

STATE OF ARIZONA

Department of Revenue
Office of the Director
(602) 716-6090



CERTIFIED MAIL [REDACTED]

Janet Napolitano
Governor

The Director's Review of the Decision
of the Hearing Officer Regarding:

ORDER

Gale Garriott
Director

[REDACTED]

Case No. 200700002-I

UTI# [REDACTED]

On April 27, 2007 the Hearing Officer issued a decision regarding the protest of [REDACTED] ("Taxpayer"), which was received by Taxpayer on May 3, 2007. Taxpayer appealed this decision on May 30, 2002. Because the appeal was timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Hearing Officer's decision and now issues this order.

Statement of Case

Based on information obtained from the Internal Revenue Service through the Department's exchange of information agreement (I.R.C. §6103(d)(1)), the Individual Income Tax Audit Section of the Audit Division ("Division") issued a deficiency assessment for tax year 2001 to Taxpayer, who had filed an Arizona resident income tax return. Taxpayer timely protested the assessment. After a hearing, the Hearing Officer denied Taxpayer's protest.

On appeal Taxpayer makes the same arguments she made during the hearing. Taxpayer argues: (1) her income from [REDACTED], Inc. is exempt under Article 19 of the tax treaty between the People's Republic of China and the United States; (2) she is entitled to a \$50 charitable contribution; (3) she is entitled to a deduction for home mortgage interest expenses; (4) she is entitled to a deduction for legal costs and fees; (5) she is entitled to the Schedule C business expenses she claimed; (6) she is entitled to a

deduction for one of her two cars because she used it for business; (7) she is entitled to a deduction for moneys repaid to family members; and (8) she is entitled to a deduction for moneys paid into her 401(k) account.

Findings of Fact

The Director adopts and incorporates into this order the findings of fact set forth in the decision of the Hearing Officer and makes additional findings as follows:

1. Taxpayer claimed \$2,867.04 interest to Bank [REDACTED] on her 2001 federal Schedule A as home mortgage interest. The Division allowed this deduction for State purposes prior to the hearing in this matter.

2. Taxpayer claimed \$280 for charitable contributions on her 2001 federal Schedule A. The Division allowed this deduction for State purposes.

3. Taxpayer provided no evidence that the \$50 charitable contribution she argued about on appeal is an amount in addition to the \$280 allowed.

4. Taxpayer states that she and her son had orthodontic treatments (braces) during 2001. Prior to the hearing in this matter, the Division allowed Taxpayer a deduction of \$1,453 for medical and dental expenses.

5. Taxpayer provided no evidence to show that the orthodontic treatment expenses were in addition to the \$1,453 already allowed.

6. Taxpayer stated that she paid \$10,500 into her 401(k) and she should get a deduction for that. Taxpayer's 2001 Form W-2 from [REDACTED], Inc. indicates that the \$10,500 Taxpayer contributed to her 401(k) was not included in her taxable wages and thus was not taxed. The Division allowed this treatment in the proposed assessment.

7. On her 2001 federal Schedule A, Taxpayer deducted \$11,000 for money paid to her mother and to her brother. Taxpayer stated that her mother and brother assisted her monetarily and this was a repayment. The Section disallowed this deduction.

8. Taxpayer provided documentation of some of the \$906 of legal expenses and fees Taxpayer claimed to have paid in 2001 related to litigation at the [REDACTED] Court.

9. Taxpayer claimed her federal adjusted gross income for 2001 was \$ 34,281.

10. Taxpayer claimed Schedule C business expenses in the amount of \$24,600 but reported no business income on her federal income tax return.

11. Taxpayer provided no documentation of the claimed business expenses and those reported were claimed in \$100 increments. The claim of expenses lacks credibility.

12. Taxpayer claimed one of her two cars was used for business purposes, but provided no documentation and did not reflect vehicle expenses on the Schedule C.

13. Taxpayer applied for a trade name and received a "Certificate of Trade Name."

14. At the hearing, Taxpayer testified that during 2001 she was a research software developer for [REDACTED], Inc.

15. Taxpayer provided no evidence to show that [REDACTED], Inc. was a "university, college, school or other accredited educational institution or scientific research institution." Furthermore, Taxpayer did not demonstrate that her job as a "research software developer" was for the primary purpose of teaching, giving lectures or conducting research.

