

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of )  
 ) DECISION OF  
[REDACTED] ) HEARING OFFICER  
 )  
 ) Case No. 200700179-I  
UTI # [REDACTED] )  
 )  
\_\_\_\_\_ )

A hearing was held on January 28, 2008 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 the tax year 2002.

FINDINGS OF FACT

Taxpayers won the Arizona lottery in 199[X], and elected to receive the payments as an annuity. When claiming their winnings at the lottery office, Taxpayers requested the administrator of the annuity to send separate payments to Mr. & Mrs. [REDACTED]. Taxpayers timely filed a joint income tax return with the State of Arizona in 2002. In their 2002 Arizona income tax return, Taxpayers claimed two \$5,000 exclusions from income relating to the lottery winnings: one subtraction for Mr. [REDACTED] and one subtraction for Mrs. [REDACTED]. The Section reviewed Taxpayers' 2002 Arizona returns, and allowed Taxpayers only one \$5,000 subtraction for 2002. The Section accordingly issued a proposed assessment for 2002 that included tax and interest.

Taxpayers timely protested the proposed assessments through their representative. In their protest, Taxpayers'

representative asserted that since Taxpayers receive separate payments for their winnings, they are each entitled to a \$5,000 exclusion from their income. The issue is the propriety of the assessment.

#### CONCLUSIONS OF LAW

A.R.S. § 43-102.A.1 provides that it is the intent of the legislature to adopt the provisions of the federal Internal Revenue Code relating to the measurement of adjusted gross income for individuals so that adjusted gross income reported to the Internal Revenue Service (IRS) shall be the identical sum reported to Arizona, subject only to modifications set forth in Title 43 of the Arizona Revised Statutes. Among the modifications set forth in Title 43 of the Arizona Revised Statutes are the additions and subtractions found in A.R.S. § 43-1021 to -1022.

A.R.S. § 43-1022 provides in part that in computing Arizona adjusted gross income, the following shall be subtracted from Arizona gross income:

16. The amount of prizes or winnings less than five thousand dollars in a single taxable year from any of the state lotteries established and operated pursuant to title 5, chapter 5, article 1, except that all such winnings before March 22, 1983, including periodic distributions from such winnings made after March 22, 1983, may be subtracted.

The Arizona Administrative Code, at A.A.C. R15-2C-304, further provides:

A. A taxpayer who won a state of Arizona lottery prize before March 22, 1983, and receives the prize in installment payments may subtract the amount of the installment payment that is included in Arizona gross income for the taxable year.

B. A taxpayer may subtract from Arizona gross income an amount not to exceed \$5,000 per taxable year from state of Arizona lottery winnings, whether paid in a lump sum or in installments, that were won and collected after March 21, 1983. The combined subtraction from lump sum and installment winnings won and collected after March 21, 1983, shall not exceed \$5,000 for a taxable year.

C. A taxpayer who collects both amounts won before March 22, 1983, and amounts won after March 21, 1983, may subtract from Arizona gross income the total winnings collected in the taxable year that the taxpayer won before March 22, 1983, plus an amount of winnings not to exceed \$5,000 won after March 21, 1983, and collected in the taxable year.

Because Taxpayers won the lottery after March 22, 1983, the subtraction is limited to \$5,000. See A.R.S. § 43-1022.16 and A.A.C. R15-2C-304.

Taxpayers claim that for married individuals, each spouse is entitled to the \$5,000 subtraction for lottery winnings, and that they should be able to claim an aggregate subtraction of \$10,000 for tax year 2002. The Section argues that a married couple filing a joint return is limited to a total subtraction of \$5,000 from their combined lottery winnings. For the reasons stated herein, the Hearing Office holds that A.R.S. § 43-1022.16

does not allow a married couple filing a joint return to take two separate \$5,000 deductions for lottery winnings.

In order to determine the scope of the statute, it is necessary to determine the intent of the legislature. See *Mailboxes, Etc. v. Indus. Comm'n of Ariz.*, 181 Ariz. 119, 121, 888 P.2d 777, 779 (1995) ("The primary rule of statutory construction is to find and give effect to legislative intent."). Where there is not only a statute, but also an administrative rule that addresses the issue in this case, it is important to note that the rules of statutory construction apply to administrative rules as well as statutes. See *Kimble v. City of Page*, 199 Ariz. 562, 565, 20 P.3d 605, 608 (App. 2001). When attempting to ascertain the legislative intent, "we look first at the language of the statute and give the words used their ordinary meaning." *Davis v. Ariz. Dep't of Revenue*, 197 Ariz. 527, 529, 4 P.3d 1070, 1072 (App. 2000).

