

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of )  
[REDACTED] )  
TID # [REDACTED] )  
\_\_\_\_\_ )

**DECISION OF  
HEARING OFFICER**

Case No. 202100028-I

The issue before the Hearing Office is the correctness of proposed assessments of additional tax by the Individual Income Tax Audit Section (“Section”) of the Arizona Department of Revenue (“the Department”) for [REDACTED] (“Taxpayer”).

A hearing was held on the matter May 25, 2021. Taxpayer and the Section’s representative appeared. Both parties presented evidence in the form of oral testimony and documents. At its conclusion, the parties agreed that the record would remain open to allow Taxpayer to provide additional information relating to his bankruptcy case. The Hearing Officer (“Officer”) issued an order establishing a schedule for the submission of the additional documentation.

Since the hearing a number of events occurred. The Officer recused herself and a new Officer was designated to review the matter. In addition, a revised scheduling order was initiated. The filing dates of subsequent documents were extended, with the final memorandum/documents from Taxpayer due December 27, 2021. That deadline has passed and the record closed accordingly.

The new Officer has carefully reviewed all documents submitted and listened intently to the recorded hearing. Based upon a review of the record, the matter has been deemed completed and ready for a final determination.

## **FINDINGS OF FACT**

1. The Section learned that Taxpayer's 2010, 2011, 2012, 2013, 2014 and 2015 federal income tax returns were modified. This discovery was based on information from the Internal Revenue Service ("IRS") through the Department's exchange of information agreement with that agency under I.R.C. § 6103(d)(1). The IRS assessed additional income based upon a number of adjustments to Taxpayer's schedules.
2. Taxpayer failed to report the additional income to the Department or to file amended Arizona returns, as required by A.R.S. § 43-327.
3. Using the federal information, the Section audited Taxpayer's Arizona income tax returns for the same tax periods. On January 2, 2019, the Section issued proposed assessments for these periods. The proposed assessments included added-on tax, statutory interest and penalties for failure to file the required returns. The assessments are listed in the Section's Exhibit "A".
4. Taxpayer timely protested each of the proposed assessments. Taxpayer raised a number of arguments in his protest, including (1) That his due process rights were violated (2) The assessments improperly combined Taxpayer's personal tax liability with an LLC he operated (3) The returns omitted certain deductions and credits to which Taxpayer is entitled (4) That both he and his spouse filed personal bankruptcy petitions, and that these are relevant to the assessments and not yet resolved and (5) That the IRS abated liability. The protest documents are listed in Exhibit "B".
5. The Section mailed Taxpayer a letter outlining its position and explaining the basis of the assessments. The letter concludes that Taxpayer did not provide documents that demonstrate the items in the protest are valid. This letter is Exhibit "C".
6. Taxpayer responded to this letter with one of his own reciting the same arguments listed in the protest. In addition, it adds the following assertions (1) The IRS violated the "240-day rule" and did not file a lien in his bankruptcy proceeding (2) That he was denied a trial on a motion for

summary judgment and (3) Alleges a number of comments and accusations against the IRS and IRS personnel.

7. Taxpayer requested a formal hearing on March 8, 2021.

8. Prior to the hearing, the Section submitted its exhibits denoted as “A” to “E”. These were incorporated into the record. The exhibits contain a number of items, including Taxpayer’s arguments and the Section’s response to those arguments.

9. Taxpayer presented evidence supporting his positions at the hearing. The evidence consisted of oral testimony concerning the following: (1) That he has been and still is in litigation with the IRS (2) He was entitled to a refund from the involuntary sale of his property subject to the homestead exemption (3) He testified that at some point his case was “joined” with that of his spouse and both his business and personal assets and liabilities were administered in the same proceeding <sup>1</sup> (4) He testified that the IRS and the Department filed proofs of claim “higher than they possessed.” He further testified that the claims were not secured and were “disallowed” (5) He testified that the IRS issued abatements for all business activities (6) He testified that the bankruptcy court granted a motion for summary judgement over his objection (7) He testified that his discharge in the bankruptcy was denied (8) He testified that issues were on appeal to both the Bankruptcy Appellate Panel and Federal District Court.

