

11-2830
INCOME TAX
TAX YEAR: 2006
SIGNED: 10-25-2012
COMMISSIONERS: R. JOHNSON, D. DIXON, M. CRAGUN
EXCUSED: M. JOHNSON

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER 1 AND PETITIONER 2,

Petitioners,

v.

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent.

INITIAL HEARING ORDER

Appeal No. 11-2830

Account No. #####

Tax Type: Income Tax

Tax Year: 2006

Judge: Phan

Presiding:

Jane Phan, Administrative Law Judge

Appearing:

For Petitioner: PETITIONER 1, By Telephone

PETITIONER 2, By Telephone

For Respondent: RESPONDENT REP., Manager, Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on August 21, 2012 for an Initial Hearing in accordance with Utah Code §59-1-502.5. Petitioners (“Taxpayers”) timely appealed the Statutory Notice of Deficiency and Estimated Income Tax, issued against them on September 22, 2011, for the 2006 tax year. The amount of the audit tax was \$\$\$\$\$. In addition, failure to file and failure to pay penalties totaling \$\$\$\$\$ had been assessed under Utah Code §59-1-401. Interest in the amount of \$\$\$\$\$ had been assessed with the audit and continues to accrue on the unpaid balance. As of the date of the Statutory Notice, the total of the tax, penalties and interest was \$\$\$\$\$.

APPLICABLE LAW

Utah imposes a tax on nonresident individual's income from Utah sources at Utah Code Sec. 59-10-116(2) (2006)¹ as follows:

Except as provided in Subsection (3), a tax is imposed on a nonresident individual in an amount equal to the product of the nonresident individual's: (a) unapportioned state tax; and (b) state income tax percentage.

Utah Code Sec. 59-10-117 defines what income would be Utah source income for purposes of determining a nonresident's income tax obligations. That section provides in relevant part:

(1) For purposes of Section 59-10-116, federal adjusted gross income derived from Utah sources shall include those items includable in federal "adjusted gross income" (as defined by Section 62 of the Internal Revenue Code) attributable to or resulting from:

(a) the ownership in this state of any interest in real or tangible personal property (including real property or property rights from which "gross income from mining" as defined by Section 613(c) of the Internal Revenue Code is derived);

. . . .

The applicable statutes specifically provide that the taxpayer bears the burden of proof in proceedings before the Tax Commission. Utah Code Sec. 59-1-1417 provides: "In a proceeding before the commission, the burden of proof is on the petitioner . . ."

There is no statutory period limiting when the Division may issue an audit in cases where a return has not been filed. Utah Code Sec. 59-1-1410(3) provides:

The Commission may assess a tax, fee, or charge or commence a proceeding for the collection of a tax, fee, or charge at any time if: (a) a person: . . . (ii) fails to file a return . .

The Commission has been granted the discretion to waive penalties and interest. Section 59-1-401(13) of the Utah Code provides, "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."

The Commission has promulgated Administrative Rule R861-1A-42 to provide additional guidance on the waiver of penalties and interest, as follows in pertinent part:

(2) Reasonable Cause for Waiver of Interest. Grounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.

¹ The Utah Individual Income Tax Act has been revised and provisions renumbered subsequent to the audit period. The Commission cites to and applies the provisions that were in effect during the audit period on substantive legal issues.

- (3) Reasonable Cause for Waiver of Penalty. The following clearly documented circumstances may constitute reasonable cause for a waiver of penalty:
- (a) Timely Mailing...
 - (b) Wrong Filing Place...
 - (c) Death or Serious Illness...
 - (d) Unavoidable Absence...
 - (e) Disaster Relief...
 - (f) Reliance on Erroneous Tax Commission Information...
 - (g) Tax Commission Office Visit...
 - (h) Unobtainable Records...
 - (i) Reliance on Competent Tax Advisor...
 - (j) First Time Filer...
 - (k) Bank Error...
 - (l) Compliance History...
 - (m) Employee Embezzlement...
 - (n) Recent Tax Law Change...

Regarding waiver of interest, Administrative Rule R861-1A-42(2), provides a different criteria as follows:

Reasonable Cause for Waiver of Interest. Grounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.

