

2001 Partnership Income Tax Return

Obtain additional information or assistance, tax forms and instructions, and copies of tax rulings and tax procedures by contacting one of the numbers listed below:

Phoenix	(602) 255-3381
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Obtain tax rulings, tax procedures, tax forms and instructions, and other tax information by accessing the department's Internet home page at:

www.revenue.state.az.us

General Instructions

Who Must Use Form 165

File Arizona Form 165 for every domestic partnership including syndicates, groups, pools, joint ventures, and every foreign partnership (syndicate, pool, etc.) doing business in Arizona.

Entity Classification Under the Federal "Check-the-Box Rules"

The federal tax classification of an entity under the federal "check-the-box rules" determines the entity's classification for Arizona tax purposes. Refer to Arizona Partnership Tax Ruling PTR 97-1 for further information. An entity that is disregarded as an entity separate from its owner is included in the tax return of its owner.

Limited Liability Companies

Under the provisions of the Arizona Limited Liability Company Act, a limited liability company is classified as a partnership, or as a corporation, or is disregarded as an entity as determined under the Internal Revenue Code as defined in ARS § 43-105. A single member limited liability company that is disregarded as an entity is treated as a branch or division of the owner. A limited liability company classified as a partnership for federal tax purposes must file Form 165. A limited liability company classified as a corporation for federal tax purposes must file Form 120. A limited liability company classified as a corporation for federal tax purposes that makes a valid federal election to be taxed as an S corporation must file Form 120S. A single member limited liability company that is disregarded as an entity for federal tax purposes is included in the Arizona return of its owner. Refer to Arizona Partnership Tax Ruling PTR 97-2 for further information.

Taxable Year Covered by Return

The partnership must have the same taxable year for Arizona purposes as it has for federal purposes. Indicate the period covered by the taxable year (in an MM/DD/YYYY format) and whether the taxable year is a calendar year or a fiscal year.

Filing Original Returns

Returns are due by the 15th day of the fourth month following the close of the taxable year (April 15, in the case of a calendar year return). If the partnership has a valid federal or Arizona extension, file the return by the extended due date. If the partnership uses a FEDERAL extension, the taxpayer must check the federal extension box on page 1 of the return. If the partnership uses an ARIZONA extension, the taxpayer must attach a copy of the Arizona extension to the front of the return. Attach a copy of the completed federal Form 1065 and supporting schedules to the Arizona return. File the return with the Arizona Department of Revenue, PO Box 29079, Phoenix AZ 85038-9079.

The department normally determines the timeliness of a return by the postmark or other official mark of the U.S. Postal Service stamped on the envelope in which the return is mailed. Refer to Arizona General Tax Ruling GTR 93-1 for further information. The department will also accept proof of mailing from a private delivery service included in the Internal Revenue Service list of designated private delivery services. Contact the private delivery service for information regarding how to obtain the written proof of mailing.

Extension of Time to File a Return

The partnership can apply for an Arizona extension by filing a completed Form 120EXT by the original due date of the return. The partnership can substitute a valid federal extension for an Arizona extension. If the partnership uses a FEDERAL extension, the taxpayer must check the federal extension box on page 1 of the return. If the partnership uses an ARIZONA extension, the taxpayer must attach a copy of the Arizona extension to the return.

NOTE: *A partnership that uses a full six-month extension of time to file Form 165 may force the partners into noncompliance. Arizona law provides that six months is the maximum extension of time to file that the department may grant the partners to file their returns.*

Composite returns: Use Form 204 to request an extension of time to file a composite return on Form 140NR for qualifying nonresident individual partners.

Filing Amended Returns

Any taxpayer who files an amended return with the Internal Revenue Service must file an Arizona amended return on Form 165 within 90 days.

The taxpayer must report changes or corrections of the taxpayer's taxable income by the Internal Revenue Service or as the result of renegotiation of a contract or subcontract with the United States to the department. The taxpayer must, within 90 days after the final determination of the change or correction, either:

- File a copy of the final determination with the department, concede the accuracy of the determination or state any errors, and request the department to recompute the tax owed to Arizona; or
- File an amended return as required by the department.

