

Arizona Nonresident and Out-of-State Partner's Share of Income and Deductions

ARIZONA FORM **165** **Schedule K-1(NR)**

Instructions for Individuals and Fiduciaries

Column (c) is your Arizona source income. Nonresident individuals should report the amounts in column (c) on the Form 140NR line numbers indicated on the Schedule K-1(NR). Nonresident trusts or nonresident estates should add lines 4 through 8, column (c), and enter the total on Arizona Form 141AZ, page 2, Schedule A.

However, if your Arizona Form 165 Schedule K-1(NR) shows a loss, you may only claim such losses on your Arizona nonresident return to the extent that such losses are included in your federal adjusted gross income (individuals) or federal taxable income (trust and estates). Therefore, if the loss is considered to be a passive activity loss for federal purposes, the loss will likewise be considered to be a passive activity loss for Arizona purposes.

If you have an Arizona source passive activity partnership loss, you would not necessarily begin the Arizona return with the amounts shown in column (c) of your Arizona Schedule K-1(NR). For Arizona purposes, you must first determine if any portion of the loss shown on your Arizona Schedule K-1(NR) has been limited on your federal return because of the federal passive activity loss rules.

The amount of passive activity loss which is derived from Arizona sources is the amount of the passive activity loss which will be allowed on the Arizona return. Therefore, any portion of the passive activity loss which is not allowed on the federal return due to the passive activity loss limitations will likewise be limited on the Arizona return. That portion of the passive activity loss derived from Arizona sources which is required to be carried forward for federal purposes will similarly be carried forward for Arizona purposes.

Note: The amount of Internal Revenue Code § 179 expense deductible is limited to the Arizona portion of the amount deducted on federal Form 1040, Schedule E.

Line 15 -

Line 15 reflects the amount of partnership income which must be adjusted to determine the difference between Internal Revenue Code § 702(a)(8) and ARS § 43-1401.2. If the amount on line 15 is a positive number, individual partners should enter this amount as an "other addition to income" on Form 140NR, line C19. Fiduciaries should enter a positive amount on line 15 as an "other addition" on Arizona Form 141AZ, page 2, line B3. If the amount on line 15 is a negative number, individual partners should enter this amount as an "other subtraction from income" on Form 140NR, line D30. Fiduciaries should enter a negative amount on line 15 as an "other subtraction" on Arizona Form 141AZ, page 2, line B8.

Instructions for Corporate Partners

Corporate partners should report the amount on line 12 of the Schedule K-1(NR) according to the instructions in Arizona Form 120 or Form 120A.

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 resident trust partners.

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 15, 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 15 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 15. 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.