

ARIZONA TAXPAYER BILL OF RIGHTS RULING

TBR 97-2

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 private schools understated their use 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:

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 treatment of the matter. 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 received a letter from a taxpayer's representative requesting that the Assistant Director of the Taxation Division ("Division") determine that as a result of the same extensive misunderstanding or misapplication of the tax laws more than 60 percent of the private nonprofit schools in Arizona unintentionally or inadvertently failed to report or pay use tax on certain purchases. The division researched the issue and found that less than 9% of the private schools had applied for and been issued transaction privilege or use tax licenses. 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 August 22, 1997. The Notice stated that a public hearing would be held on September 16, 1997, at 1:00 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 private schools did not report and pay use tax on their taxable purchases not previously subjected to Arizona transaction privilege tax; and that the proposed definition of the affected class of taxpayers is all non-state supported, pre-kindergarten through grade 12 private schools, both for profit and nonprofit. The Notice provided that copies of relevant, nonconfidential 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) 542-4542, ext. 7506 or by writing her at 1600 West Monroe, Phoenix, Arizona 85007.

On September 16, 1997, at 1:00 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 failure of private schools to file returns and pay use tax.

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 defined the proposed class of affected taxpayers as all non-state supported, pre-kindergarten through grade 12 private schools, both for profit and nonprofit, and that the nature of the possible misunderstanding or misapplication of the tax laws is that private schools did not report and pay use tax on their taxable purchases not previously subjected to Arizona transaction privilege tax. 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 and that a tax ruling and closing agreements would be forthcoming if the department determined that the affected class qualifies for the provisions of A.R.S. §42-139.06.

Joyce Kinkead, Taxation Division ("Division"), testified that, after the receipt of a letter from a taxpayer's representative requesting relief under A.R.S. §42-139.06, the division researched the issue and found that less than 9% of the private schools had transaction privilege or use tax licenses. Therefore, the review indicated that greater than 60% of the private schools were not paying use tax on purchases subject to use tax.

Mr. Stephen C. Newmark testified on behalf of his client, Phoenix Country Day School. Mr. Newmark indicated that his analysis of private schools also reflected that private schools were not paying use tax on purchases to which it is applicable. Although Mr. Newmark stated his client had requested a much narrower class consisting of only nonprofit schools, he testified that he had no objection to the proposed class. He said that he agreed with the department that the private schools need educating on use tax, and he thanked the department for doing the research necessary to make a determination concerning the extent of the misunderstanding or misapplication of the tax law.

There was no further testimony. However, at the request of a private school, its letter was read into the record as part of the testimony.

RULING:

The hearing officer found that certain private schools may have understated their Arizona use tax liability by failing to report or pay use tax on certain purchases through an extensive misunderstanding or misapplication of the tax laws and that the class of affected taxpayers is all non-state supported, pre-kindergarten through grade 12 private schools, both for profit and nonprofit.

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 tax, penalties and interest otherwise due will be waived in accordance with A.R.S. §42-139.06 for tax periods beginning on and after January 1, 1994, subject to the applicable statute of limitations, through tax periods ended December 31, 1997. Private schools who correctly reported and paid use tax on taxable purchases 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 their proper reporting and payment of use tax. Taxpayers entering into the closing agreements must in the future properly account for and pay any use taxes due. Private schools who want to avail themselves of this Ruling must enter into closing agreements within sixty (60) days of receiving notice of this Ruling.

The department will provide private schools with a copy of the department's use tax brochure and notify the private schools of the seminars on use tax, which have been scheduled by the department for January and February, 1998. To request additional information concerning closing agreements, please contact Joyce Kinhead, Department of Revenue, 1600 West Monroe, by telephone at (602) 542-4542, Ext. 7506 or by facsimile at (602) 542-3258.

Mark W. Killian, Director
Signed , 1997

In accordance with A.R.S. §42-139.06(C), the above ruling is hereby approved this day of , 1997.

Grant Woods
Attorney General
By: _