



ARIZONA GENERAL TAX RULING GTR 04-2

Janet Napolitano
Governor

J. Elliott Hibbs
Director

(This ruling supersedes and rescinds GTR 94-4)

(Note: The general tax ruling and general tax procedure originally referenced on page 5 were updated on August 17, 2020. See footnotes 1 and 2 on page 5 of this ruling. The method to request abatement of non-audit penalties was also updated on August 17, 2020. See footnote 3 on page 11. No substantive change was made to this ruling.)

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Arizona Department of Revenue standards for abatement of penalties based on reasonable cause.

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 42-1125 prescribes the application of various civil penalties. In addition, A.R.S. § 42-1107 regarding an extension to file an income tax return, and A.R.S. §§ 43-581 and 43-582 regarding the requirement to make estimated income tax payments, specifically provide for the assessment of penalties for noncompliance. There is an allowance for abatement of the following penalties where reasonable cause is found to exist:

- A.R.S. § 42-1107, extension to file penalty
- A.R.S. § 42-1125(A), late filing penalty
- A.R.S. § 42-1125(B), notice and demand penalty-filing
- A.R.S. § 42-1125(C), failure to furnish information penalty
- A.R.S. § 42-1125(D), late payment penalty
- A.R.S. § 42-1125(E), notice and demand penalty-payment
- A.R.S. § 42-1125(H), late withholding penalty
- A.R.S. § 42-1125(K), information return penalty
- A.R.S. § 42-1125(O), failure to provide taxpayer identification number
- A.R.S. § 42-1125(P), failure to pay required estimated income tax

The tax types to which these penalties apply, as set out in A.R.S. § 42-1101, are:

- Estimated income taxes
- Income taxes
- Transaction privilege tax

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Withholding tax
Severance tax
Use tax
Luxury tax
Rental occupancy tax
Estate tax
Municipal taxes administered and collected by the department
Telecommunication services excise tax
County excise taxes
Municipal water tax
Jet fuel excise and use taxes

Additionally, statutes provide for inclusion of the car rental surcharge and the waste tire fee imposed under A.R.S. §§ 48-4234 and 44-1302, respectively.

A.R.S. §§ 42-1125(S) and 42-2062(C) provide that for purposes of taxes imposed by chapter 5, articles 1 through 6 and chapter 6, articles 1, 2, and 3 of title 42, "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.

A.R.S. § 42-2052(A) provides that:

[N]otwithstanding sections 42-1123 and 42-1125, no interest or penalty may be assessed on an amount assessed as a deficiency if either:

1. The deficiency assessed is directly attributable to erroneous written advice furnished to the taxpayer by an employee of the department acting in an official capacity in response to a specific request from the taxpayer and not from the taxpayer's failure to provide adequate or accurate information.
2. All of the following are true:
 - (a) A tax return form or tax ruling prepared by the department contains a statement that, if followed by a taxpayer, would cause the taxpayer to misapply this title [42] or title 43.
 - (b) The taxpayer reasonably relies on the statement.
 - (c) The taxpayer's underpayment directly results from this reliance.

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A.R.S. § 42-2062 provides that penalties which have been assessed under A.R.S. §§ 42-1107, 42-1125, 43-581 and 43-582 shall be abated upon written application of the taxpayer if reasonable cause is found to exist. Additionally, a taxpayer who is under audit, but who has not yet been issued an assessment, may request a waiver of any penalties it might be subjected to by the above statutory sections. The department shall not assess the penalties if reasonable cause is found to exist.

LEGAL REFERENCES:

Every person is presumed to know the law and its requirements, and a mistake as to such requirements is no excuse for failure to meet them. *Newman v. Fidelity Savings and Loan Association*, 14 Ariz. 354, 128 P. 53 (1912).

Reasonable cause requires the taxpayer to demonstrate that he exercised ordinary business care and prudence but nevertheless was unable to file the return or pay the tax within the prescribed time. The failure to make a timely filing of a tax return or pay the tax is not excused by a taxpayer's reliance on an agent, and this reliance does not constitute reasonable cause. *United States v. Boyle*, 105 S. Ct. 687 (1985).

The filing of a tax return when due is a personal, nondelegable duty of the taxpayer; as a general proposition, it is no valid excuse for him to say that the matter was put in charge of an employee or accountant or attorney, no matter how trustworthy that person may be. *Ferrando v. United States*, 245 F.2d 582 (9th Cir. 1957).

Employee embezzlement of tax payments and concealment of the embezzlement does not present reasonable cause for abating penalties unless the corporation was in fact "disabled" in complying timely with its tax obligations. *Conklin Brothers of Santa Rosa, Inc. v. United States*, 986 F.2d 315 (9th Cir. 1993).

