ARIZONA CORPORATE TAX RULING

CTR 99-3

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Can the income or loss of an affiliated group of corporations, as defined by Arizona Revised Statutes (A.R.S.) § 43-942, which filed separate returns for a period outside the statute of limitations, be recalculated as if those corporations had filed a combined return in order to determine the correct amount of net operating loss which may be allowed as a deduction against the combined income of those corporations for a period within the statute of limitations?

APPLICABLE LAW:

A.R.S. § 43-1123 permits a corporation incurring a net operating loss (NOL) during one taxable year to deduct that loss against income in a subsequent five taxable year carryforward period.

A.R.S. § 42-1104 permits the department to seek additional taxes due if it mails a notice of deficiency assessment within four years after the report or return is required to be filed or is filed, whichever period expires later.

A.R.S. § 42-1106 permits the taxpayer to make a claim for credit or refund if the period in which the taxpayer makes the claim is within the period in which the department may make an assessment under A.R.S. § 42-1104.

DISCUSSION:

As discussed in Arizona Corporate Tax Ruling CTR 94-4, the department or a taxpayer may recalculate a corporation's income or loss for a period outside the statute of limitations in order to determine the correct amount of net operating loss which may be allowed as a deduction against income for a period within the statute of limitations.

The recomputation of income or loss based on a change in filing method for years outside the statute of limitations may result in a change in the allowable loss carryover to years open under the statute of limitations. However, if the change in filing method results in a change in the taxable income for years outside the statute of limitations, additional tax deficiencies cannot be assessed and refunds cannot be issued for those years.

Example 1:

A group of commonly owned corporations filed separate returns to Arizona for taxable years 1988 through 1996. The department conducted an audit for the years open under the statute of limitations, 1993 through 1996. The department determined that the affiliated group comprised a unitary business and required a combined filing for the years 1993 through 1996. For the years 1988 through 1992, some members of the group had Arizona net operating losses which totaled $180,000. Another member of the group reported income and paid a total of $10,000 in Arizona tax. Other members of the affiliated group had large losses, but did not have Arizona nexus or file Arizona returns.

A review of the years 1988 through 1992 revealed that a combined return should have been filed for those years. The combined returns would have reflected a total Arizona net operating loss for the period of $400,000. Because 1988 through 1992 are closed to refund or assessment under the statute of limitations, the $10,000 in Arizona tax cannot be refunded. However, the net operating loss carryforward into 1993 and subsequent open years may be adjusted to reflect the proper deduction based on the corrected loss for years 1988 through 1992. This is a loss of $400,000 rather than $180,000.

Example 2:

A group of corporations filed separate returns to Arizona for taxable years 1988 through 1996. The department conducted an audit for the years open under the statute of limitations, 1993 through 1996. The department determined that the affiliated group comprised a unitary business and required a combined filing for the years 1993 through 1996. For the years 1988 through 1992, some members of the group had Arizona net operating losses which totaled $180,000. Another member of the group reported income and paid a total of $10,000 in Arizona tax. Other members of the affiliated group had net income, but did not have Arizona nexus or file Arizona returns. A recalculation of the years 1988 through 1992 on a combined return basis results in net income for all years. Since 1988 through 1992 are closed to assessment under the statute of limitations, no assessment for additional tax will be issued. However, since the Arizona combined group did not incur a net operating loss, no net operating loss carryforward would be allowed.

RULING:

In the case of an Arizona net operating loss carryforward from a group of corporations that filed separately but should have filed a combined return, or that filed a combined return but should have filed separately, the loss which may be carried forward shall be the loss recomputed as if the corporations had filed using the proper filing method.

If the corporations filed using the proper filing method, but the proper filing method changed in subsequent years, the Arizona net operating loss carryforward shall be computed pursuant to CTR 91-2.

Note: See related ruling CTR 91-2 which explains the computation for determining the allowable amount of net operating loss which may be carried forward and applied when losses from separate year taxpayers are included in a combined filing group or a portion of the combined loss is carried forward to corporations separated from the group.

Mark W. Killian, Director

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.