

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of	)	DECISION OF
	)	HEARING OFFICER
[REDACTED]	)	
	)	Case No. 200700195-I
UTI #[REDACTED]	)	
_____	)	

A hearing was held on February 20, 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 tax year 2002.

FINDINGS OF FACT

Taxpayers were full-year Arizona residents in 2002, and timely filed their 2002 Arizona resident income tax return. Based on information obtained from the Internal Revenue Service (IRS) through the Department's exchange of information agreement with the IRS (I.R.C. § 6103(d)(1)), the Section audited Taxpayers' 2002 Arizona resident income tax return. As a result of the audit, the Section issued a proposed assessment on February 14, 2007, disallowing various itemized deductions amounting to \$[REDACTED] and a \$[REDACTED] subtraction from income pertaining to an IRA distribution. The total amount assessed by the Section came to \$[REDACTED], including tax and interest. No penalties were assessed.

Taxpayers timely protested the assessment and submitted documentation in support of their protest. Based upon the documentation submitted, the Section issued a modified proposed

assessment on August 8, 2007, allowing itemized deductions that it was able to verify. Taxpayers disagreed with the modified assessment, and requested a hearing. With their protest, Taxpayers submitted additional documentation as well as a claim for a school tax credit.

On October 3, 2007, the Section issued a second modified proposed assessment to allow the school tax credit. In this second modified proposed assessment the Section also allowed some additional itemized deductions, including various medical expenses, and charitable deductions for items that could be verified from the documentation submitted. The total amount due under this modified assessment was \$[REDACTED]. On or about October 8, 2007, Taxpayers sent a response to the assessment, along with their payment in full, but noting their disagreement with the assessment and requesting a hearing on the matter.

At the hearing, [TAXPAYER] clarified that the only item that he was disputing from the October 3, 2007 modified assessment was the Section's disallowance of Taxpayers' \$[REDACTED] subtraction from income. The subtraction stemmed from an IRA distribution Taxpayers received in 2002 while residents of Arizona.

[TAXPAYER] testified that they contributed to the IRA at issue in the 1980s while they were residents of Pennsylvania. Because of this, Taxpayers argued that the \$[REDACTED] distribution from that IRA was not taxable in Arizona.

In support of Taxpayers' argument, they provided a copy of a letter from one of the Department's tax analysts dated March 12, 1990 (the "Letter"). The Letter states that it was written in

response to Taxpayers' December 30, 1989 letter concerning "Arizona's tax treatment of amounts contributed to an IRA prior to establishing Arizona residency." In the Letter, the Department's tax analyst opined as follows:

. . . Arizona Department of Revenue Income Tax Ruling 82-10-1 (which is based on A.R.S. § 43-1097) provides that a taxpayer would not be taxable on distributions of principal or cost of an IRA account to the extent that contributions to the IRA account were based upon compensation earned in another state prior to Arizona residency.

Based on A.R.S. § 43-1097 and Arizona Department of Revenue Income Tax Ruling 82-10-1, it is the Department's current position to allow a taxpayer a subtraction from Arizona gross income for that portion of an IRA distribution which is comprised of contributions made prior to the taxpayer establishing Arizona residency.

However, the Letter also stated as follows:

For your information, the Department's policy with respect to taxation of amounts contributed to an IRA prior to establishing Arizona residency is currently under review. However, this determination is the present position of the Department and is subject to future change depending on changes in the statutes, case law or administrative rules.

Also attached to the Letter was a copy of Arizona Department of Revenue Income Tax Ruling ITR 82-10-1.

At the hearing, the Section noted that a change in the law occurred after the Letter was issued, and argued that the Department's Letter, as well as the Income Tax Ruling upon which the Letter was based, were obsolete. The Section referenced a more recent Income Tax Ruling which held that in tax years following 1990, "income distributions from an IRA to a full-year

Arizona resident which are comprised of contributions made before the taxpayer became an Arizona resident cannot be subtracted from the taxpayer's Arizona gross income." Arizona Department of Revenue Income Tax Ruling ITR 93-27. Therefore, the section argued, ITR 93-27 superseded both the Department's Letter and ITR 82-10-1.

However, Taxpayers pointed out that while ITR 93-27 specifically states that it "supersedes Arizona Department of Revenue Income Tax Ruling 81-10-8," it says nothing about superseding ITR 82-10-1. The Section maintained that the reference in ITR 93-27 was an error and that it should have cited ITR 82-10-1 as being superseded instead of 81-10-8.

Finally, Taxpayers also raised the issue of double taxation at the hearing. Taxpayers reiterated that the money contributed to the IRA in the 1980s was already subject to state taxes in Pennsylvania while Taxpayers were residents of Pennsylvania. Taxpayers asserted that if the IRA distribution was taxed in Arizona, then it would constitute double taxation, and that Arizona Department of Revenue Income Tax Ruling ITR 93-27 does not address the issue of double taxation. The details of the type and amount of the Pennsylvania tax were not adequately provided at the hearing. However, [TAXPAYER] requested that if the IRA distribution was determined to be taxable in Arizona, the statute of limitations period for the 2002 tax year should be left open to allow Taxpayers to file Arizona Form 309 to seek a credit for taxes paid to another state. The Section did not

object to allowing Taxpayers to file Arizona Form 309. At issue is the propriety of the October 3, 2007 modified assessment.