10. At the conclusion of the hearing the parties agreed to leave the record open to allow the Taxpayer to provide additional evidence from his bankruptcy case. Taxpayer subsequently submitted additional documents in the form of letters, docket reports, pleadings and court reports on a wide-range of matters from the Arizona Tax Court, the Federal Bankruptcy Court, the Federal District Court and the Bankruptcy Appellate Panel. These items bear witness to the disputes between Taxpayer and the IRS. The Officer notes that most of these involve issues that are not relevant to Taxpayer’s protest.

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<sup>1</sup> It’s unclear whether the cases were jointly administered or consolidated. For bankruptcy purposes, this distinction is significant. For the limited purpose of this Decision, the difference is incidental.

11. The Section also submitted additional memorandum and documents. Among these were pleadings related to an IRS summary judgment proceeding in the Taxpayer's bankruptcy. In this action, the Federal Bankruptcy Judge ruled:

*The Judgment entered contemporaneously with this Memorandum Decision will be a final judgment, determining the tax liabilities in the IRS's amended proofs of claim for tax years 2010 – 2015.*

12. The record for this appeal was deemed closed effective December 27, 2021.

13. This matter is ready for a written determination by the Hearing Office.

### **CONCLUSIONS OF LAW**

1. The assessment of additional income tax is presumed correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948).

2. Once the presumption of correctness attaches, the taxpayer must present substantial credible and relevant evidence sufficient to establish that the assessment was erroneous. *U.S. v. McMullin*, 948 F.2d 1188 (10<sup>th</sup> Cir. 1991); *Anastasato v. C.I.R.*, 794 F.2d 884 (3<sup>rd</sup> Cir. 1986).

3. A.R.S. § 43-1001(2) defines Arizona gross income of a resident individual as the individual's federal adjusted gross income for the taxable year, computed pursuant to the Internal Revenue Code.

4. A.R.S. § 43-102(A)(1) provides that it is the intent of the Arizona legislature to adopt the provisions of the Federal Internal Revenue Code relating to the measurement of adjusted gross income for individuals so that federal adjusted gross income reported to the IRS shall be the identical sum reported to Arizona, subject only to modifications set forth in Title 43 of the Arizona Revised Statutes.

5. A.R.S. § 43-327 requires a taxpayer to report a change or correction by the IRS or to file an amended return within ninety (90) days after the final determination of the change or correction by the IRS.

6. If a taxpayer fails to report a change by the IRS or fails to file an amended return as required by A.R.S. § 43-327, the Department may assess any deficiency resulting from the federal adjustments within four (4) years after the change, correction or amended return is reported to or filed with the IRS. A.R.S. § 42-1104(B)(5).

7. The Department's proposed assessments resulted from adjustments made by the IRS to Taxpayer's federal returns.

8. Taxpayer does not dispute that he did not report the changes or file amended returns for Arizona. Rather, Taxpayer alleges that the IRS assessments are not valid or accurate. Taxpayer raised a number of arguments in support of his protest.

9. Taxpayer argued that the IRS abated all liability owed. Taxpayer failed to provide any evidence to corroborate this claim. The record shows that the IRS appeared in the bankruptcy and litigated a number of issues including the validity of the tax liability at issue in this proceeding. This effectively contradicts the conclusion that the liability was abated. Based upon the record, this argument is denied.

10. Taxpayer argued that mixing his personal tax information with business information is improper. This issue also appears to have been litigated in the bankruptcy proceedings. The Officer gives full faith and credit to the ruling by the Bankruptcy Court and deems Taxpayer's argument denied.

