

06-0801
Income Tax
Signed 02/23/2007

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)		
)	ORDER	
Petitioner,)		
)	Appeal No.	06-0801
v.)	Account No.	#####
)		
AUDITING DIVISION OF)	Tax Type:	Income Tax
THE UTAH STATE TAX)		
COMMISSION,)	Judge:	Jensen
)		
Respondent.)		

Presiding:
Clinton Jensen, Administrative Law Judge

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

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing on October 5, 2006 in accordance with Utah Code Ann. §59-1-502.5.

Petitioner is appealing individual income tax audit deficiencies for the tax years 2001, 2003, 2004, and 2005, which are the years at issue in these appeals. The Division issued Statutory Notices of Audit Change for these tax years on April 25, 2006. The penalties assessed were \$\$\$\$ for each year for frivolous returns. The notices included interest at the statutory rate and interest continues to accrue on the unpaid balance. The amounts of the deficiencies for each year are as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalty</u>	<u>Interest as of Notice Date</u>
2001	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2004	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

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2005 \$932.45 \$500.00 \$5.82

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)(t) as:

(i) (A) an individual who is domiciled in this state for any period of time during the taxable year, but only for the duration the period during which the individual is domiciled on this state; or (B) an individual who is not domiciled in this state but: (I) maintains a permanent place of abode n this state; and (II) spends I the aggregate 183 or more days of the taxable year in this state. (ii) For purposes of Subsection (1)(t)(i)(B), 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 the resident individual's federal taxable income as defined by Section 59-10-111, with the additions and subtractions required by 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 provided that the taxpayer bears the burden of proof in proceedings before the Tax Commission. Utah Code Ann. §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 . .

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 hearing, the Petitioner made three requests. First, she asked that the Division's audit be overturned. Second, because her tax returns were correct or at least filed in good faith, she requested that there be no penalty imposed. Third, the Petitioner requested a stay of the Utah state action pending the outcome of a case pending before the Internal Revenue Service for the same tax years.

Income Tax on Audits

For each of the four years at issue in this appeal, the Petitioner filed a separate Utah tax return with a “0” listed for the amount of income. The Petitioner claims that she had no income for each of these four years. The Division presented evidence that indicates payments by employers for the tax years in question. The Petitioner has no dispute with Division’s assertion that she received payments as indicated by the Division, but claims that she defines “income’ differently. The Petitioner maintains that her income, as she defines it, is zero.

"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. When the definitional links are followed, 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 federal taxable income as defined at the specified code section. However, it should be noted that Utah has the authority to make a state individual income tax assessment regardless of whether an assessment has been made by the IRS.¹ In addition the courts have specifically considered the issue of whether wages are included in federal taxable income and have clearly concluded that wages are taxable income.²

¹The 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).

²The 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

Utah Code Ann. 59-10-543 places the burden of proof in this matter on Petitioner. Petitioner did not provide any evidence that the dollar amounts Respondent had relied on as wage income from Petitioner's employer was incorrect. Respondent's information came from a reliable source and from records, which were kept in the regular course business. Certainly Petitioner presented no evidence that the amount of wages or other payments received was incorrect.

Penalties for Frivolous Filing

In its Statutory Notice of Audit Change dated January 26, 2006, the Division imposed a \$\$\$\$ penalty pursuant to Section 59-1-401(7). This statute provides for the assessment of the \$\$\$\$ 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.* For each of the tax years at issue, the Petitioner filed a tax return indicating no income. Given the clear evidence that the Petitioner did in fact have income in each of the years at issue, the Commission considers such a claim to be frivolous, regardless of whether the Petitioner *believes* that “wages” are exempt from taxation.³ Accordingly, the Commission finds that the Petitioner committed a frivolous action for each of the tax returns from 2000 through 2005.

United States v. Mann, 884 F.2d 532 (10th Cir. 1989).

³ 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

(2) *Prima facie intent to delay or impede administration of the tax law.* The Petitioner filed tax returns that were frivolous. Each filing has required time and effort by the Tax Commission to properly analyze and address the Petitioner's frivolous action. By purposely filing tax returns that assert 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 and her past experience of filing income tax returns and followed a novel theory that has no support in either case law or the statutes. For these reasons, 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 tax returns clearly contain a frivolous position by asserting that the Petitioner's income is not subject to taxation. The documents accompanying the returns included IRS 4852 forms, but failed to include the IRS Form W-2s that the 4852 forms were intended to replace, even though the Petitioner had access to the W-2 forms. Without the IRS Form W-2, it was not initially clear that the IRS Form 4852 and the amended Utah return were incorrect. Accordingly, the Commission also finds that the Petitioner's tax returns for the years 2001, 2003, 2004, and 2005 included insufficient information to determine whether the liability shown on the returns was correct.

The Commission finds that the Division has shown that all elements required for it to impose the \$\$\$\$ penalty exist in this matter. Accordingly, the Division sustains the \$\$\$\$ penalty for each of the tax

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

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years in question pursuant to Section 59-1-401(7).

Request to Stay Utah Action

Even if the Petitioner does not prevail on her other arguments, she requests that the Commission stay its decision in the state tax action to await results from an IRS action for the same tax years. The Petitioner explained that she filed federal tax returns with the IRS for the same tax years with the same zero income for all four years. The Petitioner indicated that as of the date of the hearing in the matter before the Utah State Tax Commission, the IRS had not ruled on the Petitioner's position with the IRS. She argues that the Tax Commission should await a decision from the IRS rather than rule on Utah income tax.

As previously indicated, there is no question that the Utah Tax Commission has the authority to determine Utah taxes independent of action by the Internal Revenue Service. *See Nelson v. Auditing Div.*, 903 P.2d 939 (Utah 1995); *see also Jensen v. State Tax Commission*, 835 P.2d 965 (Utah 1992). Nevertheless, the Commission may decline to do so under the facts of a given case. One reason for declining to determine Utah tax liability independently of action by the IRS is the possibility of inconsistent rulings from two taxing entities on the same question. In this case, however, the petitioner's claims have already been determined to be frivolous. As such, there is no reason in this case to await a decision by the Internal Revenue Service because reasonable minds could not differ on the subject of this appeal.

DECISION AND ORDER

Based on the foregoing, the Tax Commission sustains the assessment of income tax, penalties and interest against Petitioner for the tax years 2001, 2003, 2004, and 2005 as stated on the Statutory Notices of 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

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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 _____, 2007.

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 _____, 2007.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

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