

11-827

TAX TYPE: INCOME TAX

TAX YEAR: 2007

DATE SIGNED: 7-12-2012

COMMISSIONERS: B. JOHNSON, M. JOHNSON, D. DIXON

EXCUSED: M. CRAGUN

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER,

Petitioner,

v.

AUDITING DIVISION OF THE UTAH
STATE TAX COMMISSION,

Respondent.

INITIAL HEARING ORDER

Appeal No. 11-827

Account No. #####

Tax Type: Income Tax

Tax Year: 2007

Judge: Phan

Presiding:

Jane Phan, Administrative Judge

Appearances:

For Petitioner: TAXPAYER

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General, By
Telephone
RESPONDENT, Manager Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Commission for a Telephone Status Conference on August 8, 2011, at which Petitioner ("Taxpayer") asked that the decision be made based on written submissions of the parties. Respondent ("Division") was given the opportunity to submit its position in a written response, but on February 10, 2012 filed a Motion to Stay Proceedings, asking the matter be stayed pending receipt of additional information from the IRS, and reserving the opportunity to submit a brief once the additional information was received from the IRS. The Division notes that the Taxpayer had asserted that they had filed a Schedule D with the IRS on or about May 2, 2009. The matter was rescheduled for a Telephone Status Conference on June

12, 2012. At the conference it was determined that the Commission would issue a decision based on the written submission of the parties, but giving the Division the opportunity to submit its brief. The Division submitted its brief on June 25, 2012.

APPLICABLE LAW

Utah imposes income tax on individuals who are residents of the state, in Utah Code §59-10-104(2007)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 §59-10-112 (2007) 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 . . .

Utah Code §59-10-111 (2007) provides the statutory definition of federal taxable income:

"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 (2007) 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).

When the IRS makes a change to the Taxpayers' taxable income, the Taxpayer is to notify the Tax Commission of the change and the Tax Commission may make the assessment as follows under Utah Code Utah Code §59-10-536(5) (2007):

(a) 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. . .

Utah Code §59-1-1417 provides that the burden of proof is upon the petitioner in proceedings before the Commission:

¹ This Decision cites to provisions in effect for the 2007 tax year.

In a proceeding before the commission, the burden of proof is on the petitioner. . . .

DISCUSSION

In this matter, the Taxpayer had wanted the Utah State Tax Commission to issue a decision independent of the IRS's action or inaction. The Utah audit deficiency that is at issue was for the 2007 tax year and had been issued with a Statutory Notice of Deficiency and Audit Change on February 2, 2011. With the audit the Division had revised the Taxpayer's Federal Adjusted Gross Income from \$\$\$\$\$ to \$\$\$\$\$, an increase of \$\$\$\$\$, based on information from the IRS that the IRS had made this change. This resulted in additional Utah individual income tax due in the amount of \$\$\$\$\$ and interest as of the date of the notice in the amount of \$\$\$\$\$.² No penalties were assessed with the Utah audit.

From the information presented the increase in federal adjusted gross income was the result of the IRS increasing the income based on unreported income. The possible sources of unreported income were amounts that the Taxpayer received from stock sales. In this matter the Taxpayer provided a copy of a letter that he mailed to the IRS in response to the IRS audit. The letter is dated May 2, 2009. It explains that "After considerable research, we have discovered that we overlooked the Schedule D . . ." It goes on to state, "We are enclosing the Schedule D you requested, which explains in detail the history of the sales in question. According to our calculations, the tax liability to us is \$\$\$\$\$." Other than sending in this letter, the Taxpayers had stated that they had not contested the IRS audit further because the Taxpayer was having health issues and just wanted the IRS to go away. It was apparent from the Telephone Status Conferences that the Taxpayer had not tried to resubmit the Schedule D, contact the IRS further or file an amended return or any other action to get the IRS to reconsider its determination regarding the increase in federal adjusted gross income.

The Taxpayer provided a copy of the Schedule D which listed individual stock sales, both in the short term and long term categories. The Schedule D provides a column for the sale price, then one for the cost or other basis which is subtracted from the sale price for the third column which indicates the gain on the sale. The Taxpayer did not provide account statements or other supporting documentation showing the cost basis for each trade.

