ARIZONA DEPARTMENT OF REVENUE

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ARIZONA CORPORATE TAX RULING
CTR 94-14

ISSUE:

What is the proper apportionment or allocation of capital gain and loss for a multistate corporation doing business in Arizona?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-1101.1 defines Arizona gross income of a corporation as its federal taxable income for the taxable year.

A.R.S. § 43-1101.2 defines Arizona taxable income of a corporation as its Arizona gross income adjusted by the specific modifications provided in Title 43, Chapter 11, Article 3.

A.R.S. §§ 43-1134 and 43-1136 provide that nonbusiness capital gains and losses shall be allocated to the situs of the property or the commercial domicile of the taxpayer depending upon the type of property sold.

A.R.S. § 43-1139 provides that all business income shall be apportioned to Arizona using an apportionment ratio based on factors of property, payroll, and sales.

Internal Revenue Code (I.R.C.) § 1211 provides that capital losses are deductible only to the extent of capital gains when computing federal taxable income.

<u>DISCUSSION</u>:

The net capital gain reported in federal taxable income may consist of a number of individual items of gain and loss. When computing Arizona taxable income of a multistate corporation, these amounts of capital gain and loss included in Arizona gross income must be analyzed and apportioned or allocated based on the business or nonbusiness nature of each item of gain or loss. A.R.S. § 43-1139 requires that all business income be apportioned to Arizona to the extent that the corporation does business within the state. Under A.R.S. §§ 43-1134 and 43-1136, nonbusiness income or loss is required to be allocated to the commercial domicile of the corporation or the situs of the nonbusiness property depending upon the type of property sold.

> *<u>Example</u>*:
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> A multistate corporation reports net capital gain of $20,000 on its federal return, consisting of $40,000 in capital loss from a nonbusiness investment and $60,000 in capital gain from business sources. The $60,000 in business gain would be apportioned. The $40,000 in nonbusiness loss would be allocated to the situs of that nonbusiness investment or to the taxpayer's commercial domicile.

Under I.R.C. § 1211, capital losses are allowable as a deduction only to the extent of capital gains when computing federal taxable income (Arizona gross income). There are no provisions within the Arizona income tax statutes for subsequent limitations when computing Arizona taxable income. Therefore, if the allocation and apportionment of the various items of capital gain and loss included in Arizona gross income results in an amount of loss greater than the amount of gain in Arizona taxable income, that loss would be fully deductible and not subject to any further offset limitation.

> *<u>Example</u>*:
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> Arizona gross income includes $10,000 in capital loss and $15,000 in capital gain for a net capital gain of $5,000. The $15,000 in capital gain is considered business income and is apportioned to Arizona. Assuming a 10 percent apportionment ratio, $1,500 in capital gain would be included in Arizona taxable income. If the $10,000 capital loss is a nonbusiness loss with an Arizona situs, the $10,000 loss would be allocated to Arizona. Arizona taxable income would include a net capital loss of $8,500.

<u>RULING</u>:

Capital gains and losses included in Arizona gross income must be apportioned or allocated to Arizona based on the business or nonbusiness character of each item of gain or loss when computing Arizona taxable income of a multistate corporation. If capital losses allocated or apportioned to Arizona exceed the capital gains allocated or apportioned to Arizona, the full amount of the net capital loss is allowable in computing Arizona taxable income.

Harold Scott, Director

Signed: November 28, 1994

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 which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the 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 92-1 for more detailed information regarding documents issued by the Department of Revenue.