

04-0997  
Audit  
Signed 02/28/2006

BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,	)	
	)	<b>ORDER FROM FORMAL</b>
Petitioner,	)	<b>HEARING</b>
	)	
v.	)	Appeal No.    04-0997
	)	Account No.   #####
	)	
AUDITING DIVISION OF	)	
THE UTAH STATE TAX	)	Tax Type:     Income Tax
COMMISSION,	)	Tax Year:     2002
	)	
Respondent.	)	Judge:        Rees

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STATEMENT OF THE CASE

This matter arises from an audit assessment issued by the Division concerning PETITIONER and PETITIONER’S WIFE 2002 income tax filing. On September 14, 2004, Respondent filed a Motion to Dismiss on the basis that a Petition for Redetermination was not filed within 30 days of the Statutory Notice of Audit Change. After a hearing on that Motion, the Motion was denied by Order issued November 23, 2004. The matter was scheduled for an Initial Hearing on July 27, 2005. Petitioners failed to appear, and an Order of Default was entered on August 9, 2005. Thereafter, Petitioners requested a Formal Hearing, which was scheduled for November 21, 2005. All parties appeared at the time and date set for the hearing.

FINDINGS

1. Petitioners filed a Federal Income Tax Return for tax year 2002. The return indicated that Petitioners had income in that year. However, Petitioners deducted \$\$\$\$ on line 27 of Schedule A of their federal return, stating it was “an unrestricted claim of right for Compensation for Personal Labor founded on 26 USC Section 1341.” In doing so, Petitioners claimed that they had no taxable income.
2. Petitioner filed a Utah Income Tax Return for tax year 2002. Although they declare income and certain deductions on the return, they also claimed zero taxable income.
3. Upon receipt of Petitioner’s Utah return, the Processing Division issued a Notice of Adjustment to Return. Petitioners objected and the matter was referred to the Auditing

Division for audit. After completion of the audit, the Auditing Division issued a Notice of Audit Change to Petitioners on May 6, 2004. The audit change corrected the Petitioners' federal adjusted gross income on Line 4 and allowed the deductions to which Petitioners are entitled. The changes resulted in taxable income of \$\$\$\$ and a Utah tax liability of \$\$\$\$\$. Additionally, the Division assessed a \$500 frivolous filing penalty and interest through June 7, 2004.

4. At the hearing, Petitioners failed to effectively argue or support their position that their income is not subject to tax. They were allowed to make a post-hearing filing to support their claim. Their filing references "Disclosure Statement 8275" and "Title 26-1341." Petitioners made no other arguments in the hearing or in their post-hearing filing to substantiate their claims that their income is not subject to tax.
  - a. Petitioners apparently filed an affidavit with their federal return that "affirms the \$\$\$\$ deduction claimed on Schedule A Line 27 is for non-taxable income that is "compensation for personal services actually rendered."
  - b. Accompanying the affidavit is Form 8275, which includes a statement claiming "common law immunity" from taxation.

#### CONCLUSIONS

1. Petitioners had income in 2002 which was subject to Utah tax and the Commission upholds the tax assessment issued by the Division.
2. Petitioners action warrant a penalty assessment under §59-1-401(7). The Commission upholds the \$500 penalty assessment.

#### APPLICABLE LAW

1. Pursuant to Utah Code Ann. §59-10-104, 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 Utah Code Ann. §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<sup>4</sup>.

3. Also for purposes of Section 59-10-104, Utah Code Ann. §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, Utah Code Ann. §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 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;
  - (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. Utah Code Ann. §59-10-543 specifically states that the taxpayer bears the burden of proof, with limited exceptions, in proceedings involving individual income tax before the Tax Commission.
8. Utah Code Ann. §59-10-539(1) provides for the imposition of penalty and interest, pertinent parts as follows:

- (1) In case of failure to file an income tax return and pay the tax required under this chapter on or before the date prescribed therefor (determined with regard to any extension of time for filing), unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on such return a penalty as provided in Section 59-1-401.

- (2) If any part of any deficiency in tax imposed by this chapter, as defined by Section 59-10-523, is due to negligence or intentional disregard of rules, but without intent to defraud, a penalty shall be assessed, collected, and paid as provided in Section 59-1-401 in the same manner as if it were an underpayment.

