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BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,  Petitioner,  vs.  AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.	<b>FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION</b>  Appeal No. 08-1583  Tax Type: Income Tax Tax Years: 2002-2005  Judge: Marshall
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**Presiding:**

D'Arcy Dixon Pignanelli, Commissioner  
Jan Marshall, Administrative Law Judge

**Appearances:**

For Petitioner: PETITIONER REP 1  
PETITIONER  
For Respondent: RESPONDENT REP 1, Assistant Attorney General  
RESPONDENT REP 2, Income Tax Audit Manager

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on January 30, 2009. The Taxpayer submitted a Motion to Dismiss Audit prior to the hearing, both parties submitted written memoranda on Taxpayer's motion, and oral argument was heard prior to the Formal Hearing. Taxpayer's motion to dismiss is a preliminary matter that must be addressed prior to the underlying issues.

MOTION TO DISMISS

Taxpayer filed a motion on January 8, 2009, asking the Commission to dismiss the audits on the grounds that the Commission lacks jurisdiction and that wages are not taxable. The Division filed an opposition to the Taxpayer's motion on January 21, 2009. The Taxpayer submitted her reply to the Division's opposition on January 26, 2009.

The Taxpayer argued that the Commission does not have jurisdiction because Taxpayer is a "non taxpayer", and therefore exempt from income taxes. Taxpayer alleges that the Commission is assuming authority and jurisdiction over Taxpayer without legal basis. In

response, the Division pointed to Article XIII, Section 4 of the Utah Constitution, which authorizes the legislature to provide by statute for taxes, deductions, exemptions, and offsets from those taxes. The Division notes that the Legislature has enacted such a statute, Utah Code Ann. §59-10-104, which provides for a tax on the state taxable income of every resident individual. Further, the Division argued that the legislature gave the Commission the responsibility to make determinations and assessments of tax, as well as to hold proceedings to determine whether an audit was correct under Utah Code Ann. §59-10-527 and §59-1-210. The Commission finds that Taxpayer's argument is without merit. As authorized by the Utah Constitution, the Legislature has imposed an income tax, and authorized the Commission to both conduct audits and hold proceedings to determine the correctness of audit assessments. Therefore, the Commission denies the Taxpayer's motion to dismiss on the ground that the Commission lacks jurisdiction.

Taxpayer also requested that the audits be dismissed on the ground that wages, salaries, compensations, earnings, fees for service, commissions, and capital are not income subject to tax. Taxpayer pointed to the 16<sup>th</sup> Amendment and numerous decisions from the U.S. Supreme Court and other jurisdictions she claims support her contention. In response, the Division cited to *United States v. Mann*, 884 F.2d 532 (10<sup>th</sup> Cir. 1989) and *United States v. Lonsdale*, 919 F.2d 1440 (10<sup>th</sup> Cir. 1990), which both rejected the argument that wages are not income. The Division also argued that because the Utah Constitution allows for the imposition of income tax, that the 16<sup>th</sup> Amendment is inapplicable in this appeal. The Commission finds that Taxpayer's argument is without merit. It has long been held by the Courts that wages and compensation for services are taxable income.<sup>1</sup> Therefore, the Commission denies the Taxpayer's motion to dismiss on the ground that wages are not taxable.

Having denied the Taxpayer's Motion to Dismiss, and based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

#### FINDINGS OF FACT

1. The issue before the Utah State Tax Commission in this matter is Taxpayer's appeal of income tax, penalty, and interest deficiencies issued for the tax years 2002 through 2005.

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<sup>1</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).

2. Taxpayer was a resident of CITY, Utah for all years at issue. She was married, but had no dependent children during the years at issue. She holds a Utah driver's license, and registered her vehicles in Utah.
3. Taxpayer was employed by the State of Utah during the years at issue, working for the court system.
4. Taxpayer did not file state income tax returns for any of the years at issue.
5. The Division submitted as Exhibit 6 a wage detail received from Taxpayer's employer. The wage details showed the following income and withholding amounts for the 2002, 2003, and 2004 tax years:

<u>Year</u>	<u>Wages</u>	<u>State Withholding</u>
2002	\$\$\$\$\$	\$\$\$\$\$
2003	\$\$\$\$\$	\$\$\$\$\$
2004	\$\$\$\$\$	\$\$\$\$\$

