



Janet Napolitano  
Governor

J. Elliott Hibbs  
Director

**ARIZONA DEPARTMENT OF REVENUE**

OFFICE OF THE DIRECTOR

1600 WEST MONROE, ROOM 910  
PHOENIX, ARIZONA 85007

Telephone: (602) 542-3572 • Fax: (602)542-4772

**CERTIFIED MAIL**

The Director's Review of the Decision )  
of the Administrative Law Judge Regarding: )  
 )  
[TAXPAYER] )  
 )  
ID No. )  
\_\_\_\_\_ )

**ORDER**

**Case No. 200200106-S**

On August 12, 2002, the Administrative Law Judge issued a decision regarding the protest of ("Taxpayer"). Taxpayer appealed this decision on September 12, 2002. As the appeal was timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Administrative Law Judge's decision and now issues this order.

**Statement of Case**

The Transaction Privilege Tax Division ("Division") issued a deficiency assessment to [REDACTED] Taxpayer for the period of July 1998 through December 2001. Taxpayer protested the assessment of late filing and late payment penalties and interest, and the Administrative Law Judge denied the protest. On appeal, Taxpayer accepts the audited tax liability but asks that, given the facts and circumstances of this case, the Director use his authority to abate interest and penalties.

**Findings of Fact**

The Director adopts and incorporates into this order the findings of fact set forth in the decision of the Administrative Law Judge, as set forth below:

1. During the audit period of July 1, 1998 through December 31, 2001, Taxpayer built townhouses in [REDACTED], Arizona. Taxpayer's gross income was taxable under the prime contracting classification. Taxpayer did not file transaction privilege tax returns or pay any transaction privilege taxes (TPT) until the end of the audit period, on October 31, 2001.
2. The Division audited Taxpayer in February 2002 and assessed unpaid TPT, along with penalties and interest, for the audit period. Taxpayer accepts the audited tax liability but protests the assessment of penalties and interest.
3. At the hearing, Taxpayer's Managing Member [REDACTED] testified that Taxpayer had been confused as to the tax liability between it and its affiliated development company. Taxpayer realized its error, filed late and amended tax returns, and was audited. Taxpayer feels that the imposition of penalties and interest is unfair and harsh.

### **Conclusions of Law**

The Department of Revenue is charged by the Arizona Legislature with collecting and enforcing the tax laws of the State of Arizona. It cannot by administrative action require anything more or less, than the law requires. Additionally, the Department must administer the tax laws in a fair and equitable manner as applied to all taxpayers. The Director does have, in defined situations, the discretion, and the authority to amend findings of fact and conclusions of law, to determine new findings and conclusions of law, or to abate elements of an assessment. But, even in those situations, the Director must have a basis for doing so. Taxpayer has not provided such basis in this appeal.

Arizona Revised Statutes § 42-5014 establishes the due dates and the delinquency of transaction privilege tax returns as follows:

"A. Except as provided in subsection B, C or D of this section, the taxes levied under this article are due and payable monthly on or before the twentieth day of the month next succeeding the month in which the tax accrues and are delinquent:

"1. If not postmarked on or before the twenty-fifth day of that month."

"2. If not received by the department on or before the business day preceding the last business day of that month for those taxpayers electing to file by mail."

"3. If not received by the department on the business day preceding the last business day of that month for those taxpayers electing to file in person."

The failure to file when due penalty and the failure to pay when due penalty may be abated only upon a showing by Taxpayer that the failure to timely file and pay is due to reasonable cause. A.R.S. § 42-1125.A, and D and E. Taxpayer has not documented reasonable cause to abate the penalty. The taxable periods involved in this appeal straddle periods in which the penalty percent provisions were amended by the Legislature. However, under either the previous law or the current law, the calculation is such that it does not affect the penalty calculation applicable to the Taxpayer. All else in the statute also remains the same as applied to Taxpayer, so the Director will quote the current provisions. Please see:

42-1125. Civil penalties; definition

"A. If a taxpayer fails to make and file a return for a tax administered pursuant to this article on or before the due date of the return or the due date as extended by the department, then, unless it is shown that the failure is due to reasonable cause and not due to willful neglect, four and one-half per cent of the tax required to be shown on such return shall be added to the tax for each month or fraction of a month elapsing between the due date of the return and the date on which it is filed. The total penalty shall not exceed twenty-five per cent of the tax found to be remaining due. The penalty so added to the tax is due and payable on notice and demand from the department....."

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"D. If a person fails to pay the amount shown as tax on any return within the time prescribed, a penalty of one-half of one per cent, not to exceed a total of ten per cent, shall be added to the amount shown as tax for each month or fraction of a month during which the failure continues, unless it is shown that the failure is due to reasonable cause and not due to wilful neglect. If the department

determines that the person's failure to pay was due to reasonable cause and not due to wilful neglect and that a payment agreement pursuant to section 42-2057 is appropriate, the department shall not impose the penalty unless the taxpayer fails to comply with the payment agreement. If the taxpayer is also subject to a penalty under subsection A of this section for the same tax period, the total penalties under subsection A of this section and this subsection shall not exceed twenty-five per cent. For the purpose of computing the penalty imposed under this subsection....."

