

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of)	DECISION OF
)	HEARING OFFICER
[REDACTED])	
)	Case No. 200700088-I
UTI # [REDACTED])	
_____)	

A hearing was held on July 23, 2007 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 2001.

FINDINGS OF FACT

Taxpayers made contributions to traditional individual retirement accounts (IRAs) while Taxpayers were residents of [REDACTED]. Taxpayers became residents of Arizona in October, 2000.

Based on information obtained from the Internal Revenue Service (IRS) through the Department's exchange of information agreement with that agency (I.R.C. § 6103(d)(1)), the Section audited Taxpayers' timely filed 2001 Arizona resident income tax return. The Section disallowed Taxpayers' subtraction of \$[REDACTED] which Taxpayers identified on their return as traditional IRAs converted to Roth IRAs in 1998 prior to becoming Arizona residents. The Section also disallowed the family income tax credit and on [REDACTED] issued a proposed assessment for 2001 that included tax and interest.

Taxpayers timely protested the assessment on the following basis:

The amount of the IRA subtraction is a result of conversion of traditional IRA to ROTH IRA in 1998. The IRS allowed the conversion to be processed in 4 annual installments. The final installment was in 2001. The traditional IRA deductions were never deducted from state income and I was not an AZ resident at any time during those years.

At the hearing, Mr. [REDACTED] stated that the contributions to the IRAs were made while Taxpayers were residents of [REDACTED] and [REDACTED] has no state income tax so the IRA contributions were never deducted from any state taxes. Since the IRA contributions were never deducted from any state taxes, Taxpayers argue that Arizona should not tax the \$[REDACTED] amount on Taxpayers' 2001 Arizona return. Taxpayers also argue that the distribution technically occurred in 1998, when Taxpayers were residents of [REDACTED]. The issue is the propriety of the proposed assessment.

CONCLUSIONS OF LAW

The presumption is that an assessment of additional income tax is correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948). Taxpayers have produced insufficient evidence to overcome that presumption.

With regard to converting amounts held in a traditional IRA to a Roth IRA, Treas. Reg. § 1.408A-4 provides in general that any amount converted to a Roth IRA is includible in gross income as a distribution according to the rules of I.R.C. § 408(d)(1)

and (2) for the taxable year in which the amount is transferred or distributed from the traditional IRA. Treas. Reg. § 1.408A-4 also provides that in the case of a distribution, including a trustee-to-trustee transfer, from a traditional IRA on or before December 31, 1998 that is converted to a Roth IRA, instead of including the entire taxable conversion amount in income in 1998, an individual may include in gross income for 1998 only one quarter of that amount and one quarter of that amount for each of the next three years. Taxpayers elected this treatment on their 1998 federal income tax return. The \$[REDACTED] amount that Taxpayers subtracted on their 2001 Arizona return is the amount includible in gross income for the fourth year on their 2001 federal income tax return.

A.R.S. § 43-102.A.4 states that "[i]t is the intent of the legislature...[t]o impose on each resident of this state a tax measured by taxable income wherever derived." Taxpayers were residents of Arizona during 2001 and therefore all of their income wherever derived was subject to Arizona tax, including the \$[REDACTED] amount.

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 IRS shall be the identical sum reported to Arizona, subject only to modifications set forth in Title 43 of the Arizona Revised Statutes. The \$[REDACTED] was included in Taxpayers' 2001 federal adjusted gross income. See I.R.C. §§ 408 and 408A

and Treas. Reg. § 1.408A-4. An individual taxpayer computes Arizona taxable income by starting with federal adjusted gross income, then makes certain additions and subtractions pursuant to A.R.S. §§ 43-1021 and 43-1022 and is then allowed certain exemptions and deductions. See A.R.S. § 43-1001. There is no provision in the Arizona statutes that would allow a full-year Arizona resident to exclude amounts converted from a traditional IRA to a Roth IRA, as Taxpayers did on their 2001 Arizona resident income tax return. The right to a deduction or subtraction does not exist in the absence of statutory authority. *Arizona Department of Revenue v. Transamerica Title Insurance Company*, 124 Ariz. 417, 604 P.2d 1128 (1979). Also see Arizona Individual Income Tax Ruling ITR 93-27. Based on the foregoing, the Section properly disallowed the \$[REDACTED] subtraction.

Taxpayers argue that the distribution technically occurred in 1998, when Taxpayers were residents of [REDACTED]. A.R.S. § 43-1097 provides:

- A. *During the tax year in which a taxpayer changes from a resident to a nonresident, Arizona taxable income shall include all of the following:*
 - 1. All income and deductions realized or recognized, or both, depending on the taxpayer's method of accounting, during the period the individual was a resident, and any income accrued by a cash basis taxpayer prior to the time the taxpayer became a nonresident of this state.
 - 2. All income and deductions earned in Arizona or derived from Arizona sources after the time the taxpayer became a nonresident of this state.
- B. *During the tax year in which a taxpayer changes from a nonresident to a resident,*

Arizona taxable income shall include all of the following:

1. All income and deductions realized or recognized, or both, depending on the taxpayer's method of accounting, during the period the individual was a resident, except any income accrued by a cash basis taxpayer prior to the time the taxpayer became a resident of this state.
2. All income and deductions earned in Arizona or derived from Arizona sources prior to the time the taxpayer became a resident of this state. (Emphasis added.)

A.R.S. § 43-1097 only applies to the year of change of residency. Taxpayers became Arizona residents during 2000.

A.R.S. § 43-1097 does not apply to the facts in this case because Taxpayers did not change their residency during 2001. Taxpayers were full-year residents of Arizona during 2001.

The evidence indicates that the Section properly disallowed Taxpayers' family income tax credit because the Section adjusted Taxpayers' income. See A.R.S. § 43-1073.

Taxpayers also object to the length of time it took the Department to notify them of this problem. However, the evidence shows that the Section issued the proposed assessment within the four-year statute of limitations established in A.R.S. § 42-1104.

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 25th day of July, 2007.

ARIZONA DEPARTMENT OF REVENUE
APPEALS SECTION

[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