

07-0365  
AUDIT  
TAX YEARS: 2000, 2001, 2002  
SIGNED 02-23-2010  
COMMISSIONERS: R. JOHNSON, M. JOHNSON, M. CRAGUN  
EXCUSED: D. DIXON  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER 1 & PETITIONER 2,  Petitioners,  v.  AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.	<b>FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECISION</b>  Appeal No.    07-0365  Account No.    ##### Tax Type:    Income Tax Tax Years:    2000, 2001 & 2002  Judge:        Chapman
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**Presiding:**

Michael J. Cragun, Commissioner  
Kerry R. Chapman, Administrative Law Judge

**Appearances:**

For Petitioner:    PETITIONER 1, Taxpayer  
For Respondent:    RESPONDENT REP 1, Assistant Attorney General  
                    RESPONDENT REP 2, from Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on February 9, 2010. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1.    The tax in question is income tax.
2.    The tax years at issue are 2000, 2001 and 2002.
3.    On February 20, 2007, Auditing Division (the "Division") issued Statutory Notices of Deficiency and Audit Change ("Statutory Notices") to PETITIONER 1 & PETITIONER 2 ("Petitioners" or

“taxpayers”), in which it imposed additional tax and interest (as of March 22, 2007) for the 2000, 2001 and 2002 years, as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2000	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2001	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2002	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

4. The Division did not assess any penalties to the taxpayers.

5. PETITIONER 1 admitted that he was domiciled in Utah for the 2000, 2001 and 2002 years at issue. No evidence was presented to show that PETITIONER 1 was domiciled in a state other than Utah for these years.

6. The taxpayers filed Utah resident returns for the 2000, 2001 and 2002 tax year, on which they reported federal adjusted gross income (“FAGI”) in the amounts of: 1) \$\$\$\$\$ for the 2000 tax year; 2) \$\$\$\$\$ for the 2001 tax year; and 3) \$\$\$\$\$ for 2002 tax year.

7. The Division assessed additional Utah income tax to the taxpayers for the years at issue based on information (tax transcripts) it received from the IRS showing the taxpayers’ FAGI to be significantly higher than reported on their Utah tax returns. The IRS information shows the taxpayers’ FAGI to be: 1) \$\$\$\$\$ for the 2000 tax year; 2) \$\$\$\$\$ for the 2001 tax year; and 3) \$\$\$\$\$ for the 2002 tax year. The IRS FAGI amounts were based on an audit performed by the IRS and are the FAGI amounts reflected in the Division’s assessments.

8. During the years at issue, PETITIONER was a member or partner in COMPANY (the “LLC”). The LLC was taxed like a partnership, and income and expenses flowed through to PETITIONER and another partner. The IRS audited PETITIONER 1 and his partner individually and increased the FAGI of both partners for the years at issue. PETITIONER 1 submitted several documents that he sent to the IRS to

protest the IRS increasing his FAGI for the years at issue. However, the IRS did not amend the FAGIs it established for PETITIONER 1 and his wife in its audit process.

9. Testimony indicates that after the IRS's initial audit of PETITIONER 1 and his partner, the IRS decreased the FAGIs it had originally established for PETITIONER 1's partner. However, neither party presented evidence to show what adjustments the IRS made to PETITIONER 1's partner's FAGI for each year at issue. In addition, neither party presented evidence to show that the adjustments the IRS made to PETITIONER 1's partner's FAGIs would also be appropriate adjustments for PETITIONER 1's FAGIs.

10. RESPONDENT REP 2, a Division tax manager, testified that it is possible that FAGIs determined by the IRS for the taxpayers are incorrect. In this matter, however, RESPONDENT REP 2 stated that he does not have sufficient information to know whether the FAGIs determined by the IRS for PETITIONER 1 are incorrect and, if incorrect, what the correct FAGIs should be. He stated that the information available to him in regards to PETITIONER 1's partner's FAGI is insufficient for him to determine PETITIONER 1's FAGI for any of the years at issue. For these reasons, the Division asks the Commission to sustain the assessments it imposed on the taxpayers based on the taxpayers' FAGIs currently found in IRS records.

11. PETITIONER 1 also stated that any adjustments the IRS made to his partner's FAGI are incorrect because the IRS improperly considers compensation received from their LLC to be taxable income for income tax purposes. For this reason, the taxpayers have not filed amended federal or Utah returns to reflect the changes made by the IRS to PETITIONER 1's partner's FAGI.

12. The taxpayers also argue that it is unconstitutional for the federal government and Utah to impose an income tax on many types of compensations that it currently taxes, such as the compensation PETITIONER 1 received from his LLC.

