factor. Express the ratio as a decimal carried out to six (6) places. The sales factor may exceed 2.0 but may not exceed 95.0

For more information on the sales factor, refer to:

A.R.S. §§ 43-1145 through 43-1147

A.A.C. R15-2D-801 through R15-2D-807, and R15-2D-903

CTR 02-2, *Apportionment of Installment Sale Gain*

CTR 07-1, *Inclusion of Short Term Investments in the Sales Factor*

Line A4 - Total Ratio

Add the ratios for the property factor, the payroll factor, and the sales factor in Column C. Enter the total.

Line A5 - Average Apportionment Ratio

NOTE: Taxpayers must exclude a factor if both the numerator and the denominator of a factor are zero (0). Do not exclude a factor if the numerator of the factor is zero (0) and the denominator of a factor is greater than zero (0).

Taxpayers Electing "STANDARD APPORTIONMENT"

If either the property factor or the payroll factor is excluded, determine the average ratio by dividing the total ratio by three (3). If the sales factor is excluded, determine the average ratio by dividing the total ratio by two (2). If two of the factors are excluded, the remaining factor, without respect to any weighting, is the apportionment ratio.

Taxpayers Electing "ENHANCED APPORTIONMENT"

If either the property factor or the payroll factor is excluded, determine the average ratio by dividing the total ratio by ninety-seven and one-half (97.5). If the sales factor is excluded, determine the average ratio by dividing the total ratio by five (5). If two of the factors are excluded, the remaining factor, without respect to any weighting, is the apportionment ratio.

Taxpayers Electing "STANDARD APPORTIONMENT"

Divide the total ratio, line A4, column C, by four (4). Enter the average ratio here and on page 1, line 7. Express the ratio as a decimal carried out to six (6) places.

Taxpayers Electing "ENHANCED APPORTIONMENT"

Divide the total ratio, line A4, column C by 100. Enter the average ratio in column C, and on page 1, line 7. Express the ratio as a decimal carried out to six (6) places.

Schedule B - Other Information

Answer all questions as accurately and completely as possible.

Question B3: List the name, title and telephone number of the individual who Arizona Department of Revenue employees may contact to schedule an audit of this return. Confidential information may be disclosed to a principal corporate officer, any person designated by a principal corporate officer, any person designated in a resolution by the corporate board of directors or other similar governing body, or to an individual designated as an authorized representative in a valid power of attorney. A principal corporate officer of a parent corporation may execute a written authorization for a controlled subsidiary. If this individual is not a principal corporate officer, or is not designated as an authorized representative in a valid power of attorney, the taxpayer understands and agrees that confidential information may be disclosed to this individual.

Certification

One or more of the following officers (president, treasurer, or any other principal corporate officer) must sign the return.

Paid preparers: Sign and date the return. Complete the firm name and address lines (the paid preparer's name and address, if self-employed). Enter the paid preparer's TIN, which is the firm's EIN or the individual paid preparer's social security number.

Schedule K-1 - S corporation Instructions

Use this schedule for resident or part-year resident individual shareholders, resident estate shareholders, and resident trust shareholders.

Form 120S, Schedule K-1, is only required if the S corporation has capital gain (loss). If the S corporation does not have any capital gain (loss) for the taxable year, the filing of Form 120S, Schedule K-1, is not necessary.

Type or print the required information in the name, address, and information boxes on the top of the Form 120S, Schedule K-1. Indicate whether the S corporation's taxable year is a calendar year or a fiscal year; if a fiscal year, indicate the period covered by the taxable year on the schedule. Indicate whether this is an original or an amended schedule.

Part 1: Net Capital Gain from Investment in a Qualified Small Business – Information Schedule

For taxable years beginning from and after December 31, 2013, Arizona allows a subtraction from Arizona gross income for any net capital gain derived from investment in a qualified small business and included in the individual taxpayer's federal adjusted gross income or the federal taxable income of the estate and trust. A qualified small business is determined by the Arizona Commerce Authority pursuant to A.R.S. § 41-1518. Although the subtraction is only available to individuals, estates and trusts, an S corporation shareholder that is a pass-through entity (estate or trust) will need this information to calculate its subtraction or complete the Arizona Form 141AZ, Schedule K-1 or Schedule K-1(NR), for each beneficiary.

If the shareholder's federal Schedule K-1 (Form 1120-S) includes any net capital gain (loss) from investment in a

qualified small business, the S corporation should complete Part 1, line 1 and Part 2, line 3. If Part 1, line 1, is zero, put zero on line 3.

If the shareholder's federal Schedule K-1 (Form 1120-S) does not include any net capital gain (loss) from investment in a qualified small business, the S corporation is not required to complete Part I and Part II, line 3.

Part 2: Net Long-Term Capital Gain Subtraction – Information Schedule

Arizona allows a subtraction from Arizona gross income for a percentage of any net long-term capital gain from assets acquired **after** December 31, 2011 that is included in the individual taxpayer's federal adjusted gross income or the federal taxable income of the estate or trust. Although the subtraction is only available to individuals, estates and trusts, a shareholder that is a pass-through entity (estate or trust) will need this information to calculate the subtraction for the estate or trust or complete the Arizona Form 141AZ, Schedule K-1 or Schedule K-1(NR), for each beneficiary.

