

2004 Defense Contracting Credits

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General Instructions

ARS §§ 43-1077 and 43-1165 provide a nonrefundable tax credit for a net increase in employment under United States Department of Defense contracts during the taxable year by a qualified defense contractor that is certified by the Arizona Department of Commerce under ARS § 41-1508. A nonrefundable tax credit is also allowed for a net increase in private commercial employment during the taxable year by a certified qualified defense contractor for full-time equivalent employee positions transferred from exclusively defense related activities to employment in exclusively private commercial activities.

ARS §§ 43-1078 and 43-1166 provide a tax credit that is equal to a portion of the amount paid as taxes during the taxable year by a certified qualified defense contractor on property in this state that is classified as class one, paragraphs 12 and 13 pursuant to ARS § 42-12001. If the taxpayer claims the credit, the taxpayer must add the amount paid as taxes on qualifying property (or the taxpayer's pro rata share of this amount) to the taxpayer's Arizona gross income.

A taxpayer may apply to the Arizona Department of Commerce for certification as a qualified defense contractor until and including June 30, 2001. The department shall not certify any new qualified defense contractor after that date.

A defense contractor obtains and maintains certification by:

- Applying to the Arizona Department of Commerce;
- Submitting and retaining copies of all required information, including information relating to the amount of tax benefits the defense contractor receives;
- Allowing such inspections and audits as are necessary to verify the accuracy of the submitted information; and
- Agreeing with the Arizona Department of Commerce in writing to furnish information relating to the amount of tax benefits the taxpayer receives each year for disclosure in composite form in an annual report by the Department of Commerce.

"Qualified defense contractor" means a business entity that, on initial qualification, meets all of the following requirements:

- Has one or more current manufacturing, assembling, fabricating, research, development, or design contracts directly with the United States Department of Defense that:
 - a. total at least five million dollars in sales of tangible personal property manufactured, assembled, fabricated, researched, developed, or designed in this state; and
 - b. do not require providing products or services directly to a particular military base or installation.
- Employs at least two hundred full-time equivalent employee positions in this state solely with respect to United States Department of Defense contracts.

The defense contracting credit for net increases in employment under the United States Department of Defense contracts and for net increases in qualified private commercial employment is equal to:

- \$2,500 for each new qualified full-time equivalent employee position created.
- \$2,000 for each qualified full-time equivalent employee position in the second year of existence.
- \$1,500 for each qualified full-time equivalent employee position in the third year of existence.
- \$1,000 for each qualified full-time equivalent employee position in the fourth year of existence.
- \$500 for each qualified full-time equivalent employee position in the fifth year of existence.

Credit carryover for corporate and individual taxpayers:
If the allowable credit exceeds the tax liability, any unused amount may be carried forward *until taxable years beginning from and after December 31, 2011*, as a credit against subsequent taxable years' tax liability regardless of continuing certification as a qualified defense contractor. This provision is effective August 9, 2001, and applies to carryovers from any taxable years that are open under the statute of limitations as of the effective date of the legislative change.

However, a credit is not allowed for defense contracting employment and private commercial employment with respect to the same employee position.

A credit is not allowed with respect to employment that was transferred from an outside contractor in this state to in-house employment by the taxpayer solely for purposes of qualifying for this credit.

The defense contracting credit under ARS § 43-1077 or § 43-1165 is in lieu of:

- The enterprise zone credit, under ARS § 43-1074 or § 43-1161, with respect to the same employees; and
- The military reuse zone credit, under ARS § 43-1079 or ARS § 43-1167, with respect to the same employees.

The taxpayer must account for qualifying full-time equivalent employee positions on a first-in first-out basis. If a decrease in qualifying employment occurs, the taxpayer must subtract the decrease from the earliest qualifying positions.

Co-owners of a business, including partners in a partnership and shareholders of an S corporation, may each claim only the pro rata share of the allowable credit based on the ownership interest.

The total of the credits allowed all such owners may not exceed the amount that would have been allowed for a sole owner of the business.

Specific Instructions

Complete the name and taxpayer identification number section at the top of the form. Indicate the period covered by the taxable year (in an MM/DD/YYYY format). Attach the completed form to the tax return.

All returns, statements, and other documents filed with the department require a taxpayer identification number (TIN). The TIN for a corporation, S corporation, or a partnership is the taxpayer's employer identification number. The TIN for an individual is the taxpayer's social security number or an IRS individual taxpayer identification number. Taxpayers that fail to include their TIN may be subject to a penalty.

