

BEFORE THE STATE BOARD OF TAX APPEALS
STATE OF ARIZONA
Bank of America Tower
101 North First Avenue - Suite 2340
Phoenix, Arizona 85003
(602) 528-3966

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5 JOEL J. and ANN MARIE KOCHER,)
6 Appellants,) Docket No. 1827-00-I
7 vs.)
8 ARIZONA DEPARTMENT OF REVENUE,) NOTICE OF DECISION:
9 Appellee.) FINDINGS OF FACT AND
) CONCLUSIONS OF LAW

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

12 FINDINGS OF FACT

13 Joel J. Kocher ("Appellant," with the plural referring to Joel J. and Ann Marie Kocher) was
14 granted non-qualified stock options to purchase stock from Dell Computer Corp. ("Dell") as a benefit of
15 his employment with Dell. Appellant was a resident of Texas when he was granted the stock options.
16 Appellant terminated his employment with Dell in 1994. Due to restrictions imposed within the option
17 agreement, Appellant could not exercise the stock options at issue until 1995. The stock options
18 exercised in 1995 by Appellant were reported by Dell as compensation on Appellant's 1995 W-2, which
19 reflected Texas as the state in which the compensation was earned.

20 Appellants were married December 1, 1994. Appellant filed a married filing separate, individual
21 federal return and a part-year married filing separate Arizona income tax return for tax year 1994.
22 Appellants filed married filing jointly federal and Arizona resident income tax returns for tax year 1995.
23 Appellants reported compensation income in 1995 as a result of the exercise of the stock options on their
24 federal return but subtracted it on their State return. A comprehensive, three-page disclosure explaining
25 the reason for the subtraction was attached to the Arizona return. The Arizona Department of Revenue
26 (the "Department") subsequently issued a refund as claimed on the return. Appellants did not receive the
27 initial refund check and the Department issued another one for the full amount of the refund.

1 In 1999, pursuant to an exchange of information agreement with the Internal Revenue Service,
2 the Department learned that adjustments were made to Appellants' 1995 federal return. The Department
3 reviewed Appellants' 1995 Arizona return, resulting in the disallowance of the subtraction at issue.
4 Thereafter, the Department issued a proposed assessment of additional income tax, including interest
5 and penalties, against Appellants. Appellants timely protested the assessment to the Department. The
6 Department's Hearing Officer upheld the assessment but waived the penalties associated with the
7 subtraction. Appellants now timely appeal to this Board.

8 DISCUSSION

9 The issue before the Board is whether Appellants are liable for the additional tax and interest
10 assessed. The burden of proof is on Appellants as to all issues of fact. R16-3-118.

11 It is the intent of the Arizona Legislature "[t]o impose on each resident of this state a tax
12 measured by taxable income wherever derived." A.R.S. § 43-102(A)(1). Absent a specifically
13 enumerated statutory adjustment, the amount of income reported to Arizona must be identical to the
14 amount of adjusted gross income reported to the Internal Revenue Service. A.R.S. § 43-102(A)(4).

15 Evidence submitted to the Board, including Appellants' joint full-year Arizona resident return for
16 tax year 1995, confirms that Appellants were Arizona residents in 1995. Appellants concede that the
17 proceeds from the exercise of the stock options at issue were received in 1995. They argue, however,
18 that the proceeds were "earned" or "accrued" while Appellant was a resident of Texas. Relying on
19 *Marchlen v. Township of Mt. Lebanon, et al.*, No. 67 W.D. Pennsylvania Supreme Court (Feb. 22, 2000),
20 Appellants claim that the stock option proceeds are not included in Arizona income under A.R.S. § 43-
21 1097(B):

22 B. During the tax year in which a taxpayer changes from a nonresident
23 to a resident, Arizona taxable income shall include all of the
24 following:

- 25 1. All income and deductions realized or recognized, or both, depending
26 on the taxpayer's method of accounting, during the period the
27 individual was a resident, **except any income accrued by a cash
28 basis taxpayer prior to the time the taxpayer became a resident
of this state.**

2. All income and deductions earned in Arizona or derived from Arizona sources prior to the time the taxpayer became a resident of this State.

(Emphasis added.)

Marchlen is a Pennsylvania case in which the court considered whether stock option compensation was "earned" income taxable by a political subdivision of the state or investment income. The case does not address the issue before the Board. In any event, the time of accrual of the stock option compensation is only pertinent under A.R.S. § 43-1097(B) in the year a taxpayer changes from a nonresident to a resident. Appellant became a resident of Arizona in November, 1994 as evidenced by the Arizona part-year resident income tax return filed for that year. The stock option proceeds at issue were received in 1995 when Appellants filed a joint full-year Arizona resident return. Therefore, A.R.S. § 43-1097(B) is inapplicable. There is no provision under Arizona law allowing Appellants to subtract the stock option compensation; accordingly, the Department properly disallowed the subtraction, and Appellants are liable for the tax assessed. A.R.S. § 43-102(A)(1).

A.R.S. § 42-134(B) provides that when tax, or any portion thereof, "is not paid on or before the date prescribed for its payment the Department shall collect, as a part of the tax, interest on the unpaid amount . . . until it is paid." The additional tax assessed by the Department due to the disallowance of the subtraction at issue relates to tax year 1995 and was due, but not paid, for that year. Accordingly, Appellants are liable for the interest imposed.

CONCLUSIONS OF LAW

1. Appellants are liable for the tax assessed. A.R.S. §§ 43-102(A)(1) and (4).
2. Appellants are liable for the interest assessed. A.R.S. § 42-134(B).

ORDER

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

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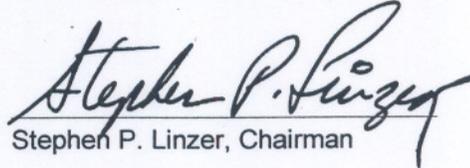
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This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer, unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this 28th day of November, 2000.

STATE BOARD OF TAX APPEALS


Stephen P. Linzer, Chairman

SPL:ALW
CERTIFIED

Copies of the foregoing
mailed or delivered to:

Gerald G. Hawley, Esq.
P.O. Box 31657
Tucson, Arizona 85751-1657

Christine Cassetta
Assistant Attorney General
Civil Division, Tax Section
1275 West Washington Street
Phoenix, Arizona 85007