14-502
TAX TYPE: INCOME TAX
TAX YEAR: 2007
DATE SIGNED: 6/27/2016
COMMISSIONERS: J. VALENTINE, R. PERO, R. ROCKWELL
EXCUSED: M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER-1 & TAXPAYER-2,[1] Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent, and TAXPAYER SERVICES DIVISION OF THE UTAH STATE TAX COMMISSION,[2] Interested Party.	**INITIAL HEARING ORDER** Appeal No. 14-502 Account No. ##### Tax Type: Income Tax Tax Year: 2007 Judge: Chapman

Presiding:
Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner TAXPAYER-1:	REPRESENTATIVE FOR TAXPAYER-1, Attorney TAXPAYER-1, Taxpayer
For Petitioner TAXPAYER-2:	REPRESENTATIVE FOR TAXPAYER-2, Attorney RESPONDENT, from Auditing Division
For Auditing Division:	REPRESENTATIVE-1 FOR RESPONDENT, Assistant Attorney General REPRESENTATIVE-2 FOR RESPONDENT, Assistant Attorney General

1 The Petitioners were married throughout the 2007 tax year, but have since divorced. They are represented by separate counsel.

2 TAXPAYER-2 has requested innocent spouse relief. Historically, the Commission has not taken jurisdiction of and issued a decision for a claim for innocent spouse relief in the appeals process. Such claims are handled by the Taxpayer Services Division, which will not process a claim while an appeal is open. Nevertheless, Taxpayer Services Division has been added as an interested party so that it can attend proceedings in this matter and obtain information about TAXPAYER-2 claim.

For Taxpayer Services Division: REPRESENTATIVE FOR INTERESTED PARTY, Assistant Attorney General

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 March 23, 2016.

TAXPAYER-1 and TAXPAYER-2 (referred to collectively as the "Petitioners" or "taxpayers" and individually as "TAXPAYER-1" and "TAXPAYER-2") are appealing Auditing Division's (the "Division") assessment of additional individual income tax for the 2007 tax year. On January 23, 2014, the Division issued a Notice of Deficiency and Audit Change ("Statutory Notice") to the taxpayers, in which it imposed additional tax and interest (calculated as of February 22, 2014),[3] as follows:

Year	Tax	Penalties	Interest	Total
2007	$$$$$	$$$$$	$$$$$	$$$$$

The taxpayers filed joint federal and Utah resident income tax returns for the 2007 tax year, on which they reported $$$$$ of federal adjusted gross income ("FAGI"). The Internal Revenue Service ("IRS") has not adjusted the $$$$$ of FAGI shown on the taxpayers' 2007 federal return. In its assessment, however, the Division has determined that the taxpayers failed to report $$$$$ of 2007 FAGI and has assessed them accordingly.[4]

The Statutory Notice contained no explanation as to why the Division increased the taxpayers' 2007 FAGI by $$$$$. In a prehearing motion, however, the Division provided a copy of a Statement of Defendant and Certificate of Counsel and Order dated December 10, 2012 from a criminal proceeding involving

3 Interest continues to accrue until any tax liability is paid.

4 As described on the Statutory Notice, the Division also made some other relatively minor adjustments to the taxpayers' 2007 Utah return. These other adjustments appear to relate in part, if not entirely, to the $$$$$ increase in FAGI. Regardless, the taxpayers have not specifically challenged or proffered information about these other adjustments.

TAXPAYER-1 ("2012 Plea Bargain").[5] In the 2012 Plea Bargain, TAXPAYER-1 stated that he was 77 years old and that he was pleading guilty to three felonies for theft involving "money, property or anything of value" that he obtained from NAME-1 in 2007. In this document, he further stated that "I also know that I may be ordered by the court to make restitution to any victim or victims of my crime[,]" and "that I have committed the conduct alleged and I am guilty of the crimes for which my plea(s) is/are entered." In addition, he agreed to pay restitution, as follows:[6]

> I agree to pay restitution on all matters originally charged in this criminal case as ordered by the Court in this case. Restitution in this case [is agreed upon and] calculated at the original amount of $$$$$ (NAME-1 money) plus $$$$$ (NAME-2 money) less $$$$$ previously refunded.

In its assessment, the Division imposed tax on the $$$$$ of money that TAXPAYER-1 received from NAME-1 in June 2007 and that he was required to pay back as restitution pursuant to his criminal plea bargain.[7] The Division originally determined that the entire $$$$$ TAXPAYER-1 obtained from NAME-1 was taxable income obtained from illegal activities. Since issuing its Statutory Notice, however, the Division has determined that it should not have imposed tax on the $$$$$ that TAXPAYER-1 had previously refunded to NAME-1 in December 2007.[8] As a result, the Division asks the Commission to revise its 2007 assessment to reflect only $$$$$ of additional FAGI that was obtained from illegal activities.

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5 This document accompanied the Division's Motion for Order Requiring Petitioner [TAXPAYER-1] to File Amended Return, which, at that time, the Commission denied. The Commission also denied motions by TAXPAYER-1 to dismiss the appeal and by TAXPAYER-2 to dismiss Auditing Division's claims against her.

6 The Division has also proffered evidence to show that before TAXPAYER-1 pled guilty to the three theft felonies, he had been charged with one felony for communications fraud (for not securing NAME-1 $$$$$ investment with real estate in which her name would be shown on title of said real estate), five felonies for theft, three felonies for money laundering, two felonies for filing of a false or fraudulent return, and one felony for pattern of unlawful activity. In the 2012 Plea Bargain, TAXPAYER-1 acknowledged that "[m]y pleas of guilty are the result of a plea bargain. . ." and that "the State has agreed to dismiss all counts . . . to which I am not entering a plea." No evidence was proffered to show that any of the counts to which TAXPAYER-1 did not plead guilty have since been reinstated.

7 The Division proffered that it did not impose tax on the $$$$$ of "NAME-2 money" in its 2007 assessment because TAXPAYER-1 received this money in a different tax year, specifically in 2006.

8 The Division also proffered a court document dated February 7, 2013 that is titled "Minutes AP&P

TAXPAYER-1 contends that he invested the $$$$$ in money he received from NAME-1 in Utah real estate or made loans secured by real estate, as set forth in a June 27, 2007 Agreement between BUSINESS-1 ("BUSINESS-1"), of which TAXPAYER-1 was manager, and NAME-1. This agreement will be referred to as the "NAME-1 Agreement." In the NAME-1 Agreement, NAME-1 agreed to invest $$$$$ with BUSINESS-1 upon certain terms and condition, including that:

> The funds will be used to purchase real estate and/or to make loans secured by real estate. All purchases will be secured by a policy of title insurance. All loans will be secured by a note and trust deed and covered by a lender's policy of title insurance, showing NAME-1 as an insured lien holder. If real estate is purchased jointly NAME-1 will show on the title of the property as a joint owner.[9]

TAXPAYER-1 also provided information showing that NAME-1 requested some funds in late 2007, after which he sent her $$$$$ in December 2007 as an "interest" payment. TAXPAYER-1 further provided information about the real estate in which BUSINESS-1 and/or TAXPAYER-1 personally invested and/or made loans after receiving NAME-1's funds and about the real estate eventually losing value and being foreclosed, which resulted in the investments being lost. TAXPAYER-1 contends that all monies that NAME-1 eventually lost were not because of theft, but because of investments that were unsuccessful, in part, because of the economic crisis of the late 2000's.

