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ARIZONA CORPORATE TAX RULING CTR 02-5

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ISSUE:

The Arizona Department of Revenue's position with respect to various questions regarding the Enterprise Zone income tax credit.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 41-1525 provides for the Department of Commerce to certify businesses for income tax credits under A.R.S. §§ 43-1074 and 43-1161.

A.R.S. §§ 43-1074 and 43-1161 provide for an income tax credit for net increases in qualified employment in an enterprise zone.

RULING:

This ruling consists of the department's answers to questions that have been raised concerning the Enterprise Zone income tax credit.

1. Does the maximum limitation of 200 new qualified employment positions each year apply to each zone location or to each taxpayer?

The limitation is a maximum number of qualified employment positions for each taxpayer.

2. Can a taxpayer that is limited in the number of first year credits by the 35 percent residency requirement claim second and third year credits for those employment positions that were not allowed in the first year?

No. The 35 percent residency requirement sets a maximum limitation on available employment positions.

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3. Can a taxpayer claim second and third year credits if first year credits were not claimed?

No. Second year credits are only allowed for positions for which first year credits were allowed and third year credits are only allowed for positions for which second year credits were allowed.

4. Can a taxpayer that did not claim first year credits in the year originally allowable amend the tax return for that year to claim the first year credits and thus qualify for second and third year credits?

For taxable years beginning on or after January 1, 2002, the tax return cannot be amended to claim additional credits after the due date of the tax return, including any valid extensions. The taxpayer cannot claim second or third year credits in those years if the first year credits were not claimed on the original return for the year the first year credits were earned.

The taxpayer could amend a tax return and claim the credit for first, second or third year credits for taxable years beginning prior to January 1, 2002.

5. For taxable years beginning from and after December 31, 2001, must the tax return be timely filed in order to claim first, second or third year credits?

Yes. A.R.S. § 41-1525(B) provides that a taxpayer must certify all required information to the Department of Revenue on or before the due date of the tax return, including any extensions.

6. If a taxpayer did not provide the certification to the Department of Commerce required by A.R.S. § 41-1525(B)(2), can the taxpayer subsequently provide the certification and qualify for the credit?

To qualify for the credit for taxable years beginning on or after January 1, 2002, the certification must be filed by the earlier of six months after the end of the taxable year in which the employment positions were created or by the date the Arizona income tax return is filed for that taxable year.

For taxable years beginning prior to January 1, 2002, the taxpayer can subsequently provide the certification and qualify for the credit. However, in order to carry over credits from taxable years beginning prior to January 1, 2002, whether from original or amended

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returns, the reporting and certification requirements of A.R.S. § 41-1525(B), as amended by Laws 2002, Ch. 237, must be met.

7. If a taxpayer was disqualified because of failure to follow the certification and reporting requirements in the second year, does the taxpayer lose the carryover of unused first year credits and may the taxpayer claim third year credits if it files the certification in the following year?

The disqualified taxpayer cannot carryover unused first year credits and could not claim second or third year credits. An S corporation or partnership that fails to follow the certification and reporting requirements with respect to credits passed through to its partners or shareholders would also cause the loss of credits for those partners or shareholders. New employees hired in subsequent years would qualify for first year credits if the taxpayer meets the certification and reporting requirements for that year.

8. What happens to existing credits when a C corporation converts to an S corporation or vice versa?

Because a C corporation and an S corporation are the same corporation, unused credits could be carried over to any S corporation liability (at the corporation level) but could not be used by the shareholders. If an S corporation converts to C corporation status, any unused credits of the S corporation retained at the corporate level could be applied to the C corporation but any credits that were passed through to the shareholders could not be used by the C corporation.

The change in the corporation's filing method would not affect the ability to claim continuing second or third year credits.

9. When a taxpayer files a short period return, is the credit based on the taxable year (short period) or on a twelve-month basis?

The credit is based on the taxable year. A tax return filed for a short period is considered to be a taxable year. For example, if a return is filed for the period from January 1, 2001 through September 30, 2001, the credit would be computed on wages paid for this nine-month period.

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10. Does the reference to second or third year of continuous employment refer to employment during a taxable year or for a twelve-month period?

A year of continuous employment would be based on a taxable year rather than a twelve-month period. If an employment position was created in July of calendar year 2000 and a short period return is filed for the four month period ending April 30, 2001, the employee in this position would be considered to be in the second year of continuous employment for that short period and in the third year of continuous employment for the subsequent period beginning May 1, 2001.

11. If an employee's second continuous year of employment falls in a short period and 1/3 of the wages for the short period is less than the \$1,000 maximum credit, is the taxpayer limited to the smaller amount even if total wages for the twelve-month period would provide a larger credit?

Yes. The credit is based on wages for the taxable year. For example, if the taxpayer filed a return for a two month short period and paid total wages for a qualified employment position for this period of \$2,500, a 1/3 credit of \$833 would be allowed rather than the maximum credit of \$1,000.

12. Does an employee have to work 1750 hours each year in order to qualify for the credit?

No. The 1750 hour requirement relates to the minimum number of hours considered a full-time job. Although the position must be a full-time job, if an individual does not work 1750 hours because of the date hired or because of a short taxable year, the employee position would still qualify for the credit.

13. What is meant by permanent employment in A.R.S. §§ 43-1074(C)(3)(a) and 43-1161(C)(3)(a)?

A permanent employment position is an employment position that is not established for a specified or limited period of time.

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14. If a zone designation is terminated so that a business is no longer in a zone, is the taxpayer allowed to take continuing (second or third year) credits as long as it does not move from what was a zone location?

