

The Arizona Pass-Through Entity Election

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For taxable years beginning from and after December 31, 2021, the partners or shareholders of a business that is treated as a partnership or S Corporation at the federal level may consent to have its flow-through (or pass-through) income taxed at the entity level in Arizona. For the 2023, the Arizona Pass-Through Entity (PTE) income tax is assessed at a rate of 2.50% of the income attributable to the partnership's or S Corporation's resident partners or shareholders, and the income derived from sources within Arizona attributable to the nonresident partners or shareholders.

Making the Pass Through Entity Election

The PTE election must be made by the partnership or S Corporation no later than the due date or extended due date for filing its Arizona income tax return, Arizona Form 165 (partnerships) or Arizona Form 120S (S Corporations). The due date for both forms (Arizona Form 165 and Arizona Form 120S) is the 15th day of the 3rd month following the close of the taxable year. If the partnership or S Corporation has a valid federal or Arizona extension, the return is due by extended due date (6 months from the original due date of the return).

NOTE: *If the PTE election is not made on a timely-filed original return (Arizona Form 165 for a partnership or Arizona Form 120S for an S Corporation), including extensions, the PTE election will be denied and all related tax payments made will be refunded to the partnership or S Corporation.*

A partnership or S Corporation that intends to make the PTE election must notify all partners or shareholders who are individuals, estates or trusts of its intent to make this election. Each individual, estate or trust partner or shareholder has the right to opt out of this election. The notice must allow each individual, estate or trust partner or shareholder at least 60 days after receiving the notice to exercise the right to opt out of the election. If the individual, estate or trust partner or shareholder does not respond (does not opt out of the PTE election), that individual, estate or trust partner or shareholder will be included in the election [eligible partner(s) or eligible shareholder(s)].

Partners or shareholders that are not individuals, estates or trusts and those individual, estate or trust partners or shareholders that opted out of the PTE election, may not participate in this election [ineligible partner(s) or ineligible shareholder(s)].

If the partnership or S Corporation making this election does not pay the tax owed to the department, the department may collect the tax owed by the partnership or S Corporation from its eligible partners or shareholders based on the proportionate share of income attributable to each eligible shareholder for Arizona tax purposes.

PTE Estimated Tax Payments

Partnerships and S Corporations making the PTE election whose taxable income for the preceding tax year exceeds \$150,000 must make four estimated income tax payments. For calendar year filers, estimated tax payments are due April 15th, June 15th, and September 15th of the current taxable year. The final payment is due January 15th of the year following the close of the taxable year. (For taxable years that do not begin January 1st, the due date(s) for estimated tax payments is(are) the 15th day of the 4th, 6th, and 9th month of the current taxable year. The fourth and final payment is due the 15th day of the 1st month following the close of the taxable year.)

Partnerships and S Corporations that made the PTE election and failed to make the required estimated payments are subject to a penalty on any estimated tax payment which is late or underpaid.

The required annual payment of estimated tax for a partnership or S Corporation that made the PTE election is the smaller of:

- Ninety percent of the partnership's or S Corporation's Arizona tax liability for the *current* taxable year; or,
- One hundred percent of the tax due for the *previous* taxable year.

Payment by Electronic Funds Transfer

Partnerships and S Corporations that anticipate having a PTE tax liability for the taxable year of \$500 or more must pay their tax liability by EFT.

Partnerships and S Corporations having a PTE tax liability are no longer required to register with the department prior to making EFT payments. Visit <https://aztaxes.gov/Home/Page>, click on “Make a Corporation/S Corporation/Partnership Payment” and follow the prompts. Payments may be made from a checking or savings account, or by credit card.

If a partnership or S Corporation is not able to pay its PTE tax liability by EFT, it may request a waiver from the department. Complete Form 292 and return it to the department. Form 292 is available here: <https://azdor.gov/forms/other-forms/electronic-filing-and-payment-waiver-application>.

NOTE: *Any partnership of S Corporation that was required to make its PTE estimated payment by EFT and did not, may be subject to the 5% penalty for failure to pay by EFT.*

FOR ADDITIONAL INFORMATION:

Browse

www.azdor.gov
www.AZTaxes.gov

Call

(602) 255-3381
Toll-free within AZ: 1-800-352-4090

Write

Arizona Department of Revenue
Taxpayer Information & Assistance
1600 W. Monroe
Phoenix AZ 85007

This publication is available in an alternative format upon request.

FREQUENTLY ASKED QUESTIONS

PTE ELECTION

How do I make the PTE election?

