

Arizona Updates Internal Revenue Code Conformity and Enacts Economic Nexus

Overview

On May 31, 2019, Arizona's Governor, Doug Ducey, signed House Bill 2757 ("HB2757" or "Bill"), which provides for a number of changes to Arizona's corporate and individual income tax law, as well as transaction privilege tax. These changes include updating the state's conformity to the Internal Revenue Code ("IRC"), which is retroactive, and establishing economic nexus provisions for remote sellers and marketplace facilitators relating to the state and municipal transaction privilege tax. The updates to the transaction privilege tax are effective October 1, 2019.

This Tax Alert discusses certain key provisions, which have various effective dates.

IRC Conformity (Corporate and Individual Income Taxes)

For tax years beginning from and after December 31, 2017 through December 31, 2018, HB2757 conforms Arizona to the IRC as in effect on January 1, 2018.¹ This conformity update is applicable for corporate and individual income tax purposes.² For tax years beginning after December 31, 2018, HB2757 conforms Arizona to the IRC as in effect on January 1, 2019, including IRC provisions that became effective during 2018.³

Corporate Income Taxes

As noted above, for taxable years beginning in 2019, Arizona conforms to the definition of federal taxable income in effect on January 1, 2019.⁴ HB2757 clarifies that certain provisions impacted, or enacted, by the Tax Cuts and Jobs Act of 2017⁵ are subject to state modification and fall within previously enacted Arizona addition and subtraction modifications. Specifically, the Bill clarifies that gross-up income under IRC section 78, Global Intangible Low-Taxed Income (GILTI) as defined in IRC section 951A, and subpart F income as defined in IRC section 952 are considered foreign dividends for Arizona purposes.⁶ In accordance, these items would qualify for Arizona's subtraction for foreign dividends in Arizona Revised Statutes ("A.R.S") section 43-1122(11).⁷ Correspondingly, due to the subtraction on these items of income, the related deductions allowed pursuant to IRC sections 243, 245, 245A and 250(a)(1)(B) are added back for Arizona corporate income tax purposes.⁸

The Arizona Department of Revenue recently issued an [Income Tax Notice for Corporate Taxpayers \("Notice"\)](#), on June 4, 2019, stating the Bill "clarifies" rather than modifies Arizona prior additions and subtractions related to the above items. Thus, the Arizona Department of Revenue appears to be interpreting these provisions to apply the treatment of IRC sections 78 and 951, as well as Subpart F income under IRC section 952 retroactively to tax years beginning in 2018.⁹ In

¹ H.B.2757, amending A.R.S. section 43-105(A). A copy of the bill is located [here](#).

² *Id.*

³ H.B.2757, amending A.R.S. section 43-105(B).

⁴ *Id.*

⁵ P.L. 115-97.

⁶ H.B.2757, amending A.R.S. section 43-1122(11)

⁷ *Id.*

⁸ H.B.2757, amending A.R.S. section 43-1121(7).

⁹ There is some uncertainty surrounding whether taxpayers must add back any IRC section 250 deduction for tax years beginning in 2018; however, given the administration interpretation of other provisions of the Bill, it appears the add back may be applicable to 2018.

addition, the Notice also provided additional guidance on income under IRC section 965, which is similar to the other provisions.¹⁰

Individual Income Taxes

Similarly, for individual taxpayers, HB2757 conforms to the definition of federal taxable income pursuant to the IRC as of January 1, 2018 for taxable years beginning in 2018, including retroactive federal changes made during 2018.¹¹ While Arizona only recently updated conformity to the IRC, the 2018 Arizona personal income tax forms, including Form 140, *Resident Personal Income Tax Return*, were drafted assuming conformity.¹² For taxpayers that have already filed a 2018 Arizona individual income tax return reporting items pursuant to anticipated updated conformity, then no additional action may be required.

