

**2019 Arizona Partnership 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](http://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 *Reports & Legal Research* then click on *Legal Research* and select a Document Type and Category from the drop down menus.

**Publications**

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

**General Instructions**

**Who Must Use Form 165**

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

**NOTE:** *A partnership that has no Arizona income, deductions or credits for taxable year 2019 is not required to file a partnership return for that year.*

**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 the department's ruling, PTR 97-1, *Federal "Check-The-Box Rules" on Elective Tax Classification*, for further information.

**Limited Liability Companies**

A limited liability company that makes a valid federal election to be classified as a partnership must file Arizona Form 165. 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 the department's ruling, PTR 97-2, *Limited Liability Companies*, for further information.

**NOTE:** *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 is organized or taxed as a partnership, it must file Form 165 to meet the filing requirements of A.R.S. § 43-306. The NMMD must also complete Form 165 Schedules K-1 and/or K-1(NR), as applicable, and provide copies to its partners, as the partners are not exempt from Arizona income tax.*

**Disaster Relief for Out-of-State Businesses**

If an out-of-state partnership 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 the department's publication, Pub. 720, *Disaster Recovery Tax Relief* to determine if the taxpayer qualifies.

**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.

**Records**

Every partnership should maintain books and records substantiating information reported on the return and keep these documents for inspection. See the department's ruling, (GTR) 96-1, *Electronic Data Processing*, for more information about record retention requirements.

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

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

**OPTIONAL REPORTING FORMAT for Schedule(s) K-1 and Schedule(s) K-1(NR) required to be included with Form 165:**

The department 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 on a CD-ROM or DVD (CD/DVD). The chosen media must be Microsoft Windows compatible.

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

The CD/DVD should be labeled with the partnership's name, employer identification number (EIN), taxable year and Form 165, Schedule K-1/K-1(NR). Partnerships may password protect the CD/DVD and email the password separately to [MediaLibrarian@azdor.gov](mailto:MediaLibrarian@azdor.gov). Include "Form 165, Schedule K-1/K-1(NR)" in the subject line of the email. In the body of the email, include the same information that is on the label. If the CD/DVD is password protected, include the email address the password originated from on the label of the CD/DVD.

**The department will not return or copy any media.**

**CAUTION:** *The partnership substitutes the CD/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.*

**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

Partnerships 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.

### Examples:

*Partnership A (A) reports federal taxable income of \$15,000. A has no Arizona additions to, or subtractions from, federal taxable income. Its apportionment ratio is .326954. A multiplies the federal taxable income by the apportionment ratio. The result is \$4,904.31. Partnership A rounds the result to \$4,904.00.*

*Partnership W (W) reports a federal taxable loss of (\$27,000). W has no Arizona additions to, or subtractions from, its federal taxable loss. Its apportionment ratio is .005946. W multiplies its federal loss of (\$27,000) by the apportionment ratio. The result is an Arizona loss of (\$160.54). Partnership W rounds the result to (\$161.00).*

*Partnership Z (Z) reports a federal taxable loss of (\$500). Z has no Arizona additions to, or subtractions from, federal taxable income. Its apportionment ratio is .075000. Z multiplies its federal loss of (\$500) by the apportionment ratio. The result is an Arizona loss of (\$37.50). Partnership Z rounds the result to (\$38.00).*

## Extension of Time to File a Return

- A request for an extension of time to file an Arizona partnership 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.
  - Arizona's extension is the same as the federal extension which allows partnerships an additional six (6) months after the original due date to file the partnership's income tax return.
- 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 82E on page 1 of your return.
- When filing Form 120EXT, follow the mailing instructions on the form.

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

**IMPORTANT:** All partnership returns are due on or before the 15<sup>th</sup> day of the third month following the close of the taxable year.

## Filing Original Returns

- Returns are due by the 15th day of the third month following the close of the taxable year.
- 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.

- 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 post-marked the next business day. See the department's ruling, GTR 16-2, *Timely Filing of Income or Withholding Tax Return – Holidays and Weekends*.
- Please do not submit a copy of your federal return with your original Arizona income tax return.
- 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 the department's ruling, GTR 16-1, *Timely Filing of Income or Withholding Tax Return 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 post-marked the next business day. See the department's ruling, GTR 16-2, *Timely Filing of Income or Withholding Tax Return – Holidays and Weekends*.

## Electronic Filing of Partnership Tax Returns

Partnership tax returns shall be filed electronically for taxable years beginning from and after December 31, 2019, or when the department establishes an electronic filing program. Any corporate taxpayer who is required to file its income tax return electronically may apply to the director for an annual waiver from the electronic filing requirement. The waiver may be granted, which may be renewed for one subsequent year, if any of the following apply:

- The partnership has no computer.
- The partnership has no internet access.
- Any other circumstance considered to be worthy by the director.

