

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of)	DECISION OF
)	HEARING OFFICER
[REDACTED])	
)	Case No. 200700157-I
UTI # [REDACTED])	
_____)	

[REDACTED TAXPAYER #1] and [REDACTED TAXPAYER #2] (Taxpayers) protested an assessment of taxes from the Individual Income Tax Audit Section (Section) of the Arizona Department of Revenue (Department). [REDACTED TAXPAYER #1] requested that this matter be resolved through the submission of written memoranda. [REDACTED TAXPAYER #2] originally requested a telephonic hearing, but later, via phone call to the Section, cancelled the hearing and agreed to allow the matter to be resolved through the submission of memoranda. [REDACTED TAXPAYER #1] timely filed his opening memorandum by October 1, 2007. [REDACTED TAXPAYER #2] did not file an opening memorandum. The Individual Income Tax Audit Section (Section) of the Arizona Department of Revenue (Department) timely filed its response memorandum on October 31, 2007, and a copy of the response memorandum was sent to both Taxpayers. Taxpayers' reply memoranda were due November 15, 2007 but as of this date the Hearing Office has not received a reply memorandum from either Taxpayer. Therefore, this matter is ready for ruling.

FINDINGS OF FACT

Taxpayers filed a joint income tax return in Arizona for tax year 2000. Taxpayers' 2000 return was selected for audit,

and on March 30, 2005, the Section issued an assessment of additional taxes, a late payment penalty and interest. Based upon insufficient documentation and verification, the original assessment denied Taxpayers' claimed credit for the purchase of a Neighborhood Electric Vehicle (NEV Credit), as well as a credit for taxes paid to another state.

Taxpayers timely protested the March 30, 2005 assessment, and [REDACTED TAXPAYER #1] subsequently submitted copies of documentation pertaining to the NEV Credit and taxes paid to the state of Georgia.

Based on the information received from Taxpayers, the Section issued a Modified Proposed Assessment on June 15, 2005 (Modified Assessment). In the Modified Assessment, the Section allowed the \$20,000 NEV Credit. It also allowed \$[REDACTED] of the \$[REDACTED] credit claimed for taxes paid to Georgia. The late payment penalty and interest were recalculated based upon the modified amount of the assessed tax.

On June 15, 2005, the Section mailed the Modified Assessment to the same [REDACTED] address to which it sent the original assessment. However, the Modified Assessment was returned to the Department and marked "temporarily away" by the post office. On September 7, 2005, the Section again mailed the Modified Assessment to the same address and it was not returned to the Department. The Section assumed that it was received, and there was no reply to the Modified Assessment. It appears that correspondence was sent to and from the Taxpayers at

multiple addresses, but the reasons for this is not clear from the record.

The case was transferred to the Department's protest unit and letters were sent to Taxpayers explaining why there was a change in the calculation of the credit for taxes paid to Georgia. The Section received replies from both Taxpayers, who requested hearings. The issue is the propriety of the Modified Assessments.

In his Opening Memorandum, [REDACTED TAXPAYER #1] claimed that their 2000 Arizona tax return was prepared by their accountant and that they had assumed it was correct. He also claimed that the Department's audit was not timely and requested that the assessment be waived in its entirety.

The Section filed a Response Memorandum on October 31, 2007. In its Response Memorandum, the Section agreed to waive the late payment penalty based upon Taxpayers' reliance on the advice from their tax preparer. The Section also agreed to abate interest from September 7, 2005 through March 23, 2007 due to the lack of communication between the Department and the Taxpayers during that period of time.

CONCLUSIONS OF LAW

Because the Section has agreed to abate the late payment penalty, as well as interest from September 7, 2005 through March 23, 2007, the only remaining issues are the recalculation of the credit for taxes paid to Georgia, the timeliness of the assessment, and the remaining interest.

An assessment of additional income tax is presumed correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948). Taxpayers have produced insufficient evidence to demonstrate that the Section's recalculation of the credit for taxes paid to Georgia is incorrect. Nor have they demonstrated that the assessment was untimely. Therefore, with the exceptions of the abatements agreed to in the Section's Response Memorandum, the Section's Modified Assessment must be upheld.

