BEFORE THE STATE BOARD OF TAX APPEALS STATE OF ARIZONA 100 North 15<sup>th</sup> Avenue - Suite 140 Phoenix, Arizona 85007 602.364.1102

VICTOR E. and MARY E. LOWMAN,

Appellants,

Vs.

ARIZONA DEPARTMENT OF REVENUE,

Appellee.

Appellee.

Docket No. 1906-03-TP

NOTICE OF DECISION:
FINDINGS OF FACT AND
CONCLUSIONS OF LAW

)

The State Board of Tax Appeals, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

## **FINDINGS OF FACT**

In 1953, the Arizona Legislature created the Arizona Retirement System ("the System") to provide retirement benefits for state employees. Participants in the System subsequently voted the Arizona State Retirement Plan ("the Plan") into effect in 1971. Each retirement plan contained language promising exemption from state taxation for the annuities, benefits, and pensions provided under the plan. Legislation was enacted in 1978 that exempted the annuities, benefits and pensions of State employees under the Arizona income tax statutes. No similar statutory exemption was afforded federal employees.

In 1989, the United States Supreme Court decided *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), holding that an income tax exemption granted to a state's own retirees, but not extended to federal retirees, violates the intergovernmental immunity doctrine, which prohibits discrimination against federal employees because of the source of their income or compensation. 4 U.S.C. § 111. That same year, Arizona amended its income tax statutes to comply with the *Davis* ruling. Laws 1989, Chapter 312. Under the amended statute, State retirement benefits received after December 31, 1988 are subject to

Notice of Decision Docket No. 1906-03-TP

4 5

income tax pursuant to Title 43. The Legislature did further amend Title 43 to allow a subtraction from Arizona gross income for State or federal retirement benefits up to \$2,500.1

Victor E. Lowman became an Arizona State employee prior to 1989. He was a public employee in Arizona for approximately 30 years prior to his retirement in 1983. For tax years 1997 through 2000, Victor E. and Mary E. Lowman ("Appellants") filed Arizona individual income tax returns and paid taxes on retirement income received by Victor E. Lowman under the Arizona State Retirement Plan.

Appellants subsequently filed amended State returns for tax years 1997 through 2000<sup>2</sup> claiming a refund for tax paid on the retirement income. Appellants also filed a "Class Income Tax Refund Claim" with the Arizona Department of Revenue (the "Department") purporting to represent a class of individuals who were employees of the State of Arizona, before the 1989 amendment of the income tax statutes, who either before or after that date retired or will receive retirement benefits from the State of Arizona (the "Class"). Additionally, Appellants filed a class action in Superior Court against the State for breach of contract, unjust enrichment, takings without just compensation and promissory estoppel.

The Department denied Appellants' claims for refund of income taxes, as well as their request for class representation. After unsuccessfully, protesting the decision before the Department, Appellants now timely appeal to this Board. They are seeking certification of the Class and refund for tax Appellants paid on their 1997 through 2000 retirement benefits.

## DISCUSSION

The issues before the Board are 1) whether the Board may certify the Class; and, 2) whether Appellants are entitled to the refund requested.

Few principles of law are as well established as the proposition that administrative agencies, as entities created by the legislature, have only such powers as are expressly granted to them by the

<sup>&</sup>lt;sup>1</sup> The subtraction is codified at A.R.S. § 43-1022.

<sup>&</sup>lt;sup>2</sup> Appellants actually claimed refunds for tax years 2001 and 2002 as well as 1997 through 2000. However, Appellants filed their refund claims in November 2001. A refund claim must identify the amount of the refund requested and the specific tax period involved. A.R.S. § 42-1118(E). Appellants' refund claims cannot include claims for unknown amounts on tax that had not yet been paid.

Notice of Decision Docket No. 1906-03-TP

legislature, or as may be necessarily implied from the applicable statues. *Boyce v. City of Scottsdale*, 157 Ariz. 265, 756 P.2d 935 (App. 1988). They are part of the executive branch of government, not the judicial branch. In determining the nature and scope of an agency's powers, its enabling statutes are to be strictly construed to preclude the exercise of power not expressly granted. Any reasonable doubt as to the existence of an implied power should be resolved against the agency. In considering the taxpayer's appeals from the Department's denial of class certification to them, this Board must therefore consider both the powers delegated to the Department, whose actions the Board reviews, and to the Board itself. This Board finds nothing in the statutes authorizing class actions in tax refund matters. The Board finds authority for class actions only in Arizona's Rules of Court. These rules dealing with class actions are by their own terms only applicable to the judicial branch of government and not to executive agencies.

