

13-558
TAX TYPE: INCOME TAX
TAX YEAR: 2009 & 2010
DATE SIGNED: 02/05/2018
COMMISSIONERS: M CRAGUN, R PERO, R ROCKWELL
EXCUSED: J VALENTINE
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYERS,</p> <p style="padding-left: 40px;">Petitioners,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="padding-left: 40px;">Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 13-558</p> <p>Account No. #####</p> <p>Tax Type: Income</p> <p>Tax Years: 2009 & 2010</p> <p>Judge: Chapman</p>
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Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER-1, Taxpayer (by telephone)
For Respondent: RESPONDENT, from Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on January 2, 2018.

TAXPAYERS (“Petitioners” or “taxpayers”) are appealing Auditing Division’s (the “Division”) assessments of additional Utah individual income taxes for the 2009 and 2010 tax years. On January 15, 2013, the Division issued Notices of Deficiency and Audit Change to the taxpayers, in which it imposed additional tax and interest (calculated as of February 14, 2013),¹ as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2009	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2010	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

¹ Interest continues to accrue until any tax liability is paid. No penalties were imposed.

The Division imposed additional Utah taxes based on changes that the Internal Revenue Service (“IRS”) made to the taxpayers’ 2009 and 2010 federal adjusted gross income (“FAGI”). For these years, the IRS disallowed a number of business expenses that the taxpayers had deducted, including vehicle expenses, travel expenses, and business equipment purchases. The taxpayers claim that these expenses were incurred by TAXPAYER-1’s insurance business. The taxpayers also claim that they were entitled to deduct these expenses and that the IRS erroneously disallowed the expenses. As a result, the taxpayers claim that the Division’s assessments, which are based on the IRS changes, are also incorrect.

TAXPAYER-1 admits, however, that he no longer has any receipts to show that the disallowed expenses were actually incurred. TAXPAYER-1 explained that TAXPAYER-2 (who did not appear at the hearing) is now his ex-wife. TAXPAYER-1 proffers that he and his ex-wife went through a difficult divorce in 2011, which led to his not living in the family home for some period of time. TAXPAYER-1 further proffers that once he and his ex-wife divorced and he was able to move back into the family home, most of his financial records, including the receipts for the 2009 and 2010 business expenses at issue, were missing.

TAXPAYER-1 stated that he and his accountant have worked with the IRS for several years in an attempt to provide the IRS with adequate “alternative information” to show that the business expenses were actually incurred, but he admits that they have not been successful. For example, TAXPAYER-1 explained that he and his accountant prepared and submitted to the IRS a “statement” about the business equipment that was purchased in 2009 and 2010. TAXPAYER-1 proffered that the IRS rejected this document and that the IRS indicated that it needed to see receipts instead.

However, it is unclear if the IRS ever issued a ruling concerning the alternative information that TAXPAYER-1 and his accountant provided the IRS. TAXPAYER-1 indicated that he had planned to contest the IRS’s disallowance of the business expenses in federal tax court until the IRS eventually decided that the 2009 and 2010 federal assessments associated with the disallowed expenses were “uncollectible.”

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TAXPAYER-1 explained that the last letter he obtained from the IRS indicated that the IRS was no longer going to pursue collection of the 2009 and 2010 federal assessments because it had deemed the amounts due to be “uncollectible.”

At the Initial Hearing before the Commission, however, TAXPAYER-1 did not proffer any letters or other documents from the IRS to show whether the IRS has or has not issued a ruling concerning the alternative information that TAXPAYER-1 and his accountant may have provided the IRS to contest the federal assessments. Furthermore, TAXPAYER-1 did not proffer at the hearing the “statement” concerning the business equipment purchases or any other alternative information so that the Commission could, if appropriate, determine whether the taxpayers had provided sufficient information to show that some portion of the business expenses disallowed by the IRS should be allowed for state tax purposes.

The Division indicated that it does not have the alternative information that TAXPAYER-1 and his accountant provided to the IRS and, thus, is unable to provide it to the Commission to review. However, the Division contends that even if the taxpayers were able to show that they properly deducted the business expenses disallowed by the IRS, the Commission should not allow the taxpayers to deduct the expenses for state tax purposes because the IRS has not amended its assessments and because the taxpayers have not shown that time has expired for the IRS to make changes to their 2009 and 2010 federal accounts. The Division indicated that because the IRS has deemed the 2009 and 2010 federal assessments to be “uncollectible,” it is possible that the IRS has decided not to review the alternative information that TAXPAYER-1 and his accountant provided the IRS. Regardless, the Division asks the Commission to sustain the Utah assessments that it issued because the assessments “match” federal records.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2009)² defines “adjusted gross income” and “‘taxable income’ or ‘state taxable income,’” as follows:

- (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
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 - (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;
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For the instant matter, UCA §59-1-1417(1) (2018) provides guidance concerning which party has the burden of proof, as follows:

- (1) In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:
 - (a) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
 - (b) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and
 - (c) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income:
 - (i) required to be reported; and
 - (ii) of which the commission has no notice at the time the commission mails the notice of deficiency.

