

HB 2153 (Chapter 301) – Credit for Contributions by S Corporations to School Tuition Organizations A.R.S. §43-1089.04

S corporations (S-corps) can donate to the low-income and disabled/displaced credit programs and pass a pro rata share of the credit onto their stockholders. The stockholders then claim the credit on their individual income tax return. The aggregate contribution made by the S-corp in the taxable year must be at least \$5,000. The bill is effective July 3, 2015, retroactive to taxable years beginning from and after December 31, 2014.

Effective date for new law

- The bill is effective July 3, 2015, retroactive to taxable years beginning from and after December 31, 2014. More specifically, S-corps can make a donation for a tax credit beginning in tax year 2015. A tax year is identified by the beginning date. S-corps must wait until the start of their tax year 2015 to be eligible to apply for a credit donation approval.
- S-corps may apply for credit donation approval July 1, 2015 **IF they are within their tax year 2015:**
 - If an S-corp's taxable year begins January 1 through June 30, they will be eligible to apply for a credit donation approval July 1, 2015.
 - If an S-corp's taxable year begins between July 1 and December 31, they are not eligible to apply for a credit donation approval July 1, 2015 and must wait until the start of their tax year 2015.
 - For example: 8/1/14 through 7/31/15 is tax year 2014. The S-corp must wait till 8/1/15 (the start of their tax year 2015) to apply for a credit donation approval.
- The "taxable year beginning" language is only an issue for donation applications this first year.
- ADOR will accept eligible applications July 1. The STOs do not need to wait till July 3rd to email applications.

S-Corps

- Tax credit is available to an S-corp as defined in section 1361 of the Internal Revenue Code.
- LLCs taxed as S-corps for federal and state purposes are eligible to make a donation for a tax credit.
- Instead of claiming this credit against income taxed at the corporate level (on the 120S) the S-corp may make an irrevocable election to pass the credit through to its individual shareholders.

- The S-corp does not have to have liability in order to pass the tax credit through to its shareholders. The shareholders will apply their share of the tax credit against their individual income tax liability.
- Each individual shareholder may claim only a pro rata share of the credit based on the individual's ownership interest in the S-corp. The total of the credits allowed to all owners may not exceed the amount that would have been allowed to a sole owner of the business.
- Any pro rata shares that would be distributed to non-eligible partners (individual partners in a partnership) or estates or trusts (shareholders in an S corporation) are lost.
- The donation(s) to the STO must be made by the S-corp in order to be eligible for the tax credit, not the individual taxpayer.
- If a company applies for and makes a donation then later determines they are not eligible for the tax credit the STO is not required to refund their donation. If the STO chooses to refund the donation, it must come from their administrative costs. Once the STO accepts the donation and it is deducted from the corporate credit cap, the STO is obligated to pay out 90% of that amount in scholarships.
- A tax credit is not allowed if the S-corp or a shareholder designates the contribution to the STO for the direct benefit of a shareholder of the corporation claiming a credit.
- A tax credit is not allowed if the S-corp or a shareholder designates a student beneficiary as a condition of the contribution to the STO.
- A tax credit is not allowed if the S-corp or a shareholder, with the intent to benefit a shareholder's dependent, agrees with one or more other taxpayers to designate reciprocal contributions to an STO for the direct benefit of the other taxpayer's dependent.

S-Corp Donation Approval Process

- The S-corp donation approval process is the same as the current corporate donation process:
 - 1) Corporations/S-corps will contact STOs regarding donations.
 - 2) STOs will complete and email the donation application form to ADOR.
 - 3) A donation approval form will be returned to the STO.
 - 4) The company has 20 days to make the donation to the STO. The donation must be made to the STO by the S-corp, not by a shareholder.
 - 5) The STO must contact ADOR when donation is received.
- The donation application form will be updated to include a box identifying donation approval requests from S corps. The revised form will be available early June.
- When the STO notifies the S-corp that the donation application is approved, the STO is to provide the S-corp with a form to provide a list of the potential shareholders for the

donation credit. This form is to be completed and returned directly to ADOR. The individual taxpayer information will not be shared with the STOs. The form will be available early June.