Employer's financial difficulties may constitute reasonable cause to abate penalties for non-payment of employment taxes. *Van Camp & Bennion v. United States*, 251 F.3d 862 (9th Cir. 2001). Whether financial difficulty can then be demonstrated is limited to the particular facts and circumstances of the request.

Arizona generally follows the federal interpretation of similar or identical statutory language. See *People of Faith, Inc. v. Arizona Department of Revenue*, 171 Ariz. 140, 829 P.2d 330 (App. 1992).

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RULING:

A.R.S. § 42-1125 imposes penalties for noncompliance with statutory requirements. In addition, A.R.S. § 42-1107 regarding an extension to file an income tax return, and A.R.S. §§ 43-581 and 43-582 regarding the requirement to make payments of estimated income tax, specifically provide for the assessment of penalties for noncompliance. A.R.S.

§ 42-2062 provides that penalties imposed under A.R.S. § 42-1125, subsections A, B, C, D, E, H, K, O and P, and penalties imposed under A.R.S. § 42-1107 may be waived or abated upon the showing of reasonable cause for failure to comply with the statutory requirements.

For purposes of abating the penalties imposed under A.R.S. § 42-1125, “reasonable cause” means that the taxpayer exercised ordinary business care and prudence but was nevertheless unable to file the return, furnish the requested information, or provide for payment of a tax liability within the prescribed time.

For purposes of the transaction privilege, use, severance, telecommunication services and county excise taxes, “reasonable cause” is additionally defined by statute as a reasonable basis for the taxpayer to believe that the tax did not apply to the business activity or storage, use or consumption of taxpayer's tangible personal property in Arizona. See A.R.S. §§ 42-1125 and 42-2062.

In addition to the reasonable cause basis for abating penalties, A.R.S. § 42-2052 specifically provides for the abatement of penalties imposed on an amount assessed as a deficiency if either:

1. The deficiency assessed is directly attributable to erroneous written advice furnished to the taxpayer by an employee of the department acting in an official capacity in response to a specific request from the taxpayer and not from the taxpayer's failure to provide adequate or accurate information.
2. All of the following are true:
 - (a) A tax return form or tax ruling prepared by the department contains a statement that, if followed by a taxpayer, would cause the taxpayer to misapply this title [42] or title 43.
 - (b) The taxpayer reasonably relies on the statement.
 - (c) The taxpayer's underpayment directly results from this reliance.

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Questions concerning the abatement of interest often arise in conjunction with the abatement of penalties. Interest on tax deficiencies is a part of the tax pursuant to A.R.S. § 42-1123 and may not be abated unless the tax to which it relates is not due. *Arizona Department of Revenue v. Driggs*, 189 Ariz. 74, 938 P.2d 469 (App. 1996); *Biles v. Robey*, 43 Ariz. 276, 30 P.2d 841 (1934). However, interest shall not be charged where a statutory provision so specifies. A.R.S. § 42-2065 provides that the director, in the director's discretion, may abate all or part of any assessment if additional interest has accrued on:

(1) a deficiency due to any unreasonable error or delay by an officer or employee of the department acting in the employee's official capacity; or (2) any payment of tax to the extent that any error or delay in the payment is attributable to an officer or employee of the department being unreasonably erroneous or dilatory. See also A.R.S. § 42-2052.

See **Arizona General Tax Ruling GTR 08-1¹**, **Arizona General Tax Procedure GTP 08-1²** and **Arizona General Tax Procedure GTP 02-1** for further information.

This ruling is intended to serve only as a guide in the determination of the existence of reasonable cause for purposes of abating penalties and is not meant to be an all inclusive document. A finding of reasonable cause is determined by the facts and circumstances of each case.

I.

Standards of Reasonable Cause

Generally, reasonable cause will exist when the taxpayer uses reasonable and prudent business practices but fails to comply with its tax obligations due to circumstances beyond its control, i.e., circumstances outside the power and authority of the taxpayer.

The following section presents examples where the standard of reasonable cause is met. The examples are not all inclusive, as the facts and circumstances of each taxpayer's specific situation determine whether reasonable cause exists. These standards are in concurrence with those followed by the Internal Revenue Service (IRS).

1. Mathematical errors:

A mathematical error on a timely filed tax return.

¹ The original ruling referenced GTR 97-1 which was superseded by GTR 07-1. GTR 07-1 was later superseded by GTR 08-1.

