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ARIZONA CORPORATE INCOME TAX RULING CTR 13-1

(Supersedes CTR 93-3, CTR 93-5, and CTR 93-12)

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ISSUE:

Is an expense which is disallowed for federal purposes because a federal credit was claimed on the same activity permitted as a subtraction for Arizona purposes?

RULING:

The starting point for the Arizona corporate income tax computation is the corporation's federal taxable income. Arizona Revised Statutes (A.R.S.) § 43-1122 provides the only subtractions from federal taxable income in arriving at Arizona taxable income for corporations. Therefore, if a federal adjustment is included in federal taxable income it will be part of a corporation's Arizona taxable income absent a statutory subtraction under A.R.S. § 43-1122.

DISCUSSION:

The internal revenue code contains several federal income tax credits available for corporations to claim. Often in order to claim a federal income tax credit, the corporation must add back expenses that would otherwise be deductible on their federal income tax returns and include those expenses in their federal taxable income. Since the starting point for Arizona corporations is federal taxable income, disallowed federal expenses are deductible from Arizona gross income only if an Arizona subtraction is available.

Example 1

Corporation A claims an employee stock option plan (ESOP) credit and as a result is not able to deduct an ESOP expense on its federal return. May Corporation A deduct the ESOP expense on its Arizona return? No, the starting point for Corporation A is its federal

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taxable income and A.R.S. § 43-1122 does not provide a subtraction from federal taxable income for ESOP expenses.

Example 2

Corporation B claims the empowerment zone credit provided by Internal Revenue Code (I.R.C.) § 1396 and as a result is not able to deduct its wage expense related to the credit on its federal return. May Corporation B deduct its wage expense on its Arizona return? Yes, while the starting point for Corporation B is its federal taxable income A.R.S. § 43-1122(1) incorporates by reference A.R.S. § 43-1022(15) that provides a specific subtraction from federal taxable income for the portion of any wages or salaries paid or incurred by the taxpayer for the taxable year that is equal to the amount of the empowerment zone credit.

Example 3

Corporation C claims the Renewal Community Employment Credit provided by I.R.C. § 1400H and as a result is not able to deduct its wage expense related to the credit on its federal return. May Corporation C deduct its wage expense on its Arizona return? No, the starting point for Corporation C is its federal taxable income and A.R.S. § 43-1122 does not provide a specific subtraction from federal taxable income for the portion of any wages or salaries paid or incurred by the taxpayer for the taxable year that is equal to the amount of the renewal community employment credit.¹

Example 4

Corporation D claims the federal investment tax credit and as a result their federal depreciation is based on the reduced basis of the property. May Corporation D claim additional depreciation expense based on the unreduced basis of the property on its Arizona return? No, the starting point for Corporation D is its federal taxable income and there is no provision in A.R.S. § 43-1122 allowing a subtraction for additional depreciation expenses based on the original basis of depreciable property rather than the reduced basis required when an investment tax credit is claimed for federal tax purposes.

¹ The renewal community employment credit and the empowerment zone credit are both 1) claimed on IRS Form 8844 and 2) calculated the same; however they are two separate credits found in two separate federal statutes. A.R.S. § 43-1122(1) incorporates by reference A.R.S. § 43-1022(15) that references the empowerment zone credit and its specific statutory reference (I.R.C. § 1396). A.R.S. § 43-1022(15) does not specifically reference the Renewal Community Employment Credit or its specific statutory reference (I.R.C. § 1400H). As a result, the wage expense equal to the amount of the renewal community employment credit is not an example of a permitted subtraction under A.R.S. § 43-1122.

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APPLICABLE LAW:

A.R.S. § 43-102 provides it is the intent of the Arizona Legislature to adopt the provisions of the federal internal revenue code relating to the measurement of taxable income for corporations to the end that taxable income reported each taxable year to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in Title 43.

A.R.S. § 43-1022(15) provides a subtraction from Arizona gross income for the portion of any wages or salaries paid or incurred by the taxpayer for the taxable year that is equal to the amount of the federal work opportunity credit, the empowerment zone employment credit, the credit for employer paid social security taxes on employee cash tips and the Indian employment credit that the taxpayer received under sections 45A, 45B, 51(a) and 1396 of the Internal Revenue Code.

A.R.S. § 43-1101(2) provides that Arizona taxable income for corporations is federal taxable income as adjusted by the modifications in A.R.S. §§ 43-1121 and 43-1122

A.R.S. § 43-1101(4) defines federal taxable income of a corporation as taxable income of a corporation computed pursuant to the Internal Revenue Code.

A.R.S. § 43-1122 provides a specific list of subtractions for corporations in adjusting federal taxable income to Arizona taxable income

A.R.S. § 43-1122(1) provides a subtraction for the amounts computed pursuant to section 43-1022, paragraphs 8 through 15, 27, 28, 29, 31 and 32. For the purposes of this paragraph, "federal adjusted gross income" as used in section 43-1022 means "federal taxable income".

Arizona State Tax Commission v. Kieckhefer, 67 Ariz. 102, 191 P.2d 729 (1948). The court held that a right to a deduction does not exist in the absence of statutory authorization and a deduction will not be allowed for items not within the terms of the statute.

A.R.S. § 43-1022(15) provides a subtraction from Arizona gross income for the portion of any wages or salaries paid or incurred by the taxpayer for the taxable year that is equal to the amount of the federal work opportunity credit, the empowerment zone employment credit, the credit for employer paid social security taxes on employee cash tips and the

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Indian employment credit that the taxpayer received under sections 45A, 45B, 51(a) and 1396 of the Internal Revenue Code.

John A. Greene, Director

Date

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 96-1 for more detailed information regarding documents issued by the Department of Revenue.