S-Corp Aggregate Contribution

- The law requires S-corps to have made aggregate contributions of at least \$5,000 within their taxable year in order to claim a credit. The donation(s) must be made to the STO by the S-corp, not by a shareholder.
- The \$5,000 aggregate contribution will represent the sum of all low-income and disabled/displaced credit donations made during the S-corp's taxable year.
- **If an S-corp does not make the aggregate contribution of at least \$5,000 during the taxable year they will not be eligible for the credit and therefore any pass-through of the credit will not be valid.**
- It is the S-corp's responsibility to be sure they hit the aggregate contribution minimum within their tax year. However, ADOR will monitor donation approvals from S-corps regarding the \$5,000 aggregate minimum.

S-Corp Reporting Requirements

- The S-corp can pass the credit onto their shareholders based on the ownership interest in the corporation.
- The S-corp does not need to have tax liability in order to pass the credit onto shareholders.
- The S-corp will pass the credit onto the shareholder at the end of their fiscal year/tax year. The individual shareholder would claim the credit on their tax return for the year in which the S-corps fiscal year ends.
 - S-corp with a taxable year beginning 1/1/15 can make a donation for approval on 7/1/15 and then pass the credit onto their shareholders at the close of their fiscal year/tax year. The end of the S-corps fiscal year would be 12/31/15 which falls into the individual's 2015 tax year. The individual taxpayer would claim their share of the credit on their 2015 tax return.
 - S-corp with a taxable year beginning 8/1/15 can make a donation for approval on 8/1/15 and then pass the credit onto their shareholders at the close of their tax year. The end of the S-corps tax year would be 7/31/16 which falls into the individual's 2016 tax year. The individual taxpayer would claim their share of the credit on their 2016 tax return.

- For low-income corporate donations - Form 335 and Form 335-S will be completed by the S-corp and submitted with their 120S. A copy of Form 335-S is also to be forwarded to the shareholders. Credit forms will be available fall 2015.
- For disabled/displaced corporate donations – Form 341 and Form 341-S will be completed by the S-corp and submitted with their 120S. A copy of Form 341-S is also to be forwarded to the shareholders. Credit forms will be available fall 2015.

Individual Shareholder Reporting Requirements

- There is no limit on the low-income or disabled/displaced credit claimed by the individual taxpayer. If the taxpayer's share of the S-corp credit is \$3,000 then their credit will be \$3,000.
- For low-income corporate donations - Form 335-S will be completed by the S-corp and forwarded to the shareholders. The individual taxpayer will claim their share of the credit on Form 335-I. Credit forms will be available fall 2015.
- For disabled/displaced corporate donations - Form 341-S will be completed by the S-corp and forwarded to the shareholders. The individual taxpayer will claim their share of the credit on Form 341-I. Credit forms will be available fall 2015.
- These new credits will not impact the individual taxpayer's ability to claim the original or switcher individual credits or the credit caps for either credit.
 - An individual taxpayer in tax year 2015 could claim the maximum original and switcher credits of \$2,134 plus their \$3,000 share of the S-corp corporate credits.
- The individual taxpayer may carryforward any unused credit for 5 years.

STO Scholarship Requirements

- Scholarships from donations made by S-corps are subject to the same prerequisites as the current low-income and disabled/displaced donations.
- A tax credit is not allowed if the S-corp or a shareholder designates the contribution to the STO for the direct benefit of a shareholder of the corporation claiming a credit.
- A tax credit is not allowed if the S-corp or a shareholder designates a student beneficiary as a condition of the contribution to the STO.
- A tax credit is not allowed if the S-corp or a shareholder, with the intent to benefit a shareholder's dependent, agrees with one or more other taxpayers to designate reciprocal contributions to an STO for the direct benefit of the other taxpayer's dependent.

Language Regarding Charter Schools

- The STO operational requirements for the corporate and individual programs (A.R.S. § 43-1503 and A.R.S. § 43-1603) have been amended to include the following language:
 - B.5. Must not award educational scholarships or tuition grants to students who are simultaneously enrolled in a district school or charter school and a qualified school.
- This additional language is clarifying the current stance regarding charter schools.