

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of

[REDACTED]

UTI # [REDACTED]

DECISION OF
HEARING OFFICER

Case No. 201300036-I

Pursuant to Taxpayers' request, it was ordered that 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 2007 be resolved through the submission of written memoranda.

Taxpayers and the Section timely filed their respective memoranda. This matter is now ready for ruling.

FINDINGS OF FACT

1. Taxpayers filed their 2007 Arizona individual income tax return on [REDACTED].
2. Taxpayers' return showed federal adjusted gross income of \$[REDACTED] and reported Schedule C expenses of \$[REDACTED] and losses of \$[REDACTED].
3. Taxpayers did not itemize their deductions but claimed a standard deduction of \$[REDACTED].
4. Taxpayers' return showed withholding of Arizona income tax of \$[REDACTED].
5. The Section reviewed Taxpayers' return and sent Taxpayers a letter dated December 16, 2011 asking Taxpayers to provide documentation regarding their Schedule C cost of goods sold, expenses and information regarding the Schedule C activity.
6. Taxpayers responded by letter dated January 14, 2012 that it was not possible to supply all the documentation requested and the information will be submitted in the following 45 days. Taxpayers also asked the Section to explain the meaning of the "UTI" number referenced in the letter.

7. The Section issued a proposed assessment dated February 15, 2012 disallowing Taxpayers' Schedule C expenses of \$[REDACTED].
8. Taxpayers responded by letter dated February 26, 2012 stating that the Department had not responded to Taxpayers' January 14, 2012 letter.
9. The Section sent Taxpayers a letter dated March 9, 2012 explaining the meaning of "UTI" and stated that since there was no record of a valid protest, the assessment was considered due and collectible.
10. The Section's Administrator sent Taxpayers a follow-up letter dated March 22, 2012 explaining the UTI in more detail, that even though the assessment had been issued Taxpayers may still submit information to reduce the amount of the assessment and clarified that the Taxpayer Response Form (protest) must be postmarked on or before May 15, 2012 to be timely.
11. Taxpayers timely submitted the Taxpayer Response Form, dated May 8, 2012 and marked received by the Section on May 10, 2012.
12. Taxpayers also submitted a copy of a letter from their accountant, amended 2007 federal and Arizona income tax returns and documentation substantiating Schedule C expenses and itemized deductions.
13. The Arizona amended return claimed Schedule A itemized deductions instead of the standard deduction of \$[REDACTED] claimed in the original return.
14. The Section reviewed Taxpayers' submissions and issued a modified proposed assessment dated July 11, 2012 that still disallowed Taxpayers' Schedule C losses but allowed itemized deductions in the amount of \$[REDACTED]. The modification reduced the total proposed assessment from \$[REDACTED] to \$[REDACTED].
15. Taxpayers continued to disagree with the modified proposed assessment and requested a formal hearing. At Taxpayers' request, a schedule for hearing by memoranda was established.

16. The Section submitted a response memorandum that included a second modified proposed assessment dated June 5, 2013 that:
 - a. Resulted in no additional tax liability under the proposed assessment.
 - b. Calculated a negative balance of tax of (\$[REDACTED]).
 - c. Stated that no refund would be allowed after four years.
17. Taxpayers replied disagreeing with the second modified proposed assessment, asking in the conclusion that:
 - a. The Section be ordered to refund Taxpayers the money due them,
 - b. In the alternative to ordering a refund, the Hearing Officer deny the Section's second modified proposed assessment and order that Taxpayers do not owe the Revenue Department anything for 2007.

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 the total amount withheld under section 43-401 exceeds the amount of the tax on the employee's entire taxable income as computed under title 43, no refund, credit or offset may be made to the employee unless the employee files a return, in respect of which the tax withheld might be credited, within four years from the due date of the original return. A.R.S. § 42-1106.B.
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. The due date for Taxpayers' 2007 Arizona return was April 15, 2008.

6. Taxpayers' amended return for claiming an additional refund of tax for tax year 2007 was required to be filed on or before April 16, 2012 to be timely.
7. Taxpayers' amended return for tax year 2007 was filed on May 10, 2012 and was therefore untimely.
8. 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.
9. The department has no obligation to refund taxes it knows 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).
10. 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*, 494 U.S. 596, 110 S.Ct. 1361 (1990).
11. Taxpayers were not entitled to a refund of taxes withheld for tax year 2007.
12. In certain circumstances, a party litigating a tax claim in a timely proceeding may, in that proceeding, seek to offset against an assessment a time-barred refund claim relating to the same transaction (tax period). See, *U.S. v. Iron Mountain Mines, Inc.* 881 F.Supp. 1432 (E.D.Cal.,1995); *Wisconsin Department of Revenue v. Van Engel*, 230 Wis.2d 607, 601 N.W.2d 830 (App. 1999).
13. The Section properly offset Taxpayers' barred refund claim against the additional taxes due under the proposed assessment.
14. Taxpayers' protest is granted in part and denied in part. Taxpayers do not owe any additional taxes to the Department for tax year 2007 consistent with the Section's second modified proposed assessment dated June 5, 2013. Taxpayers' refund request submitted May 10, 2012 is denied.

DISCUSSION

Taxpayers had claimed Schedule C expenses of \$[REDACTED] on their return filed for tax year 2007. The Section issued a proposed assessment that disallowed the Schedule C expenses. Taxpayers timely protested, submitted additional information and an amended return for tax year 2007.

A major change in Taxpayers' amended return was claiming itemized Schedule A deductions instead of the standard deduction they had previously claimed. The itemized deductions were significantly greater than the standard deduction. Based on Taxpayers' amended return and additional information, the Section issued two modified proposed assessments. The second modified proposed assessment calculated an overpayment of \$[REDACTED]. The assessment indicated however that a refund would not be allowed after four years. Taxpayers' amended return claiming a refund for tax year 2007 was not submitted until more than 4 years after the due date of the return.

Because Taxpayers' claim was outside the statute of limitations the Section had no authority to refund taxes that had been overpaid. However, a barred refund may be used to offset a tax assessment under certain limited circumstances. The Section thus offset the barred refund against any amounts that were due under the assessment.

Taxpayers also argued that the Department violated the Taxpayers' Bill of Rights. The issue before the Hearing Office is the correctness of the Section's second modified proposed assessment for tax year 2007. The violations advanced by Taxpayers focused on the Department's failure to respond to certain correspondence and questions after the assessment was issued. The alleged violations do not bear on the validity of the proposed assessment or the modified proposed assessments. The Hearing Office does not have the authority to review the alleged violations of the Taxpayers' Bill of Rights.

Based on the foregoing, Taxpayers do not owe any additional taxes to the Department for tax year 2007 consistent with the Section's second modified proposed

assessment dated June 5, 2013. Taxpayers' refund request submitted May 10, 2012 is denied.

DATED this 19th day of July, 2013.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[REDACTED]
Hearing Officer

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