

# ARIZONA DEPARTMENT OF REVENUE

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## **ARIZONA CORPORATE TAX RULING CTR 93-9**

(On November 23, 2012 the citations to Arizona Administrative Code rules were updated. See the footnotes for details. No substantive changes were made.)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

### **ISSUES:**

1. What is the filing obligation of a corporation that does not have any connection with Arizona other than a partnership interest in a partnership that is a partner in a tiered partnership?
2. What is the filing obligation of a multistate corporation that has business activities within and without Arizona in addition to a partnership interest in a partnership that is a partner in a tiered partnership?

### **APPLICABLE LAW:**

Arizona Revised Statutes (A.R.S.) § 43-306 requires the filing of Arizona partnership returns which must identify the partners.

A.R.S. § 43-1132.A states that any taxpayer, other than a foreign corporation which is not itself subject to tax, having income from business activity which is taxable both within and without this state shall allocate and apportion its net income.

A.R.S. § 43-1401.1 defines "Arizona gross income" of a partnership to mean its taxable income for the year as computed pursuant to the Internal Revenue Code (I.R.C.) exclusive of items requiring separate computation under paragraphs 1 through 18 of A.R.S. § 43-1412.

A.R.S. § 43-1401.2 defines "Arizona taxable income" of a partnership to mean its Arizona gross income adjusted by the modifications specified in A.R.S. §§ 43-1021 and 43-1022.

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A.R.S. § 43-1131.1<sup>1</sup> defines "business income" to mean income arising from transactions and activity in the regular course of the taxpayer's trade or business.

A.R.S. § 43-1131.4 defines "nonbusiness income" to mean all income other than business income.

A.A.C. R15-2D-101<sup>2</sup> defines "allocation" as the assignment of nonbusiness income to a particular state.

I.R.C. § 704(b) provides the basis for distributing partnership income, loss, gain and other items in accordance with the partner's interest in the partnership.

I.R.C. § 702(b) and Treasury Regulation (Treas. Reg.) § 1.702-1(b) address the conduit or pass-through treatment of income, loss, gain and other items to the partners.

### **DISCUSSION:**

For the purposes of this tax ruling, a "tiered partnership" is defined as a partnership whose partners are partnerships.

A corporation that is a partner in a partnership that in turn is a partner in yet another partnership is not immune from Arizona taxation simply because of the tiered partnership. The ultimate tax burden and loss benefit falls on the nonconduit partners (corporations and individuals).

The underlying basis for requiring the corporate partner to report its income or loss from the tiered partnership is that the operating partner's **business activity** in Arizona requires the partner to either apportion or allocate its distributive share of the partnership's income or loss.

If the corporation's partnership interest is **business**, the corporate partner must apportion its distributive share of the partnership's income or loss from Arizona activities. If the corporation's partnership interest is **nonbusiness**, the corporate partner must allocate its distributive share of the partnership's income or loss from Arizona activities.

### **Issue 1:**

*What is the filing obligation of a corporation that does not have any connection with Arizona other than a partnership interest in a partnership that is a partner in a tiered partnership that has Arizona activities?*

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<sup>1</sup> The definition of "business income" in former A.A.C. R15-2-1131.A was removed from the rules because it simply repeated the definition that was already in A.R.S. § 43-1131.1. Therefore, the reference to the rule was removed from this ruling. No substantive change was made.

<sup>2</sup> When the ruling was issued the citation was to A.A.C. 15-2-1131.A which has since been renumbered to R15-2D-101. No substantive change was made.

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The corporation must file an Arizona corporate income tax return either apportioning or allocating its ultimate distributive share of the tiered partnership's income or loss from Arizona activities.

### **Example:**

Partnership A has a 50% apportionment ratio for its Arizona operations. Partnership B has a 25% interest in Partnership A. Corporation C has a 10% interest in Partnership B. **Partnership B and Corporation C do not have any connection with Arizona other than these partnership interests.**

Corporation C must file an Arizona corporate income tax return reporting its ultimate distributive share of Partnership A's Arizona income, loss, gain and other items. If Corporation C has a business partnership interest in Partnership B, the corporation will apportion its income or loss from the tiered partnership. If Corporation C has a nonbusiness partnership interest in Partnership B, the corporation will allocate its income or loss from the tiered partnership.

### **RULING:**

A corporation that does not have any connection with Arizona, other than a partnership interest in a partnership that is a partner in a tiered partnership, must file an Arizona corporate income tax return reporting its ultimate distributive share of the tiered partnership's income or loss from Arizona activities.

### **Issue 2:**

*What is the filing obligation of a multistate corporation that has business activities within and without Arizona, in addition to a partnership interest in a partnership that is a partner in a tiered partnership?*

A multistate corporation that has business activities within and without Arizona must file an Arizona corporate income tax return apportioning its income from such activities. The corporation must also report its ultimate distributive share of the tiered partnership's income or loss from Arizona activities.

### **Example:**

Partnership A has a 50% apportionment ratio for its Arizona operations. Partnership B has a 25% interest in Partnership A. Corporation C has a 10% interest in Partnership B. Partnership B does not have any other connection with Arizona other than its partnership interest. **Corporation C has business activities within and without Arizona in addition to its partnership interest in a partnership that is a partner in a tiered partnership.**

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Corporation C must file an Arizona corporate income tax return apportioning its income from business activities within and without Arizona. Corporation C must also report its ultimate distributive share of Partnership A's Arizona income, loss, gain and other items. If Corporation C has a business partnership interest in Partnership B, the corporation will apportion its income or loss from the tiered partnership. If Corporation C has a nonbusiness partnership interest in Partnership B, the corporation will allocate its income or loss from the tiered partnership.

### **RULING:**

A multistate corporation that has business activities within and without Arizona must file an Arizona corporate tax return apportioning its income from such business activities. A multistate corporation that has a partnership interest in a partnership that is a partner in a tiered partnership must also report its ultimate distributive share of the tiered partnership's income or loss from Arizona activities.

(See CTR 93-10 for additional information on tiered partnerships.)

Harold Scott, Director

Signed: April 30, 1993

### Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling.** See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.