

ARIZONA CHARITABLE DONATIONS FOR TAX CREDITS

The Basics

Arizona allows taxpayers to claim nonrefundable tax credits for a wide variety of contributions or donations made to specific organizations or groups. The most common are:

- a. Credit for Contributions to Qualifying Charitable Organizations – AZ Form 321
- b. Credit for Contributions Made or Fees Paid to Public Schools – AZ Form 322
- c. Credit for Contributions to Private School Tuition Organizations – AZ Form 323
- d. Credit for Contributions to Certified School Tuition Organizations (for amounts that exceed the allowable credit on AZ Form 323) – AZ Form 348
- e. Credit for Contributions to Qualifying Foster Care Charitable Organizations – AZ Form 352

It's important to know that any of these "contributions" that result in Arizona tax credits **are not** charitable contributions; rather, the IRS and Arizona consider them state income tax payments. They are **never** to be entered as Gifts to Charity in the Federal Itemized Deductions section of TaxSlayer.

Arizona sets limits each year on the maximum amount taxpayers may contribute each tax year to count as these tax credits. For example, for 2021 the maximum amount that can be contributed to count for AZ 321 credit is \$800 for taxpayers filing MFJ and \$400 for all other taxpayers. Note that taxpayers may contribute amounts above the annual Arizona limits, but any amount contributed above the limit is considered a charitable donation. As an example, if a single person contributes \$600 to an AZ321 Qualifying Charitable Organization, only \$400 (the annual limit) of the contribution can be used as an Arizona tax credit and the remaining \$200 is considered a donation to charity.

Because these tax credits are nonrefundable, the maximum amount taxpayers can use in a single tax year is limited to their tax liability for the year, which in nearly all cases is their tax as given on line 48 of the Arizona 140 return less any Dependent Tax Credits they may have. Any contributions within the annual limits they make that are above their tax liability may be carried over and used in up to five subsequent tax years. As an example, if a married couple has a tax liability of \$500 and makes contributions of \$800 to an AZ321 Qualifying Charitable Organization, they could use \$500 for a credit in the current filing year and carry over the remaining \$300 to potentially use in future years (maximum of 5 years).

Contributions that qualify to be current filing year tax credits

There are three possible sources of contributions that may qualify to be tax credits within a given tax year:

- a. Carryover(s) from prior years.
- b. Contributions made during the current filing year that qualify for AZ 321, 322, 323, 348 and 352 credits.
- c. Contributions made after the current filing year (and before the filing due date) that the taxpayer wishes to apply to the current filing year.

Remember that the total of the three sources cannot exceed the taxpayer's current filing year Arizona tax liability. In general, you'll want to use contributions from the three sources in the order given above: carryovers, current filing year and finally contributions made after the current filing year. You can use partial amounts of carryovers if that's all that's needed to reach the tax liability. Arizona law does not specify the order carryovers must be used, so in general it's best to use the oldest carryovers first since they'll be the first to reach the 5-year limit after which they disappear and can no longer be used.

Example: A couple filing MFJ has a 2021 tax liability of \$700. They contributed \$400 to an AZ321 organization in June 2021, and they have two carryovers: a \$200 AZ322 credit from 2020 and a \$200 AZ352 credit from 2018. To fulfill their tax liability, they would use their 2018 \$200 carryover, then the 2020 \$200 AZ322 carryover and finally \$300 of the current filing year AZ 321 contribution. The remaining \$100 of AZ321 carryover will remain available for use in future years.

ALL ARIZONA CREDITS USED IN A TAX YEAR WILL BE INCLUDED IN THE FEDERAL SCHEDULE A AS "STATE TAXES PAID"

In the above example, the 2021 Federal Schedule A will include the 2018 AZ 352 carryover credit and the \$200 2020 carryover in addition to \$300 of the 2021 AZ321 credit for a total of \$700.

How to enter AZ3XX contribution/tax credit data in TaxSlayer

[Note: the scenarios below assume the taxpayer made the following contributions DURING the tax year, except for the AZ322 contribution. Choose the appropriate scenario based on the taxpayer's use of either Standard Deduction or Itemized Deduction]

\$300 to an AZ Qualifying Charitable Organization (qualifies for AZ321 credit)

\$200 to an AZ Public School (qualifies for AZ322 credit)--made AFTER the tax year

\$250 to their church

\$150 to a non-Arizona 501.c.3 fund

\$395 non-cash donations

Scenario 1: Taxpayer will use the Federal Standard Deduction.