Businesses that are treated as partnerships or S Corporations at the federal level may make the PTE election on a timely filed, original Arizona Income Tax Return (Arizona Form 165 – partnerships; Arizona Form 120S – S Corporations), including extensions. If the partnership or S Corporation wishes to make the PTE election, it must notify its partners or shareholders who are individuals, estates or trusts of its intent to make the election and that those partners or shareholders who are individuals, estates or trusts may opt out of the election. The partnership or S Corporation must allow its individual, estate or trust partners and shareholders a minimum of 60 days in which to respond. Only those partners or shareholders who are individuals, estates or trusts who do not opt out of the PTE election may participate.

What is the first year I may make the PTE election?

Taxable year 2022 is the first year a partnership or S Corporation may make the PTE election.

What happens if the partnership's or S Corporation's return making the PTE election is not filed timely?

If the partnership or S Corporation does not file its return making the PTE election on or before the due date, including extensions, for that return, the PTE election will be denied. Any estimated or extension payments made on the PTE tax liability will be refunded to the partnership or S Corporation.

If the PTE election is not made timely, the partnership or S Corporation must file an amended return, revoking the PTE election and re-issuing the appropriate corrected Schedules K-1 and/or K-1(NR) to all partners or shareholders.

If the PTE election is denied, each partner or shareholder who did not opt out of the PTE election must file an amended individual income tax return to remove from his/her Arizona taxable income any addition(s) for PTE taxes paid and to no longer claim his/her portion of the PTE tax credit passed through from the partnership/S Corporation.

Can the PTE election be made on an amended return?

A partnership or S Corporation may file an amended return to make the PTE election if that amended return is filed by the due date, including extensions, for that return. If the amended return is filed after the due date including extensions, the PTE election will be denied.

If the amended return making the PTE election is accepted, each partner or shareholder that does not opt out of the PTE election must file an amended individual

income return to add back to the calculation of his/her Arizona taxable income an addition for PTE taxes paid during the taxable year on his/her behalf and then to claim his/her portion of the PTE tax credit passed through to him/her from the partnership or S Corporation.

Can a partnership or S Corporation that made the PTE election revoke that election?

A partnership or S Corporation may file an amended return to revoke the PTE election if that amended return is filed by the due date, including extensions, for that return. If the amended return is filed after the due date including extensions, the revocation of the PTE election will be denied.

If the amended return revoking the PTE election is accepted, each partner or shareholder that did not opt out of the original PTE election must file an amended individual income tax return to remove from the calculation of his/her Arizona taxable income any addition(s) for PTE taxes paid during the taxable year on his/her behalf and to no longer claim his/her portion of the PTE tax credit passed through to him/her from the partnership or S Corporation.

Can a partnership or S Corporation make the PTE election on its final Arizona return?

Yes. Nothing in statute prevents a partnership or an S Corporation from making the PTE election on its final Arizona income tax return.

Can a Limited Liability Company make the PTE election?

A Limited Liability Company that makes the election to be treated as a partnership or S Corporation for federal income tax purposes may make the PTE election.

NOTE: *A single member Limited Liability Company that is disregarded at the federal level cannot make the PTE election.*

Our partnership has a loss for 2022 but we want to make the PTE election. Is it possible to make that election?

While it is possible to make the PTE election when the partnership or S Corporation incurs a loss for the taxable year, there is no benefit to the partners or shareholders to make that election.

Can a partner or shareholder participate in more than one partnership or S Corporation PTE election?

Yes. As long as the partner or shareholder is an individual, estate or trust that does not opt out of the entity's PTE election, they may participate in more than one entity's PTE election. At the end of the taxable year, those partners or shareholders will receive a K-1 or K1-

(NR) from each entity that made the PTE election. They must total the amounts of all distributions received, PTE tax credits, and PTE taxes paid on their behalf and enter those amounts on the appropriate lines of their Arizona income tax form.

ELIGIBILITY

Which partners or shareholders may participate in the PTE election?

Only partners or shareholders who are individuals, or estates or trusts who have not opted out of the partnership's or S Corporation's PTE election¹ are eligible to participate.

- A grantor trust that is disregarded for federal tax purposes is treated as owned by the grantor (individual taxpayer). The grantor may claim his/her share of the PTE tax credit.
- A partnership or S Corporation ownership share that is owned by a Single Member LLC that is disregarded to an individual for federal tax purposes may claim that individual's share of the PTE tax credit.

Partners or shareholders who are not individuals, estates or trusts (corporations, partnerships, etc.), or who are individuals, estates or trusts that opted out of the partnership's or S Corporation's PTE election, are not eligible to participate in the PTE election.

Can a lower tier partnership or S Corporation make the PTE election and pass the credit through to its partners or shareholders that are other partnerships or S Corporations?

