

07-1403
TAX TYPE: INCOME TAX
TAX YEAR: 2003 & 2004
DATE SIGNED: 2-26-2015
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO
EXCUSED: D. DIXON

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER-1 & TAXPAYER-2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.</p>	<p>FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECISION</p> <p>Appeal No. 07-1403</p> <p>Account No. ##### Tax Type: Income Tax Year: 2003 & 2004</p> <p>Judge: Chapman</p>
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Presiding:

Michael J. Cragun, Commissioner
Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER-1, Taxpayer (by telephone)
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT-1, from Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on October 20, 2014.

Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The tax at issue is Utah individual income tax.
2. The tax years at issue are 2003 and 2004.
3. On November 13, 2007, Auditing Division (the "Division") issued Notices of Deficiency and Audit Change ("Initial Statutory Notices") to TAXPAYER-1 and TAXPAYER-2 ("Petitioners" or

“taxpayers”), in which it imposed additional Utah individual income tax and interest (calculated as of December 13, 2007)¹ for the 2003 and 2004 tax years, as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2003	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$
2004	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$

4. In the Initial Statutory Notices, the Division informed the taxpayers that it was making its assessments because the Internal Revenue Service had increased the federal adjusted gross income (“FAGI”) they had reported and decreased the itemized deductions they had claimed for these two years.² In the Initial Statutory Notice for 2003, the Division showed that the IRS had increased the taxpayers’ FAGI from \$\$\$\$ to \$\$\$\$ and had decreased their itemized deductions from \$\$\$\$ to \$\$\$\$.³ In the Initial Statutory Notice for 2004, the Division showed that the IRS had increased the taxpayers’ FAGI from \$\$\$\$ to \$\$\$\$ and had decreased their itemized deductions from \$\$\$\$ to \$\$\$\$.⁴

5. On November 16, 2007, the taxpayers timely appealed the Division’s assessments to the Commission.

6. An Initial Hearing in this matter was scheduled for September 15, 2008. At the Initial Hearing, the presiding officer telephoned the taxpayers and their representative, who indicated that they were not prepared to participate at the Initial Hearing. On October 13, 2008, the Commission issued an Order of Default against the taxpayers, in which it informed the taxpayers that they could request to proceed to a Formal

1 Interest continues to accrue until any liability is paid.

2 Division’s Exhibit R-1, pp. 6-9 (2003); Exhibit R-2, pp. 17-20 (2004).

3 Division’s Exhibit R-6, p. 46 (IRS Record of Account dated October 25, 2007 shows the taxpayers’ 2003 FAGI to be \$\$\$\$).

4 Division’s Exhibit R-6, p. 55 (IRS Record of Account dated October 26, 2007 shows the taxpayers’ 2004 FAGI to be \$\$\$\$).

Hearing within 30 days of the date of the Order of Default.

7. On November 10, 2008, the taxpayers timely requested to proceed to a Formal Hearing. A Formal Hearing was scheduled for January 6, 2009.

8. All parties attended the January 6, 2009 Formal Hearing. At this hearing, however, the taxpayers asked the Commission to stay their appeal because they were waiting for the Internal Revenue Service (“IRS”) to rule on matters that would directly impact the state assessments. On January 15, 2009, the Commission issued an Order Concerning Petitioners’ Motion for Stay, in which it granted a stay.⁵

9. For the next several years, the taxpayers worked with the IRS in an attempt to resolve the IRS changes that affected both their federal and state tax liability. In 2012 or 2013, the IRS made revisions to its original changes it had made to the taxpayers’ 2003 and 2004 federal returns.

10. On January 24, 2013, the Division issued amended Notices of Deficiency and Audit Change (“Amended Statutory Notices”) to the taxpayers to reflect the revisions the IRS made in or about 2012. In the Amended Statutory Notices, the Division revised its assessments to reflect additional Utah tax and interest (calculated as of February 23, 2013) for 2003 and 2004, as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u> ⁶	<u>Total</u>
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2004	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

The Division has not assessed any penalties for either 2003 or 2004.

