

04-1382
Audit
Signed 04/11/2006

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)	
)	FINDINGS OF FACT,
Petitioners,)	CONCLUSIONS OF LAW,
)	AND FINAL DECISION
)	
v.)	Appeal No. 04-1382
)	
AUDITING DIVISION OF)	Tax Years: 1995-2003
THE UTAH STATE TAX)	Tax Type: Income Tax
COMMISSION,)	
)	Judge: Phan
Respondent.)	

Presiding:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER

For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
 RESPONDENT REPRESENTATIVE 2, Manager Income Tax

Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on February 9, 2006. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioner is appealing income tax, penalty and interest deficiencies against him for the tax years 1995 through 2003. For audit years 1995 through 2001 the Statutory Notices of Estimated Income Tax were issued on October 29, 2004. For audit years 2002 through 2003 the Statutory Notices of Audit Change were issued on November 2, 2004. Petitioner timely filed an appeal of the audit deficiencies and the matter proceeded to the Formal Hearing.

2. The amount of the deficiencies determined by Respondent are as follows:

Year	Tax	Penalty	Interest as of Notice Date
1995	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
1996	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
1997	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
1998	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
1999	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2000	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2001	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2002	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

3. Interest continues to accrue on the unpaid balance. Penalties were assessed pursuant to Utah Code Ann. §59-1-401. The penalties assessed for audit years 1995 through 2001 were 10% failure to file, 10% failure to pay and \$500 frivolous return penalties. For audit years 2002 and 2003 the penalties were the \$500 frivolous return penalties.

4. Petitioner originally failed to file Utah Individual Income Tax Returns as they became due for the audit years at issue. Then in June 2004 Petitioner filed all Utah returns at one time. The returns were filed prior to the issuance of the Statutory Notices. Respondent determined that Petitioner's Utah returns were in error so they were not "posted." On his Utah returns Petitioner had claimed that he had \$\$\$\$\$ income on Line No. 4. Line No. 4 requests the federal adjusted gross income from the federal return. For tax years 1995 through 2001 Respondent treated Petitioner as a non-filer, preparing Statutory Notices of Estimated Tax as if no return was filed. For tax years 2002 and 2003, Respondent treated Petitioner as a filer and issued Statutory Notices of Audit Change. These type of audits are performed when a return has been filed.

5. Respondent's audits were based on information provided by the Internal Revenue Service that indicated Petitioner had received income, primarily from wages, during each of the years at issue.

6 During the audit period Petitioner was a "resident individual" for the purposes of Utah Code Ann. §59-10-104. He acknowledged that he resided in Utah during all the years in question.

7. Petitioner acknowledges he received wages from his employer during the audit period. He does not dispute the dollar amount of income Respondent had used in determining the audit deficiencies. His contention was that his income would not be included in federal adjusted gross income. As it was his position that he had \$\$\$\$ federal adjusted gross income for all the years at issue and the Utah tax return asked for the federal adjusted gross income reported on the federal return, instead of wages or some other amount, he had claimed \$\$\$\$ income on his state return. He indicates had the Utah return asked for wages as reported on the W-2, he would have complied and paid tax to the state of Utah.

APPLICABLE LAW

Utah imposes income tax on individuals who are residents of the state, in Utah Code Ann. §59-10-104 as follows:

...a tax is imposed on the state taxable income, as defined in Section 59-10-112, of every resident individual...

"Resident individual" is defined in Utah Code Ann. §59-10-103(1)(k) as:

(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. For purposes of this Subsection (1)(k)(ii), a fraction of a calendar day shall be counted as a whole day.

State taxable income is defined in Utah Code Ann. §59-10-112 as follows:

"State 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 . . .

Federal taxable income is defined in Utah Code Ann. §59-10-111 as follows:

"Federal taxable income" means taxable income as currently defined in Section 63, Internal Revenue Code of 1986.

Taxable income is defined in the Internal Revenue Code at 26 U.S.C. 63 as:

Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

Gross income is defined in the Internal Revenue Code at 26 U.S.C. 61(a) as:

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; ...

The Utah Legislature has specifically provided that the taxpayer bear the burden of proof in proceedings before the Tax Commission. Utah Code Ann. §59-10-543 provides the following:

In any proceeding before the commission under this chapter, the burden of proof shall be upon the petitioner . . .

Utah Code Ann. §59-1-401 provides that penalties are imposed for failure to file returns, filing frivolous returns and failure to pay taxes. In relevant part, Utah Code Ann. §59-1-401 states:

(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. (b) This subsection (1) does not apply to amended returns.

(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). . .

