

12-1345

TAX TYPE: INCOME TAX

TAX YEAR: 2006, 2007, 2008, and 2009

DATE SIGNED: 12-2-2016

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER-1 & TAXPAYER-2,</p> <p style="text-align: center;">Petitioners,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="text-align: center;">Respondent.</p>	<p>FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION</p> <p>Appeal No. 12-1345</p> <p>Account No. #####</p> <p>Tax Type: Income Tax</p> <p>Tax Year: 2006, 2007, 2008 and 2009</p> <p>Judge: Phan</p>
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Presiding:

John Valentine, Commission Chair
Jane Phan, Administrative Law Judge

Appearances:

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

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on August 30, 2016, 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 Utah individual income tax audit deficiencies for the years 2006, 2007, 2008 and 2009. For the 2006 tax year, the original Notice of Deficiency and Audit Change had been issued by Respondent (“Division”) on June 2, 2010. A second Notice of Deficiency for 2006, which is the one at issue in this hearing, was issued on April 17, 2012, and the Notices of Deficiency and Audit Change for tax years 2007 and 2008 had been issued on April 17, 2012. The Notice

of Deficiency and Estimated Income Tax for tax year 2009 had been issued on August 1, 2013. The Taxpayers timely appealed the deficiencies and the matter proceeded to this Formal Hearing.

2. Tax year 2010 had at one time been included in this appeal, but the Taxpayer explained she did not contest or have unresolved issues with 2010, so that tax year was not addressed at the hearing.

3. No penalties were issued with the audit deficiency for the years 2006 through 2008. For tax year 2009, penalties were added to the audit, which were a 10% failure to timely file and a 10% failure to timely pay penalty under Utah Code Sec. 59-1-401.

4. Interest continues to accrue on the unpaid balance. As of the date the Notices were issued, the tax, penalties where applicable, and interest as accrued up to the date of the Notices for each of the years are as follows:

Year	Tax	Interest ¹	Penalty	Total as of Date of Notices
2006	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2008	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2009	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

5. The Taxpayers had filed Utah resident individual income tax returns for tax years 2006 through 2008 and federal returns for those years. The Taxpayer testified that her accountant later told her to file amended federal returns for 2006 and 2007, which they filed. The Internal Revenue Service then audited the Taxpayers for the years 2006 through 2008. The Taxpayer attended the Formal Hearing by herself so the accountant who prepared the returns was not there to explain the changes and the Taxpayer was unclear on what the changes had been or whether or not they were correct. It was the Taxpayer's testimony that after auditing the amended returns, the IRS had raised their taxable income significantly above what they had claimed on their original returns. While these issues were ongoing with the IRS, she testified that she had held off on filing her 2009 federal and state returns. At some point the IRS then issued a 2009 assessment and the State Tax Commission issued its assessment based on the federal information. After the IRS issued its assessment the Taxpayers filed a 2009 federal return. As of the date of the Formal Hearing, Taxpayer had not filed a 2009 Utah Individual Income Tax Return. The Taxpayer was not able to state what she thought was the correct federal adjusted gross income for 2009 at the hearing. After the hearing, the Taxpayers did submit a 2009 Utah Individual Income Tax return, but it was

¹ Interest continues to accrue on the unpaid balance so this amount will continue to increase until the balance is paid in full.

undated and unsigned. This return did indicate a higher federal adjusted gross income than the federal adjusted gross income the Division had determined in its Utah Individual Income Tax Audit for 2009.

6. The following table shows the federal adjusted gross income amounts as claimed by the Taxpayers on their returns, as determined by the IRS, and as used by the Division in its audits:

Year	FAGI Reported on Taxpayers' Original Federal Returns	FAGI Reported on Taxpayers' Amended Federal Returns	FAGI Determined by IRS After Audit²	FAGI Used by Division in its Assessments³	FAGI Proposed by Taxpayers
2006	\$\$\$\$\$ ⁴	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2007	\$\$\$\$\$ ⁵	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2008	\$\$\$\$\$	None Filed	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2009	\$\$\$\$\$	None Filed	\$\$\$\$\$	\$\$\$\$\$	Unknown