#### CONCLUSIONS OF LAW

The presumption is that an assessment of additional income tax is correct. See *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948). Taxpayers have produced insufficient evidence to overcome that presumption or to prove that the Section's modified assessment is incorrect. There being insufficient evidence to the contrary, the Section's modified proposed assessment must be upheld as being correct.

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." The evidence indicates that Taxpayers were residents of Arizona during 2002 and therefore all of their income wherever derived was subject to Arizona tax, including the \$[REDACTED] IRA distribution.

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] IRA distribution was included in Taxpayers' 2002 federal adjusted gross income. See I.R.C. § 408.

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. 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). In 2002, there was no provision in the Arizona statutes that would allow full-year Arizona residents to exclude amounts received from an IRA, even where the contributions to the IRA were made in another state.

In addition, Arizona Individual Income Tax Ruling ITR 93-27, issued by the Department on December 3, 1993, specifically addresses the issue at hand. ITR 93-27 provides as follows:

For tax years subsequent to 1990, income distributions from an IRA to a full-year Arizona resident which are comprised of contributions made before the taxpayer became an Arizona resident cannot be subtracted from the taxpayer's Arizona gross income. Therefore, the distribution amount included in Arizona gross income is subject to Arizona income tax.

Thus, Taxpayers' \$[REDACTED] distribution from the IRA was subject to Arizona income tax in 2002.

#### Applicability of ITR 82-10-1

Taxpayer argues that Arizona Individual Income Tax Ruling ITR 82-10-1 is in conflict with the Section's current position. However, ITR 82-10-1 has been superseded.

ITR 82-10-1 was a Tax Ruling issued by the Department. Tax Rulings are "public written statement[s] of the department's position interpreting the Arizona tax law." See Arizona General Tax Procedure GTP 96-1. Tax Rulings can be revoked or superseded "by intervening changes in applicable statute, administrative

rules, case law and other so noted tax rulings." See Arizona General Tax Ruling GTR 91-4.

The language in ITR 93-27 directly contradicts ITR 82-10-1, and therefore was likely intended to supersede ITR 82-10-1 whether or not the citation therein was correct. However, ITR 93-27 is not necessary in order to determine whether or not ITR 82-10-1 was superseded. As stated above, Arizona General Tax Ruling GTR 91-4 states that Tax Rulings can be revoked or superseded in a number of ways, including "by intervening changes in applicable statute." As shown below, ITR 82-10-1 was superseded by statute regardless of the intentions of ITR 93-27.

ITR 82-10-1 was issued in 1982, and specifically states that the applicable law upon which it was based was former A.R.S. § 43-1097. At the time ITR 82-10-1 was issued, A.R.S. § 43-1097 provided as follows:

If the status of a taxpayer changes from resident to nonresident or from nonresident to resident, there shall be included in determining income from sources within or without this state, as the case may be, income and deductions accrued prior to the change of status even though not otherwise includible in respect of the period prior to such change, but the taxation or deduction of items accrued prior to the change of status shall not be affected by the change.  
(Emphasis added)

Based on the language that existed in A.R.S. § 43-1097 at the time ITR 82-10-1 was issued, the Department of Revenue opined as follows:

Taxpayers would not be taxable on distributions of principal or cost of an IRA account to the extent that contributions to the IRA account were based upon compensation earned in another state prior to Arizona residency.

Arizona Individual Income Tax Ruling ITR 82-10-1.

However, in 1991, A.R.S. § 42-1097 was substantially amended. See Laws 1991, Ch. 22, § 2. After the 1991 amendment, and as it currently stands, A.R.S. § 42-1097 reads as follows:

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)

As amended in 1991, A.R.S. § 43-1097 clearly indicated that the language therein was now only to apply to the year of the change in residency. Because ITR 82-10-1 was based upon A.R.S. § 43-1097 as written in 1982, and because A.R.S. § 43-1097 was amended in 1991, the "intervening change in [the] applicable statute" caused ITR 82-10-1 to be superseded. See Arizona General Tax Ruling GTR 91-4. Thus, ITR 82-10-1 was no longer valid and could not be reasonably relied upon.

As enacted in 2002, the language in A.R.S. § 43-1097 only allowed an adjustment in the year in which a taxpayer had a change in residency. In this case, Taxpayers did not change their residence from Pennsylvania to Arizona in 2002. Therefore, A.R.S. § 43-1097 does not allow Taxpayers a subtraction of income in this case.