No. Only individuals, estates or trusts that did not opt out of the PTE election may participate.

Can a Fiduciary of an estate or trust distribute the PTE tax credit to its beneficiaries?

Any remaining PTE tax credit not used on Form 141AZ to off-set the current year's estate or trust's tax liability may be distributed to the estate or trust's **individual beneficiaries**. The Fiduciary cannot distribute any remaining PTE tax credit to a beneficiary who is **not** an individual. The distributed tax credit amount is reported on the beneficiary's 141AZ Schedule K-1, Part 3; or Schedule K-1(NR), Part 4.

Can a partnership or S Corporation file a composite return on behalf of its nonresident partners or shareholders who did not opt out of the PTE Election?

No. Each partner or shareholder who did not opt out of the partnership's or S Corporation's PTE election must file

¹ Unless specifically indicated, all references to "partners" or "shareholders" will be to individuals, estates or trusts who have not opted out of the partnership's or S Corporation's PTE election. These "partners" or "shareholders" may also be referred to as "eligible partners" or "eligible shareholders".

his/her own Arizona income tax return to claim the PTE tax credit.

How do partnerships and S Corporations pass the PTE tax credit through to their partners or shareholders?

Partnerships and S Corporations that make the PTE election pass the PTE credit through to their partners and shareholders using Schedules K-1 (for resident partners and shareholders) and Schedules K-1(NR) (for nonresident partners and shareholders) for Arizona Forms 165 and Arizona Forms 120S.

What happens to the portion of the partnership or S Corporation attributable to those partners or shareholders who do not participate in the PTE election?

The income attributable to those partners or shareholders who opt out of the PTE election and those partners who are not eligible to participate in the PTE election is not included in the calculation of PTE income and the PTE tax credit. It is distributed to those partners or shareholders using the partnership's or S Corporation's distribution methodology (percentage of ownership or for a partnership, the partnership distribution approved by the partnership operating agreement).

HOW DO PARTNERS & SHAREHOLDERS CLAIM THE PTE CREDIT

How do partners and shareholders claim their share of the PTE credit?

Individual taxpayers who receive a pass through of this credit from partnerships or S Corporations, enter the PTE credit information on Form 355 and Forms 301 and/or 301-SBI. You may then claim the PTE credit on your appropriate Arizona Individual Income Tax Return (Forms 140, 140PY, 140NR, 140X, 140-SBI, 140PT-SBI, 140NR-SBI, or 140X-SBI). Include completed Forms 355 and 301 and/or 301-SBI with your return.

Estate or trust partners that receive a PTE Tax Credit, enter the credit information on Form 141AZ.

If the allowable credit exceeds the taxes otherwise due, or if there are no taxes due, the amount of the claim not used to offset taxes may be carried forward for not more than 5 taxable years as a credit against subsequent year's tax liability.

An individual, estate or trust who claims this credit must also adjust their Arizona gross income by adding the amount of tax paid by the PTE for which the tax credit is claimed.

Is the PTE tax credit refundable?

No. The PTE tax credit is not refundable. The unused portion of any valid PTE tax credit may be carried forward to the next five consecutive taxable years.

Our partnership considered making the PTE election for the taxable year. Before the return was filed, the partnership decided not to make the PTE election. How does the partnership request a refund of its estimated tax payments?

File the partnership's return making sure to check the "No" box as the answer to Question A. The department will automatically return the estimated tax payment(s) to the partnership.

PTE TAX RATE

What will the PTE tax rate be for 2023?

The PTE tax rate for the 2023 taxable year will be 2.5%.

Our partnership has a fiscal year end of September 30, 2023. What tax rate do we use to compute estimated income tax payments?

The 2024 PTE tax rate is effective for taxable years beginning after December 31, 2023. The partnership's taxable (fiscal) year begins October 1, 2023. Compute the partnership's PTE estimated income tax payments using the 2023 tax rate, 2.5%.

INCOME SUBJECT TO THE PTE PAYMENT CALCULATION

What income is subject to the PTE payments calculation?

For a partnership making the PTE Election, only its ordinary income and rental income (lines 1 and 2 from Form 1065, Schedule) plus the Arizona additions found in A.R.S. § 43-1021 less the subtractions found in A.R.S. § 43-1022 are included in the starting point for calculating the PTE tax.

The 2023 legislative session mandated a change in the starting point to compute the Arizona taxable income for partnerships making the PTE election (See SB 1734.). For taxable years beginning from and after December 31, 2022, the starting point to calculate Arizona taxable income for partnerships making the PTE election is the partnership's ordinary income and rental income including any Arizona additions found in A.R.S. § 43-1021 less any Arizona subtractions found in A.R.S. § 43-1022, plus, the items that require separate computation under A.R.S. § 43-1412, paragraphs 1 through 16.²

For an S Corporation making the PTE election, all its total federal distributable income is included in the starting point for calculating the PTE tax.