TAXPAYER-1, however, did not show that he purchased real estate and made loans secured by real estate pursuant to the terms of the NAME-1 Agreement. Specifically, he did not show that all purchases of real estate were secured by a policy of title insurance. In addition, he did not show that all loans were secured by a

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Sentencing Sentence, Judgment, Commitment" ("2013 Minutes"), which indicates that TAXPAYER-1 is to pay $$$$$ of restitution (plus interest) to NAME-1 and $$$$$ to NAME-2. This document also indicates that TAXPAYER-1 was placed on probation for 108 months (i.e., 9 years) and that "[t]he amount of Restitution is to be determined by Adult Probation & Parole." No evidence was submitted to show that Adult Probation & Parole has determined restitution amounts that are different from the amounts shown in the 2012 Plea Bargain and in the 2013 Minutes. The 2013 Minutes also indicate that as a condition of TAXPAYER-1's probation, he will "[c]ooperate with the Utah State Tax Commission with respect to [his] liabilities on the funds taken in this case."

note and trust deed and covered by a lender's policy of title insurance reflecting NAME-1 as an insured lien holder. In addition, for real estate purchased jointly, he did not show that the title of the property reflected NAME-1 as a joint owner.

TAXPAYER-1 acknowledges that under the terms of his 2012 Plea Bargain, he was required to pay $$$$$ of restitution to NAME-1.[10] In addition, TAXPAYER-1 does not challenge the Division's position that funds received from illegal activities are subject to income taxation. However, he contends that the 2012 Plea Bargain only shows that he received a total of $$$$$ from NAME-1 through illegal activities, not $$$$$ as asserted by the Division. He refers the Commission to the 2012 Plea Bargain, which shows that he pled guilty only to three crimes and that these three crimes only involved a total of $$$$$, specifically: (A) Count 2 – third degree felony theft of $$$$$; (B) Count 4 – third degree felony theft of $$$$$; and (C) Count 7 – second degree felony theft of $$$$$. The 2012 Plea Bargain describes the "elements and specifics of the crimes" to which TAXPAYER-1 pled guilty, as follows:

> - With Respect to (A)
>
> That on or about July 2, 2007, TAXPAYER-1 (sic) TAXPAYER-1 obtained from NAME-1 (sic) NAME-1, money, property or anything of value with a purpose of deprive here (sic) thereof, and the value of the property, money or thnig (sic) obtained or sought to be obtained exceeded, $$$$$ in that TAXPAYER-1 took $$$$$ of money that he had obtained from NAME-1.[11]

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9 The NAME-1 Agreement also provided that NAME-1 would receive 12.0% interest on the amount invested (payable every six months) and that the funds would be invested for a minimum of 24 months (or longer at the discretion of NAME-1).

10 TAXPAYER-1 proffered that he is paying $$$$$ of restitution per month. He indicates, however, that he will never be able to pay the full amount of restitution because he is unemployed and lives on his Social Security income.

11 The Division also proffered an Amended Information And Statement of Probable Cause from the criminal case involving both TAXPAYER-1 and TAXPAYER-2 ("Amended Statement of Probable Cause"). In this document, "Background" facts were prepared by Special Agent NAME-3 of the Utah Attorney General's Office. Background fact #26 indicates that after NAME-1 $$$$$ was deposited into BUSINESS-1 bank account on June 28, 2007, a number of checks were written from this account, including one to TAXPAYER-2 on July 2, 2007 in the amount of $$$$$.

The Division also proffered a "Diversion Agreement" dated March 8, 2013, in which TAXPAYER-2 only was listed as defendant and which indicated that she "is currently charged with two (2) counts relating to taxation." It does not appear that TAXPAYER-2 has pled guilty to any crimes in the Diversion Agreement. The Diversion Agreement provides for it to be in effect for two years and that the criminal proceeding against

- With Respect to (B)

> That on or about August 3, 2007, TAXPAYER-1 (sic) TAXPAYER-1 obtained from NAME-1 money, property or anything of value with the purpose to deprive her thereof and the value of the property, money or thing obtained or sought to be obtained exceeded $$$$$ in that TAXPAYER-1 took $$$$$ of money that he had obtained from NAME-1 and used that money for purposes other that (sic) for which that money was intended by issuing a check to his spouse.[12]