Nor, in the Board's opinion, can the statute authorizing the Board to establish its own "rules of practice and procedure" be reasonably construed to empower this Board to permit an individual taxpayer, in an appeal from an adverse ruling of the Department on his or her individual refund claim, to undertake to represent a class of thousands of other taxpayers in the appeal proceedings. For the Board to so take unto itself such a power would be contrary to the plainly worded and mandatory statutes prescribing refund procedures before both the Department and the Board itself. It would permit the addition of thousands of parties and claims never processed before the Department as required by the statute. The Board does not see its statutory powers as broad enough to add so greatly to its own jurisdiction – much less to negate statutes and rules governing procedures before another agency. In the interests of justice, a court may find it equitable to take such a step, but this Board is not a court and does not have equitable powers.

Undoubtedly, a class-action procedure before the Department and the Board – at least in extraordinary cases such as this one – would, as Appellants argue, greatly benefit the taxpayers in the Class by relieving them from making individual applications for refunds in the event the Board were to decide for the Appellants on the substantive issue here involved. Because this Board cannot expand the Department or the Board's authority beyond that granted by the Legislature, any such relief will have to come from that body or from the courts.

Apart from the certification argument, Appellants contend that Arizona made a contractual promise that, as part of their state employment compensation, their benefits would not be subject to Arizona income taxation. Because the promise of a tax-free pension was a part of their employment contract, Appellants argue that the State cannot now impose a tax on that income.<sup>3</sup>

The "power of taxation shall never be surrendered, suspended or contracted away." Ariz. Const. art. 9, § 1. Therefore, the pre-1989 statutes cannot be construed as granting permanent tax immunity to State retirees hired before 1989. Although section 12 of article 9 of the Arizona Constitution allows the State to create tax exemptions, section 1 of article 9 prevents the State from making such exemptions permanent, and the Legislature is free to amend or repeal tax exemptions.

The language of the statutes is clear. Laws 1989, Chapter 312 amended the retirement statutes found in Title 38 to eliminate the tax exemption for State retirement benefits, specifically providing that benefits, annuities and pensions received after December 31, 1988 shall be subject to tax pursuant to Title 43.

In any event, Appellants are, in effect, arguing that Arizona breached their employment contract.

A breach of contract action belongs in Superior Court, not at this Board, which adjudicates tax matters.

Appellants have, in fact, filed an action in Superior Court based on several legal theories under contract law, and any remedy that may be available to them must come from that court.

## **CONCLUSIONS OF LAW**

- 1. The Board may not certify the Class. See A.R.S. §§ 42-1252 and 1253; Boyce v. City of Scottsdale, 157 Ariz. 265, 756 P.2d 935 (App. 1988).
- Appellants are not entitled under Arizona income tax statutes to a refund for tax paid on their State retirement pension for tax years 1997 through 2000. See Laws 1989, Chapter 312.

<sup>&</sup>lt;sup>3</sup> Appellants maintain that the Department may only impose income tax on the retirement benefits of State employees beginning employment after the 1989 statutory amendment.

Notice of Decision Docket No. 1906-03-TP

2

3

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

**ORDER** 

THEREFORE, IT IS HEREBY ORDERED that the appeal is denied, and the final order of the Department is affirmed.

This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer, unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this 16th day of December , 2003.

STATE BOARD OF TAX APPEALS

Juli .

William L.Raby, Chairman

WLR:alw

## **CERTIFIED**

Copies of the foregoing Mailed or delivered to:

Brian A. Luscher, Randall D. Wilkins Bonn & Wilkins, Chartered 805 North Second Street Phoenix, Arizona 85007

Lisa A. Neuville Assistant Attorney General Civil Division, Tax Section 1275 West Washington Street Phoenix, Arizona 85007

20

21

22

2324

25