It was the Division's position that since the IRS has not made any changes to the Taxpayer's federal taxable income after its initial audit and upward adjustment, the Division's audit should be sustained. The Division's audit is based on the federal adjusted gross income as shown in the IRS account transcripts which indicated that the possible sources of unreported income were all from 1099-B's issued to the Taxpayer by NAME, Inc. The Division would not amend its audit based on the Schedule D information provided by the Taxpayer. The Division did provide a copy of the IRS Account Transcript for the Taxpayer's 2007 tax year.

² Interest continues to accrue on any unpaid balance.

This showed federal adjusted gross income in the amount of \$\$\$\$\$. It also showed that the IRS has not made any changes to the account since 2009 when it had assessed the additional tax and interest based on its audit and the balance was paid in full by the Taxpayer at that time.

After reviewing the information presented in this matter by the parties, it appears that the 2007 tax year is not under any further review by the IRS and the IRS considers that the increase in tax amount was final and paid in full in 2009. Whether the Taxpayer has any remedies remaining with the IRS to contest the federal audit or request a refund of the federal taxes, which are not barred by statute of limitations is unknown and the Division did not assert that any were still possible. It appears that that one letter and a Schedule D were sent to the IRS by the Taxpayer, but no changes were made. The Taxpayer has asked the Tax Commission to consider the information provided including the IRS Schedule D independently from the federal review. The Division did not provide any information or argument to assert that the information in the Schedule D was erroneous. The Division merely argued that it could not make an adjustment different from the IRS.

The Tax Commission has independently reviewed a taxpayer's evidence of federal taxable income in situations where a taxpayer was unable to contest the IRS action, generally in situations where it was too late to have the matter considered with the IRS. The Commission heard a similar case in *Appeal No. 06-1408* (Utah State Tax Comm'n Nov. 5, 2007)³. In *Appeal No. 06-1408*, documentation was proffered that supported the Petitioner's original federal and Utah returns and indicated that the revised FAGI determined by the IRS was incorrect. In that case, the Commission reversed the Division's assessment, even though it reflected the IRS's current FAGI, stating that:

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.

In *Appeal No. 06-1408*, the Petitioner had been told that the IRS considered the federal matter final and closed. In the appeal at hand it is unclear whether the Taxpayer may have any procedures left available to him with the IRS that are not barred by statute of limitations. However, the Commission has indicated it is willing to independently review taxable income in *Appeal No. 08-1313*, in which the Commission acknowledged that the taxpayer in that case might still have been able to file an amended federal

³ Decisions cited herein and numerous other decisions from the Utah State Tax Commission are available for review

return, which might have resulted in the IRS reversing the assessment. In that case the Commission held:

Regardless, the Commission finds that the evidence proffered by the Division shows that the taxpayer's original Utah return reflects the correct amount of "federal taxable income" as defined in Sections 59-10-111 and 59-10-112. Accordingly, under these specific circumstances, the Commission finds that the Division's assessment is incorrect, even though it reflects the FAGI currently recognized by the IRS. As a result, the Commission reverses the Division's assessment.

In this matter currently before the Tax Commission there was no argument from the Division against the Taxpayer's contention that he could deduct the basis from his stock sales and was required to claim only the gain in his federal taxable income as defined in the Internal Revenue Code. The Division did not argue whether or not the Taxpayer had filled out the Schedule D correctly, nor that he had provided insufficient back up information to support the Schedule D. Instead the Division's position was that it would not accept a federal adjusted gross income different from the IRS. The Taxpayer's Schedule D showed \$\$\$\$ in short-term capital gain and \$\$\$\$ in long term capital gain from the stock sales that were listed in the audit as possible sources for the unreported income. The Division should amend the audit accordingly.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Division is to amend its audit of Utah Individual Income Tax for tax year 2007 based on the actual gains shown on the Taxpayer's Schedule D as the unreported income. 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:

in a redacted format at tax.utah.gov/commission/decisions.

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 _____, 2012.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner