

IN THE MAGISTRATE DIVISION
OF THE OREGON TAX COURT
Income Tax

ALBERT L. ZEMKE,)	
)	
Plaintiff,)	No. 010584D
)	
v.)	
)	
DEPARTMENT OF REVENUE,)	
STATE OF OREGON,)	
)	
Defendant.)	DECISION

Plaintiff appeals Defendant’s Notice of Tax Assessment, dated January 23, 2001, assessing Plaintiff additional tax for tax year 1997 after disallowing Plaintiff’s net operating loss carryforward deduction.¹ There is no dispute of fact, and the matter has been submitted to the court on cross motions for summary judgment.²

STATEMENT OF FACTS

Plaintiff became an Oregon resident on December 2, 1993, moving from California. On Plaintiff’s Oregon income tax return for the tax year 1997, Plaintiff claimed a net operating loss (NOL) carryforward in the amount of \$509,040. The NOL was a result of losses incurred in a California real estate business owned by Plaintiff when he was a resident of California.

Plaintiff alleges that he is entitled to deduct the NOL carryforward at the time he became a resident in Oregon even though the losses arose from a non-Oregon source. (Ptf’s Response to Defendant’s Motion at 1.) Plaintiff relies on ORS 316.014(1) which permits a NOL carryforward to be deducted from taxable income. Plaintiff concludes

¹Defendant agreed that it erroneously assessed Plaintiff a five percent penalty for tax year 1997.

²In Defendant’s Reply to Plaintiff’s Response, Defendant concluded that its “prior motion for partial summary judgment is more appropriately characterized as a motion for summary judgment.” The court agrees. The court will consider each party’s pleading as a Cross Motion for Summary Judgment.

ORS 316.014(2) does not apply to Plaintiff because he was a resident of Oregon, not a nonresident, at the time he claimed the deduction. (*Id.* at 3.)

Defendant alleges that Plaintiff misconstrues ORS 316.014(2) because the statute does apply to Plaintiff who was a nonresident at the time the NOL arose and became available for carryover to other tax years. (Def's Reply to Plaintiff's Response at 2.) In addition, Defendant alleges that Plaintiff misconstrues case law. (*Id.* at 3.) Defendant concludes that Plaintiff is entitled to claim the NOL carryforward on Plaintiff's nonresident California income tax return, using the NOL to offset other California source income. (*Id.* at 4.) Defendant alleges that Plaintiff is not entitled to claim a "deduction on his 1997 Oregon income tax return for California-source NOLs that arose while plaintiff was a nonresident" of Oregon. (*Id.* at 5.)

COURT'S ANALYSIS

At issue in this case is the ability of an Oregon resident to reduce state taxable income by a net operating loss (NOL) carryforward. The starting point in this case is the determination of the NOL because without a NOL there can be no NOL carryforward.

In determining a net operating loss, the applicable statute is ORS 316.014(1)³ which reads:

"In the computation of state taxable income the net operating loss, net operating loss carryback and net operating loss carryforward shall be the same as that contained in the Internal Revenue Code as it exists at the close of the tax year for which the return is filed and shall not be adjusted for any changes or modifications contained in this chapter or by the case law of this state."

In interpreting this statute, the court held that "NOLs are to be determined" using the

³All references to the Oregon Revised Statutes are to 1997.

definition found in the Internal Revenue Code (IRC) “as it exists at the close of the tax year without regard to a ‘connection’ date.” *Lufkin v. Dept. of Rev.*, 11 OTR 410, 413 (1990). The court goes on in *Lufkin* to discuss the computation of the federal NOL and Oregon NOL.

Section 172 of the IRC sets forth the NOL computation. Section 172(e) defines NOL computations: “In determining the amount of any net operating loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year.” IRS §172(e). In order to determine whether Plaintiff had a NOL carryforward which may be deducted on his 1997 Oregon income tax return it is necessary to first compute the available NOL carryforward amount according to the “law applicable” to the tax year in which the NOL arose. See e.g., *Morris v. Comm’r*, 20 TCM (CCH) 341 (1961); *Sobol v. Comm’r*, 69 TCM (CCH) 2840 (1995) (providing that pursuant to Section 172(e) the IRC applicable to the year the net operating loss arose must be used to compute the available NOL carryforward amount.)

The court in *Lufkin* makes it clear that in most cases the federal NOL and Oregon NOL will be the same for an Oregon resident because an Oregon resident is taxed on all items of income, regardless of their geographical source. *Lufkin*, 11 OTR at 414-415. In contrast, a nonresident’s Oregon NOL is “defined in the IRC, using income and expenses attributable to Oregon sources.” *Id.*

The parties agree that Plaintiff was not a resident of Oregon at the time the NOL arose. At that time, Plaintiff did not have an excess of expenses over income attributable to Oregon sources. See ORS 316.014(2). Plaintiff did not have an Oregon NOL. However, Plaintiff was a resident of California and he did have an excess of

expenses over income attributable to California sources. Plaintiff computed a federal NOL and a California-sourced NOL.

Over the years, Plaintiff deducted the NOL and subsequently NOL carryforwards on his federal and California state income tax returns. In 1993, Plaintiff moved to Oregon. At that time, a portion of the NOL was available as a NOL carryforward. Plaintiff alleges that because Plaintiff was a resident when the NOL carryforward was available ORS 316.014(2) is not applicable. The court agrees. Plaintiff's NOL carryforward arose from a NOL, the excess of expenses over income attributable to California sources. Plaintiff's decision to move from California to Oregon did not change the source of the NOL. While Plaintiff's federal NOL and California NOL carryforward was \$509,040, Plaintiff did not have an Oregon NOL carryforward because he never had an Oregon NOL. Without an Oregon NOL, Plaintiff cannot have an Oregon NOL carryforward.

CONCLUSION

Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiff's Cross Motion for Summary Judgment is denied.

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IT IS FURTHER DECIDED that Defendant's Cross Motion for Summary Judgment is granted.

Dated this _____ day of February, 2002.

JILL A. TANNER
MAGISTRATE

IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, FOURTH FLOOR, 1241 STATE ST., SALEM, OR 97301-2563. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.

THIS DOCUMENT WAS SIGNED BY MAGISTRATE JILL A. TANNER ON FEBRUARY 27, 2002. THE COURT FILED THIS DOCUMENT ON FEBRUARY 27, 2002.