The taxpayer must include additional schedules that provide sufficient information for the department to recompute the taxpayer's Arizona taxable income based on the Revenue Agent Report (RAR) changes. The department may require the taxpayer to file an amended return if the department does not have the necessary information to recompute the tax owed to Arizona.

NOTE: *File amended returns for prior taxable years on the Forms 165 for those taxable years. Use the 2001 Form 165 to amend only the taxable year 2001.*

Records

The partnership should maintain books and records substantiating information reported on the return and keep these documents for inspection. Arizona General Tax Ruling GTR 96-1 discusses the general requirements for the maintenance and retention of books, records and other sources of information received, created, maintained or generated through various computer, electronic and imaging processes and systems. Refer to this tax ruling for further information.

Rounding Dollar Amounts

Taxpayers must round amounts to the nearest whole dollar. If 50 cents or more, round up to the next dollar. If less than 50 cents, round down.

Penalties

A partnership information return that is incomplete or filed after its due date (including extensions) is subject to a \$500 penalty.

IRC § 7519 - Required Payments

Taxpayers cannot deduct the federal required payments on their Arizona tax returns as an ordinary and necessary business expense or otherwise.

Specific Instructions

Type or print the required information in the name, address, and information boxes on the top of page 1. Indicate the period covered by the taxable year on page 1 of the return (in an MM/DD/YYYY format) and whether the taxable year is a calendar year or a fiscal year. Indicate whether this return is an original or an amended return.

Enter the partnership's federal employer identification number, which is the taxpayer identification number (TIN). Enter the Arizona withholding tax number and Arizona transaction privilege tax number for the partnership.

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 federal 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. Paid tax return preparers must include their TIN where requested. The TIN for a paid tax return preparer is the individual's social security number or preparer identification number or the federal employer

identification number of the business. Paid tax return preparers that fail to include their TIN may be subject to a penalty.

Other Information (Page 1)

Answer all questions (A through L).

Question E: Enter the total number of entity partners (exempt organizations, corporations, S corporations, trusts, estates, partnerships). **NOTE:** *The total of the amounts entered for questions C, D, and E should equal the total number of partners.*

Question K: Report any adjustments made by the Internal Revenue Service to any federal income tax return filed by the partnership not previously reported to the department. Submit these adjustments under separate cover to Arizona Department of Revenue, PO Box 29080, Phoenix, AZ 85038-9080.

Adjustment of Partnership Income From Federal to Arizona Basis

Line 1 - Federal Ordinary Business and Rental Income

Enter the total of ordinary income (loss) from trade or business activities, net income (loss) from rental real estate activities, and the net income (loss) from other rental activities from the federal Form 1065, Schedule K. Attach a copy of the federal Form 1065 and its component schedules.

Line 2 - Additions to Partnership Income

Enter the amount from page 2, Schedule A, line A5.

Line 4 - Subtractions From Partnership Income

Enter the amount from page 2, Schedule B, line B6.

Line 5 - Partnership Income Adjusted to Arizona Basis

Subtract line 4 from line 3. Enter the difference. This is the partnership income adjusted to an Arizona basis.

Line 6 - Net Adjustment of Partnership Income From Federal to Arizona Basis

Subtract line 1 from line 5. Enter the difference. This is the adjustment of partnership income from federal to Arizona basis that will be reported on the Form 165 Schedules K-1 and K-1(NR).

Line 7 - Penalty

This form is an information return. An information return that is incomplete or filed after its due date (including extensions) is subject to a \$500 penalty.

If the partnership files this return after its due date (including extensions), enter \$500 on this line. Attach a check for that amount to the return. Make the check payable to the Arizona Department of Revenue. Include the partnership's TIN on the check.

Certification

One of the partners must sign the return. If receivers, trustees in bankruptcy, or assignees are in control of the property or business of the organization, such receivers, trustees, or assignees must sign the return.

Paid preparers: Sign and date the return. Complete the firm name and address lines (the preparer's name and address if self-employed). Enter the preparer's TIN, which is the firm's FEIN or the individual preparer's social security number or preparer identification number.