6. The Division submitted as Exhibit 7 the Taxpayer's W-2 for the 2005 tax year. The W-2 shows that Taxpayer had \$\$\$\$\$ in wages and state withholding of \$\$\$\$\$.
7. For the 2002 tax year, the Division issued a Notice of Deficiency and Estimated Income Tax on June 13, 2008. The statutory notice reflected a filing status of married filing separate. Taxpayer had Utah taxable income of \$\$\$\$\$. The Division assessed additional tax in the amount of \$\$\$\$\$, penalties in the amount of \$\$\$\$\$, and interest.
8. For the 2003 tax year, the Division issued a Notice of Deficiency and Estimated Income Tax on June 13, 2008. The statutory notice reflected a filing status of married filing separate. Taxpayer had Utah taxable income of \$\$\$\$\$. The Division assessed additional tax in the amount of \$\$\$\$\$, penalties in the amount of \$\$\$\$\$, and interest.
9. For the 2004 tax year, the Division issued a Notice of Deficiency and Estimated Income Tax on June 13, 2008. The statutory notice reflected a filing status of single. Taxpayer had Utah taxable income of \$\$\$\$\$. The Division assessed additional tax in the amount of \$\$\$\$\$, penalties in the amount of \$\$\$\$\$, and interest.
10. For the 2005 tax year, the Division issued a Notice of Deficiency and Estimated Income Tax on June 13, 2008. The statutory notice reflected a filing status of married filing separate. Taxpayer had Utah taxable income of \$\$\$\$\$. The Division assessed additional tax in the amount of \$\$\$\$\$, penalties in the amount of \$\$\$\$\$, and interest.

APPLICABLE LAW

Utah Code Ann. §59-10-104 provides for the imposition of tax as follows in pertinent part:

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

Utah Code Ann. §59-10-104 (2002-2005).

“Resident individual” is defined in Utah Code Ann. §59-10-103 as follows:

“Resident individual” means:

- (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. For purposes of this Subsection (1)(j)(ii), a fraction of a calendar day shall be counted as a whole day.

Utah Code Ann. §59-10-103(1)(k) (2002).

Utah Code Ann. §59-10-103 was amended in 2003, as follows:

(i) “Resident individual” means:

(A) an individual who is domiciled in this state for any period of time during the taxable year, but only for the duration of the period during which the individual is domiciled in this state; or

(B) an individual who is not domiciled in this state but:

- (I) maintains a permanent place of abode in this state; and
- (II) spends in the aggregate 183 or more days of the taxable year in this state.

Utah Code Ann. §59-10-103(q) (2003-2004) and §59-10-103(s) 2005).

Utah Code Ann. §59-10-112 defines “state taxable income” for purposes of Utah Code Ann. §59-10-104 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. The state taxable income of a resident individual who is the beneficiary of an estate or trust shall be modified by the adjustments provided in Section 59-10-209.

Utah Code Ann. §59-10-112 (2002-2005).

Utah Code Ann. §59-10-111 defines “[f]ederal taxable income” for purposes of Utah Code Ann. §5-10-112 as follows:

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

Utah Code Ann. §59-10-111 (2002-2005).

For purposes of Utah Code Ann. §59-10-111, and as defined in Section 63 of the Internal Revenue Code, is as follows in pertinent part:

[T]he term “taxable income” means gross income minus the deductions allowed by this chapter...

26 U.S.C. 63 (1986, as amended).

For purposes of determining “taxable income” Section 61 of the Internal Revenue Code defines “gross income” as follows:

- (a) 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 dealings 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.

26 U.S.C. 61 (1986, as amended).

Utah Code Ann. §59-10-539(1) imposes penalties and interest, as follows in pertinent part:

- (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 therefore (determined with regard to any extension of time for filing), unless it is shown that such failure is 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. For the purposes of this subsection, the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed upon the return.

Utah Code Ann. §59-10-539 (2002-2005).

Utah Code Ann. §59-1-401 sets the penalties as provided for in Utah Code Ann. §59-10-539 as set forth below in relevant part:

- (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) 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 issued 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.

Utah Code Ann. §59-1-401 (2002-2005).

Section 59-1-501 of the Utah Code provides that a taxpayer may file a petition for a redetermination of a deficiency:

Any taxpayer may file a request for agency action, petitioning the commission for redetermination of a deficiency.