Waivers are granted on an annual basis and expire at the end of the requested tax year. Waivers must be renewed each calendar year. If a waiver is not renewed, you will be subject to statutory electronic filing and payment requirements at the expiration of your waiver.

A waiver is not required if the partnership tax return cannot be electronically filed for reasons beyond the taxpayer's control, including situations in which the taxpayer was instructed by either the Internal Revenue Service or the Arizona Department of Revenue to file by paper.

Electronic filing of Arizona partnership tax returns is available for the 2019 taxable year. Partnerships may elect to file their Arizona partnership tax return electronically. Please see the department's website at [www.azdor.gov](http://www.azdor.gov) for a list of approved software vendors.

Please contact the department at [azefile@azdor.gov](mailto:azefile@azdor.gov) if you need assistance in electronically submitting your Arizona partnership tax return.

**Filing Amended Returns:**

- Any partnership that files an amended return with the IRS *must* file an Arizona amended return on Form 165 for the tax year to be amended, (i.e. 2019 Form 165 for tax year 2019).
- When submitting an amended return, check the box labeled “Amended” in the upper right corner of the return.
- Partnerships *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 partnership 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 partnership must provide sufficient information for the department to recompute the partnership’s Arizona income based on the Revenue Agent Report changes.
- The department may require the partnership to file an amended return if the department does not have this information.
- If your amended Arizona return is due to federal changes, either an amended federal return or an RAR, please include a copy of your amended federal return or RAR with your amended Arizona return.
- Amended returns that are not based on federal changes should include any schedules, forms, and/or statements which are necessary to fully explain and substantiate the change(s).
- DO NOT USE FORM 165PA to file an amended partnership return. Form 165PA must be used *only* after a partnership received a federal audit resulting in a *federal imputed underpayment* pursuant to *Section 1101(g)(4)* of the *Bipartisan Budget Act of 2015*.
- Mail the amended return to the address shown on the form.

**NOTE:** File amended returns for prior taxable years on the respective Form 165 for those taxable years. Use the 2019 Form 165 to amend only the taxable year 2019.

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

**NOTE:** If the IRS adjustments were for tax years 2016 through 2019 and resulted in a federal imputed underpayment assessment, you must file Arizona Form 165PA to report those changes.

**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.

**Specific Instructions**

For calendar year filers, check the box, “calendar year 2019.” 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 partnership's EIN. Partnerships that fail to include their EIN may be subject to a penalty. All returns, statements, or other documents filed with the department must have the partnership’s EIN indicated on them.

**Box 68:**

- Check Box “A” if this is the partnership’s first return filed to Arizona.
- Check Box “B” if the partnership changed its name during the tax year.
- Check Box “C” if the partnership changed its address during the tax year.

**Box 82E:**

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

**Line A:**

- If the partnership operates using a different name (Doing Business As) enter that DBA.

**Line B:**

- Will a composite return be filed on Form 140NR?
  - If yes, check “Yes.”
  - If no, check “No.”

**Line C:**

- Enter the total number of nonresident individual partners.

**Line D:**

- Enter the total number of resident and part-year resident individual partners.

**Line E:**

- Enter the total number of entity partners (corporations, estates, exempt organizations, partnerships, S corporations, and/or trusts).

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

**Line F:**

- Enter the date the partnership began its business operations.

**Line G:**

- Check the box indicating the method the partnership is using to apportion its income to Arizona:
  - Check Box 1, if the partnership used the Air Carrier Apportionment. Complete Form ACA and include it with this return.
  - Check Box 2, if the partnership used the Standard apportionment formula.
  - Check Box 3, if the partnership used the Sales Factor Only apportionment formula.
- If the partnership is not required to apportion its income to Arizona, leave this line blank.

**Line H:**

- Check this box only if the partnership elected to be treated as a Multistate Service Provider (MSP) by completing Arizona Schedule MSP and including it with this return.

Check the appropriate box, 1 through 5, to indicate the year of the taxpayer's election cycle.

- If the partnership did not elect multistate service provider treatment, leave this line blank.

**Line I:**

- If this is the partnership's final return to Arizona using this EIN, check "Yes."
- If this is not the partnership's final return to Arizona using this EIN, check "No."

**Line J:**

- If the partnership filed 2017 and 2018 Arizona partnership returns, check "Yes."
- If the partnership did not file 2017 and 2018 Arizona partnership returns, check "No." Enter the reason for not filing Arizona partnership returns on the line below.

**Line K:**

- If the partnership filed amended federal partnership returns for prior years, check "Yes." List the tax years on the line below.
- If the partnership did not file amended federal partnership returns for prior years, check "No."

**Line L:**

- If the IRS made adjustments to any federal income tax return the partnership filed that were not reported to the department, check the box labeled, "Yes." List the years not reported on the line below. Submit these adjustments separately to the department using the address indicated on Form 165.
- If the partnership has reported adjustments made to its previously filed federal Forms 1065 by the IRS, check "No."