² Paragraphs 1 through 16 of A.R.S. § 43-1412 include such items as capital gains (losses), section 1231 gains (losses), income taxes imposed and paid to another state or country, etc.

What happens to the portion of the partnership or S Corporation attributable to those partners or shareholders who do not participate in the PTE election?

The income attributable to those partners or shareholders who opt out of the PTE election and those partners who are not eligible to participate in the PTE election is not included in the calculation of PTE income and the PTE tax credit. It is distributed to those partners or shareholders using the partnership's or S Corporation's distribution methodology (percentage of ownership or for a partnership, the partnership distribution approved by the partnership operating agreement).

We are a partnership that included our Capital Gains in the calculation of our PTE income for taxable year 2022. How do we correct this error? Is there a mechanism to transfer these payments to the individual partners or shareholders?

There is no mechanism for a partnership to transfer the "credit" for the taxes paid on its capital gains (in error) to its partners. For taxable year 2022, the only option available is for the partnership to re-compute its PTE income by removing the capital gains from its calculation of PTE income and PTE tax paid on behalf of each partner. NOTE: if the partnership has already filed its 2022 Arizona Partnership Income Tax return, it must correct its calculations, file an Amended Partnership Return and notify all its partners of the correction using Schedule K-1 for Arizona resident partners and Schedule K-1(NR) for its nonresident partners. Each partner must then file an Amended Individual Income Tax Return for taxable year 2022 correcting his/her income and Arizona tax liability.

If the partnership has not filed its 2022 Arizona Partnership Income Tax Return, it must correct its calculations before filing the return.

In both situations, the overpayment of PTE taxes will be refunded automatically to the partnership.

How does the partnership or S Corporation allocate the PTE tax credit to its partners or shareholders?

Please see the Addendum for an example of how a PTE Entity allocates its income to its partners or shareholders.

Are special allocations of the PTE tax credit permitted?

A partnership may allocate its income and loss items using a special allocation. Please see; Example of a Partnership Using a Special Allocation, in the Addendum for an example of how a partnership, using special allocation can allocate its income and pass-through PTE tax credit to its partners.

An S Corporation may not allocate its income and loss items to its shareholders using a special allocation.

We are Arizona resident partners in a multi-state partnership that operates in Arizona and two other states. There are no other partners. The other states do not permit a credit for taxes paid to nonresident taxpayers. The partnership is electing to make the PTE election. The Arizona PTE tax is calculated at 100% of federal income tax since the partners are Arizona residents. The income attributable to the two other states is now double-taxed and there is no credit for taxes paid to another state at the entity level. Are we understanding this election correctly?

Unlike most states, Arizona's PTE tax credit is not refundable. In addition, Arizona does not have a statutory credit ordering rule other than the credit for taxes paid, which is calculated last out of necessity to calculate the amount of tax actually paid.

If the PTE Tax Credit wipes out the Arizona income tax liability, the credit for taxes paid to another state cannot be claimed because there is no Arizona income tax liability. Given this current situation, which the department believes requires a legislative fix, it may not be beneficial to have a partnership in this situation make the PTE Election.

ESTIMATED PAYMENTS

Were 2022 estimated tax payments required to be made?

Partnerships and S Corporations making the PTE election for taxable year 2022 were not required to make the first two estimated payments (due in April and June). The September 15th estimated tax payment was required to be made.

Will the estimated underpayment penalty be assessed for the 2022 tax year?

For partnerships and S Corporations making the PTE election, the estimated underpayment penalty will not be assessed for the 2022 taxable year. The estimated underpayment penalty will not be assessed when the PTE entity's prior year tax liability is \$0. For taxable years 2023 and beyond, the estimated underpayment penalty may be assessed.

The individual partners or shareholders of a PTE entity may be assessed the estimated underpayment penalty if the total of their estimated payments PLUS withholding tax does not equal at least 90% of their current year's tax liability or 100% of their previous year's tax liability.

For taxable year 2023, will estimated payments be required to be made?

Yes. Estimated payments are required to be made for the 2023 taxable year if the partnership or S Corporation making the PTE election meets or exceeds the income threshold requiring estimated payments to be made.

Are the partnerships and S Corporations making the PTE election required to make estimated income tax payments?

Partnerships and S Corporations that make the PTE election whose Arizona taxable income for the prior year was \$150,000 or more are required to make estimated tax payments. The amount of the payments must be an amount that reasonably reflects the PTE's tax liability that will be unpaid at the end of the taxable year.