Utah Code Ann. §59-1-501 (2002-2005).

“Deficiency” is defined in §59-10-523 of the Utah Code, as follows:

- (1) As used in this chapter, “deficiency” means the amount by which the tax imposed by this chapter exceeds the excess of (a) the sum of (i) the amount shown as the tax by the taxpayer upon his return, if the return was made by the taxpayer and if an amount was shown as the tax by the taxpayer thereon plus (ii) the amounts previously assessed (or collected without assessment) as a deficiency over (b) the amounts previously abated, refunded, or otherwise repaid in respect of such tax.
- (2) For purposes of Subsection (1):
  - (a) If no return is filed, or the return does not show any tax, a return shall be considered as having been made by the taxpayer and the amount shown as the tax by the taxpayer upon his return shall be considered to be zero.
  - (b) The tax imposed by this chapter and the tax shown on the return shall both be determined without regard to any amounts, the tax imposed by this chapter exceeds the excess of the amount specified in Subsection (1)(a) over the amount specified in Subsection (1)(b).

Utah Code Ann. §59-10-524 (2002-2005).

The burden of proof is on the Petitioner, except in certain instances, as set forth in Utah Code Ann. §59-10-543, below:

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;
- (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.

Utah Code Ann. §59-10-543 (2002-2005).

#### CONCLUSIONS OF LAW

Tax is imposed on the “state taxable income” of every “resident individual” under Utah Code Ann. §59-10-104. Taxpayer acknowledged that she was domiciled in the State of Utah during the years at issue, she held a Utah driver’s license, registered her vehicles in Utah, and owned real property. The Commission concludes that Taxpayer is a “resident individual” as defined in Utah Code Ann. §59-10-103. “State taxable income” is determined from an individual’s federal taxable income less certain adjustments, and is defined as “federal taxable income” as defined in I.R.C. §63. *See* Utah Code Ann. §59-10-112 and §59-10-111. Section 63 of the Internal Revenue Code defines “taxable income” as “gross income” minus certain deductions. “Gross income” is defined as “all income from whatever source derived” and provides a list of examples, including compensation for services. *See* 26 U.S.C. §61 (1986, as amended). The Division provided evidence, including wage detail reports from Taxpayer’s employer and a print-out of Taxpayer’s W-2, which shows that the Taxpayer had income for the years at issue. The Taxpayer acknowledged that she did work, and though she could not recall the exact amounts, believed the income reported by her employer to be accurate. The Commission concludes that the Taxpayer had state taxable income for the 2002, 2003, 2004, and 2005 tax years.

The Division calculated Taxpayer’s liability for the 2002, 2003, and 2005 tax years as married, filing separately. However, Taxpayer’s 2004 tax liability was calculated as though Taxpayer were single. Taxpayer testified that she was married during all of the years at issue. The Division did not refute this testimony. Thus, the Commission finds that the Taxpayer’s liability for the 2004 tax year should be based upon a married filing separate filing status, rather than single.

Pursuant to Utah Code Ann. §59-10-539, penalties and interest are imposed for the failure to file an income tax return. Taxpayer failed to timely file returns or pay the tax due for each of the years at issue. The Commission finds that the Division properly assessed the 10% failure to file penalty under Utah Code Ann. §59-1-401(1) and the 10% failure to pay penalty under Utah Code Ann. §59-1-401(2). The Taxpayer offered no testimony or other evidence that



would support a waiver of penalties or interest, therefore, the Commission sustains the penalties and interest as assessed for the 2002, 2003, and 2005 tax years. The penalties and interest for the 2004 tax year should be re-calculated based upon the tax liability resulting from a change in filing status from single to married filing separate.

DECISION AND ORDER

Based on the foregoing, the Taxpayer's Motion to Dismiss Audit is denied. The Commission sustains the audit assessment of income tax, interest, and penalties for failure to timely file and pay, for the 2002, 2003, and 2005 tax years. The Division is ordered to recalculate the tax liability, penalties and interest for the 2004 tax year to reflect a filing status of married filing separate. It is so ordered.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2009.

\_\_\_\_\_  
Jan Marshall  
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 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. Sec. 63-46b-13. 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 Sec. 59-1-601 et seq. and 63-46b-13 et seq.

*JM/08-1583.fof*