**Line M:**

- Enter the name and complete location of the person or entity responsible for maintaining the partnership's books and records.

**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.

**Schedule A - Additions to Partnership Income**

**Line A1 - Total Federal Depreciation**

Enter the total amount of depreciation deducted on the federal return.

**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 - Additions Related to Arizona Tax Credits**

Enter on line A3 the following additions to partnership income that are related to Arizona tax credits. Complete the worksheet for Schedule A, line A3 on page 4 of the return before entering the total. If you enter an amount on line A3, include the worksheet with your return.

**A. Environmental Technology Facility Credit**

These adjustments apply to partnerships that elected to claim a tax credit using Form 305 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. Make this adjustment for the facility for which this credit was claimed on Form 305 in a current or prior taxable year.

- **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. Make this adjustment if the facility or any component of the facility for which a credit was claimed on Form 305 in a prior taxable year was sold or otherwise disposed of during this taxable year.

**B. Agricultural Water Conservation System Credit**

Enter the total amount of expenses used to calculate the allowable credit claimed on Form 312 for this taxable year.

**C. 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 on Form 315 in a current or prior taxable year.

- **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 on Form 315 in a prior taxable year was sold or otherwise disposed of during the taxable year.

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

Enter the amount of expenses deducted pursuant to the IRC for which the partnership 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 on Form 318.



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

Enter the amount of wage expenses deducted pursuant to the IRC for which the taxpayer claimed the TANF credit on Form 320.

**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 on Form 325 in a current or prior taxable year.

• **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 on Form 325 in a prior taxable year was sold or otherwise disposed of during this taxable year.

**G. Total Additions Related to Arizona Income Tax Credits**

Add lines A through F. Enter the total. Also, enter the total on Page 1, line A3.

**Line A4 - Other Additions to Partnership Income**

Enter the following "other additions" to the partnership income. Complete the worksheet for Schedule A, line A4 on page 4 of the return before entering the total. If you enter an amount on line A4, include the worksheet with your return.

**A. Positive Partnership Income Adjustment**

Make this adjustment if this partnership is a partner of another partnership.

If the partnership received Form 165 Schedule K-1(NR), and the net amount on line 17 is positive, enter the amount from column (a). If the partnership received more than one Form 165, Schedule K-1(NR), total the amounts from line 17, column (a) and enter that total on line A4.

If the net amount on Form 165 Schedule K-1(NR), line 17 is negative, enter the amount from column (a) on Schedule B, line B5. See the instructions for Schedule B, line B5 on page 6 for additional information.

**Form 165PA Schedule K-1(NR):** *If this partnership received Form 165PA Schedule K-1(NR) for this taxable year, and the amount on line 3, is positive, file an amended Form 165 for this taxable year. Enter the positive amount from line 3 of the 165PA Schedule K-1(NR) on line A4. Complete the amended return. Provide amended Form 165 Schedule(s) K-1 and K-1(NR) to the partners. Submit the amended Form 165 and the amended Form 165 Schedule(s) K-1 and K-1(NR) to the department.*

**B. Federal Depreciation of Child Care Facilities**

Arizona's statutes, which allow special amortization 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 depreciation deducted for these items on the federal partnership return.

**C. Expenditures for the Americans With Disabilities Act**

If a subtraction is or has been taken in the current or a prior taxable year for the full amount of eligible access expenditures paid or incurred to comply with the Americans with Disabilities Act of 1990 or Title 41, chapter 9, article 8, enter any amount of eligible access expenditures that is recognized under the internal revenue code, including any amount that is amortized and that is included in computing Arizona taxable income for the current taxable year.

**Line 2 - Total Additions to Partnership Income**

Add lines A1 through A4. 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 For Current Year**

**For assets placed in service in taxable years beginning before December 31, 2012,** 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.

**For assets placed in service in taxable years beginning from and after December 31, 2012 through December 31, 2013,** the amount of the subtraction for these assets depends on the method used to compute the depreciation for assets. See the department's procedure, ITP 16-2, *Procedure for Individuals who Claim Federal and/or Arizona Bonus Depreciation*.

**For assets placed in service in taxable years beginning from and after December 31, 2013 through December 31, 2015,** enter the total amount of depreciation allowable pursuant to IRC § 167(a) for the taxable year calculated as if the bonus depreciation is 10% of the amount of federal bonus depreciation pursuant to IRC § 168(k). See the department's procedure, ITP 16-2, *Procedure for Individuals who Claim Federal and/or Arizona Bonus Depreciation*.

**For assets placed in service in taxable years beginning from and after December 31, 2015 through December 31, 2016,** enter the total amount of depreciation allowable pursuant to IRC § 167(a) for the taxable year calculated as if the bonus depreciation is 55% of the amount of federal bonus depreciation pursuant to IRC § 168(k).

