

8. The amendment to A.R.S. § 43-1021 enacted by House Bill 2156 was retroactive to taxable years ending from and after December 31, 2008. House Bill 2156, § 9.
9. The Department issued a news release on May 28, 2010 regarding the non-conformance in House Bill 2156 and the information was also placed on the Department's website.
10. The information stated that if a taxpayer filed an Arizona income tax return that had excluded unemployment compensation pursuant to IRC Section 85(c), the taxpayer was required to file an amended Arizona return to add the excluded amount back into Arizona gross income.
11. The Arizona income tax instructions for tax year 2010 included a "Special Notice for 2009 Returns" that the Arizona legislature had not conformed to all federal changes for 2009 and listed the items that might affect a taxpayer's 2009 return. The first item listed was the federal unemployment compensation exclusion.
12. The Notice also stated that taxpayers could use form 140X-NC to correct their 2009 return.
13. The Notice provided that if the additional tax due were paid in full by October 17, 2011, no penalty or interest would be charged on that tax.
14. Taxpayers did not file an amended Arizona return to add back the excluded unemployment compensation or pay any additional tax.
15. The Section issued a proposed assessment dated [REDACTED] for tax year 2009 that added back into Taxpayers' Arizona income the \$4,800 unemployment compensation they had excluded.
16. The proposed assessment included interest but no penalties.
17. Taxpayers timely protested the assessment and paid the assessment under protest.
18. Taxpayers contend their return was correct at the time they filed it and no additional taxes should be due.

CONCLUSIONS OF LAW

1. The presumption is that an assessment of additional income tax is correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948).
2. Arizona gross income is defined as an individual's federal adjusted gross income computed pursuant to the Internal Revenue Code. A.R.S. § 43-1001(2).
3. Arizona adjusted gross income is defined as the individual's Arizona gross income subject to modifications specified in A.R.S. §§ 43-1021 and 43-1022.
4. The intent of the Arizona legislature was to adopt the provisions of the federal Internal Revenue Code relating to the measurement of adjusted gross income for individuals so that federal adjusted gross income reported to the Internal Revenue Service shall be the identical sum reported to Arizona, subject to modifications set forth in Title 43 of the Arizona Revised Statutes. A.R.S. § 43-102(A)(1).
5. A.R.S. § 43-1021, Paragraph 32 enacted by House Bill 2156 modified federal adjusted gross income by adding back any unemployment compensation that a taxpayer excluded from federal adjusted gross income pursuant to IRC section 85(c).
6. A statute may be retroactive if it is expressly declared in the law. A.R.S. § 1-244.
7. The retroactive application of House Bill 2156 does not violate due process. *See, United States v. Carlton*, 512 U.S. 26, 114 S.Ct. 2018 (1994); *Watts v. Arizona Department of Revenue*, 221 Ariz. 97, 210 P.3d 1268 (App. 2009).
8. Taxpayers were required to add back the unemployment compensation they had excluded on their federal return pursuant to IRC section 85(c).
9. A.R.S. § 42-1123(C) provides that if the tax "or any portion of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid.

10. A.R.S. § 42-1123(C) recognizes the time value of money, and thus requires a taxpayer that is holding or using money that rightfully belongs to the State to pay interest for the use of that money. *Valencia Energy Co. v. Arizona Dep't of Revenue*, 191 Ariz. 565, 959 P.2d 1256 (1998).
11. Interest is a part of the tax and generally may not be abated.
12. The legislature enacted A.R.S. § 43-107 in 2011 (House Bill 2332) prohibiting the Department from assessing penalty or interest on a nonconformity deficiency if:
 - a. The taxpayer filed a return and paid taxes due, relying on the Department's published forms and instructions;
 - b. Conformity does not occur;
 - c. The Department supplements its published forms and instructions relating to nonconformity and requires the taxpayer to file an amended return; and
 - d. The taxpayer amends its return to report the nonconformity deficiency and pays the additional tax by the extended due date of the next taxable year.
13. Because Taxpayers did not file an amended return and pay the taxes due by the extended due date of the next taxable year, interest was properly included in the proposed assessment.
14. Because Taxpayers paid the tax and interest protested, this matter is treated as a protest of a denial of a claim for refund. A.R.S. § 42-1118(I).
15. Taxpayers are not entitled to a refund of their payment of the proposed assessment.

DISCUSSION

Taxpayers timely filed their Arizona state income tax return for tax year 2009. A taxpayer's Arizona adjusted gross income is generally the same as a taxpayer's federal adjusted gross income, subject to certain modifications provided by statute. When Taxpayers filed their return in February 2010, the IRC allowed an exclusion of up to \$2,400 of unemployment compensation and Arizona law did not require a modification.

Taxpayers therefore excluded the unemployment compensation on their Arizona income tax return.

In April of 2010 the legislature passed House Bill 2156 that required taxpayers to add back the unemployment compensation excluded from federal adjusted gross income. House Bill 2156 was retroactive and applied to tax year 2009. The Department issued a news release, included information on the its website and included a notice in the income tax instructions for tax year 2010 regarding the non-conformance in House Bill 2156. The information stated that if a taxpayer filed an Arizona income tax return that had excluded unemployment compensation pursuant to federal law, the taxpayer was required to file an amended return to add the excluded amount back into Arizona gross income. The information also provided that if an amended return was filed and the additional tax paid in full by October 17, 2011, no penalty or interest would be charged on that tax.

Taxpayers did not file an amended return or pay the taxes due. The Section therefore issued a proposed assessment including in Taxpayers' income the unemployment compensation they had previously excluded. Because no amended return was filed or taxes paid by October 17, 2011, the proposed assessment included interest.

Taxpayers timely protested stating that their return was correct at the time it was filed. Taxpayers should therefore not be liable for additional tax because the law was later changed. However, the legislature may enact legislation that is retroactive. Pursuant to House Bill 2156, the proposed assessment properly assessed tax on the unemployment compensation Taxpayers had excluded on their Arizona income tax return.

The proposed assessment included interest. A.R.S. § 42-1123(C) provides that if the tax "or any portion of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid. Interest

is not a penalty, but is simply compensation to the state for the lost time-value of money received after the due date. *Valencia Energy Co. v. Arizona Dep't of Revenue, supra.*

Interest may generally not be abated. The legislature therefore enacted specific legislation precluding the Department from imposing interest on taxes due because of nonconformity if certain conditions are met. A.R.S. § 43-107 requires that an amended return be filed and all taxes paid by the extended due date of the following taxable year, which in this case was October 17, 2011. Taxpayers did not file an amended return or pay the tax due by October 17, 2011. Interest was therefore properly included in the proposed assessment.

Based on the foregoing, the Section's denial of Taxpayers' claim for refund of their payment of the proposed assessment is affirmed.

DATED this 5th day of March, 2014.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[REDACTED]
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Individual Income Tax Audit Section