- (3) If any part of a deficiency in tax imposed by this chapter, as defined by Section 59-10-523, is due to fraud, there shall be added to the tax a penalty as provided in Section 59-1-401. This amount shall be in lieu of any other addition to tax imposed by Subsection (1) or (2).

9. With regard to a frivolous filing penalty, Utah Code Ann. §59-1-401(7) provides:

If any taxpayer, in furtherance of a frivolous position, has a prima facie intent to delay or impede administration of the tax law and files a purported return that fails to contain information from which the correctness of reported tax liability can be determined or that clearly indicates that the tax liability shown must be substantially incorrect, the penalty is \$500.

### DISCUSSION

Petitioners do not dispute that they were Utah residents pursuant to Utah Code Ann. §59-10-543 and 59-10-103(1)(k) in 2002. In fact, Petitioners filed a Utah tax return. Nor do the Petitioners deny that they received income in 2002. The issue here is whether Petitioners' 2002 income was taxable in Utah. Petitioners have the burden to show that their income is not taxable. Utah Code Ann. §59-10-543.

In claiming that their income is not subject to tax, Petitioners reference 26 USC 1341, a section of the Internal Revenue Code that allows a taxpayer to recover overpayments of tax in situations where previously reported income must be repaid. The overpayment of tax may be calculated as an adjustment to taxable income for the year in which repayment was made or

through a credit adjustment against tax liability for the repayment year. In this case, Petitioner made no demonstration that they were required to repay income or that this provision of the Internal Revenue Code otherwise applied to them in any way. Nor did they demonstrate that 26 USC 1341 of the Federal Income Tax Code relieves them from Utah tax liability.

#### Tax Assessment

The evidence produced by the Division, particularly the copy of the Petitioners' 2002 Utah return and accompanying documents, indicate that the Petitioners each received income that year, pursuant to Utah Tax Code section 59-10-111. The Division's audit resulted in a correction of the information reported on Petitioners' Utah return, beginning with a federal adjusted gross income in the amount of \$\$\$\$\$, essentially setting aside the "claim of right" deduction argument. The Division allowed itemized deductions in the amount of \$\$\$\$\$, which correspond to the itemized deductions as shown on lines 4, 9, 14, and 18 of their Schedule A, Itemized Deductions of Petitioners' federal return and other adjustments. Overall, the corrected return results in a Utah tax liability of \$\$\$\$\$. Including penalty and interest through June 7, 2004, the total amount assessed was \$\$\$\$\$. Petitioners presented no testimony or evidence to challenge these calculations. Based on the evidence presented, the Commission affirms the assessment for unpaid taxes.

#### Frivolous Filing Penalty

The assessment includes a \$500 penalty assessment pursuant to Utah Code section 59-1-401(7). This penalty applies to a taxpayer who, in furtherance of a frivolous position, has a prima facie intent to delay or impede administration of the tax and who files a return that fails to contain information from which the correctness of reported tax liability can be determined or that clearly indicates that the tax liability shown must be substantially incorrect. The Commission considers such a claim to be frivolous, regardless whether the Petitioners *believe* that "wages" are exempt from taxation.

In this case, Petitioners rely on a specious argument that the 26 USC 1341 of the Federal Code relieves them of tax liability at the state and federal level. Moreover, they filed a return indicating a federal adjusted gross income of \$\$\$\$\$ and various adjustments down through line 14. On line 15, Petitioners enter a \$\$\$\$\$ for the amount of Utah taxable income. Even if the adjustments claimed were correct, the net taxable income would not total \$\$\$\$\$. Accordingly, the

Commission finds that the Petitioners committed a frivolous action when they filed their amended 2002 tax return and affirms the penalty assessment.

ORDER

Based upon the Commission's review of the motion and consideration of the parties' positions, the Commission upholds the assessment.

DATED \_\_\_\_\_ day of \_\_\_\_\_, 2006.

\_\_\_\_\_  
Irene Rees  
Administrative Law Judge

BY ORDER OF THE UTAH STATE TAX COMMISSION.

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

Pam Hendrickson  
Commission Chair

R. Bruce Johnson  
Commissioner

Palmer DePaulis  
Commissioner

Marc B. Johnson  
Commissioner