

11-2817
TAX TYPE: INCOME TAX
TAX YEAR: 2003, 2006 and 2007
DATE SIGNED: 7-30-2014
COMMISSIONERS: D. DIXON, M. CRAGUN, R. PERO
EXCUSED: B. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER,</p> <p style="text-align: center;">Petitioner,</p> <p>vs.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="text-align: center;">Respondent.</p>	<p style="text-align: center;">INITIAL HEARING ORDER</p> <p>Appeal No. 11-2817</p> <p>Account No. ##### Tax Type: Income Tax Tax Year: 2003, 2006 and 2007</p> <p>Judge: Nielson-Larios</p>
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Presiding:
Aimee Nielson-Larios, Administrative Law Judge

Appearances:
For Petitioner: TAXPAYER, in person
REPRESENTATIVE FOR TAXPAYER, Petitioner's daughter, in person

For Respondent: REPRESENTATIVE FOR RESPONDENT, Utah Assistant Attorney
General, in person
RESPONDENT, Auditing Division, in person

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on June 24, 2014 for an Initial Hearing in accordance with Utah Code § 59-1-502.5. On September 7, 2011, Respondent ("Division") issued to Petitioner ("Taxpayer") Notices of Deficiency and Estimated Income Tax ("Notices of Deficiency") for the 2003, 2006, and 2007, reflecting the following amounts:

<u>Year</u>	<u>Audit Tax</u>	<u>Interest</u>	<u>Penalties</u>	<u>Total Due</u>
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

Interest was calculated through October 7, 2011. Because the Taxpayer filed 2003 and 2007 Utah returns with his Petition for Redetermination, the Division revised the amounts owing, calculated as of June 24, 2014, to be the following:

<u>Year</u>	<u>Audit Tax</u>	<u>Interest</u>	<u>Penalties</u>	<u>Payment</u>	<u>Total Due</u>
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$		\$\$\$\$\$
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	(\$\$\$\$\$)	\$\$\$\$\$
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$		\$\$\$\$\$

Interest continues to accrue on any unpaid balance. The Taxpayer’s 2003 Utah return showed a refund of \$\$\$\$\$; however, this refund will not be issued because the refund request is past the Utah statute of limitations for refunds. The amounts for the 2006 tax year include a \$\$\$\$\$ payment, which was collected through the federal government. The Taxpayer’s 2007 tax return showed a tax owing of \$\$\$\$\$; however, that amount was calculated using \$\$\$\$\$ of withholding and the Division has record of only \$\$\$\$\$ of withholding. The Division requested from the Taxpayer proof of the remaining withholding, and the Taxpayer had not provided such proof as of the date of the Initial Hearing, so the Division recalculated the audit tax, interest, and penalty amounts for the 2007 tax year using only the \$\$\$\$\$ of withholding, of which the Division has record.

At the Initial Hearing, the Taxpayer argued he does not owe Utah income tax for the 2003, 2006, and 2007 tax years because a federal bankruptcy court discharged these debts through its order issued on April 19, 2013.

APPLICABLE LAW

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

11 U.S.C. § 1328(a) addresses a bankruptcy court’s order of discharge, stating the following in pertinent part:

Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan, . . . the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502 of this title, except any debt-

 (2) of the kind specified . . . in paragraph (1)(B) . . . of section 523(a)

11 U.S.C. § 523(a) provides that certain taxes are not discharged, stating in the following pertinent part:

A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt-

(1) for a tax or a customs duty-

 (B) with respect to which a return, or equivalent report or notice, if required-

(i) was not filed or given; or
 (ii) was filed or given after the date on which such return, report, or notice was last due, under applicable law or under any extension, and after two years before the date of the filing of the petition; . . .

11 U.S.C. § 362 provides both an automatic stay of collection activities and exceptions to that automatic stay, stating the following in pertinent part:

- (a) Except as provided in subsection (b) of this section, a petition filed under section 301 , 302 , or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of-
.....
 - (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
.....
- (b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay-
.....
 - (9) under subsection (a), of-
 - (A) an audit by a governmental unit to determine tax liability;
 - (B) the issuance to the debtor by a governmental unit of a notice of tax deficiency;
 - (C) a demand for tax returns; or
 - (D) the making of an assessment for any tax and issuance of a notice and demand for payment of such an assessment (but any tax lien that would otherwise attach to property of the estate by reason of such an assessment shall not take effect unless such tax is a debt of the debtor that will not be discharged in the case and such property or its proceeds are transferred out of the estate to, or otherwise revested in, the debtor).

11 U.S.C. § 505(a)(1) provides that a bankruptcy court “may” determine a tax liability, stating the following:

Except as provided in paragraph (2) of this subsection, the court may determine the amount or legality of any tax, any fine or penalty relating to a tax, or any addition to tax, whether or not previously assessed, whether or not paid, and whether or not contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction.

