

11-1780
TAX TYPE: INCOME TAX
TAX YEAR: 2007
DATE SIGNED: 3-15-13
COMMISSIONERS: B. JOHNSON, D. DIXON, M. CRAGUN, R. PERO
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER 1 AND TAXPAYER 2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	INITIAL HEARING ORDER Appeal No. 11-1780 Account No. ##### Tax Type: Income Tax Tax Year: 2007 Judge: Phan
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Presiding:
Jane Phan, Administrative Law Judge

Appearances:
For Petitioner: TAXPAYER 1
For Respondent: RESPONDENT 1, Manager, Income Tax Auditing
RESPONDENT 2, Auditor

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Sec. 59-1-502.5, on December 13, 2012. Petitioners ("Taxpayers") are appealing an audit deficiency of Utah individual income tax for 2007. The statutory Notice of Deficiency and Audit Change had been issued on March 24, 2011. Taxpayers timely appealed the audit. The amount of the audit deficiency listed on the statutory notice at issue is as follows:

	Tax	Penalty	Interest	Total as of Notice Date ¹
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

¹ Interest continues to accrue on the unpaid balance.

APPLICABLE LAW

Utah imposes income tax on part-year residents of the state at Utah Code Sec. 59-10-120 (2007)² as follows:

- (1) If an individual changes his status during his taxable year from resident to nonresident or from nonresident to resident, the commission may by rule require him to file on return for the portion of the year during which he is a resident and another return for the portion of the year during which he is a nonresident.
- (2) Except as provided in Subsection (3) the taxable income of the individual described in Subsection (1) shall be determined as provided in this chapter for residents and for nonresidents as if the individual's taxable year for federal income tax purposes were limited to the period of his resident and nonresident status respectively.
- (3) There shall be included in determining taxable income from sources within or without this state, as the case may be, income, gain, loss or deduction accrued prior to the change of status, even though not otherwise includable or allowable in respect of the period prior to such change, but the taxation or deduction of items received or accrued prior to the change of status shall not be affected by the change.

The Commission may waive penalties under Utah Code Sec. 59-1-401(13) as follows:

Upon making a record of its actions, and upon reasonable cause shown the commission may waive, reduce or compromise any of the penalties or interest imposed under this part.

The Commission has promulgated Administrative Rule R861-1A-42 to provide additional guidance on the waiver of penalties and interest, as follows in pertinent part:

- (2) Reasonable Cause for Waiver of Interest. Grounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.
- (3) Reasonable Cause for Waiver of Penalty. The following clearly documented circumstances may constitute reasonable cause for a waiver of penalty:
 - (a) Timely Mailing...
 - (b) Wrong Filing Place...
 - (c) Death or Serious Illness...
 - (d) Unavoidable Absence...
 - (e) Disaster Relief...
 - (f) Reliance on Erroneous Tax Commission Information...

² The Utah Individual Income Tax Act has been revised and provisions renumbered subsequent to the audit period. The Commission cites to and applies the provisions that were in effect during the audit period on substantive legal issues.

- (g) Tax Commission Office Visit...
 - (h) Unobtainable Records...
 - (i) Reliance on Competent Tax Advisor...
 - (j) First Time Filer...
 - (k) Bank Error...
 - (l) Compliance History...
 - (m) Employee Embezzlement...
 - (n) Recent Tax Law Change...
- (4) Other Considerations for Determining Reasonable Cause. (a) The commission allows for equitable considerations in determining whether reasonable cause exists to waive a penalty. Equitable considerations include: (i) whether the commission had to take legal means to collect the taxes; (ii) if the error is caught and corrected by the taxpayer; (iii) the length of time between the event cited and the filing date; (iv) typographical or other written errors; and (v) other factors the commission deems appropriate.

The applicable statutes specifically provide that the taxpayer bears the burden of proof in proceedings before the Tax Commission. Utah Code Sec. 59-1-1417 provides:

In a proceeding before the commission, the burden of proof is on the petitioner. . .

DISCUSSION

The Taxpayers had originally filed as Utah residents a Utah Individual Income Tax Return for tax year 2007. They had also filed a federal return for that year. On their returns the Taxpayers had failed to include \$\$\$\$ in 1099-Misc-Non-Employee Compensation. After the Internal Revenue Services had audited the Taxpayers, the IRS increased their federal adjusted gross income from \$\$\$\$ to \$\$. The Division then made the same change to the Utah return, including this amount in their Utah taxable income, and that was the basis for the additional tax and interest indicated in the statutory notice as listed above. The Division's assumption with the original audit had been that the Taxpayers were domiciled in Utah for all of 2007. If domiciled in Utah they were Utah residents under Utah Code 59-10-103(1)(v) (2007). As residents all income earned during the year was subject to Utah individual income regardless of whether it had been earned in Utah or another state.