DISCUSSION

The facts in this matter were not in dispute. The Taxpayers were residents of STATE 1 for the 2006 year, which is the year at issue in this appeal and had been residents of that state for many years. The Taxpayers were members in COMPANY 1. That limited liability company owned property located in Utah which it sold in 2006. The Taxpayers received \$\$\$\$ as their share of the proceeds from that sale. This was %%% of their total income for 2006. The Taxpayers state that they did have an accountant prepare their STATE 1 and Federal Individual Income Tax Returns for that year and they claimed their share of the proceeds on both returns. They paid taxes to STATE 1 on these proceeds as well as their total income and they calculated that \$\$\$\$ of the tax they paid to STATE 1 was due to the proceeds from the Utah land sale.

It was their representation that they had never been informed by their tax advisor that they would also need to file a Utah return claiming the income from the sale as Utah source income. They had never previously had to file a Utah return, and did not recall any other year having source income from a state other than the one in which they resided. So no Utah return was filed.

It was not until they received the audit notice in September 2011 that the Taxpayers found out they should have filed a Utah return as nonresidents and claimed the income from the

proceeds of the land sale as Utah source income. Once they became aware of this claim, they began researching this issue and discovered that they were liable for Utah taxes and they should have filed a Utah return in 2006. However, as they had filed their 2006 STATE 1 return on time, it was too late for them to file an amended STATE 1 return to receive a refund of the \$\$\$\$ in taxes paid in that state due to the proceeds from the land sale. They stated that STATE 1 has a hard four year limit on amending tax returns. Had they known sooner, they could have filed an amended return and received back a refund of the taxes paid to STATE 1. Without a refund of the taxes paid to STATE 1, it is their position that they are paying the taxes in duplicate in both states.

The Taxpayers also state that they are now retired and paying the tax in duplicate creates a financial hardship. They ask that the Utah tax be offset by the amount of tax they have already paid to STATE 1 on these proceeds, as well for waiver of the penalties and interest. They point out that they did file their 2006 tax returns in good faith to STATE 1 and the IRS and in a timely manner. They had relied on an accountant to help them with their returns.

It was the Division's position that the Division did not think the Taxpayers had been trying to avoid paying the Utah tax, that this was just an oversight on the part of the Taxpayers' accountant. The Division indicated that it was unfortunate that when the audit was issued it was too late for the Taxpayers to request a refund from STATE 1. He stated that the audit was issued in 2011 because that was when it came to the Division's attention. He also indicated that there were no statutory provisions to allow the Division to offset the Utah taxes by the amount of taxes the Taxpayers had already paid to the state of STATE 1. He indicated in the Division's calculation, the amount of the Utah adjusted gross income was \$\$\$\$ and that was the amount on which the Division had based the tax, allowing for a joint filing status and two exemptions. The Division's representative noted that there were no other years where the Taxpayers had filed Individual Income Returns in Utah as nonresidents or residents.

Upon reviewing the facts and the law in this matter, the tax on the proceeds from the property sale was due to the State of Utah under Code Sec. 59-10-116(2) with a 2006 Utah Non-Resident Income Tax Return. The Taxpayers, however, as non-residents of Utah as well as not having income sourced to other states previously were unaware of the statutory provisions and filed and paid taxes in STATE 1, their state of residence. The law does not allow for an offset of the amount paid to STATE 1 even given these circumstances. The unfortunate situation for these Taxpayers, because it is now too late to obtain a refund in STATE 1, is that they will be paying tax on this income in two separate states.

There is basis for waiver of the penalties do to the fact that this would have been a first time filing in Utah for the Taxpayers and the Taxpayers were relying on a tax advisor to prepare their returns for 2006. With regard to the waiver of interest, Rule R861-1A-42 specifically provides, “[g]rounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, you must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.” In this matter, no Commission error was shown. Although the Division did not notify the Taxpayers until the Division performed the audit in 2011, it is following within the general process and statutory provisions which provide no statute of limitations on audits where a return has not been filed. The tax and the interest assessed with the audit should be upheld. The penalties should be waived.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Utah non-resident individual income tax audit for tax year 2006 as it pertains to tax and interest. The Commission waives the penalties assessed in the audit. 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 _____, 2012.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

Appeal No. 11-2830

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
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.