

13-2034  
TAX TYPE: INCOME TAX  
TAX YEAR: 9-1-07 through 1-31-13  
DATE SIGNED: 6-10-14  
COMMISSIONERS: B. JOHNSON, M. CRAGUN, R. PERO  
EXCUSED: D. DIXON  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner,  vs.  AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.	<b>INITIAL HEARING ORDER</b>  Appeal No. 13-2034  Account No. ##### Tax Type: Income Tax Audit Period: 09/01/07 – 1/31/13  Judge: Phan
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**Presiding:**  
Jane Phan, Administrative Law Judge

**Appearances:**  
For Petitioner: REPRESENTATIVE FOR TAXPAYER, President, TAXPAYER.  
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney  
General  
RESPONDENT, Manager, Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on March 17, 2014, for an Initial Hearing in accordance with Utah Code §59-1-502.5. Petitioner (Taxpayer) is appealing the penalties and interest assessed with a sales and use tax audit. The Statutory Notice-Sales and Use Tax had been issued on September 23, 2013. The amount of the tax deficiency was \$\$\$\$\$, which the Taxpayer did not dispute. The penalty assessed was a 10% negligence penalty in the amount of \$\$\$\$\$ and the interest as of the date of the notice was \$\$\$\$\$.

APPLICABLE LAW

- Utah Code Sec. 59-1-401(7) provides:
- (a) Additional penalties for an underpayment of a tax, fee, or charge are as provided in this Subsection (7)(a).
    - (i) Except as provided in Subsection (7)(c), if any portion of an underpayment of a tax, fee, or charge is due to negligence, the penalty is 10% of the portion of the underpayment that is due to negligence.

. . . .

- (b) A seller that voluntarily collects a tax under Subsection 59-12-107(2)(d) is not subject to the penalty under Subsection (7)(a)(i) if on or after July 1, 2001:
  - (i) a court of competent jurisdiction issues a final unappealable judgment or order determining that: (A) the seller meets one or more of the criteria described in Subsection 59-12-107(2)(a) . . .
  - (ii) the commission issues a final unappealable administrative order determining that: (A) the seller meets one or more of the criteria described in Subsection 59-12-107(2)(a) . . .

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(2) 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...

(4) Other considerations for Determining Reasonable Cause.

- . . . .
- (b) Other clearly supported extraordinary and unanticipated reasons for late filing or payment, which demonstrate reasonable cause and the inability to comply, may justify a waiver of the penalty.
- (c) In most cases, ignorance of the law, carelessness, or forgetfulness does not constitute reasonable cause for waiver. Nonetheless, other supporting circumstances may indicate that reasonable cause for waiver exists.
- (d) Intentional disregard, evasion, or fraud does not constitute reasonable cause for waiver under any circumstances.

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

#### DISCUSSION

The Taxpayer is a small business registered and based in STATE-1 and did not have nexus with Utah. There were no offices, salespeople or a business location in Utah. The Taxpayer sells (X) equipment and on a few occasions received orders for this equipment from customers in Utah. The Taxpayer would drop ship the equipment into Utah using common carriers. When the Taxpayer started business operations in 2007, one of its vendors, which was located in STATE-2, stated that they would have to collect sales tax from the Taxpayer and remit it to Utah on those sales of its equipment into Utah. So the Taxpayer had set up its accounting to charge sales tax on those Utah sales. The tax charged went into the Taxpayer’s consolidated balance sheet under “sales tax liability” which the Taxpayer used to accrue sales tax liabilities for several states where the Taxpayer did have nexus.

The Taxpayer indicated that at some point fairly quickly the STATE-2 vendor changed its billing to the Taxpayer to “no nexus” with Utah and stopped collecting the sales tax from the Taxpayer. The Taxpayer states that this had gone unnoticed for many years until the Taxpayer was contacted by an auditor from Respondent (Division) about two invoices that total tax in the amount of \$\$\$\$\$. After being contacted, the Taxpayer’s representative states the Taxpayer did a full review and concluded that this had occurred on numerous other invoices to a total tax amount of \$\$\$\$\$, which amount the Taxpayer paid. The Taxpayer requested waiver of penalties and interest based on this being a genuine error and not as a result of actions to evade the tax. Additionally the Taxpayer points out that it had voluntarily discussed that this error was much larger than the Division had originally determined and had promptly paid the tax amount.