DISCUSSION

The parties agreed that the Taxpayer filed for chapter 13 bankruptcy on March 24, 2011, the bankruptcy court confirmed the chapter 13 plan on August 29, 2011, and the bankruptcy court issued its order of discharge on April 19, 2013. The Taxpayer provided a copy of that order of discharge, which states that the Taxpayer is “granted a discharge under section 1328(a) of title 11, United States Code, (the Bankruptcy Code).” The order also includes general information about non-discharged debts, stating: “Some of the common types of debts which are not discharged in a chapter 13 bankruptcy case are: . . .
b. Debts for most taxes . . .”

The Taxpayer stated that the State of Utah was listed as a satisfied debtor and that he did all he was required to do under the bankruptcy law. The Taxpayer explained that he paid all his debts in full

through the chapter 13 bankruptcy and he was not trying to hide amounts owing or to defraud his creditors.

The Taxpayer also argued that the Division's audit assessments for the 2003, 2006, and 2007 tax years were illegal based on their timing. The Division issued the Notices of Deficiency on September 7, 2011, after the bankruptcy court confirmed the Taxpayer's chapter 13 plan on August 29, 2011. The Taxpayer said representatives for the Utah State Tax Commission ("Tax Commission") and the IRS were at the first meeting of creditors and gave him assignments. The Taxpayer said the IRS requested returns for the 2003, 2006, 2007, and 2010 tax years. The Taxpayer asserted that the Tax Commission should have requested returns for all of these years as well. The Taxpayer contends the Tax Commission could have easily seen the years for which he had not filed Utah returns. The Division responded that the Tax Commission would not have been aware of the unfiled Utah returns for the 2003, 2006, and 2007 tax years until the Taxpayer had filed his federal returns. The Division further explained that when the Tax Commission's Bankruptcy Unit looked at the Tax Commission's system, the system would have shown that the Taxpayer had no Utah tax liabilities for the years with missing Utah returns.

The Taxpayer also asserted that the representative for the Tax Commission had signed off on the Taxpayer's chapter 13 plan. To clarify the Taxpayer's assertion, the Division explained that the Tax Commission filed an "Objection to Confirmation of Chapter 13 Plan," in which the Tax Commission requested that the Taxpayer file his 2010 Utah tax return. The Division further explained that the Tax Commission withdrew its objection when the Taxpayer provided his 2010 Utah return. The Taxpayer contends the Tax Commission should have researched whether he had filed Utah returns for all years before the court approved the plan. The Taxpayer asserts the Tax Commission could have objected to the amounts owing for the 2003, 2006, and 2007 tax years before the chapter 13 plan was confirmed, but it failed to do so. The Taxpayer asserts that because the Tax Commission did not object, the Tax Commission hurt his right and ability to pay off all his liabilities in a timely manner through the chapter 13 plan. The Taxpayer explained he thought all people at the meeting of creditors, such as the trustee, his attorney, and the representatives of the taxing entities, would handle matters such as the missing tax returns. The Taxpayer also said he thought if a tax audit takes place, it must go through the bankruptcy trustee.

Overall, the Taxpayer contends it is unfair for the Tax Commission to inform him of a large tax liability after the chapter 13 plan was approved and he had no reasonable way of paying it, thus putting an unfair burden on him. The Taxpayer explained how he has complied with all requests of the Tax Commission but is still getting more requests from the Tax Commission. He explained as an example that he received a request from the Tax Commission for proof of withholding for the 2010 tax year and he

provided copies of his W-2 forms for that year. The Taxpayer explained how he sees these requests from the Tax Commission as “oops” by the state, caused by the state’s lack of due diligence.

The Division explained that the liability for the 2003 tax year has been resolved. The Taxpayer filed a 2003 Utah return, the Division accepted it, and there is now no balance due.

The Division explained that for the 2006 tax year, the Taxpayer has not filed a Utah return. The Taxpayer responded that he lived and worked in STATE, and he did not remember if he was in Utah for any part of 2006. The Division said that for the 2006 tax year BUSINESS-1 and BUSINESS-2 reported Utah wages and withholdings. The Division explained that if the Taxpayer files a 2006 Utah tax return, the Division would still consider accepting it to replace the Division’s non-filing estimate, regardless of whether the Taxpayer’s appeal is open or closed.

The Division explained for the 2007 tax year, the Taxpayer filed a Utah return on or about October 1, 2011 with his Petition for Redetermination, showing a tax amount owing of \$\$\$\$\$. The Division explained that it requested proof of about \$\$\$\$\$ of withholding from BUSINESS-3, but the Taxpayer has not yet supplied a copy of the W-2. The Division explained that if the Taxpayer provides the Division with a copy of the W-2 from BUSINESS-3 then the Division will allow the additional withholding from that company, regardless of whether the Taxpayer’s appeal is open or closed.

The Division explained that the bankruptcy court’s order of discharge does not discharge the 2006 and 2007 Utah tax liabilities. The Division stated such taxes are not dischargeable under 11 U.S.C. § 523(a). At the hearing, the Division provided a copy of a bankruptcy court case and said the bankruptcy court in that case explained which debts are not dischargeable under 11 U.S.C. § 523(a). The Division explained that for the 2006 tax year, the Taxpayer’s Utah income taxes are not dischargeable because 11 U.S.C. § 523(a)(1)(B)(i) applies. Under this subsection, a tax debt is not discharged when a tax return is required but not filed. The Division explained that for the 2007 tax year, the Taxpayer’s Utah income taxes are not dischargeable because 11 U.S.C. § 523(a)(1)(B)(ii) applies. Under that subsection, a tax debt is not discharged when a tax return is required, but the tax return was filed after its due date and after two years before the bankruptcy was filed.

