

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

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| In the Matter of |) | DECISION OF |
| |) | HEARING OFFICER |
| [REDACTED] |) | |
| |) | Case No. 200900067-I |
| UTI # [REDACTED] |) | |
| _____ |) | |

A hearing was held on January 13, 2010 in the matter of the protest of [REDACTED] (Taxpayers) to an assessment of income tax, penalty and interest by the Individual Income Tax Audit Section (Section) of the Arizona Department of Revenue (Department) for tax year 2001. Pursuant to Taxpayer [REDACTED] request, his letter to the Director of the Department dated January 9, 2010 and response letter by [REDACTED] dated January 12, 2010 were made part of the record in this case.

This matter is now ready for ruling.

FINDINGS OF FACT

1. Taxpayers did not file an Arizona state income tax return with the state of Arizona for tax year 2001.
2. Taxpayers filed full-year Arizona resident state income tax returns for 1997 through 2000 and 2002 through 2008.
3. Based on information the Section received from the Internal Revenue Service (IRS), the Section issued an assessment to Taxpayers dated June 8, 2005 indicating that Taxpayers were residents of Arizona.
4. Taxpayers received in excess of \$[REDACTED] of federal gross income during tax year 2001.
5. The assessment was issued pursuant to Arizona Revised Statutes (A.R.S.) § 42-1108.
6. The Department's records indicate the Department had sent Taxpayers a demand to file under A.R.S. § 42-1109 dated February 22, 2005.

7. There was no evidence presented that Taxpayers received or considered the letter.
8. The assessment was based on Taxpayers' federal adjusted gross income (FAGI) reported to the Internal Revenue Service for tax year 2001 and allowed statutory deductions and exemptions.
9. Taxpayers timely protested the assessment stating they were residents of [REDACTED] during tax year 2001.
10. Taxpayer [REDACTED] requested information from the Department regarding residency and received a copy of Income Tax Procedure ITP 92-1 in early 2002.
11. After looking at ITP 92-1 Taxpayer [REDACTED] came to the conclusion he was not required to file an Arizona income tax return for tax year 2001.
12. Taxpayers sent a letter to the Department dated April 1, 2002 that stated in part "This is notice to the Az. Dept. of Revenue that we will not be filing AZ income tax return for tax year 2001."
13. The letter stated Taxpayers were residents of [REDACTED].
14. The letter concluded "We believe our analysis is correct after examining A.D.R. brochure # ITP 92-1. Please call if there are any questions."
15. The Department did not respond to Taxpayers' letter.
16. There was no evidence presented that the Department received the letter in 2002.
17. Taxpayers did not file a state income tax return with the state of [REDACTED] for tax year 2001.
18. Taxpayers registered to vote in [REDACTED] in August of 1999 and cancelled their voter registration in November of 2002.
19. Taxpayers changed voter registration to [REDACTED] in 1999 because there were some issues coming up in [REDACTED] they wanted to vote on.

20. Later there were some issues in Arizona they wanted to express their right to vote on so they switched registration back to Arizona.
21. Taxpayers voted in [REDACTED] at the general election held November 7, 2000 and at the election held November 6, 2001.
22. Taxpayers owned residential property in both Arizona and [REDACTED].
23. Taxpayers received the following tax documents at their Arizona address: 5498 IRA information, SSA-1099, 1099-G, 1099-DIV, 1099-INT, 1099-MISC and 1099-R.
24. Social Security direct deposit notices were sent to the Arizona address.
25. Taxpayers had bank accounts in both Arizona and [REDACTED].
26. During 2001, twenty-seven of Taxpayers' thirty financial and investment accounts continued to use their Arizona address.
27. During 2001 Taxpayers maintained Arizona driver's licenses, showing their Arizona address.
28. Taxpayer [REDACTED] testified at the hearing that Taxpayers maintained Arizona driver's licenses because Arizona has a five-year renewal period.
29. Taxpayers maintained their vehicle registration in [REDACTED] during 2001.
30. Taxpayer [REDACTED] testified at the hearing that Taxpayers maintained [REDACTED] vehicle registration because the registration fee in [REDACTED] was less expensive than in Arizona.
31. Taxpayer [REDACTED] testified at the hearing that Taxpayers filed Arizona resident income tax returns for years when they had no taxable income because they received a \$[REDACTED] rebate.
32. Taxpayers considered the rebate a small offset for the ever increasing property tax in the state of Arizona.

33. Taxpayer [REDACTED] testified at the hearing that in 2001 they wanted to try a winter in [REDACTED]. Friends had suggested they spend a winter in [REDACTED].
34. Taxpayer [REDACTED] testified that they tried the winter in [REDACTED] and once was enough.
35. Taxpayer [REDACTED] testified that they spent a greater part of 2001 in [REDACTED] and were going to spend a good part of 2002 in [REDACTED].