It was the Division’s contention that interest and penalty should be upheld. Regarding the negligence penalty it was the Division’s contention that it was negligent for an unlicensed, non nexus company to collect Utah sales tax without remitting the tax to Utah. The Division cites to *Hales Sand & Gravel Inc. v. Audit Div.*, 842 P.2d 887, 895 (Utah 1992) and *Benjamin v. Utah State Tax Comm’n*, 250 P.3d 39, 47 (Utah 2011) for the position that, “A negligence penalty is appropriate where the taxpayer fails to pay a tax obligation and a reasonable investigation would have revealed that taxes were due.”<sup>1</sup> The Division also cites to *Tax Commission Initial Hearing Order, Appeal No. 07-1517*, in that decision the Tax Commission had upheld a negligence penalty where a Taxpayer failed to use due care in addressing a legal requirement.

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<sup>1</sup> Respondent’s Pre-Hearing Memorandum, pg. 4.

The Division points to the fact that the criteria for waiver of interest is different in that interest is only waived under Utah Admin. Rule R861-1A-42(2) where a taxpayer proves that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error. In this matter there was no such showing.

Upon review of the facts and the law in the case the penalty should be abated. The facts before the Commission are distinguishable from the facts in the cases noted by the Division as support for this penalty. In *Tax Commission Initial Hearing Order, Appeal No. 07-1517* (2008) the Tax Commission upheld a negligence penalty, but a factor in that case was that it had been a second audit and that taxpayer had made the same type of error in the second audit as had been caught and pointed out to the Taxpayer during the first audit. In the subject appeal this is the first audit against the Taxpayer. This was similar to *Tax Commission Initial Hearing Order, Appeal No. 09-2701* (2010). Again one of the factors noted in upholding the negligence penalty in *Appeal No. 09-2701* was that a second audit caught the same type of error as had occurred in the first audit. *Benjamin v. Utah State Tax Comm'n*, 250 P.3d 39, 47 (Utah 2011), also cited by the Division, is distinguishable as well. The court did uphold the negligence penalty, but in that case the Taxpayers had sought tax advice from accountants, but did not follow the advice they were given. In *Tax Commission Initial Hearing Order, Appeal No. 02-1712*, the Commission waived the negligence penalty and one of the factors considered was that it had been a first time error and the Commission noted that the taxpayer's actions in that case were not gross negligence.

Negligence is generally recognized to be the omission to do something which a reasonably prudent and careful person would do, or the doing of something which the reasonably prudent and careful person would not do. At some point over the years, it would be expected that a reasonably prudent or careful person would have caught the extra tax in the sales tax account and corrected the error. The Taxpayer failed to correct the error over the years until notified of the audit. However, in this matter, it was not disputed that the Taxpayer was very cooperative with the audit and once it was brought to the Taxpayer's attention acknowledged and remitted a substantially larger amount than what the Division had originally been concerned with. This Taxpayer was not a Utah company, did not have a Utah filing requirement, had not previously filed in Utah and did not have nexus with Utah. This is not a second audit against this Taxpayer.

The Division's position in imposing the penalty is not without merit. Normally, if a company collects a sales tax from its customer and fails to pay it over, a penalty would be fully justified, whether or not the company had been audited before. This case, however, is unusual. The Taxpayer was collecting the tax and, apparently remitting it as Utah tax to the STATE-2 vendor, which apparently then remitted that tax to Utah. As some point, the STATE-2 vendor

changed its procedure and stopped billing the Taxpayer. There is no evidence that the vendor discussed this decision with the Taxpayer and the Taxpayer failed to make a corresponding adjustment in its own billing system. The Taxpayer continued to bill and collect as it had been doing before. The Taxpayer continued to pay the STATE-2 vendor what it was billed. The Taxpayer's error was in failing to reconcile its accounts receivables with its accounts payable. Because the Taxpayer collects sales tax for numerous states, presumably pays taxes to several states on different days, and because the amount of Utah tax was relatively small, it may not have been obvious that the sales tax payable account was not reconciling. This was clearly an error, but it was rectified as soon as it was brought to the Taxpayer's attention. The negligence penalty should be waived in this matter. There is no basis for waiver of the interest based on the provisions of Utah Admin. Rule R861-1A-42(2).

Jane Phan  
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing the Commission sustains the audit deficiency as to the tax and interest assessed against the Taxpayer for the audit period of September 1, 2007 through January 31, 2013. The Commission waives the negligence penalty.

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 \_\_\_\_\_, 2014.

R. Bruce Johnson  
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.**