

05-0322  
Audit  
Signed 06/09/2006

BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,	)	
	)	<b>ORDER FROM FORMAL</b>
Petitioner,	)	<b>HEARING</b>
	)	
v.	)	Appeal No.    05-0322
	)	Account No.    #####
	)	
AUDITING DIVISION OF	)	
THE UTAH STATE TAX	)	Tax Type:    Income Tax
COMMISSION,	)	Tax Years:    1996-2002
	)	
Respondent.	)	Judge:        Rees

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**Presiding:**          Marc B. Johnson, Commissioner, and Irene Rees, Administrative Law Judge

**Appearances:**  
For Petitioner:      PETITIONER, Petitioner  
For Respondent:      RESPONDENT REPRESENTATIVE 1, Assistant Attorney General,  
                          with RESPONDENT REPRESENTATIVE 2, Senior Auditor

STATEMENT OF THE CASE

This matter arises from an audit assessment issued by the Division concerning returns filed by Petitioner for tax years 1996 through 2002. Petitioner's original returns for tax years 1996 through 1999 were prepared by his representative, ( X ). In March of 2005, Petitioner amended the ( X ) returns and filed his 2000 through 2002 returns. In those returns, Petitioner claimed that he had \$\$\$\$ income for the years in question. The Division issued Petitioner Notices of Deficiency relating to all tax years. Petitioner filed an appeal, arguing that he had no income that was subject to state and federal tax during the years in question and requesting a refund of amounts withheld in those years. Petitioner failed to appear at an Initial Hearing set for August 2, 2005 and the Commission issued an Order of Default. Petitioner requested a Formal Hearing, which was held on March 23, 2006.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1. Petitioner was a Utah resident and subject to Utah Income Tax laws during all years at

issue.

2. Petitioner was employed during the years at issue and received compensation through his employer, as evidenced by W-2 forms, information from the Bureau of Labor Statistics and by federal transcripts. Petitioner does not assert that he did not work for money in the tax years at issue here. Rather he argues he did not work for “compensation” within the meaning of state and federal tax laws.
3. For tax year 1996, Petitioner’s representative, ( X ), prepared and Petitioner filed “Payment Affidavits” which indicated that Petitioner earned compensation from self-employment and other employment. However, the entire amount of compensation in the amount of \$\$\$\$\$ was declared as itemized deductions, and the tax liability declared was \$\$\$\$\$. Petitioner later amended the return to indicate that he received \$\$\$\$\$ compensation.
  - a. The 1996 W-2 prepared by COMPANY A indicates that Petitioner had compensation in the amount of \$\$\$\$\$. No federal or state tax was withheld.
  - b. Petitioner prepared his own “Substitute for Form W-2” declaring that he earned no compensation in 1996 along with the following statement:

I knew the company would refuse to issue forms correctly listing payments of “wages” as defined in IRC Sections 3401 (a) and 3121 (a) for fear of IRS retaliation. The amounts listed as withheld on the W-2 it submitted are correct, however.
  - c. The IRS transcript indicates that the IRS did not accept the amended return as filed or the substitute W-2 form. The IRS determined that Petitioner’s federal adjusted gross income for 1996 was \$\$\$\$\$ and his federal taxable income was \$\$\$\$\$.
  - d. The evidence indicates that Petitioner worked for compensation in 1996 and that his income, plus or minus allowable add-ins and deductions, is subject to Utah income tax.

- i. The Division's assessment in the amount of \$\$\$\$\$, plus interest and penalties, is based on a federal adjusted gross income of \$\$\$\$\$ and a Utah taxable income of \$\$\$\$\$. The assessment is supported by the evidence.
  - ii. The interest and penalty included in the assessment notice is also supportable by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns prepared by ( X ) to be filed, then deliberately amended those returns with additional erroneous information.
4. For tax year 1997, Petitioner's representative, ( X ), prepared and Petitioner filed "Payment Affidavits" which indicated that Petitioner earned compensation his employment. However, the entire amount of compensation in the amount of \$\$\$\$\$ was declared as itemized deductions, and the tax liability declared was \$\$\$\$\$. Petitioner later amended the return to indicate that he received \$\$\$\$\$ compensation.
  - a. The 1997 W-2 prepared by COMPANY A indicates that Petitioner had compensation in the amount of \$\$\$\$\$. No federal tax was withheld, \$\$\$\$\$ was withheld for the state. A W-2 for Petitioner's wife indicates that she was paid \$\$\$\$\$ by ( X ), but Petitioner filed "married, filing separately."
  - b. Petitioner prepared his own "Substitute for Form W-2" declaring that he earned no compensation in 1997 along with the following statement:

I knew the company would refuse to issue forms correctly listing payments of "wages" as defined in IRC Sections 3401 (a) and 3121 (a) for fear of IRS retaliation. The amounts listed as withheld on the W-2 it submitted are correct, however.

