

12-2963
TAX TYPE: INCOME TAX
TAX YEAR: 2009
DATE SIGNED: 2-23-2015
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO
EXCUSED: D. DIXON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER-1 & TAXPAYER-2, Petitioners, vs. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.</p>	<p style="text-align: center;">INITIAL HEARING ORDER</p> <p>Appeal No. 12-2963</p> <p>Account No. #####</p> <p>Tax Type: Income Tax</p> <p>Tax Year: 2009</p> <p>Judge: Phan</p>
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Presiding:

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 on October 28, 2014, for an Initial Hearing in accordance with Utah Code §59-1-502.5. Petitioners (“Taxpayers”) had filed an appeal of a Utah Individual Income Tax Audit Deficiency which had been issued against them by Respondent (“Division”). The Division had issued the Notice of Deficiency and Audit Change on November 15, 2012. In the audit the Division had increased the Taxpayers’ federal adjusted gross income from \$\$\$\$ to \$\$\$\$\$. There was also a small change to the itemized deductions which were not in dispute. The result was an audit tax due of \$\$\$\$\$. Interest as of the date of the Notice was \$\$\$\$ or a total due as of that date of \$\$\$\$\$. Interest continues to accrue on the unpaid balance. No penalties were assessed with the audit.

APPLICABLE LAW

State taxable income is defined in Utah Code §59-10-104(1) (2009)¹ as follows:

For taxable years beginning on or after January 1, 2008, a tax is imposed on the state taxable income of a resident individual as provided in this section.

State taxable income is defined in Utah Code Sec. 59-10-103(1)(w) (2009) as follows:

“Taxable income” or “State taxable income”: (i) subject to Section 59-10-1404(3), 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 . . .

“Adjusted gross income” is defined in Utah Code Sec. 59-10-103(1)(a) (2008) as follows:

“Adjusted gross income”: (i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code; or (ii) for a resident or nonresident estate or trust, is as calculated in Section 67(e), Internal Revenue Code.

The Commission has been granted the discretion to waive penalties and interest. Utah Code Ann. §59-1-401(13) 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.

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

DISCUSSION

The Taxpayers had originally claimed on their 2009 Utah Individual Income Tax Return that they had \$\$\$\$ in federal adjusted gross income. The Taxpayers in 2005 through 2008 were engaged in the activity of privately lending large sums of money. This was TAXPAYER-1 primary source of income during these years. He often obtained funds by

¹ The Commission applies the law in effect during the audit year.

securing lower interest loans in his name and then lending this in exchange for the principle and high yield interest. However, after the housing market crash in 2008, he saw few payments on the loans he had made. One of the borrowers, BUSINESS-1, did pay towards the loan an amount totaling \$\$\$\$\$ in 2009. He did not, however, repay the full amount of the loan and interest, the principle amount on the loan being \$\$\$\$\$. The Taxpayers filed an original 2009 Federal Return. However, the IRS made changes to the return. After which the Taxpayers filed an amended federal return and then the IRS audited the Taxpayers. The Taxpayers explain that as part of the IRS audit, they personally attended an audit meeting with NAME-1, of the IRS's Salt Lake City Office. It is not clear from the Taxpayers when this meeting occurred.

It was the Taxpayers understanding from that meeting that NAME-1 would reduce the Taxpayers' taxable income by the \$\$\$\$\$ in payments, as the payments resulted in a net loss. The Taxpayers had provided to NAME-1 a letter from NAME-2, of BUSINESS-1. In the letter, NAME-2 acknowledges borrowing \$\$\$\$\$ from the Taxpayer. NAME-2 states that any payments he had made on the loans in 2008 and 2009 should be "considered a partial repayment of principle, and not interest due to breach of contract and default of loans." This letter was dated June 30, 2011. The Taxpayers explained that they provided NAME-1 this letter and it was the Taxpayers' understanding that NAME-1 agreed that no interest income had been received so the payments actually resulted in a loss of the principle. However, the Taxpayers argue that NAME-1 never made this change to the Taxpayers' federal account. The Taxpayers made several follow-up attempts to contact him, but their case had been closed at the IRS without the \$\$\$\$\$ adjustment being applied, so their IRS Federal Account Transcripts showed that they had received \$\$\$\$\$ in federal adjusted gross income. The Division did provide a copy of the IRS Federal Account Transcript and it does note an abatement of a substantial portion of tax on October 17, 2011. The abatement amount was \$\$\$\$\$, with the notation, "Prior tax abated by examination."

Then the Taxpayers started receiving lien notices from the IRS. It was their statement that they were advised by their accountant to set up a payment plan with the IRS to halt the lien process. Based on the IRS Federal Account Transcript, they had entered into an installment agreement on July 10, 2012. It was the Taxpayers' understanding that if they did this they could still contest the tax amount. The Taxpayers state that they found out later from the IRS that by agreeing to the payment plan it was an agreement to the amount owed.

The Division's audit of the Taxpayers' Utah Individual Return was based on the federal adjusted gross income of \$\$\$\$\$ as determined by the IRS. At the Initial Hearing, the Taxpayers request that the Commission reduce the federal adjusted gross income by the \$\$\$\$\$ in payments

they had received from NAME-2, of BUSINESS-1. They do not cite any federal statutory provisions or guidelines or provide IRS rulings or Tax Court Cases to support their position that the IRS would treat the 2009 installment payments received as payments on the principle and not interest based on a letter written in 2011 by the defaulted borrower. Their case is based on the assertion that an IRS auditor had agreed to do this verbally during an examination meeting, but did not do so and the IRS had since refused to make this change.

The Division had pulled the IRS Federal Account Transcript and they note that the IRS had made some changes to the account, including reducing the amount of the federal tax owed by \$\$\$\$\$. The Utah audit is based on the federal adjusted gross income as shown on the most recent IRS transcript, dated October 14, 2014. It appeared to the Division that the IRS had reviewed the information provided by the Taxpayers and determined that the \$\$\$\$\$ was, in fact, properly included in the federal adjusted gross income as interest income. The Taxpayers argued it was not interest income and was instead business income. They had reported it as business income on their return, claiming the \$\$\$\$\$ in payments as gross receipts on their Schedule C, which they offset with \$\$\$\$\$ in Schedule C Business Losses. It was the Division's interpretation from the IRS information that the IRS concluded the \$\$\$\$\$ in payments was not a gross receipt and was instead Schedule B taxable interest income. The Division points out that as such, it cannot be offset by Schedule C business losses. It appears from the transcript that after the examination, the IRS had reclassified the \$\$\$\$\$ as capital losses, and then did allow the full \$\$\$\$\$ limit as a capital loss.

The Tax Commission generally gives deference to the IRS in determining federal taxable income for purposes of the Utah income tax filing which is based on the federal taxable income by statute. The Commission has found in limited circumstances that it would consider making an independent determination regarding a person's federal taxable income.² Generally, this occurs 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.

Given that the Taxpayers cite no Federal statutes, regulations or IRS Revenue Rulings to support their position that under federal law the IRS should have treated the \$\$\$\$\$ in installment loan payments received by the Taxpayers in 2009 as a payment against the principle,

² See Tax Commission decisions issued in *Utah State Tax Commission Appeal Nos. 12-2967, 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.

they have provided insufficient basis to support their contention that the IRS calculation of their federal adjusted gross income was in error. The Taxpayers' appeal should be denied.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission denies the Taxpayers' appeal. 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, or emailed, 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

or emailed to:

taxappeals@utah.gov

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2015.

John L. Valentine
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.