Schedule A - Additions to Partnership Income

Line A1 - Non-Arizona Municipal Bond Interest

Enter interest income received from any state or municipal obligations (other than Arizona) credited to or earned by the partnership during the taxable year. Do not include interest from obligations specifically exempt from Arizona income tax. Examples of such tax exempt obligations are Arizona municipal bonds or bonds of Arizona political subdivisions.

The partnership must reduce the amount of interest income by certain expenses. Reduce the amount of interest income by the amount of any interest on indebtedness and other related expenses incurred or continued to purchase or carry those obligations, that were not otherwise deducted or subtracted in the computation of Arizona gross income.

Line A2 - Capital Investment by Qualified Defense Contractor

- **Federal Depreciation or Deduction for Cost of Capital Investment**

Enter the amount of depreciation deducted pursuant to IRC § 167 or the amount of expense deducted pursuant to IRC § 179. Make this adjustment if the partnership made an election, pursuant to ARS § 43-1024, to amortize the cost of any new device, machinery, equipment, or other capital investment. The partnership must use the device, machinery, equipment, or other capital investment exclusively for private commercial activities in Arizona.

- **Gain on Sale of Capital Investment**

Enter the amount of gain from the sale or other disposition of a capital investment which a qualified defense contractor elected to amortize pursuant to ARS § 43-1024.

Line A3 - Additions Related to Arizona Tax Credits

Enter on line A3 the following additions to partnership income that are related to Arizona tax credits. Attach a schedule detailing these additions.

A. Credit for Property Taxes Paid by a Qualified Defense Contractor

Enter the amount paid as taxes on property located in Arizona included in the federal taxable income of a qualified defense contractor. Make this adjustment if the partnership made an election to claim a credit under ARS § 43-1078 or § 43-1166 for such taxes.

B. Environmental Technology Facility Credit

- **Excess Federal Depreciation or Amortization**

Enter the excess of depreciation or amortization computed on the federal basis of the facility over depreciation or amortization computed on the Arizona

adjusted basis of the facility. Make this adjustment for the facility for which the partnership elected to claim a tax credit under ARS § 43-1080 or § 43-1169.

- **Excess in Federal Adjusted Basis**

Enter the amount by which the federal adjusted basis of the facility exceeds the Arizona adjusted basis of the facility. Make this adjustment if the facility or any component of the facility for which the partnership elected to claim a tax credit under ARS § 43-1080 or § 43-1169 was sold or otherwise disposed of during the taxable year.

C. Pollution Control Credit

- **Excess Federal Depreciation or Amortization**

Enter the excess of depreciation or amortization computed on the federal basis of the property over depreciation or amortization computed on the Arizona adjusted basis of the property. Make this adjustment for the property for which the partnership elected to claim a tax credit under ARS § 43-1081 or § 43-1170.

- **Excess in Federal Adjusted Basis**

Enter the amount by which the federal adjusted basis of the property exceeds the Arizona adjusted basis of the property. Make this adjustment if the property for which the partnership elected to claim a tax credit under ARS § 43-1081 or § 43-1170 was sold or otherwise disposed of during the taxable year.

D. Agricultural Pollution Control Equipment Credit

- **Excess Federal Depreciation or Amortization**

Enter the excess of depreciation or amortization computed on the federal basis of the property over depreciation or amortization computed on the Arizona adjusted basis of the property. Make this adjustment for the property for which the partnership elected to claim a tax credit under ARS § 43-1081.01 or § 43-1170.01.

- **Excess in Federal Adjusted Basis**

Enter the amount by which the federal adjusted basis of the property exceeds the Arizona adjusted basis of the property. Make this adjustment if the property for which the partnership elected to claim a tax credit under ARS § 43-1081.01 or § 43-1170.01 was sold or otherwise disposed of during the taxable year.

E. Credit for Employment of Temporary Assistance for Needy Families (TANF) Recipients

Enter the amount of wage expenses deducted pursuant to the Internal Revenue Code for which the partnership elected to claim a tax credit under ARS § 43-1087 or § 43-1175.

F. Credit for Solar Hot Water Heater Plumbing Stub Outs or Electric Vehicle Recharge Outlets

Enter the amount of expenses deducted in computing Arizona gross income for the installation of solar hot water heater plumbing stub outs or electric vehicle recharge outlets for which the partnership elected to claim the tax credit under ARS § 43-1090 or § 43-1176.