1. In TaxSlayer>Federal Section>Deductions>Itemized Deductions>Gifts to Charity, enter \$400 (the total of the \$250 and \$150 cash donations that do not count for AZ tax credits) as Cash Gifts to Charity.
2. In TaxSlayer>Federal Section>Deductions>Itemized Deductions>Gifts to Charity, enter \$395 as Non-Cash Gifts to Charity.
3. In Arizona>Credits>Credit for Contributions Made to Qualifying Charitable Organizations – Form 321, enter \$300 and the appropriate code information.
4. In Arizona>Credits>Credit for Contributions Made or Fees Paid to Public Schools – Form 322, enter \$200 and the appropriate code information, including “Donation made AFTER tax year.”
5. Two sub-scenarios (follow a or b below depending on how AZ return will be filed):If

Arizona return will also use Standard Deduction,

(1) In Arizona>Standard Deduction, enter \$300 in the box titled “Additional Eligible Cash Charitable Contributions NOT claimed on the Federal Schedule A.” (Caution: *do not* make any adjustment for the \$200 contribution made after the tax year)

(2) Exit the Arizona return

Arizona return will use Itemized Deduction

(usually occurs when there are high medical bill offsets on Federal Schedule A),

(1) In TaxSlayer>Federal Section>Deductions>Itemized Deductions>Taxes You Paid>Schedule A – Taxes You Paid, enter \$500 in the top box “Additional State and Local Income Tax.” (Total of the two contributions for Arizona Tax Credit)

(2) In Arizona>Itemized Deduction, enter \$-300 in the box titled “Amount of Charitable Contributions that were claimed as Arizona credit(s).” (Note: only the current filing year filing year year contribution for tax credit is offset)

(3) Exit the Arizona return.

Scenario 2: Taxpayer will use the Federal Itemized Deduction

1. In TaxSlayer>Federal Section>Deductions>Itemized Deductions>Gifts to Charity, enter \$400 (the total of the \$250 and \$150 cash donations that do not count for AZ tax credits) as Cash Gifts to Charity.
2. In TaxSlayer>Federal Section>Deductions>Itemized Deductions>Gifts to Charity, enter \$395 as Non-Cash Gifts to Charity.
3. In TaxSlayer>Federal Section>Deductions>Itemized Deductions>Taxes You Paid>Schedule A – Taxes You Paid, enter \$500 in the top box “Additional State and Local Income Tax.” (Total of the two contributions for Arizona Tax Credit)
4. In Arizona>Credits>Credit for Contributions Made to Qualifying Charitable Organizations – Form 321, enter \$300 and the appropriate code information.
5. In Arizona>Credits>Credit for Contributions Made or Fees Paid to Public Schools – Form 322, enter \$200 and the appropriate code information, including “Donation made AFTER tax year.”
6. In Arizona>Itemized Deduction, enter \$-300 in the box titled “Amount of Charitable Contributions that were claimed as Arizona credit(s).” (Note: only the current filing year contribution for tax credit is offset)
7. Exit the Arizona return

Background/Rationale

From the 2020 IRS Publication 526, Charitable Contributions:

“State or local tax credit. If you make a payment...to or for the use of a qualified organization and receive or expect to receive a state or local tax credit in return, then the amount treated as a charitable contribution deduction is reduced by the amount of the state or local tax credit you receive or expect to receive in consideration for your payment or transfer....”

Since Arizona allows full tax credit for the amounts contributed to AZ 321, 322, 323, 348 and 352 (up to annual limits), this means the reduction is 100% and therefore there’s no charitable contribution deduction allowed for those contributions. However, if the taxpayer is itemizing, the contributions that result in AZ tax credits can be entered as Taxes Paid.

This means that any amounts contributed to Arizona charities that result in Arizona tax credits should

NEVER be entered in TaxSlayer in the Federal Section>Deductions>Itemized Deductions>Gifts to Charity location, because (1) they’re really Taxes Paid, not charitable contributions, and (2) if entered as contributions, they could affect the Federal return by showing up as part or all of the “Charitable contributions if you take the standard deduction” on 2021’s 1040 line 10a, which can reduce taxable income up to \$600 if MFJ.

ARS 43-1042 Section C states:

“A taxpayer shall not claim both a deduction provided by this section and a credit allowed by this title with respect to the same charitable contributions. This subsection applies to any contribution for which a credit is allowed by this title even if the contribution is treated as a payment of state income tax.”

The adjustments made to the Arizona Standard Deduction or Itemized Deduction areas in the Scenarios above do not violate this ARS provision. Rather, they ensure that the Arizona returns accurately reflect the Federal standard or itemized deduction amounts and still yield the appropriate Arizona tax credits to the taxpayer. The Adjustments are necessary because TaxSlayer incorrectly *assumes* (at least for 2020 returns) that ‘contributions that qualify for AZ tax credits’ must have already been entered as charitable contributions in the Federal return and “corrects” the AZ return via line 6 on the AZ140 Schedule A worksheet. The adjustments made in the Scenarios above fix that inaccurate “correction.”