

13-223
TAX TYPE: PERSONAL INCOME TAX
TAX YEAR: 2007
DATE SIGNED: 7-6-2016
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL
EXCUSED: R. PERO
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. 13-223 Account No. ##### Tax Type: Personal Income Tax Tax Year: 2007 Judge: Jensen
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Presiding:

John L. Valentine, Commission Chair
Clinton Jensen, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER, Taxpayer
REPRESENTATIVE FOR TAXPAYER, for the Taxpayer
Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT-1, Income Tax Audit Manager
RESPONDENT-2, for the Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on September 16, 2015. Based on the evidence and testimony presented at the hearing, the Tax Commission makes its:

FINDINGS OF FACT

1. Petitioner (the "Taxpayer") is appealing the assessment of Utah individual income tax and penalties for the 2007 tax year.
2. On December 4, 2012, the Auditing Division of the Utah State Tax Commission (the "Division") sent a Statutory Notice of Deficiency. The Statutory Notice indicated that the Taxpayer owed additional tax and interest as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest¹</u>
2007	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

¹ Interest continues to accrue on any unpaid balance.

3. For all periods at issue in this case, the Taxpayer was a resident of STATE-1.
4. Neither party claims that the Taxpayer has 2007 Utah tax liability based on having Utah domicile or residency.
5. The Division's sole claim is that the Taxpayer has 2007 Utah personal income tax liability because he received Utah source income of \$\$\$\$\$.
6. The Taxpayer did not file a 2007 Utah individual income tax return because the tax professionals from whom he sought tax advice indicated that he had no Utah tax liability.
7. For the 2007 tax year, the Taxpayer was a 100% shareholder in BUSINESS-1 ("BUSINESS-1").
8. For the 2007 tax year, BUSINESS-1 made an election for the federal government to tax it under Subchapter S of Chapter 1 of the Internal Revenue Code.
9. The Taxpayer asserted that BUSINESS-1 was a STATE-1 corporation, but provided no documentation to support this assertion.
10. The Division asserted that BUSINESS-1 was a Utah corporation. To support this assertion, it provided the following:
 - a. A Utah Division of Corporations registration document for BUSINESS-1, which indicated (X) COUNTY, Utah addresses for BUSINESS-1, its registered agent, its only listed officer, and its only listed director.
 - b. A Utah Division of Corporations registration document for COMPANY-1 ("COMPANY-1"), a Limited Liability Company with an address in (X-1) COUNTY Utah, showing all three of its members, of which BUSINESS-1 is one, at Utah addresses. This document also indicates a Utah manager and registered agent and indicates no members, managers, or agents in STATE-1.
 - c. A 2007 K-1 filing for BUSINESS-1 indicating a Utah address for BUSINESS-1 and a Utah address for TAXPAYER as its only shareholder.
 - d. For the 2007 tax year, COMPANY-1 filed a K-1 showing \$\$\$\$\$ in ordinary business income and \$\$\$\$\$ in guaranteed payments and attributing 31.1475% ownership to BUSINESS-1.
11. BUSINESS-1 filed a K-1 for the 2007 tax year showing ordinary business income and a section 179 deduction of \$\$\$\$\$ for a net income of \$\$\$\$\$ for 2007.

12. The Taxpayer argued that income attributed to BUSINESS-1 from COMPANY-1 should not be considered Utah source income because COMPANY-1 provided services for, and received payment from, customers from various places, few of which were in Utah.

APPLICABLE LAW²

Utah Code Ann. §59-10-116(2) provides that “[e]xcept as provided in Subsection (3), or Part 12, Single Rate Individual Income Tax Act, 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 Ann. §59-10-117 provides as follows:

(1) For the purpose of Section 59-10-116, federal adjusted gross income derived from Utah sources shall include those items includable in federal “adjusted gross income” attributable to or resulting from: . . . (b) the carrying on of a business, trade, profession, or occupation in this state.

