

ARIZONA TAXPAYER BILL OF RIGHTS RULING

TBR 97-1

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:

Whether certain corporations understated their tax obligations as a result of an extensive misunderstanding or misapplication of the tax laws and, if so, who is the affected class of taxpayers and what are the terms of the closing agreements.

APPLICABLE LAW:

A.R.S. §42-139.02 provides that no penalties or interest will be assessed if the deficiency is directly attributable to erroneous written advice furnished to the taxpayer by an employee acting in an official capacity; a tax form contains a statement which if followed by the taxpayer would cause the taxpayer to misapply the tax law; the taxpayer reasonably relies on the statement; and the underpayment directly results from this reliance.

Arizona Revised Statutes (A.R.S.) §42-139.06(A) provides that the Arizona Department of Revenue (department) may enter into closing agreements with taxpayers if the department determines that, as a result of the same extensive misunderstanding or misapplication of the tax laws, taxpayers failed to properly account for their taxes.

A.R.S. §42-139.06(A)(1) states that an extensive misunderstanding or misapplication occurs if the department determines that more than sixty percent of the affected class failed to properly account for their taxes due to the same extensive misunderstanding or misapplication of the tax laws.

A.R.S. §42-139.06(A)(2) requires the department to publicly declare the nature of the possible misunderstanding or misapplication and the proposed definition of the class of affected taxpayers and to conduct a public hearing to hear testimony regarding the extent of the misunderstanding or misapplication of the affected class.

A.R.S. §42-139.06(A)(3) requires the department to issue a tax ruling announcing its finding and publish the ruling in a newspaper of general circulation if it determines after the public hearing that an affected class of taxpayers has failed to properly account for their taxes due to an extensive misunderstanding or misapplication of the tax law.

Pursuant to A.R.S. §42-139.06(A)(4), the department may abate some or all of the penalties, interest and tax in a closing agreement, or the closing agreement may provide for prospective relief only. All taxpayers in the affected class will be offered the opportunity to enter into a similar closing agreement for the same tax periods.

A.R.S. §42-139.06(A)(5) requires the department to offer to taxpayers who have correctly computed their tax obligations the opportunity to enter into closing agreements, which provide for a pro rata credit or refund of the tax previously paid, subject to the applicable statute of limitations provisions.

To comply with A.R.S. §42-139.06(B), the department must secure the approval of the attorney general of the tax ruling and closing agreements before entering into closing agreements.

A.R.S. §42-139.06(C) provides that a closing agreement signed under this section and subject to the taxpayer's accounting for and paying such taxes in the future, is final and conclusive except upon the showing of fraud, malfeasance or misrepresentation of a material fact and cannot be reopened as to the matters agreed on nor modified by any officer, employee or agent of the state. The agreement or any determination, assessment, collection, payment abatement, refund or credit made pursuant to the agreement shall not be annulled, modified, set aside or disregarded in any suit, action or proceeding.

DISCUSSION:

The department found that certain corporate taxpayers who claimed tax credits against their Arizona tax had not reduced their deduction for Arizona taxes by the amount of the credits utilized and that, prior to the 1995 return, the instructions and schedules for the corporate income tax returns did not indicate that the adjustment should be made. As a result of this finding, a Notice of Public Hearing (Notice) was published in the Arizona Capitol Times, a newspaper of general circulation on November 22, 1996. The Notice stated that a public hearing would be held on December 12, 1996, at 1:30 p.m. at the Industrial Commission, 800 West Washington, Phoenix, Arizona; that the nature of the possible misunderstanding or misapplication of the tax laws is that the taxpayers may not have adjusted the deduction for Arizona taxes to reflect the tax credits claimed; and that the proposed definition of the affected class of taxpayers was set forth as being corporations who claimed tax credits against their Arizona tax and who also claimed a deduction for Arizona taxes. The Notice provided that copies of relevant, non confidential documents could be obtained and reviewed from 8:00 a.m. to 5:00 p.m. at the reception desk in the lobby of the Revenue Building located at 1600 West Monroe, Phoenix, Arizona. It also indicated that if additional information was needed, the taxpayer could contact Joyce Kinkead at (602) 542-4656, ext.

