

08-1498
AUDIT – INCOME TAX
SIGNED 05-04-2009

BEFORE THE UTAH STATE TAX COMMISSION

<p>PETITIONER 1 & PETITIONER 2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 08-1498</p> <p>Account No. ##### Tax Type: Income Tax Tax Year: 2004</p> <p>Judge: Phan</p>
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Presiding:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER 1
 PETITIONER 2
For Respondent: RESPONDENT REP, Tax Audit Manager

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing pursuant to Utah Code Sec. 59-1-502.5, on February 2, 2009. The matter was before the Commission on Petitioners' (the "Taxpayers") appeal of a Utah individual income tax audit deficiency for tax year 2004. The Statutory Notice of Deficiency and Audit Change had been issued on June 9, 2008. 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

Utah imposes income tax on individuals who are residents of the state, in Utah Code Sec. 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...

State taxable income is defined in Utah Code Sec. 59-10-112 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 as follows:

"Federal taxable income" means taxable income as currently defined in Section 63, Internal Revenue Code of 1986.

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. 59-10-539 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 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 audit change was the result of an increase to the Taxpayers' federal adjusted gross income made by the Internal Revenue Service. The amount of federal adjusted gross income the Taxpayers had claimed on their return had been \$\$\$\$ and the IRS increased this amount to \$\$\$\$\$. This increase was primarily based on a 1099-C issued by COMPANY A for debt cancellation in the amount of \$\$\$\$\$. Additionally there had been an amount of \$\$\$\$\$ based on a 1099-Misc for non-employee compensation from

COMPANY B.

Utah state taxable income is based on federal adjusted gross income. In this case the Taxpayers do not dispute that their federal adjusted gross income had been increased, nor do they provide a legal basis that would indicate the change was incorrect. They explained that they had a home built in 2002 and financed it with a first and second mortgage. Before they even had made their first payment on the mortgage, the Taxpayer, PETITIONER 1, was laid-off from his employment. The Taxpayers put the residence up for sale and they stated no one even came to look at it for months. PETITIONER 1 was unable to find employment and they were unable to sell the residence. The residence went into foreclosure. The Taxpayers filed for bankruptcy. They had some advice from a bankruptcy attorney that they did not need to claim the home mortgages in the bankruptcy because they were already in foreclosure. So they thought the matter was resolved in the bankruptcy. No one attempted to collect anything further from them on the mortgages.

In 2006 or 2007 the Taxpayers were contacted by the IRS about additional taxes owed from the debt cancellation of the second mortgage amount. The Taxpayers indicated that they had never received a 1099-C regarding this debt. When they looked into it further they found out that the attorney who had given them advice on the bankruptcy did not know that there was a different treatment for second mortgages. The Taxpayers indicated that they tried to appeal the IRS action, but the IRS never responded back to them and then just took their refund to pay the tax. After this they thought the matter was behind them. They did find out later when trying to obtain a mortgage for a new property that there was a claim or lien against them from this second mortgage, which supposedly had been canceled. The Taxpayers stated that they attempted to track down the debt to clear up their credit and went to the company the IRS indicated had issued the 1099-C, but were told they had sold the note to another company. That company never acknowledged actually handling the note.

It was the Division's position that because the IRS had increased the Taxpayer's federal adjusted gross income, and that action had not been successfully appealed or contested by the Taxpayers, the law required the same change in Utah taxable income.

Upon review of the information submitted, the Taxpayers have not provided a sufficient evidentiary or legal basis that would indicate the IRS adjustment was incorrect. They did have a second mortgage that went into foreclosure. It was not included in the bankruptcy. Debt cancellations are often handled in such a manner that they result in taxable income. There are exceptions that would exclude debt

cancellation which are provided at Internal Revenue Code Sec. 108, including an exception for insolvency. The Taxpayers did not argue that the income would have qualified for exclusion under this exception.

The Commission generally gives deference to the IRS's determination on whether debt cancellation income is excluded under the provisions at IRC Sec. 108. In this case, however, the information indicates that the Taxpayers were unable to get the matter into an appeal before the IRS, therefore, the merits may not have been fully reviewed. On this basis, the Commission would consider evidence independently of the IRS on whether or not the Taxpayers would have been entitled to have this income excluded from their federal taxable income.

However, the Taxpayers do not cite to any specific provision or subsection of Sec. 108, under which they contend they would qualify and provide no evidence that their situation complied with the requirements of the subsection claimed. The Utah taxable income is based on federal taxable income. In order to prevail the Taxpayers would need to show the income should have been excluded from federal taxable income under the provisions of the Internal Revenue Code.

The Taxpayers argue that in addition to a 1099-C debt cancellation that was filed with the IRS but never received by the Taxpayers, the Taxpayers also had a lien or other indication on their credit report that the same amount appeared unresolved. But the Taxpayers did not provide any documentation including the credit report or correspondence with the various possible lenders. This is insufficient to show that the debt was not canceled as indicated in the 1099-C, it may just indicate a failure to follow through with credit reporting agencies to show the debt canceled after it had been reported.

DECISION AND ORDER

Based upon the foregoing, the Taxpayers have failed to show that the income at issue qualified for exclusion from the federal taxable income and the Commission sustains the audit deficiency of additional individual income tax of tax and interest for the tax year 2004. 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

Appeal No. 08-1498

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2009.

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 _____, 2009.

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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