

11-2205  
TAX TYPE: INCOME TAX  
TAX YEARS: 2007 AND 2009  
DATE SIGNED: 8-15-2013  
COMMISSIONERS: B. JOHNSON, D. DIXON, R. PERO  
EXCUSED: M. CRAGUN  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

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<p>TAXPAYER-1 AND TAXPAYER-2,  Petitioners,  vs.  AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.</p>	<p><b>FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION</b></p> <p>Appeal No. 11-2205</p> <p>Account No. ##### Tax Type: Income Tax Tax Years: 2007 and 2009</p> <p>Judge: Phan</p>
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**Presiding:**

Robert Pero, Commissioner  
Jane Phan, Administrative Law Judge

**Appearances:**

For Petitioner: TAXPAYER-1  
TAXPAYER-2  
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney  
General  
RESPONDENT, Manager, Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on May 7, 2013, in accordance with Utah Code §59-1-501 and §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioners (“Taxpayers”) are appealing individual income tax audit deficiencies issued against them for tax years 2007 and 2009. The Notices of Deficiency and Audit Change had been issued on May 18, 2011.<sup>1</sup>

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<sup>1</sup> Respondent’s Exhibits 1 & 2

2. The amount of the deficiencies for each year is as follows:

Year	Tax	Interest	Penalty	Total as of Notice Date <sup>2</sup>
2007	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$
2009	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$

3. Taxpayers did not refute that they were residents of Utah during 2007 and 2009.

4. On October 15, 2008, Taxpayers filed a Utah Individual Income Tax Return for tax year 2007. On that return Taxpayers claimed \$\$\$\$ in Federal Adjusted Gross Income and a total Utah tax in the amount of \$\$\$\$ on Line 23.<sup>3</sup>

5. On April 4, 2011, Taxpayers filed an amended Utah Individual Income Tax return for tax year 2007. On the amended return, Taxpayers claimed \$\$\$\$ in Federal Adjusted Gross Income and \$\$\$\$ in Utah tax on Line 23.<sup>4</sup>

6. For the 2007 tax year, two W-2s had been issued by BUSINESS-1 to TAXPAYER-2 on which it was reported in Box 1 that BUSINESS-1 had paid to TAXPAYER-2 \$\$\$\$ in “Wages, tips, other compensation” on one of the forms and \$\$\$\$ on the second form. A W-2 issued by BUSINESS-2, had been issued to TAXPAYER-2 for the 2007 year reporting an amount of \$\$\$\$ on Box 1 as “Wages, tips, other compensation.” A W-2 had been issued by BUSINESS-3 to TAXPAYER-1 reporting an amount of \$\$\$\$ on Box 1, for the 2007 year. Each of these W-2s reported some state income tax withhold.<sup>5</sup>

7. The Taxpayers did not refute with either exhibits or testimony that they had received these amounts from these businesses.

8. For the 2007 tax year, the audit deficiency issued by Respondent (“Division”) was based on a federal adjusted gross income of \$\$\$\$.<sup>6</sup>

9. On December 31, 2010, Taxpayers filed a Utah Individual Income Tax Return for the 2009 tax year. On the return they reported \$\$\$\$ in Federal Adjusted Gross Income. On line 31 of that return they reported \$\$\$\$ for the total Utah tax amount.<sup>7</sup>

10. The Division had received information from the Internal Revenue Service that W-2s or 1099s reporting income paid to the Taxpayers for the 2009 tax year had been filed with the IRS. The IRS information showed that BUSINESS-4 had paid to TAXPAYER-2 \$\$\$\$ in “Wages, tips, other compensation.” GOVERNMENT ENTITY reported \$\$\$\$ paid to

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<sup>2</sup> Interest continues to accrue on the unpaid balance.

<sup>3</sup> Respondent’s Exhibit 3.

<sup>4</sup> Respondent’s Exhibit 3.

<sup>5</sup> Respondent’s Exhibit 4.

<sup>6</sup> Respondent’s Exhibit 1.

<sup>7</sup> Respondent’s Exhibit 7.

TAXPAYER-2 in (X) Compensation. The income reported as paid to TAXPAYER-1 was a W-2 from BUSINESS-3 with \$\$\$\$ in wages tips, other compensation, a 1099-G from the GOVERNMENT ENTITY reporting \$\$\$\$ in (X) compensation, and a 1099-MISC reporting \$\$\$\$ in (X-1) compensation.<sup>8</sup>

11. The Taxpayers did not refute with either exhibits or testimony that they received this income from the various employers or entities during the 2009 tax year.