11. Taxpayer argued that the Section failed to follow the rules outlined in A.R.S. § 42-1251(a) and 42-1123 in issuing the assessments. Taxpayer supplied no evidence in support of this argument. The Officer finds the Section appropriately followed the correct process in issuing the assessments.

12. Taxpayer argued that his due process rights were violated. It's unclear as to which proceeding this assertion applies. Taxpayer's due process rights in this proceeding are not at issue as he timely protested the assessments and had the opportunity to be heard at the May 25, 2021 hearing. The record indicates that Taxpayer has appeared in a number of other proceedings

to argue his position(s). The Officer notes that Taxpayer failed to appear at the hearing in his bankruptcy when the amount of the IRS tax liability was litigated. The Officer finds that this argument is without merit and denied accordingly.

13. Taxpayer argues that the returns he filed with the IRS contain omitted deductions and other credits that have not been included in the assessments. Taxpayer offered no substantive evidence on this allegation other than to point out that he has litigated this issue. The Officer finds the amount of the liability owed to the IRS for the relevant periods was determined in the bankruptcy proceeding. It further finds that the Section's use of the IRS information to issue the assessments is appropriate.

14 Taxpayer argued that the IRS violated "the 240-day rule" and did not timely file a lien in the bankruptcy proceedings. This appears to be an allegation that the proof of claim filed by the IRS is either invalid, untimely or insufficient. Although Taxpayer did not provide a citation for this rule, the Officer notes that the 240-day rule is the colloquial term for a statute relating to a tax claim entitled to priority status. See 11 U.S.C. § 507(a)(8).<sup>2</sup> This issue is not relevant to this proceeding as the bankruptcy classification of a tax liability is not at issue. Similarly, whether the IRS filed a lien has no bearing on this hearing as this would only determine whether the IRS claim was entitled to secured status in the bankruptcy proceeding.<sup>3</sup> The Bankruptcy Court validated the IRS claim in its order granting summary judgment. The Officer gives full faith and credit to this ruling. This argument is denied on the merits.

15. Taxpayer alleges that IRS employees committed fraud. No evidence was introduced to support this allegation. It is deemed denied.

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<sup>2</sup> This statute deals with unsecured claim entitled to priority treatment. It states that tax returns filed within 240-days of the filing of the petition are deemed to have priority status. It has nothing to do with the validity of the claim itself. The record indicates that the Court validated the IRS claim in the order dated February 7, 2019.

<sup>3</sup> In bankruptcy terminology, debts are referred to as claims. The type of claim affects the priority of payment from bankruptcy estate assets. Secured claims are those in which the creditor holds a perfected security interest in property owned by the debtor. 11 U.S.C. § 506. This has no relevancy in determining if the underlying debt is valid. See 11 U.S.C. § 502.

16. Taxpayer alleges that the IRS didn't refer his case to its Insolvency Division. This argument is denied on the grounds of relevancy and a lack of evidence.

17. Taxpayer's argument that the Tax Court did not hold an evidentiary hearing on his dispute with the IRS is also denied on grounds of relevancy and lack of evidence. The Officer notes that courts are permitted to issue rulings to determine the outcome of a case without resorting to evidentiary hearings. Summary judgement is based on the premise that there are no material facts at issue and the court can decide the outcome of the proceeding as a matter of law. Ariz. R. Civ. P. 56. It appears that both the Arizona Tax Court (a division of Superior Court) and the Federal Bankruptcy Court reached the same conclusion in determining that there were no material facts to litigate.

18. Taxpayer argues that the statute of limitations has expired on the tax liability in the assessments. Taxpayer did not provide an analysis of when he alleges that the statute of limitations terminated on any of the obligations. The Officer takes judicial notice that litigation and filing a bankruptcy petition both service to toll the normal dates for the running of the statute of limitations on tax obligations. A.R.S. § 42-1104(B). This claim is therefore denied as being procedurally and legally incorrect.

