

2011 Arizona Partnership Income Tax Return

Obtain additional information or assistance by calling one of the numbers listed below:

Phoenix	(602) 255-3381
From area codes 520 and 928, toll-free	(800) 352-4090
Hearing impaired TDD user	
Phoenix	(602) 542-4021
From area codes 520 and 928, toll-free	(800) 397-0256

Obtain tax rulings, tax procedures, tax forms and instructions, and other tax information by accessing the department's Internet home page at www.azdor.gov.

General Instructions

Who Must Use Form 165

File Arizona Form 165 for every domestic partnership including syndicates, groups, pools, joint ventures, and every foreign partnership (syndicate, pool, etc.) doing business in Arizona.

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. Refer to Arizona Partnership Tax Ruling PTR 97-1 for further information.

Limited Liability Companies

Under the provisions of the Arizona Limited Liability Company Act, a limited liability company is classified as a partnership, or as a corporation, or is disregarded as an entity as determined under the Internal Revenue Code as defined in ARS § 43-105. A limited liability company classified as a partnership for federal tax purposes must file Form 165. A limited liability company classified as a corporation for federal tax purposes must file Form 120. A limited liability company classified as a corporation for federal tax purposes 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 for federal tax purposes is included in the Arizona return of its owner. Refer to Arizona Partnership Tax Ruling PTR 97-2 for further information.

Taxable Year Covered by Return

The partnership must have the same taxable year for Arizona purposes as it has for federal purposes. Indicate the period covered by the taxable year and whether the taxable year is a calendar year or a fiscal year.

Filing Original Returns

Returns are due by the 15th day of the fourth month following the close of the taxable year (April 17, in the case of a 2011 calendar year return). If the partnership has a valid federal or Arizona extension, file the return by the extended due date. If the partnership files under an extension, the taxpayer must check box 82E, on page 1 of the return. Attach a copy of the completed federal Form 1065 and supporting schedules to the Arizona return. File the return with the Arizona Department of Revenue, PO Box 52153, Phoenix AZ 85072-2153.

The department normally determines the timeliness of a return by the postmark or other official mark of the U.S. Postal Service stamped on the envelope in which the return is mailed. Refer to Arizona General Tax Ruling GTR 93-1 for further information. The department will also accept proof of mailing from a private delivery service included in the Internal Revenue Service list of designated private delivery services. Contact the private delivery service for information regarding how to obtain written proof of mailing.

Extension of Time to File a Return

The partnership can apply for an Arizona extension by filing a completed Form 120EXT by the original due date of the return. The partnership can substitute a valid federal extension for an Arizona extension.

NOTE: *Arizona's extension conforms to the federal extension, which allows partnerships an additional five months after the original due date to file the income tax return. See Arizona Partnership Tax Ruling (PTR) 09-1.*

Composite returns: Use Form 204 to request an extension of time to file a composite return on Form 140NR for qualifying nonresident individual partners.

Filing Amended Returns

Any taxpayer who files an amended return with the Internal Revenue Service must file an Arizona amended return on Form 165 within 90 days of its final determination by the IRS.

The taxpayer must report changes or corrections of the taxpayer's taxable income by the Internal Revenue Service or as the result of renegotiation of a contract or subcontract with the United States to the department. The taxpayer must, within 90 days after the final determination of the change or correction, either:

- File a copy of the final determination with the department, concede the accuracy of the determination or state any errors, and request the department to recompute the tax owed to Arizona; or
- File an amended return as required by the department.

The taxpayer must include additional schedules that provide sufficient information for the department to recompute the taxpayer's Arizona taxable income based on the Revenue Agent Report (RAR) changes. The department may require the taxpayer to file an amended return if the department does not have the necessary information to recompute the tax owed to Arizona.

NOTE: *File amended returns for prior taxable years on Form 165 for those taxable years. Use the 2011 Form 165 to amend only the taxable year 2011.*

Do not file an amended return until the original return has been processed.

Records

The partnership should maintain books and records substantiating information reported on the return and keep these documents for inspection. Arizona General Tax Ruling GTR

96-1 discusses the general requirements for the maintenance and retention of books, records and other sources of information received, created, maintained or generated through various computer, electronic and imaging processes and systems. Refer to this tax ruling for further information.

