

Arizona Qualified Charitable Donations – Tax Treatment in TSO

Arizona allows taxpayers to claim a nonrefundable tax credit for contributions to Qualified Charities. There are many qualifying charities grouped into specific categories.

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

Contributions to an Arizona Qualified Charity that result in a State Tax Credit are **not** considered charitable contributions. Both the IRS and Arizona classify contributions that result in a tax credit as a state income tax payment.

The qualified amount must not be entered in TaxSlayer as a Charitable Donation. The Qualified Amount is entered as additional State Taxes Paid in Federal Itemized Deductions. (Note: Charity in the Federal Itemized Deductions section of TaxSlayer).

Arizona sets annual limits for the maximum qualifying amount taxpayers may contribute each tax year to each Qualified Charity Group.

For TY22 the maximum qualifying amount which can be contributed to a Charitable Organization (AZ Form 321) is \$800 for taxpayers filing MFJ and \$400 for all other taxpayers.

Taxpayers may contribute amounts greater than the qualified amount. The amount contributed above the qualified amount is considered a charitable donation.

Example, if a single person contributes \$600 to an AZ321 Qualifying Charitable Organization, only \$400 (the qualifying amount) of the contribution can be claimed as an Arizona Tax Credit on Form 321 and the remaining \$200 is considered a charitable donation. The amount more than the annual qualifying limit is entered in TaxSlayer as a charitable donation on Schedule A, while the qualifying amount is entered as State Taxes Paid.

AZ Tax Credits are nonrefundable, which means the maximum amount taxpayers can use in a single tax year is limited to their tax liability for the year. This is the tax shown on line 48 of Arizona Form 140 less any Dependent Tax Credits.

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Qualified contributions made which are above the tax liability may be carried over and applied to tax liability for up to five tax years.

Example, if a married couple has a tax liability of \$500 and contribute \$800 to an AZ321 Qualifying Charitable Organization, they could use \$500 as a nonrefundable tax credit to offset the current year tax liability and carry forward the remaining \$300 to offset future years tax liabilities (maximum of 5 years).

There are three sources of qualified contributions that may be used as tax credits to offset tax liability within a given tax year:

- a. Carryforwards from prior years.
- b. Qualified contributions made during the current filing year.
- c. Qualified contributions made after the current filing year, but before the filing due date. Taxpayers have a choice to apply or carryforward these contributions.

The total of the three sources cannot exceed the taxpayer's current filing year tax liability. As a rule, we should use the oldest contribution first as they may expire. Partial amounts of qualified contributions may also be used.

Arizona tax law does not specify the order in which carryforwards must be used.

Example: A couple filing MFJ has a TY22 AZ tax liability of \$700. They contributed \$400 to an AZ321 organization in June 2022, and they have two carryforwards:

1. \$200 AZ322 credit from TY20
2. \$200 AZ352 credit from TY18

To fulfill their tax liability, they would apply their TY18 carryforward of \$200, then apply the TY20 AZ322 carryover of \$200 and finally use \$300 of the current year AZ321 contribution. The remaining \$100 of AZ321 carryover will be a new carryforward for use in future years.

IMPORTANT:

QUALIFIED ARIZONA TAX CREDITS RECEIVED IN THE TAX YEAR WILL BE INCLUDED IN FEDERAL SCHEDULE A as "STATE TAXES PAID"

TaxSlayer input [Choose the appropriate scenario based on the taxpayer's use of either a Standard Deduction or Itemized Deduction] to enter the following example:

\$300 to an AZ Qualifying Charitable Organization – Form 321

\$200 to an AZ Qualifying Public School – Form 322 - made AFTER the tax year

\$250 to their Church

\$150 to a non-Arizona 501.c.3 fund and \$395 non-cash donations

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Scenario 1: Taxpayer uses the Federal Standard Deduction.

Federal Section>Deductions>Itemized Deductions>Gifts to Charity>Cash. Enter \$400 (\$250 Church and \$150 cash donations that do not qualify for an AZ Tax Credit)

Federal Section>Deductions>Itemized Deductions>Gifts to Charity>non-Cash. Enter \$395 for non-cash donations.

Arizona>Credits>Credit for Contributions Made to Qualifying Charitable Organizations - Form 321. Enter \$300 and the appropriate code information.

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.”

If the Arizona return will also use Standard Deduction, then:

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

Exit the Arizona return

Arizona return will use Itemized Deduction

This may occur when there are high medical bills on Federal Schedule A.

Federal Section>Deductions>Itemized Deductions>Taxes You Paid: Enter \$500 in the top box “Additional State and Local Income Tax.” (Total of the two contributions for the Arizona Tax Credit)

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)

Exit the Arizona return.

Scenario 2: Taxpayer uses the Federal Itemized Deduction

Federal Section>Deductions>Itemized Deductions>Gifts to Charity>Cash: Enter \$400 (\$250 Church and \$150 cash donations that do not qualify for AZ Tax Credits).

Federal Section>Deductions>Itemized Deductions>Gifts to Charity>non-Cash. Enter \$395 for non-cash donations.

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)

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Arizona>Credits>Credit for Contributions Made to Qualifying Charitable Organizations – Form 321. Enter \$300 and the appropriate code information.

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.”

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)

Exit the Arizona return

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Background:

IRS Publication 526 (2020), 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 a tax credit for the amounts contributed to AZ 321, 322, 323, 348 and 352 (up to annual limits), 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.

Therefore, amounts contributed to qualified Arizona charities that result in an Arizona tax credit should NEVER be entered in TaxSlayer as a Federal Itemized Deduction Gifts to Charity, because the payment is made to the qualified charity in order to obtain an Arizona Tax Credit to offset tax liability, not as a charitable contributions, and (2) if entered as contributions, the amount could affect the Federal return by showing up as part or all of the charitable contributions if you take the standard deduction” on TY21'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 shown above to the Arizona Standard Deduction or Itemized Deduction 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.

These 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 therefore TaxSlayer “corrects” the AZ return via line 6 on the AZ140 Schedule A worksheet.

The adjustments made in the Scenarios above fix the TaxSlayer “correction.”.