The required annual minimum payment of estimated PTE tax for a partnership or S Corporation making the PTE election is the smaller of:

- 90% of the PTE entity's Arizona tax liability for the current taxable year; or,
- 100% of the PTE entity's Arizona tax liability for the previous taxable year.

When are the estimated income tax payments due?

Estimated tax payments are due the 15th day of the 4th, 6th, 9th months of the current taxable year. The final payment is due the 15th day of the 1st month following the close of the taxable year.

Is there a penalty for overpayment of PTE tax?

No. There is no penalty for the overpayment of PTE tax.

What happens if the partnership or S Corporation making the PTE election overpays its estimated PTE tax?

For taxable years beginning from and after December 31, 2022, if a partnership making the PTE election overpays its PTE tax, it may elect to have all, or a portion of the overpayment applied to the next year's PTE tax. Any amount(s) not applied to the next year's PTE estimated tax will be refunded to the partnership.

If an S Corporation making the PTE election overpays its estimated PTE tax, it may elect to have all, or a portion of the overpayment applied to next year's PTE tax. Any amount(s) not applied to the next year's PTE estimated tax will be refunded to the S Corporation.

Can composite return estimated income tax payments be converted to PTE estimated income tax payments?

No. Composite return payments cannot be converted to PTE estimated income tax payments.

A partnership or S Corporation made the PTE election but has nonresident partners or shareholders who opted out of that election who wish to file a composite return. How does the partnership or S Corporation make voluntary estimated payments for those nonresident partners or shareholders who wish to file a composite return?

A partnership or S Corporation making voluntary estimated payments for its nonresident partners or

shareholders who opted out of the PTE election but wish to file a composite return must make those estimated payments using Form 140ES. Do not use Form 120/165ES to make voluntary estimated payments for composite return filers.

PAYMENT OF PTE TAX LIABILITY BY ELECTRONIC FUNDS TRANSFER

Are partnerships and S Corporations making the PTE election required to pay their tax liability by Electronic Funds Transfer?

Partnerships and S Corporations making the PTE election that anticipate having a tax liability of \$500 or more for the year are required to pay their tax liability by EFT.

How does the partnership or S Corporation pay its tax liability by EFT?

Partnerships having a PTE tax liability or S Corporations having a tax liability are no longer required to register with the department prior to making EFT payments. Visit <https://aztaxes.gov/Home/Page>, click on “Make a Corporation/S Corporation/Partnership Payment” and follow the prompts. Payments may be made from a checking or savings account, or by credit card.

What if the partnership or S Corporation is not able to pay its tax liability by EFT?

If a partnership or S Corporation is not able to pay its PTE tax liability by EFT, it may request a waiver from the department. Complete Form 292 and return it to the department. Form 292 is available here: <https://azdor.gov/forms/other-forms/electronic-filing-and-payment-waiver-application>.

Partnerships and S Corporations making the PTE election that do not pay their tax liability by EFT may be subject to a penalty of 5% of the amount of the payment not made by EFT. [See A.R.S. § 42-1125(O).]

For additional information on electronic funds transfer, refer to A.R.S. § 42-1129 and the related Arizona Administrative Code rules (A.A.C. R15-10-301 through R15-10-307).

PTE TAX FORMS

What is the name and form number associated with the new PTE tax return?

The department modified existing Forms 165 and 120S to allow partnerships and S Corporations that wish to make the PTE election to claim that election and then pass the PTE tax credit through to their eligible partners and shareholders. The revised forms and related instructions are available on our website.

PTE TAX CREDIT & OTHER TAX CREDITS

Can the PTE tax due be offset by Arizona income tax credits?

No. The tax credits in Chapter 10 of Title 43 apply to individuals to claim on their own Arizona Income Tax Returns. They do not apply to the PTE tax.

Are there credit ordering rules for the PTE credit?

In general, Arizona does not have credit ordering rules. The exception, the Credit for Taxes Paid to Another State or Country is computed after all other credits have been applied.

Can an Arizona resident who files a nonresident return to another state claim a credit for taxes paid to that state if the PTE election was made in that state?

Arizona allows a PTE credit for residents of Arizona who file nonresident return to certain other states. Please refer to the instructions for Credit Form 309 or 309-SBI for further information.

PTE PENALTIES

Does the Information Return Penalty apply to Arizona income tax returns making the PTE election?

- If the partnership or S Corporation is making the PTE election and a portion of its partners or shareholders opt out of the PTE election, or are not eligible to participate in the election, the partnership or S Corporation may be subject to the Information Return Penalty.
- If the partnership or S Corporation makes the PTE Election and all of its partners or shareholders do not opt out of the PTE election, it is not subject to the Information Return Penalty.

