BEFORE THE STATE BOARD OF TAX APPEALS
STATE OF ARIZONA
100 North 15th Avenue - Suite 140
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CHARLES RICHARDSON, JR. (deceased) and GAYE RICHARDSON, Appellants, vs. ARIZONA DEPARTMENT OF REVENUE, Appellee.	Docket No. 1949-06-I 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 follow:

FINDINGS OF FACT

Charles, Jr. and Gaye Richardson ("Appellants," with the singular referring to Gaye Richardson) filed an Arizona individual income tax return for tax year 1999. Thereafter, Appellant filed returns for tax years 2000, 2001 and 2003. On each of these returns, Appellants included as taxable income interest they earned on non-Arizona municipal obligations. Appellant subsequently filed amended returns for tax years 1999, 2000 and 2001 subtracting from taxable income this interest and claiming refunds of tax paid on the interest income. Appellant purported to have filed the amended returns on behalf of herself and similarly-situated Arizona taxpayers who paid or will pay Arizona income tax pursuant to A.R.S. § 43-1021(3)[1] on earnings from obligations of states other than Arizona or their political subdivisions or quasi-governmental entities from October 22, 1999 through the date of the claims' final adjudication.[2]

[1] Appellant further purported to file on behalf of corporations and estates that were subject to the tax at issue under A.R.S. § 43-1121(1) and § 43-1331(1). However, these statutes are not at issue before the Board because this case does not involve any corporation or estate involved in the case before the Board.

[2] Appellant filed new amended returns for tax years 1999, 2000 and 2001 to correct a typographical error. Again, Appellant contends that the corrected returns were filed on behalf of herself and other similarly-situated taxpayers.

The Arizona Department of Revenue ("Department") issued the refunds to Appellant. However, the Department contends that it did not receive a Representative Claim Form with the amended returns; therefore, no hearing was held or decision issued regarding the Representative Claim. Appellant ultimately filed a Class Action Complaint for Declaratory Judgment, Injunction, and Tax Refunds in the Arizona Tax Court.

Thereafter, the Department concluded that it had erroneously issued refunds to Appellant. Appellant returned the refunds in full with all interest owing. In August 2005, Appellant filed an amended return and a Representative Claim Form with the Department for tax year 2003 claiming refunds on behalf of herself and all similarly-situated taxpayers for the period beginning August 25, 2001 through the claims' final adjudication.

In November 2005, the Department and Appellant entered a Stipulation of Voluntary Dismissal in the Arizona Tax Court. Pursuant to the Stipulation: (1) the Department would consolidate Appellant's claim for refunds for tax year 1999, 2000, and 2001 with her refund claim for 2003; (2) Appellant would be allowed to argue before the Department that her claims were submitted as Representative Claims; (3) the Department would be allowed to dispute this fact; and, (4) Appellant would dismiss her Complaint. Appellant did dismiss her Complaint, and on January 4, 2006, the Department denied the claims for refunds for tax years 1999, 2000, 2001, and 2003. Appellant protested the decision to the Department's hearing officer who denied the protest. Appellant now timely appeals to this Board.

DISCUSSION

The issue before the Board is whether the Department properly denied Appellants' refund claims. Appellant argues that the Arizona law that includes out-of-state municipal bond interest, but excludes Arizona municipal bond interest from taxable income is facially discriminatory and violates the Commerce Clause of the United Stated Constitution, the Equal Protection Clauses of the United States and Arizona Constitutions, and the Uniformity Clause of the Arizona Constitution.

1 The Board can apply constitutional doctrines to resolve claims, but it does not have the authority
2 to declare a statute unconstitutional. *Bohn v. Waddell*, 174 Ariz. 239, 848 P.2d 325 (App. 1992) *rev.*
3 *denied*. Having noted this, the Board finds that the law at issue has been applied in a constitutional
4 manner.

5 Arizona imposes income taxes upon the "entire taxable income of every resident of this state and
6 upon the entire taxable income of every nonresident which is derived from sources within this state."
7 A.R.S. § 43-1011. A.R.S. defines "taxable income" as Arizona adjusted gross income less certain
8 allowable exemptions and deductions. Arizona adjusted gross income is "the individual's Arizona gross
9 income subject to [certain specifically enumerated] modifications." A.R.S. § 43-1001(1). Among the
10 additions to Arizona adjusted gross income is the inclusion of "[t]he amount of interest income received
11 on obligations of any state, territory or possession of the United States, or any political subdivision
12 thereof, located outside of the state of Arizona . . . ." This income is not included in federal gross income
13 by virtue of section 103 of the Internal Revenue Code ("IRC"), which provides that federal "gross income
14 does not include interest on any state or local bond." IRC § 103(c)(1).