**For assets placed in service in taxable years beginning after December 31, 2016,** enter the total amount of depreciation allowable pursuant to IRC § 167(a) for the taxable year calculated as if the bonus depreciation had been the full amount of federal bonus depreciation pursuant to IRC § 168(k).

Add all amounts together and enter the total on line B1.

**NEW Arizona Bonus Depreciation:** For more information and examples of how to calculate Arizona bonus depreciation, see the department's procedure, *ITP 16-2, Procedure for Individuals who Claim Federal and/or Arizona Bonus Depreciation*, before completing line B1.

**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.*

See the department's ruling, *ITR 06-1, Obligations of the United States Government, Federal Agencies, and United States Territories, for a listing of qualifying U.S. obligations.*

**Line B4 - 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 the department's procedure, *ITP 12-1, Establishing an Income Tax Subtraction for Agricultural Crops Contributed to Charitable Organizations*, for information on how to determine if the contribution qualifies for the subtraction.

**Line B5 - Other Subtractions from Partnership Income**

Enter the following "other subtractions" from partnership income. Complete the worksheet for Schedule B, line B5 on page 4 of the return before entering the total. If you enter an amount on line B5, include the worksheet with your return.

**A. Negative Partnership Income Adjustment**

Make this adjustment if the partnership is a partner in another partnership.

If the partnership received Form 165, Schedule K-1(NR) and the net amount on line 17 is negative, enter the amount from column (a) as a positive number on line B5. If the partnership received more than one Form 165 Schedule (K-1(NR)), total the amounts from line 17, column (a) and enter that total on line B5 as a positive number.

If the net amount on Form 165, Schedule K-1(NR), line 17 is positive, enter the amount from column (a) on Schedule A, line A4.

See the instructions for Schedule A, line A4 on page 5 for additional information.

**Form 165PA Schedule K-1(NR):** *If this partnership received Form 165PA Schedule K-1(NR) for this taxable year, and the amount on line 3 is negative, file an amended Form 165 for this taxable year. Enter the negative amount from line 3 of the 165PA Schedule K-1(NR) as a positive number on line B5. Complete the amended return. Provide amended Form 165, Schedule(s) K-1 and K-1(NR) to the partners. Submit the amended Form 165 and the amended Form 165 Schedule(s) K-1 and K-1(NR) to the department.*

**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 Evidenced by Bonds**

Enter the amount of interest income received on obligations of the State of Arizona, or any of its political subdivisions, evidenced by bonds, that is 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 A.R.S. § 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. 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 computing Arizona gross income if the taxpayer received the following federal credits:

- The work opportunity credit,
- The empowerment zone employment credit,
- The credit for employer-paid social security taxes on employee cash tips, and/or
- The Indian employment credit.

**F. Expenditures for the Americans With Disabilities Act**

Enter the amount of expenditures paid or incurred during the taxable year to comply with the Americans with disabilities act of 1990 or A.R.S. Title 41, chapter 9, article 8 by retrofitting real property that was originally placed in service at least ten years before the current taxable year. (See A.R.S. §§ 43-1122 and 43-1124).

"*Eligible business access expenditures*" include reasonable and necessary amounts paid or incurred to:

- Remove any barriers that prevent a business from being accessible to or usable by individuals with disabilities.

- Provide qualified interpreters or other methods of making audio materials available to hearing-impaired individuals.
- Provide qualified readers, taped texts and other effective methods of making visually delivered materials available to individuals with visual impairments.
- Acquire or modify equipment or devices for individuals with disabilities.
- Provide other similar services, modifications, materials or equipment.

**NOTE:** *A taxpayer who has been cited for noncompliance with the Americans with Disabilities Act of 1990 or Title 41, Chapter 9, Article 8 by either federal or state enforcement officials is ineligible for a subtraction under this section for any expenditure required to cure the cited violation.*

**G. Total Other Subtractions from Partnership Income**

Add lines A through F. Enter the total. Also, enter the total on Page 1, line B5.

**Line 4 - Total Subtractions From Partnership Income**

Add lines B1 through B5. 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 Schedule K-1 or Schedule K-1(NR) for each partner.

**Line 7 - Penalty for Late Filing or Incomplete Filing**

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 during which 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 by check or money order.

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

**Schedule C - Apportionment Formula**

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

A.R.S. § 43-306 requires partnerships having nonresident partners to allocate and apportion their income under the Arizona Uniform Division of Income for Tax Purposes Act (UDITPA) (see A.R.S. §§ 43-1131 through 43-1150). The basis of the apportionment formula is property, payroll, and sales in Arizona 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.

**NON-APPORTIONABLE INCOME**

Apportionment factors generating non-apportionable or non-taxable 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 places after the decimal. If the seventh place after the decimal is five or more, round the sixth decimal place up to the next higher digit. If the seventh place after the decimal is less than five, leave the sixth place decimal as it is.

**Example #1:**

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

The seventh digit after the decimal is "8". Since "8" is greater than "5," the sixth digit after the decimal is increased to the next higher digit, "2".

