

ARIZONA DEPARTMENT OF REVENUE

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ARIZONA CORPORATE TAX RULING CTR 94-1

(On July 30, 2020 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.

ISSUE:

Should a taxpayer include a distributive share of the income or loss from a partnership in an Arizona combined return for a unitary business if the threshold percentage of ownership requirement is not met for the partnership?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-1131.1¹ 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 defines a "unitary business" and "combined return". It also provides that the determination of whether an entity, group of entities, or components of an entity constitute a unitary business is made under A.A.C. R15-2D-401.²

A.A.C. R15-2D-401 provides that the entities comprising the unitary business must be united by a bond of direct or indirect ownership or control of more than 50 percent of the voting stock

¹ 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.

² When the ruling was issued the ruling cited A.A.C. R-15-2-1131.E for the definition of a "unitary business as well as the 50 percent voting stock requirement. The ruling also cited A.A.C. R-15-2-1132.E for the definition of "combined report," the reiteration of the 50 percent requirement and the methodology for determining the portion of the business attributable to Arizona. Both rules have since been renumbered and rearranged. The definitions are now in A.A.C. R15-2D-101 and the 50 percent requirement as well as the methodology for determining the portion attributable to Arizona are now in A.A.C. R15-2D-401

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of a subsidiary corporation. The administrative rule also prescribes the methodology for determining the portion of income from the unitary business that is attributable to Arizona.³

DISCUSSION:

The concept of the threshold percentage of ownership requirement (more than 50 percent) for a unitary business revolves around the voting stock of subsidiary corporations. The threshold percentage of ownership requirement is one of the tests that must be met in order to determine whether the income of particular corporations may be included in a combined return for a unitary business. Partnerships are primarily conduits through which the partnership income or loss passes to the partners. Therefore, a corporate partner should have already included its distributive share of the partnership's income or loss in the corporation's net income. Accordingly, the threshold percentage of ownership requirement does not apply to partnerships.

The determining factor in how to treat a distributive share of partnership income or loss in the combined return is whether it is classified as **business or nonbusiness income** of the corporate partner. Business income is income that arises from transactions and activity in the regular course of the taxpayer's trade or business.

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

In a combined return, the **business income** attributable to members of the unitary business group is apportioned by the average of the property, payroll, and sales factors for the unitary business.

Example:

Corporation A is a member of a unitary business group that is doing business within and without Arizona. Corporation A is headquartered in Ohio and has a 20 percent interest in the profits, losses, and capital of Partnership B, which is located in Arizona. Partnership B conducts all of its business in Arizona. Corporation A does not have any connection with Arizona other than its partnership interest in Partnership B.

If Corporation A's partnership interest in Partnership B is **business**, the unitary business group will apportion Corporation A's income or loss from the partnership regardless of the percentage interest held in Partnership B. The unitary business group would include 20 percent of Partnership B's sales, property, and payroll in the numerator and denominator of the unitary business group's apportionment

³ See Footnote 2.

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ratio. The unitary business group would include Corporation A's distributive share of Partnership B's income or loss in its apportionable income.

If Corporation A's partnership interest in Partnership B is **nonbusiness**, the unitary business will allocate Corporation A's distributive share of income or loss from the partnership to Arizona. In this case, the unitary business group would not be given apportionment factor representation for Corporation A's distributive share of Partnership B's property, payroll, and sales in either the numerator or denominator of the unitary business group's apportionment ratio.

RULING:

The threshold percentage of ownership requirement does not apply to partnerships.

Therefore, the inclusion of a distributive share of partnership income or loss in a combined return for a unitary business is dependent upon its classification as business or nonbusiness income of a member of the unitary business group.

See CTR 94-2 for additional information on reporting by corporate partners in Arizona partnership.

Harold Scott, Director

Signed: April 4, 1994

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.