

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of)
) DECISION OF
[TAXPAYERS]) HEARING OFFICER
)
) Case No. 200300122-I
Social Security No. [REDACTED])
)
_____)

A hearing was held on September 16, 2003 in the matter of the protest of [REDACTED] (Petitioner) to proposed assessments of income tax, penalties and interest by the Individual Income Tax Audit Section (Section) of the Arizona Department of Revenue (Department) for the tax years 1995, 1996, 1997 and 1998. Petitioner's post-hearing memorandum was timely filed by postmark dated September 30, 2003. Therefore, this matter is ready for ruling.

FINDINGS OF FACT

Based on information received from the Internal Revenue Service (IRS) through the Department's exchange of information agreement with that agency, (I.R.C. § 6103(d)(1)), the Section learned that Petitioner had taxable income for 1995, 1996, 1997 and 1998. The taxable income included non-employee compensation. The Section reviewed Department records and discovered that Petitioner had not filed Arizona income tax returns for 1995, 1996, 1997 and 1998. Based on the IRS information, the Section issued proposed assessments for 1995, 1996, 1997 and 1998 that included tax, interest and penalties for failure to file when due.

Petitioner timely protested the assessments on the following basis. Petitioner asserts that the Department relied on fraudulent documents in preparing the proposed assessments because the IRS information does not conform with I.R.C. § 6065 which requires that certain documents be verified by a written declaration that they are made under penalties of perjury. Petitioner asserts that the information relied on by the Department is double hearsay and results in a "naked assessment." Petitioner also states that it appears that the person who obtained the IRS documents failed to obtain them by means of a written request, as required by I.R.C. § 6103(d)(1), and therefore the Department employee who obtained the IRS documents and information committed a crime. Petitioner argues that therefore the information is tainted and cannot be used or relied upon by the Department under the "fruit of the poisonous tree" doctrine. The issue is the propriety of the proposed assessments.

CONCLUSIONS OF LAW

An individual computes Arizona taxable income by starting with federal adjusted gross income, then makes certain additions and subtractions pursuant to A.R.S. §§ 43-1021 and 43-1022 and is then allowed certain exemptions and itemized deductions. See A.R.S. § 43-1001.

The Internal Revenue Code, at I.R.C. § 61(a), provides that "gross income" means all income from whatever source derived, and includes, among other items, compensation for services,

commissions, gross income derived from business, interest, rents, royalties, dividends, annuities and pensions. It is well settled that all realized accessions to wealth are presumed to be taxable income unless a taxpayer can demonstrate that an acquisition is specifically exempted or excluded. *Reese v. United States*, 24 F.3d 228 (Fed. Cir. 1994). Clearly, Petitioner's non-employee compensation and other income fall within this definition of "gross income."

A.R.S. § 43-102.A.4 states that "[i]t is the intent of the legislature...[t]o impose on each resident of this state a tax measured by taxable income wherever derived." A.R.S. § 43-104.19(a) provides that "resident" includes every individual who is in Arizona for other than a temporary or transitory purpose. A.R.S. § 43-104.19(b) states that "resident" includes every individual domiciled in Arizona who is outside Arizona for a temporary or transitory purpose. Petitioner has produced no evidence to show that he was not a resident of Arizona during 1995, 1996, 1997 and 1998. It must be concluded that Petitioner was a resident of Arizona during these years. Therefore, all of his income was subject to Arizona tax pursuant to A.R.S. § 43-102.A.4.

The United States Supreme Court has reiterated the well established principle of taxation that a state may tax all the income of its residents:

"That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such

taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government . . . These are rights and privileges which attach to domicil within the state . . . Neither the privilege nor the burden is affected by the character of the source from which the income is derived." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312-313, 57 S.Ct. 466, 467-468, 81 L.Ed. 666 (1937).

Oklahoma Tax Commission v. Chickasaw Nation, 115 S.Ct. 2214, 2222 (1995).

An assessment of additional income tax is presumed correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948). Additionally, the Arizona Administrative Code provides at A.A.C. R15-10-118.A that the burden of proof is on the petitioner as to all issues of fact. Petitioner has produced insufficient evidence to demonstrate that the Section's assessments are incorrect. Petitioner has produced insufficient evidence to prove that the Section improperly relied on the information from the IRS in issuing its proposed assessments against Petitioner. Therefore, the Section's assessments must be upheld.

Petitioner asserts that the Department relied on fraudulent documents in preparing the proposed assessments because the IRS information does not conform with I.R.C. § 6065 which requires that certain documents be verified by a written declaration that they are made under penalties of perjury. Petitioner has cited no provision in the Arizona statutes that requires the Department to rely solely upon documents signed under penalty of perjury in issuing its assessments. In fact, A.R.S. § 42-1112.1

provides that, in performing its duties, the Department may "[e]xamine any books, papers, records or memoranda bearing on the matters required to be included in the return of any taxpayer." A.R.S. § 42-1112.1 has no requirement that the books, papers, records or memoranda be signed under penalty of perjury. Petitioner's argument is without merit.

Petitioner asserts that the information relied on by the Department is inadmissible double hearsay and results in a "naked assessment." Petitioner has presented insufficient evidence to support this assertion. Additionally, A.R.S. § 41-1062.A.1 provides in part that in contested cases "[a] hearing may be conducted in an informal manner and without adherence to the rules of evidence required in judicial proceedings."

Petitioner states that it appears that the person who obtained the IRS documents failed to obtain them by means of a written request, as required by I.R.C. § 6103(d)(1). Petitioner asserts that the Department employee who obtained the IRS documents and information committed a crime and therefore, Petitioner argues, the information is tainted and cannot be used or relied upon by the Department under the "fruit of the poisonous tree" doctrine.

The Section's representative produced a document showing that a written request for information pertaining to Petitioner was in fact submitted to the IRS by the Department for tax years 1994 through 1997. Although tax year 1998 was not included in this particular request, the Section received the information

for 1998 through the Department's exchange of information agreement with the IRS, which constitutes a written request. The evidence indicates that the IRS information was obtained properly, in accordance with Arizona statutes, and that the Section properly relied on this information in issuing the proposed assessments.

The failure to file when due penalty may be abated only upon a showing that the failure to timely file is due to reasonable cause and not due to wilful neglect. See A.R.S. § 42-1125.A. "Reasonable cause" is generally defined to mean the exercise of "ordinary business care and prudence." *Daley v. United States*, 480 F. Supp. 808 (D.N.D. 1979). Petitioner has not provided any evidence to establish reasonable cause. Therefore, the imposition of the failure to file when due penalties must be upheld.

As to the interest portion of the assessments, A.R.S. § 42-1123.C provides that if the tax "or any portion of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid. For Arizona purposes, therefore, interest is a part of the tax and generally may not be abated unless the tax to which it relates is found not to be due for whatever reason. The tax was due in this case and the associated interest cannot be abated.

Based on the foregoing, the Section's proposed assessments are affirmed.

DATED this 7th day of October, 2003.

ARIZONA DEPARTMENT OF REVENUE
APPEALS SECTION

[REDACTED]
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing mailed to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Individual Income Tax Audit Section