12. For the 2009 year the Division's audit deficiency had been based on Federal Adjusted Gross Income in the amount of \$\$\$\$.

13. For both years at issue, the Division has assessed \$500 penalties under Utah Code Sec. 59-1-401(9).

#### APPLICABLE LAW

Under Utah Code §59-10-104 (2009),<sup>9</sup> a tax is imposed on the "state taxable income" of every "resident individual."

"State taxable income" is defined in Utah Code §59-10-103(w) (2009) as follows:

- (i) subject to Subsection 59-10-302(2), for a resident individual other than a resident individual described in Subsection (1)(y)(iii), means the resident individual's federal taxable income after making the:
  - (A) additions and subtractions required by Section 59-10-114; and
  - (B) adjustments required by Section 59-10-115...

"Federal taxable income" is defined in Utah Code Ann. §59-10-103(f) (2009) to mean "taxable income as defined by Section 63, Internal Revenue Code..."

Taxable income is defined in §63 of the Internal Revenue Code, set forth below:

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).

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;

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<sup>8</sup> Respondent's Exhibit 8.

<sup>9</sup> The Code has been revised and renumbered since the tax years at issue. The Commission applies the substantive provisions that were in effect during the audit years.

- (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.

Utah Code Sec. 59-1-401(9) provides for the assessment of penalties as follows:

If a person, in furtherance of a frivolous position, has a prima facie intent to delay or impede administration of a law relating to a tax, fee, or charge and files a purported return that fails to contain information from which the correctness of reported tax, fee or charge liability can be determined or that clearly indicates that the tax, fee, or charge liability shown is substantially incorrect, the penalty is \$500.

Section 59-1-402(5) of the Utah Code provides, “[i]nterest on any underpayment, deficiency, or delinquency of any tax or fee administered by the 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.”

Utah Code Ann. §59-1-1417 provides, “[i]n a proceeding before the commission, the burden of proof is on the petitioner...”

#### DISCUSSION

At the hearing Petitioners did not dispute that they were Utah residents. Nor did they dispute that they had received the income during the audit years in the amounts indicated by the W-2s, 1099s and IRS information. They did not dispute the W-2 income had been compensation for their services to the various businesses. The Taxpayers argued that because they worked for and were paid by “private-sector” businesses they were not “employees” for purposes of federal law and, therefore, the wages or compensation that they had received was not subject to tax. They argued that their “work for pay” was an exercise of rights and had no privilege associated with it, so the “work for pay” did not fall under the Internal Revenue Code. The Taxpayers’ position is

contrary to the applicable statutory provisions and is without merit.<sup>10</sup> That they received compensation for their services from their employers was not in dispute. Compensation for services is included in the Utah taxable income regardless of whether they were working for a private sector employer or a government employer.

The statutes and case law clearly support federal individual income tax on wages regardless of the type of employer.<sup>11</sup> However, it should be noted that Utah may make a state individual income tax assessment whether or not an assessment has been made by the IRS.<sup>12</sup> Utah individual income tax is governed by Utah state statute. Utah Code §59-10-104 imposes a tax on every “resident individual.” Utah “resident individuals” are subject to state income tax on their “state taxable income.” “State taxable income” is defined at Utah Code §59-10-103 as “federal taxable income” (with some modifications and adjustments) as defined in Section 63, Internal Revenue Code. Based on these statutory provisions, state taxable income is income from whatever source derived and specifically includes compensation for services. See Internal Revenue Code at 26 U.S.C. 63 and 61(a). In addition the courts have specifically considered the

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<sup>10</sup> The Division provided a copy of Rev. Rul. 2006-18 which addresses the IRS’s position on similar claims and holds, “Federal income tax laws do not apply solely to federal employees and persons residing in the District of Columbia, or federal territories and enclaves, and any contrary contention is frivolous. The terms “employee” and “wages” as used by the Internal Revenue Code apply to all employees, unless specifically exempted by the Internal Revenue Code. The income tax withholding provisions do not affect whether an amount is gross income.”

