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Governor

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Director

PRIVATE TAXPAYER RULING LR04-002

March 2, 2004

The following private taxpayer ruling is provided in response to your letter dated October 1, 2003, in which you requested the department to rule whether two separate income tax credit carryovers from a pre-merger subsidiary would be allowed against the post-merger liability of the merged corporations.

The following is a restatement of the facts as presented in the request for a private taxpayer ruling.

Statement of Facts:

... (hereafter "Taxpayer") is a ... based corporation that designs, engineers, and manufactures ... components for aerospace and military markets. This activity is conducted through two subsidiaries: ..., which operates in ..., and ..., which operates in ...

Taxpayer is contemplating the merger of ... and ... with ... as the surviving entity. Subsequent to the merger the operations will continue as they had prior to the merger. ... has existing R & D and enterprise zone credits available for carryover.

Applicable Statutory Provisions:

Arizona Revised Statutes (A.R.S.) § 43-1161 provides a credit for increases in qualified employment at a business location in an enterprise zone, except at a zone location where more than ten percent of the business conducted at the location consists of retail activities. Unused credits may be carried forward for five years.

A.R.S. § 43-1161(I) states:

If a person purchases a business in a zone or changes ownership through reorganization, stock purchase or merger, the new taxpayer may claim first year credits only for one or more qualified employment positions that it created and filled with an eligible employee after the purchase or reorganization was complete. If a person purchases a taxpayer that had qualified for first or second year credits or changes ownership through reorganization, stock purchase or merger, the new taxpayer may claim the second or third year credits if it meets other eligibility requirements of this

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section. Credits for which a taxpayer qualified before the changes described in this subsection are terminated and lost at the time the changes are implemented.

(Emphasis added.)

A.R.S. § 43-1168 allows a credit for increased research activities and unused credits may be carried forward for five years.

State Tax Commission v. Oliver's Laundry & Dry Cleaning Co., 19 Ariz. App. 442, 508 P.2d 107 (1973), wherein the Court held that when a loss corporation and a gain corporation are merged, the loss may be carried over only to the extent that the losses being used to offset the subsequent gains are from the same business unit.

Discussion:

Arizona statutes generally do not address the situation of credit carryovers in the case where two corporations are merged, one of which has credits available for carryover. However, an Arizona case, State Tax Commission v. Oliver's Laundry & Dry Cleaning Co., addressed the carryover of tax attributes (net operating loss) when a merger occurs. The court held that the pre-merger Arizona losses could be applied to post-merger income to the extent the income was attributable to business activities of the same business unit that had incurred the losses.

This same rationale is applied to the carryover of Arizona credits. The pre-merger Arizona credits could be applied to post-merger liabilities to the extent the liability was attributable to business activities of the same business unit that earned the credits unless a specific credit statute provides otherwise.

Conclusion and Ruling:

On the basis of the information provided, we rule that the pre-merger R & D credits of . . . can be applied against the post-merger tax liability of . . . to the extent that the credits are being used to offset the tax liability attributable to the operations of the . . . business unit.

Pursuant to A.R.S. § 43-1161(I) the pre-merger enterprise zone credits of . . . are terminated at the time of the merger and are unavailable for carryover.

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the letter dated October 1, 2003, requesting a private taxpayer ruling.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. This determination is subject to change should the facts prove to be different on audit. If it is determined that undisclosed

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facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.

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