The factor rounded to six decimal places is .156342.

**Example #2:**

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

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

The apportionment ratio rounded to six decimal places is .044966.

**SCHEDULE ACA - AIR CARRIER APPORTIONMENT  
FORMULA  
(MULTISTATE AIR CARRIERS ONLY)**

A.R.S. § 43-1139 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.

Check the box labeled “AIR CARRIER” on line G of page 1 of the return. Do not complete Schedule C on page 2 of the return.

Complete Schedule ACA and include with the return. Schedule ACA is available on the department’s website at: <http://www.azdor.gov/FORMS/Corporate.aspx>.

**NON-AIR CARRIER APPORTIONMENT  
FORMULA  
(MULTISTATE PARTNERSHIPS ONLY)**

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

- The standard apportionment formula; or
- The sales factor only apportionment formula.

Check the box on line G of page 1 of the return to indicate which apportionment formula, “Standard,” or “Sales Factor Only,” will be used to calculate the apportionment ratio on the partnership’s return. Whichever apportionment method is indicated, the partnership must complete the apportionment ratio using that formula. The partnership cannot use “Standard” to calculate one portion of the ratio, and “Sales Factor Only” to calculate another portion of the ratio.

For the standard apportionment ratio, the numerator of the fraction is the property factor plus the payroll factor plus two times the sales factor. The denominator of the fraction is four.

For taxable years beginning after December 31, 2016, Sales Factor Only Apportionment replaced the enhanced apportionment ratio. The numerator is Arizona sales. The denominator is Everywhere sales. The property factor and the payroll factor are not included in this computation.

**Line C1 - Property Factor – Standard Apportionment**

*Partnerships electing “SALES FACTOR ONLY APPORTIONMENT” – leave blank.*

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

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.

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 partnership is eight times its net annual rental rate. The net annual rental rate is the annual rental rate paid by the partnership for 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.

For a discussion of the treatment of computer software in the property factor, refer to the department’s ruling, 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.

**Partnerships Electing “STANDARD APPORTIONMENT”**

Divide the numerator of the property factor by the denominator. Express the ratio as a decimal carried out to six places. (The property factor may not exceed 1.0.) Enter the result on line C1c, Column C.

*Partnerships Electing “SALES FACTOR ONLY APPORTIONMENT,” leave line C1, Columns A through C, blank.*

*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 C2 - Payroll Factor – Standard Apportionment**

*Partnerships electing “SALES FACTOR ONLY APPORTIONMENT” - leave blank.*

The Payroll Factor is a fraction that represents the compensation paid in Arizona by the partnership to the total compensation paid by the partnership 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;
- The employee's base of operation is in Arizona;
- 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.

**Partnerships Electing "STANDARD APPORTIONMENT"**

Divide the numerator of the payroll factor by the denominator. Express the ratio as a decimal carried out to six (6) places. (The payroll factor may not exceed 1.0) Enter the result on line C2, Column C.

**Partnerships Electing "SALES FACTOR ONLY APPORTIONMENT,"** leave line C2, Columns A through C, blank.

*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 C3 - 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 is determined 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.)

**PARTNERSHIPS THAT QUALIFY AS MULTISTATE SERVICE PROVIDERS ELECTING TO SOURCE SALES OF SERVICES TO ARIZONA USING MARKET SALES**

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

*Partnerships that qualify, and that want to make the election, should:*

- *Ensure the completed Schedule MSP is included with the return.*
- *Ensure the box on line H of the return is checked.*
- *Ensure the box indicating the year of the partnership's election cycle is checked.*
- *Enter on line C3b, Column A, the Arizona sales from services from the completed Schedule MSP, line B1.*

- *Complete the calculation of the sales factor following the instructions for the partnership's choice of the "STANDARD" or "SALES FACTOR ONLY" apportionment formula.*

**Partnerships qualifying as an MSP, and electing to be treated as an MSP:**

Enter the Arizona sales from services on line C3b from the completed Schedule MSP, line B1.

**Partnerships not making the election to be treated as an MSP:**

- Leave line C3b blank.
- Include Arizona sales from services on line C3c.

**Partnerships Electing "STANDARD APPORTIONMENT"**

- Check the box on line G of the return labeled "STANDARD."
- Multiply the numerator of the sales factor by two. Divide that result by the denominator. Express the ratio as a decimal carried out to six places. (The sales factor may not exceed 2.0.) Enter the result on line C3f, Column C.

**Partnerships Electing "SALES FACTOR ONLY APPORTIONMENT"**

- Check the box on line G of the return labeled "SALES FACTOR ONLY."
- Divide the numerator (Arizona sales) by the denominator (Everywhere sales). Express the ratio as a decimal carried out to six places. (The sales factor may not exceed 1.0) Enter the result. Also, enter the result Form 165, Schedule K-1(NR), Part 1, column (b).

