

## Arizona's Little-Known Managed Audit Program

by James G. Busby Jr.



James G. Busby Jr.

James G. Busby Jr. is a state and local tax attorney at the Cavanagh Law Firm in Phoenix. He previously worked in the SALT departments at Arthur Andersen and Deloitte & Touche. Before entering private practice in 1999, Busby was the chief auditor in charge of transaction privilege (sales) tax audits at the Arizona Department of Revenue. He can be reached at [JBusby@CavanaghLaw.com](mailto:JBusby@CavanaghLaw.com).

In this article, Busby explains how Arizona taxpayers can resolve tax liabilities without paying penalties or interest under the state's managed audit program, and he analyzes situations that lend themselves to managed audits versus other methods of resolving unsatisfied tax liabilities in Arizona.

Copyright 2015 James G. Busby Jr.  
All rights reserved.

Arizona's managed audit program is now a decade old, but very few taxpayers and tax professionals know anything about it. The program gives Arizona taxpayers that discover they have an unsatisfied tax liability a chance to resolve the liability without paying penalties or interest.

### How to Initiate a Managed Audit

Arizona law permits taxpayers to request a managed audit and gives the Arizona Department of Revenue sole discretion to determine whether to allow the taxpayer to participate in the program.<sup>1</sup> In making its decision, the department may consider all relevant factors, including:

- the taxpayer's history of tax compliance;
- the amount of time and quality of resources the taxpayer can dedicate to the audit;
- the extent and availability of the taxpayer's records; and
- the nature and scope of any legal disputes the taxpayer has with the department and their relevance to the taxpayer's proposal.<sup>2</sup>

<sup>1</sup>Ariz. Rev. Stat. section 42-2302(A).

<sup>2</sup>Ariz. Rev. Stat. section 42-2302(C).

If the department allows the taxpayer to participate in the program, the parties must enter into a written managed audit agreement to document the type of taxes involved, the audit period, any limitations on the scope of the audit, the name of the taxpayer's representative, if any, and the audit plan.<sup>3</sup>

### The Managed Audit Process in Arizona

Once the parties execute a managed audit agreement, the taxpayer and the taxpayer's authorized tax professional perform the audit and furnish the department with their written findings.<sup>4</sup> The department then reviews the findings and may examine records and perform other reviews as necessary to verify the results.<sup>5</sup>

Once the department finishes reviewing the findings of the managed audit, it assesses any tax deficiency or issues any refunds that it considers appropriate, and the taxpayer has the same appeal rights it would have had if the department had conducted the audit.<sup>6</sup>

The department is not allowed to assess penalties along with an assessment under Arizona's managed audit program unless the audit discovered fraud, willful tax evasion, or that the taxpayer collected amounts represented as tax that it did not remit to the department.<sup>7</sup> The same conditions apply to interest, provided that the taxpayer pays the assessment within 45 days of the expiration of its appeal rights.<sup>8</sup> Likewise, if the managed audit results in a refund, the department is not required to pay interest as long as it pays the refund within 45 days of the expiration of the taxpayer's appeal rights.<sup>9</sup>

### Pros and Cons of Managed Audits in Arizona

While the Arizona Legislature periodically establishes amnesty programs that last for a couple of months, the department always entertains offers to enter into managed audit agreements. Like voluntary disclosure agreements

<sup>3</sup>Ariz. Rev. Stat. section 42-2302(A).

<sup>4</sup>Ariz. Rev. Stat. section 42-2303(A).

<sup>5</sup>Ariz. Rev. Stat. section 42-2303(B).

<sup>6</sup>Ariz. Rev. Stat. section 42-2303(C) and (D).

<sup>7</sup>Ariz. Rev. Stat. section 42-2304(A).

<sup>8</sup>Ariz. Rev. Stat. section 42-2304(B).

<sup>9</sup>Ariz. Rev. Stat. section 42-2304(C).

(VDAs), managed audits are a good alternative for taxpayers that missed out on an amnesty opportunity.

For taxpayers that can choose among amnesty, a managed audit, or a VDA, there are several things to consider. Taxpayers participating in an amnesty program may be required to submit numerous original or amended tax returns. They may want to negotiate a discount on the tax that otherwise would be due, given the risks and perils of litigation relating to a gray issue. These taxpayers may be better off pursuing a managed audit or a VDA.

Managed audits may be preferable to VDAs for taxpayers that would owe a lot of interest under Arizona's VDA program because interest generally is not abated as part of a VDA. But Arizona's VDA program may work out better than its managed audit program for taxpayers that have outstanding tax liabilities for more than four years, which are not protected by Arizona's standard four-year statute of limitations. And, of course, managed audits only work if the taxpayer is willing to do some of the work — or to hire a tax professional to assist with some of the work — that the department's auditor would otherwise perform.

Tax professionals who encounter taxpayers with unsatisfied Arizona tax liabilities should help them evaluate whether Arizona's managed audit program is the best way for them to satisfy their outstanding tax liability. ☆

## IN THE WORKS

A look ahead to planned commentary and analysis.

### **The perfect case for reform** (*State Tax Notes*)

Brian Hamer examines spending programs designed to overwhelmingly benefit wealthy or high-income individuals, including the deduction (a credit in three states) granted by most states for contributions to a college savings plan.

### **Time to question the public benefits of pro sports subsidies** (*State Tax Notes*)

Ronald Fisher and Robert Wassmer discuss the flaws surrounding massive government subsidies for professional sports venues that often produce overly optimistic economic impact estimates.

### **A practitioner's guide to FATCA and NRA withholding statements** (*Tax Notes International*)

Tom Plank offers a user guide to U.S. Treasury regulations requiring foreign partnerships to provide a nonresident alien tax and Foreign Account Tax Compliance Act withholding statement before they may receive U.S.-source fixed or determinable annual or periodical income.

### **The common reporting standard: Impact on U.S. mutual funds and trusts** (*Tax Notes International*)

Denise Hintzke discusses the OECD's common reporting standard, which many countries will begin implementing on January 1, 2016. As the U.S.'s nonparticipation in CRS may cause issues for U.S. financial entities, especially mutual funds and trusts, the article highlights actions that U.S. entities should take to prepare for its implementation.

### **VIX in sticks and VAX in stacks** (*Tax Notes*)

John Kaufmann argues that current law indicates that products based on the Market Volatility Index should be treated as securities, commodities, or other assets that give rise to qualifying income.

### **The road to renunciation: FATCA and the expatriation tax under section 877A** (*Tax Notes*)

To more accurately tax expatriates under the so-called exit tax, Matthew Morris proposes that the IRS should require taxpayers to certify that they have not willfully structured their affairs to fall below the applicable net income threshold and tax only those that cannot do so.