

## ARIZONA CORPORATE TAX RULING

### CTR 94-4

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:**

May a corporation's income or loss for a period outside the statute of limitations be recalculated 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?

#### **APPLICABLE LAW:**

Arizona Revised Statutes (A.R.S.) ½ 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-year carryforward period.

A.R.S. ½ 42-113.A 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. ½ 42-115.A permits the taxpayer to make a claim for credits or refunds 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. ½ 42-113.A.

Internal Revenue Code (I.R.C.) ½ 6501(a) provides the statutory period in which the Internal Revenue Service may assess additional tax.

#### **DISCUSSION:**

A corporation may incur a NOL in year one, and five years later it may be determined that the corporation either miscalculated the NOL itself or miscalculated the income available to offset the NOL. At issue is whether the department or the taxpayer may go back and recalculate the income or loss reported by the corporation in a year outside the statute of limitations in order to determine the correct amount of NOL which may be allowed as a deduction against income for

another taxable year which is within the statute of limitations.

Example 1:

A taxpayer reports a loss of \$5,000 in 1989 and claims a net operating loss deduction in 1990 (a year still open under the statute of limitations). Subsequently taxpayer discovers errors on the 1989 return and determines the correct loss is \$7,000. Although 1989 is closed to refund or assessment under the statute of limitations, the net operating loss deduction claimed in 1990 may be adjusted to reflect the proper deduction based on the corrected 1989 loss.

Example 2:

A taxpayer incurs a loss of \$10,000 in 1988 and carries it forward against reported income of \$3,000 in 1989 and deducts the remaining loss of \$7,000 in 1990. Both 1988 and 1989 are closed under the statute of limitations but 1990 remains open. Subsequently the department determines that the correct income for 1989 is \$12,000. The department may apply the entire 1988 loss of \$10,000 against the corrected 1989 income of \$12,000 leaving taxable income of \$2,000 for 1989 and no loss available for carryover to 1990. The department may disallow the loss claimed on the open 1990 return and assess additional tax, but may not assess tax on the \$2,000 of taxable income for 1989 which is closed.

A.R.S. ½ 42-113.A requires the department to mail every notice of deficiency within four years after the report or return is either actually filed or is required to be filed, whichever period expires later. The department acts in accordance with A.R.S. ½ 42-113.A when it *recalculates* a corporate taxpayer's income or loss for a period beyond the statute of limitations without *assessing* additional taxes due for that period. The department may then adjust the NOL deduction for the current year using the recalculated NOL deduction.

This position, based on the language of A.R.S. ½ 42-113.A, is identical to that taken by federal courts in construing the federal statute of limitations. As one court stated in *ABKCO Industries, Inc. v. Commissioner of Internal Revenue*, 56 T.C. 1083, 1089 (1971):

The Commissioner does not dispute that the 1961 period is closed by the statute of limitations...He simply points out that he has not determined a deficiency for that period, that he has recomputed petitioner's short period income only for the purpose of determining its tax liability for 1962 [(an open year)], and that the statute does not bar such a recomputation.

The statute of limitations language found in A.R.S. ½ 42-113.A and its federal counterpart I.R.C. ½ 6501(a) are very similar. The Arizona Supreme Court has stated that where the Arizona Income Tax Act is similar to the federal income tax law, the interpretations of the federal courts will be very persuasive in determining how to construe the Arizona counterpart. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102 (1948); *Arizona State Tax Commissioner v. Fagerberg*, 59 Ariz. 29 (1942).

## **RULING:**

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.

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 taxpayers are included in or separated from a combined filing group.

Harold Scott, Director  
Signed April 14, 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.