Applicability of the Department's March 12, 1990 Letter

In support of their argument at the hearing, Taxpayers also referred to the March 12, 1990 letter they received from a tax analyst at the Department. The letter stated in part as follows:

. . . it is the Department's current position to allow a taxpayer a subtraction from Arizona gross income for that portion of an IRA distribution which is comprised of contributions made prior to the taxpayer establishing Arizona residency.

Information Letters and Private Taxpayer Rulings are written documents (usually issued by the Department's Tax Policy and Research Division) in response to a taxpayer's written inquiry. See Arizona General Tax Ruling GTR 07-1. Like tax rulings, an Information Letter or Private Taxpayer Ruling can be revoked or

modified by subsequent changes in the law. A.R.S. § 42-2101.B provides in part as follows:

B. A private taxpayer ruling may be revoked or modified by either:

1. A change or clarification in the law that was applicable at the time the ruling was issued, including changes or clarifications caused by legislation, adopted administrative rules and court decisions.

The March 12, 1990 letter to Taxpayers stated that the Department's position was based upon A.R.S. § 43-1097, as it existed in 1990 and ITR 82-10-1 (which was attached with the letter). The Department's tax analyst also warned the Taxpayers that such law or position may change, by stating as follows:

For your information, the Department's policy with respect to taxation of amounts contributed to an IRA prior to establishing Arizona residency is currently under review. However, this determination is the present position of the Department and is subject to future change depending on changes in the statutes, case law or administrative rules.  
(Emphasis added)

Indeed, as warned by the tax analyst, the year after the letter was issued to the Taxpayers, A.R.S. § 43-1097 was significantly amended by the legislature. See Laws 1991, Ch. 22, § 2. Because of this "change or clarification in the [applicable] law," the March 12, 1990 letter to the Taxpayers was revoked or became obsolete, along with ITR 82-10-1. See A.R.S. § 42-2101.B.1. Consequently, while the letter was not erroneous at the time, because it became obsolete through the change in the law, Taxpayers could no longer reasonably rely on the letter in 2002 when they filed their Arizona income tax return.

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. In this case, the tax was due and the associated interest cannot be abated.

#### Double Taxation

With regard to Taxpayers' assertion regarding double taxation, double taxation occurs "when the same property or person is taxed twice for the same purpose for the same taxing period by the same taxing authority . . ." *Lake Havasu City v. Mohave County*, 138 Ariz. 552, 562 (App. 1983); *Miami Copper Company Division, Tennessee Corporation v. State Tax Commission*, 121 Ariz. 150, 589 P.2d 24 (App. 1978). All the above elements must be present in order for double taxation to occur.

In this case, the precise type of tax paid by Taxpayers in Pennsylvania was not clear from the record. However, because the alleged double tax refers to a Pennsylvania tax assessed in the 1980s and an Arizona tax assessed for 2002, the Taxpayers were not taxed twice "for the same taxing period by the same taxing authority." Therefore, double taxation has not occurred in this case.

#### Credit for Taxes Paid to Another State

At the hearing, Taxpayers stated their belief that if the 2002 distribution from the IRA was taxable, then they should be allowed to receive a credit for taxes previously paid with respect to the IRA in Pennsylvania. There was not enough

evidence provided at the hearing to ascertain the specifics of the taxes paid in Pennsylvania. In addition, Taxpayers have not filed an Arizona Form 309 to seek a credit for taxes paid to another state. Without these items, the Hearing Office is unable to grant or even determine whether a credit for taxes paid to another state is applicable.

However, Taxpayers have requested that if the IRA distribution was determined to be taxable in Arizona, the statute of limitations period for the 2002 tax year should be left open to allow Taxpayers to file Arizona Form 309 to seek a credit for taxes paid to another state. A.R.S. § 42-1251.B. states that if a taxpayer "pays the total deficiency assessment, including interest and penalties" then he or she "may then file a claim for refund . . . within six months of payment of the deficiency assessment . . . ."

In this case, Taxpayers timely protested the assessment and paid the assessed tax in full under protest on or about October 8, 2007. Consequently, Taxpayers may still file a claim for refund, including seeking a credit for taxes paid to another state under A.R.S. § 43-1071, at least until April 8, 2008. However, Taxpayers would need to submit Arizona Form 309, along with sufficient documentation to verify the claim. Further, it must be noted that just because a claim for refund or Form 309 is filed, it does not mean that Taxpayers are entitled to such a credit. The claim would need to be reviewed by the Department to determine whether the facts and circumstances in this case would warrant a credit pursuant to A.R.S. § 43-1071 and any applicable

rules regulations (see, e.g. Arizona Individual Income Tax Procedure ITP 07-1).

Conclusion

Based on the foregoing, the Section's modified proposed assessment dated October 3, 2007 is affirmed.

In addition, Taxpayers shall be allowed to file a claim for a credit for taxes paid to another state (along with the applicable forms and information) until April 8, 2008. If such a claim is sought, it shall be treated as a claim for refund.

DATED this 7th day of March, 2008.

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