[- With Respect to (C)]

> That on or about September 4, 2007, TAXPAYER-1 obtained from NAME-1 money, property or anything of value with the purpose to deprive her thereof, and the value of the property, money or thing obtained or sought to be obtained exceeded $$$$$; to wit, TAXPAYER-1 used $$$$$ of NAME-1's money for purposes other than that for which that money was intended by issuing a check to TAXPAYER-2.[13]

Based on the three theft crimes to which he pled guilty, TAXPAYER-1 proffers that he is willing to amend his and his ex-wife's 2007 Utah return to reflect additional FAGI of $$$$$. As a result, TAXPAYER-1 asks the Commission to revise the Division's 2007 assessment to reflect only $$$$$ of additional FAGI that was obtained from illegal activities.[14]

In the Amended Statement of Probable Cause the Division proffered, NAME-3 stated in Background fact #28 that "I have traced funds received by TAXPAYER-1 as a result of the aforementioned actions and allegations into and out of bank (sic) various bank accounts." In Background fact #29, NAME-3 further stated that "[s]ignificant amounts of those funds were used for personal expenses and/or were removed as cash

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TAXPAYER-2 would be dismissed if she abided with the terms of the agreement. No party indicated whether the counts with which TAXPAYER-2 was "currently charged" were dismissed. However, no party suggested that TAXPAYER-2 did not abide by the terms of her Diversion Agreement or that the criminal court subsequently allowed for the prosecution of the crimes with which she had been charged.

12 In the Amended Statement of Probable Cause, Background fact #26 also indicates that a check was written from the BUSINESS-1 bank account to TAXPAYER-2 on August 3, 2007 in the amount of $$$$$.

13 In the Amended Statement of Probable Cause, Background fact #26 also indicates that a "counter check" from the BUSINESS-1 bank account was written to TAXPAYER-1 on August 17, 2007 in the amount of $$$$$ and deposited into his personal bank account. Background fact #27 indicates that after this $$$$$ deposit was made into TAXPAYER-1's personal account, a number of checks were written from this account, including one to TAXPAYER-2 on September 4, 2007 in the amount of $$$$$.

14 It is noted that when TAXPAYER-1 originally filed his appeal of the Division's 2007 assessment, he did so, at least in part, on his belief that the Division has not issued this assessment within the statute of limitations period allowed under Utah law. TAXPAYER-1 clarified at the Initial Hearing that he is no longer contesting the 2007 assessment on this basis.

payments to TAXPAYER-1 and/or TAXPAYER-2 (aka: TAXPAYER-1) and as such those funds appear to be personal income to TAXPAYER-1 and/or TAXPAYER-2."

As previously mentioned, in Background facts #26 and #27 of the Amended Statement of Probable Cause, NAME-3 listed the three checks written to TAXPAYER-2 in 2007 in amounts that correspond to the descriptions of the three theft felonies to which TAXPAYER-1 pled guilty. These three checks totaled $$$$$. In Background fact #27, NAME-3 listed other checks and withdrawals from 2007 and 2008 that were written to and/or withdrawn by TAXPAYER-1 and/or TAXPAYER-2. The amounts of these other checks and/or withdrawals do not correspond to the descriptions of the three theft felonies to which TAXPAYER-1 pled guilty. These other checks and withdrawals totaled $$$$$ in 2007 and $$$$$ in 2008.[15] In Background facts #26 and #27, NAME-3 also indicates that after NAME-1's $$$$$ of money was deposited into BUSINESS-1's account, a number of other checks were written from the BUSINESS-1 account and/or TAXPAYER-1's personal account to BUSINESS-2, BUSINESS-3, NAME-2, and NAME-1, the total of which was $$$$$.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2007)[16] defines "adjusted gross income," "federal taxable 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
> . . . .
> (k) "Federal taxable income":

