

amend the return at a later date to reflect any differences between Arizona and federal law.

7. On April 27, 2010 the governor signed House Bill 2156 (Laws 2010, Ch. 176). The House Bill did not conform Arizona income tax law to I.R.C. § 85(c) that excluded up to \$2,400 of unemployment compensation from federal gross income for tax year 2009.
8. House Bill 2156 enacted Arizona Revised Statutes (A.R.S.) § 43-1021, paragraph 32 (later re-numbered as paragraph 30) that added back to Arizona gross income unemployment compensation that was excluded from federal adjusted gross income pursuant to I.R.C. § 85(c).¹
9. 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.
10. 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.
11. The information stated that if a taxpayer filed an Arizona income tax return that had excluded unemployment compensation pursuant to I.R.C. § 85(c), the taxpayer was required to file an amended Arizona return to add the excluded amount back into Arizona gross income.
12. 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.

¹ A.R.S. § 43-1021 paragraph 30 was repealed in 2014 as obsolete by S.B. 1301 (Laws 2014, Ch. 245, § 15.)

13. The Notice also stated that taxpayers could use form 140X-NC to correct their 2009 return.
14. 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.
15. Taxpayers did not file an amended Arizona return to add back the excluded unemployment compensation or pay any additional tax.
16. The Section issued Taxpayers a proposed assessment dated [REDACTED] for tax year 2009 that added back into Taxpayers' Arizona income the \$2,400 unemployment compensation they had excluded.
17. The proposed assessment included interest but no penalties.
18. Taxpayers timely protested the assessment contending the law was changed after they filed their return.
19. Taxpayers have paid the proposed assessment in full.

CONCLUSIONS OF LAW

1. The Arizona Legislature has the authority to levy and collect taxes, including income taxes. Ariz. Const. Art. 9, § 12.
2. At the time Taxpayers filed their return, Arizona gross income was defined as an individual's federal adjusted gross income computed pursuant to the Internal Revenue Code in effect on January 1, 2009, excluding any change to the Code enacted after January 1, 2009. A.R.S. §§ 43-105(A) and 43-1001(2).
3. Before the enactment of I.R.C. § 85(c) by the American Recovery and Reinvestment Act of 2009 on February 17, 2009, federal adjusted gross income included all unemployment compensation received by a taxpayer.
4. 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.

5. 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).
6. A.R.S. § 43-1021, Paragraph 32 enacted by House Bill 2156 added back to federal adjusted gross income any unemployment compensation a taxpayer excluded from federal adjusted gross income pursuant to I.R.C. § 85(c).
7. The information the Section had received indicated Taxpayers received unemployment compensation during 2009 and had excluded \$2,400 on their federal return. Taxpayers also excluded \$2,400 of the unemployment compensation on their Arizona return.
8. A statute may be retroactive if it is expressly declared in the law. A.R.S. § 1-244.
9. 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).
10. Every person is presumed to know the law and its requirements, and a mistake as to such requirements is no excuse for failure to meet them. *See, Newman v. Fidelity Savings and Loan Association*, 14 Ariz. 354, 128 P. 53 (1912).
11. Taxpayers were required to add back to Arizona income the unemployment compensation they excluded on their federal return pursuant to I.R.C. § 85(c).
12. 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.

13. 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).
14. Interest is a part of the tax and generally may not be abated.
15. 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.
16. 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.
17. The Section's proposed assessment dated [REDACTED] is affirmed.
18. 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).
19. 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 as of a certain date, subject to modifications provided by statute.

When Taxpayers filed their return in April 2010, the Internal Revenue Code allowed an exclusion of up to \$2,400 of unemployment compensation received by a person. This was reflected in the federal return instructions and forms. Taxpayers excluded the unemployment compensation they had received on their federal return and thus also on their Arizona income tax return. However, the Arizona legislature had not yet at that time determined whether Arizona would conform to the federal changes allowing the \$2,400 exclusion. Thus neither the Arizona return forms nor the instructions specifically addressed the unemployment compensation issue.

Because Arizona gross income is based on federal adjusted gross income as of a certain date and is also subject to modifications specified in A.R.S. §§ 43-1021 and 43-1022, the Arizona income tax is independent of the federal income tax. In April of 2010 the legislature passed House Bill 2156 that did not conform to (adopt) the federal legislation. The bill specifically required taxpayers to add back unemployment compensation they 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 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 tax 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 the law was changed after they had filed their Arizona return. Taxpayers appear to be under the impression that before the enactment of House Bill 2156 Arizona law allowed an exclusion of the first \$2,400 of unemployment compensation which House Bill 2156 repealed. However, this is not a situation where Arizona first allowed the exclusion for unemployment and then retroactively repealed the same. When Taxpayers filed their 2009 tax return, Arizona law did not in fact allow an exclusion for unemployment compensation because Arizona gross income was defined as federal adjusted gross income under the Internal Revenue Code in effect on January 1, 2009, excluding any change to the Code enacted after January 1, 2009. Congress enacted the American Recovery and Reinvestment Act of 2009 on February 17, 2009, which was after January 1, 2009.

Before the enactment of I.R.C. § 85(c), all unemployment compensation received by an individual was taxable. Therefore, when Taxpayers filed their return, because Arizona law referred to the Internal Revenue Code before the enactment of I.R.C. § 85(c), Arizona did not allow an exclusion for the first \$2,400 of unemployment compensation. By excluding \$2,400 of their unemployment compensation in their Arizona tax return, Taxpayers' Arizona return was not correct under Arizona law.

The problem was that the Arizona legislature had not yet acted whether or not to adopt the federal changes. Because the tax return forms and instructions had been prepared before a decision was made on conformity, neither the return forms nor the instructions specifically addressed the unemployment compensation issue. The 2009 instructions however provided a caution that Arizona had not conformed to changes to the Internal Revenue Code which may have been enacted after January 1, 2009. The caution further provided that if the legislature did not conform to code changes enacted

after January 1, 2009, the taxpayer may have to amend the return at a later date to reflect any differences between Arizona and federal law.

When House Bill 2156 was enacted in 2010, it did not adopt the provision of the American Recovery and Reinvestment Act of 2009 that excluded the first \$2,400 of unemployment compensation. Because the definition of Arizona gross income had not allowed the federal \$2,400 exclusion before the enactment of House Bill 2156, House Bill 2156 did not eliminate an existing exclusion but clarified that unemployment compensation excluded on the federal return had to be added back to Arizona income. Because the add-back related to compensation received during tax year 2009, the provision was made retroactive. The legislature may enact legislation that is retroactive. The proposed assessment properly included the unemployment compensation in Taxpayers' Arizona income.

While the Department made efforts to inform taxpayers of the nonconformance, not all taxpayers became aware of the nonconformance. Legally, taxpayers are presumed to know the law. Therefore the fact a taxpayer was not aware of the law is not a basis to abate an otherwise proper assessment.

The proposed assessment included interest pursuant to A.R.S. § 42-1123(C) which 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 14th day of August, 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