7504 or by write her at 1600 West Monroe, Phoenix, Arizona 85007.

On December 12, 1996, at 1:30 p.m. in the Industrial Commission Amphitheater, a public hearing was held, pursuant to the Taxpayer Bill of Rights Arizona Revised Statutes §42-139.06, regarding the deduction of Arizona income tax by corporations.

John D. Sylvester, Problem Resolution Officer for the Department of Revenue and designated hearing officer, presided at the hearing, which was recorded, and announced that under A.R.S. §42-139.06 the Department of Revenue may enter into closing agreements with the members of a class of taxpayers if the department determines that, as a result of the same extensive misunderstanding or misapplication of the tax laws, more than 60 percent of the persons in the affected class of taxpayers failed to properly account for their taxes. In addition, he stated that the Department of Revenue defines the proposed class of affected taxpayers as corporations who claimed tax credits against their Arizona tax and who also claimed a deduction for Arizona taxes and that the nature of the possible misunderstanding or misapplication of the tax laws is that the taxpayers may not have adjusted the deduction for Arizona tax to reflect the tax credits claimed. All relevant portions of the notice of public hearing were read. He also disclosed that the Department of Revenue anticipated a decision within the next 60 days. A tax ruling and closing agreements will be forthcoming if the department determines that the affected class qualifies for the provisions of A.R.S. §42-139.06.

Joyce Kinkead, Compliance Division, testified that auditors in the Compliance Division discovered that some corporations were not adjusting the amount of their deduction for Arizona income taxes paid by tax credits utilized to offset the amount of tax due. The division also discovered that the instructions for the corporate return and Schedule F of the corporate return did not specify that the deduction must be adjusted for tax credits claimed. She stated that she reviewed approximately 100 1994 tax year corporate returns which had claimed both tax credits and a deduction for Arizona income taxes and found that substantially more than sixty percent of those corporations did not reduce the deduction by the credit claimed against tax.

Mr. Sylvester stated that a letter was received from a corporation that requested its letter be made a part of the record. The taxpayer indicated that it falls into the proposed class of affected taxpayers, since it claimed tax credits against its Arizona tax and also claimed a deduction for the Arizona taxes. The letter also stated that the taxpayer was not aware of the adjustment requirement but had followed the instructions provided by the department, which did not inform taxpayers that the adjustment must be made. The taxpayer recommended that no action be taken on 1993 and 1994 returns, since following the instructions to the tax forms caused taxpayers to fail to made the adjustment. The taxpayer further reasoned that the interest and penalties should be waived pursuant to A.R.S. §42.139.02, so only the tax remained for consideration. A desire to enter into a closing agreements was stated.

RULING:

The hearing officer found that certain corporate taxpayers who claimed tax credits against their

deduction for Arizona taxes understated their Arizona tax through an extensive misunderstanding or misapplication of the tax laws and that the class of affected taxpayers is corporations who claimed tax credits against their Arizona tax and who also claimed a deduction for Arizona taxes.

At the recommendation of the hearing officer and in the interest of fair dealing and equity, the department will provide to members of the affected class an opportunity to enter into closing agreements under which penalties and interest will be abated pursuant to A.R.S. §42-139.02 and tax otherwise due will be waived in accordance with A.R.S. §42-139.06 for tax years beginning on or after June 23, 1989, subject to the applicable statute of limitations, through tax years beginning on or before December 31, 1994. For subsequent tax years, the instructions were changed to correctly reflect the law. Corporations who correctly adjusted the deduction for Arizona taxes may also enter into closing agreements for the same tax periods, and the department will refund the amount of tax, penalties and interest paid as a result of the correct treatment of this deduction. Taxpayers entering into the closing agreements must in the future properly account for the deduction for Arizona taxes by reducing said deduction by the tax credits utilized against Arizona corporate income tax and pay any taxes due as a result of the adjustment. Corporations who want to avail themselves of this Ruling must enter into closing agreements within thirty (30) days of receiving notice of this Ruling. To request additional information concerning closing agreements please contact Joyce Kinkead, Department of Revenue, 1600 West Monroe, or by telephone at (602) 542-4542, Ext 7504 or facsimile at (602) 542-3258.