15 Background fact #27 indicates that TAXPAYER-1 and/or TAXPAYER-2 received the following additional amounts from TAXPAYER-1's personal account either by check or withdrawal: 1) a check written to TAXPAYER-1 on September 19, 2007 in the amount of $$$$$; 2) a check written to TAXPAYER-2 on October 4, 2007 in the amount of $$$$$; 3) a withdrawal made by TAXPAYER-1 on October 26, 2007 in the amount of $$$$$; 4) a check written to TAXPAYER-2 on December 5, 2007 in the amount of $$$$$; and 5) a check written to TAXPAYER-2 on January 7, 2008 in the amount of $$$$$. In addition, Background fact #27 indicates that a "cash" withdrawal was made from TAXPAYER-1's personal account on January 3, 2008 in the amount of $$$$$.

16 The 2007 version of Utah law and the Internal Revenue Code is cited in the decision, unless otherwise indicated.

> (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;
> . . . .

Subsection (a) of Internal Revenue Code ("IRC") §63 defines "taxable income," in pertinent part, to mean "gross income minus the deductions allowed by this chapter (other than the standard deduction)."

IRC §61 defines "gross income," as follows in pertinent part:

> (a) General definition Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items;
> (2) Gross income derived from business;
> (3) Gains derived from dealings in property;
> (4) Interest;
> (5) Rents;
> (6) Royalties;
> (7) Dividends;
> (8) Alimony and separate maintenance payments;
> (9) Annuities;
> (10) Income from life insurance and endowment contracts;
> (11) Pensions;
> (12) Income from discharge of indebtedness;
> (13) Distributive share of partnership gross income;
> (14) Income in respect of a decedent; and
> (15) Income from an interest in an estate or trust.
> . . . .

IRS Publication 17 (p.89) provides that "[i]llegal income, such as money from dealing illegal drugs, must be included in your income on Form 1040, line 21, or on Schedule C of Schedule C-EZ (Form 1040) if from your self-employment activity."

UCA §59-1-1417(1) (2016) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions 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

For the 2007 tax year, Subsection 59-10-103(1)(y) defines Utah "state taxable income" to mean a person's "federal taxable income" after making certain additions or subtractions that are not applicable to this case. Subsection 59-10-103(1)(k)(i) defines "federal taxable income" to mean "taxable income as defined by Section 63, Internal Revenue Code[.]" In relevant part, IRC §63(a) defines "taxable income" to mean "gross income minus the deductions allowed by this chapter (other than the standard deduction)." Finally, IRC §61 defines "gross income" to mean "all income from whatever source derived, including (but not limited to) the following items. . . ."

Although income obtained from illegal activities is not one of the items specifically listed in IRC §61 as "gross income," the Division contends that it is includable in "gross income" because that definition contains the non-exclusive phrase "including (but not limited to)" and because IRS Publication 17 specifically indicates that income from illegal activities is subject to taxation. The taxpayers do not dispute the Division's claim that income from illegal activities is "gross income" under the IRC. Because income obtained from illegal activities is "gross income" under the IRC, it is "taxable income" under IRC §63, "federal taxable income" under Subsection 59-10-103(1)(k)(i), and Utah "state taxable income" under Subsection 59-10-

103(1)(y). Accordingly, any income that the taxpayers obtained from illegal activities in 2007 is subject to Utah income taxation for this year.

While all parties agree that illegal income is subject to taxation, they disagree on the amount of the taxpayers' 2007 illegal income. The taxpayers contend that the amount of their 2007 illegal income is the total of the amounts described in the three theft charges to which TAXPAYER-1 pled guilty (i.e., $$$$$). The Division, on the other hand, contends that the amount of taxpayers' 2007 illegal income is the amount that TAXPAYER-1 was ordered in his 2012 Plea Bargain to pay back to NAME-1 as restitution (i.e., $$$$$).[17] In this appeal, each of the taxpayers has the burden of proof pursuant to Subsection 59-1-1417(1).

