

09-1711
PENALTY & INTEREST
SIGNED 07-20-2009

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,

Petitioners,

v.

TAXPAYER SERVICES DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent.

INITIAL HEARING ORDER

Appeal No. 09-1711

Account No. #####

Tax Type: Corporate Franchise Tax

Tax Year: 2007

Judge: Marshall

Presiding:

Jan Marshall, Administrative Law Judge

Appearing:

For Petitioner: PETITIONER REP, Tax Director, PETITIONER

For Respondent: RESPONDENT REP 1, Waivers Unit, Taxpayer Service Division
RESPONDENT REP 2, Waivers Unit, Taxpayer Service Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5 on June 11, 2009. Taxpayer was assessed an extension penalty in the amount of \$\$\$\$\$, an underestimated pre-payment penalty in the amount of \$\$\$\$\$, and a late payment penalty in the amount of \$\$\$\$\$. The Division waived the extension and late payment penalties. Taxpayer request the underestimated pre-payment penalty be recalculated based on quarterly payments determined by the annualized income method.

APPLICABLE LAW

The Commission has been granted the discretion to waive, reduce, or compromise penalties and interest, as set forth in Utah Code Ann. §59-1-401(13), below:

Upon 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.

Utah Code Ann. §59-1-401(13) (2008).

Estimated corporate franchise tax payments are required as set forth in Utah Code Ann. §59-7-504, as follows:

- (1) Except as otherwise provided in this section, each corporation subject to taxation under this chapter having a tax liability of \$3,000 or more in the current tax year, or which had a tax liability of \$3,000 or more in the previous tax year, shall make payments of estimated tax at the same time and using any method provided under Section 6655, Internal Revenue Code.
- (2) The following are modifications or exceptions to the provisions of Section 6655, Internal Revenue Code:
 - (a) for the first year a corporation is required to file a return in Utah, that corporation is not subject to Subsection (1) if it makes a payment on or before the due date of the return, without extensions, equal to or greater than the minimum tax required under Section 59-7-104 or 59-7-201;
 - (b) the applicable percentage of the required annual payment, as defined in Section 6655, Internal Revenue Code, for annualized income installments, adjusted seasonal installments, and those estimated tax payments based on the current year tax liability shall be:

Installment:	Percentage:
1 st	22.5
2 nd	45.0
3 rd	67.5
4 th	90.0
 - (c) large corporations shall be treated as any other corporation for purposes of this section; and
 - (d) if a taxpayer elects a different annualization period than the one used for federal purposes, the taxpayer shall make an election with the Tax Commission at the same time as provided under Section 6655, Internal Revenue Code.
- (3) A penalty shall be added as provided in Section 59-1-401 for any quarterly estimated tax payments which is not made in accordance with this section.
- (4) There shall be no interest added to any estimated tax payments subject to a penalty under this section.

Utah Code Ann. §59-7-504 (2007).

Section 6655 sets forth the requirements for installment payments as follows, in pertinent part:

- (d) Amount of required installments – for purposes of this section –
 - (1) Amount.
 - (A) In general. Except as otherwise provided in this section, the amount of any required installments shall be 25 percent of the required annual payment.
 - (B) Required annual payment. Except as otherwise provided in this subsection, the term “required annual payment” means the lesser of –
 - (i) 100 percent of the tax shown on the return for the taxable year (or, if no return is filed, 100 percent of the tax for such year), or
 - (ii) 100 percent of the tax shown on the return of the corporation for the preceding taxable year.Clause (ii) shall not apply if the preceding taxable year was not a taxable year of 12 months, or the corporation did not file a return for such preceding taxable year showing a liability for tax.
 - (2) Large corporations required to pay 100 percent of current year tax.
 - (A) In general. Except as provided in subparagraph (B), clause (ii) of paragraph (1)(B) shall not apply in the case of a large corporation.
 - (B) May use last year’s tax for 1st installment. Subparagraph (A) shall not apply for purposes of determining the amount of the 1st required installment for any taxable year. Any reduction in such 1st installment by reason of the preceding sentence shall be recaptured by increasing the amount of the next required installment determined under paragraph (1) by the amount of such reduction.
- (e) Lower required installment where annualized income installment or adjusted seasonal installment is less than amount determined under subsection (d).
 - (1) In general. In the case of any required installment, if the corporation establishes that the annualized income installment or the adjusted seasonal installment is less than the amount determined under subsection (d)(1) (as modified by paragraphs (2) and (3) of subsection (d)) -

- (A) the amount of such required installment shall be the annualized income installment (or, if lesser, the adjusted seasonal installment), and
 - (B) any reduction in a required installment resulting from the application of this paragraph shall be recaptured by increasing the amount of the next required installment determined under subsection (d)(1) (as so modified) by the amount of such reduction (and by increasing subsequent required installments to the extent that the reduction has not previously been recaptured under this subparagraph).
- (2) Determination of annualized income installment.
- (A) In general. In the case of any required installment, the annualized income installment is the excess (if any) of –
 - (i) An amount equal to the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the taxable income, alternative minimum taxable income, and modified alternative minimum taxable income –
 - (I) for the first 3 months of the taxable year, in the case of the 1st required installment,
 - (II) for the first 3 months of the taxable year in the case of the 2nd required installment,
 - (III) for the first 6 months of the taxable year in the case of the 3rd required installment, and
 - (IV) for the first 9 months of the taxable year, in the case of the 4th required installment, over
 - (ii) the aggregate amount of any prior required installments for the taxable year.
 - (B) Special rules – for purposes of this paragraph –
 - (i) Annualization. The taxable income, alternative minimum

taxable income, and modified alternative minimum taxable income shall be placed on an annualized basis under regulations prescribed by the Secretary.