For tax year 2019, HB2757 enacts a number of changes for personal income tax, in addition to the conformity update, including:

- Arizona adopts the federal standard deduction amount (\$12,200 single/married filing separate, \$18,350 head of household, \$24,400 married filing joint).¹³
- No Arizona personal or dependent exemptions will be allowed.¹⁴
- Provides for a child tax care credit of \$100 per dependent under the age of 17 and \$25 for dependents 17 and older, which is phased out for federal adjusted gross income greater than \$200,000 single/married filing separate and head of household, \$400,000 married filing joint.¹⁵
- Allows taxpayers to increase the standard deduction by 25% of the charitable contributions that would have been claimed as an itemized deduction.¹⁶
- Amends the tax brackets from five tax brackets to four tax brackets. Additionally, the highest individual tax rate decreases from 4.54% to 4.5%.¹⁷

Transaction Privilege Tax: Economic Nexus for Remote Sellers

HB2757 specifies that any person that conducts retail business with purchasers in Arizona are subject to state, county and municipal transaction privilege taxes.¹⁸ Such a person, with no other physical presence with the state, is classified as a remote seller.¹⁹ The Bill specifically defines a remote seller as:

A person that sells products for delivery into Arizona and that does not have a physical presence or other legal requirement to obtain a transaction privilege tax license in Arizona other than because the person's business exceeds the specific thresholds.²⁰

Remote sellers with state annual gross receipts that exceed the following thresholds are required to remit transaction privilege tax on taxable gross receipts:

- For calendar year 2019 - \$200,000.

¹⁰ The Tax Cuts and Jobs Act of 2017 requires the accumulated post-1986 deferred foreign income of a deferred foreign income corporate to be included in taxable income of the corporation that begins before January 1, 2018 (IRC section 965(a)). For federal purposes, the taxpayer is allowed a related deduction under IRC section 965(c). Arizona noted that the IRC section 965(a) income is considered a foreign dividend and may be subtracted to the extent it is included in Federal Taxable Income. Because of the subtraction for IRC section 965(a), the related federal deduction within IRC § 965(c) are required to be added back.

¹¹ H.B.2757, amending A.R.S. section 43-105(A).

¹² See Arizona Form 140 Resident Personal Income Tax Booklet, available here: <https://azdor.gov/forms/individual/form-140-arizona-resident-personal-income-tax-booklet> (accessed on July 1, 2019).

¹³ H.B. 2757, amending A.R.S. section 43-1041.

¹⁴ H.B. 2757, amending A.R.S. Section 43-1001(11).

¹⁵ H.B. 2757, amending A.R.S. Section 43-1073.01.

¹⁶ H.B. 2757, amending A.R.S. Section 43-1041(I).

¹⁷ H.B. 2757, amending A.R.S. section 43-1011(A)(6).

¹⁸ See H.B. 2757, amending A.R.S. section 42-5043.

¹⁹ H.B. 2757, amending A.R.S. section 42-5001(11), which expands the definition of person to include a marketplace facilitator or remote seller.

²⁰ H.B. 2757, amending A.R.S. section 42-5001(16).

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- For calendar year 2020 - \$150,000.
- For calendar year 2021 and each succeeding calendar year - \$100,000.²¹

The Bill provides that remote sellers do not have to pay the initial or renewal municipal privilege tax license fee.²² Further, remote sellers are not liable for failing to pay the correct amount of transaction privilege tax if failure to pay the correct amount of tax was due to an error other than an error in sourcing the sale.²³ This liability relief may not exceed five percent of the total tax due in calendar year 2019, three percent of the total tax due in calendar year 2020, and is essentially phased out for calendar year 2021 and succeeding calendar years as the threshold is zero percent.²⁴ These thresholds relate to tax sourced to Arizona.²⁵

HB2757 provides for municipal transaction privilege tax purposes, the state's retail classification and definitions, supersedes all city or town ordinances or other local laws.²⁶ However, a city or town may, among other things, levy a transaction privilege tax on several specific types of gross receipts.²⁷

