

06-1408
INCOME TAX
TAX YEARS: 2003 & 2004
SIGNED: 11-05-2007
COMMISSIONERS: R. JOHNSON, M. JOHNSON, D. DIXON
ABSENT: P. HENDRICKSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	ORDER Appeal No. 06-1408 Account No. ##### Tax Type: Income Tax Tax Years: 2003 & 2004 Judge: Phan
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Presiding:
 Jane Phan, Administrative Law Judge

Appearances:
 For Petitioner: PETITIONER
 For Respondent: RESPONDENT REP., Tax Audit Manager

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing on July 30, 2007, pursuant to Utah Code Sec. 59-1-502.5. The matter was before the Commission on Petitioner's appeal of a Utah individual income tax audit deficiency for tax years 2003 and 2004. The Statutory Notices of Audit Change had been issued on November 1, 2006. The amount of the deficiency for 2003 was \$\$\$\$ in tax and \$\$\$\$ in interest as of the date of the notice. For 2004 the amount of the deficiency was \$\$\$\$ in tax and \$\$\$\$ in interest as of the date of the notice. Interest continues to accrue on the unpaid balance.

APPLICABLE LAW

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Utah imposes income tax on individuals who are residents of the state, at Utah Code Sec. 59-10-104 (2003-2004)¹ as follows:

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

State taxable income is defined in Utah Code Sec. 59-10-112 (2003 & 2004) 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 Sec. 59-10-111 (2003 & 2004) 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).

If a change is made by the Internal Revenue Service to a Utah resident's federal taxable income the resident must file an amended Utah return in Utah Code Sec. 59-10-536 (2003 & 2004) as follows:

If a change is made in a taxpayer's net income on his or her federal income tax return, either because the taxpayer has filed an amended return or because of an action by the federal government, the taxpayer must notify the commission within 90 days after the final determination of such change. The taxpayer shall file a copy of the amended federal return and an amended state return, which conforms to the changes on the federal return. No notification is required of changes in the taxpayer's federal income tax return, which do not affect state tax liability. (b) The commission may assess any deficiency in state income taxes within three years after such report or amended return was filed. The amount of such assessment of tax shall not exceed the amount of the increase in Utah tax attributable to such federal change or correction. The provisions of this Subsection (b) do not affect the time within which or the amount for which an assessment may otherwise be made. However, if the taxpayer fails to report to the

¹ The Commission cites to, and applies, the Utah Individual Income Tax Act that was in effect during the audit period at issue in this matter. In 2007 the Individual Income Tax Act was revised.

commission the correction specified in this Subsection (b) the assessment may be made any time within six years after the date of said correction.

Interest is assessed pursuant to Utah Code Sec. 59-1-402(5) as follows:

Interest 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

The Utah tax audit deficiency was the result of a federal tax audit determination of the Internal Revenue Service for tax years 2003 and 2004. In its audit the IRS disallowed all Petitioner's Schedule A Deductions, which resulted in increased federal taxable income for the years at issue. For 2003 the IRS had in this manner increased Petitioner's taxable income from the amount of \$\$\$\$ that she had indicated on her federal return to \$\$\$\$\$. For Tax year 2004 the IRS had increased Petitioner's taxable income from the amount of \$\$\$\$ that she had claimed on her federal return, to \$\$\$\$\$.

Petitioner explained that she had been ill with (X) when she received the notice from the IRS that they had made these changes and increased her tax liability. She states that over the next couple of weeks she made several telephone calls to her tax accountant, to assist her with the IRS audit, but he never returned her call. She then attempted to respond to the IRS on her own. She indicates that she called the IRS and sent them the documents she thought were needed. Her illness had worsened and she was worried that she would be hospitalized, so she sent in payment to the IRS and had determined that she would take care of the matter later, when she was better. Two months later she called the IRS again. They indicated they never received her original mail or correspondence, so she sent the information again. It was her understanding of the audit that the IRS had disallowed all her Schedule A deductions and so what she had mailed had been the documents that supported her deductions. Then she called the IRS again. This time she spoke with someone

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who told her that as far as the IRS was concerned she had not appealed the IRS audit and so the assessment had become final.

The IRS adjustment was eventually forwarded to the Tax Commission and the Division made the same changes to Petitioner's state taxable income, which, pursuant to Utah Code Sec. 59-10-112 (2003 & 2004), is based on federal taxable income. Federal taxable income is defined as "taxable income as currently defined in Section 63, Internal Revenue Code of 1986. See Utah Code Sec. 59-10-111 (2003 & 2004). It was Respondent's position that once the IRS had made an audit determination that increased federal taxable income, Respondent was required by statute to follow what the IRS had done regardless of whether amounts were properly excluded or included.

At the hearing Petitioner provided copies of the supporting documentation for her Schedule A Deductions. For tax year 2003 she had claimed \$\$\$\$\$ in itemized deductions. Of this \$\$\$\$\$ was for mortgage interest. Petitioner provided copies of the 1098's issued by the mortgage company. Petitioner had also claimed some medical expenses of \$\$\$\$\$, state and local taxes of \$\$\$\$\$ and charitable donations of \$\$\$\$\$. The other large deduction item was investment and advisory service fees of \$\$\$\$\$. For the 2004-year the deductions were similar. Petitioner did provide documentation supporting all of the deductions. Respondent did not contend that any of the expenses or amounts claimed were improper deductions, incorrect amounts, or that they were inadequately supported. Respondent merely claimed that because the IRS had made an audit determination to disallow the deductions, the Commission must also disallow them.

The Tax Commission has previously held in two prior decisions that where the federal taxable income as determined by the Internal Revenue Services was clearly erroneous, and the taxpayer had been unable to correct the federal taxable income with the Internal Revenue Service due to expired statute of limitations, the Commission could make an independent determination of federal taxable income for the purposes of determining the correct state taxable income. These decisions were Tax Commission Orders in

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Appeal 03-0586, dated May 24, 2004, and Appeal 03-0510 dated January 1, 2005. Although the Division argued that these cases did not apply to the facts in this matter, the Commission disagrees with limiting its decisions as narrowly as the Division requests. The Utah Code sections specify that state taxable income is federal taxable income as defined in the Internal Revenue Code, they do not tie the state taxable income to the federal taxable income as determined by the IRS. Certainly the Tax Commission will give great deference in the interpretation of the Internal Revenue Code to the IRS, as they are the experts in this area. However, where there is a clear error and the taxpayer was unable to have the merits reviewed by the IRS due to the statute of limitations or for other procedural reasons, the Commission concludes that it is appropriate to give consideration to the definitions provided in the Internal Revenue Code.

Items like mortgage interest and state and local taxes are clearly deductible from federal adjusted gross income. Petitioner has the documentation that supports her original federal and Utah returns. The fact that she was unable to navigate her way through the federal appeal process, while ill and without assistance, should not be basis to disallow her the deductions to which she is entitled. From the information before the Commission, it appears the original Utah returns that she had filed were based on the correct federal taxable income.

DECISION AND ORDER

Based upon the foregoing, the Commission abates the audits for both tax years 2003 and 2004 in their entirety. 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

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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.

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 _____, 2007.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Notice: Unless a party requests a Formal Hearing, the balance of tax and interest resulting from this decision must be paid within thirty days from the date this decision is issued or an additional late payment penalty may be assessed.

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