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"E. If a person fails to pay any amount required to be shown on any return that is not so shown within twenty-one calendar days after the date of notice and demand, a penalty of one-half of one per cent, not to exceed a total of ten per cent, shall be added to the amount of tax for each month or fraction of a month during which the failure continues, unless it is shown that the failure is due to reasonable cause and not due to wilful neglect. If the taxpayer is also subject to penalty under subsection A of this section for the same tax period, the total penalties under subsection A of this section and this subsection shall not exceed twenty-five per cent....."

As can be seen, Arizona Revised Statutes § 42-1125 titled "Civil Penalties, definition", effective during these periods, provides, in relevant part, that the Department shall add a penalty for late filing and late payment unless it is shown that the failure is due to "reasonable cause".

"Reasonable cause" is generally defined to mean the exercise of "ordinary business care and prudence." See *Daley v. United States*, 480 F. Supp. 808 (D.N.D. 1979). Ordinary business care must be viewed in light of one of the oldest maxims of law: "As a matter of public policy, all persons are charged with knowledge of law pertaining to their transactions and that the legislature may enact, amend or repeal a statute. Everyone is presumed to know the law". See *Conway v. State Consolidated Publishing Co.*, 57 Ariz. 162, 112 P.2d 218 (1941). Every person is presumed to know the law's requirements, and a mistake as to such requirements is no excuse for a failure to meet them, *Newman v. Fidelity Savings and Loan Association*, 14 Ariz. 3534, 128 P. 53 (1912). Oversights in determining whether, when or how the applicable taxes are due with respect to a taxpayer's activity generally cannot be a negating factor in taxpayer's responsibilities.

It is also well settled that lack of sufficient funds does not constitute reasonable cause. *Fitch v. Commissioner*, 34 T.C.M. 233 (1975). Economic difficulties alone do not constitute reasonable cause for failure to file returns or pay taxes. *See Copper Basin Supply Co., Inc. v. Arizona Department of Revenue*, Ariz. Bd. of Tax App., Docket No. 762-90-S (July 30, 1991). The Taxpayer's financial difficulties do not constitute reasonable cause for his failure to timely file the required Arizona tax returns or for his failure to timely pay the tax.

The Director is of the opinion that the Taxpayer's circumstances do not rise to the administrative law level of reasonable cause and must be disregarded. Also, see A.R.S. § 42-1125.Q, which was recodified to A.R.S. 42-1125.S effective January 1, 2001, which provides as follows:

"For the purposes of this section, and only as applied to the taxes imposed by chapter 5, articles 1 through 6 and chapter 6, articles 1, 2 and 3 of this title, "reasonable cause" means a reasonable basis for the taxpayer to believe that the tax did not apply to the business activity or the storage, use or consumption of the taxpayer's tangible personal property in this state."

The Director in this case is not unsympathetic to the financial circumstances of the Taxpayer. Nor is there any suggestion of purposeful evasion of the payment of the taxes at issue when they were due. However, even the Director's discretionary authorities are limited by statutorily established criteria. Taxpayer has not demonstrated that it exercised ordinary business care and prudence in determining and providing for payment of its liability.

The interest portion of the assessments are added to the tax due pursuant to A.R.S. §42-1123 A, B and C. Please see:

42-1123. Interest

"A. If it is provided by law that interest applies as determined pursuant to this section, the department shall apply interest, compounded annually, in the same manner and at the same times as prescribed by section 6621 of the United States Internal Revenue Code, except that the rate of interest for both overpayments

and underpayments for all taxpayers is the federal short-term rate, determined pursuant to section 6621(b) of the internal revenue code, plus three percentage points.

"B. On January 1 of each year the department shall add any interest outstanding as of that date to the principal amount of the tax. For purposes of this section the amount added to the principal is thereafter considered a part of the principal amount of the tax and accrues interest pursuant to this section.

"C. If the tax, whether determined by the department or the taxpayer, or any portion of the tax is not paid on or before the date prescribed for its payment the department shall collect, as a part of the tax, interest on the unpaid amount at the rate determined pursuant to this section from the date prescribed for its payment until it is paid."

As noted in the opinion of the ALJ, There is no "reasonable cause" abatement provision regarding interest. Interest accrues as a matter of right since Taxpayer held money belonging to the State of Arizona. There are very limited provisions in the law for the abatement of interest by the Director. They generally are applicable when the Department has done something, which has acted to the prejudice of the Taxpayer. None of those provisions are applicable to the appeal before us.

The assessment issued by the Division of the department is presumed correct. The taxpayer has the burden of proving the penalty assessment is not valid. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 105; 191 P.2d 729 (1948). Title 15, Chapter 10, Article 1 of the Arizona Administrative Code (A.A.C.) contains the Department of Revenue's hearing procedures. A.A.C. R15-10-118 provides that "[t]he burden of proof is on the taxpayer as to all issues of fact." Taxpayer has not presented evidence, which overcomes the presumption that the penalty and interest assessment is correct.

## **ORDER**

The Administrative Law Judge's decision is affirmed.

This decision is the final order of the Department of Revenue. Taxpayer may contest the final order of the Department in one of two manners. Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15<sup>th</sup> Avenue, Suite 140 Phoenix, AZ 85007

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or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within thirty (30) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this 6<sup>th</sup> Day of March 2003.

ARIZONA DEPARTMENT OF REVENUE

J. Elliott Hibbs  
Director

Certified original of the foregoing  
mailed to:

[REDACTED]

JEH:lh

cc: Transaction Privilege Tax Division  
Office of Administrative Hearings  
Contested Audit Resolution Section  
Tax Policy Group