Transaction Privilege Tax: Marketplace Facilitators and Sellers

HB2757 specifies that transaction privilege tax also applies to sales of tangible personal property, conducted by a marketplace seller, which are facilitated by a marketplace facilitator where the marketplace facilitator has remitted, or will remit, the applicable tax.²⁸ In accordance, the Bill adds and updates a number of definitions related to marketplace facilitators and sellers.²⁹ The Bill generally provides:

- "Marketplace" - a physical or electronic place, platform or forum, including a store, booth, internet website, catalog or dedicated sales software application, where products, including tangible personal property, are offered for sale.³⁰
- "Marketplace facilitator" - a person that facilitates a retail sale by a marketplace seller by listing or advertising for sale by the marketplace seller in a marketplace tangible personal property and, either directly or indirectly, through agreements or arrangements with third parties collecting payment from the purchaser and transmitting that payment to the marketplace seller, regardless of whether the marketplace facilitator receives compensation for the marketplace facilitator's services.³¹
- "Marketplace seller" - a person that makes retail sales through any physical or electronic marketplace that is operated by a marketplace facilitator.³²
- "Person" - includes a marketplace facilitator.³³
- "Sale" - includes transactions facilitated by a marketplace facilitator on behalf of a marketplace seller.³⁴

Further, a marketplace facilitator whose annual gross receipts on its own behalf, or behalf of at least one marketplace seller, in Arizona, exceeds \$100,000 is generally required to remit transaction privilege tax.³⁵ Marketplace sellers are typically not required to remit tax when a marketplace facilitator remits the applicable tax.³⁶

²¹ H.B. 2757, amending A.R.S. section 42-5043(A)(1).

²² H.B. 2757, amending A.R.S. section 42-5005.

²³ H.B. 2757, amending A.R.S. section 42-5042(C).

²⁴ *Id.*

²⁵ *Id.*

²⁶ H.B. 2757, amending A.R.S. section 42-6017.

²⁷ *Id.*

²⁸ *See*

²⁹ H.B. 2757, amending A.R.S. section 42-5001.

³⁰ *Id.* at subsection (8).

³¹ *Id.* at subsection (9).

³² *Id.* at subsection (16).

³³ *Id.* at subsection (11).

³⁴ *Id.* at subsection (18).

³⁵ H.B. 2757, amending A.R.S. section 42-5043(A)(2).

³⁶ *See Id.* at subsection (E).

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Similar to remote sellers, marketplace facilitators do not have to pay the initial or renewal municipal privilege tax license fee³⁷ and are not liable for failing to pay the correct amount of transaction privilege tax in certain instances.³⁸ The marketplace facilitators are not liable for a marketplace seller's sales through its marketplace if meeting certain standards:

- The failure to pay the correct amount of tax was due to incorrect information given to the marketplace facilitator by the seller and the two parties are not affiliated persons;³⁹ or
- The marketplace facilitator and the marketplace seller are not affiliated persons and the failure to pay the correct amount of tax was due to an error, other than error in sourcing the sale.⁴⁰

The liability relief mentioned above may not exceed five percent of the total tax due in calendar year 2019, three percent of the total tax due in calendar year 2020, and is essentially phased out for calendar year 2021 and succeeding calendar years as the threshold is zero percent.⁴¹

HB2757 also provides that the municipal tax rate for businesses selling tangible personal property at retail for marketplace facilitators must be the same rate for businesses selling tangible personal property at retail at the same time.⁴²

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³⁷ H.B. 2757, amending A.R.S. section 42-5005(B).

³⁸ H.B. 2757, amending A.R.S. section 42-5042

³⁹ *Id.* at subsection (A) and (B).

⁴⁰ *Id.* at subsection (C).

⁴¹ *Id.*

⁴² H.B. 2757, amending A.R.S. section 42-6017(B).