

6. Taxpayers timely protested the assessment stating that the pension income was earned outside of Arizona and the assessment was past the statute of limitations.

CONCLUSIONS OF LAW

1. A resident of Arizona is subject to income tax on all of his taxable income wherever derived. Arizona Revised Statutes (A.R.S.) § 43-102(A)(4).
2. A.R.S. § 43-1001(2) defines Arizona gross income of a resident individual as the individual's federal adjusted gross income for the taxable year, computed pursuant to the Internal Revenue Code.
3. 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.
4. A state may not impose an income tax on any retirement income of an individual who is not a resident or domiciliary of that state, determined under the laws of that state. 4 U.S.C.A. § 114(a).
5. Taxpayers were residents of Arizona during 2005; therefore, all of their income wherever derived was subject to Arizona tax, including the unreported pension income.
6. The Department may issue an assessment within four years after a taxpayer filed the return or within four years after the due date of the return, whichever period is later. A.R.S. § 42-1104(A).
7. The assessment issued by the Department was within the four year statute of limitations provided by A.R.S. § 42-1104(A).
8. 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.

9. 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).

DISCUSSION

The starting point for Arizona's individual income tax is FAGI. Taxpayers are required to report to Arizona the FAGI they had reported on their federal income tax return. Taxpayers failed to include pension income in their Arizona resident income tax return that was included in their FAGI.

The Section's assessment adjusted Taxpayers' Arizona gross income to include the pension income. Because Taxpayers were Arizona residents when they received the pension income, they were required to report it to Arizona. A.R.S. § 43-102(A)(4). Taxpayers have not shown that the income was not subject to Arizona income tax.

Taxpayers believe that since the pension was earned in another state the income cannot be taxed by Arizona. Residents of Arizona are subject to income tax on all of their taxable income, no matter where the income was derived. Federal law (4 U.S.C.A. § 114(a)) prohibits another state from taxing the pension income of a non-resident Taxpayer. Therefore, the Section properly included Taxpayers' pension income in the assessment.

Taxpayers argued that the assessment was outside the statute of limitations. Under A.R.S. § 42-1104(A) the Department may issue an assessment within four years after Taxpayers filed their return. The Section had until April 17, 2010 to issue the assessment. The assessment was issued on January 13, 2010, within the four year statute of limitations.

Taxpayers protested the interest included in the assessment because they believed the pension income was not taxable by Arizona. 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.)

Based on the foregoing, the Section's proposed assessment dated January 13, 2010 is affirmed.

DATED this 9th day of February, 2011.

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