CONCLUSIONS OF LAW

1. The Section timely issued the assessment to Taxpayers pursuant to A.R.S. § 42-1108.
2. A.R.S. § 42-1108 does not require a demand to file as is provided in A.R.S. § 42-1109.
3. The presumption is that an assessment of additional income tax is correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948).
4. For tax years prior to 2001 Taxpayers were Arizona residents and had their domicile in Arizona.
5. Once a domicile is established it is presumed to continue until a change in domicile has been shown. *Jizmejjan v. Jizmejjan*, 16 Ariz.App. 270, 492 P.2d 1208 (1972).
6. A person cannot have more than one domicile at a time. *Clark v. Clark*, 71 Ariz. 194, 225 P.2d 486 (1950).
7. The burden of proof is on the party asserting that an earlier domicile has been abandoned for a new domicile. *Jizmejjan v. Jizmejjan, supra*.
8. A new residence or domicile is acquired only by the concurrence of an intention to establish a new domicile and acts evidencing that intention. *Kauzlarich v. Board of Trustees*, 78 Ariz. 267, 278 P.2d 888 (1955).

9. A change of domicile requires an intent to abandon the former domicile and remain at the new. *DeWitt v. McFarland*, 112 Ariz. 33, 537 P.2d 20 (1975).
10. A person who is a resident for a part of a taxable year is liable for Arizona income taxes for the portion of the tax year the person was an Arizona resident. A.R.S. § 43-1097.
11. Taxpayers were Arizona residents for the 2001 tax year for Arizona income tax purposes.
12. A.R.S. § 43-301 requires individuals whose income is taxable under Title 43 to file a return with the department if the person has gross income of fifteen thousand dollars or more for the taxable year.
13. For purposes of A.R.S. § 43-301, "gross income" means gross income as defined in the internal revenue code minus income included in gross income but excluded from taxation under Title 43.
14. Taxpayers were required to file an Arizona income tax return for tax year 2001.
15. 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.
16. A.R.S. § 42-1125.A imposes a penalty for failure to file an Arizona income tax return when due.
17. The Section's assessment of tax, penalty and interest in this case was proper.

DISCUSSION

Residency:

The issue in this protest is whether Taxpayers were Arizona residents during tax year 2001 and therefore required to file an Arizona individual income tax return for that year. Taxpayers maintain that they were [REDACTED] residents during tax year 2001 and were not required to file an Arizona income tax return for 2001.

There is substantial authority in Arizona concerning the determination of residency status. Once a domicile is established, it is presumed to continue until a change in domicile has been shown. *Jizmejian v. Jizmejian*, 16 Ariz.App. 270, 492 P.2d 1208 (1972). A person cannot have more than one domicile at a time. *Clark v. Clark*, 71 Ariz. 194, 225 P.2d 486 (1950). A new residence or domicile is acquired only by the concurrence of an intention to abandon the former domicile and establish a new domicile where they will remain for an indefinite period of time and acts evidencing that intention.¹ *Kauzlarich v. Board of Trustees*, 78 Ariz. 267, 278 P.2d 888 (1955); *DeWitt v. McFarland*, 112 Ariz. 33, 537 P.2d 20 (1975). The burden of proof is on the party asserting that an earlier domicile has been abandoned for a new domicile. *Jizmejian v. Jizmejian, supra*.

Prior to 2001, Taxpayers were Arizona residents domiciled in Arizona and filed Arizona resident income tax returns. The question therefore is whether Taxpayers demonstrated that they abandoned their Arizona domicile at the beginning of tax year 2001 and established a new domicile in [REDACTED]. Based on the record, Taxpayers did not abandon their Arizona domicile at any time during tax year 2001 and did not establish a new domicile in [REDACTED].

The evidence presented in this case establishes that Taxpayers were domiciled in Arizona prior to tax year 2001. Taxpayers had a desire to try a winter in [REDACTED] and spent a greater part of their time during 2001 in [REDACTED]. However, it was not until 2002 that Taxpayer [REDACTED] asked for and received any information from the Department regarding residency. Taxpayer received a copy of Income Tax Procedure ITP 92-1 in early 2002. It was after Taxpayer [REDACTED] looked at ITP 92-1 in 2002 that [REDACTED] came to the conclusion that they were not

¹ By filing no Arizona income tax return for tax year 2001, Taxpayers appear to be stating they abandoned their Arizona residency at the beginning of 2001.

required to file an Arizona income tax return for tax year 2001. There was no evidence presented that Taxpayers had the intent to abandon their Arizona domicile and establish a new domicile in [REDACTED] at the beginning of tax year 2001.