(7) 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

At the hearing Petitioner acknowledged that he was a Utah resident and that he received wage income in Utah during all the audit years at issue. He did not dispute the amount of the income determined by Respondent. Instead Petitioner argues that his wages and other income are not “federal adjusted gross income” pursuant to federal law and, therefore, not subject to federal tax. Based on his interpretation of the federal tax code he concluded that he had \$\$\$\$ federal adjusted gross income for each of the years at issue.

He argues that Utah bases its tax on the federal amount. He points out that the Utah Tax Returns and instruction booklets for each year at issue indicate that the taxpayer is to enter the amount of “federal adjusted gross income” from the federal return. He states if the Utah return and instruction booklet had indicated to report on Line No. 4 all wages, or the amount from a box on his W-2, he would have reported that amount and paid the resulting tax. He acknowledges that he was a Utah resident. He states that he did not object to paying Utah income tax. However, the booklet asked instead for a line on his federal form and it was his belief that the correct amount on his federal form on that line was \$\$\$\$.

Upon reviewing Petitioner’s claim in this matter, Petitioner’s argument as to why he does not owe Utah tax is without merit. The Commission disagrees with Petitioner’s conclusion regarding his federal income tax. The statutes and case law clearly support federal individual

income tax.¹ However, for state tax purposes, his arguments about federal income tax are largely irrelevant.

Utah individual income tax is governed by Utah state statute. Utah Code Ann. §59-10-104 imposes a tax on every “resident individual.” Utah “resident individuals” are subject to state income tax on their “state taxable income.” “State taxable income” is defined at Utah Code Ann. §59-10-112 and Utah Code Ann. §59-10-111 as “federal taxable income” (with some modifications and adjustments) as defined in Section 63, Internal Revenue Code of 1986. Based on this state taxable income is income from whatever source derived and specifically includes compensation for services. See Internal Revenue Code at 26 U.S.C. 63 and 61(a).

The Internal Revenue Code is relevant to Utah tax purposes to the extent that Utah state taxable income is based on a specified definition from the Internal Revenue Code. However, it should be noted that Utah may make a state individual income tax assessment regardless of whether an assessment has been made by the IRS.² In addition the courts have specifically

¹See **United States v. Mann**, 884 F.2d 532 (10th Cir. 1989). In that case, Mann offered many theories as to why he was not required to file income tax returns. The court stated, “His many theories include the asserted beliefs that 1) the United States Supreme Court has declared that the sixteenth amendment applies only to corporations, 2) the Internal Revenue Service (IRS) has no jurisdiction over him, 3) he is not a “person” within the meaning of 26 I.R.C. §7203, 4) wages are not income, 5) federal reserve notes are not legal tender, and 6) the income tax is voluntary.” The court in **Mann** responded to these assertions as follows, “. . . each of the views offered by Mann, whether found in his published materials or articulated additionally at trial, falls somewhere on a continuum between untrue and absurd.” See also **United States v. Collins**, 920 F.2d 619 (10th Cir. 1990), **cert. denied**, 500 U.S. 920, (1991); **United States v. Lonsdale**, 919 F.2d 1440 (10th Cir. 1990); **United States v. Hanson**, 2 F.3d 942,945 (9th Cir. 1993); **United States v. Studley**, 783 F.2d 934, 937, n. 3 (9th Cir. 1986); **United States v. Sloan**, 939 F.2d 499, 501 (7th Cir. 1991), **cert. den.** 112 S.Ct. 940 (1992); **United States v. Kruger**, 923 F.2d 587, 587-588 (8th Cir. 1991); **United States v. Gerads**, 999 F.2d 1255 (8th Cir. 1993); **United States v. Slater**, 96 F.R.D. 53, 55-56 (D. Del. 1982); and **United States v. Mundt**, 29 F.3d 233,237 (6th Cir. 1994). **Cox V. Commissioner of Internal Revenue**, 99 F.3d 1149 (10th Cir. 1996); **Baker v. Towns**, 849 F. Supp. 775 (D.Utah 1993);and **United States v. Hanson**, 2 F.3d 942 (9th Cir. 1993);

²The Utah Supreme Court has addressed this issue in **Nelson v. Auditing Div.**, 903 P.2d 939 (Utah 1995) and **Jensen v. State Tax Commission**, 835 P.2d 965 (Utah 1992).

considered the issue of whether wages are included in federal taxable income and have clearly concluded that wages are taxable income.³

Petitioner was assessed both failure to pay and failure to file timely penalties in this matter pursuant to Utah Code Ann. Section 59-1-401, for the years 1995 through 2001. There is no intent element to these penalties and Petitioner did fail to file and pay timely.