<sup>11</sup>See **United States v. Mann**, 884 F.2d 532 (10th Cir. 1989). In that case, Mann offered many theories as to why he was not required to file income tax returns. The court stated, “His many theories include the asserted beliefs that 1) the United States Supreme Court has declared that the sixteenth amendment applies only to corporations, 2) the Internal Revenue Service (IRS) has no jurisdiction over him, 3) he is not a “person” within the meaning of 26 I.R.C. §7203, 4) wages are not income, 5) federal reserve notes are not legal tender, and 6) the income tax is voluntary.” The court in **Mann** responded to these assertions as follows, “. . . each of the views offered by Mann, whether found in his published materials or articulated additionally at trial, falls somewhere on a continuum between untrue and absurd.” See also **United States v. Collins**, 920 F.2d 619 (10th Cir. 1990), **cert. denied**, 500 U.S. 920, (1991); **United States v. Lonsdale**, 919 F.2d 1440 (10th Cir. 1990); **United States v. Hanson**, 2 F.3d 942,945 (9th Cir. 1993); **United States v. Studley**, 783 F.2d 934, 937, n. 3 (9th Cir. 1986); **United States v. Sloan**, 939 F.2d 499, 501 (7th Cir. 1991), **cert. den.** 112 S.Ct. 940 (1992); **United States v. Kruger**, 923 F.2d 587, 587-588 (8th Cir. 1991); **United States v. Gerads**, 999 F.2d 1255 (8th Cir. 1993); **United States v. Slater**, 96 F.R.D. 53, 55-56 (D. Del. 1982); and **United States v. Mundt**, 29 F.3d 233,237 (6th Cir. 1994). **Cox V. Commissioner of Internal Revenue**, 99 F.3d 1149 (10th Cir. 1996); **Baker v. Towns**, 849 F. Supp. 775 (D.Utah 1993);and **United States v. Hanson**, 2 F.3d 942 (9th Cir. 1993);

<sup>12</sup>The Utah Supreme Court has addressed this issue in **Nelson v. Auditing Div.**, 903 P.2d 939 (Utah 1995) and **Jensen v. State Tax Commission**, 835 P.2d 965 (Utah 1992).

issue of whether wages are included in federal taxable income and have concluded that wages are taxable income.<sup>13</sup>

#### CONCLUSIONS OF LAW

1. As Taxpayers were “resident individuals” of Utah during the two tax years at issue, a tax is imposed on their “state taxable income” pursuant to §59-10-104 (2009).

2. “State taxable income” is defined as the resident individual’s “federal taxable income.” See Utah Code §59-10-103(w) (2009). Utah Code §59-10-103(f) (2009) provides a definition for “Federal Taxable Income” as “taxable income as defined by Section 63, Internal Revenue Code. Under Sec. 63 of the Internal Revenue Code “taxable income” is “gross income.” “Gross income” is “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; . . .” Section 61, Internal Revenue Code. The compensation that the Taxpayers received as remuneration for their services from their employers is “taxable income” under Sections 61 & 63, Internal Revenue Code, which means it is “Federal Taxable Income” and, therefore, their “State Taxable Income” under Utah Code 59-10-103. The Taxpayers’ argument that because they worked for and were paid by “private-sector” businesses they were not “employees” for purposes of federal law and, therefore, the wages or compensation that they had received was not subject to tax is contrary to these statutory provisions and without merit. That they received compensation for their services from their employers was not in dispute. As compensation for their services, it is included in the Utah taxable income.

3. The amount of income the Taxpayers received during the years as shown by the W-2s and information from the IRS was not disputed by the Taxpayers. Under Utah Code §59-1-1417 the Taxpayers have the burden of proof to show that the audit was incorrect. The Division’s audit is based on the reported income that was undisputed by the Taxpayer’s and should be upheld.

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<sup>13</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).

4. The Division imposed a penalty under Utah Code Sec. 59-1-401(9) in the amount of \$500 for each tax year. Utah Code Sec. 59-1-401(9) provides the penalty may be assessed if a person, in furtherance of a frivolous position, has a prima facie intent to delay or impede administration of a tax law files a return that fails to contain information from which the correctness of the tax can be determined or that clearly indicates that the tax is substantially incorrect. The Taxpayers' position that the compensation they received for their services was not subject to tax because they worked for "private-sector" employees is clearly frivolous. They argued they were not taking a position, but filing a return is taking a position. As noted above wages are state taxable income, and this has been addressed by the courts in prior decisions. The Taxpayers intentionally filed returns in furtherance of the frivolous position. They noted that they thought what they had filed complied with the law and had not filed the returns impulsively. Filing of frivolous returns impedes the administration of the tax laws, requiring numerous hours of time in audits and hearings and constitutes a prima facie intent to delay or impede administration of tax laws. The \$500 penalty should be upheld for both audit years.

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Jane Phan  
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the audits including tax, penalty and interest for 2007 and 2009. It is so ordered.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2013.

R. Bruce Johnson  
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

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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 et seq. and §63G-4-401 et seq.