

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of)	DECISION OF
[REDACTED])	HEARING OFFICER
UTI # [REDACTED])	Case No. 201100248-I
_____)	

A hearing was held on [REDACTED] in the matter of the protest of [REDACTED] (Taxpayers) to an assessment of income tax and interest by the Individual Income Tax Audit Section (Section) of the Arizona Department of Revenue (Department) for tax year [REDACTED].

This matter is ready for ruling.

FINDINGS OF FACT

1. Taxpayers timely filed a joint individual income tax return for tax year [REDACTED] claiming a clean election fund credit in the amount of \$[REDACTED].
2. Taxpayers are owners and sole members of [REDACTED] (LLC).
3. The LLC is treated as a partnership for federal income tax purposes.
4. The Section reviewed Taxpayers' [REDACTED] return and issued a proposed assessment dated [REDACTED] disallowing Taxpayers' claimed credit.
5. The proposed assessment included corresponding interest. No penalties were assessed.
6. Taxpayers timely protested the assessment stating that the contribution to the clean election fund was made in the form of a check written on Taxpayers' LLC account and was treated as a distribution to the members (Taxpayers).
7. Taxpayers paid the assessment in full.

8. Taxpayers' Schedule K-1 (Form 1065) shows that Taxpayers received distributions from the LLC in excess of the amount claimed as the clean elections fund credit.
9. Payment of the contribution to the clean election fund in the amount of \$[REDACTED] was made by Check No. [REDACTED] drawn on the LLC account.
10. A receipt was issued by the Citizens Clean Elections Commission to the LLC acknowledging the contribution.

CONCLUSIONS OF LAW

1. Arizona Revised Statutes (A.R.S.) § 16-954(B) provides that a taxpayer may make a payment directly to the clean election fund and receive the credit.
2. A distribution by a corporation to a third party for the benefit of a shareholder constitutes a constructive dividend, which will be taxed as a dividend to the shareholder for whose benefit the distribution is made. *See, Montgomery Engineering Co v. U.S.*, 344 F2d 996 (CA3 1965); *Barbourville Brick Co.*, 37 T.C. 7 (1961).
3. The payment to the clean elections fund by the LLC was a payment for the benefit of the LLC's sole members and was treated as a distribution by the LLC to its members, Taxpayers here.
4. Taxpayers were entitled to claim the credit for the \$[REDACTED] contribution on their joint Arizona individual income tax return.
5. The Section's proposed assessment dated [REDACTED] was not proper.
6. Because Taxpayers paid the tax and interest protested, this matter is treated as a protest of a denial of a claim for refund. A.R.S. § 42-1118(I).
7. Taxpayers are entitled to a refund of their payment of the proposed assessment with interest as provided by law.

DISCUSSION

Taxpayers filed their resident Arizona individual income tax return and claimed a clean elections fund credit in the amount of \$[REDACTED]. The contribution to the fund was made by a check drawn on Taxpayers' LLC and not by a check drawn on Taxpayers' individual bank account. There is no question that the contribution was made.

The Section disallowed the credit because payment was made by the LLC and not directly by Taxpayers. Because the LLC is treated as a partnership, the LLC does not have a tax liability against which the credit could be applied. Because the entitlement to the credit does not flow through to its partners (members), the Section argues that the members cannot take the credit.

Taxpayers do not argue that the credit flows through to them from the LLC, but argue that the payment by the LLC was directed by them and was made for their benefit so that in essence the payment was made by them. In support of this argument Taxpayers testified that the payment was included as a distribution to them from the LLC.

No cases have been cited to us and we have not found any addressing this precise question. However, Taxpayers' argument finds support in cases addressing whether a payment by a corporation to a third party at the direction of the sole or a majority shareholder is a deductible expense. Those cases have held that a distribution by a corporation to a third party for the benefit of a shareholder constitutes a constructive dividend, which will be taxed as a dividend to the shareholder for whose benefit the distribution is made.

Here, because the payment was made at the direction of Taxpayers and was accounted for as a distribution to Taxpayers, the payment to the clean election fund constituted a payment by Taxpayers within the meaning of A.R.S. § 16-954(B).

Based on the foregoing, the Section's proposed assessment dated [REDACTED] is reversed and Taxpayers are entitled to a refund of their payment of the proposed assessment, with interest as provided by law.

DATED this 22nd day of February, 2012.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[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