(2) For the purposes of Subsection (1): (a) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property shall constitute income derived from Utah sources only to the extent that such income is from property employed in a trade, business, profession, or occupation carried on in this state; . . . (c) salaries, wages, commissions, and compensation for personal services rendered outside this state shall not be considered to be derived from Utah sources; . . . (g) A nonresident partner’s distributive share of partnership income, gain, loss, and deduction derived from or connected with Utah sources shall be determined under Section 59-10-303;

Utah Code Ann. §59-10-303(1) provides as follows:

In determining the adjusted gross income of a nonresident partner of any partnership, there shall be included only that part derived from or connected with sources in this state of the partner’s distributive share of items of partnership income, gain, loss, and deduction entering into his federal adjusted gross income, as such part is determined under rules prescribed by the commission in accordance with the general rules in Section 59-10-116.

Utah Code Ann. §59-10-301 provides that “[a] partnership is not subject to the tax imposed by this chapter. Persons carrying on business as partners are liable for the tax imposed by this chapter only in their separate or individual capacities.”

Utah Code Ann. §59-10-302(1) provides as follows:

Each item of partnership income, gain, loss or deduction has the same character for a partner under this chapter as it has for federal income tax purposes. When an item is not characterized for federal income tax purposes, it has the same character for a partner as if realized direct from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

² Unless noted otherwise, the Commission cites Utah law as of 2007.

Utah Code Ann. §59-10-801 provides that “[f]or purposes of taxation under this title, a limited liability company or a foreign limited liability company transacting business in the state shall be classified in the same manner as it is classified for federal income tax purposes.”

Utah Administrative Rule R865-9I-21 provides additional detail regarding partnership income as follows in pertinent part:

- (1) Every partnership having a nonresident partner and income derived from sources in this state shall file a return in accordance with forms and instructions provided by the Tax Commission.
- (2) If the partnership has income derived from or connected with sources both inside and outside Utah and if any partner was not a resident of Utah, the portion derived from or connected with sources in this state must be determined and shown.
 - (a) The Utah portion must be determined and shown for each item of the partnership’s, and each nonresident partner’s, distributive shares of income, credits, deductions, etc., shown on Schedules K and K-1 of the federal return.
 - (b) The Utah portion may be shown: (i) alongside the total for each item on the federal schedules K and K-1; or (ii) on an attachment to the Utah return.

The Commission has discretion to waive penalties and interest. Utah Code §59-1-401(13) provides that “[u]pon 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.”

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

CONCLUSIONS OF LAW

The Taxpayer does not dispute that he would be required to file a Utah income tax return and pay Utah income tax if he had Utah source income. He disputes, however, that he had Utah source income for 2007. He characterizes payments from COMPANY-1 to BUSINESS-1 as payments from a STATE-1 partnership to a STATE-1 corporation. Documents for COMPANY-1 and BUSINESS-1 show otherwise. All of the documents presented to the Commission indicate all Utah members, shareholders, registered agents, and managers, and Utah business addresses for these entities. There may be evidence that would support the Taxpayer’s assertions that his payments are STATE-1 rather than Utah source income, but the Taxpayer presented none to the Commission. The Taxpayer presented evidence that COMPANY-1 had customers outside Utah, but provided no case law, statutes, or rules that would turn Utah entities into entities of other states based on the location of their customers. Based on the evidence presented at the formal hearing, there is good cause to sustain the Division’s audit for tax and interest for the 2007 tax year.

As a separate issue, the Commission considers the issue of penalties imposed by the Division as part of its audit. The Commission has discretion to waive penalties. Utah Code Ann. §59-1-401(13). Given the complexity and fact-sensitive nature of source income and domicile issues covering multiple states, the Commission has often waived penalties when a taxpayer was reasonable in thinking that they had insufficient ties to Utah to require the filing of a Utah tax return. *See, e.g.*, Utah State Tax Commission Case Nos. 05-1058 and 12-889.³ Those factors are present in this case and provide good cause to waive the penalties imposed by the Division in connection with its audit.

Clinton Jensen
Administrative Law Judge

DECISION AND ORDER

Based on the information presented at the hearing, the Commission sustains the Division's audit for income tax and interest, and waives the penalties associated with the audit. 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: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit in accordance with 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 and 63G-4-401 et. seq.

³ Many previous Tax Commission decisions, including those cited in this decision, are available online at <http://tax.utah.gov/commission-office/decisions>.