11. In the Amended Statutory Notices, the Division informed the taxpayers that it was decreasing

⁵ At the January 9, 2009 Formal Hearing, the presiding officer informed the parties that the Commission would consider the taxpayers’ request for a stay and issue a decision concerning the request subsequent to the hearing. As a result, the presiding officer went ahead and heard the parties’ arguments and received evidence at the January 9, 2009 hearing. The Commission decided to grant the taxpayers’ request for a stay, and the Formal Hearing was eventually rescheduled to October 20, 2014. At the October 20, 2014 Formal Hearing, the parties agreed that the Commission would make its decision on the evidence and arguments received at the October 20, 2014 hearing and not on the evidence and arguments from the January 9, 2009 hearing.

⁶ The Division stated that as of the October 20, 2014 hearing date, the interest amounts had increased to

the FAGI amounts and increasing the itemized deductions reflected on the Initial Statutory Notices.⁷ In the Amended Statutory Notice for 2003, the Division showed that it had decreased the taxpayers' FAGI from \$\$\$\$\$ to \$\$\$\$\$ and increased their itemized deductions from \$\$\$\$\$ to \$\$\$\$\$.⁸ In the Amended Statutory Notice for 2004, the Division showed that it had decreased the taxpayers' FAGI from \$\$\$\$\$ to \$\$\$\$\$ and had increased their itemized deductions from \$\$\$\$\$ to \$\$\$\$\$.⁹

12. At the Telephone Status Conferences in 2013, the taxpayers indicated that they were still considering an appeal of the revisions made by the IRS. At an April 8, 2014 Telephone Status Conference, the taxpayers indicated that the IRS had reached a final determination concerning their federal tax issues for 2003 and 2004 and that they had not filed an appeal of the IRS's determination in the United States Tax Court. Given this information, the Formal Hearing for this matter was rescheduled for October 20, 2014.

13. At the October 20, 2014 Formal Hearing, the taxpayers acknowledged that the IRS had eventually reconsidered and made revisions to its original adjustments. The taxpayers stated that the IRS eventually allowed a number of deductions (such as charitable deductions, attorney fees, etc.) that it had originally disallowed. The taxpayers stated that IRS, however, did not change its original determination to disallow IRC §1031 exchanges they had taken and that they still disagree with the IRS on this issue. However, they indicated that they could not afford to appeal the IRS's most recent decision to the United States Tax Court and, thus, are no longer contesting the IRS's determinations at the federal level.

14. The taxpayers submitted no evidence at the October 20, 2014 Formal Hearing. In addition, they did not identify what portions of the Division's amended assessments reflected the IRS's disallowance of

\$\$\$\$\$ for the 2003 tax year and \$\$\$\$\$ for the 2004 tax year.

7 Division's Exhibit R-1, p. 2 (2003); Exhibit R-2, p. 13 (2004).

8 Division's Exhibit R-6, p. 39 (IRS Account Transcript dated October 3, 2014 shows the taxpayers' 2003 FAGI to be \$\$\$\$\$).

9 Division's Exhibit R-6, p. 43 (IRS Record of Account dated October 3, 2014 shows the taxpayers' 2004 FAGI to be \$\$\$\$\$).

IRC §1031 exchanges. Nor did they present arguments to show why they qualified for the IRC §1031 exchanges that the IRS disallowed. Moreover, they admitted that they were unable to show that the IRS's final determinations concerning the IRC §1031 exchanges were incorrect.

15. The taxpayers asked the Commission to consider waiving the interest that has accrued for both tax years at issue. They explained that their financial circumstances have changed since 2007 (when the Division issued its Initial Statutory Notices) because they lost properties to the bank in the economic downturn of 2008. They explain that TAXPAYER-1 is now on permanent disability and that they no longer have the money to pay the assessments. They also ask the Commission to consider that they had no control over the numerous years it took the IRS to address the changes made to their federal returns. Lastly, they ask the Commission to consider that they have always paid their taxes in full.