Part I - Net Increase in Defense Employment Positions

First credit year - The taxpayer's net increase in average employment is the increase in employment reported to the Arizona Department of Economic Security for the taxable year over the employment baseline. **Each succeeding credit year** - The taxpayer's net increase in average employment is the increase in employment reported to the Arizona Department of Economic Security for the taxable year over the preceding taxable year's average employment.

Line 2 -

Enter the average employment under United States Department of Defense contracts for the current taxable year.

Line 3 -

Enter the employment baseline. The taxpayer must establish an employment baseline by:

- Using the multi-year forecast of employment on United States Department of Defense contracts that was submitted to the Department of Defense before June 1, 1992. The annual average employment forecast for the first year that the taxpayer qualified is the baseline; **or**
- If the taxpayer did not make such a forecast before June 1, 1992, the baseline is the average annual employment as reported to the Arizona Department of Economic Security during the preceding taxable year, **or**
- If a taxpayer qualifies in the same year it relocates into this state, the taxpayer's baseline is zero.

Line 4 -

Subtract the amount on line 3 from the amount on line 2. If this amount is less than one, enter zero. This is the net increase in defense employment positions.

Part II - Net Increase in Qualified Private Commercial Employment Positions

The taxpayer must compute the number of qualified new full-time equivalent employment positions in private commercial employment by prorating employment during the taxable year according to the date of transfer from defense to private commercial activities or the date of transfer from private commercial activities to defense.

Line 5 -

Enter the net increase in private commercial employment positions for the current taxable year.

Line 6 -

Enter the number of new qualified private commercial employment positions created during the current taxable year. Qualified private commercial employment positions are created when a taxpayer transfers full-time equivalent employment positions from exclusively defense related activities to employment by the taxpayer in exclusively private commercial activities.

Line 7 -

Enter the lesser of line 5 or line 6. This is the net increase in qualified private commercial employment positions.

Part III - Credit Calculation for Qualified Employment Positions

Line 8, column (a) -

Enter the amount from Part I, line 4.

Line 8, column (b) -

Enter the amount from Part II, line 7.

Line 8, column (d) -

Add the amounts on line 8, column (a) and on line 8, column (b). Multiply the total by the amount on line 8, column (c). Enter the result on line 8, column (d). This is the allowable credit for qualified net new employment positions.

Line 9, column (a) -

Enter the number of qualified defense employment positions in the second year of existence. Arizona statutes do not require that the employee filling the qualified position in the first year be the same employee filling the qualified position during the second continuous year of the position.

Line 9, column (b) -

Enter the number of qualified private commercial employment positions in the second year of existence. Arizona statutes do not require that the employee filling the qualified position in the first year be the same employee filling the qualified position during the second continuous year of the position.

Line 9, column (d) -

Add the amounts on line 9, in columns (a) and (b). Multiply the total by the amount on line 9, column (c) and enter the result in column (d). This is the allowable credit for qualified employment positions in the second year of existence.

Line 10, column (a) -

Enter the number of qualified defense employment positions in the third year of existence. Arizona statutes do not require that the employee filling the qualified position in the second year be the same employee filling the qualified position during the third continuous year of the position.

Line 10, column (b) -

Enter the number of qualified private commercial employment positions in the third year of existence. Arizona statutes do not require that the employee filling the qualified position in the second year be the same employee filling the qualified position during the third continuous year of the position.

Line 10, column (d) -

Add the amounts on line 10, in columns (a) and (b). Multiply the total by the amount on line 10, column (c) and enter the result in column (d). This is the allowable credit for qualified employment positions in the third year of existence.

Line 11, column (a) -

Enter the number of qualified defense employment positions in the fourth year of existence. Arizona statutes do not require that the employee filling the qualified position in the third year be the same employee filling the qualified position during the fourth continuous year of the position.

Line 11, column (b) -

Enter the number of qualified private commercial employment positions in the fourth year of existence. Arizona statutes do not require that the employee filling the qualified position in the third year be the same employee filling the qualified position during the fourth continuous year of the position.

Line 11, column (d) -

Add the amounts on line 11, in columns (a) and (b). Multiply the total by the amount on line 11, column (c) and enter the result in column (d). This is the allowable credit for qualified employment positions in the fourth year of existence.

Line 12, column (a) -

Enter the number of qualified defense employment positions in the fifth year of existence. Arizona statutes do not require that the employee filling the qualified position in the fourth year be the same employee filling the qualified position during the fifth continuous year of the position.

Line 12, column (b) -

Enter the number of qualified private commercial employment positions in the fifth year of existence. Arizona statutes do not require that the employee filling the qualified position in the fourth year be the same employee filling the qualified position during the fifth continuous year of the position.

