

1 Under A.R.S. § 43-1071, Arizona residents may claim a credit for net income tax imposed by and
2 paid to another state. The underlying income that the tax is based upon must be derived from sources
3 within that state and must be taxable irrespective of the resident of the recipient. *Id.* Further, the credit
4 "shall not exceed such proportion of the tax payable under this chapter as the income subject to tax in the
5 other state . . . and also taxable under this title bears to the taxpayer's entire income upon which the tax is
6 imposed by this chapter." *Id.*(A)(3).

7 During the tax year 1995, A.A.C. R15-2-1071 defined "income subject to tax" as Arizona adjusted
8 gross income calculated pursuant to A.R.S. § 43-1071(A)(3) by adding all exemptions back. See A.A.C.
9 R15-2-1071. The resulting figure was the denominator used to calculate the credit. Income taxable by
10 Arizona and also subject to tax in New York was the numerator in the calculation. The percentage
11 resulting from the division of the numerator by the denominator was multiplied by the Arizona tax liability
12 to determine the credit allowed for taxes paid to New York. The instructions for the 1995 tax year
13 explained this method of calculating the credit.

14 Appellants argue that the requirements of A.A.C. R15-2-1071 exceed the scope of the
15 Department's authority and that the proper denominator in calculating the credit at issue is Arizona gross
16 income *minus* exemptions and deductions. This method of calculation results in a larger credit.

17 The Department's regulations are presumed valid unless they are unreasonable or are in conflict
18 with the law. The Board finds A.A.C. R15-2-1071 to be neither. The regulation applies a gross income
19 concept to both the numerator and the denominator of the tax credit fraction. This is reasonable and in
20 accord with the apparent objective of the statute. Appellants would apply a gross income concept to the
21 New York income numerator of the credit fraction but a net income concept to the denominator by
22 reducing total gross income in the denominator by exemptions and deductions. The Board finds that this
23 approach is not in accord with the statute. Accordingly, Appellants are liable for the tax assessed.

24 The penalty imposed may not be abated because Appellants have not shown that their failure to
25 pay the tax was due to reasonable cause and not willful neglect. A.R.S. § 42-1125(D) (formerly A.R.S.
§ 42-136). Finally, the interest at issue is made a part of the tax by statute and represents a reasonable
interest rate on the tax due, therefore, it may not be abated. A.R.S. § 42-1123 (formerly A.R.S. § 42-
134); *Biles v. Robey*, 43 Ariz. 276, 286, 30 P.2d 841 (1934).

CONCLUSIONS OF LAW

1
2 1. Appellants are liable for the tax assessed. A.R.S. § 43-1071; A.A.C. R15-2-1071(A).

3 2. Appellants have not shown that their failure to pay the tax at issue was due to reasonable
4 cause and not willful neglect; therefore, the penalty imposed may not be abated. A.R.S. § 42-1125(D).

5 3. Because the interest at issue is made a part of the tax by statute and represents a reasonable
6 interest rate on the tax due, it may not be abated. A.R.S. § 42-1123; *Biles v. Robey*, 43 Ariz. 276, 286, 30
7 P.2d 841 (1934).

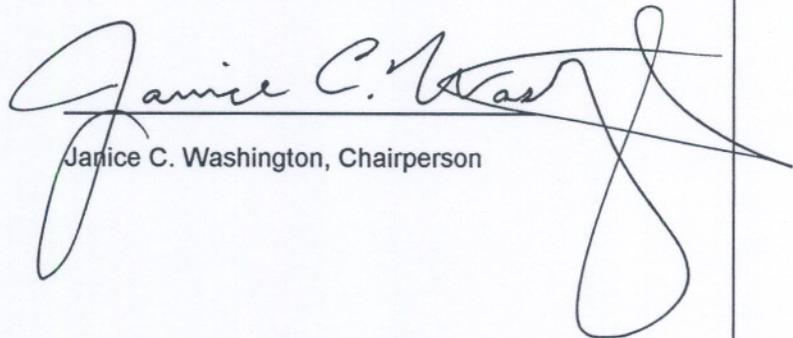
ORDER

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

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

12 DATED this 17th day of May, 2001.

13
14 STATE BOARD OF TAX APPEALS

15
16 
17 Janice C. Washington, Chairperson

18 JCW:ALW

CERTIFIED

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