16. Taxpayer provided a copy of her H1B visa dated 2001. However, the Division claimed in its response to Taxpayer's Notice of Appeal that Taxpayer's green card was issued in 1995 and Taxpayer did not refute this claim in her reply.

17. The Decree of Dissolution of Marriage, dated [REDACTED], 1994, provided by Taxpayer states that Taxpayer was domiciled in Arizona at the time the case was filed.

Conclusions of Law

The Director adopts and incorporates into this order the conclusions of law set forth in the

decision of the Hearing Officer and makes additional conclusions as follows:

1. Taxpayers are required to keep and preserve "suitable records and other books and accounts necessary to determine the tax for which the person is liable for the period prescribed in § 42-1104." See A.R.S. § 42-1105.D.

2. Taxpayer has not provided sufficient evidence that she had a business in 2001, that she had \$24,600 of business expenses or that she was entitled to a deduction for one of her cars. The Division properly denied the loss Taxpayer claimed on Schedule C.

3. Because Taxpayer is not entitled to the loss claimed on Schedule C, her claimed federal adjusted gross income of \$34,281 must be increased by \$24,600 to a total of \$58,881.

4. With regard to itemized deductions, A.R.S. § 43-1042.A provides:

Except as provided by subsections B, D and E of this section, at the election of the taxpayer, and in lieu of the standard deduction allowed by § 43-1041, in computing taxable income the taxpayer may take the amount of itemized deductions allowable for the taxable year pursuant to subtitle A, chapter 1, subchapter B, parts VI and VII, but subject to the limitations prescribed by §§ 67, 68 and 274, of the internal revenue code.

5. I.R.C. § 67 (a) provides:

In the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income.

Taxpayer's miscellaneous itemized deductions may be deducted only to the extent they exceed 2 percent of her federal adjusted gross income of \$58,881.

6. Two percent of Taxpayer's adjusted gross income is \$1,177, which is greater than the \$906 legal costs and fees claimed as miscellaneous deductions. Taxpayer is not entitled to a deduction of miscellaneous expenses.

7. Taxpayer did not provide sufficient evidence to show she was entitled to a deduction for home mortgage interest of greater than the \$2,867.04 allowed by the Division for interest paid to Bank [REDACTED].

8. Taxpayer did not provide sufficient evidence to show she was entitled to a deduction of \$50 in addition to the \$280 already allowed for charitable contributions.

9. Taxpayer was allowed \$1,453 in medical and dental expenses and has not provided any evidence that an additional amount should be allowed for orthodontic treatments (braces) for her and her son.

10. Taxpayer excluded from the income she reported on her federal income tax return the \$10,500 she paid into her 401(k) at [REDACTED] Inc., and there is no provision in Arizona law that would allow Taxpayer a deduction for 401(k) contributions that were already excluded from her taxable income.

11. There is no provision in Arizona law to allow a deduction for repaying family members for financial assistance.

12. Article 19 of the tax treaty between the People's Republic of China and the United States ("Tax Treaty") provides that a resident of China that is temporarily present in the United States for the primary purpose of teaching, giving lectures or conducting research at a university, college, school or other accredited educational institution or scientific research institution in the United States shall be exempt from tax in the United States for a period not exceeding three years with respect to the remuneration for such teaching, lectures or research.

13. Taxpayer was a resident of Arizona prior to August of 1994; therefore, any tax exemption that would be allowed by Article 19 would have expired in 1997 or before.

14. Taxpayer has produced no evidence to show that [REDACTED] was a "university, college, school or other accredited educational institution or scientific research institution" within the meaning of Article 19 of the Tax Treaty.

15. Taxpayer's position as a research software developer has not been shown to be teaching, giving lectures or conducting research within the meaning of Article 19.

16. Article 19 of the Tax Treaty does not exempt Taxpayer from Arizona income tax during 2001.

17. Article 14 of the Tax Treaty provides that as between China and the United States only the country of residence shall tax its residents with respect to wage income unless employment is exercised in the non-residence country or one of the other provisions, such as Article 19, is applicable.

18. Taxpayer has not shown that any other provisions of the Tax Treaty is applicable to her; therefore, she, as a resident of the United States working in the United States, is not taxable by China, but is taxable by the United States on her wage income.

