

04-1114
Audit
Signed 11/21/2005

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)	
)	FINDINGS OF FACT, CONCLUSIONS
Petitioner,)	OF LAW, AND FINAL DECISION
)	
v.)	Appeal No. 04-1114
)	
AUDITING DIVISION OF)	Account No. #####
THE UTAH STATE TAX)	Tax Year: 1997 & 1998
COMMISSION,)	Tax Type: Income Tax
)	
Respondent.)	Judge: Chapman

Presiding:
Palmer DePaulis, Commissioner
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER

For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
 RESPONDENT REPRESENTATIVE 2, Manager, from Auditing Division
 RESPONDENT REPRESENTATIVE 3, from Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on September 28, 2005. 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 Utah individual income tax.
2. The tax years at issue are 1997 and 1998.
3. For the years at issue, the Petitioner lived and worked in Utah.
4. For the years at issue, the Petitioner did not file Utah individual income tax returns for tax years 1997 and 1998 in a timely manner.

5. Auditing Division (“Division”) obtained information from the Internal Revenue Service (“IRS”) concerning the Petitioner’s income for the two tax years at issue. For the 1997 tax year, the IRS information shows the Petitioner’s federal adjusted gross income to be \$\$\$\$ and his federal taxable income to be \$\$\$\$ (Exhibit R-3). For the 1998 tax year, the information shows the Petitioner’s federal adjusted gross income to be \$\$\$\$ and his federal taxable income to be \$\$\$\$ (Exhibit R-4).

6. On July 26, 2004, the Division issued Statutory Notices of Estimated Income Tax to the Petitioner for tax years 1997 and 1998, which stated that the Petitioner had failed to file Utah individual income tax returns for these years. For the 1997 tax year, the Division assessed \$\$\$\$ in tax (based on federal adjusted gross income of \$\$\$\$), plus a 10% failure to timely file penalty, a 10% failure to timely pay penalty, and interest (Exhibit R-1). For the 1998 tax year, the Division assessed \$\$\$\$ in tax (based on federal adjusted gross income of \$\$\$\$), plus a 10% failure to timely file penalty, a 10% failure to timely pay penalty, and interest (Exhibit R-2).

7. The Petitioner acknowledged that he earned the revenue at issue, but claims that it is nontaxable because his employer was a “private” employer, not a government employer. The Petitioner submits evidence to show that only income earned by a government employee is taxable (Exhibit P-1).

8. On August 22, 2005, the Petitioner submitted Utah incomes returns for the years at issue on which he reported his Utah taxable income for both years to be \$\$\$\$ (Exhibits R-6 and R-7).

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. . . .”

Appeal No. 04-1114

2. For purposes of Section 59-10-104, "resident individual" is defined in UCA §59-10-103(1)(k)¹ 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 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;

¹ This subsection has been renumbered since the years at issue.

- (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. For situations where a taxpayer fails to file a Utah individual income tax return, UCA

§59-10-506(2) provides, as follows in pertinent part:

....

(2) (a) If any person fails to make and file any return required by this chapter at the time prescribed therefor, or makes, willfully or otherwise, a false or fraudulent return, the commission shall make such return from its own knowledge and from such information as it can obtain through testimony or otherwise.

(b) Any return so made and subscribed by the commission shall be prima facie good and sufficient for all legal purposes.

8. The Utah Legislature has specifically provided that the taxpayer bears the burden of

proof, with limited exceptions, in proceedings involving individual income tax before the Tax Commission.

UCA §59-10-543 provides, as follows:

In any proceeding before the commission under this chapter, the burden of proof shall be upon the petitioner except for the following issues, as to which the burden of proof shall be upon the commission:

- (1) whether the petitioner has been guilty of fraud with intent to evade tax;
- (2) whether the petitioner is liable as the transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax; and
- (3) whether the petitioner is liable for any increase in a deficiency where such increase is asserted initially after a notice of deficiency was mailed and a petition under Title 59, Chapter 1, Part 5 is filed, unless such increase in deficiency is the result of a change or correction of federal taxable income required to be reported, and of which change or correction the commission had no notice at the time it mailed the notice of deficiency.

9. UCA §59-10-539(1) provides for the imposition of penalty and interest, pertinent

parts as follow:

- (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.

....

(8) In addition to the penalties added by this section, there shall be added to the tax due interest payable at the rate and in the manner prescribed in Section 59-1-402 for underpayments.

10. For purposes of Section 59-10-539, UCA §59-1-401 provides for the imposition of penalties for failure to file a tax return within the prescribed time and for failure to pay tax when due, as follows:

(1) (a) The penalty for failure to file a tax return within the time prescribed by law including extensions is the greater of \$20 or 10% of the unpaid tax due on the return.

...

(2) The penalty for failure to pay tax due shall be the greater of \$20 or 10% of the unpaid tax for:

(a) failure to pay any tax, as reported on a timely filed return;

(b) failure to pay any tax within 90 days of the due date of the return, if there was a late filed return subject to the penalty provided under Subsection (1)(a);

(c) failure to pay any tax within 30 days of the date of mailing any notice of deficiency of tax unless a petition for redetermination or a request for agency action is filed within 30 days of the date of mailing the notice of deficiency;

(d) failure to pay any tax within 30 days after the date the commission's order constituting final agency action resulting from a timely filed petition for redetermination or request for agency action is issued or is considered to have been denied under Subsection 63-46b-13(3)(b); and

(e) failure to pay any tax within 30 days after the date of a final judicial decision resulting from a timely filed petition for judicial review.

