



## How to Resolve Tax Liabilities Without Paying Penalties or Interest Under Arizona's Managed Audit Program

*This month's state and local tax (SALT) column explains how Arizona taxpayers can resolve tax liabilities without paying penalties or interest under the state's managed audit program, and analyzes situations that lend themselves to managed audits versus other methods of resolving unsatisfied tax liabilities in Arizona.*

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 (Department) the sole discretion to determine whether to allow the taxpayer to participate in the program. In making its decision, the Department may consider all relevant factors, including the: (1) taxpayer's history of tax compliance, (2) amount of time and quality of resources the taxpayer can dedicate to the audit, (3) extent and availability of the taxpayer's records, and (4) nature and scope of any legal disputes the taxpayer has with the Department and their relevance to the taxpayer's proposal.

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.

### The Managed Audit Process

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. Then the Department reviews the findings and may examine records and perform other reviews as necessary to verify the findings.

Once the Department finishes reviewing the findings of the managed audit, it assesses any tax deficiency or issues any refund that it considers appropriate, and the taxpayer has the same appeal rights it would have had if the Department had conducted the audit.

The Department is not allowed to assess penalties along with an assessment under Arizona's managed audit program unless the audit uncovered fraud, willful tax evasion, or that the taxpayer collected amounts represented as tax that it did not remit to the Department. The same conditions apply to interest, provided that the taxpayer pays the assessment within 45 days of the expiration of its appeal rights. 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.



**by James G. Busby, Jr., CPA**

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### Pros and Cons of Managed Audits

While the Arizona legislature periodically establishes amnesty programs that last for a couple of months at a time, the Department always entertains offers to enter into managed audit agreements. Like voluntary disclosure agreements (VDAs), managed audits are a good alternative for taxpayers that missed out on an opportunity for amnesty.

For taxpayers that can choose between amnesty, a managed audit, and a VDA, there are several factors to consider. Taxpayers that do not want to submit numerous original or amended tax returns as generally required by Arizona's amnesty programs, or that 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, 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 Arizona's VDA program. 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 otherwise would perform.

**Practice Tip!** – CPAs that 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. ■

### Editor's note:

Thank you to all of you who quickly pointed out a typo in last month's Dash of SALT column. The cap for the credit for donations to public schools remains unchanged at \$200 for an individual and \$400 for a married couple filing jointly. We are sorry for the confusion, but glad to see how many of you are following this column! A corrected version of last month's column is available on the ASCPA website.