

ARIZONA DEPARTMENT OF REVENUE**ARIZONA CORPORATE TAX RULING****NO. CTR 91-2**

(Effective Date: For tax years beginning on or after 12-31-90)

This ruling supersedes and rescinds Arizona Income**Tax Ruling No. 85-10-4**

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ISSUE:

The calculation of the allowable Arizona net operating loss for corporations which change their method of filing to Arizona from separate to combined or combined to separate.

APPLICABLE LAW:

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.

A.R.S. § 43-1123 which is the general statutory provision regarding Arizona net operating losses.

A.A.C. R15-2-1025.B.4. which provides that

Net operating losses may not be carried forward if:

- a. they were incurred by a corporation prior to it doing business in Arizona; or
- b. they were incurred by a corporation prior to a merger, consolidation or other type of

reorganization with another corporation or group of corporations, to the extent that postmerger, consolidation or reorganization gains are not attributable to the same business unit and enterprise as that which incurred the prior losses. (Emphasis added).

A.R.S. § 43-1121.7 which provides that, in computing Arizona taxable income of a corporation, the amount of net operating loss taken pursuant to section 172 of the Internal Revenue Code shall be added back to Arizona gross income.

DISCUSSION:

This ruling addresses:

- a) the calculation of Arizona net operating losses for corporations that had originally filed separate income tax returns but which are subsequently required to file a combined return to Arizona due to the unitary nature of their operations, and
- b) the calculation of Arizona net operating losses for corporations that originally filed combined income tax returns but which are subsequently required to file separate returns to Arizona due to the non-unitary nature of their operations.

The principles followed in State Tax Commission v. Oliver's Laundry & Dry Cleaning Co., supra, and A.C. R15-2-1025.B.4. are the keys to these calculations. These principles require that only a loss from the same business unit that is reporting the income may be carried forward to reduce that income.

The determination of that portion of the combined income (loss) which is considered to be related to a specific business unit (separate corporation) within the combined group is determined by computing a ratio based on the property, payroll and sales factors of the separate company to the combined group's total property, payroll and sales factors. This ratio is multiplied by the combined net income subject to apportionment. This product is the portion of the combined net income or loss related to that business unit (separate company). The Arizona portion of that business unit's net income or loss is computed by multiplying the income related to that business unit by that unit's ratio of Arizona property, payroll and sales factors to that unit's total property, payroll and sales factors plus any income or loss allocable to Arizona.

This computation of the portion of the Arizona income or loss related to a corporation included within a combined return is reflected by the following formula:

$$A/B \times C \times D/A + E = L$$

A/B = Ratio based on separate company property, payroll and sales factors to combined group's total property, payroll and sales factors.

C = Combined income subject to apportionment.

D/A = Ratio based on separate company's Arizona property, payroll and sales factors to separate company's total property, payroll and sales factors.

E = Separate corporation income and expense allocable to Arizona.

L = (a) The amount of separate company income within the combined return to which the separate company loss can be applied or (b) the amount of the combined loss available for carryover against the separate company income. This computation should be made for each year of combined filing to determine (a) what portion of the combined income may be offset by prior separate company losses or (b) what portion of the combined loss may be carried forward against separate company income.

CONCLUSION AND RULING:

When a separate company which has incurred a net operating loss joins in the filing of a combined return the loss may be carried forward only to the extent of that portion of the combined income related to the business unit which incurred the prior loss.

When a group of corporations files a combined return reporting a loss and subsequently is required to file separate returns, only that portion of the combined loss related to each corporation may be carried forward against subsequent income of that corporation.

This ruling supersedes and rescinds Arizona Income Tax Ruling No. 85-10-4, effective for tax years beginning on or after December 31, 1990.

Paul Waddell, Director
Signed April 2, 1991