11. Also for purposes of Section 59-10-539, UCA §59-1-402(5) provides that “[i]nterest on any underpayment, deficiency, or delinquency of any tax or fee administered by the tax commission shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.”

DISCUSSION AND CONCLUSIONS OF LAW

The Division assessed the Petitioner individual income tax, penalties, and interest for tax years 1997 and 1998, which the Petitioner has appealed. At the hearing, the Petitioner admits that he moved to Utah

in 1995 and, during the tax years at issue, lived and worked in Utah. As a result, the Petitioner was domiciled in Utah during the tax years at issue and, subject to Section 59-10-103(1)(k), is considered a Utah “resident individual” for Utah income tax purposes. Accordingly, the Petitioner is subject to Utah income tax pursuant to Section 59-10-104 if he received “state taxable income,” as defined in Section 59-10- 112.

The Petitioner admits that his employer paid him wages during 1997 and 1998 and that the employer reported his wages to taxing authorities on IRS W-2 forms. However, the Petitioner contends that the employer was a “private” employer who reported the wages by mistake. The Petitioner contends that only wages paid by a “government” employer are subject to federal taxation. For these reasons, the Petitioner contends that his wages for the years at issue are not subject to taxation, either by the federal government or by the Utah state government.

The Petitioner asserts that the original IRS Act was enacted in 1862 and provided that the only income subject to taxation was that earned by government employees. However, the Petitioner did not provide evidence to show that these provisions have ever been interpreted in this manner and, if they did, whether they still apply in this manner for the years in question, given the numerous revisions of the federal tax code in the interim. Furthermore, the IRS Sections upon which Utah “state taxable income” is determined make no mention that income earned by employees of “private” employers are nontaxable. In fact, 26 U.S.C. 61(a) defines “gross income” to mean “[e]xcept as otherwise provided in this subtitle, gross income means all income from whatever source derived . . .” That subtitle does not provide that income earned by employees of “private” employers is nontaxable or exempt from taxation. For these reasons, the Commission finds that the Petitioner’s 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. Accordingly, the Commission finds that the Petitioner not only is a Utah “resident individual, but also

that he earned Utah “state taxable income” in 1997 and 1998. For these reasons, both of the conditions set forth in Section 59-10-104 exist for the income at issue to be subject to taxation by Utah.

Burden of Proof. The Petitioner argued that the Division, and not himself, should have the burden of proof in this matter. However, Section 59-10-543 specifically provides that the taxpayer bears the burden of proof in proceedings involving individual income tax before the Tax Commission, except for three circumstances that are not present in this matter.

This matter involves the failure to make and file tax returns. Section 59-10-506(2) allows the Commission, under such circumstances, to “make such return[s] from its own knowledge and from such information as it can obtain through testimony or otherwise.” In *Jensen v. State Tax Comm'n*, 835 P.2d 965 (Utah 1992), the Utah Supreme Court stated that:

When a recalcitrant or evading taxpayer refuses to file an income tax return and the Commission is therefore compelled to reconstruct financial data from available evidence to estimate the taxpayer's income, it is reasonable to shift the burden to the taxpayer under §59-10-543 to show that the Commission's figures are incorrect. But to apply §59-10-543 in that fashion, the Commission must first clearly establish that the taxpayer earned some taxable income and then show that its predicate for computing taxable income is not arbitrary or capricious.

Accordingly, before the burden of proof is shifted to the Petitioner, the Division must: (1) establish that the taxpayer earned some taxable income; and (2) show that its predicate for computing the taxable income was not arbitrary or capricious.

The Division’s evidence is sufficient to shift the burden of proof to the Petitioner. First, the Division has obtained IRS information showing the Petitioner’s federal adjusted gross income and taxable income amounts for the years at issue. The Division assessed Utah income tax to the Petitioner based on these amounts. The Commission finds this information sufficient to show that the Petitioner earned taxable income for the years at issue and that the Division’s estimate for computing Utah taxable income was not arbitrary or

Appeal No. 04-1293

capricious. For these reasons, the burden is shifted to the Petitioner under Section 59-10-543 to show that the Commission's assessment is incorrect.

The Petitioner has not submitted evidence to prove that the Division's assessments are incorrect, even though he bears the burden to do so. For these reasons, the Commission finds that the Petitioner is a Utah resident individual who has state taxable income in the amounts respectively established by the Division for tax years 1997 and 1998. Furthermore, Sections 59-10-539, 59-1-401, and 59-1-402 provide, under the circumstances present in this manner, for the assessment of interest and penalties for failure to file a tax return when due and failure to pay tax when due. For the two tax years at issue, Petitioner both failed to file a return when due and failed to pay the tax when due. Accordingly, the Commission sustains the Division's assessments and denies the Petitioner's appeal.

DECISION AND ORDER

Based upon the foregoing, the Tax Commission finds that the Division has sufficiently defended its assessments of income tax to the Petitioner for the tax years 1997 and 1998 so that the burden of proof to disprove the assessments falls upon the Petitioner. The Commission further finds that the Petitioner has failed to show the assessments to be incorrect. For these reasons, the Commission sustains the audit assessments at issue and denies the Petitioner's appeal. It is so ordered.

DATED this ____ day of _____, 2005.

Kerry R. Chapman
Administrative Law Judge

Appeal No. 04-1293

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 _____, 2005.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

Notice of Appeal Rights: Failure to pay the balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty. 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. §63-46b-13. 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. §§99-1-601 and 63-46b-13 et. seq.

KRC/04-1114.fof