16. The Division contends that the taxpayers have not met their burden of proof to show that the Division's revised assessments, as shown in the Amended Statutory Notices, are incorrect. The Division points out that the taxpayers have presented no legal arguments or documents to show that its revised assessments are incorrect. Furthermore, the Division contends that the Commission should also deny the taxpayer's request for a waiver of interest. The Division contends that interest is not to be waived unless the taxpayers show that the Tax Commission gave them erroneous information that contributed to the error.

17. The taxpayers have not shown that the Division's assessments arose because of erroneous information they received from the Tax Commission or that the Tax Commission took inappropriate actions that contributed to the taxpayer's errors.

APPLICABLE LAW

1. Utah Code Ann. §59-10-112 (2003)¹⁰ defines “state taxable income” to mean “federal taxable income (as defined by Section 59-10-111) with the modifications, subtractions, and adjustments provided in §59-10-114.”

2. UCA §59-10-111 defines “federal taxable income” to mean “taxable income as currently defined in Section 63, Internal Revenue Code of 1986.”

3. UCA §59-1-401(13) (2014) provides that “[u]pon making a record of its actions, and upon reasonable cause shown, the commission may waive, reduce, or compromise any of the penalties or interest imposed under this part.”

4. Utah Admin. Rule R865-1A-42(2) (“Rule 42”) (2014) provides guidance concerning the waiver of interest, as follows in pertinent part:

(2) Reasonable Cause for Waiver of Interest. Grounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.

5. UCA §59-1-1417 (2014) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions as follows:

In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:

- (1) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
- (2) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and
- (3) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income;
 - (a) required to be reported; and

¹⁰ The 2003 version of the Utah law is cited, unless otherwise indicated. UCA §§59-10-111 and 59-10-112 were repealed in 2007. The definitions in these sections are currently found in UCA §59-10-103 (2014).

(b) of which the commission has no notice at the time the commission mails the notice of deficiency.

CONCLUSIONS OF LAW

1. Section 59-1-1417 provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions. One of those exceptions, in Subsection 59-1-1417(3), provides that the burden is upon the Commission where the petitioner is liable for an increase in a deficiency if the increase is initially asserted after a notice of deficiency was mailed and after the petitioner has requested an appeal, unless the increase is the result of a change or correction of federal taxable income required to be reported and of which the commission has no notice at the time the commission mails the notice of deficiency. In this case, the Division issued revised assessments after mailing its initial notices of deficiency and after the taxpayers filed their appeal. For 2004, the Division's revised assessment was lower than the initial assessment. Accordingly, it is clear that the burden of proof concerning the 2004 tax year is upon the taxpayers.

2. As to the 2003 tax year, the Division's initial assessment in 2007 was for \$\$\$\$ of tax and \$\$\$\$ of accrued interest, for a total assessment of \$\$\$\$\$, whereas its revised assessment in 2013 was for \$\$\$\$ of tax and \$\$\$\$ of accrued interest, for a total assessment of \$\$\$\$\$. Although the total amount of the 2003 assessment increased between the initial and revised assessments, the burden of proof is not "shifted" to the Tax Commission in regards to the 2003 assessment. The only reason the total assessment increased was due to interest continuing to accrue over the many years the assessment remain unpaid. In fact, the Division did not increase, but actually reduced, the amount of tax that it had initially assessed pursuant to changes made by the IRS. In addition, the Division's changes between the Initial and Amended Statutory Notices reflected IRS changes not known when the Initial Statutory Notice was issued. Under these circumstances, the burden of proof concerning the 2003 tax year is also upon the taxpayers.

