

# ARIZONA DEPARTMENT OF REVENUE

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## ARIZONA CORPORATE TAX RULING CTR 94-12

(This ruling was updated on July 30, 2020 to show the correct administrative code references. The administrative code sections originally referenced had been renumbered. See the footnotes for details. No substantive changes were made.)

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:**

How does an Arizona affiliated group filing an Arizona consolidated income tax return determine what is business or nonbusiness income?

### **APPLICABLE LAW:**

Arizona Revised Statutes (A.R.S.) § 43-947 allows a common parent of an affiliated group of corporations to elect to file a consolidated tax return for Arizona income tax purposes.

A.R.S. § 43-947.F provides that:

The affiliated group shall allocate and apportion its income to this state in the manner prescribed in chapter 11, article 4 of this title. For the purposes of allocation and apportionment of income, the Arizona affiliated group is considered to be and shall be treated as a single taxpayer.

Title 43, Chapter 11, Article 4, consisting of A.R.S. §§ 43-1131 to 43-1150 and known as the Uniform Division of Income for Tax Purposes Act (UDITPA), sets forth the procedures for the apportionment and allocation of income.

Arizona Administrative Code (A.A.C.) rules R15-2D-401 through R15-2D-903<sup>1</sup> discuss the apportionment and allocation of income.

### **DISCUSSION:**

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<sup>1</sup> This ruling originally cited A.A.C. R15-2-1131 to R15-2-1148 which were renumbered to R15-2D-401 through R15-2D-903.

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Taxpayers may elect to file tax returns on a consolidated basis for purposes of the Arizona corporate income tax. An election to file an Arizona consolidated return may only be made by corporations which file a federal consolidated return in accordance with section 1501 of the Internal Revenue Code. This group of corporations is statutorily defined as an "Arizona affiliated group."

An Arizona affiliated group is treated as a single taxpayer. Arizona gross income is the consolidated federal taxable income of the affiliated group. Income on an Arizona consolidated return is classified as either business or nonbusiness income. Business and nonbusiness income are specifically defined in A.R.S. 43-1131<sup>2</sup>. Additionally, United States Supreme Court judicial decisions provide guidance, and should be consulted, as to the proper classification of income. See *Allied Signal v. New Jersey*, 112 S.Ct. 2251 (1992); *F.W. Woolworth Co. v. Taxation and Revenue Dept. of New Mexico*, 102 S.Ct. 3128 (1982); *Asarco Inc. v. Idaho State Tax Commissioner*, 102 S.Ct. 3103 (1982).

The affiliated group is required to allocate and apportion its income in accordance with the provisions contained in Title 43, Chapter 11, Article 4. The article contains the provisions of UDITPA which prescribe the methods and requirements of apportioning and allocating income. Additionally, A.A.C. R15-2D-401 through R15-2D-903<sup>3</sup> interpret and implement these statutory provisions.

In order to identify business or nonbusiness income, one must identify whether it is income arising from transactions and activities in the regular course of the taxpayer's trade or business. There may be multiple unrelated trades or businesses within the Arizona affiliated group.

In determining whether income is business or nonbusiness, one may look to a single corporation, a part of a corporation, or a group of corporations sufficiently integrated to constitute a business. If a transaction is within the regular course of a trade or business, the income from that transaction will be business income. If a transaction is not within the regular course of a trade or business, the income from that transaction will be nonbusiness income.

In apportioning and allocating income as business or nonbusiness, respectively, the principles of UDITPA, as set forth in A.R.S. §§ 43-1131 to 43-1150 and administrative rules A.A.C. R15-2D-401 through R15-2D-508<sup>4</sup>, are applied.

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<sup>2</sup> Originally the ruling also cited A.A.C. R15-2-1131 for the definition of "business income." The rule was renumbered to R15-2D-501 and the portion containing the definition was removed because it repeated verbatim the definition contained in statute. Therefore, the reference to the rule was removed.

<sup>3</sup> See footnote number 1.

<sup>4</sup> The ruling originally cited A.A.C. R15-2-1131 and R15-2-1132 which were renumbered and divided up into A.A.C. R15-2D-401 through R15-2D-508.

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A.R.S. 43-1131<sup>5</sup>, in setting forth the transactional and functional tests for business income, defines business income as "income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations."

#### Example 1:

Corporations A, B, C, D, and E file a federal consolidated return. They elect to file to Arizona as an Arizona affiliated group. Corporation A manufactures mobile homes. Corporation B markets these mobile homes. Corporation C finances the mobile homes marketed by Corporation B. Corporation D operates a chain of pet food stores. Corporation E invests in and markets commercial real estate.

Corporations A, B, and C constitute a single business. Corporations D and E constitute two other separate businesses.

Corporations A, B, and C do not engage in any real estate activities or transactions with Corporation E. Corporation A sells a former manufacturing facility which has been vacant and unused for nine years.

The income from this sale would be allocable nonbusiness income.

Corporation E, on the other hand, sells a shopping center. Since this transaction is in the course of Corporation E's regular trade or business, the income from the sale of this real estate would be business income.

#### Example 2:

Corporation X and Y, which do not engage in any business activities with each other, properly elect to file as an Arizona affiliated group. Corporation X has two businesses: selling shoes and investing in stocks and bonds.

Corporation Y sells auto parts in its regular course of trade or business. It also has a long term investment in stock of an unrelated corporation. It then sells this stock.

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<sup>5</sup> The ruling originally cited A.A.C R15-2-1131.A for the definition of business income. The rule was renumbered to R15-2D-501(A) and the portion that contained the definition of business income was removed because it repeated verbatim the definition contained in statute. Therefore, it was replaced by the reference to A.R.S. 43-1131 which contains the definition.

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The stock transactions conducted by Corporation X are a separate trade or business and would be apportioned as business income.

The one-time stock transaction by Corporation Y is nonbusiness income and would be allocated.

### **RULING:**

In determining whether income generated by an Arizona affiliated group is business or nonbusiness income, the taxpayer must first determine what are the trades or businesses within the Arizona affiliated group. Once this is done, the taxpayer must examine the transactions carried out by those trades or businesses.

If income is earned in the regular course of a trade or business of a corporation, a part of a corporation, or group of corporations sufficiently integrated to constitute a business, that income will be apportioned as business income.

If income is not earned in the regular course of a trade or business, it will be allocated as nonbusiness income.

The determination that a transaction occurs in the regular course of a trade or business must be made by considering all relevant facts and circumstances.

Note: See related rulings CTR 94-10 and CTR 94-11 for additional information on filing consolidated returns.

Harold Scott, Director

Signed: November 15, 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.