

Federal Capital Loss Carryforward Deduction

When Incurred from Non-Arizona Sources Prior to Arizona

(Instructions for AZ Form 140, Additions to Income)

Overview:

- ◆ This is an in-scope item for AARP Foundation Tax-Aide as applied to Arizona Income tax Return preparation.
- ◆ If a taxpayer presents a Capital Loss Carryforward on their Federal Income Tax Return, we must ask the taxpayer when the loss occurred and then determine if they were a non-resident at the time the loss occurred.
- ◆ If the loss, which is being carried forward until completely used, occurred when they were a resident of Arizona, then there is no adjustment. We expect this will be the situation for most of our taxpayers.

AZ Tax-Aide Cactus Guide & TSO Entry –

Other Additions To Income

BACK CONTINUE

Married Persons Filing Separate Returns
\$

Ordinary Income from Lump-Sum Distributions
\$

Federal NOL carry forward from Non-AZ sources accrued while a non-resident
\$

Federal Capital Loss carry forward deduction incurred from Non-AZ sources prior to AZ Residency
\$

Out of Scope
Note: a few exceptions

Out of Scope

Residency considerations: (see page 5 of Form 1040 instructions).

- ◆ An individual cannot include a capital loss carryforward deduction, incurred from non-Arizona sources while the taxpayer was an Arizona nonresident, in the Arizona taxable income of a return filed for a taxable year in which the taxpayer is an Arizona resident. Therefore, a capital loss incurred from non-Arizona sources while the taxpayer was an Arizona nonresident cannot be carried forward to a taxpayer's Arizona resident return when the loss carryover is reflected in the taxpayer's federal adjusted gross income.
- ◆ The taxpayer must make an addition to Arizona gross income on the full-year Arizona resident return for the amount of such capital loss carryforward deduction included in the computation of the taxpayer's federal adjusted gross income.

- ◆ For more information, see the department’s ruling, ITR 13-6, *Can a Capital Loss Incurred as a Non-Resident Be Used to Offset Income in a Year in Which the Taxpayer Is a Resident?*

Arizona Concerns:

- ◆ Arizona is concerned with the recent migration into Arizona, that there may be increased occurrences of Capital Losses which occurred prior to moving to Arizona.
- ◆ Typically, we would enter the full Capital Loss carryforward shown on the prior year Federal tax return, which would then be available to offset any current year capital gains. After offsetting capital gains, TaxSlayer will allow up to \$3,000 of the remaining carryforward to offset Adjusted Gross Income.
- ◆ Since Arizona begins the state tax return with the Federal Adjusted Gross Income, this loss carryforward is included on the Arizona tax return.
- ◆ If a taxpayer indicates the loss occurred prior to residency in Arizona, then we would need to calculate the amount to adjust on the Arizona tax return.
- ◆ The amount to enter as an addition to income on the Arizona return will be the total amount of the carryforward used to offset taxable income on the Federal return.

Example 1:

Taxpayers have a \$10,000 capital loss carryforward which was due to a loss which occurred when they were non-residents of Arizona. They have no current year capital gains. We enter the \$10,000 capital loss in TaxSlayer Schedule D – Capital Loss Carryover. TaxSlayer will calculate the maximum \$3,000 capital loss for the current year.

On the Arizona return, the Federal AGI includes a \$3,000 capital loss carryforward. Since the loss occurred when the taxpayers were not Arizona residents, we must add \$3,000 to the Arizona income.

Click Begin on “Additions to Income”. Next, click Begin on “Other Additional to Income” at the bottom of the screen. Enter \$3000 in the box labeled “Federal Capital Loss carry forward deduction incurred from non-AZ sources prior to AZ Residency”.

Add a Note to the return with the title- “:LT Loss Carryover”. Add text - Taxpayer's \$7000 non-resident LT Loss Carryover cannot be used to offset AZ income.

Example 2:

Taxpayers have a \$12,000 Capital Loss Carryforward from when they were not AZ residents. They sell stock in TY23 for \$15,000 that they bought for \$8000 in TY21. Their Federal AGI is reduced by \$3,000 (1040 line 7) and they have a remaining carryforward of \$2,000.

This is because \$7000 of the carryover was used to offset the gain from the stock sale (which should have been AZ income) and another \$3000 was used to reduce Federal AGI.

In this case we'll add \$10,000 as an adjustment to their Arizona return. TaxSlayer adds \$10000 to Line 18 on AZ Form 140 and AZ AGI goes up by \$7000 to reflect that Arizona will tax the \$7000 capital gain from the stock sale (can't be offset by non-resident loss carryover).

Should add a Note to the return, title "LT Loss Carryover," text "Taxpayer's \$2000 non-resident LT Loss Carryover cannot be used to offset AZ income."

Example 3:

Taxpayers have a LT Loss Carryover from pre-AZ residency of only \$2000. Taxpayers sell stock for \$8000 they bought for \$10000 in 2021. Their Federal AGI is reduced by \$3,000 (1040 line 7) and now there's only a remaining carryover of \$1,000 on the Federal Capital Loss Carryover Worksheet.

This is because the \$2000 "AZ loss" plus \$1000 of the non-resident carryover was used to offset Federal AGI (taxpayers would want to use AZ losses first since they also reduce AZ taxable income).

In this case we'll add \$1,000 as an adjustment to their Arizona return. TaxSlayer adds \$1000 to Line 18 on AZ Form 140 and AZ AGI goes up by \$1000 to reflect the non-use of "non-resident carryover.". Should add a Note to the return, title "LT Loss Carryover," text "Taxpayer's \$1000 non-resident LT Loss Carryover cannot be used to offset AZ income."