

06-0181  
Audit  
Signed 12/05/2006

BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,	)		
	)	<b>ORDER</b>	
Petitioner,	)		
	)	Appeal No.	06-0181
v.	)	Account No.	#####
	)		
AUDITING DIVISION OF	)	Tax Type:	Income Tax
THE UTAH STATE TAX	)		
COMMISSION,	)	Judge:	Jensen
	)		
Respondent.	)		

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**Presiding:**

Clinton Jensen, Administrative Law Judge

**Appearances:**

For Petitioner: PETITIONER  
For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General  
RESPONDENT REPRESENTATIVE 2, Manager, Income Tax Auditing  
RESPONDENT REPRESENTATIVE 3, Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing on May 18, 2006 in accordance with Utah Code Ann. §59-1-502.5.

Petitioner is appealing individual income tax audit deficiencies for the tax years 2002 through 2004 which are the years at issue in these appeals. The Statutory Notice of Estimated Income Tax for the tax years 2002 and 2004 were issued on January 17, 2006. For the tax year 2003, the notice was issued on January 19, 2006. The penalties assessed were \$500 for each year for frivolous tax filings. Interest continues to accrue on the unpaid balance. The amounts of the deficiencies for each year are as follows:

Year	Tax	Penalty	Interest as of Notice Date
2002	\$\$\$\$	\$500	\$\$\$\$
2003	\$\$\$\$	\$500	\$\$\$\$
2004	\$\$\$\$	\$500	\$\$\$\$

Appeal No. 04-0216

The Division claims deficiencies on the basis of unreported income on the Petitioner's Utah Income Tax Return forms for each of the above years. The Division gained information regarding income attributable to the Petitioner through investigation including income reported to Utah Job Service and the federal government.

The Petitioner does not dispute the amounts, payees, or the times of the transfers of money from employers as claimed by the Division. However, the Petitioner takes the position that the Utah tax returns files are nevertheless valid because they match the Petitioner's federal tax returns filed for 2002, 2003, and 2004, which also show zero income.

#### APPLICABLE LAW

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. . . ."

For purposes of Section 59-10-104, "resident individual" is defined in UCA §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....

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 . . . ."

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."

Appeal No. 04-0216

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).”

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.

Utah Code Ann. §59-10-506(2) provides that when a taxpayer files a return that is either false or fraudulent, the Tax Commission has the authority to make a tax return “from its own knowledge and from such information as it can obtain through testimony or otherwise.”

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.

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.
- (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).

- . . . .
- (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.

For purposes of Section 59-10-539, UCA §59-1-401 provides for the imposition of penalties, 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.

.....  
(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.

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

Petitioner's arguments are without merit. "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. This includes 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 federal taxable income as defined at the specified code section. 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.<sup>1</sup> In addition, the courts have specifically considered the issue of whether wages are

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<sup>1</sup>The 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).

included in federal taxable income and have clearly concluded that wages are taxable income.<sup>2</sup> The imposition of taxes as determined by the Division is proper in accordance with Utah law.

In its Statutory Notice of Audit Change dated January 26, 2006, the Division imposed a \$500 penalty pursuant to Section 59-1-401(7). This Section provides for the assessment of the \$500 penalty if a taxpayer takes action that includes the following three elements: (1) the action is in furtherance of a frivolous position; (2) there exists a prima facie intent to delay or impede administration of the tax law; and (3) the taxpayer 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. If all three elements exist, the penalty has been properly imposed.

(1) *Furtherance of a frivolous position.* The Petitioner filed tax returns indicating zero income on the belief that wages are not subject to income tax. The Commission considers such a claim to be frivolous, regardless whether the Petitioners *believe* that “wages” are exempt from taxation.<sup>3</sup> Accordingly, the

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<sup>2</sup>The 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).

<sup>3</sup> See *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.” The courts have also rejected the argument that only government employees or officials are subject to the federal individual income tax. See *United States v. Latham*, 754 F.2d 747,750 (7th Cir. 1985) and *Sullivan v. United States*,

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Commission finds that the Petitioner committed a frivolous action in filing state tax returns for 2002, 2003, and 2004 indicating zero income.

(2) *Prima facie intent to delay or impede administration of the tax law.* The Petitioner filed 2002, 2003, and 2004 tax returns that are frivolous and have required time and effort by the Tax Commission to properly analyze and address the Petitioners' frivolous action. By purposely filing a tax return that asserts this frivolous position, the Petitioner has delayed and impeded the administration of the tax laws. The Commission also finds that the Petitioner's delay or impediment of tax law administration was intentional. The Petitioner has ignored common knowledge in filing income tax returns and followed a novel theory that has no support in either case law or the statutes. On this basis, the Commission finds that the Petitioner has acted in an intentional manner to delay or impede tax law administration.

(3) *Return has insufficient information to determine liability or clearly indicates that the liability shown is incorrect.* The Petitioner's 2002, 2003, and 2004 tax returns contains a frivolous position by asserting that the Petitioner's income is not subject to taxation. These state returns show zero income notwithstanding the income actually earned by the Petitioner during these years. Accordingly, the Commission also finds that the returns included insufficient information to determine whether the liability shown on it was correct.

The Commission finds that the Division has shown that all elements required for it to impose the \$500 penalty exist in this matter. Accordingly, the Division sustains the \$500 penalty that the Division assessed pursuant to Section 59-1-401(7).

#### DECISION AND ORDER

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788 F.2d 813, 815 (1st Cir. 1986).

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Based on the foregoing, the Tax Commission sustains the assessment of additional income tax, penalties and interest against Petitioner for the tax years 2002, 2003, and 2004 as stated on the Statutory Notices of Estimated Income Tax. 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:

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 \_\_\_\_\_, 2006.

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Clinton Jensen  
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

Marc B. Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
Commissioner



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