DISCUSSION

Pursuant to Subsection 59-1-1417(1), the taxpayers have the burden of proof in this matter. The Division proffers that the IRS increased the taxpayers’ 2009 and 2010 FAGI’s after disallowing business expenses that the taxpayers had deducted for these years. In addition, the Division proffers that the FAGI’s on which it based its 2009 and 2010 Utah assessments “match” the revised FAGI’s that the IRS derived for these

² All substantive law citations will refer to the 2009 version of Utah law. The substantive law remained the same for the 2009 and 2010 tax years.

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years (as shown in IRS records). The Division asks the Commission to sustain its assessments primarily because they reflect the taxpayers' 2009 and 2010 FAGI's, as shown on IRS records.

Subsections 59-10-103(1)(a) and (w) provide that Utah "state taxable income" is based on the definition of "adjusted gross income" as found in the Internal Revenue Code, which the IRS uses to determine federal taxable income. As a result, the Tax Commission generally relies on federal taxable income, as reflected in IRS records, when determining Utah taxable income. Nevertheless, the Commission has, on occasion, independently reviewed a petitioner's evidence of federal taxable income instead of relying on IRS records where the petitioner was unable to contest the matter at the IRS, generally in situations where a federal deadline had expired and it was too late for the IRS to consider the matter.

One such case is *USTC Appeal No. 06-1408* (Initial Hearing Order Nov. 5, 2007),³ where the petitioner in that case had been told that the IRS considered the federal matter final and closed and where the petitioner proffered documentation showing that the IRS's revised FAGI was incorrect. In that case, the Commission reversed the Division's assessment, stating that:

The Utah Code sections specify that state taxable income is federal taxable income **as defined in the Internal Revenue Code**, they do not tie the state taxable income to the federal taxable income **as determined by the IRS**. Certainly the Tax Commission will give great deference in the interpretation of the Internal Revenue Code to the IRS, as they are the experts in this area. However, where there is a clear error and the taxpayer was unable to have the merits reviewed by the IRS due to the statute of limitations or for other procedural reasons, the Commission concludes that it is appropriate to give consideration to the definitions provided in the Internal Revenue Code. (emphasis added).

In *USTC Appeal No. 08-1313* (Initial Hearing Order Mar. 19, 2009), the Commission indicated a further willingness to independently review federal taxable income even in certain situations where a petitioner might still be able to have the IRS review the federal matter. In this case, the Division suggested that the IRS's action that increased the taxpayer's FAGI was incorrect because the petitioner had merely reported his

³ Redacted versions of this and other selected decisions can be viewed on the Tax Commission's website at <http://www.tax.utah.gov/commission-office/decisions>.

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unemployment insurance income on the wrong line of his federal return. Given these circumstances, the Commission held:

The taxpayer in this appeal has not been told that the federal matter is closed. . . . Regardless, the Commission finds that the evidence proffered by the Division shows that the taxpayer's original Utah return reflects the correct amount of "federal taxable income" as defined in [Utah law]. Accordingly, under these specific circumstances, the Commission finds that the Division's assessment is incorrect, even though it reflects the FAGI currently recognized by the IRS. As a result, the Commission reverses the Division's assessment.

In other cases where the Commission has decided to make an independent determination of federal taxable income, the Commission has sustained the Division unless clear and uncontroverted evidence showed the IRS records to be incorrect or unless the Division either agreed with or failed to refute the petitioner's assertion that an error existed on the IRS records.⁴ In the instant case, it is unclear whether the IRS has reviewed or will review the information that TAXPAYER-1 and his accountant provided the IRS to contest the 2009 and 2010 federal assessments. TAXPAYER-1 did not provide the IRS letters he has received so that the Commission could review them. Regardless, even if this is a case where the Commission decides that it should independently review the taxpayers' evidence of "federal taxable income" instead of relying on IRS records, TAXPAYER-1 did not proffer at the hearing the alternative information that he claims that he and his accountant has generated that he indicated that they provided to the IRS. Without reviewing this information, the Commission cannot determine that the taxpayers properly deducted any of the expenses that the IRS

⁴ See *USTC Appeal No. 03-0586* (Initial Hearing Order May 24, 2004); *USTC Appeal No. 03-0510* (Initial Hearing Order Oct. 1, 2005); *USTC Appeal No. 08-0515* (Initial Hearing Order May 14, 2009); and *USTC Appeal No. 11-827* (Initial Hearing Order Jul. 12, 2012) (which are cases in which the Commission found that IRS records were incorrect and found in favor of the petitioner).

See also *USTC Appeal No. 04-1077* (Initial Hearing Order Feb. 25, 2005); *USTC Appeal No. 07-1036* (Initial Hearing Order Jul. 17, 2008); *USTC Appeal No. 07-0365* (Findings of Fact, Conclusions of Law, and Final Decision Feb. 23, 2010); and *USTC Appeal No. 11-2709* (Initial Hearing Order Sept. 16, 2013) (which are cases in which the Commission found that the evidence was insufficient to show that IRS records were

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disallowed. As a result, the taxpayers, who have the burden of proof, have not shown that the IRS records on which the Division's 2009 and 2010 assessments are based are incorrect. For these reasons, the Commission should deny the taxpayers' appeal and sustain the Division's assessments.

Kerry R. Chapman
Administrative Law Judge

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DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's assessments in their entirety. 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 _____, 2018.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice: If a Formal Hearing is not requested as discussed above, failure to pay the balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty.