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ARIZONA INDIVIDUAL INCOME TAX PROCEDURE ITP 13-1

Procedure for Individuals Deducting a
Net Operating Loss Carryback

(Supersedes ITP 99-1)

ISSUE:

How does an individual who incurs a net operating loss carry that net operating loss back for Arizona purposes?

PROCEDURE:

Arizona's individual net operating loss treatment conforms to the federal net operating loss provisions, including the carryback provisions, since the starting point for the individual income tax computation is the federal adjusted gross income. However, a net operating loss incurred from non-Arizona sources while the individual was a nonresident cannot be carried back for Arizona purposes.

In order to carry a net operating loss back for Arizona individual income tax purposes, an individual must follow the procedures set forth below.

When an individual files a federal Form 1045 or Form 1040X to deduct a net operating loss carryback for federal tax purposes, that individual may amend his or her Arizona return for the same taxable years to reflect the federal net operating loss carryback provided:

- (1) The individual amends his or her return using Arizona Form 140X.
- (2) The Arizona Form 140X is for the same taxable year that the net operating loss carryback deduction was taken for federal tax purposes.
- (3) The Arizona Form 140X reflects the federal net operating loss carryback as an adjustment to the individual's Arizona gross income (federal adjusted gross income) reported for that taxable year.
 - (a) If the individual was a full-year Arizona resident during the taxable year being amended, the amount of the net operating loss carryback reflected on the Arizona Form 140X for that year must be the same amount of net operating loss carryback deducted for the same taxable year for federal purposes. A federal net operating loss

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incurred from non-Arizona sources after the individual has terminated Arizona residency cannot be carried back to the individual's full year Arizona resident return.

- (b) If the individual was a part-year Arizona resident during the taxable year being amended, the amount of the net operating loss carryback reflected on the Arizona Form 140X for that year must be only that portion of the federal net operating loss carryback deducted for the taxable year for federal tax purposes which was attributable to income taxed by Arizona for that taxable year.
- (c) If the individual was an Arizona nonresident during the taxable year being amended, the amount of the net operating loss carryback reflected on the Arizona Form 140X for that year must be only that portion of the federal net operating loss deducted for the same taxable year for federal tax purposes which was derived from Arizona sources.

The following example will illustrate how an Arizona resident uses the amounts shown on federal Form 1045 to amend the prior year Arizona resident returns.

Example:

For federal income tax purposes, an Arizona full-year resident for taxable years 2009, 2010 and 2011 incurred a \$200,000 net operating loss during the 2011 taxable year. The taxpayer elects to carry the loss back to taxable years 2009, and 2010. The taxpayer files a federal Form 1045 reflecting the following.

Federal Form 1045	Taxable Year 2009		Taxable Year 2010	
	Before Carryback	After Carryback	Before Carryback	After Carryback
NOL Deduction After Carryback		200,000		140,300
Adjusted gross income	75,000	<125,000>	78,000	<62,300>
Deductions	15,300	15,300	16,100	16,100
Exemptions	<u>7,300</u>	<u>7,300</u>	<u>7,300</u>	<u>7,300</u>
Taxable income	52,400	<147,600>	54,600	<85,700>

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Federal Form 1045 Schedule B NOL Carryover		
	Taxable Year 2009	Taxable Year 2010
NOL Deduction	200,000	140,300
Taxable income before 2011 NOL	52,400	54,600
Adjustments to adjusted gross income	0	0
Adjustments to itemized deductions	0	0
Exemptions	<u>7,300</u>	<u>7,300</u>
Modified Taxable income	<u>59,700</u>	<u>61,900</u>
NOL Carryover	140,300	78,400

For Arizona income tax purposes, the taxpayer files amended Arizona income tax returns for taxable years 2009, and 2010. On each amended return, the taxpayer will reduce the Arizona gross income reported on the original Arizona return by the amount of the net operating loss carryback actually utilized each year for federal income tax purposes. Therefore, on the 2009 Arizona Form 140X, the taxpayer will reduce the Arizona gross income reported on the original 2009 Arizona return by \$59,700. On the 2010 Arizona Form 140X, the taxpayer will reduce the Arizona gross income reported on the original 2010 Arizona return by \$61,900.

Arizona Returns 140 & 140X	Taxable Year 2009		Taxable Year 2010	
	Federal NOL Carryback Utilized <\$59,700>		Federal NOL Carryback Utilized <\$61,900>	
	140 Before Carryback	140 X After Carryback	140 Before Carryback	140X After Carryback
Federal adjusted gross income	75,000	15,300	78,000	16,100
Arizona Adjusted Gross Income	85,000*	25,300	68,000**	6,100
Deductions	15,300	15,300	16,100	16,100
Personal Exemptions	<u>4,200</u>	<u>4,200</u>	<u>4,200</u>	<u>4,200</u>
Arizona taxable income	65,500	5,800	47,700	<14,200>

* For the 2009 taxable year, the taxpayer had \$10,000 of interest income from non-Arizona municipal bonds. Therefore, for 2009, the taxpayer's Arizona adjusted gross income is \$10,000 more than the federal adjusted gross income.

** For the 2010 taxable year, the taxpayer had \$10,000 of interest income from U.S. Government obligations. Therefore, for 2010, the taxpayer's Arizona adjusted gross income is \$10,000 less than the federal adjusted gross income.

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Note: Please see Arizona Individual Income Tax Ruling ITR 13-5 for a discussion of NOL carryovers incurred from non-Arizona sources prior to Arizona residency.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-961(5) disallows deductions that are otherwise allowable when the deductions are allocable to a class of income that is not required to be included in the taxpayer's Arizona adjusted gross income or Arizona taxable income.

A.R.S. § 43-1001 provides that the Arizona adjusted gross income of a resident individual is the federal adjusted gross income subject to the modifications specified in A.R.S. §§ 43-1021 and 43-1022.

A.R.S. § 43-1091 defines the Arizona gross income of a nonresident individual to include only that portion of federal adjusted gross income which represents income from sources within Arizona.

A.R.S. § 43-1097 provides for allocation of items of income and deduction in the year in which a taxpayer changes residency status.

Arizona Administrative Code (A.A.C.) rule R15-2C-210 addresses the Arizona treatment of individual net operating loss deductions.

Arizona State Tax Commission v. Kieckhefer, 67 Ariz. 102, 191 P.2d 729 (1948), held that a right to a deduction does not exist in the absence of statutory authorization and a deduction will not be allowed for items not within the terms of the statute.

David Raber, Acting Director

Signed: December 5, 2013

Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to Department personnel. A tax procedure is a written statement issued by the Department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.