Line A4 - Other Additions to Partnership Income

Enter the following "other additions" to the partnership income reported on page 1, line 1. Attach a schedule listing each item separately.

A. Excess of a Partner's Share of Partnership Taxable Income or Loss

Make this adjustment if the partnership is a partner of another partnership. Enter the excess of a partner's share of partnership taxable income included under ARS §§ 43-1401 through 43-1413 over the income reported under IRC § 702(a)(8). Enter the excess of a partner's share of partnership losses determined according to IRC § 702(a)(8) over the losses allowable under ARS §§ 43-1401 through 43-1413.

B. Income Recognized Because of Difference in Adjusted Basis of Property

Enter the amount by which the adjusted basis of property described in this paragraph, computed according to the Internal Revenue Code, exceeds the adjusted basis according to Arizona law. Basis computed according to Arizona law means according to Title 43 of the Arizona Revised Statutes effective January 1, 1979, and the Income Tax Act of 1954, as amended. This adjustment applies to all property held for the production of income sold or otherwise disposed of during the taxable year. This adjustment does not apply to depreciable property used in a trade or business.

C. Federal Amortization of Pollution Control Devices and Federal Depreciation of Child Care Facilities

Arizona's statutes which allow special amortization for pollution control devices and for the cost of day care facilities are no longer applicable to partnerships. However, if the partnership elected to claim the special amortization under Arizona's former statutory provisions, the partnership must continue to amortize these items in accordance with these provisions. Therefore, the partnership must make the same additions to and subtractions from Arizona gross income that Arizona's former statutory provisions required the partnership to make. If the partnership is amortizing these items under Arizona's former provisions, enter the amount of amortization or depreciation deducted for these items on the federal partnership return.

Line A5 - Total Additions to Partnership Income

Add lines A1 through A4. Enter the total on line A5 and on page 1, line 2.

Schedule B - Subtractions From Partnership Income

Line B1 - Interest From U.S. Government Obligations

Enter the interest income received from U.S. obligations included on the federal Form 1065, Schedule K, exempt from state income taxes under federal law.

NOTE: *Not all obligations associated with the federal government are obligations of the federal government. Obligations of the Government National Mortgage Association (GNMA) or the Federal National Mortgage*

Association (FNMA) are not obligations of the U.S. government and, therefore, are taxable to Arizona.

Line B2 - Difference in Adjusted Basis of Property

Enter the amount by which the adjusted basis of property described in this paragraph, computed according to Arizona law, exceeds the adjusted basis of such property computed according to the Internal Revenue Code. Basis computed according to Arizona law means according to Title 43 of the Arizona Revised Statutes, effective January 1, 1979, and the Income Tax Act of 1954, as amended. This adjustment applies to all property held for the production of income sold or otherwise disposed of during the taxable year. This adjustment does not apply to depreciable property used in a trade or business.

Line B3 - Agricultural Crops Contributed to Charitable Organizations

Arizona law allows a subtraction for qualified crop contributions made during the taxable year to one or more Arizona tax exempt charitable organizations for use in Arizona. Refer to Income Tax Procedure ITP 93-2 for information on how to determine if the contribution qualifies for the subtraction.

Line B4 - Capital Investment by Qualified Defense Contractor

- **Arizona Amortization of Cost of Capital Investment**
Enter the amount allowed by ARS § 43-1024 for amortization by a qualified defense contractor of a capital investment for private commercial activities.
- **Gain on Sale of Capital Investment**
Enter the amount of gain included in Arizona gross income on the sale or other disposition of a capital investment. Make this adjustment if a qualified defense contractor elected to amortize the capital investment pursuant to ARS § 43-1024.

Line B5 - Other Subtractions From Partnership Income

Enter the following "other subtractions" from the partnership income reported on page 1, line 1. Attach a schedule listing each item separately.

A. Excess of Partner's Share of Partnership Income or Loss

Make this adjustment if the partnership is a partner in another partnership. Enter the excess of the partner's share of the income included under IRC § 702(a)(8) over the income included under ARS §§ 43-1401 through 43-1413. Enter the excess of a partner's share of partnership losses, determined by ARS §§ 43-1401 through 43-1413, over the losses allowable under IRC § 702(a)(8).