Line 12, column (d) -

Add the amounts on line 12, in columns (a) and (b). Multiply the total by the amount on line 12, column (c) and enter the result in column (d). This is the allowable credit for qualified employment positions in the fifth year of existence.

Line 13, column (a) -

Add the amounts on lines 8 through 12 in column (a). Enter the total on line 13, column (a). This is the total number of qualified defense employment positions for which the business is claiming the credit.

Line 13, column (b) -

Add the amounts on lines 8 through 12 in column (b). Enter the total on line 13, column (b). This is the total number of qualified private commercial employment positions for which the business is claiming the credit.

Line 13, column (d) -

Add the amounts on lines 8 through 12 in column (d). Enter the total on line 13, column (d). This is the total allowable credit for qualified defense and private commercial employment positions.

Part IV - Credit Calculation for Property Taxes Paid on Class One Property

Line 14 -

Enter the amount paid as taxes during the taxable year by the qualified defense contractor that is certified by the Arizona Department of Commerce on property in this state that is classified as class one property.

Line 15 -

Compare the amount from Part I, line 4, to the table below. Enter the applicable percent from the table (expressed as a decimal).

New Employment Credit Percentage	
More than 900	40% (.40)
601 – 900	30% (.30)
301 – 600	20% (.20)
1 – 300	10% (.10)

Line 16 -

Multiply the amount on line 14 by the percent on line 15. Enter the result.

Line 17 -

Divide the business's total gross income from United States Department of Defense contracts apportioned to this state for the current taxable year by the business's total gross income from all sources apportioned to this state for the current taxable year. Enter the quotient (expressed as a decimal).

Line 18 -

Multiply the amount on line 16 by the percent on line 17. Enter the result. This is the allowable credit for property taxes paid on class one property in Arizona.

Part V - S Corporation Credit Election and Shareholder's Share of Credit

Line 19 -

This portion of the Form 302 must be completed by the S corporation in order for the S corporation or its shareholders to claim the defense contracting credits.

The S corporation must make an irrevocable election either to claim the credits or to pass the credits through to its shareholders. The election statement must be signed by one of the officers of the S corporation who is also a signatory to the Form 120S.

Lines 20 through 23 -

If the S corporation elects to pass the credits through to its shareholders, it must also complete lines 20 through 23. The S corporation must complete Form 302, Parts I through IV. Then, complete Part V, lines 20 through 23, separately for each shareholder. The S corporation must furnish each shareholder with a copy of the completed Form 302.

If the S corporation passes the credit for property taxes paid through to its shareholders, it must notify each shareholder of the shareholder's pro rata share of the adjustment to income required by the disallowance of the deduction for property taxes for which the credit is claimed.

Each shareholder must complete Parts VII and VIII.

Part VI - Partner's Share of Credit

Lines 24 through 27 -

The partnership must complete Form 302, Parts I through IV. Then, complete Part VI, lines 24 through 27, separately for each partner. The partnership must furnish each partner with a copy of the completed Form 302.

Each partner must complete Parts VII and VIII.

Part VII - Available Credit Carryover

Unused credits may be carried forward *until taxable years beginning from and after December 31, 2011*, as a credit against subsequent years' income tax liability regardless of continuing certification as a qualified defense contractor. This provision is effective August 9, 2001, and applies to carryovers from any taxable years that are open under the statute of limitations as of the effective date of the legislative change.

Complete Part VII only if the allowable defense contracting credits for qualifying prior taxable years exceeded the Arizona income tax liability for those taxable years. In column (a), enter the total credit amount originally computed for those taxable years. In column (b), enter the total amount of the credits from those taxable years that has already been used. Subtract the amount in column (b) from column (a) and enter the difference in column (c).

Part VIII - Total Available Credit

Line 29 -

Enter the current year's credit for qualified employment positions.

Individuals and corporations (including S corporations that elected to claim the credit) - Enter the credit from Part III, line 13, column (d).

S corporation shareholders - Enter the credit from Part V, line 22.

Partners of a partnership - Enter the credit from Part VI, line 26.

Line 30 -

Enter the current year's credit for property taxes paid on class one property.

Individuals and corporations (including S corporations that elected to claim the credit) - Enter the credit from Part IV, line 18.

S corporation shareholders - Enter the credit from Part V, line 23.

Partners of a partnership - Enter the credit from Part VI, line 27.

Line 31 -

Enter the amount from Part VII, line 28, column (c).

Line 32 -

Add lines 29, 30, and 31. This is the total available defense contracting credit which may be applied to the current taxable year's tax liability. Enter the total here and on Form 300, Part I, line 1, or Form 301, Part I, line 1.