For the resident and part-year resident individual shareholder, Form 120S, Schedule K-1, provides information so the shareholder can calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011.

For the resident estate shareholder or resident trust shareholder, Form 120S, Schedule K-1, provides information to the shareholder so the shareholder can (1) calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011; and/or (2) provide information to each beneficiary so each beneficiary can calculate its subtraction for net long-term

Complete Part 2, line 2 and line 3 (if applicable) of Form 120S, Schedule K-1, as instructed on the form. If the shareholder's federal Schedule K-1 (Form 1120-S) does not include any capital gain (loss), the S corporation is not required to complete Part II.

A worksheet is provided at the end of these instructions that may assist the S corporation in determining the amounts to include in Part 2, line 2 for each shareholder's Form 120S, Schedule K-1.

Schedule K-1(NR) - S corporation Instructions

Use this schedule for nonresident individual shareholders, nonresident estate shareholders, nonresident trust shareholders and exempt organization shareholders.

Type or print the required information in the name, address, and information boxes on the top of the Form 120S, Schedule K-1(NR). Indicate whether the S corporation's taxable year is a calendar year or a fiscal year; if a fiscal year, indicate the period covered by the taxable year on the schedule. Indicate whether this is an original or an amended schedule.

Part 1: Share of Income and Deductions

Column (a) - Distributive Share Amount

Wholly Arizona S corporations - in column (a), enter the distributive share amount for each line item from the federal Form 1120-S, Schedule K-1.

Multistate S corporations - in column (a), enter the nonresident shareholder's distributive share of the multistate S corporation's income (loss) that is subject to apportionment from the federal Form 1120-S, Schedule K-1.

Column (b) - Arizona Apportionment Ratio

Wholly Arizona S corporations - enter 100%.

Multistate S corporations - enter the average ratio amount from Form 120S, Schedule A, line A5, column C, or Schedule ACA, line 3. (Refer to Schedule A or Schedule ACA instructions.)

Column (c) - Arizona Source Income

Wholly Arizona S corporations - multiply column (a) by column (b). Enter the result in column (c).

Multistate S corporations - include a schedule that details (for each line item) the following computation:

- Step 1 The shareholder's distributive share of the S corporation's income subject to apportionment multiplied by the average ratio in column (b).
- Step 2 The shareholder's distributive share of the S corporation's income (loss) which is specifically allocable to Arizona.
- Step 3 The total of the amounts computed in steps 1 and 2 that is to be entered in column (c).

NOTE: Do not include the amount of any nonbusiness income allocable to another state in the total entered in column (c).

All S corporations - Column (c) is the shareholder's Arizona source income from the S corporation. Shareholders should refer to the instructions for Form 120S, Schedule K-1(NR), for information on completing their Arizona tax returns.

Part 2: Net Capital Gain From Investment in a Qualified Small Business – Information Schedule

For taxable years beginning from and after December 31, 2013, Arizona allows a subtraction from Arizona gross income for any net capital gain derived from investment in a qualified small business and included in the individual taxpayer's federal adjusted gross income or the federal taxable income of the estate and trust. A qualified small business is determined by the Arizona Commerce Authority pursuant to *A.R.S. § 41-1518*. Although the subtraction is only available to individuals, estates and trusts, an S corporation shareholder that is a pass-through entity (estate or trust) will need this information to calculate its subtraction or complete the Form 141AZ, Schedule K-1 or Schedule K-1(NR), for each beneficiary.

If the shareholder's federal Schedule K-1 (Form 1120-S) includes any net capital gain (loss) from investment in a qualified small business, the S corporation should complete Part 2, line 16, and Part 3, line 18. If Part 2, line 16, is zero, put zero on line 18.

If the shareholder's federal Schedule K-1 (Form 1120-S) does not include any net capital gain (loss) from investment in a qualified small business, the S corporation is not required to complete Part II or Part III, line 18.

Part 3: Net Long-Term Capital Gain Subtraction – Information Schedule

For the nonresident individual shareholder, Part III provides information so the shareholder can calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011.

For the nonresident estate shareholder or nonresident trust shareholder, Part 3 provides information so the shareholder can (1) calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011; and/or (2) provide information to each beneficiary so each beneficiary can calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011.

The subtraction is only available to individuals, estates, and trusts.

A worksheet is provided at the end of these instructions that may assist the S corporation in determining the amounts to include on Part 3, line 17, of each nonresident shareholder's Arizona Form 120S, Schedule K-1(NR).

Shareholder Reporting Requirements for 2016

Exempt Organization Shareholders

Exempt organization shareholders must file Form 99T, *Arizona Exempt Organization Business Income Tax Return*, to report the income (loss) from the S corporation. This income (loss) is included in the organization's unrelated business taxable income from the federal Form 990-T.

Resident or Part-Year Resident Individual Shareholders

Resident or part-year individual shareholders are taxable on their entire distributive share of income from the S corporation. The distributive share of income reported on the federal return will flow through to Form 140, *Resident Personal Income Tax Return* or Form 140PY, *Part-Year Resident Personal Income Tax*.