APPLICABLE LAW

1. Pursuant to Utah Code Ann. §59-10-104 (2002),<sup>1</sup> Utah imposes a tax “on the state taxable income, as defined in Section 59-10-112, of every resident individual. . . .”

2. For purposes of Section 59-10-104, “resident individual” is defined in UCA §59-10-103(1)(k) to mean:

- (i) an individual who is domiciled in this state for any period of time during the taxable year, but only for the duration of such period; or
- (ii) an individual who is not domiciled in this state but maintains a permanent place of abode in this state and spends in the aggregate 183 or more days of the taxable year in this state....

3. Also for purposes of Section 59-10-104, UCA §59-10-112 provides that “[s]tate taxable income’ in the case of a resident individual means his federal taxable income (as defined by Section 59-10-111) with the modifications, subtractions, and adjustments provided in Section 59-10-114 . . . .”

4. For purposes of Section 59-10-112, UCA §59-10-111 provides that “[f]ederal taxable income’ means taxable income as currently defined in Section 63, Internal Revenue Code of 1986.”

5. For purposes of Section 59-10-111 and as defined in the Internal Revenue Code (“IRC”) at 26 U.S.C. 63, “taxable income” means “. . . gross income minus the deductions allowed by this chapter (other than the standard deduction).”

6. For purposes of determining “taxable income,” the Internal Revenue Code at 26 U.S.C. 61(a) defines “gross income” to mean:

- Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
- (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;

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<sup>1</sup> Subsequent to the audit period, the Utah Individual Income Tax Act has been revised, and provisions have been renumbered. The Commission cites to and applies the provisions that were in effect during the audit period on substantive legal issues. All cites will refer to the 2002 version of Utah law, unless stated otherwise.

- (2) Gross income derived from business;
- (3) Gains derived from dealing in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

7. If the IRS makes a change to a Utah resident individual's federal taxable income, the resident individual must file an amended Utah return in accordance with UCA §59-10-536(5), which provides as follows:

(5) (a) If a change is made in a taxpayer's net income on his or her federal income tax return, either because the taxpayer has filed an amended return or because of an action by the federal government, the taxpayer must notify the commission within 90 days after the final determination of such change. The taxpayer shall file a copy of the amended federal return and an amended state return, which conforms to the changes on the federal return. No notification is required of changes in the taxpayer's federal income tax return, which do not affect state tax liability.

(b) The commission may assess any deficiency in state income taxes within three years after such report or amended return was filed. The amount of such assessment of tax shall not exceed the amount of the increase in Utah tax attributable to such federal change or correction. The provisions of this Subsection (b) do not affect the time within which or the amount for which an assessment may otherwise be made. However, if the taxpayer fails to report to the commission the correction specified in this Subsection (b) the assessment may be made any time within six years after the date of said correction.

8. UCA §59-1-1417 (2010) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions as follows:

In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:

- (1) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
- (2) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and
- (3) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income;

- (a) required to be reported; and
- (b) of which the commission has no notice at the time the commission mails the notice of deficiency.

#### CONCLUSIONS OF LAW

1. The taxpayers are Utah domiciliaries for the 2000, 2001 and 2002 tax years. In accordance with Section 59-10-103(1)(k), the taxpayers are also Utah “resident individuals” for these tax years.
2. The taxpayers have the burden of proof to show that the Division’s assessments are incorrect.
3. The taxpayers’ arguments to show that it is unconstitutional to tax compensation PETITIONER 1 received from his LLC have no merit. The taxpayers have presented no court cases or other authority that expressly finds it to be illegal to impose federal or state income tax on compensation received from an LLC. The taxpayers proffered no evidence to show that the federal or state tax provisions are interpreted by courts in the manner expressed in their brief. The taxpayers’ income is federal “gross income” for purposes of 26 U.S.C. 61(a) and, consequently, federal “taxable income,” as defined in 26 U.S.C. 63, and Utah “state taxable income,” as defined in Section 59-10-112.
4. The taxpayers have not provided any information to show that the FAGIs determined by the IRS and used by the Division for its assessments for the taxpayers for the years at issue are incorrect. The taxpayers have not shown that any portion of the Division’s assessments is incorrect.

Appeal No. 07-0365

5. Based on the evidence and testimony submitted at the Formal Hearing, the Division's assessments should be sustained in their entirety.

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Kerry R. Chapman  
Administrative Law Judge

DECISION AND ORDER

Based upon the foregoing, the Commission sustains the Division's assessments for the 2000, 2001 and 2002 tax years in their entirety. It is so ordered.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2010.

R. Bruce Johnson  
Commission Chair

Marc B. Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
Commissioner

Michael J. Cragun  
Commissioner

**Notice of Appeal Rights:** You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-601 et seq. and 63G-4-401 et seq.

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