B. Mine Exploration Expenses

Arizona no longer has special mine exploration expense provisions for partnerships. Arizona now conforms to the federal treatment of mine exploration expenses. However, if the partnership deferred exploration expenses under Arizona's former provisions, the partnership may subtract such deferred

expenses. The partnership claims the subtraction on a ratable basis as the units of produced ores or minerals discovered or explored as a result of such expenditures are sold. Enter the amount of such deferred exploration expenses.

C. Interest on Federally Taxable Arizona Obligations

Enter the amount of interest income received on obligations of the State of Arizona, or any of its political subdivisions, included on the federal Form 1065, Schedule K. Omit interest income received on obligations of the State of Arizona, or any of its political subdivisions, exempt from federal taxation and not included in the partnership's federal distributive income.

D. Wood Stoves, Wood Fireplaces or Gas-fired Fireplaces

Enter the amount allowed by ARS § 43-1027 for the cost of *converting* an existing wood fireplace to a qualified wood stove, wood fireplace, or gas-fired fireplace on property located in Arizona.

DO NOT claim a subtraction for the purchase and installation of a qualified wood stove, wood fireplace, or gas-fired fireplace on property located in Arizona. The subtraction for the purchase and installation of qualifying fireplaces and wood stoves was repealed effective for taxable years beginning from and after December 31, 1998.

E. Employer Contributions to Medical Savings Accounts

Enter the amount of contributions made by the partnership during the taxable year to medical savings accounts established on behalf of the partnership's employees as provided by ARS § 43-1028. The subtraction is allowed for such contributions to the extent that the contributions are not deductible by the partnership under the Internal Revenue Code.

F. Expenses Related to Certain Federal Tax Credits

Enter the amount of wages or salaries paid or incurred by the taxpayer for the taxable year not deducted in the computation of Arizona gross income if the taxpayer received certain federal tax credits. The specific federal tax credits are the 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. This subtraction applies to taxable years beginning from and after December 31, 1996.

Line B6 - Total Subtractions From Partnership Income

Add lines B1 through B5. Enter the total here and on page 1, line 4.

**Schedule ACA – Air Carrier Apportionment
Formula
(Multistate Air Carriers Only)**

ARS §§ 43-1131 through 43-1150 govern the apportionment of income. A partnership that engages in activities both within and without Arizona must apportion its business income.

Effective for taxable years beginning from and after December 31, 2000, ARS § 43-1139 requires a taxpayer that is a qualifying air carrier to use an alternate apportionment method to apportion its business income to Arizona. The

taxpayer must complete Schedule ACA. Do not complete Schedule C.

The taxpayer must be engaged in air commerce. "Air commerce" means transporting persons or property for hire by aircraft in interstate, intrastate or international transportation.

**Schedule C - Apportionment Formula
(Non-Air Carrier Multistate Partnerships Only)**

The provisions of ARS §§ 43-1131 through 43-1150 govern the apportionment of income. A partnership that engages in activities both within and without Arizona apportions its business income. The basis of the apportionment (for a taxpayer other than a multistate air carrier) is property, payroll, and sales in Arizona as compared with everywhere. "Everywhere" means the property, payroll, and sales factors related to the whole unitary business. Refer to Arizona Administrative Code rules AAC R15-2D-101 through AAC R15-2D-903.

NOTE: ARS § 43-1139 (*Allocation of business income*) provides that the apportionment ratio is a fraction. The numerator of the fraction is the property factor plus the payroll factor plus two times the sales factor. The denominator of the fraction is four.

When the partnership uses the apportionment method, complete Schedule C.

ADMINISTRATIVE RELIEF REQUESTS

ARS § 43-1148 provides administrative relief if the allocation and apportionment provisions do not fairly represent the extent of the taxpayer's business activity in Arizona. **The taxpayer may petition for, or the department may require,** in respect to all or any part of the taxpayer's business activity, if reasonable:

- Separate accounting.
- The exclusion of any one or more of the factors.
- The inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state.
- The employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

This section permits a departure from the allocation and apportionment provisions only in limited and specific cases. ARS § 43-1148 may be invoked only in specific cases where unusual fact situations produce incongruous results under the apportionment and allocation provisions.