*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 C4 – Total Ratio**

**Partnerships Electing "STANDARD APPORTIONMENT"**

Add the amounts in Column C of lines C1c, C2, and C3f, and enter the total.

**Partnerships Electing "SALES FACTOR ONLY APPORTIONMENT,"** leave this line blank.

**Line C5 - Average Apportionment Ratio – Standard Apportionment**

**NOTE:** *Partnerships must exclude a factor if both the numerator and the denominator of a factor are zero. Do not exclude a factor if the numerator of the factor is zero and the denominator of a factor is greater than zero.*

**Partnerships Electing "STANDARD APPORTIONMENT"**

*If either the property or the payroll factor is excluded, determine the average ratio 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.*



**Partnerships Electing “STANDARD APPORTIONMENT”**

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

**Partnerships Electing “SALES FACTOR ONLY APPORTIONMENT,” leave this line blank.**

**NOTE:** If line C5 is “0.000000”, the partnership is considered to have no Arizona nexus.

If line C5 is blank, the partnership’s income is considered to be sourced entirely within Arizona.

**Schedule D - Business Information**

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

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

**Schedule E - Partner Information**

Enter the requested information for each partner. If the partnership has more than 8 partners, include additional schedules as necessary.

**NOTE:** Column (d), enter the partner’s Tax Information Number with no dashes.

Column (e) requires the ownership percentage to be entered as 3 digits to the left of the decimal and 6 digits to the right of the decimal. For example, for a partner with a 1% ownership share, enter the partner’s ownership percentage as 001.000000.

For Column (g) enter “R” for resident, “N” for Nonresident, or “O” for other entity (i.e. corporation, partnership, etc.).

**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 paid preparer’s name and address, if self-employed).

Paid preparers must provide a Tax Identification Number (TIN). Paid preparers that fail to include their TIN may be subject to a penalty.

The TIN for a paid preparer may be one of the following:

- The preparer’s PTIN,
- The EIN for the business,
- The individual preparer’s social security number (SSN), if self-employed.

**Form 165, Schedule K-1 - Partnership Instructions**

Use Form 165, Schedule K-1, for all resident or part-year 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 Form 165, Schedule K-1. Indicate whether the partnership’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: Arizona Partnership Adjustment**

Complete Part 1, lines 1 through 3 as instructed on the form.

**Part 2: Net Capital Gain (Loss) from Investment in a Qualified Small Business – Information Schedule**

Arizona allows individuals, estates, and trusts a subtraction from Arizona gross income for any net capital gain derived from investment in a qualified small business if:

- The gain is included in:
  - The individual taxpayer’s federal adjusted gross income, or,
  - The estate or trust’s federal taxable income.
- The business in which the S corporation invested is determined to be a qualified small business by the Arizona Commerce Authority.

A partner that is a pass-through entity (estate or trust) will need this information to:

- Calculate its subtraction, or,
- Complete Form 141AZ, Schedule K-1 or Schedule K-1(NR), for each beneficiary.

Complete Form 165, Schedule K-1, Part 2 to provide information to:

- The resident and part-year resident individual partner to calculate the subtraction for net capital gain from investment in a qualified small business.
- The resident estate or trust partner to:
  - Calculate the subtraction for net capital gain from investment in a qualified small business; or,
  - Complete Form 141AZ, Schedule K-1 or Schedule K-1(NR) for each beneficiary.

Complete Form 165, Schedule K-1, Part 2, line 4, and Part 4, line 7 if the partner’s federal Schedule K-1 (Form 1065) includes any net capital gain (loss) from investment in a qualified small business. If Part 2, line 4, is zero, enter “0” on Part 4, line 7.

Do NOT complete Form 165, Schedule K-1, Part 2, line 4 and Part 4, line 7 if the partner’s federal Schedule K-1 (Form 1065) does not include any net capital gain (loss) from investment in a qualified small business.

**Part 3: Net Capital Gain (Loss) From the Exchange of Legal Tender – Information Schedule**

For taxable years beginning from and after December 31, 2017, Arizona allows individuals, estates, trusts and corporations an exclusion for any net capital gain included in Arizona gross income that is derived from the exchange of one kind of legal tender for another kind of legal tender.

A partner 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.

Complete Form 165 Schedule K-1, Part 3 to provide information to:

- The resident and part-year resident individual partner to calculate the exclusion for any net capital gain (loss) derived from the exchange of one kind of legal tender for another kind of legal tender.
- The resident estate or trust partner to:
  - Calculate the exclusion for net capital gain (loss) derived from the exchange of one kind of legal tender for another kind of legal tender, or,
  - Complete Form 141AZ Schedule K-1 or Schedule K-1(NR) for each beneficiary.

Complete Form 165 Schedule K-1, Part 3, line 5 and Part 4, line 8, if the partner's federal Schedule K-1 (Form 1065) includes any net capital gain (loss) from the exchange of one kind of legal tender for another kind of legal tender. If Part 3, line 5 is zero, enter "0" on Part 4, line 8.