ITP 92-1 supports the conclusion that Taxpayers did not abandon their Arizona domicile and establish a [REDACTED] domicile during 2001. The procedure is clear when it states that a new residence or domicile can be acquired only by the concurrence of an intention to establish a new residence or domicile, abandoning the old one and acts evidencing such an intention. The procedure further states that a question of residency for state income tax purposes cannot be answered by a general rule but depends largely on the circumstances of each case, considering all relevant facts.

ITP 92-1 sets out examples of actions normally considered in determining a person's residency. Applying the examples in ITP 92-1 to the facts in this case do not demonstrate an intent by Taxpayers to abandon their Arizona domicile and establish a new one in [REDACTED]:

(1) physical presence of an individual, and his or her spouse and children, if any, in the new locality. Here Taxpayers travelled between Arizona and [REDACTED] prior to and during 2001.

(2) registration of an automobile. While Taxpayers did register their cars in [REDACTED] prior to and during 2001, it was because [REDACTED] registration was less expensive than in Arizona.

(3) application for a driver's license or renewing or relinquishing an old one. Here Taxpayers maintained their Arizona driver's licenses prior to and during 2001 because Arizona has a five-year renewal period.

(4) location of bank accounts and business connections. Here Taxpayers maintained a majority of their financial accounts using their Arizona address prior to and during 2001.

(5) purchase of a home and/or sale of an old home. Here Taxpayers had owned residences in both Arizona and [REDACTED] prior to and during 2001.

(6) payment of personal or real property taxes. Here Taxpayers paid both Arizona and [REDACTED] property taxes prior to and during 2001.

(7) payment of state income taxes. While Taxpayers had taxable income during 2001, they did not file either an Arizona or [REDACTED] income tax return. Taxpayers filed Arizona state income tax returns before and after 2001 because they got a rebate.

(8) registering to vote in the location of the new domicile and notifying voter registration officials in the old locality of such change of domicile. Here Taxpayers were registered to vote in [REDACTED] prior to and during 2001 because there were issues they wanted to vote on in [REDACTED].

(9) consistent use of new permanent address on all appropriate records and correspondence. Here taxpayers continued to use both Arizona and [REDACTED] addresses prior to and during 2001.

A consideration of the above examples do not indicate any intent to abandon Arizona domicile and to establish a [REDACTED] domicile at any time during 2001. Taxpayers' actions did not change during 2001 indicating that they abandoned their

Arizona residency in favor of [REDACTED]. The evidence indicates Taxpayers first reviewed the issue of residency in 2002 when they asked for and received a copy of ITP 92-1. Taxpayers were therefore Arizona residents during tax year 2001 for Arizona income tax purposes.

A.R.S. § 43-301 requires individuals whose income is taxable under Title 43 to file a return with the department if the person has gross income of fifteen thousand dollars or more for the taxable year. Taxpayers had gross income in excess of fifteen thousand dollars during tax year 2001. Taxpayers were therefore required to file an Arizona income tax return reporting their income. The assessment by the Income Tax Section was proper.

The proposed assessment also included interest. 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 imposition of interest in this case was proper.

Taxpayers failed to timely file their Arizona income tax return for tax year 2001. The failure to file when due penalty may be abated only if the failure to file "is due to reasonable cause and not due to wilful neglect." 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). Reasonable cause has not been established. Therefore, the imposition of the failure to file when due penalty must be upheld.

Taxpayers' Bill of Rights:

Taxpayers argued that the assessment should be abated because of the Department's violation of the Taxpayers' Bill of Rights. The issue before the Hearing Office is the correctness of the Section's assessment for tax year 2001. The violations

advanced by Taxpayers focused on the Department's failure to respond to certain correspondence and questions after the assessment was issued. None of the alleged violations of the Taxpayers' Bill of Rights occurred before or at the time the assessment was issued. Therefore the alleged violations do not bear on the validity of the assessment. The Hearing Office does not have the authority to review these alleged violations of the Taxpayers' Bill of Rights.

Disqualification of Hearing Officer:

Taxpayers requested the disqualification of any past or present Arizona Department of Revenue employee acting as hearing officer in this matter. The basis for the request for disqualification was a denial of due process because the Hearing Officer is employed by the Department. The Hearing Officer previously ruled that there was no basis for disqualification.

Taxpayers' due process was not violated by having a hearing officer who is employed by the Department. *Morrissey v. Brewer*, 408 U.S. 471, 92 S.Ct. 2593, 33 L.Ed.2d 484 (1972); *C & D Trailer Sales v. Taxation & Revenue Dept'*, 93 N.M. 697, 700, 604 P.2d 835, 838 (Ct.App.1979).

