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Arizona enacts limited market sourcing election; proposed legislation would increase NOL carryforward period

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Arizona Governor Jan Brewer signed into law a phased-in market sourcing election that allows certain multistate service providers to elect to source sales of services for Arizona apportionment purposes based on the purchaser's receipt of the benefit of the service in the state, beginning in tax year 2014. The election is binding for at least five consecutive years. [[S.B. 1046](#), enacted 2/21/12]

Also, Arizona legislation has passed the Senate and been transmitted to the house that would extend the net operating loss carryforward period from five succeeding taxable years to twenty succeeding taxable years. [[S.B. 1084](#)]

Background

Currently, gross receipts from the performance of a service are attributable to Arizona only if a greater proportion of the service is performed in Arizona, based on costs of performance.

A market sourcing bill was introduced during the last legislative session, [S.B. 1552](#) that would have allowed multistate service providers a market sourcing election for sales of services for Arizona apportionment purposes. Notably, this legislation did not include a phase-in of the election and was vetoed by Governor Brewer on April 13, 2011. ([Click here](#) for an analysis)



Phase-in of market sourcing election

The current legislation allows a "multistate service provider" to elect to source sales of services to Arizona to the extent that the purchaser of the service received the benefit of the service in the state, effective for taxable years beginning from and after December 31, 2013. The election would be phased-in as follows:

- For tax years beginning from and after December 31, 2013 through December 31, 2014, 85% on market sales and 15% on income producing activity sales;
- For tax years beginning from and after December 31, 2014 through December 31, 2015, 90% on market sales and 10% on income producing activity sales;
- For tax years beginning from and after December 31, 2015 through December 31, 2016, 95% on market sales and 5% on income producing activity sales; and
- For tax years beginning from and after December 31, 2016, 100% on market sales.

Importantly, the legislation defines "multistate service provider" as a taxpayer that derives more than 85 percent of its sales from services provided to purchasers who receive the benefit of the service outside Arizona in the taxable year in which the election is made. A "multistate service provider" includes all taxpayers required to file a combined return pursuant to Ariz. Rev. Stat. Sec. 43-942 and all members of an affiliated group included in a consolidated return pursuant to Sec. 43-947.

The election must be made on the taxpayer's timely filed original income tax return and is effective retroactively for the full taxable year covered by the return. Also, the election is binding on the taxpayer for at least five consecutive taxable years, regardless of whether the taxpayer no longer derives more than 85 percent of its sales from out-of-state customers.

The election may be terminated without permission of the DOR upon the acquisition or merger of the taxpayer or after the election has been in effect for five consecutive taxable years. The election may be terminated prior to the expiration of the five taxable years with the permission of the DOR. The termination must be made on the taxpayer's income tax return for the first taxable year in which the election is terminated.

Extending net operating loss carryforward period

Proposed legislation would extend the net operating loss carryforward period from five succeeding taxable years to twenty succeeding taxable years for net operating losses generated in taxable years beginning from and after December 31, 2011. Net operating losses generated in taxable years before January 1, 2012 would still have a carryforward period of five succeeding taxable years.

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