Regarding the timeliness of the audit, A.R.S. § 42-1104.A establishes a general four-year statute of limitations and provides in pertinent part:

. . . every notice of every additional tax due shall be prepared on forms prescribed by the department and mailed within four years after the report or return is required to be filed or within four years after the report or return is filed, whichever period expires later.

Taxpayers filed their 2000 Arizona return on April 16, 2001. Because April 15, 2001 fell on a Sunday that year, Taxpayers' return was timely filed. The Section mailed the original proposed assessment to Taxpayers on March 30, 2005 which is within the four-year period established by the Arizona Legislature in A.R.S. § 42-1104.A. Therefore, the Section's assessment was timely.

With respect to the credit claimed by Taxpayers for taxes paid to Georgia, A.R.S. § 43-1071 allows a credit for taxes paid to another state, under certain terms and conditions. Arizona

Administrative Code (A.A.C.) R15-2C-501 sets forth regulations pertaining to Arizona's "Credit for Net Income Taxes Paid to Another State or Country by an Arizona Resident." A.A.C. R15-2C-501.C provides as follows:

- C. The amount of credit for taxes paid to another state is the lesser of the Arizona income tax liability that relates to the income subject to tax by both Arizona and the other state or the net income tax liability of the other state that relates to the income subject to tax by both Arizona and the other state.
 1. The *Arizona income tax liability* that relates to the income subject to tax by both Arizona and the other state is the amount of the income subject to tax in both Arizona and the other state, divided by the entire income upon which Arizona tax is imposed, multiplied by the *Arizona income tax liability*.
 2. The net income tax liability of the other state that relates to the income subject to tax by both Arizona and the other state is the amount of the income subject to tax in both Arizona and the other state, divided by the entire income upon which the other state's tax is imposed, multiplied by the net income tax liability of the other state.

A.A.C. R15-2C-501.C (emphasis added).

The term "Arizona income tax liability" is defined in A.A.C. R15-2C-501.A.1 as follows:

1. "Arizona income tax liability" means the Arizona income tax imposed on the entire income upon which Arizona tax is imposed minus the sum of:
 - a. The clean elections fund tax reduction taken under A.R.S. § 16-954; and
 - b. Any Arizona income tax credits claimed for the taxable year, except

the credit for taxes paid to another state.

A.A.C. R15-2C-501.A.1 (emphasis added). For purposes of the formula above, this requires a taxpayer to reduce his Arizona tax liability by any credits it claims in the taxable year when calculating the amount of the credit for "Net Income Taxes Paid to Another State."

Arizona Form 309, the form used by taxpayers to calculate the credit, confirms this initial reduction. The instructions to Arizona Form 309 clarify that "[i]f you are taking other tax credits, you must reduce your Arizona tax by the amount of those other tax credits" before entering the amount on line 7 of such form. See 2000 Instructions to Arizona Form 309, p. 4.

Taxpayers claimed, and the Section subsequently allowed, a \$20,000 NEV Credit. However, Taxpayers failed to reduce its Arizona tax liability by such \$20,000 on line 7 of Arizona Form 309 when calculating its credit for "Net Income Taxes Paid to Another State." In its Modified Assessment, the Section recalculated the credit by subtracting the \$20,000 from the Arizona tax liability on line 7 of Arizona Form 309. This recalculation reduced Taxpayers' credit for "Net Income Taxes Paid to Another State" from \$[REDACTED] to \$[REDACTED]. This calculation was proper and therefore the Section's recalculation of tax in its Modified Assessment was proper.

As to the interest portion of the assessment, 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. Therefore, the associated interest can be abated only for the lack of communication period conceded by the Section in its Response Memorandum. See A.R.S. § 42-2065.

Based on the foregoing, the Section's Modified Assessment is affirmed except that the late payment penalty is abated and the interest is abated for the period from September 7, 2005 through March 23, 2007.

DATED this 27th day of November, 2007.

ARIZONA DEPARTMENT OF REVENUE
APPEALS SECTION

[REDACTED]
Hearing Officer

Originals of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Individual Income Tax Audit Section