Partnerships should complete three copies of Form 165, Schedule K-1 or Schedule K-1(NR) for each partner. File one copy of each partner's Schedule K-1 with the partnership's Form 165. Provide all partners with a copy of their Schedule K-1. Retain a copy for the partnership's records.

OPTIONAL REPORTING FORMAT FOR FORM 165, Schedule K-1 and Schedule K-1(NR): The Department of Revenue will accept a hard copy spreadsheet that contains all the requested information or the information may be submitted on electronic media as a Microsoft Excel spreadsheet or pdf file on a CD-ROM or DVD. The chosen media must be Microsoft Windows compatible.

Taxpayers submitting the information on CD-ROM or DVD should secure the CD-ROM or DVD in a hard case and include it with the tax return. The Schedule K-1 and Schedule K-1(NR) submitted on CD-ROM or DVD are part of the income tax return and are subject to the sworn statement on the return that they are true and correct to the best of the signer's knowledge and belief.

The CD-ROM or DVD should be labeled with the partnership's name, employer identification number, taxable year and Form 165, Schedule K-1/K-1(NR). Partnerships may password protect the CD-ROM or DVD and email the password separately to MediaLibrarian@azdor.gov. The Department of Revenue **will not** return or copy any media.

CAUTION: The partnership substitutes the CD-ROM or DVD at its own risk and understands that the information may need to be provided to the department again at a later date if it is not accessible by the department for any reason.

The Department is currently evaluating other methods of accepting the required schedules. Please contact the Process Administration Section at (602) 716-7095 for the most updated filing options.

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.

Penalties

This form is an information return. 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.

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.

Specific Instructions

Type or print the required information in the name, address, and information boxes on the top of page 1. Indicate the period covered by the taxable year and whether the taxable year is a calendar year or a fiscal year. Indicate whether this return is an original or an amended return.

Enter the partnership's employer identification number, which is the taxpayer identification number (TIN). If the partnership has an Arizona transaction privilege tax number, enter the number in the place provided.

All returns, statements, and other documents filed with the department require a TIN. The TIN for a corporation, S corporation, or a partnership is the taxpayer's employer identification number (EIN). The TIN for an individual is the taxpayer's social security number or an IRS individual taxpayer identification number. The TIN for a paid tax return preparer is that individual's social security number, preparer tax identification number, or the employer identification number of the business. Taxpayers and tax preparers who fail to include their TIN may be subject to a penalty.

If the taxpayer has a valid federal or Arizona extension, file the return by the extended due date. If the taxpayer files under extension, the taxpayer must check box 82E on page 1 of the return.

Other Information (Page 1)

Answer all questions (A through M).

Information Question E: Enter the total number of entity partners (exempt organizations, corporations, S corporations, trusts, estates, partnerships).

NOTE: *The total of the amounts entered for questions C, D, and E should equal the total number of partners.*

Information Question L: Report any adjustments made by the Internal Revenue Service to any federal income tax return filed by the partnership not previously reported to the department. Submit these adjustments separately to Arizona Department of Revenue, PO Box 52153, Phoenix, AZ 85072-2153.

Adjustment of Partnership Income From Federal to Arizona Basis

Note: The 2004 Internal Revenue Code conformity bill (SB 1389) made changes affecting tax years beginning from and after December 31, 1999. Arizona conforms but makes specific additions and subtractions that have the effect of not conforming to the increased IRC § 179 expense limitation and the 30% and 50% bonus depreciation provisions of IRC § 168(k). Because depreciation is reported at the partnership level, adjustments will need to be made in the partnership additions and subtractions. Because IRC § 179 expenses are reported at the partner level, Form 165 requires no adjustments relating to those expenses. Partners must make the adjustments on their income tax returns (for example, on Form 140 or Form 120).

Note: The 2009 Internal Revenue Code conformity bill (HB 2156) made changes affecting tax years beginning from and after

December 31, 2008. Arizona conforms but makes specific additions and subtractions that have the effect of not conforming to the deferral of discharge of indebtedness (DOI) income under IRC § 108(i) and the deferral of original issue discount (OID) deduction under IRC § 108(i). Because the partnership can determine the amount of deferred DOI and OID to allocate to each partner in any manner, not necessarily based on ownership or profit percentage, Form 165 requires no adjustments relating to these deferrals. Partners must make the adjustments on their income tax returns (for example, on Form 140 or Form 120).