7. Regarding the IRS audit process, the Taxpayer testified that she was told by an IRS agent that she had to attend an in person meeting with the IRS agent by herself and could not bring her accountant or other representative to assist her. The Taxpayer testified that while she was by herself, the IRS agent coerced her into signing paperwork that indicated she agreed with the audit even though she did not agree. She also testified that an IRS agent told her “that is how he works because that is how he gets paid the most.” She states that one item added by the IRS audit was imputed income in the amount of \$\$\$\$\$ per year. The Taxpayer said she was told by the IRS auditor that she should have paid herself that from her business. She testified that her business was making insufficient money for her to pay herself from the proceeds and that she had not been taking money from her business at this time. She stated the business was rental properties that were “underwater” during the financial crisis and she lost them in foreclosure. She testified that after the IRS audit was concluded, she had spoken with two different attorneys about the problem and they had sent letters to the IRS, but the Taxpayer did not provide the letters as exhibits at the hearing. It was the Taxpayer’s testimony that the IRS has placed her into an uncollectable status so is not actively collecting its audit deficiencies against her.

8. The Taxpayers have the burden of proof in this matter to show that the audit was incorrect and that the taxable income they are proposing for each year is correct. The evidence presented at this hearing regarding tax year 2006 included an original Utah Individual Income Tax Return, signed

² These amounts are from the Internal Revenue Service Account Transcripts, Respondent’s Exhibit 4.

³ See Respondent’s Exhibits 1 & 7.

⁴ Although at the hearing, the Taxpayers were told to provide a copy of their original 2006 and 2007 federal returns, these were never submitted. The Taxpayers did, however, provide copies of their 2006 and 2007 amended federal returns which provide both the original federal adjusted gross income and the amended federal adjusted gross income. Post Hearing Submission received on September 19, 2016.

⁵ Id.

on June 2008, and an amended Utah Individual Income Tax Return, signed on May 19, 2009.⁶ At the hearing the Commission requested the Taxpayers provide a copy of their original federal return for 2006 and their amended federal return for 2006. After the hearing, the Taxpayers provided only the amended 2006 federal return.⁷ The information provided on the amended filing indicated a reduction of federal adjusted gross income from \$\$\$\$\$ to \$\$\$\$\$ and the explanation “on original return, taxpayer incorrectly stated rental income.” The amended return showed that the Taxpayers had received Schedule B Interest and Ordinary Dividend income, Schedule D Capital Gains, Schedule E Income from Partnerships and S Corporations. This resulted in \$\$\$\$\$ in adjusted gross income claimed on the amended return. Because the Taxpayers did not provide a copy of their original 2006 Federal Return, it is not known what types of income they had claimed and how that differed from the amended return. The Division provided as evidence at the hearing the Account Transcript from the IRS, which had been printed on August 26, 2016. The account transcripts showed \$\$\$\$\$ in federal adjusted gross income and that the IRS assessed tax on this adjusted gross income. However, the account transcript also indicates that the account is “currently not collectable.”⁸

9. For tax year 2007, the original Utah return was not provided. The amended Utah return was signed on May 19, 2009⁹ and indicated \$\$\$\$\$ in federal adjusted gross income. At the hearing the Commission requested the Taxpayers provide a copy of their original federal return for 2007 and their amended federal return for 2007. After the hearing, the Taxpayers provided only the amended 2007 federal return.¹⁰ The information provided on the amended filing indicated a reduction of federal adjusted gross income from \$\$\$\$\$ to \$\$\$\$\$ and the explanation “on original return, taxpayer did not include rental income/loss.” The amended return showed that the Taxpayers had interest and dividend income, business income, a capital loss and Schedule E Income from Partnerships and S Corporations. The Division provided the Account Transcript from the IRS, which had been printed on August 26, 2016. The account transcripts showed \$\$\$\$\$ in federal adjusted gross income. They indicate that the IRS assessed tax on this adjusted gross income. However, they also indicate that the account is “currently not collectable.”¹¹

10. For the 2008 tax year, the original Utah return was filed on October 28, 2009 and the Taxpayers had claimed \$\$\$\$\$ in federal adjusted gross income on that return.¹² There did not appear to be an amended return for that year. A copy of the 2008 federal return was not provided. A copy of the

6 Respondent's Exhibit 3.

7 Post Hearing submission received on September 19, 2016.

8 Respondent's Exhibit 4.

9 Respondent's Exhibit 3.

10 Post Hearing submission received on September 19, 2016.

11 Respondent's Exhibit 4.

12 Respondent's Exhibit 3.

Internal Revenue Account Transcript was provided and it indicated federal adjusted gross income of \$\$\$\$\$ and the same “currently not collectable” status.