What other penalties may apply to Arizona income tax returns making the PTE election?

Partnerships and S Corporations that make the PTE Election may be subject to the following penalties:

- Late Filing Penalty
- Extension Underpayment Penalty
- Late Payment Penalty
- Underpayment of Estimated Tax Penalty
- Failure to Pay by Electronic Funds Transfer

Refer to the section labeled, Penalties, in the instructions for Forms 165 and 120S.

PTE TAX CREDIT CARRYFORWARD

Can PTE tax credits be carried forward?

PTE tax credits that are not used to offset taxes under Title 43 may be carried forward for not more than five consecutive taxable years as a credit against subsequent years' income tax liability.

If the partnership or S Corporation has a carry forward from the 2022 PTE tax credit, can it apply the 2022 credit carryforward to its tax liability before claiming the 2023 PTE tax credit?

Yes. The 2022 PTE tax credit carryforward can be used up before applying the 2023 PTE tax credit.

OTHER

How does the PTE Entity allocate the PTE tax payments made on behalf of its partners or shareholders?

Please see the Addendum for an example of how a PTE Entity allocates the PTE tax payments to its partners.

Can estimated payments made in 2023 be claimed on the partner/shareholder's 2022 federal return?

In general, estimated tax payments made by the pass-through entity in 2023 would be deducted on the pass-through entity's 2023 federal income tax return. In the case of fiscal year filers and accrual method taxpayers, the taxpayer should contact the IRS about the proper year of deduction. Arizona will accept the federal determination.

We are tax practitioners located in another state. We have a client that made the Arizona PTE election. After reviewing the Arizona income tax forms (Form 165 and Form 120S) we are unable to determine where the add back of the taxes paid on behalf of the partner/shareholder is listed. Please provide direction.

The add back of taxes paid on behalf of the partner/shareholder by the partnership or S Corporation is passed through to that individual partner or shareholder. The individual partner or shareholder reports this amount on his/her individual federal income tax return.

I'm a partner in a partnership that made the PTE election for the 2022 taxable year. The partnership paid a portion of its 2022 PTE tax liability during 2023. The partnership is not making the PTE election for the 2023 taxable year. Am I required to add back the 2022 PTE taxes paid in 2023 even though the partnership is not making the PTE election for 2023?

Yes. You must add back to your calculation of Arizona taxable income the PTE taxes paid on your behalf by the partnership in 2023 for the 2022 taxable year.

ADDENDUM

Example Allocation PTE Income, PTE Tax Credit and PTE Tax Paid to a Partner³.

Partnership Z has 6 partners and has an Arizona taxable income of \$1,000,000.

- Z is a multi-state partnership; its Arizona apportionment ratio is 50% (0.500000).
- Z made estimated income tax payments on 9/15/2022 and 1/15/2023. On each date, Z made a payment of \$ 4,600.

Partner D is an Arizona resident and owns 15% of Z.

Partner E is a nonresident and owns 20% of Z

Partner F is a part-year resident and owns 15% of Z. One-half of Partner F's distribution was earned as a resident of Arizona; the other half was earned as a nonresident.

Partner G is a nonresident and owns 15% of Z

Partner H is an Arizona resident and owns 20% of Z

Partner S is a corporate partner and owns 15% of Z.

NOTE: *Partners D, E, F, G, and H are individuals.*

Z is making the PTE Election. PTE sent notices to all of its individual partners notifying them of the intent to make the PTE Election. Only Partner H opted out of Z's PTE Election. Partner S is not eligible to make the PTE election.

Z completes Schedule E of Arizona Form 165. Schedule E indicates:

- 1 resident partner (D) with a 15% ownership
- 2 nonresident partners (E & G) with a total ownership of 35%
- 1 part-year resident partner (F) with a 15% ownership
- 2 partners that either opted out of the PTE Election (H), or was not eligible to participate in the election (S). These partners have a 35% ownership.

Computing the income attributable to the partners:

Compute the income attributable to each type of partner.