Do NOT complete Form 165 Schedule K-1, Part 3, line 5 and Part 4, line 8, if the partner's federal Schedule K-1 (Form 1065) does not include any net capital gain (loss) from the exchange of one kind of legal tender for another kind of legal tender.

**Part 4: Net Long-Term Capital Gain Subtraction – Information Schedule**

Arizona allows individuals, estates, and trusts a subtraction from Arizona gross income for a percentage of any net long-term capital gain if:

- The asset was acquired after December 31, 2011.
- The gain is included in:
  - The individual's federal adjusted gross income, or,
  - The estate or trust's federal taxable income.

In addition:

- Only include net long-term gains if the partnership can verify the asset was acquired after December 31, 2011.
- If the partnership cannot verify the asset was acquired after December 31, 2011, treat it as a capital gain asset acquired before January 1, 2012.

A partner that is a pass-through entity (estate or trust) will need this information to:

- Calculate its subtraction; or,
- Complete Form 141AZ, Schedule K-1, or Schedule K-1(NR) for each beneficiary.

Complete Part 4 (if line 6 is applicable) of Form 165, Schedule K-1 as instructed on the form. Do NOT complete Part 4 if the partner's federal Schedule K-1 (Form 1065) does not include any net capital gain (loss).

Complete Form 165, Schedule K-1, Part 4 to provide information to:

- The resident or part-year resident individual partner to calculate the subtraction for net long-term capital gain for assets acquired after December 31, 2011.

- The resident estate or trust partner to:
  - Calculate the subtraction for long-term capital gain for assets acquired after December 31, 2011; or,
  - Complete Form 141AZ Schedule K-1 or Schedule K-1(NR) for each beneficiary.

A worksheet is provided at the end of these instructions to assist the partnership in determining the amount(s) to include on each partner's Form 165, Schedule K-1, Part 4, lines 6 through 8.

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

**Form 165 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 UDITPA, A.R.S. §§ 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 Form 165, Schedule K-1(NR). Indicate whether the partnership'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 and Part 2: Distributive Share Items**

**Column (a) - Distributive Share Amount**

**Wholly Arizona partnerships** - In column (a), enter the distributive share amount for each line item from federal Form 1065, Schedule K-1. On Part 2, 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:** *Leave Part 1 blank. Complete Part 2, Part 3 and Part 4 of Form 165 Schedule K-1(NR).*

**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.

"Nonbusiness income" means all income other than business income.

**In column (a)**, enter the partner's distributive share of the multistate partnership's income (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 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 A.R.S. §§ 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 2, line 17. Do not complete Part 1.

**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** - Enter the amount from column (a).

**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 (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:** A.R.S. §§ 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 Form 165, Schedule K-1(NR), instructions for information on completing their Arizona returns.

**Part 3: Net Capital Gain (Loss) from Investment in a Qualified Small Business – Information Schedule**

Arizona allows individuals, estates, and trusts a subtraction from Arizona gross income for any net capital gain derived from investment in a qualified small business if:

- The gain is included in:
  - The individual's federal adjusted gross income, or
  - The estate or trust's federal taxable income
- The business in which the partnership invested is determined to be a qualified small business by the Arizona Commerce Authority.

A partner that is a pass-through entity (estate or trust) will need this information to:

- Calculate its subtraction for the estate or trust, or
- Complete Form 141AZ, Schedule K-1, or Schedule K-1(NR), for each beneficiary.

Complete Form 165, Schedule K-1, Part 3 to provide information to:

- The resident or part-year resident individual partner to calculate its subtraction for net capital gain from investment in a qualified small business.
- The resident estate partner or resident trust partner to:
  - Calculate its subtraction for net capital gain from investment in a qualified small business, or,
  - Complete Form 141AZ, Schedule K-1, or Schedule K-1(NR) for each beneficiary so the beneficiary can calculate its subtraction for net capital gain from investment in a qualified small business.

Complete Form 165, Schedule K-1(NR), Part 3, line 18, and Part 5, line 21, if the partner's federal Schedule K-1 (Form 1065) includes any net capital gain (loss) from investment in a qualified small business. If Part 3, line 18, is zero, enter "0" on Part 5, line 21.

Do NOT complete Form 165, Schedule K-1(NR), Part 3, line 18, and Part 5, line 21 if the partner's federal Schedule K-1 (Form 1065) does not include any net capital gain (loss) from investment in a qualified small business.

**Part 4: Net Capital Gain (Loss) From the Exchange of Legal Tender – Information Schedule**

For taxable years beginning from and after December 31, 2017, Arizona allows individuals, estates, trusts and corporations an exclusion for any net capital gain included in Arizona gross income that is derived from the exchange of one kind of legal tender for another kind of legal tender.