The Division explained that under the federal bankruptcy law, the Division could still audit the Taxpayer and issue the Notices of Deficiency on September 7, 2011. The Division explained that under the bankruptcy law, governments may file claims 180 days after a debtor files a petition for bankruptcy. The Division explained that the Taxpayer filed for bankruptcy on March 24, 2011, so the September 7, 2011 date falls within the 180-day time frame. The Division also explained that under the bankruptcy law the Taxpayer had a choice of disputing the Utah audit amounts through the bankruptcy forum or through the administrative process. The Division stated that if the Taxpayer had filed a motion with the bankruptcy court, he could have had the bankruptcy court determine the Utah audit amounts but he did

not file such a motion. The Division explained that the Notices of Deficiency were issued to him and not also to his bankruptcy attorney because of privacy requirements.

This Initial Hearing Order sustains the Division’s position for the three years at issue; specifically the amounts owing, calculated through June 24, 2014, are as follows, with interest continuing to accrue on any unpaid balance:

<u>Year</u>	<u>Audit Tax</u>	<u>Interest</u>	<u>Penalties</u>	<u>Payment</u>	<u>Total Due</u>
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$		\$\$\$\$\$
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	(\$\$\$\$\$)	\$\$\$\$\$
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$		\$\$\$\$\$

Analysis for this conclusion follows.

The bankruptcy court did not discharge the amounts the Taxpayer owes for 2006 and 2007 Utah taxes. In the bankruptcy court’s order of discharge, the bankruptcy court “granted a discharge under section 1328(a).” 11 U.S.C. § 1328(a) provides a discharge of debts *except for* the debts of the kind specified in 11 U.S.C. § 523(a)(1)(B) and in other specific code sections. Under 11 U.S.C. § 523(a)(1)(B)(i), taxes are not discharged when a taxpayer has not filed a required return. Thus, the Taxpayer’s 2006 Utah income taxes were not discharged because the Taxpayer was required to file, but did not file, a 2006 Utah return to report the income his employers reported as Utah income for 2006. Under 11 U.S.C. § 523(a)(1)(B)(ii), the taxes are not discharged when a taxpayer is required to file a return, but he or she files the return after its due date and after two years before the bankruptcy petition was filed. For the 2007 tax year, the Taxpayer was required to file a 2007 Utah return, but he filed that return on or about October 1, 2011, well after the return’s due date in 2008 and clearly after two years before the bankruptcy was filed on March 24, 2011. Thus, the Taxpayer’s 2007 Utah taxes were not discharged based on 11 U.S.C. § 523(a)(1)(B)(ii).

The Division’s audit assessments issued on September 7, 2011 were not illegal. Under 11 U.S.C. § 362(b)(9)(A)-(D), there is no automatic stay of “(A) an audit by a governmental unit to determine tax liability; (B) the issuance to the debtor by a governmental unity of a notice of tax deficiency; . . . and (D) the making of an assessment for any tax and the issuance of a notice and demand for payment of such an assessment.” Furthermore, a Utah income tax audit is not required to go through the bankruptcy trustee. Under 11 U.S.C. § 505(a)(1), a bankruptcy “court **may** determine the amount or legality of any tax [and] any fine or penalty related to a tax” (emphasis added). The bankruptcy code does not require the bankruptcy court to determine such liabilities. The bankruptcy code did not require the Tax Commission to request returns for the 2003, 2006, and 2007 tax years at the meeting of creditors or to object to the bankruptcy court’s confirmation of the Taxpayer’s chapter 13 plan if Utah returns were not filed. The Taxpayer has not shown the Division acted illegally through its audit assessments.

In conclusion, the bankruptcy court did not discharge the 2006 and 2007 Utah tax liabilities of the Taxpayer, and the Division did not act illegally when it prepared its audit assessments for the 2006 and 2007 tax years. Thus, the audit amounts for the 2006 and 2007 tax years should be sustained.

Aimee Nielson-Larios
Administrative Law Judge

DECISION AND ORDER

Based on the above analysis, the Commission sustains the following audit amounts for the 2003, 2006, and 2007 tax years:

<u>Year</u>	<u>Audit Tax</u>	<u>Interest</u>	<u>Penalties</u>	<u>Payment</u>	<u>Total Due</u>
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$		\$\$\$\$\$
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	(\$\$\$\$\$)	\$\$\$\$\$
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$		\$\$\$\$\$

Interest was calculated through June 24, 2014 and continues to accrue on any unpaid balance.

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 _____, 2014.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Notice of Payment Requirement: Any balance due as a result of this order must be paid within thirty (30) days of the date of this order, or a late payment penalty could be applied.