11. For the 2009 tax year, the Taxpayer explained that she had held off on filing a federal return because the IRS audit was ongoing for the prior years. She testified that the IRS had issued an estimated assessment before she actually filed her federal return. A copy of the front page of a federal return for 2009 was provided with a photocopy of a check for payment of the tax. There is no signature or date on the front page of this return and the date on the check appears to be stated in error, however the amount of the check had been \$\$\$\$\$.¹³ The amount of the federal adjusted gross income listed on this return had been \$\$\$\$\$. The Division provided a copy of the IRS Account Transcript for 2009. It showed \$\$\$\$\$ in federal adjusted gross income. The transcript also showed that a 2009 federal return had been received on January 7, 2011, and “payment with return” in the amount of \$\$\$\$\$ was received on December 27, 2011. These support that the Taxpayer had filed the return with the check for payment. The transcript lists a “substitute return prepared by IRS on February 14, 2011, which increased the federal adjusted gross income to \$\$\$\$\$.” The Division’s tax deficiency was based on the \$\$\$\$\$ in federal adjusted gross income.¹⁴ The Division reported that as of the hearing date, the Taxpayers had never filed a 2009 Utah Individual Income Tax Return. In their post hearing submission the Taxpayers provided an unsigned and undated 2009 Utah Individual Income Tax Return on which \$\$\$\$\$ was listed as the federal adjusted gross income. This is higher than the amount claimed on the federal return or as determined by the IRS in its audit.

12. The Taxpayers have not established that the amounts they had claimed on the federal and Utah returns were the correct amounts and the amounts determined by the IRS were in error. The Division’s representatives acknowledged that they had relied on the IRS information, but point out that the Taxpayers have never provided to the Division the books, records and supporting documents for the businesses and income and expenses that were claimed on the Taxpayers’ returns. The Taxpayer had attended the hearing by herself and did not provide testimony about how the returns had been prepared, what income and expenses should have been claimed or to demonstrate that the returns were correct based on the law.

13. The Taxpayer argued financial hardship at the hearing, stating that she and her spouse do not have the financial means to pay the tax assessments. She states she lost the properties and business and now has dependents which require her care most of the time.

13 Petitioner’s Exhibit 3.

14 Respondent’s Exhibit 7.

APPLICABLE LAW

Utah Code §59-10-111 (2006) defines “federal taxable income” to mean “taxable income as currently defined in Section 63, Internal Revenue Code of 1986.”

Utah Code §59-10-112 (2006)¹⁵ defines “state taxable income” to mean “federal taxable income (as defined by Section 59-10-111) with the modifications, subtractions, and adjustments provided in §59-10-114.”

For the 2007 tax year, Utah Code §59-10-103 (2007) defines “adjusted gross income,” “federal taxable income,” and “‘taxable income’ or ‘state taxable income,’” as follows in pertinent part:

- (1) As used in this chapter:
 - (a) "Adjusted gross income":
 - (i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code; or
 -
 - (k) "Federal taxable income":
 - (i) for a resident or nonresident individual, means taxable income as defined by Section 63, Internal Revenue Code; or
 -
 - (y) "Taxable income" or "state taxable income":
 - (i) . . . for a resident individual . . . 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;
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For the 2008 and 2009 tax years, the definitions of “adjusted gross income” and “federal taxable income” remained the same as for the 2007 tax year. Effective for the 2008 tax year, however, the definition of “‘taxable income’ or ‘state taxable income’” was amended. For 2008 and 2009, these definitions are again found in Utah Code §59-10-103 (2008), as follows in pertinent part:

- (1) As used in this chapter:
 - (a) "Adjusted gross income":
 - (i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code; or
 -

¹⁵ Effective for the 2007 tax year, Sections 59-10-111 and 59-10-112 were repealed.