- (ii) Applicable percentage. In the case of the following required installments, percentage is:

1st 25

2nd 50

3rd 75

4th 100

- (iii) Modified alternative minimum taxable income. The term “modified alternative minimum taxable income” has the meaning given to such term by section 59A(b)...

I.R.C. §6655 (2007).

DISCUSSION

Taxpayer is requesting an adjustment of the underestimated prepayment penalty. The Commission calculated the required quarterly prepayments to be \$\$\$\$\$, based on 90% of the tax due for 2007. The Taxpayer contends that the required quarterly prepayments should be calculated based on the annualized income method. Taxpayer’s representative calculated that under the annualized income method, the estimated tax for 2007 is \$\$\$\$\$ in each of the annualized periods because the Taxpayer experienced net operating losses through September 30, 2007.

Taxpayer provided information to show that the company’s estimated operating losses, after apportionment were \$\$\$\$\$ as of March 31; \$\$\$\$\$ as of June 30; and \$\$\$\$\$ as of September 30. Taxpayer incurred a net capital gain between October 1, 2007 and December 31, 2007 of\$\$\$\$\$, with \$\$\$\$\$ being apportioned to Utah. That gain cause Taxpayer to have taxable income for the 2007 tax year, but because that gain was recognized after the final annualization period for 2007, it was not taken into consideration when determining Taxpayer’s quarterly estimated tax payments under the annualized installment method.

Taxpayer’s representative testified that due to the nature of Taxpayer’s business, there are wild swings in income, and their tax liability changes from quarter to quarter. Taxpayer’s representative stated that a prepayment was not made for the first quarter because they believed there would be an overpayment from the 2006 tax year that would be applied. He testified that

the second quarter, Taxpayer knew there would not be an overpayment and so a “cushion payment” of \$\$\$\$\$ was made on June 15, 2007. Taxpayer did not make prepayments in the third and fourth quarters because they believed they were going to have a net operating loss for the year.

The Division’s representative acknowledges that the annualized method is an acceptable means of determining the required quarterly prepayment. However, the Division argues that there is not reasonable cause to reduce the penalty amount. The Taxpayer did not make the \$\$\$\$\$ quarterly prepayments on which it is asking the Commission to base the penalty assessment. The Division provided a copy of Taxpayer’s federal transcript for the 2007 tax year, which shows estimated tax payments on April 17, 2007 and June 15, 2007 in the amount of \$\$\$\$\$ each; as well as a payment of \$\$\$\$\$ on March 17, 2008. The Division argued that the federal prepayments indicate Taxpayer anticipated a larger tax liability. Taxpayer’s representative stated that because the Taxpayer is a personal holding company and subject to the alternative minimum tax, the company can have a loss for Utah purposes but still have a federal tax obligation. In addition, the Division argued that the Taxpayer should have made more substantial prepayments, and noted that the Taxpayer’s lowest tax liability was \$\$\$\$\$ in 2002. Finally, the Division noted that Taxpayer had been assessed an underestimated prepayment penalty for the 2006 tax year, and therefore did not have a good compliance history.

There is no dispute that the underpayment prepayment penalty should be assessed because Taxpayer failed to make prepayments on April 15, 2007, September 15, 2007, and December 15, 2007. Rather, Taxpayer disputes the calculation of that assessment by the Commission. The Commission has the discretion to waive, reduce, or compromise penalties upon reasonable cause shown under Utah Code Ann. §59-1-401(13). Utah Code Ann. §59-7-504 provides that a corporation subject to a tax liability of \$\$\$\$\$ or more in the current or previous tax year is required to make payments of estimated tax using any method provided in Section 6655 of the Internal Revenue Code. Internal Revenue Code Section 6655(e)(1) allows for a lower required prepayment if the corporation can establish that the annualized income installment method is less than the amount determined under Section 6655(d)(1). The Taxpayer has provided calculations and documentation to show that under the annualized income installment method, their required payments would have been \$\$\$\$\$ in each of the annualized periods because of its net operating losses through September 30, 2007. Thus, the Commission finds there is reasonable cause to assess the penalty based on the prepayments required under the annualized income installment method.

DECISION AND ORDER

Based on the foregoing, the Commission grants Taxpayer's request to reduce the underestimated prepayment penalty so that it is assessed based on Taxpayer's required prepayments under the annualized income installment method for the 2007 tax year. 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

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

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: Failure to pay the balance due as a result of this order within thirty days from the date hereon may result in an additional penalty.

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