Line 1 - Federal Ordinary Business and Rental Income

Enter the total of ordinary income (loss) from trade or business activities, rental real estate activities, and other rental activities from the federal Form 1065, Schedule K. Attach a copy of the federal Form 1065 and its component schedules.

Schedule A - Additions to Partnership Income

Line A1 - Total Federal Depreciation

Enter the total amount of depreciation deducted on the federal return. Do not include depreciation included on line A3.

Line A2 - Non-Arizona Municipal Bond Interest

Enter interest income received from any state or municipal obligations (other than Arizona) credited to or earned by the partnership during the taxable year. Reduce the amount of interest income by the amount of any interest on indebtedness and other related expenses incurred or continued to purchase or carry those obligations that were not otherwise deducted or subtracted in the computation of Arizona gross income. Do not include interest from obligations specifically exempt from Arizona income tax, nor any related expenses.

Line A3 - Capital Investment by Certified Defense Contractor

- **Federal Depreciation or Deduction for Cost of Capital Investment**

If the taxpayer was a certified defense contractor that previously elected to amortize capital investments in accordance with ARS § 43-1024, enter the amount of IRC § 167 depreciation or IRC § 179 expense deducted in calculating federal taxable income that was not already included on line A1. This adjustment must continue until the property is completely depreciated, otherwise disposed of, or the taxpayer opts out of the election. This adjustment should not be made for property placed in service after the certification expired.

- **Gain on Sale of Capital Investment**

Enter the amount of gain from the sale or other disposition of a capital investment which a certified defense contractor elected to amortize pursuant to ARS § 43-1024.

Line A4 - Additions Related to Arizona Tax Credits

Enter on line A4 the following additions to partnership income that are related to Arizona tax credits. Attach a schedule detailing these additions.

A. Environmental Technology Facility Credit

These adjustments apply to partnerships that elected to claim a tax credit under ARS § 43-1080 or § 43-1169 and have sold or otherwise disposed of the facility or any component of the facility during the taxable year.

- **Excess Federal Depreciation or Amortization**

Enter the excess of depreciation or amortization computed on the federal basis of the facility over depreciation or amortization computed on the Arizona adjusted basis of the facility.

- **Excess in Federal Adjusted Basis**

Enter the amount by which the federal adjusted basis of the facility exceeds the Arizona adjusted basis of the facility.

B. Pollution Control Credit

- **Excess Federal Depreciation or Amortization**

Enter the excess of depreciation or amortization computed on the federal basis of the property over depreciation or amortization computed on the Arizona adjusted basis of the property. Make this adjustment for the property for which the partnership elected to claim a tax credit under ARS § 43-1081 or § 43-1170.

- **Excess in Federal Adjusted Basis**

Enter the amount by which the federal adjusted basis of the property exceeds the Arizona adjusted basis of the property. Make this adjustment if the property for which the partnership elected to claim a tax credit under ARS § 43-1081 or § 43-1170 was sold or otherwise disposed of during the taxable year.

C. Credit for Taxes Paid for Coal Consumed in Generating Electrical Power in Arizona

Enter the amount of expenses deducted pursuant to the Internal Revenue Code for which the taxpayer claimed the credit for taxes paid for coal consumed in generating electrical power in Arizona. The addition is required for the amount of Arizona transaction privilege taxes and Arizona use taxes included in the computation of federal taxable income for which the Arizona credit is claimed under ARS § 43-1178.

D. Credit for Solar Hot Water Heater Plumbing Stub Outs or Electric Vehicle Recharge Outlets

Enter the amount of expenses deducted in computing Arizona taxable income for the installation of solar hot water heater plumbing stub outs or electric vehicle recharge outlets for which the taxpayer claimed the credit under ARS § 43-1090 or § 43-1176.

E. Credit for Employment of Temporary Assistance for Needy Families (TANF) Recipients

Enter the amount of wage expenses deducted pursuant to the Internal Revenue Code for which the taxpayer claimed the TANF credit under ARS § 43-1087 or § 43-1175.

F. Agricultural Pollution Control Equipment Credit

• Excess Federal Depreciation or Amortization

Enter the excess of depreciation or amortization computed on the federal basis of the property over depreciation or amortization computed on the Arizona adjusted basis of the property. Make this adjustment for the property for which the partnership elected to claim a tax credit under ARS § 43-1081.01 or § 43-1170.01.

• Excess in Federal Adjusted Basis

Enter the amount by which the federal adjusted basis of the property exceeds the Arizona adjusted basis of the property. Make this adjustment if the property for which the partnership elected to claim a tax credit under ARS § 43-1081.01 or § 43-1170.01 was sold or otherwise disposed of during the taxable year.

G. Credit for Donation of School Site

Enter the amount deducted pursuant to the Internal Revenue Code representing a donation of a school site for which the taxpayer claimed the credit for donation of school site under ARS § 43-1089.02 or § 43-1181.

H. Motion Picture Credits

This credit is in lieu of any allowance for deduction of expenses related to the production or related to a transferred credit. Enter the amount of any such expenses that were deducted in computing federal taxable income for which the credit was claimed or transferred under ARS § 43-1075 or § 43-1163.

I. Credit for Corporate Contributions to School Tuition Organizations

Enter the amount deducted in computing federal taxable income as contributions for which a credit is claimed under ARS § 43-1183.

J. Credit for Water Conservation System Plumbing Stub Outs

Enter the amount of expenses deducted in computing Arizona taxable income for the installation of water conservation system plumbing stub outs for which the taxpayer claimed the credit under ARS § 43-1182.

K. Credit for Corporate Contributions to School Tuition Organizations for Displaced Students or Students With Disabilities

Enter the amount deducted in computing federal taxable income as contributions for which a tax credit is claimed under ARS § 43-1184.

Line A5 - Other Additions to Partnership Income

Enter the following "other additions" to the partnership income reported on line 1. Attach a schedule listing each item separately.

A. Excess of a Partner's Share of Partnership Taxable Income or Loss

Make this adjustment if the partnership is a partner of another partnership. Enter the excess of a partner's share of partnership taxable income or loss included under ARS

§§ 43-1401 through 43-1413 over the income reported under IRC § 702(a)(8).

B. Income Recognized Because of Difference in Adjusted Basis of Property

Enter the amount by which the adjusted basis of property described in ARS § 43-1021(7), computed according to the Internal Revenue Code, exceeds the adjusted basis according to Arizona law. Basis computed according to Arizona law means according to Title 43 of the Arizona Revised Statutes effective January 1, 1979, and the Income Tax Act of 1954, as amended. This adjustment applies to all property, held for the production of income, sold, or otherwise disposed of during the taxable year. This adjustment does not apply to depreciable property used in a trade or business.

C. Federal Amortization of Pollution Control Devices and Federal Depreciation of Child Care Facilities

Arizona's statutes, which allow special amortization for pollution control devices and for the cost of day care facilities, are no longer applicable to partnerships. However, if the partnership elected to claim the special amortization under Arizona's former statutory provisions, the partnership must continue to amortize these items in accordance with those provisions. Therefore, the partnership must make the same additions to and subtractions from Arizona gross income that Arizona's former statutory provisions required. If this applies to the partnership, enter the amount of amortization or depreciation deducted for these items on the federal partnership return.

Line 2 - Total Additions to Partnership Income

Add lines A1 through A5. Enter the total.

Line 3 - Subtotal

Add lines 1 and 2. Enter the total.

Schedule B - Subtractions From Partnership Income

Line B1 - Recalculated Arizona Depreciation

Enter the total amount of depreciation allowable pursuant to IRC § 167(a) for the taxable year calculated as if the taxpayer had elected not to claim bonus depreciation for eligible properties for federal purposes. Do not include amortization included on Line B6.

Line B2 - Basis Adjustment for Property Sold or Otherwise Disposed of During the Taxable Year

With respect to property that is sold or otherwise disposed of during the taxable year by a taxpayer who has complied with the requirement to add back all depreciation with respect to that property on tax returns for all taxable years beginning from and after December 31, 1999, enter the amount of depreciation that has been allowed pursuant to IRC § 167(a) to the extent that the amount has not already reduced Arizona taxable income in the current or prior years. The effect of this is to allow a subtraction for the difference in basis for any asset for which bonus depreciation has been claimed on the federal return.

Line B3 - Interest From U.S. Government Obligations

Enter the interest income received from U.S. obligations included on the federal Form 1065, Schedule K, exempt from state income taxes under federal law.

NOTE: *Not all obligations associated with the federal government are obligations of the federal government. Obligations of the Government National Mortgage Association (GNMA) or the Federal National Mortgage Association (FNMA) are not obligations of the U.S. government and, therefore, are taxable to Arizona.*

Line B4 - Difference in Adjusted Basis of Property

Enter the amount by which the adjusted basis of property described in this paragraph, computed according to Arizona law, exceeds the adjusted basis of such property computed according to the Internal Revenue Code. Basis computed according to Arizona law means according to Title 43 of the Arizona Revised Statutes, effective January 1, 1979, and the Income Tax Act of 1954, as amended. This adjustment applies to all property held for the production of income sold or otherwise disposed of during the taxable year. This adjustment does not apply to depreciable property used in a trade or business.

Line B5 - Agricultural Crops Charitable Contribution

Enter the amount of the allowable subtraction for qualified crop contributions made during the taxable year to one or more Arizona tax exempt charitable organizations for use in Arizona. Refer to Arizona Individual Income Tax Procedure ITP 93-2 for information on how to determine if the contribution qualifies for the subtraction.

Line B6 - Capital Investment by Certified Defense Contractor

- Arizona Amortization of Cost of Capital Investment**

If the taxpayer was a certified defense contractor that previously elected to amortize capital investments in accordance with ARS § 43-1024, enter the amount allowed by ARS § 43-1024 that was not already included on line B1, for assets placed in service while certified. This adjustment must continue until the property is completely depreciated, otherwise disposed of, or the taxpayer opts out of the election. This adjustment should not be made for property placed in service after the certification expired.

- Gain on Sale of Capital Investment**

Enter the amount of gain included in Arizona gross income on the sale or other disposition of a capital investment. Make this adjustment if a certified defense contractor elected to amortize the capital investment pursuant to ARS § 43-1024.

Line B7 - Other Subtractions From Partnership Income

Enter the following "other subtractions" from partnership income; attach a schedule listing each item separately.

A. Excess of Partner's Share of Partnership Income or Loss

Make this adjustment if the partnership is a partner in another partnership. Enter the excess of the partner's share of the income or losses included under IRC § 702(a)(8) over the income included under ARS §§ 43-1401 through 43-1413.

B. Mine Exploration Expenses

Arizona no longer has special mine exploration expense provisions for partnerships. Arizona now conforms to the federal treatment of mine exploration expenses. However, if the partnership deferred exploration expenses under Arizona's former provisions, the partnership may subtract such deferred expenses. The partnership claims the subtraction on a ratable basis as the units of produced ores or minerals discovered or explored as a result of such expenditures are sold. Enter the amount of such deferred exploration expenses.

C. Interest on Federally Taxable Arizona Obligations

Enter the amount of interest income received on obligations of the State of Arizona, or any of its political subdivisions, included on the federal Form 1065, Schedule K. Omit interest income received on obligations of the State of Arizona, or any of its political subdivisions, exempt from federal taxation and not included in the partnership's federal distributive income.

D. Wood Stoves, Wood Fireplaces or Gas-Fired Fireplaces

Enter the amount allowed by ARS § 43-1027 for the cost of *converting* an existing wood fireplace to a qualified wood stove, wood fireplace, or gas-fired fireplace on property located in Arizona.

E. Employer Contributions to Medical Savings Accounts

Enter the amount of contributions made by the partnership during the taxable year to medical savings accounts established on behalf of the partnership's employees as provided by ARS § 43-1028. The subtraction is allowed for such contributions to the extent that the contributions are not deductible by the partnership under the Internal Revenue Code.

F. Expenses Related to Certain Federal Tax Credits

Enter the amount of wages or salaries paid or incurred by the taxpayer for the taxable year not deducted in the computation of Arizona gross income if the taxpayer received certain federal tax credits. The specific federal tax credits are the work opportunity credit, the empowerment zone employment credit, the credit for employer-paid social security taxes on employee cash tips, and the Indian employment credit.

Line 4 - Total Subtractions From Partnership Income

Add lines B1 through B7. Enter the total.

Line 5 - Partnership Income Adjusted to Arizona Basis

Subtract line 4 from line 3. Enter the difference. This is the partnership income adjusted to an Arizona basis.

Line 6 - Net Adjustment of Partnership Income From Federal to Arizona Basis

Subtract line 1 from line 5. Enter the difference. This is the adjustment of partnership income from federal to Arizona basis that will be reported on Form 165, Schedules K-1 and K-1(NR).

Line 7 - Penalty

This form is an information return. An information return that is incomplete or filed after its due date (including extensions) is subject to a penalty of \$100 per month, or fraction of a month, the failure continues, up to a maximum penalty of \$500.

If the partnership files this return after its due date (including extensions), enter the amount of the penalty on this line. 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. Write the partnership's EIN on the front of the check or money order. Include the check or money order with the return.

Internet Payments

Partnerships must be licensed by the Department of Revenue before they can register to pay taxes online. Go to 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. Go to 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. Go to 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.

Schedule C - Apportionment Formula

NOTE: *Qualifying multistate air carriers are required to use revenue miles, and cannot use Schedule C. Multistate air carriers must use Schedule ACA, which is a separate form available on the department's website: www.azdor.gov. See Schedule ACA for information.*

ARS § 43-306 requires partnerships having nonresident partners to allocate and apportion their income under the Arizona Uniform Division of Income for Tax Purposes Act (ARS §§ 43-1131 through 43-1150). The basis of the apportionment formula is property, payroll, and sales in Arizona as compared with everywhere. "Everywhere" means the property, payroll, and sales related to the whole business.

In addition to being required for partnerships with nonresident partners, all partnerships with corporate partners may use Schedule C to provide partners with information needed to accurately allocate and apportion Arizona source income.

For tax years beginning from and after December 31, 2006, non-air carrier multistate partnerships have the opportunity to choose one of two apportionment formulae for calculating the apportionment ratio. Non-air carrier multistate partnerships may select the enhanced sales factor formula. The standard sales factor formula must be used by partnerships not selecting to use the enhanced sales factor formula.

The numerator of the fraction of the standard sales factor formula is the property factor plus the payroll factor plus two times the sales factor. The denominator of the fraction is four. For tax years beginning from and after December 31, 2008, the numerator of the fraction of the enhanced sales factor formula is the property factor plus the payroll factor plus eight times the sales factor. The denominator of the fraction is ten.

NOTE: *When computing the factors of the apportionment ratio, 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.*

Line C1 - Property Factor

Refer to AAC R15-2D-601 through R15-2D-607 and R15-2D-902. The value of tangible personal property and real property owned by the partnership is its original cost. The partnership normally determines the average value of its owned property by averaging the values at the beginning and ending of the tax period. Refer to Arizona Corporate Tax Ruling CTR 01-2 regarding the treatment of computer software in the property factor (whether to include it and attribution to particular state(s) in the numerator).

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

Report real property situated in and tangible personal property permanently located in Arizona as property within Arizona, if connected with the business activity. Allocate the value of mobile property to Arizona based on the total time the property was within Arizona.

Compute the property factor on line C1(c), by dividing column A by column B and entering the resulting ratio in column C. Express the ratio as a decimal carried out to six

places. The property factor on line C1(c), column C, will never exceed 100 percent.

Line C2 - Payroll Factor

Refer to AAC R15-2D-701 through R15-2D-705. Report salaries, wages, or other compensation of officers, employees, etc., as within Arizona if performance of the services occurs here. 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.

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.

Compute the payroll factor on line C2 by dividing column A by column B and entering the resulting ratio in column C. Express the ratio as a decimal carried out to six places. The payroll factor on line C2, column C, will never exceed 100 percent.

Instructions for the standard sales factor formula are below. If you have selected the enhanced sales factor formula, skip ahead to the section titled "Enhanced Sales Factor".

Standard Sales Factor

Check the box for information question G on page 1 of the return to indicate that the standard double weighting of the sales factor will be used to calculate the apportionment ratio on the partnership's return. Use the number located on the left-hand side of Schedule C, line C3(d), column A, to double weight the sales factor.

Line C3 - Standard Sales Factor

Refer to AAC R15-2D-801 through R15-2D-807 and R15-2D-903. The term "sales" includes all gross receipts from transactions and activities in the course of the regular trade or business that produce income.

Determine sales within Arizona on a destination sales basis.

NOTE: Multiply the amount entered on line C3(c), column A, of Schedule C (the total Arizona sales) by two (double weighted sales factor) on line C3(d), column A. Enter the result on line C3(e), column A. Do not multiply the amount entered on line C3(c), column B, of Schedule C (the everywhere sales of the taxpayer) by two.

EXAMPLE: The partnership has total Arizona sales of \$100,000 and total everywhere sales of \$1,000,000. On line C3(e), column A, enter \$200,000 of Arizona sales. On line C3(e), column B, enter \$1,000,000 of everywhere sales for the partnership.

The sales factor ratio on line C3(e), column C, may, in certain circumstances, exceed 100 percent. However, since the total ratio (line C4) is divided by four, the average ratio (line C5) will not exceed 100 percent.

Line C5 - Average Apportionment Ratio

Divide the total ratio, line C4, column C, by four. Enter the average ratio here and on Form 165, Schedule K-1(NR), column (b). Express the ratio as a decimal carried out to six places.

NOTE: The partnership must exclude a factor if both the numerator and the denominator of a factor are zero. Do not exclude a factor from the total ratio if the numerator of a factor is zero and the denominator of a factor is greater than zero. If the property or payroll factor is excluded, determine the average ratio (line C5, column C) by dividing the total ratio by three. If the sales factor is excluded, determine the average ratio by dividing the total ratio by two. If two of the factors are excluded, the remaining factor, without respect to any weighting, is the apportionment ratio.

Enhanced Sales Factor

Check the box for information question G on page 1 of the return to indicate that the enhanced sales factor formula will be used to calculate the apportionment ratio on the partnership's return. Use the number located on the right-hand side of Schedule C, line C3(d), column A, to weight the sales factor at eight times.

Line C3 - Enhanced Sales Factor

Refer to AAC R15-2D-801 through R15-2D-807 and R15-2D-903. The term "sales" includes all gross receipts from transactions and activities in the course of the regular trade or business that produce income.

Determine sales within Arizona on a destination sales basis.

NOTE: Multiply the amount entered on line C3(c), column A, of Schedule C (the total Arizona sales) by eight on line C3(d), column A. Enter the amount on line C3(e), column A. Do not multiply the amount entered on line C3(c), column B, of Schedule C (the everywhere sales of the taxpayer) by eight.

EXAMPLE: The partnership has total Arizona sales of \$100,000 and total everywhere sales of \$1,000,000. On line C3(e), column A, enter \$800,000 of Arizona sales. On line C3(e), column B, enter \$1,000,000 of everywhere sales for the partnership.

The sales factor on line C3(e), column C, may, in certain circumstances, exceed 100 percent. However, since the total ratio (line C4) is divided by ten, the average ratio (line C5) will not exceed 100 percent.

Line C5 - Average Apportionment Ratio

Divide the total ratio, line C4, column C, by ten. Enter the average ratio here and on Form 165, Schedule K-1(NR), column (b). Express the ratio as a decimal carried out to six places.

NOTE: *The partnership must exclude a factor if both the numerator and the denominator of a factor are zero. Do not exclude a factor from the total ratio if the numerator of a factor is zero and the denominator of a factor is greater than zero. If the property or payroll factor is excluded, determine the average ratio (line C5, column C) by dividing the total ratio by nine. If the sales factor is excluded, determine the average ratio by dividing the total ratio by two. If two of the factors are excluded, the remaining factor, without respect to any weighting, is the apportionment ratio.*

ADMINISTRATIVE RELIEF REQUESTS

ARS § 43-1148 provides administrative relief if the allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in Arizona. **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.
- 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.

This section permits a departure from the allocation and apportionment provisions only in limited cases. ARS § 43-1148 may be invoked only in specific cases where unusual fact situations produce incongruous results under the apportionment and allocation provisions.

Taxpayers seeking 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.

Schedule D - Business Information

If the partnership has income from business activity *taxable entirely within Arizona*, complete only the first section of the schedule.

If the partnership has income from business activity *taxable within and without Arizona*, complete both parts of the schedule.

Certification

One of the partners must sign the return. If receivers, trustees in bankruptcy, or assignees are in control of the property or business of the organization, such receivers, trustees, or assignees must sign the return.

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

EIN, or the individual preparer's social security number, or preparer tax identification number.

Schedule K-1 - Partnership Instructions

Use Form 165, Schedule K-1, for all resident individual partners, all resident estate partners, and all resident trust partners. Use Form 165, Schedule K-1(NR), for all other partners.

Type or print the required information in the name, address, and information boxes on the top of the Arizona Form 165, Schedule K-1. Indicate the period covered by the taxable year on the schedule and whether the partnership's taxable year is a calendar year or a fiscal year. Indicate whether this is an original or an amended schedule.