While *Morrissey* dealt with hearings relating to the revocation of paroles, the case discussed the due process requirements for an examination of the initial decision to revoke a person's parole. The Court in *Morrissey* held that due process requires that after the arrest, the determination that reasonable ground exists for revocation of parole should be made by someone not directly involved in the case. There should be an uninvolved person to make this preliminary evaluation of the basis for believing the conditions of parole have been violated.

The Court made it clear that this independent, uninvolved person does not have to be a judicial officer or even a neutral and detached officer. Due process requires only that the hearing be conducted by some person other than the one initially dealing with the case. The Court considered it sufficient in the parole revocation context if the initial

evaluation was made by someone such as a parole officer other than the one who made the report of parole violations or has recommended revocation.

Here it would not have been appropriate to have the hearing conducted by the auditor who issued the assessment. But there is no violation of due process by having a hearing officer who was not involved in issuing the audit conduct the hearing.

Taxpayers cited *Caperton v. A.T. Massey Coal Co., Inc.*, --- U.S. ----, 129 S.Ct. 2252 (2009) in support of their argument that the Hearing Officer should be disqualified. In *Caperton* the United States Supreme Court held that a state supreme court of appeals judge who received a \$3 million campaign contribution should have recused himself under due process from a case involving the person who made the contribution.

As the California Supreme Court noted in *People v. Freeman*, 47 Cal.4th 993, 222 P.3d 177, 103 Cal.Rptr.3d 723 (2010), the facts in *Caperton* were egregious. The court in *Freeman* stated that under *Caperton* while a showing of actual bias is not required for judicial disqualification under the due process clause, neither is the mere appearance of bias sufficient. Instead, based on an objective assessment of the circumstances in the particular case, there must exist the probability of actual bias on the part of the judge or decisionmaker that is too high to be constitutionally tolerable. Other than the fact the Hearing Officer is employed by the Department, there was no allegation or showing of any probability of bias or impartiality by the Hearing Officer.

Taxpayer also cited Rules 2.1 and 2.2 of Rule 81 of the Arizona Supreme Court relating to rules of judicial conduct. Part A to Rule 81 provides that those provisions apply to all judges. The comment to the rule makes clear that the code does not apply to administrative law judges or administrative hearing officers unless expressly made applicable by statute or by agency rules.

Taxpayers' 2002 Letter:

Taxpayers argued that a letter they sent to the Department in April of 2002 excuses their obligation to file because the Department did not respond to their letter.

The letter notified the Department that Taxpayers will not be filing an Arizona income tax return for tax year 2001. The letter concluded "We believe our analysis is correct after examining A.D.R. brochure # ITP 92-1. Please call if there are any questions." Taxpayers contend that by not responding to the letter, the Department has waived any right it may have had to contest Taxpayers' non-filing for tax year 2001.

A Taxpayer cannot estop the Department by a unilateral letter stating they were not going to file a return and thereby foreclose the Department from later issuing an assessment to the Taxpayer. The Department can only be estopped from enforcing the revenue laws of the state under very limited circumstances, and only by actions or statements of its employees.

Equitable estoppel may lie against a taxing authority under the following four circumstances: (1) the taxing authority engaged in affirmative conduct inconsistent with a position it later adopted that is adverse to the taxpayer, (2) the taxpayer actually and reasonably relied on the taxing authority's prior conduct, (3) the taxing authority's repudiation of its prior conduct caused the taxpayer to suffer a substantial detriment because the taxpayer changed its position in a way not compelled by law, and (4) applying estoppel against the taxing authority would neither unduly damage the public interest nor substantially and adversely affect the exercise of governmental powers. *Luther Construction Co., Inc. v. Arizona Department of Revenue*, 205 Ariz. 602, 74 P.3d 276 (2003). Here Taxpayers have not met any of the elements. The payment of tax legitimately owing, together with interest, is not a "substantial detriment" supporting equitable estoppel against an assessment. *Valencia Energy Company v. Arizona Department of Revenue*, 191 Ariz. 565, 959 P.2d 1256 (1998).

Taxpayers also argue that when a taxing authority fails to respond to taxpayer questions for an extended period of time, the authority either agrees with the taxpayers' position or has decided not to pursue the matter. No authority was stated for this contention. Inaction by an administrative agency does not constitute a construction of a

statute, favorable or otherwise. *Arizona Department of Revenue v. Transamerica Title Insurance Company*, 124 Ariz. 417, 604 P.2d 1128 (1979).

Based on the foregoing, the Section's proposed assessment dated June 8, 2005 is affirmed.

DATED this 4th day of March, 2010.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[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