Additionally, a \$500 penalty for filing a frivolous return was assessed on each year at issue in this matter. The returns filed were clearly frivolous. However, the statute imposing this penalty provides an intent element, a “prima facie intent” to delay or impede the administration of the tax laws. Petitioner argues that he was trying to comply with the laws of Utah by filling out his Utah return according to the instruction booklet and tax form. He argues that the returns he filed, although late, complied exactly with the instructions.

Considering the penalty for filing a frivolous return, the returns were clearly frivolous. The Commission concludes that filing the obviously frivolous returns indicates a “prima facie intent,” regardless of Petitioner’s testimony as to his intent and rationale for preparing the returns in that manner. However, the returns had been caught as erroneous returns and were never processed. Further, Respondent appears to have treated Petitioner as a non-filer for the years 1995 through 2001 for some purposes, but as a filer for the purposes of imposing the frivolous penalty. For this reason the Commission finds it appropriate to waive the \$500 penalty for the 1995 through 2001 years. Respondent treated Petitioner as a filer for the years 2002 and 2003

³The 5th Circuit stated “it is clear beyond peradventure that the income tax on wages is constitutional.” **Stelly v. Commissioner**, 761 F.2d 1113, 115 (1985). See also **Granzow v. C.I.R.**, 739 F.2d 265, 267 (1984) in which the Seventh Circuit stated, “It is well settled that wages received by taxpayers constitute gross income within the meaning of Section 61 (a) of the Internal Revenue Code . . . and that such gross income is subject to taxation.” In **United States v. Koliboski**, 732 F.2d 1328, 1329 fn 1 (1984), the Seventh Circuit stated “the defendant’s entire case at trial rested on his claim that he in good faith believed that wages are not income for taxation purposes. Whatever his mental state, he, of course, was wrong, as all of us already are aware. Nonetheless, the defendant still insists that no case holds that wages are income. Let us now put that to rest: WAGES ARE INCOME.” See also **United States v. Mann**, 884 F.2d 532 (10th Cir. 1989).

and the returns were clearly frivolous. The Commission sustains the \$500 frivolous penalty for those years.

The Commission finds Petitioner clearly filed erroneous returns. Had Petitioner calculated the federal return correctly the amount indicated as federal adjusted gross income on the federal return would result in a correct Utah tax liability when entered on Line 4 of the Utah return. Additionally, it is the statute, not the instruction booklet that takes precedent should there be an actual conflict, which is not present in this matter. Under Utah law Petitioner's wage income is clearly included in state taxable income and subject to income tax.

CONCLUSIONS OF LAW

1. The Commission has made a finding of fact that Petitioner was a Utah resident individual throughout the tax years at issue. For this reason the Commission concludes that Petitioner is liable for Utah individual income tax on his state taxable income. Utah Code Ann. §59-10-104.

2. Petitioner did not dispute that he had received income during the years at issue, nor dispute the dollar amount of the income as determined by Respondent. This income came primarily from wages. Wages are clearly taxable as compensation for services and clearly included in Utah taxable income. Utah Code Ann. §59-10-112; Utah Code Ann. §59-10-111; 26 U.S.C. 63; 26 U.S.C. 61(a). Petitioner's argument that his income is not subject to state income tax is without merit and has no basis in statute or case law.

3. Late payment and late filing penalties were appropriately assessed pursuant to Utah Code Ann. §59-1-401. However, the evidence before the Commission did not support the additional \$500 penalty pursuant to Utah Code Ann. 59-1-401(7) for the years 1995 through 2001 as Respondent appears to have treated Petitioner as a non-filer for some purposes for those years, and as a filer for the purpose of imposing the penalty. Filing returns that are clearly frivolous constitutes the showing of "prima facie intent to delay or impede administration

of the tax law” sufficient for purposes of the \$500 penalty and for that reason the penalty for the years 2002 and 2003 is sustained.

DECISION AND ORDER

Based on the foregoing, the Tax Commission sustains the audit assessments of additional income tax, late payment and late filing penalties and interest against Petitioner for the years 1995 through 2003. However, the Commission abates the \$500 penalty for filing a frivolous return for tax years 1995 through 2001. The Commission sustains the \$500 penalty for tax years 2002 and 2003. It is so ordered.

DATED this ____ day of _____, 2006.

Jane Phan
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

Notice and Appeal Rights: If payment of the balance due resulting from this decision is not made within thirty days of the date of this order an additional late payment penalty may be assessed. 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. §§59-1-601 and 63-46b-13 et. Seq.

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