

6. The proposed assessment included the additional annuity/pension income and calculated interest at the statutory rate. No penalties were imposed.
7. Taxpayer timely protested the proposed assessment stating that when she withdrew her annuity she was told that if it was a “financial hardship,” which it was, she would not have to pay the penalty. The IRS forgave the interest and she requested that the Department do the same.
8. Taxpayer agreed with the IRS assessment.
9. The Section’s representative testified that IRS records do not show that the IRS abated the interest 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 Revised Statutes (A.R.S.) § 43-102(A)(1) provides that it is the intent of the Arizona legislature to adopt the provisions of the federal Internal Revenue Code relating to the measurement of adjusted gross income for individuals so that adjusted gross income reported to the IRS shall be the identical sum reported to Arizona, subject only to modifications set forth in Title 43 of the Arizona Revised Statutes.
3. A.R.S. § 43-327 requires that taxpayers report a change or correction by the IRS or to file an amended return with the Department within ninety days after the final determination of the change or correction by the IRS.
4. If a taxpayer fails to report a change or correction by the IRS or fails to file an amended return as required by A.R.S. § 43-327, A.R.S. § 42-1104(B)(5) allows the Department to assess any deficiency resulting from the federal adjustments within four years after the change, correction or amended return is reported to or filed with the IRS.

5. The assessment by the Department for tax year 2006 resulted from the adjustments made by the IRS.
6. The assessment included interest. A.R.S. § 42-1123(C) provides that if the tax, whether determined by the department or the taxpayer, or any portion of the tax is not paid on or before the date prescribed for its payment the department shall collect, as a part of the tax, interest on the unpaid amount from the date prescribed for its payment until it is paid.
7. 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).
8. The Section's proposed assessment dated February 2, 2011 is proper.

DISCUSSION

Taxpayer filed her 2006 Arizona resident income tax return but failed to include certain annuity/pension income. The IRS issued an audit including the annuity/pension income in Taxpayer's FAGI.

The starting point for Arizona's individual income tax is FAGI. Therefore, if the IRS makes changes to a taxpayer's FAGI, there is a corresponding change that needs to be made to the taxpayer's Arizona income. Taxpayers are therefore required to report federal changes to the Department. If federal changes are not timely reported by a taxpayer to the Department, the Department may issue an assessment resulting from the federal changes within four years after the federal changes are reported to or filed with the IRS.

Taxpayer has not questioned the validity of the state's assessment based on the federal audit. Taxpayer's argument is that the IRS forgave the interest it had included in its assessment. Taxpayer asked for the same treatment.

The Section indicated that IRS records did not show that it abated the interest included in its assessment. In addition, irrespective of what the IRS may do, 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*. (Non-punitive interest is, after all, nothing more than compensation for the use of money. The taxpayer had the benefit of using the funds before paying the tax claim and, in the legal sense, suffers no loss by reason of paying interest on the money it retained in its possession.) Therefore, interest was properly assessed by the Section.

Based on the foregoing, the Section's proposed assessment dated February 2, 2011 is affirmed.

DATED this 5th day of January, 2012.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

Frank Migray
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

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Individual Income Tax Audit Section