



8. Taxpayer was thereafter found to be 100% disabled since [REDACTED].
9. Taxpayer filed Arizona amended income tax returns for tax years 2005, 2006, 2007, 2008 and 2009 on August 2, 2010.
10. Taxpayer filed Arizona amended income tax returns for tax years 2001, 2002, 2003 and 2004 on August 25, 2010.
11. Taxpayer's amended returns excluded from Arizona taxable income payments Taxpayer received for his service connected disability. Taxpayer sought a refund of taxes paid on such income.
12. The Section denied Taxpayer's claims for refund for tax years 2001, 2002, 2003, 2004 and 2005.
13. The Section agreed that the amended returns for tax years 2006, 2007, 2008 and 2009 were timely filed and Taxpayer's refund claims for those years were approved.
14. The Section stated in its memorandum that it issued refunds for tax years 2006 through 2009.
15. Taxpayer timely protested the denials of his claims for refund.
16. Taxpayer's protest stated that the Department had denied Taxpayer's claim for refund for tax year 2006.
17. Taxpayer contends that his claims for refund that are outside the statute of limitations should be allowed under the doctrine of equitable recoupment.
18. The Department has not issued an assessment to Taxpayer seeking additional taxes from Taxpayer for any of the tax years at issue.

#### CONCLUSIONS OF LAW

1. Arizona Revised Statutes (A.R.S.) § 42-1106.A requires that claims for credit or refund be filed within the period within which the department may make an assessment.

2. If no claim is filed, the department may not allow a credit past the period within which it may make an assessment. A.R.S. § 42-1106.A.
3. The department may make an assessment of additional tax due 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. A.R.S. § 42-1104.A.
4. Calendar year returns are required to be filed on or before the fifteenth day of April following the close of the calendar year. A.R.S. § 43-325.
5. Taxpayer's amended return for claiming a refund of tax for tax year 2005 was required to be filed on or before April 15, 2010.
6. Taxpayer's amended returns for tax years 2001, 2002, 2003, 2004 and 2005 were not timely filed.
7. The failure to begin an action for refund or credit within the time specified in A.R.S. § 42-1106 is a bar against the recovery of taxes by the taxpayer. A.R.S. § 42-1106.D.
8. The department has no obligation to refund taxes that have been overpaid if a timely refund claim is not presented. *McNutt v. Ariz. Dep't of Revenue*, 196 Ariz. 255, 995 P.2d 691 (App.1998).
9. Equitable recoupment is a rule of law which diminishes the right of a party invoking legal process to recover a debt to the extent he holds money or property of the debtor to which he has no moral right. *Black's Law Dictionary*, Sixth Edition.
10. Recoupment is an equitable doctrine and, therefore, the claim of the defendant can be used to reduce or to eliminate a judgment, but it cannot be used for purposes of affirmative relief. *W. J. Kroeger Co. v. Travelers Indem. Co.* 112 Ariz. 285, 541 P.2d 385 (1975).
11. Federal cases have held that a party litigating a tax claim in a timely proceeding may, in that proceeding, seek recoupment of a related and inconsistent, but now

- time-barred tax claim relating to the same transaction. *U.S. v. Iron Mountain Mines, Inc.* 881 F.Supp. 1432 (E.D.Cal.,1995).
12. Equitable recoupment may not be the sole basis for jurisdiction. *U.S. v. Iron Mountain Mines, Inc., supra.*
  13. Equitable recoupment can only be invoked in connection with the government's timely tax claim against the taxpayer and will not provide jurisdictional basis for independent suit against the government after the time for filing refund claim has expired. *U.S. v. Dalm*, 494 U.S. 596, 110 S.Ct. 1361 (1990).
  14. A tax refund claim not filed within limitations period cannot be maintained, regardless of whether the tax is alleged to have been erroneously, illegally or wrongfully collected. *U.S. v. Dalm, supra.*
  15. Equitable recoupment does not operate to lift the statute of limitations even if the taxpayer does not learn that he had a ground on which to claim a refund until after the limitation period had expired. *U.S. v. Dalm, supra.*
  16. The doctrine of equitable recoupment is not applicable in this case.
  17. Taxpayer was not entitled to a refund of taxes paid for tax years 2001, 2002, 2003, 2004 and 2005.
  18. Taxpayer was entitled to the refund claimed in his amended return for tax year 2006 and if not already paid as contended by the Section, the refund for tax year 2006 should be paid.

#### DISCUSSION

Taxpayer had served in the military. In 2001 Taxpayer filed a claim for service connected disability which was denied. Taxpayer appealed the denial and Taxpayer was granted service connected disability in 2009, retroactive to August 2001. Thereafter Taxpayer filed amended returns (claims for refund) with the Department for tax years 2001 through 2009. Taxpayer's amended returns excluded from Arizona

taxable income payments Taxpayer received for his service connected disability and sought refunds for taxes paid on such income.

The Department granted Taxpayer's claims for tax years 2006 through 2009, but denied the claims for tax years 2001 through 2005 because the claims were outside the refund statute of limitations. There is no question that the claims were outside the statute of limitations. The only question presented is whether the Department must nevertheless consider the claims for tax years 2001 through 2005 under the doctrine of equitable recoupment.

Equitable recoupment allows a person to offset amounts he may be owed against a claim against him even if the statute of limitations had run on his recover of the amount he was owed. However, the claim of equitable recoupment can only be used as a defense to reduce or to eliminate a claim against the person. It cannot be used for purposes of affirmative relief. Here, the Department has not made a claim against Taxpayer for any of tax years 2001 through 2005 that might be reduced through equitable recoupment. Therefore equitable recoupment cannot be used by Taxpayer to recover erroneously paid tax for which a timely claim for refund was not filed.<sup>1</sup>

Based on the foregoing, the Section's denials of Taxpayer's claims for refund for tax years 2001, 2002, 2003, 2004 and 2005 are affirmed.

DATED this 30th day of March, 2012.

ARIZONA DEPARTMENT OF REVENUE  
HEARING OFFICE

Frank Migray  
Hearing Officer

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<sup>1</sup> We have not found any Arizona cases addressing whether and to what extent the doctrine of equitable recoupment might be available as a defense in an Arizona tax case. Because Taxpayer here is not seeking to use equitable recoupment as a defense, we do not need to address the potential applicability of equitable recoupment in tax cases.

Original of the foregoing sent by  
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue  
Individual Income Tax Audit Section