² The original ruling referenced GTP 97-1 which was superseded by GTP 07-1. GTP 07-1 was later superseded by GTP 08-1.

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2. Unexpected illness or unavoidable absence:

a) **Individual returns**

- i) Delay caused by serious illness of the taxpayer, or member of the taxpayer's immediate family.

"Immediate family" is defined as a spouse, parent, child, brother, sister, in-law, grandparent or grandchild.

- ii) Delay caused by unavoidable absence of taxpayer.

"Unavoidable absence" is defined as an absence which is incapable of being prevented. Vacation time is not acceptable as an unavoidable absence.

b) **Entity returns**

- i) In the case of corporate, estate, trust, or other business returns, delay caused by unexpected serious illness of the individual with sole authority to execute the return, or member of such individual's immediate family.

- ii) Delay caused by unavoidable absence of the individual with sole authority to execute return. See a.ii, above.

- c) If unexpected illness is the basis of the request for penalty abatement, the department may require proof of the date of illness. This proof includes, but is not limited to, doctor statements.

3. Death:

- a) In the case of individual returns, delay caused by the death of taxpayer or member of taxpayer's immediate family. "Immediate family" has the same meaning as in example 2, above.

- b) In the case of corporate, estate, trust, or other business returns, the delay must have been caused by the death of an individual with sole authority to execute the return, or a member of such individual's immediate family.

- c) For both individual and business returns, a reasonable time frame should apply for filing of the return and payment of the tax. A copy of a death certificate must be provided, unless other proof, such as an insurance claim for death benefits of the individual can be obtained.

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4. Forms/payment sent to another agency:

If a taxpayer can provide proof (such as a postmarked envelope) that tax forms or payments were timely completed and mailed to another taxing authority, i.e., the IRS, or to another state agency, i.e., the Department of Economic Security, penalties may be abated. This is a "one time only" abatement and the completed return or payment must have been remailed to the department within a reasonable amount of time.

5. Incorrect advice:

The taxpayer must demonstrate the following factors:

- a) That it contacted an independent tax advisor, i.e., tax attorney, certified public accountant, or enrolled agent, who was competent on the specific tax matter;
- b) That it furnished all necessary and relevant information;
- c) That it was incorrectly advised that the filing of a return was not required, or was incorrectly advised as to the manner or reporting; and
- d) That it exercised ordinary business care and prudence based on its own information and knowledge in determining if further advice was needed.

6. Reliance on a third party:

The timely payment and filing of a tax return are personal, nondelegable duties of the taxpayer. Placing those responsibilities with an employee, accountant or attorney, no matter how trustworthy that person may be, does not excuse the taxpayer. Reasonable cause does not exist if the taxpayer is aware that a return is required but the responsibility for filing and paying the return is delegated to a third party who fails to carry out the responsibility.

7. Absence of records:

The taxpayer is unable to obtain records necessary to determine the amount of tax due for reasons beyond the taxpayer's control. An example would be a fire which destroys the taxpayer's records.

8. Department of Revenue error:

- a) Delay or failure to file and/or pay properly was due to erroneous written advice furnished to the taxpayer by an employee of the department acting in an official

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capacity. Reasonable cause will not be found to exist if the penalties resulted from the taxpayer's failure to provide the department with adequate or accurate information.

- b) Delay or failure to file and/or pay properly was due to a tax return form, including the instructions, or tax ruling prepared by the department containing a statement that, if followed, would cause the taxpayer to misapply title 42 or title 43; the taxpayer reasonably relied on the statement; and, the taxpayer's underpayment directly resulted from this reliance. Reasonable cause will only be found to exist if all of the above are shown to be true.

9. Financial difficulties:

Under limited situations, upon a showing of specific facts and circumstances, a taxpayer's financial difficulties may present reasonable cause for failure to timely pay the tax. However, financial difficulties have no effect on the taxpayer's ability to file returns in a timely fashion.

10. Compliance with IRS abatement decisions:

The department will conform to abatement decisions made by the IRS for the same filing periods if the same conditions apply.

11. Recent changes in the law:

The taxpayer may have reasonable cause if the failure to comply was a result of a recent law change or form revision and the taxpayer could not reasonably be expected to be aware of the change.

II.

Determination of Existence of Reasonable Cause

As a means of determining whether reasonable cause exists in a particular situation and that failure to comply was not due to willful neglect, the taxpayer should address the following questions; taxpayer's justification should satisfy all applicable questions. The following questions are to be used as an instructive guide; they are neither all-inclusive nor definitive of a final determination.

1. Do taxpayer's reasons relate to the penalty that was applied?
2. Does the length of time between the event cited as a reason and the filing or payment date negate the event's effect?