Income attributable to resident partner (D)

AZ income	\$ 1,000,000
* Resident partners ownership %	15%
<i>Resident partners income</i>	<i>\$ 150,000</i>

Income attributable to nonresident partners (E & G)

AZ income	\$ 1,000,000
X Nonresident partners ownership %	35%
<i>Nonresident partners income</i>	<i>\$ 350,000</i>

Income attributable to part-year resident partner (F)

AZ income	\$ 1,000,000
* Part-year resident partners ownership	15%
Part-year resident partners income	\$ 150,000
<i>Income while a resident⁴</i>	<i>\$ 75,000</i>
<i>Income while a nonresident</i>	<i>\$ 75,000</i>

Income attributable to partners not participating or not eligible to participate in the election (H & S)

AZ income	\$ 1,000,000
* Partners ownership %	35%
<i>Income of partners not eligible</i>	<i>\$ 350,000</i>

NOTE: *The total of the resident partners income, the nonresident partners income, the part-year resident partners income and the income of the partners not eligible MUST equal the amount of the partnership's Arizona taxable income.*

Computing income attributable to part-year resident partners:

To compute the income attributable to part-year resident partners, the partnership must first compute the income attributable to each part-year resident partner.

Partner F is a part-year resident partner whose ownership percentage of Z is 15%. F earned 50% of his distribution as a resident of Arizona, and 50% of his distribution as a nonresident.

First, compute F's attributable income:

AZ Income	\$ 1,000,000
F's ownership percentage	15%
Income attributable to F	\$ 150,000
F's AZ residency	50%
<i>F's income as a resident</i>	<i>\$ 75,000</i>
<i>F's income as a nonresident</i>	<i>\$ 75,000</i>

NOTE: *The amounts entered on lines 39A and 39B should represent the actual amounts earned by the shareholder as an Arizona resident (line 39A) and as a nonresident of Arizona (line 39B).*

Computing the PTE Tax:

Total the resident partners' PTE income.

- Partner D, \$ 1,000,000 * 15%, \$ 150,000
 - Partner F, \$ 1,000,000 * (15%*50%) \$ 75,000
- | | |
|---|------------|
| Resident partners PTE income ⁵ | \$ 225,000 |
| * PTE Tax Rate | 2.98% |

³ While this ADDENDUM specifically states "Partnership" or "Partner" (that made the PTE Election), these examples also apply to an S Corporation or shareholder that made the PTE Election.

⁴ NOTE: Partner earned one-half of his/her distribution as a resident of Arizona.

⁵ Total includes part-year resident income earned while the partner was a resident of Arizona.

Resident partners' PTE tax liability \$ 6,705

Total the nonresident partners' PTE income.

- Partner E, \$ 1,000,000 * 20%, \$ 200,000
- Partner G, \$ 1,000,000 * 15%, \$ 150,000
- Partner F, \$ 1,000,000 * (15%*50%) \$ 75,000

Nonresident partners PTE income⁶ \$ 425,000

* AZ Apportionment Ratio 0.500000

Income attributable to AZ \$ 212,500

* PTE Tax Rate 2.98%

Nonresident partners PTE liability \$ 6,333

PTE Tax Liability (\$6,705 + \$6,333) \$ 13,038

Distributing the PTE Tax Credit to the Partners

The PTE Tax Credit distributed to each partner is the amount of PTE tax paid by the partnership that is attributable to the partner's share of income taxable in Arizona.

Distribution to Resident & Part-Year Resident Partners

Resident and part-year resident partners PTE tax liability \$ 6,705.

Resident partner is D, whose ownership % is 15%.

Part-year resident partner is F, whose ownership % is 15%; one-half (7.5%) of his/her distribution (\$75,000) was earned as a resident of Arizona

To compute the PTE Tax Credit to be distributed to each resident or part-year resident partner, divide that partner's ownership percentage by the total of all the resident partners who did not opt out of the PTE Election. (NOTE: As 50% of Partner F's distribution was earned as a resident, include one-half of his/her ownership percentage in the total.) Then multiply the result by the partnership's PTE tax liability for the resident and part-year partners.

Compute Partner F's resident PTE Tax Credit:

Compute F's Arizona distribution as a percentage of his/her total distribution. Multiply that amount by F's ownership percentage. Divide this ratio by the sum of all resident partners ownership percentages. Multiply the result by the total of the resident partners PTE tax liability.

Calculation of Partner F's PTE Tax Credit as a resident

$(15%*50%) / (15% + (15%*50%)) * \$6,705$

$(7.5%/27.5%) * \$6,705 = \$2,235$

Similar calculations for the remaining resident partner yield PTE Tax Credits as follows:

Partner D \$ 4,470

Partner F \$ 2,235

Total Tax Liability for Resident Partners \$ 6,705

Distribution to Resident & Part-Year Resident Partners

Nonresident and part-year resident partners PTE tax liability \$ 6,333

Nonresident partners are:

- E, whose ownership % is 20%,
- G, whose ownership % is 15%, and
- F whose ownership % is 15%; fifty percent of his/her distribution (\$75,000) was earned as a nonresident of Arizona.