At the hearing, Taxpayers' representative focused on the use of the word "taxpayer" in A.A.C. R15-2C-304. The regulation states that a "taxpayer may subtract from Arizona gross income an amount not to exceed \$5,000 per taxable year . . . ." A.A.C. R15-2C-304.B. Taxpayers' representative then argued that A.R.S. § 42-2001.6 provides a definition of the word "taxpayer", which states that "with respect to a joint return," taxpayer "means either party." The Section argued that while the definition of taxpayer in A.R.S. § 42-2001.6 can mean "either party" of a joint return, A.R.S. § 42-2001.6 does not state that it means "both parties" of a joint return.

The Hearing Office does not find the definition in A.R.S. § 42-2001.6 either persuasive or relevant. Besides being subject to different interpretations of how such a definition would apply to the language found in the A.R.S. § 43-1022.16 subtraction, the definition cited by Taxpayers only applies to a specific portion of the Arizona Revised Statutes, a portion that does not include the subtraction at issue here. A.R.S. § 42-2001 states as follows:

In this article, unless the context otherwise requires:

6. "Taxpayer", with respect to a joint return, means either party.

(emphasis added). By using the phrase, "[i]n this article," the legislature meant that the definition applied specifically to that article (Article 4 of Chapter 2 in Title 42 - "Confidentiality of Taxpayer Information"). This limiting language in A.R.S. § 42-2001 implies that the definitions therein do not apply to the A.R.S. § 43-1022 subtraction for lottery winnings, which is found in Article 3 of Chapter 10 in Title 43.

With no definitive language in either the statute or the regulation that states whether or not the \$5,000 subtraction can be taken for one or both spouses, the proper interpretation of the statute is somewhat uncertain. The Arizona Court of Appeals held that when interpreting an ambiguous statute, it is important to "consider the statute as a whole and attempt to give it a fair and sensible meaning while avoiding a

construction that produces an absurd result." *Arizona Department of Revenue v. Raby*, 204 Ariz. 509, 511, 65 P.3d 458, 460 (App. 2003). However, it is also well settled that where there is any ambiguity in the interpretation of a deduction or subtraction, such as the one at issue in this case, the interpretation must be strictly construed against deducting or subtracting the item from tax. See *Raby*, 204 Ariz. at 511-12, 65 P.3d at 460-61; see also *Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).

In both their protest, and at the hearing, Taxpayers made reference to the subtraction for retirement benefits and pensions found in A.R.S. § 43-1022.2. Taxpayers asserted that with respect to retirement benefits and pensions, the Department has interpreted that provision to allow each spouse to receive a \$2,500 subtraction, provided that they had each received their own pension or retirement pay. They argued that if taxpayers are allowed a \$2,500 subtraction for each spouse that receives a pension, then taxpayers should also be allowed a \$5,000 subtraction for each spouse that receives lottery winnings.

However, the Section argued that there was a difference between the subtractions for pensions and the subtractions for lottery winnings. The Section pointed out that the regulations specifically allow married taxpayers to take two deductions where each spouse receives their own pension or retirement benefits from their former government employer. See A.A.C. R15-2C-301; see also *Raby*, 204 Ariz. 509, 65 P.3d 458. Yet, there is no such language in the statutes or the regulations

that would allow a married couple to take two deductions for their community property interest in lottery winnings.

The Taxpayers' theory in the present case is similar to that of the taxpayers in *Raby*. That is, that because each spouse is entitled to their one-half share of the community property interest in the income, that each should be allowed to receive a subtraction for their community property share. See *Raby*, 204 Ariz. at 511, 65 P.3d at 460. However, in *Raby*, the Arizona Court of Appeals did not interpret the statute to allow two deductions for each spouse's one-half interest in the husband's pension. See *Raby*, 204 Ariz. 509, 65 P.3d 458.

In this case, the Hearing Office does not believe that the legislature intended to provide two subtractions to married taxpayers filing a joint return who ask the lottery administrator to send the winnings via separate check to each spouse. Further, where there is any ambiguity as to whether A.R.S. § 43-1022.16 allows more than one deduction for a married couple, any such ambiguity must be resolved against allowing the deduction. See *Raby*, 204 Ariz. at 511-12, 65 P.3d at 460-61; *Ebasco*, 105 Ariz. at 99, 459 P.2d at 724. Therefore, the Hearing Office finds that Taxpayers are not allowed to take two \$5,000 deductions for their lottery winnings.

As to the interest portion of the assessment, 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 tax was due in this case and the associated interest cannot be abated.

Based on the foregoing, the Section's proposed assessment is affirmed.

DATED this 1st day of February, 2008.

ARIZONA DEPARTMENT OF REVENUE  
APPEALS SECTION

[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