Taxpayers seeking relief should submit a letter to the Corporate Income Tax Audit Section 60 days prior to the filing of the return setting forth the relief that is requested and the justification for the relief.

The department normally makes such determinations only upon audit of the taxpayer. Such a detailed examination of the specific facts and circumstances reveals whether such unusual fact situations and incongruous results exist.

Line C1 - Property Factor

The value of tangible personal property and real property owned by the partnership is its original cost. The partnership normally determines the average value of its owned property by averaging the values at the beginning and ending of the tax period. Refer to Arizona Corporate Tax Ruling CTR 01-2 regarding the treatment of computer software in the property factor (whether to include it and attribution to particular state(s) in the numerator).

The value of tangible personal property and real property rented by the partnership is eight times its net annual rental rate. The net annual rental rate is the annual rental rate paid by the partnership for the rented property less the aggregate annual subrental rates paid by subtenants of the partnership. The partnership automatically achieves averaging for rented property by the method of determining the net annual rental rate of such property.

Report real property situated in and tangible personal property permanently located in Arizona as property within Arizona, if connected with the business activity. Allocate the value of mobile property to Arizona on the basis of the total time the property was within Arizona.

Line C2 - Payroll Factor

Report salaries, wages, or other compensation of officers, employees, etc., as within Arizona if performance of the services occurs here. This rule applies regardless of where payment is made or control exercised. This rule also applies regardless of whether the performance of the services is partly or wholly in connection with the apportionable business carried on outside the state or in interstate or foreign commerce.

Allocate the compensation of officers and employees who perform services partly within and partly without Arizona to this state when:

- The services performed outside of Arizona are incidental to the employee's service within Arizona; or
- The employee's base of operation is in Arizona; or
- The employee has no base of operation in any state, but the direction or control of the employee is from Arizona; or
- The employee has no base of operation in any state, and there is no direction or control from a state in which the employee performs some part of his services, but the employee's residence is in Arizona.

Line C3 - Sales Factor

The term "sales" includes all gross receipts from transactions and activities in the course of the regular trade or business that produce income.

Determine sales within Arizona on a destination sales basis.

NOTE: Multiply the amount entered on line C3(c), column A, of the Schedule C (the total Arizona sales) by 2 (double weighted sales factor) on line C3(d), column A. Enter the amount on line C3(e), column A. Do not double the amount

entered on line C3(e), column B, of the Schedule C (the everywhere sales of the taxpayer).

EXAMPLE: The partnership has total Arizona sales of \$100,000 and total everywhere sales of \$1,000,000. On line C3(e), column A, enter \$200,000 of Arizona sales. On line C3(e), column B, enter \$1,000,000 of everywhere sales for the partnership.

The sales factor ratio on line C3(e), column C, may, in certain circumstances, exceed 100 percent. However, since the total ratio (line C4) is divided by four, the average ratio (line C5) will not exceed 100 percent.

Line C5 - Average Ratio

Divide the total ratio, line C4, column C, by four. Enter the average ratio here and on Form 165 Schedule K-1(NR), column (b). Express the ratio as a decimal carried out to six places.

NOTE: Do not exclude a factor from the total ratio if the numerator of a factor is zero and the denominator of a factor is greater than zero. However, the taxpayer must exclude a factor if both the numerator and the denominator of a factor are zero. If the property or payroll factor is excluded, determine the average ratio (line C5, column C) by dividing the total ratio by three. If the sales factor is excluded, determine the average ratio by dividing the total ratio by two.

Schedule D - Business Information

If the partnership has income from business activity *taxable entirely within Arizona*, complete only the first section of the schedule.

If the partnership has income from business activity *taxable within and without Arizona*, complete both parts of the schedule.

Schedule K-1 - Partnership Instructions

Use Schedule K-1 for all resident individual partners, all resident estate partners and all trust partners with only resident fiduciaries and resident beneficiaries.

Complete three copies of Form 165 Schedule K-1 for each partner. File one copy of each partner's Schedule K-1 with the partnership's Form 165. Provide all partners with a copy of their Schedule K-1. Retain a copy for the partnership's records.

