

1 "excess of the subtractions specified in section 43-1122 over the sum of the Arizona gross income
2 plus the additions specified in section 43-1121."

3 Among the subtractions specified for computing a corporation's Arizona taxable income is "the
4 amount of income from a domestic international sales corporation [DISC] required to be included in the
5 income of its shareholders" under the Internal Revenue Code ("IRC"). A.R.S. § 43-1122(15). There is no
6 mention of any adjustment for the amount of income (*or loss*) from an S corporation required to be
7 included in the income of its shareholders under the IRC, which is certainly a much more common
8 situation than a DISC and one of which the legislature can be presumed to be aware.

9 Under the doctrine of *inclusio unis est exclusio alterius*, the specific inclusion of *one* type of
10 corporation that has its income taxed to its shareholders should be interpreted to absolutely exclude *any*
11 *other corporation* which has its income taxed to its shareholders. Thus, the Board concludes that for
12 purposes of calculating an S corporation's NOL, there is no adjustment to the amount available to the
13 corporation for the amounts passed through to the shareholders. The result is that Denali had NOL
14 carryovers to 1998 for the five preceding years. See A.R.S. § 43-1123(B). It is undisputed that the
15 portion of those losses attributable to the taxpayers amounted to \$1,185,386.

16 It may be argued that the legislature could not have intended such a result. However, the statute
17 seems clearly to provide the S corporation with a five-year Arizona net operating loss carryforward.
18 Where a statute is clear and not ambiguous, it is not the Board's role to attempt to ascertain the
19 legislative intent. That the interaction of the S corporation and its shareholders even under the federal
20 internal revenue code is not always clear or intuitive is well-known to any tax practitioner. See, e.g.,
21 *Gitlitz v. Commissioner*, 531 U.S. 206 (2002). *Gitlitz* involved the interplay of S corporation and
22 cancellation of indebtedness rules. The Internal Revenue Service argued unsuccessfully that Congress
23 could not possibly have intended what the literal language of the tax statutes was ultimately held by the
24 Supreme Court to permit. The last paragraph of the Court's opinion is instructive in this regard.
25

"Courts have discussed the policy concern that, if shareholders were permitted to pass through the discharge of indebtedness, before

1 reducing any tax attributes, the shareholders would wrongly experience a
2 'double windfall': They would be exempted from paying taxes on the full
3 amount of the discharge of indebtedness, and they would be able to
4 increase basis and deduct their previously suspended losses. See, e.g.,
5 182 F.3d at 1147-1148. Because the Code's plain text permits the
6 taxpayers here to receive those benefits, we need not address this policy
7 concern.

8 There is no tax windfall for Appellants in the instant situation. If Appellants had had Arizona
9 taxable income between 1993 and 1997 that had been offset by the losses, the Board would hold against
10 Appellants on the ground that they were equitably estopped from obtaining a second tax benefit for the
11 same deductions. However, that is not the situation before the Board. Appellants had no Arizona gross
12 income, only the Denali losses. The corporation had an NOL deduction available to it in 1998, of which
13 Appellants' share as stockholders in the S corporation was \$1,185,386. Under IRC § 1366(a), items of
14 income, expense, and loss all pass through from the corporation to the shareholders. These would, thus,
15 reduce the Arizona gross income on Appellants' Form 140NR for 1998. Therefore, the Board holds that
16 \$1,185,386 is available to Appellants as a reduction in calculating the income they derived from the
17 Denali S corporation for Arizona income tax purposes, and that Appellants are entitled to a refund of the
18 Arizona tax paid on that amount.

19 CONCLUSIONS OF LAW

20 Appellants are entitled to the refund claimed. See A.R.S. § 43-1123.

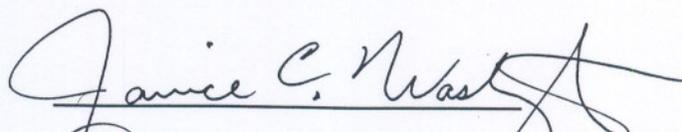
21 ORDER

22 THEREFORE, IT IS HEREBY ORDERED that the appeal is granted, and the final order of the
23 Department is vacated.

24 This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer,
25 unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this 22nd day of April, 2002.

STATE BOARD OF TAX APPEALS


Janice C. Washington, Chairperson

1 WLR:alw

2 CERTIFIED

3 Copies of the foregoing
4 Mailed or delivered to:

5 Timothy T. and Barbara J. Cerny
6 1501 Queens Way
7 Fairbanks, Alaska 99701

8 Lisa Woods
9 Assistant Attorney General
10 Civil Division, Tax Section
11 1275 West Washington Street
12 Phoenix, Arizona 85007

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25