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to block the IRS from taxing last year's rebate.


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By Howard Fischer, The Arizona Daily Star, Tucson, Ariz. (TNS)

Calling its actions illegal, Attorney General Kris Mayes is asking a federal magistrate to block the IRS from **taxing the proceeds of last year's family rebate**.

In legal papers filed Wednesday, Mayes points out that the IRS had previously concluded that rebates and payments made by 17 other states to its residents—up to \$750 for eligible families—were not subject to federal income tax.



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wrote Carlton Currett, an assistant attorney general.

“Arizona’s reasonable expectation was therefore that every dime it returned to taxpayers would stay in their pockets, to be spent or otherwise enjoyed as they saw fit,” he said.

“And of course, a portion of the money would then end up back in state coffers via transaction privilege taxes (commonly referred to as sales tax) and other state taxes,” the lawsuit reads. “Instead, the IRS declared that the tax rebate payments were taxable in full by the federal government.”

How quickly Magistrate Deborah Fine can act is unclear, given that the IRS has yet to respond.

What makes that critical is that Arizonans have until April 15 to file their federal tax returns.

The state Department of Revenue, in response to the initial IRS determination that the rebates are taxable, already has issued 1099-MISC forms—not only to rebate recipients but also a copy to the IRS.

That means the federal agency now has records showing how much each person got. And that, in turn, puts Arizona taxpayers in the position of not reporting the rebate—something that could provoke a deficiency letter from the IRS, if not an audit—or reporting the income, paying the tax and then having to file an amended return if Mayes wins the case.

Richie Taylor, spokesman for the AG’s office, said a request will be made for Fine to issue a preliminary injunction before April 15 barring the IRS from collecting the tax or penalizing Arizonans who do not include the rebate on their federal income tax.

And what if that doesn’t happen?

Taylor said his office can't provide tax guidance to individual Arizonans.

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million for 750,000 Arizona families.

“When Arizona’s elected leaders chose to refund tax revenue to Arizona taxpayers last year, their reasonable expectation was therefore that the money would go to Arizona taxpayers, not to the Internal Revenue Service,” the lawsuit states. “But the IRS had a different idea.”

Central to the legal issue could be how the court sees the payments.

The state’s position is that it was paid out of the general fund to qualifying Arizonans. And, more importantly, the state argues it was not paid as “compensation for services,” something that would be taxable.

It notes that the legislation itself specifically cited inflation being at a 40-year high, “putting gas, groceries and other necessities out of reach for many Arizonans.” And the law said the rebate was possible because of “responsible budgeting” that allowed the state to return a portion of the surplus that existed at the time.

There’s a lot of money at stake.

According to the lawsuit, allowing the IRS to tax the rebates would cost affected Arizonans an estimated \$20.8 million.

How much individual Arizonans would owe if the IRS does not back off depends on how much they earn.

There are seven federal tax brackets, ranging from 10% for individuals with a federally adjusted gross income of up to \$11,000—double that for married couples filing jointly—to 37% for those making \$578,126 or more.

So, everything else being equal, someone getting a \$500 rebate who is in the 22% bracket—from \$44,726 to \$95,375 for individuals—would be required to give back

\$110 to Uncle Sam.

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