After the audit had been issued, the Taxpayer provided additional information that indicated he was a part-year resident of Utah during 2007 and that the additional income, which was sourced to a 1099-MISC Non-Employee Compensation in the amount of \$, was commission income that he had earned from sales of STATE property while he was still residing in STATE. The Taxpayer's spouse and children had moved to Utah earlier in 2007. The Taxpayer provided evidence of a STATE Driver License and that he had not sold his STATE residence until July 2007. As the Taxpayer had originally filed the Utah return as full year

residents, the Taxpayer subsequently submitted an amended return, filed as part-year residents. Other than the \$\$\$\$\$, all other income earned by the Taxpayers was earned while in Utah. When the Taxpayers filled out their amended Utah part-year resident return they concluded that they did owe Utah an additional \$\$\$\$\$ in Utah individual income taxes. For part-year residents, under Utah law the tax amount is calculated out first as if the taxpayer is a full year Utah resident and then the tax is multiplied by the ratio of Utah income divided by federal taxable income. It was the Taxpayer's concern that if none of this income was sourced to Utah, why there would still be such a large increase in the amount of tax due.

After review of the additional information provided by the Taxpayers as well as the amended return, the Division accepted the position that the Taxpayer was a part-year resident of Utah during 2007 and that the \$\$\$\$\$ in income was not Utah source income. However, the Division noted that there had been several errors on the Amended Utah Return filed by the Taxpayer. It was the Division's contention that even accepting the premise that the \$\$\$\$\$ in income was STATE source income, once a corrected Utah Part-Year Resident return was calculated, the Taxpayer would owe \$\$\$\$\$ in additional tax, plus a 10% late payment penalty and interest, for a total of \$\$\$\$\$.

The Division pointed out that the errors on the Amended Utah Return filed by the Taxpayer had been first on Line 8-Total Adjusted Income, because the Taxpayer had subtracted Line 7 from Line 6, rather than adding Line 7. If this was corrected, Line 8 would be \$\$\$\$\$. This error was carried over to Line 10-Utah Taxable Income and Line 14-Utah Income Tax. For Line 14 the Taxpayer had calculated that the amount of the tax would be \$\$\$\$\$. The Division recalculated this based on the corrected adjusted income to be a Utah tax of \$\$\$\$\$. The Division also indicated that there had been an error in the calculation of the Utah income tax ratio and thus corrected this from %%% to %%%. This resulted in a Utah tax amount owed for the year of \$\$\$\$\$. Because of the withholding and prior refund, the amount of additional tax owed based on the corrections to the amended return had been \$\$\$\$\$. Although the Division had not assessed any penalties with the audit, it was the Division's contention that if it accepted the part-year resident return with the corrections, a 10% late payment penalty would need to be applied.

Based on review of the information submitted, the facts in this matter are not now in dispute. The Division has conceded that the Taxpayer was not a resident of Utah at the time he had received the \$\$\$\$\$ commissions relating to property that he had sold in STATE while still a resident of STATE. The Taxpayer changed his domicile to Utah later in the year. The question with the Taxpayer was why there was so little difference between the original audit assessment which included \$\$\$\$\$ of the income and indicated tax in the

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amount of \$\$\$\$ plus interest for a total of \$\$\$\$ and the Division's new calculation based on corrections to the Taxpayer's amended part-year return in which the income was treated as non Utah source, but, the new calculation indicated a tax amount of \$\$\$\$\$. With penalty of \$\$\$\$\$ and interest of \$\$\$\$\$, the Division indicated the correct amount totaled \$\$\$\$\$.

Upon review of the return information and corrections, the Commission does not find an error with the Division's calculation of the tax amount of \$\$\$\$\$ based on a part year resident and the additional income not being Utah sourced. The difference of just over \$\$\$\$\$ from the original audit tax of \$\$\$\$\$ and the new tax amount of \$\$\$\$\$ is how this is calculated based on Utah law.

The Division maintained that if it accepts the premise of the Taxpayer's amended return, although making a number of changes, it would assess a late payment penalty. This was not well supported at the hearing. There was no penalty issued with the original audit. The Taxpayer was trying to contest the audit by filing a corrected return and because of that a penalty has now been assessed. Regardless of whether an amended return had been filed, the Commission could have made a determination that the tax amount be reduced to \$\$\$\$\$, which, from the evidence submitted, is the correct amount. Utah Code 59-1-401(13) provides that the Commission may waive penalties for reasonable cause. Utah Admin. Rule R861-1A-42 provides what may constitute reasonable cause including an allowance for equitable considerations. This situation meets the equitable consideration factor as it appears the Division has determined that it would leave the original audit with its higher tax amount or reduce the tax to the correct amount but add a penalty.

The audit should be amended to \$\$\$\$\$ in tax and the interest accrued thereon. The 10% late payment penalty should be waived.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based upon the foregoing, the Commission concludes that audit tax deficiency for the 2007 tax year be reduced to \$\$\$\$\$ with the interest accrued on that amount. The penalty of \$\$\$\$\$ is hereby waived. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

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Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2013.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

NOTICE: If a Formal Hearing is not requested, failure to pay the balance due as determined by this order within thirty days of the date hereon, may result in a late payment penalty. Petitioner may contact Taxpayer Services at (801) 297-7703 to make payment arrangements.