Complete lines 1 through 3 as instructed on the schedule.

Schedule K-1(NR) - Partnership Instructions

Any partnership that has income from business activity that is taxable both within and without Arizona must allocate and apportion its net income. The partnership must allocate and apportion its net income according to the Uniform Division of Income for Tax Purposes Act (UDITPA), ARS §§ 43-1131 through 43-1150. A partnership that has income from business activity taxable in more than one state is a *multistate partnership*. A partnership that has income from business activity taxable entirely within Arizona is a *wholly Arizona partnership*.

Type or print the required information in the name, address, and information boxes on the top of the Arizona Form 165, Schedule K-1(NR). Indicate the period covered by the taxable year on the schedule and whether the partnership's taxable year is a calendar year or a fiscal year. Indicate whether this is an original or an amended schedule.

Column (a) - Distributive Share Amount

Wholly Arizona partnerships - In column (a), enter the distributive share amount for each line item from the federal Form 1065, Schedule K-1. On Part II, line 17, enter the adjustment of partnership income from federal to Arizona basis (Form 165, page 1, line 6) multiplied by the partner's percentage of gain or loss.

NOTE: *For corporate partners: complete only Part II, line 17, of Form 165, Schedule K-1(NR). Leave Part I blank.*

Multistate partnerships - Apportion all business income of a multistate partnership by the use of the apportionment formula. Nonbusiness income of a multistate partnership is nonapportionable and specifically allocable to a particular state.

"Business income" under the transactional test means income arising from transactions and activity in the regular course of the taxpayer's trade or business. Business income under the functional test 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. (ARS § 43-1131(1))

"Nonbusiness income" means all income other than business income. (ARS § 43-1131(4))

In column (a), enter the partner's distributive share of the multistate partnership's income or (loss) that is subject to apportionment.

The multistate partnership must compute the partner's distributive share of the partnership's income that is subject to apportionment. Make this computation by subtracting the partner's distributive share of the multistate partnership's nonbusiness income from the partner's total distributive share amount of the partnership's income. The multistate partnership must attach a computation schedule that details the following, for each line item:

- The partner's distributive share amount from the federal Form 1065, Schedule K-1, or from the adjustment of partnership income from federal to Arizona basis (Form 165, page 1, line 6).
- The partner's distributive share amount of the partnership's nonapportionable or allocable income.
- The partner's distributive share of the partnership's income that is subject to apportionment. Refer to ARS §§ 43-1134 through 43-1138 for the methods of allocating certain types of nonbusiness income.

NOTE: *For corporate partners, apply this computation only for the amount to be entered on Part II, line 17. Do not complete any other lines on the schedule for a corporate partner.*

Column (b) - Arizona Apportionment Ratio

Wholly Arizona partnerships - Enter 100 percent.

Multistate partnerships - Enter the average ratio amount from Form 165, Schedule C, line C5, column C, or from Schedule ACA, line 3. (Refer to Schedule ACA or Schedule C instructions.)

Column (c) - Arizona Source Income

Wholly Arizona partnerships - Multiply column (a) by column (b). Enter the result in column (c).

Multistate partnerships - Attach a schedule that details (for each line item) the following computation:

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

NOTE: *ARS §§ 43-1134 through 43-1138 specify the methods for allocating certain types of income to Arizona. Do not include the amount of any nonbusiness income allocable to another state in the total entered in column (c).*

All partnerships - Column (c) is the partner's Arizona source income from the partnership. Partners should refer to the Form 165, Schedule K-1(NR), instructions for information on completing their Arizona returns.

Complete three copies of Form 165, Schedule K-1(NR), for each partner. File one copy of each partner's Form 165, Schedule K-1(NR), with the partnership's Form 165. Provide all partners with a copy of their Form 165, Schedule K-1(NR). Retain a copy for the partnership's records.

Information on Filing Composite Returns on Form 140NR for Qualifying Nonresident Partners

Arizona law requires an individual resident or nonresident to file his or her own income tax return. The Arizona Department of Revenue will accept a composite return on Form 140NR for qualifying nonresident individual partners of a partnership.

NOTE: *A composite return cannot be filed with fewer than ten participating members.*

Refer to Arizona Individual Income Tax Ruling ITR 97-1 for information regarding the requirements for filing a composite return on Form 140NR.