

ARIZONA DEPARTMENT OF REVENUE

ARIZONA CORPORATE TAX RULING

CTR 93-7

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

What is the Arizona tax treatment of a required payment or refund of a required payment under Internal Revenue Code § 7519 for an S corporation?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-901 and Internal Revenue Code (I.R.C.) §§ 441 and 446 provide general rules for accounting periods and methods of accounting which are used to compute taxable income.

I.R.C. § 444 governs the election of a taxable year other than the required taxable year by an S corporation and requires the S corporation to make payments pursuant to I.R.C. § 7519 and the accompanying Treasury regulations.

I.R.C. § 7519, Treas. Reg. §§ 1.7519-1T and 1.7519-2T provide the requirement for, and the procedures to make, required payments for S corporations electing not to have the required taxable year.

A.R.S. § 43-1121 provides, and former § 43-1021 provided for, an addition to Arizona gross income for federal income tax refunds received during the taxable year, to the extent that the federal income taxes were deducted in arriving at Arizona taxable income in a previous taxable year.

A.R.S. §§ 43-1122.1 and 43-1022.10 provided a subtraction from Arizona gross income for the amount of federal income taxes paid, accrued or withheld during the taxable year. **NOTE:** The provision for the subtraction of federal income taxes from Arizona gross income was repealed effective for tax years beginning from and after December 31, 1989.

A.R.S. § 43-1126 provides that an S corporation is not subject to Arizona income tax, but only to the extent that it is not subject to federal tax.

DISCUSSION:

An S corporation may elect under the provisions of I.R.C. § 444 to use a tax year other than the required tax year. If the S corporation makes such an election, the S corporation must make required payments pursuant to I.R.C. § 7519 and the accompanying Treasury regulations.

Treas. Reg. § 1.7519-1T provides that an S corporation which elects to have a tax year other than the required tax year must make required payments in the manner prescribed by Treas. Reg. § 1.7519-2T. The required payments are not a tax of any kind. The required payments are simply a charge, in the nature of refundable deposits, imposed on the taxpayer for the use of a tax year other than the required tax year. Treas. Reg. § 1.7519-2T further states that the required payment is not deductible by the S corporation or its owners.

Therefore, required payments do not constitute federal income taxes under the provisions of former A.R.S. §§ 43-1122 and 43-1022 or refunds of federal income taxes under the provisions of A.R.S. § 43-1121 and former § 43-1021.

A.R.S. § 43-901 requires that the tax year (accounting period) and the methods of accounting used by a taxpayer reflect proper income. I.R.C. § 446 and Treas. Reg. § 1.446-1 require that the accounting method of a taxpayer must clearly reflect income. The Treasury regulation also states that a method of accounting which reflects the consistent application of generally accepted accounting principles (GAAP) in that trade or business will generally be regarded as clearly reflecting income.

The Financial Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) has considered the GAAP reporting of payments to elect other than a required tax year. The EITF (in Issue No. 88-4) determined that the payment should be accounted for as an asset of the entity, specifically as a permanent deposit that is adjusted annually based upon income levels. The deposit will only be *fully recovered* when the entity liquidates, converts to a required year, or income declines to zero.

Therefore, required payments are not deductible in the computation of taxable income nor are refunds of required payments includible in the computation of taxable income.

RULING:

Required payments made under I.R.C. § 7519 are not deductible in the computation of Arizona

taxable income by the S corporation or its shareholders.

Conversely, refunds of required payments received under I.R.C. § 7519 are not included in the computation of Arizona taxable income by the S corporation or its shareholders.

Harold Scott, Director
Signed March 23, 1993

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling.** See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.