15 Appellant relies on a recent Kentucky case to support her argument that Arizona's tax scheme is
16 unconstitutional. *See, Davis v. Commonwealth of Kentucky*, 197 S.W. 3d 557 (Ky. App. 2006). However,
17 the Board is neither bound by nor persuaded by this case from an outside jurisdiction.

18 In that case, the Kentucky Court of Appeals did hold that a similar taxation scheme was in
19 violation of the Commerce Clause. The flaw in *Davis* is that the Commerce Clause was enacted to
20 prevent preferential treatment by the government of in-state *business* entities. As the United States
21 Supreme Court stated in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995):

22 We have understood this construction to serve the Commerce Clause's purpose of preventing a State from retreating into economic isolation or jeopardizing the welfare of
23 the Nation as a whole, as it would do if it were free to place *burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.*

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514 U.S. at 177 (emphasis added). Municipal and other issuers of the bonds at issue are not business entities conducting activities of commerce. They are governmental entities. The Kentucky Court of Appeals never recovered from this flaw in their analysis. This is likely why the U.S. Supreme Court granted review of the case on May 21, 2007. In any event, the Board is not bound by a Kentucky decision and due to its foundational flaws, the Board chooses not to follow it. Appellant's arguments as to the Commerce Clause are rejected by the Board.

Next the Appellant contends that the Arizona taxation scheme violates the Equal Protection Clause of the United States and Arizona Constitutions. If a tribunal can determine that there is some rational basis for the tax treatment at issue, it will not violate the Equal Protection Clause of either Constitution. *Nordlinger v. Hahn*, 505 U.S. 1(1992). Here the interest of the state in making the cost of borrowing money for the issuers of municipal obligations as low as possible is a strong basis for the tax treatment. Appellant's argument as to the Equal Protection Clause is without merit.

Finally, Appellant argues that the tax structure violates the Uniformity Clause of the Arizona Constitution. Article IX Section 1 of the Arizona Constitution provides that:

> Except as provided by § 18 of this article, all taxes shall be uniform upon the same class of property within the territorial limits of the authority levying the tax, and shall be levied and collected for public purposes only.

Under the clear wording, the uniformity provision applies to taxes levied on property. The tax at issue here is the income tax. The Arizona Supreme Court has also held that the uniformity provision only applies to ad valorem property taxes and not to forms of excise taxation. *Tilton v. Board of Supervisors*, 55 Ariz. 503, 103 P.2d 960 (1940). The income tax is an excise tax. Appellant's argument regarding the Uniformity Clause is completely without merit. For the foregoing reasons, the Board finds that the Department properly denied Appellants' refund claims.

Finally, Appellant relies on *Arizona Dep't of Rev. v. Dougherty*, 200 Ariz. 515, 29 P.3d 862 (2001) to contend that her claim constitutes a Representative Claim on behalf of other similarly-situated

taxpayers. In *Dougherty*, the Arizona Supreme Court held that, in light of applicable statutes and regulations in that case, Arizona law permits class action lawsuits in *Tax Court*. However, there are no statutory provisions or administrative rules that authorize administrative class refund claims or class actions. Administrative agencies derive their powers from their enabling legislation, and their authority can not exceed that granted by the legislature. *Pima County v. Pima County Law Enforcement Merit System Council*, 211 Ariz. 24, 119 P.3d 27 (2005). The Board has no authority to recognize an administrative class refund claim or class action.

CONCLUSIONS OF LAW

1. The Arizona income tax upon the income from non-Arizona municipal interest does not violate the Commerce Clause, Equal Protection Clause or Uniformity Clause.

2. The Board has no authority to recognize an administrative class refund claim or class action. *Pima County v. Pima County Law Enforcement Merit System Council*, 211 Ariz. 24, 119 P.3d 27 (2005).

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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 18th day of July, 2007.

STATE BOARD OF TAX APPEALS

Janice C. Washington

JCW:ALW

CERTIFIED

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