Discussion

Taxpayer made several statements in her appeal suggesting that the Department should contact various people or governmental agencies, such as her orthodontist, the Motor Vehicles Division and Immigration and Naturalization to get additional information. Taxpayers are required to keep and preserve "suitable records and other books and accounts necessary to determine the tax for which the person is liable for the period prescribed in § 42-1104." Taxpayer has not stated she even attempted to obtain the information she desired from these third parties. It is not the Department's responsibility to obtain information from third parties.

Taxpayer described many difficulties she has experienced, including divorce, financial problems, immigration problems and health problems. Because these unfortunate

hardships do not directly affect the analysis of the Taxpayer's Arizona tax liability for 2001, they will not be discussed.

The expenses taken on Taxpayer's federal Schedule C were in hundred dollar increments. This coupled with lack of documentation and no declared income makes the claim of expenses lack credibility. Merely having a trade name is not sufficient to demonstrate Taxpayer had a business. The Division properly denied the loss claimed on the Schedule C.

Taxpayer did provide documentation of some legal costs and expenses. Unfortunately these miscellaneous expenses can be deducted only to the extent they exceed 2 percent of federal adjusted gross income. The \$906 of expenses does not exceed two percent of federal adjusted gross income, \$1,177. The Division properly denied the deduction for miscellaneous expenses.

Taxpayer provided information on home mortgage interest, charitable contributions and medical and dental expenses. However, the Division had already allowed deductions for these and Taxpayer did not show that she was entitled to amounts greater than has already been allowed. The Division properly declined to grant larger deductions.

Taxpayer sought a deduction for the amount she contributed to her 401(k); however, the W-2 from at [REDACTED] Inc. showed she excluded those contributions from the income reported. The Division properly declined to allow a deduction for income already excluded.

Taxpayer sought a deduction for moneys she repaid to family members who she stated had assisted her financially. Just as there is no general provision allowing people to deduct personal living expenses, there is no provision in Arizona law to allow a deduction for repaying family members for financial assistance for living expenses. The Division properly denied the deduction.

Taxpayer argued she was entitled to the protection of Article 19 of the tax treaty between the People's Republic of China and the United States. Article 19 provides:

An individual who is, or immediately before visiting a Contracting State was, a resident of the other Contracting State and is temporarily present in the first-mentioned Contracting State for the primary purpose of *teaching, giving lectures or conducting research at a university, college, school or other accredited educational institution or scientific research institution* in the first mentioned Contracting State shall be exempt from tax in the first mentioned Contracting State for a period not exceeding three years in the aggregate in respect of remuneration for such teaching, lectures or research. (Emphasis added.)

Article 3.1(c) of the treaty provides that the terms "a Contracting State" and "the other Contracting State" means the People's Republic of China or the United States, as the context requires.

This provision does not assist Taxpayer for two reasons. First, the evidence demonstrates that Taxpayer was a resident of Arizona prior to August of 1994. The fact that Taxpayer's most recent visa shows a date of 2001 does not change that fact. Any tax exemption that would be allowed by Article 19 would have expired in 1997. Secondly, Taxpayer has produced no evidence to show that [REDACTED] was a "university, college, school or other accredited educational institution or scientific research institution" or that her job was primary teaching, giving lectures or conducting research within the meaning of Article 19 of the Tax Treaty.

Finally, Article 14 of the Tax Treaty provides that as between China and the United States only the country of residence shall tax its residents with respect to wage income unless employment is exercised in the non-residence country or one of the other provisions, such as Article 19, is applicable. Because Taxpayer has not shown that any other provision of the Tax Treaty is applicable to her, she is not taxable by China, but is

taxable by the United States on her wage income. The Division properly denied the claim of exemption.

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 and the associated interest cannot be abated.

ORDER

The Hearing Officer's decision is affirmed.

This decision is the final order of the Department of Revenue. Taxpayer may contest the final order of the Department in one of two manners. Within 60 days of the receipt of the final order, Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140 Phoenix, AZ 85007 or, if the amount in dispute is greater than five thousand dollars, Taxpayer may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003). For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this 15th day of January 2008.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott
Director

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Certified original of the foregoing
mailed to:

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cc: Individual Income Tax Appeals Section
Individual Income Tax Audit Section
Audit Division