A partner 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.

Complete Form 165, Schedule K-1(NR) Part 4, line 19, and Part 5, line 22 if the partner's federal Schedule K-1 (Form 1065) includes any net capital gain (loss) from the exchange of one kind of legal tender for another kind of legal tender. If Part 4, line 19, is zero, enter "0" on Part 5, line 22.

Do NOT complete Form 165 Schedule K-1(NR), Part 4 or Part 5, line 22 if the partner's federal Schedule K-1 (Form 1065) does not include any net capital gain (loss) from the exchange of one kind of legal tender for another kind of legal tender.

## Part 5: Net Long-Term Capital Gain Subtraction – Information Schedule

Arizona allows individuals, estates, and trusts a subtraction from Arizona gross income for a percentage of any net long-term capital gain if:

- The asset was acquired after December 31, 2011.
- The gain is included in:
  - The individual's federal adjusted gross income, or,
  - The estate or trust's federal taxable income.

In addition:

- Only include net long-term gains if the partnership can verify the asset was acquired after December 31, 2011.
- If the partnership cannot verify the asset was acquired after December 31, 2011, treat it as a capital gain asset acquired before January 1, 2012.

A partner that is a pass-through entity (estate, trust, S corporation, or partnership) will need this information to:

- Calculate its subtraction, or,
- Complete:
  - Form 141AZ, Schedule K-1, or Schedule K-1(NR) for each beneficiary; or,
  - Form 120S, Schedule K-1, or Schedule K-1(NR) for each shareholder; or,
  - Form 165, Schedule K-1, or Schedule K-1(NR) for each partner.

Complete Form 165, Schedule K-1(NR), Part 5, lines 20 through 22 (if applicable) if the partner's federal Schedule K-1 (Form 1065) includes capital gain (loss).

Do NOT complete Form 165, Schedule K-1(NR), Part 5, lines 20 through 22 if the partner's federal Schedule K-1 (Form 1065) does not include any capital gain (loss).

Complete Form 165, Schedule K-1(NR), Part 5 to provide information to:

- The nonresident individual partner to calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011.

- The nonresident estate partner or nonresident trust partner to:
  - Calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011,
  - Complete Form, 141AZ Schedule K-1, or Schedule K-1(NR) for each beneficiary so each beneficiary can calculate its subtraction for net long-term capital gain for assets acquired after December 31, 2011.

For the partnership partner or S corporation partner, Form 165 Schedule K-1(NR), Part 5, provides information so the partner can provide information to each partner or shareholder to provide to lower tiered partners or shareholders.

For the C corporation partner, Form 165, Schedule K-1(NR), Part 5, is informational only.

A worksheet is provided at the end of these instructions to assist the partnership in determining the amounts to include on each nonresident partner's Form 165, Schedule K-1(NR), Part 5, lines 20 through 22.

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 Arizona 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 the department's ruling, *ITR 16-2, Composite Individual Income Tax Returns* for information regarding the requirements for filing a composite return on Form 140NR.

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

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

Original return  Amended return

<b>Net long-term capital gain (loss) as reported on federal Schedule D (or other form/schedule) and included in the distributive share amount.</b>		(a)	(b)	(c)
Enter the total net long-term capital gain (loss) from the following forms in each applicable column. See instructions below the worksheet.		Net long-term capital gain (loss)	Net long-term capital gain (loss) included in column (a) from assets acquired <b>before</b> January 1, 2012	Net long-term capital gain (loss) included in column (a) from assets acquired <b>after</b> 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 Form 141AZ or Form 165 Schedule K-1 or Schedule K-1(NR).	4		
5	Any other long-term capital gain (loss)	5		
6	<b>Net long-term capital gain (loss).</b> Add lines 1 through 5 in each column, and enter the total.  For each partner, enter the distributive share of the amounts from line 6 on Form 165 Schedule K-1 or Schedule K-1(NR).	6		

**Worksheet Instructions**

**Purpose of the Worksheet**

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](http://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 partnership can use this worksheet to calculate each partner's distributive share of the net long-term capital gain (loss) included in Schedule K of federal Form 1065 for assets purchased after December 31, 2011.

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

- The partnership does not have any capital gain (loss) to report for the current tax year; or
- The partnership does not have any net capital gain (loss) from asset(s) acquired after December 31, 2011, to report for the current tax year; or
- All of the partners are C corporations that have not made an election to be taxed under Subchapter S of the IRC.

Keep the completed worksheet for the partnership's records.

**Columns (a) through (c)**

- Column (a) is the total amount of net long-term capital gain (loss) reported on federal 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 partnership's federal Schedule D and included on Schedule K of federal Form 1065.

**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 partner, enter the distributive share of the amounts in each column on line 6 of the worksheet on Parts 2, 3, and 4 of Form 165, Schedule K-1, or on Parts 3, 4 and 5 of Form 165, Schedule K-1(NR).