3. The Division provided evidence to show that its revised assessments, as reflected in the

Amended Statutory Notices, reflect changes that the IRS made to the taxpayers' 2003 and 2004 federal income tax returns. Pursuant to Section 59-10-112, the taxpayer's Utah taxable income is based on their federal taxable income. The Commission generally gives deference to IRS audit decisions.¹¹ Because the taxpayers have not shown that the Division's revised assessments do not reflect their federal taxable income, the Division's revised assessments of tax for 2003 and 2004 should be sustained. It is also noted that even had this been one of the cases where it would have been appropriate for the Commission to make an independent review of the taxpayer's federal taxable income, the taxpayers provided no information to show that their federal taxable income as reflected in IRS records for 2003 and 2004 is incorrect. For these reasons, the Division's assessments of tax, as reflected in the Amended Statutory Notices for 2003 and 2004, should be sustained.

4. Pursuant to Section 59-1-401(13), the Commission is authorized to waive penalties and interest upon a showing of "reasonable cause." The Division imposed interest on the 2003 and 2004 tax assessments, but did not impose any penalties. The taxpayers did not contest the correctness of the Division's imposition of interest, but did ask the Commission to waive the interest. The taxpayers explained that their financial circumstances had changed since 2007. They also asked the Commission to consider the time it took the IRS to review their federal tax liability and their good compliance history of paying their taxes.

11 In some situations where the IRS is not going to review a taxpayer's federal return (such as when a taxpayer submits an amended federal return after the statute of limitations has expired), the Commission has made an independent review of the federal issues affecting Utah tax liability. In this case, however, the IRS did review the items contested by the taxpayers, and the taxpayers elected not to appeal the IRS's decision further.

For decisions in which the Commission has decided whether to make an independent review of the federal issues affecting state liability, see *USTC Appeal No. 06-1408* (Initial Hearing Order Nov. 5, 2007), *USTC Appeal No. 08-1313* (Initial Hearing Order Mar. 19, 2009), *USTC Appeal No. 03-0586* (Initial Hearing Order May 24, 2004), *USTC Appeal No. 03-0510* (Initial Hearing Order Oct. 1, 2005), *USTC Appeal No. 08-0515* (Initial Hearing Order May 14, 2009), *USTC Appeal No. 07-1036* (Initial Hearing Order Jul. 17, 2008), and *USTC Appeal No. 07-0365* (Findings of Fact, Conclusions of Law, and Final Decision Feb. 23, 2010). The decisions for these appeal, as well as other selected Commission decisions, can be viewed in a redacted Oformat on the Tax Commission's website at <http://www.tax.utah.gov/commission-office/decisions>.

5. The Commission has promulgated Rule 42 to provide guidance as to whether reasonable cause exists to waive penalties and interest. Interest is imposed because a taxpayer has had use of monies that should have been remitted to the state. As a result, the criteria to waive interest are more stringent than the criteria to waive penalties. For example, Rule 42(3) provides that penalties can be waived for a number of reasons including good compliance history, whereas Rule 42(2) provides that interest will only be waived if a taxpayer shows that the Commission gave erroneous information or took inappropriate action that contributed to the error. In this case, the Tax Commission did not give the taxpayers erroneous information or take inappropriate action that contributed to the error. As a result, reasonable cause does not exist to waive the interest that has accrued on the Division's revised tax assessments for 2003 and 2004. Accordingly, the taxpayers' request for a waiver of interest should be denied.

6. In conclusion, the Commission should sustain the Division's revised assessments, as reflected in the Amended Statutory Notices, in their entireties.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission denies the taxpayers' appeal and sustains the Division's assessments, as reflected in the Amended Statutory Notices, in their entireties. It is so ordered.

DATED this _____ day of _____, 2015.

John L. Valentine
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
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. §63G-4-302. 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 63G-4-401 et seq. **Failure to pay any remaining balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty. The taxpayers may contact Taxpayer Services Division at 801-297-7703 to discuss payment arrangements or financial hardship.**