- c. The IRS transcript indicates that the IRS did not accept the amended return as filed or the substitute W-2 form. The IRS determined that Petitioner's gross income for 1997 was \$\$\$\$\$ and his federal taxable income was \$\$\$\$\$.
  - d. The evidence indicates that Petitioner worked for compensation in 1997 and that his income, plus or minus allowable add-ins and deductions, is subject to Utah income tax.
    - i. The Division's assessment of \$\$\$\$\$, plus interest and penalty, is based on federal gross income of \$\$\$\$\$ and a Utah taxable income of \$\$\$\$\$. Credit was allowed for state tax withheld. The assessment for tax is supported by the evidence.
      - ii. The interest and penalty included in the assessment notice is also supportable by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns prepared by ( X ) to be filed, then deliberately amended those returns with additional erroneous information.
5. For tax year 1998, Petitioner's representative, ( X ), prepared and Petitioner filed "Payment Affidavits" which indicated that Petitioner earned compensation his employment. However, the entire amount of compensation in the amount of \$\$\$\$\$ was declared as itemized deductions, and the tax liability declared was \$\$\$\$\$. Petitioner later amended the return to indicate that he received \$\$\$\$\$ compensation.
- a. The 1998 W-2 prepared by Petitioner's ( X ) indicates that Petitioner had compensation in the amount of \$\$\$\$\$. No federal tax or state tax was withheld.
  - b. Petitioner prepared his own "Substitute for Form W-2" declaring that he earned no compensation in 1998 along with the following statement:

I knew the company would refuse to issue forms correctly listing payments of "wages" as defined in IRC Sections 3401 (a) and 3121 (a) for fear of IRS retaliation. The amounts listed as withheld on the

W-2 it submitted are correct, however.

- c. The IRS transcript indicates that the IRS did not accept the amended return as filed or the substitute W-2 form. The IRS determined that Petitioner's Adjusted Gross Income for 1996 was \$\$\$\$\$ and his federal taxable income was \$\$\$\$\$.
  - d. The evidence indicates that Petitioner worked for compensation in 1998 and that his income, plus or minus allowable add-ins and deductions, is subject to Utah income tax.
    - i. The Division's assessment in the amount of \$\$\$\$\$, plus interest and penalty, is based on gross income in the amount of \$\$\$\$\$ and a Utah taxable income of \$\$\$\$\$. The assessment of tax is supported by the evidence.
    - ii. The interest and penalty included in the assessment notice is also supportable by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns prepared by ( X ) to be filed, then deliberately amended those returns with additional erroneous information.
6. For tax year 1999, Petitioner's representative, ( X ), prepared and Petitioner filed "Payment Affidavits" which indicated that Petitioner earned compensation his employment. However, the entire amount of compensation in the amount of \$\$\$\$\$ was declared as itemized deductions, and the tax liability declared was \$\$\$\$\$. Petitioner later amended the return to indicate that he received \$\$\$\$\$ compensation
- a. The 1999 W-2 prepared by COMPANY B indicates that Petitioner had compensation in the amount of \$\$\$\$\$. No federal tax was withheld, but Utah withholding in the amount of \$\$\$\$\$ was reported. Petitioner's wife also had income from the same employer.
  - b. Petitioner prepared his own "Substitute for Form W-2" declaring that he earned

no compensation in 1999 along with the following statement:

I knew the company would refuse to issue forms correctly listing payments of “wages” as defined in IRC Sections 3401 (a) and 3121 (a) for fear of IRS retaliation. The amounts listed as withheld on the W-2 it submitted are correct, however.

- c. The IRS transcript indicates that the IRS did not accept the amended return as filed or the substitute W-2 form. The IRS determined that Petitioner’s Adjusted Gross Income for 1999 was \$\$\$\$\$ and his federal taxable income was \$\$\$\$\$.
- d. The evidence indicates that Petitioner worked for compensation in 1999 and that his income, plus or minus allowable add-ins and deductions, is subject to Utah income tax.
  - i. The Division’s assessment in the amount of \$\$\$\$\$, plus interest and penalty, is based on gross income in the amount of \$\$\$\$\$ and a Utah taxable income of \$\$\$\$\$. Credit was allowed for state tax withheld. The assessment of tax is supported by the evidence.
  - ii. The interest and penalty included in the assessment notice is also supportable by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns prepared by ( X ) to be filed, then deliberately amended those returns with additional erroneous information.