- (f) "Federal taxable income":
 - (i) for a resident or nonresident individual, means taxable income as defined by Section 63, Internal Revenue Code; or
-
- (w) "Taxable income" or "state taxable income":
 - (i) . . . for a resident individual, means the resident individual's adjusted gross income after making the:
 - (A) additions and subtractions required by Section 59-10-114; and
 - (B) adjustments required by Section 59-10-115;
-

The Commission has been granted the discretion to waive penalties and interest. Utah Code §59-1-401(14) 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.
- (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...

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

CONCLUSIONS OF LAW

1. Under Utah Code §59-1-1417 the Taxpayers have the burden of proof to show that the audit is incorrect and to support the returns that they had filed. The Taxpayers have not provided the underlying documentation supporting the returns that they are now asking the Commission to accept. This is a situation where the IRS had audited the Taxpayers' federal returns and had made adjustments to

the Taxpayers' federal adjusted gross income as a result of the audits. The Tax Commission generally gives deference to the IRS' determination of federal adjusted gross income, which becomes the basis of the Utah taxable income. The Commission has considered making an independent determination regarding a person's federal adjusted gross income in certain limited circumstances.¹⁶ However, this generally occurred if the person had failed to appeal an IRS audit administratively or with amended filings, due to failing to meet deadlines or other procedural issues, and if it was clear that the IRS's determination was in error. In this case, it is apparent that the Taxpayers had an audit examination on this issue and the IRS did not accept their position. The Taxpayers did not provide sufficient information to support the amounts determined by the IRS were in error, or, in fact, to support the amounts they had claimed on their returns.

2. At the hearing the Taxpayer made various statements about conduct of IRS agents during the course of the federal audit. The Utah State Tax Commission lacks jurisdiction over the actions of IRS employees and has no means to investigate or inquire into these types of claims.

3. The Taxpayers had filed Utah Individual Income Tax returns for tax years 2006 through 2008, and although the Division determined them to be incorrect, no penalties were assessed with the audits for these years. For 2009 the Taxpayers had never filed a Utah Individual Income Tax Return. The audit was issued as a non-filing estimate with 10% failure to file and 10% failure to pay penalties. Under Utah Code §59-1-401(14) the commission may waive, reduce, or compromise any of the penalties or interest if reasonable cause has been shown. However, under Administrative Rule R861-1A-42(2) interest may be waived only if the taxpayer proves that the Commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error. There was no showing in this matter that would support waiver of interest.

4. Under Utah Administrative Rule R861-1A-42(3) there are guidelines for reasonable cause for waiver of penalties. One showing of reasonable cause is account history. Previous to tax year 2009, the Taxpayers had been filing Utah Individual Income Tax Returns. By the time tax year 2009 was due, they were under audit with the IRS for prior years and put off filing 2009 while audits were ongoing. There is cause based on account history for waiver of the 2009 penalties.

5. Financial hardship is not accepted as reasonable cause for waiver of penalties in this audit hearing. However, after the appeal is closed by this order, the Taxpayers may contact the Taxpayer

¹⁶ See Tax Commission decisions issued in *Utah State Tax Commission Appeal Nos. 12-2963, 12-2967, 11-827, 07-0365, 06-1408, 07-1036, 03-0510 & 03-0586*. These and other Tax Commission decisions are available in a redacted format at tax.utah.gov/commission-office/decisions.

Services Division and discuss options based on their financial hardship for how the amount is collected. The telephone number for the Taxpayers to contact Taxpayer Services Division is (801) 297-7703.

Based on the foregoing, the Division's audit deficiencies of tax and the interest accrued thereon should be upheld for tax years 2006 through 2009. The penalties for tax year 2009 should be waived.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Division's Utah individual income tax audit deficiencies of tax and the interest issued against the Taxpayers are upheld for tax years 2006 through 2009. The penalties for tax year 2009 are hereby waived. It is so ordered.

DATED this _____ day of _____, 2016.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Appeal Rights and 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 assessed. 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 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.