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BEFORE THE STATE BOARD OF TAX APPEALS  
STATE OF ARIZONA  
100 North 15<sup>th</sup> Avenue - Suite 140  
Phoenix, Arizona 85007  
602.364.1102

4 SESEK & ASSOCIATES, LTD )  
5 Appellant, ) Docket No. 1912-03-I  
6 vs. )  
7 ARIZONA DEPARTMENT OF REVENUE, ) NOTICE OF DECISION:  
8 Appellee. ) FINDINGS OF FACT AND  
9 ) CONCLUSIONS OF LAW

10 The State Board of Tax Appeals, having considered all evidence and arguments presented, and  
11 having taken the matter under advisement, finds and concludes as follows:

12 FINDINGS OF FACT

13 Sesek & Associates, Ltd ("Appellant") was incorporated in Illinois and did business there until  
14 1996. In 1997, Appellant relocated and was incorporated in Arizona. While in Illinois, Appellant incurred  
15 losses. The Arizona Department of Revenue (the "Department") audited Appellant for the tax years  
16 ending March 31, 1998 and March 31, 1999 and disallowed Net Operating Loss (NOL) carryforwards.  
17 The Department denied the NOL carryforwards because Appellant failed to establish that it had incurred  
18 losses while doing business in Arizona. Thereafter, the Department issued an assessment, including tax,  
19 a late payment penalty and interest for tax years 1998 and 1999.

20 Appellant protested the assessment to the Department's Hearing Officer who abated the late  
21 payment penalty but otherwise upheld the assessment. Appellant now timely appeals to this Board.

22 DISCUSSION

23 The issue before the Board is whether Appellant may take NOL deductions on its 1998 and 1999  
24 Arizona corporate income tax returns for losses incurred before it incorporated in Arizona or filed Arizona  
25 income tax returns.

1 Arizona's income tax statutes impose on each corporation with a business situs in Arizona a tax  
2 measured by taxable income that is the result of activity within or derived from sources within Arizona.  
3 A.R.S. § 43-102. If for a taxable year the corporation has an NOL, Arizona law allows the corporate  
4 taxpayer to carryforward the NOL deduction to offset the taxpayer's taxable income for the five years  
5 succeeding the taxable year of the NOL. A.R.S. § 43-1123(B).

6 Appellant argues that NOLs sustained at the federal level of taxation are allowable deductions  
7 against current year income under Arizona law regardless of whether or not the losses were sustained in  
8 Arizona. Appellant focuses on subsection C of A.R.S. § 43-1123, which simply states that "[t]he amount  
9 of net operating loss deduction shall be the aggregate of the NOL carryovers to the taxable year."  
10 However, this subsection cannot be read alone.

11 Arizona has its own NOL computation for corporate taxpayers. A.R.S. § 43-1123(A) defines "net  
12 operating loss" for purposes of applying the rules of §43-1123 to be "within the meaning of section 172(c)  
13 of the internal revenue code . . . , " adjusted by subtractions specified in A.R.S. § 43-1122 (with a noted  
14 exception), and reduced by the additions specified in A.R.S. § 43-1121. In computing Arizona taxable  
15 income for a corporation, the amount of NOL taken at the federal level is added back to income (A.R.S. §  
16 43-1121(7)), while an Arizona NOL computed pursuant to A.R.S. § 43-1123 is subtracted from income.  
17 (A.R.S. § 43-1122(8)). The companion-administrative rule addressing NOLs clarifies that in calculating  
18 the Arizona NOL, a taxpayer shall not include "[a] net operating loss incurred by the taxpayer prior to  
19 doing business in Arizona." A.A.C. R15-2D-302(B)(2).

20 In order to have an NOL for purposes of Arizona income tax, Appellant must first establish the  
21 existence of Arizona adjusted income in a negative amount. A.A.C. R15-2D-302(A)(3). Appellant has  
22 presented no evidence that it incurred the NOLs at issue while doing business in Arizona. Therefore, the  
23 Department properly disallowed the NOLs claimed.  
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1 Because the interest at issue is made a part of the tax by statute and represents a reasonable  
2 interest rate on the tax due, it may not be abated. A.R.S. § 42-1123; *Biles v. Robey*, 43 Ariz. 276, 286, 30  
3 P.2d 841 (1934).

4 CONCLUSIONS OF LAW

5 1. Appellant may not deduct on its Arizona corporate income tax return, NOLs incurred prior to  
6 doing business in Arizona. A.R.S. § 43-1123; A.A.C. R15-2D-302.

7 2. The interest imposed represents a reasonable interest rate on the tax due and owing and is  
8 made part of the tax by statute; therefore, it may not be abated. *Biles v. Robey*, 43 Ariz. 276, 286, 30  
9 P.2d 841 (1934).

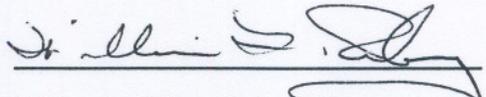
10 ORDER

11 THEREFORE, IT IS HEREBY ORDERED that the appeal is denied, and the final order of the  
12 Department is affirmed.

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

15 DATED this 2nd day of April, 2004.

16 STATE BOARD OF TAX APPEALS

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18 \_\_\_\_\_  
19 William L. Raby, Chairperson

20  
21 WLR:ALW

22 CERTIFIED

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