Schedule K-1(NR) - Partnership Instructions

Use Schedule K-1(NR) for all other partners.

Any partnership that has income from business activity that is taxable both within and without Arizona must allocate and apportion its net income. The partnership must allocate and apportion its net income according to the Uniform Division of Income for Tax Purposes Act (UDITPA), ARS §§ 43-1131 through 43-1150.

A partnership that has income from business activity taxable in more than one state is a *multistate partnership*. A partnership that has income from business activity taxable entirely within Arizona is a *wholly Arizona partnership*.

Column (a) - Distributive Share Amount

Wholly Arizona partnerships - In column (a), enter the distributive share amount for each line item from the federal Form 1065, Schedule K-1. On Part II, line 12, enter the adjustment of partnership income from federal to Arizona basis (Form 165, page 1, line 6) multiplied by the partner's percentage of gain or loss.

NOTE: *Complete only Part II, line 12 of Schedule K-1(NR) for corporate partners.*

Multistate partnerships - Apportion all business income of a multistate partnership by the use of the apportionment formula. Nonbusiness income of a multistate partnership is nonapportionable and specifically allocable to a particular state.

"Business income" under the transactional test means income arising from transactions and activity in the regular course of the taxpayer's trade or business. Business income under the functional test includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. (ARS § 43-1131) "Nonbusiness income" means all income other than business income. (ARS § 43-1131)

In column (a), enter the partner's distributive share of the multistate partnership's income (or loss) that is subject to apportionment.

The multistate partnership must compute the partner's distributive share of the partnership's income that is subject to apportionment. Make this computation by subtracting the partner's distributive share of the multistate partnership's nonbusiness income from the partner's total distributive share amount of the partnership's income. The multistate partnership must attach a computation schedule that details (for each line item):

- The partner's distributive share amount from the federal Form 1065, Schedule K-1, or from the adjustment of partnership income from federal to Arizona basis (Form 165, page 1, line 6).
- The partner's distributive share amount of the partnership's nonapportionable or allocable income.
- The partner's distributive share of the partnership's income that is subject to apportionment. Refer to ARS §§ 43-1134 through 43-1138 for the methods of allocating certain types of nonbusiness income.

NOTE: *For corporate partners, apply this computation only for the amount to be entered on Part II, line 12. Do not complete any other lines on the schedule for a corporate partner.*

Column (b) - Arizona Apportionment Ratio

Wholly Arizona partnerships – Enter 100 percent.

Multistate partnerships - Enter the average ratio amount from Form 165, Schedule C, line C5, column C or from Schedule ACA, line 3. (Refer to Schedule ACA or Schedule C instructions.)

Column (c) - Arizona Source Income

Wholly Arizona partnerships – Multiply column (a) by column (b). Enter the result in column (c).

Multistate partnerships - Attach a schedule that details (for each line item) the following computation:

1. The partner's distributive share of the partnership's income subject to apportionment multiplied by the average ratio in column (b).
2. The partner's distributive share of the partnership's income (or loss) which is specifically allocable to Arizona.
3. The total of the amounts computed in steps 1 and 2 that is to be entered in column (c).

NOTE: *ARS §§ 43-1134 through 43-1138 specify the methods for allocating certain types of income to Arizona. Do not include the amount of any nonbusiness income allocable to another state in the total entered in column (c).*

All partnerships - Column (c) is the partner's Arizona source income from the partnership. Partners should refer to the Schedule K-1(NR) instructions for information on completing their Arizona returns.

Complete three copies of Form 165 Schedule K-1(NR) for the partners. File one copy of each partner's Schedule K-1(NR) with the partnership's Form 165. Provide all partners with a copy of their Schedule K-1(NR). Retain a copy for the partnership's records.

Information on Filing Composite Returns on Form 140NR for Qualifying Nonresident Partners

Arizona law requires an individual resident or nonresident to file his or her own income tax return. The Arizona Department of Revenue will accept a composite return on Form 140NR for qualifying nonresident individual partners of a partnership.

However, a composite return cannot be filed with fewer than ten participating members.

Refer to Arizona Individual Income Tax Ruling ITR 97-1 for information regarding the requirements for filing a composite return on Form 140NR.