Yes. As long as it meets all other requirements, the taxpayer could continue to claim any available second or third year credits. No credits would be allowed for positions created after the zone designation changed.

15. If an employee at a zone location resides outside the county of employment but resides in an enterprise zone in another county, would the employee satisfy the residency requirement?

No. The employee must reside, at the date of hire, in an enterprise zone located in the same county as the zone location at which he is employed in order to satisfy the residency requirement.

16. If an existing business located in an enterprise zone is sold or reorganized, are employees of the former business considered to be new employees of the “new” business and eligible for first year credits?

No.

17. If a business located in an enterprise zone is reorganized or sold as an ongoing business, are employees of the former business considered to be continuing employees of the “new” business and eligible for any continuing credits available to the “old” business?

Yes. As long as the business and employment positions continue to meet all requirements, it may claim any available second and third year credits. However, the new owners would not be eligible to claim carryover credits from the “old” business. If the sale is not the sale of an ongoing business that is substantially unchanged but the sale of only some physical assets, the purchaser would not be eligible for continuing credits.

18. What credit is available for a qualified employment position when an employee employed at one enterprise zone location is transferred to a location in another enterprise zone?

The employee would be considered to be in continuous employment and would be eligible for second or third year credits at the new location if the transferred employee meets all qualified employment position requirements at the new location.

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19. What credit is available if a business moves from one enterprise zone to another?

The business would be eligible for continuing and carryover credits in the new zone if the business met the statutory requirements in the new zone.

20. What credit is available if a business moves out of an enterprise zone?

A business that moves to a location out of a zone would lose both unused carryover and continuing credits. In order to claim the credit, a business must be located in the zone at the end of the taxable year. A business that moves out of the zone during the taxable year would not be eligible for a partial credit.

21. Is a construction site considered to be a zone location for the contractor?

No. The zone location must be a taxpayer's permanent place of business within the enterprise zone. A.R.S. § 43-1161(M)(4) defines a zone location of the taxpayer and A.R.S. § 43-1161(C)(3)(b) requires the job duties be performed at the zone location. Property owned by the customer and intended for the customer's use is not a zone location of the contractor.

22. Do mail order, telephone, or internet sales constitute retail sales activity at the location from which they are solicited?

Yes. The definition of retail activities includes taking or filling orders by a retailer. An unrelated third party providing mail, phone, or internet solicitation services for a retail business would not itself be engaged in retail activity.

23. How is the 10 percent retail exception determined?

For taxable years beginning from and after December 31, 2001, a taxpayer that conducts more than 10 percent of its business selling tangible personal property at retail, measured by either the number of employees assigned to retail or square footage of the facility used for retail transactions at the zone location, does not meet the retail exception.

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24. Does retail activity that does not exceed 10 percent disqualify a taxpayer if the activity is not the type described in A.R.S. § 43-1074(A)(1), (2) or (3) or A.R.S. § 43-1161(A)(1), (2) or (3)?

Yes. For taxable years beginning from and after December 31, 2001, allowable retail activity must not exceed 10 percent of the business activity at the zone location and must be the type of retail activity described in A.R.S. § 43-1074(A)(1), (2) or (3) or A.R.S. § 43-1161(A)(1), (2) or (3). For example, if the taxpayer had less than 10 percent of its business activity related to retail activity but that retail activity was sale of unrelated products to the general public, the taxpayer would not meet the retail exemption and would not qualify for the credit for taxable years beginning from and after December 31, 2001. Under the same circumstances the taxpayer would meet the retail exemption for a taxable year beginning from and after December 31, 2000 and ending on or before November 30, 2002 since the retail exemption for that period only required that retail activity not exceed 10 percent of the business activity at the zone location. For a taxable year beginning prior to January 1, 2001, a taxpayer would not qualify for the credit if any retail activity was conducted at the zone location.

25. If a taxpayer was disqualified because of retail activity in the second year, does the taxpayer lose the carryover of unused first year credits and may the taxpayer claim third year credits if it is not disqualified in that year?

The taxpayer can carryover unused first year credits. A taxpayer could not claim second or third year credits. New employees hired in the second year would not qualify for any credits. New employees hired in the third year would qualify for first year credits if the taxpayer did not have disqualifying retail activity in that year.

26. Is a taxpayer filing a combined/consolidated Arizona income tax return allowed to claim separate credits for each corporation within the group or is the combined/consolidated group considered to be a single taxpayer for purposes of the Enterprise Zone income tax credit?

A taxpayer filing a combined or consolidated Arizona income tax return is considered to be a single taxpayer and limitations such as the 200 maximum credits would apply to the combined or consolidated group rather than each corporation.

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27. How is a group of affiliated corporations operating at the same location treated for purposes of the retail restriction, residency requirements or computation of net increase in new qualified employment positions?

A combined or consolidated group that has one or more corporations conducting business at the same location is considered to be a single taxpayer and the determination of retail restriction, residency requirements and computation of net increase in new qualified employment positions is based on the total activity of all members of the group at that location. For example, two affiliated corporations are conducting business at the same location; one corporation has 100 new positions, 5 of which are residents of the county. The other corporation has 50 new positions, all of which are residents of the county. Together the corporations have 150 new employment positions, 55 of which are residents of the county, therefore, the business meets the residency requirement for all 150 new positions.

Gale Garriott, Deputy Director,
for J. Elliott Hibbs, Director

Signed: April 15, 2004

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 that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning 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 96-1 for more detailed information regarding documents issued by the Department of Revenue.