To compute the PTE Tax Credit to be distributed to each nonresident partner, divide that partner's ownership percentage by the total of all the nonresident partners who did not opt out of the PTE Election. (NOTE: As 50% of Partner F's distribution was earned as a nonresident, include one-half of his/her ownership percentage in the total.) Then multiply the result by the partnership's PTE tax liability for the nonresident partners.

Compute Partner F's nonresident PTE Tax Credit:

Compute F's nonresident distribution as a percentage of his/her total distribution. Multiply that amount by F's ownership percentage. Divide this ratio by the sum of all nonresident partners ownership percentages. Multiply the result by the total of the nonresident partners PTE tax liability. The result is F's portion of the PTE tax credit while he/she was not a resident of Arizona.

Calculation of Partner F's PTE Tax Credit as a nonresident

$(15%*50%) / (20% + 15% + (15%*50%)) * \$6,333$

$7.5%/42.5% * \$6,333 = \$1,118$

Similar calculations for the remaining nonresident partners yield PTE Tax Credits as follows:

Partner E \$ 2,980

Partner G \$ 2,235

Partner F \$ 1,118

Total Tax Liability for Nonresident Partners \$ 6,333

⁶ Total includes part-year resident income earned while the partner was not a resident of Arizona.

PTE Tax Credit for All Partners

Partner D	\$4,470
Partner E	\$2,980
Partner F	
Resident	\$2,235
Nonresident	<u>\$1,118</u>
Total	\$3,353
Partner G	\$2,235
<u>Total</u>	<u>\$13,038</u>

Verify PTE Tax Credit for all partners

Resident and Part-Year Residents	\$6,705
Nonresident and Part-Year Residents	<u>\$6,333</u>
<u>Total</u>	<u>\$13,038</u>

What is the Correct Amount of PTE Tax Paid to be Added Back by the Partners or Shareholders?

EXAMPLE: A one shareholder S Corporation paid estimated PTE tax of \$1,800 during 2022. The Arizona PTE tax liability is \$1,700. The S Corporation receives a refund of \$100 in 2023 when Arizona Form 120S is filed. Is the proper add back on the shareholder's Arizona Form 140, \$1,800, the amount of estimated tax paid? Or, is it \$1,700, the amount of the PTE tax liability?

ANSWER: *The proper amount to add back to this shareholder's calculation of Arizona taxable income is \$1,700, the amount of the PTE Tax liability paid in taxable year 2022.*

Compute the PTE Tax Paid & Distributed to the Partners

During the year, Z made two payments of estimated tax. The first on September 15, 2022 in the amount of \$4,600. The second payment was made January 15, 2023 in the amount of \$4,600. Z paid the balance of the tax due, \$3,838, when its partnership return was filed.

Divide each partner's PTE Tax Credit by the total tax liability of the partnership. Multiply that result by the amount of tax paid by the partnership. The result is the PTE Tax Paid Distribution to the partner.

Compute PTE Tax Paid on behalf of Partner F with the 9/15/2022 payment:

F's PTE Tax Credit (\$3,353)/Z's Total Tax Liability (\$13,038) * Tax Payment (\$4,600) = F's PTE Tax Paid

$$\$3,353/\$13,038 * \$4,600 = \$1,183$$

Similar calculations for the remaining partners yield PTE Tax paid as follows:

Partner D	\$1,577
Partner E	\$1,051
Partner F	\$1,183
Partner G	<u>\$ 789</u>
<u>Total</u>	<u>\$4,600</u>

Example of a Partnership Using a Special Allocation

The PTE Credit and PTE Taxes Paid are allocated to the partner based on his/her proportionate share of income that is attributable to that partner for Arizona tax purposes. For example, if the distributable income of a partner is 60% of the partnership's taxable income, that partner is entitled to 60% of the PTE Credit, and 60% of the PTE taxes paid by the partnership.

NOTE: *The total of all PTE Credits or PTE taxes paid that is distributed to the partners cannot exceed the maximum amount of the credit or the total amount of PTE taxes paid.*

EXAMPLE: A partnership has two partners, A & B. The partnership made the PTE election. Both partners, A & B did not opt out of the PTE election. The partnership's Arizona taxable income for the year is \$100,000. Due to a special allocation, Partner A's distribution of the partnership income is \$120,000. Partner B's distribution is (\$20,000). The partnership's PTE tax credit for the year is \$2,980 (\$100,000 * 2.98%).

ANSWER: *Partner A's pass-through PTE tax credit is \$2,980.*

Partner B does not receive a pass-through of the PTE tax credit.

NOTE: *If a partnership uses a special allocation to distribute partnership income rather than ownership share, complete Schedules D and E of Form 165 using that special allocation method for each partner.*