19. The Officer notes that although it was a challenge to navigate through the plethora of bankruptcy items submitted, it is clear that the Federal Bankruptcy Court reviewed and validated the IRS proofs of claim in its order dated February 7, 2019. The Section used this same liability in the assessments it issued.

20. The Officer finds that the Section correctly followed its standard procedure in issuing the assessments and deems the assessments valid.

## **DISCUSSION**

### **A. Issuance of the Assessments**

An individual's gross income in Arizona is based on the individual's federal adjusted gross income. A.R.S. § 43-1001(2). Arizona taxpayers are required to report their federal adjusted gross income to Arizona. If the IRS makes changes to a taxpayer's federal adjusted gross income, there is a corresponding change that needs to be made to the taxpayer's Arizona gross income. Taxpayers are therefore required to report federal changes to the Department. If federal changes are not timely reported, the Department may issue an assessment resulting from the federal changes within four (4) years after the federal changes are reported to or filed with the IRS.

The Section issued proposed assessments using the federal information. These included the IRS changes. Taxpayer has not alleged that the Section erred in interpreting or transcribing the information from the IRS.

An additional assessment of income tax based on unreported federal income is presumed correct. Taxpayer has the burden to overcome this presumption by presenting substantial credible and relevant evidence sufficient to establish that the proposed assessment was erroneous. Taxpayer has not met this burden and therefore has not overcome the presumption of correctness.

The proposed assessments 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, the interest is a part of the tax.

### **B. Bankruptcy events**

Taxpayer testified and provided documents establishing that both he and his spouse filed separate individual bankruptcy petitions. He testified, and the record verifies, that these were involuntarily converted to a Chapter 7 liquidation proceeding.



When a debtor files a bankruptcy petition, two noteworthy events occur. The first is the creation of the bankruptcy estate 11 U.S.C. § 541. The bankruptcy estate consists of all assets owned or claimed to be owned by the debtor at the time the petition is filed. In a chapter 7 proceeding, the estate is administered by a trustee. The second event is the imposition of an automatic stay. 11. U.S.C § 362(a). The stay operates as a temporary injunction against efforts to collect debts against both the debtor and the bankruptcy estate.

The Section's issuance of the assessments is not an action to collect a debt against either the debtor (Taxpayer) or the bankruptcy estate, but rather an act to determine liability. Congress created an express exception to the automatic stay to allow taxing authorities to conduct audits and issue assessments after the petition is filed. 11 U.S.C. § 362(b)(9).

Whether some or part of the tax assessed is affected by the bankruptcy is a different question than the proper *issuance* of the assessment. In theory, a discharge order could affect the *collection* of a debt subject to discharge. The discharge order however, would not invalidate the *existence* of the debt. In other words, the discharge order acts as a permanent injunction against the debtor's personal liability of a debt subject to the discharge order. The debt itself, however, still exist. 11 U.S.C § 524.

The record indicates that the Bankruptcy Court issued an order denying Taxpayer's discharge. This renders an analysis of the effect of the bankruptcy filing on the collection of the assessments unnecessary.

The Bankruptcy Court also entered an order on February 7, 2019 explicitly validating the IRS tax liability for the tax years from 2010 through and including 2015. The Section used the same liability in preparing the assessments for Arizona.

Based upon the record, the Officer concludes that the automatic stay does not apply to this protest and the determination of the amount of the assessments is correct.

**C. Other Litigation**

Taxpayer provided testimony and documents avowing that there are various matters pending before other tribunals related to the IRS tax liability. These other matters do not affect the limited purpose of determining this matter. Taxpayer's arguments concerning these are deemed denied on the grounds of relevancy.

**Conclusion.**

The question before this Office is whether the Section properly issued the assessments. Based on the evidence submitted and arguments advanced, the Officer concludes that Taxpayer has not met his burden in overcoming the presumption that the assessments were properly issued. The protest is deemed denied and Section's proposed assessments is affirmed.

DATED this 27<sup>th</sup> day of January, 2022.

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