7. For tax year 2000, the Petitioner failed to file his W-2 with his amended return.

However, Petitioner’s employer reported Petitioner’s total compensation to the State in the amount of \$\$\$\$\$. This amount agrees with the adjusted gross income reported by the IRS on Petitioner’s Account Transcript.

- a. The Division calculated Petitioner’s Utah taxable income in the amount of \$\$\$\$\$, resulting in a tax liability of \$\$\$\$\$. An assessment in that amount, plus interest and penalty, was issued. No credit was given for Utah withholding, as

there is no record that any amount was withheld by Petitioner's employer. The assessment for tax is supported by the evidence.

- b. The interest and penalty included in the assessment notice is also supported by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns to be filed, then deliberately amended those returns with additional erroneous information.
8. For tax year 2001, the Petitioner failed to file his W-2 with his amended return. However, Petitioner's employer reported Petitioner's total compensation to the State in the amount of \$\$\$\$\$. This amount agrees with the adjusted gross income reported by the IRS on Petitioner's Account Transcript.
- a. The Division calculated Petitioner's Utah taxable income in the amount of \$\$\$\$\$, resulting in a tax liability of \$\$\$\$\$. The Division issued an assessment in that amount, plus interest and penalty. No credit was given for state withholding, as no withholding was reported. The assessment for tax is supported by the evidence.
  - b. The interest and penalty included in the assessment notice is also supported by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns to be filed, then deliberately amended those returns with additional erroneous information.
9. For the 2002 tax year, Petitioner failed to file a W-2 with his amended return. However, Petitioner's employer reported Petitioner's total compensation to the State in the amount of \$\$\$\$\$. This amount corresponds to the amount reported by the IRS on Petitioner's Account Transcript.
- a. The Division calculated the Petitioner's Utah taxable income to be \$\$\$\$\$, yielding a tax liability of \$\$\$\$\$. The Division issued an assessment in that amount, plus interest and penalty. The assessment for tax is supported by the

evidence.

- b. The interest and penalty included in the assessment notice is also supported by the evidence. Regarding the \$500 penalty in particular, the Petitioner caused the erroneous returns to be filed, then deliberately amended those returns with additional erroneous information.

#### 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>1/4</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

Petitioner does not dispute that he was a Utah resident pursuant to Utah Code Ann. §59-10-543 and 59-10-103(1)(k) during the tax years at issue here. In fact, Petitioner filed Utah resident tax returns and amended returns for all years. Neither does the Petitioner deny that he had income in the tax years at issue. The argument presented by Petition is that his income is not “compensation” within his interpretation of the tax laws, that he is not required to declare his income on his tax return, and that the assessments issued against him represent a misapplication of the Division’s examination and audit authority. Petitioner also argues he is due a refund of any amounts withheld. Petitioner has the burden to show that his income is not taxable. Utah Code Ann. §59-10-543.

In a written statement, Petitioner claims that the returns he filed in 2005 rebut “and therefore render a legal nullity” allegations of others that he received payments of the kind that give rise to tax liability. (Pet. Affidavit, March 11, 2006.) Petitioner argues that by claiming \$\$\$\$ compensation on his returns, that the federal and state taxing authorities have to accept those returns as true and valid. Because the Utah return draws from the federal adjusted gross income figure calculated on the federal return, Petitioner reasons that the state has to accept the figure he entered on his federal return. Petitioner argues that the state has no legal authority to challenge his sworn declarations on that return.

Petitioner’s argument is without merit. Section 59-10-506 of the Utah Code authorizes the Division to calculate Petitioner’s tax liability for years in which he failed to file returns conforming to the Utah Individual Income Tax Act. The Division is authorized to base its calculations on all relevant information that it can obtain from other sources. The returns prepared by the Division are prima facie sufficient for all legal purposes.

Under the authority of Section 59-10-506, the Division prepared returns for all years based on W-2s issued in the Petitioner's name, wage information reported to Work Force Services, and information received from the IRS. Information from these sources indicates that Petitioner had income in all tax years. Petitioner's state taxable income is equivalent to his federal taxable income with modifications prescribed in the Utah Tax Code. Utah Code Ann. §59-10-112. Petitioner's federal taxable income is defined in Section 63 of the Internal Revenue Code. It includes "compensation for services, including fees, commissions, fringe benefits, and similar items" and "gross income derived from business" minus allowable deductions and adjustments set out in section 63 of the IRS Code.

The Division's calculations of Petitioner's Utah taxable income is based on the Petitioner's federal taxable income, which appears on the IRS transcripts and which conforms with information from other sources, minus the standard deduction due and any credit due for tax withheld. If Petitioner was eligible for any other deductions or credits, it was his responsibility to offer up evidence of that fact. He did not, and the Division's calculations are legally sufficient to establish Petitioner's tax liability.

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

**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. §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