Nonresident Individual Shareholders

Nonresident individual shareholders of S corporations operating in Arizona are subject to Arizona income tax on their distributive share of the income (loss) earned by the S corporation in Arizona. Refer to Arizona Form 120S, Schedule K-1(NR). Nonresident shareholders must file Form 140NR, *Nonresident Personal Income Tax Return*, to report this income (loss).

Composite return: The Arizona Department of Revenue will accept a composite return filed by the S corporation on Form 140NR for nonresident individual shareholders so long as the return includes ten or more participating members.

Refer to *Individual Income Tax Ruling (ITR) 16-2*, for more information regarding filing a composite return on Form 140NR.

Estate and Trust Shareholders

Shareholders that are estates or trusts are taxable on their entire distributive share of income from the S corporation. Resident trust or estate distributive share income will flow through to Form 141AZ, *Arizona Fiduciary Income Tax Return*. Nonresident estate or trust distributive share income should be reported on Schedule A of Form 141AZ, *Arizona Fiduciary Income Tax Return*.

The instructions for the *Worksheet for Net Long-Term Capital Gain Subtraction for Assets Acquired After December 31, 2011*, are on the next page.

Worksheet for Net Long-Term Capital Gain Subtraction for Assets Acquired After December 31, 2011

Original return Amended return

| Net long-term capital gain (loss) as reported on federal Schedule D (or other form/schedule) and included in the distributive share amount. Enter the total net long-term capital gain (loss) from the following forms in each applicable column. See instructions on the following page. | | (a) | (b) | (c) |
|---|---|-----------------------------------|---|--|
| | | Net long-term capital gain (loss) | Net long-term capital gain (loss) included in column (a) from assets acquired before January 1, 2012 | Net long-term capital gain (loss) included in column (a) from assets acquired after December 31, 2011 |
| 1 | Long-term capital gain (loss) reported on federal Schedule D from Form(s) 8949. Combine the amounts and enter the total. | 1 | | |
| 2 | Form(s) 6252 <i>Installment Sale Income</i> | 2 | | |
| 3 | Form(s) 8824 <i>Like-Kind Exchanges</i> | 3 | | |
| 4 | Pass-through from Estate, Partnership, and/or Trust – from Arizona Form 141AZ or Form 165, Schedule K-1 or Schedule K-1(NR). | 4 | | |
| 5 | Any other long-term capital gain (loss) | 5 | | |
| 6 | Net long-term capital gain (loss). Add lines 1 through 5 in each column and enter the total(s). For each shareholder, enter the distributive share of the amounts from line 6 on Form 120S, Schedule K-1 or Schedule K-1(NR). | 6 | | |

Worksheet Instructions

Purpose of the Worksheet

Beginning in 2013, a subtraction is available for a percentage of any net long-term capital gain that is from an investment in an asset acquired after December 31, 2011, and included in an individual taxpayer's federal adjusted gross income or the federal taxable income of an estate or trust.

To take the allowable subtraction, the taxpayer must know whether the capital gain (loss) is considered short-term or long-term. Only the net long-term capital gain from assets acquired after December 31, 2011, is used to compute the allowable subtraction. For more information about determining whether a gain (loss) is short-term or long-term, see federal *Publication 544* at www.irs.gov.

NOTE: *If you cannot verify that the capital gain is from the sale of an asset acquired after December 31, 2011, then the capital gain should be treated as a capital gain asset acquired before January 1, 2012.*

An asset acquired by gift or inheritance is considered acquired on the date it was acquired by the gift-giver or the deceased individual.

Who Should Complete the Worksheet?

The S corporation can use this worksheet to calculate each shareholder's distributive share of the net long-term capital gain (loss) included in Schedule K of federal Form 1120-S for assets purchased after December 31, 2011.

Do not complete this worksheet if either of the following apply:

- The S corporation does not have any capital gain (loss) to report for the current tax year; or
- The S corporation does not have any net capital gain (loss) from asset(s) acquired after December 31, 2011, to report for the current tax year.

Keep the completed worksheet for the S corporation's records.

Columns (a) through (c)

- Column (a) is the total amount of net long-term capital gain (loss) reported on Schedule D or other federal forms/schedules.
- Column (b) is the amount of the net long-term capital gain (loss) included in column (a) for assets acquired **before** January 1, 2012.
- Column (c) is the amount of the net long-term capital gain (loss) included in column (a) for assets acquired **after** December 31, 2011.

Lines 1 through 5 - Capital Gain (Loss) Reported on Federal Schedule D

Enter the long-term capital gain (loss) from each federal form listed that was reported on the S corporation's federal Schedule D and included on Schedule K of federal Form 1120-S.

Line 6 - Net Long-Term Capital Gain (Loss)

For each column, add the amounts on lines 1 through 5 and enter the total.

For each shareholder, enter the distributive share of the amounts from line 6 on Part 2 of Form 120S, Schedule K-1 or on Part 2 of Form 120S, Schedule K-1(NR).