

1 exchange of information agreement with the Internal Revenue Service, the Arizona Department of
2 Revenue ("Department") audited Appellants' 2000 Arizona resident income tax return and determined that
3 Appellants had improperly claimed a deduction of \$49,300. Appellants had reached this figure by
4 subtracting the \$54,477 actual gain on the sale of the Arizona property (i.e., the \$178,500 sale price less
5 the \$124,023 purchase price) from the \$103,777 gain reported on their federal return. Appellants argue
6 that \$49,300 is not subject to Arizona tax because this gain resulted from the sale of the Washington
7 property sold in 1994 when they were residents of Washington and not Arizona.

8 Subsequently, the Department issued a proposed assessment of additional tax, a late payment
9 penalty, and interest for tax year 2000. Appellants protested the assessment to the Department's
10 Hearing Officer, who upheld the assessment. Appellants then protested to the Director of the
11 Department, who affirmed the Hearing Officer's decision. Appellants now timely appeal to this Board.

12 DISCUSSION

13 The issue before the Board is whether the Department properly disallowed the \$49,300 deduction
14 claimed by Appellants.

15 A.R.S. § 43-102(A)(4) states that it is the "[i]ntent of the legislature . . . to impose on each resident
16 of this state a tax measured by taxable income wherever derived." Appellants were residents of Arizona
17 during 2000; therefore, all of their income wherever derived was subject to Arizona tax, including the
18 \$49,300 amount. It is further the intent of the legislature, under A.R.S. 43-102(A)(1), to adopt the
19 provisions of the IRC relating to the measurement of adjusted gross income for individuals so that
20 adjusted gross income reported to the Internal Revenue Service shall be *the identical sum reported to*
21 *Arizona*, subject only to modifications set forth in Title 43 of the Arizona Revised Statutes. Therefore,
22 Appellants were required to report on their 2000 Arizona return the full \$103,777 gain reported on their
23 2000 federal return.

1 Appellants chose to structure their 1994 transaction to avoid recognition of gain at the time they
2 sold the property in Washington. Consequently, their basis in the Arizona property was \$49,300 less than
3 it would have been had they recognized the gain on the 1994 exchange. As a result, the deferred gain
4 must be recognized upon the subsequent sale at both the federal and state levels. The U.S. Supreme
5 Court declared: "[W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once
6 having done so, he must accept the tax consequences of his choice, whether contemplated or not." *C.I.R.*
7 *v. National Alfalfa Dehydrating & Mining Co.*, 417 U.S. 134, 149 (1979) citing *Higgins v. Smith*, 308 U.S.
8 473, 477 (1940).

9 Appellants additionally argue that they were entitled to deduct the \$49,300 because they paid an
10 excise transfer tax in Washington on the exchange of their Washington property in 1994. While Arizona
11 does provide a "credit against the taxes imposed by this chapter for net income taxes imposed by and
12 paid to another state or country on income taxable under this chapter," Appellants did not pay any "net
13 income taxes" in Washington on the 1994 exchange of their property. See A.R.S. 43-1071(A). The
14 Washington excise transfer tax was based on a percentage of the selling price (without regard to basis or
15 gain) of the property transferred. Washington Revised Code § 82.45.60. It was not a tax on "net income"
16 as required by A.R.S. § 43-1071. See, generally, *Ariz. Dep't of Rev. v. Short*, 192 Ariz. 322, 965 P.2d 56
17 (App. 1998). Also, the excise transfer tax was paid in 1994 not 2000.

18 The right to a deduction does not exist in the absence of statutory authority. See *Ariz. Dep't of*
19 *Rev. v. Transamerica Title Ins. Co.*, 124 Ariz. 417, 604 P.2d 1128 (1979). There is no Arizona law that
20 allows Appellants to take the \$49,300 deduction at issue. Further, under A.R.S. 42-1125(D), the late
21 payment penalty may be abated only if the failure to timely pay is due to reasonable cause and not due to
22 willful neglect. Appellant have not shown that their failure to timely pay was due to reasonable cause.
23 Finally, A.R.S. 42-1123(C) provides that if the tax "or any portion of the tax is not paid" when due "the
24 department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid.

1 For Arizona purposes, therefore, interest is a part of the tax and generally may not be abated unless the
2 tax to which it relates is found not to be due for whatever reason. The tax is due in this case and the
3 associated interest cannot be abated.

4 CONCLUSIONS OF LAW

5 1. The Department properly disallowed the \$49,300 deduction claimed by Appellants. A.R.S. §
6 43-102(A); see *Ariz. Dep't of Rev. v. Transamerica Title Ins. Co.*, 124 Ariz. 417, 604 P.2d 1128, (1979).

7 2. Appellants have not shown that their failure to timely pay was due to reasonable cause;
8 therefore, they are liable for the penalty assessed. A.R.S. 42-1125(D).

9 3. The interest assessed may not be abated. A.R.S. 42-1123(C).

10 ORDER

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

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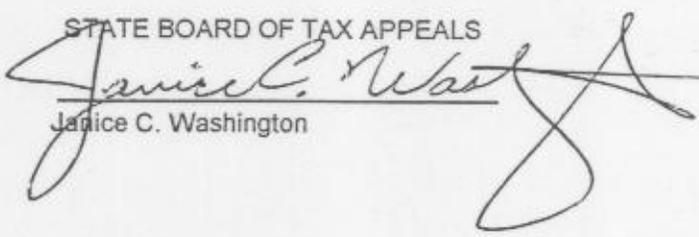
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1 This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer,
2 unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

3 DATED this 1st day of May, 2007.

4 STATE BOARD OF TAX APPEALS
5 
6 Janice C. Washington

7 JCW:ALW

8 CERTIFIED

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