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3. Does the continued operation of a business after the event that caused the taxpayer's noncompliance negate the event's effect?
4. Should the event that caused the taxpayer's noncompliance have reasonably been anticipated?
5. Was the penalty the result of carelessness or did the taxpayer appear to have made an honest mistake? (Carelessness and forgetfulness are the same as civil willful neglect and are not examples of ordinary business care and prudence.)
6. Has sufficient detail (dates, relationships) been provided to determine whether the taxpayer exercised ordinary business care and prudence?
7. Is a nonliable individual being blamed for the taxpayer's noncompliance? What is the nature of the relationship between the taxpayer and this individual? Is the individual an employee of the taxpayer or an independent third party such as an accountant or lawyer?
8. Has the taxpayer documented all pertinent facts, i.e., death certificate, doctor's statement, insurance statement for proof of fire, etc.?
9. Does the taxpayer have a history of having the same penalty applied?
10. Where applicable, could the taxpayer have requested an extension or filed an amended return?
11. Did the taxpayer possess sufficient funds to satisfy its other debts and obligations and yet not fulfill its tax liabilities?

III.

Failure to Meet Reasonable Cause Ignorance of the Law

Ignorance of the law, in and of itself, does not meet the standard of reasonable cause for any tax type. Other factors must be present to support a finding of reasonable cause. It is also important that the taxpayer prove either that ordinary business care and prudence was exercised or that the failure was due to circumstances beyond the taxpayer's control.

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IV.

Statutory Exceptions to Imposition of Penalties

A. Pursuant to A.R.S. § 42-1125(R), penalties shall not be applied to additional amounts of tax paid by a taxpayer at the time the taxpayer voluntarily files an amended return.

1. This exception from the application of penalties does not apply if:

- a) Taxpayer is under audit by the department for the tax period and the tax type being amended;
- b) The amended return was filed on demand or request by the department; or
- c) The total additional tax paid and due for the tax period represents a substantial understatement of tax liability.

There is a substantial understatement of tax for any tax period if the amount of understatement for the tax period exceeds the greater of 10 percent of the actual tax liability for the tax period or \$2,000.

2. For purposes of this section, “amended return” is a return filed subsequent to a timely filed original return.

B. Pursuant to A.R.S. § 42-1125(D), if the department determines that the person’s failure to pay was due to reasonable cause and not willful neglect and that a payment agreement pursuant to A.R.S. § 42-2057 is appropriate, the department shall not impose the penalty unless the taxpayer fails to comply with the payment agreement.

C. Pursuant to A.R.S. § 42-1125(E), if the taxpayer makes payment within twenty-one calendar days after notice and demand of any amount required to be shown, that is not so shown, on any return, the penalty will not be assessed.

V.

Transaction Privilege, Use, Severance, Telecommunications and County Excise Tax

A.R.S. § 42-1125(S) provides an additional definition of “reasonable cause” for purposes of abating penalties on transaction privilege, use, severance, telecommunication services and county excise taxes. A.R.S. § 42-2062(C) provides a similar definition. The sections provide that for such taxes, reasonable cause shall mean “... a reasonable basis for the

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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.”

In determining the reasonableness of a taxpayer's belief that the tax did not apply, the taxpayer must demonstrate facts and circumstances that would lead a reasonable person in its position to believe that the tax did not apply to activities, transactions, or uses of that nature. If a taxpayer does not qualify for penalty relief under this provision, the taxpayer might qualify for relief under the general definition of “reasonable cause.”

VI.

Request for Abatement

Taxpayers who believe they are entitled to abatement of a penalty not associated with an audit shall request in writing that such penalty be abated by completing and mailing Arizona Form 290, *Request for Penalty Abatement*.³ Form 290 is available on the department's website at: www.azdor.gov/forms/other-forms. The request should be addressed to:

Penalty Review Unit, Division 9
Arizona Department of Revenue
1600 West Monroe St.
Phoenix, Arizona 85007-2612
or fax to: 602-716-6787

Taxpayers may, during the course of an audit, request that penalties be waived prior to the issuance of an assessment. This request should be made to the appropriate audit section. Audit assessed penalties may also qualify for abatement under A.R.S. § 42-2062, see page 4.

J. Elliott Hibbs, Director

Signed: October 14, 2004

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law that are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement that provides interpretation, detail, or supplementary information concerning

³ The original ruling required a taxpayer to make the request for penalty abatement in writing. Arizona Form 290 is now available to request abatement for non-audit penalties assessed on taxpayers.

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application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.