Each of the taxpayers' counsels proffered that no Utah case law exists concerning illegal income. Consequently, there is no Utah precedent to support the taxpayers' position that illegal income should be limited to the amounts described in the charges for which a person is convicted. Furthermore, each of the taxpayers' counsels admit that they did not search federal cases or rulings to see if the federal courts or the IRS had addressed this issue for federal tax purposes. As a result, the taxpayers have not shown that illegal income is limited only to those amounts described in the charges for which a person is convicted. For that matter, the taxpayers have not shown that a criminal conviction must even exist before income obtained through illegal activities is considered subject to taxation.

The Division, on the other hand, did refer the Commission to federal cases that discuss some aspects of the taxation of illegal income. In *James v. United States*, 366 U.S. 213, 81 S.Ct. 1052, 6 L.Ed.2d 246 (1961), the United States Supreme Court held that an embezzler was required to include his "ill-gotten gains" in his

17 In Background fact #29 of the Amended Statement of Probable Cause, NAME-3 stated that "[s]ignificant amounts of those funds were used for personal expenses and/or were removed as cash payments to TAXPAYER-1 and/or TAXPAYER-2 (aka: TAXPAYER-2) and as such those funds **appear to be personal income** to TAXPAYER-1 and/orTAXPAYER-2" (emphasis added). It appears that NAME-3 may be suggesting that the amounts subject to taxation are limited to those funds that the taxpayers used for personal expenses and/or removed as cash payments. None of the parties, however, argued for such a position, and no precedents were submitted to support this position. As a result, the Commission will not consider NAME-3 statement any further.

gross income for federal income tax purposes. In *James*, the Court did not indicate that the taxpayer had to have been convicted of embezzlement in order for the ill-gotten gains to be considered gross income. As a result, *James* does not support the taxpayers' positions. The Court did state, however, that "a gain constitutes taxable income when its recipient has such control over it that, as a practical matter, he derives readily realizable economic value from it" and that "[w]hat is important is that the right to recoupment exists. . . ." The Court further stated "if, when, and to the extent that the victim recovers back the misappropriated funds, there is, of course, a reduction in the embezzler's income."[18]

In *James*, the Court did not specifically state that the amount of restitution a person must repay to a victim pursuant to criminal proceedings is subject to taxation. In addition, neither party contends that TAXPAYER-1 is an embezzler. Nevertheless, it appears that the Court's statements better support the Division's position than the taxpayers' positions. In the instant case, it appears that TAXPAYER-1 misappropriated the $$$$$ that NAME-1 gave BUSINESS-1 to invest because he redirected a majority of these funds into his personal bank account, because he wrote checks from BUSINESS-1's bank account and his personal bank account to himself and/or TAXPAYER-2, and because he invested the funds in real estate and made loans without satisfying the terms set forth in the NAME-1 Agreement. Because TAXPAYER-1 had such control over the $$$$$ of funds that NAME-1 invested, he appears, as a practical matter, to have derived readily realizable economic value from these funds until the investments were lost.

Furthermore, the Court stated that the right to recoupment is an important factor in determining whether gross income exists. In the criminal proceedings arising out of TAXPAYER-1's use of NAME-1's money, TAXPAYER-1 was required to return $$$$$ to NAME-1 (all $$$$$ that NAME-1 invested minus the

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18 The Division reduced the additional income it assessed to the taxpayers for the 2007 tax year by the $$$$$ TAXPAYER-1 returned to NAME-1 in 2007. Neither party, however, addressed what effect, if any, the $$$$$ monthly restitution payments that TAXPAYER-1 has made since 2012 would have in determining the taxpayers' taxable income for 2007 or a subsequent tax year(s). As a result, the Commission will not consider these monthly payments in reaching its decision.

$$$$$ he had already returned), not just the $$$$$ described in the three theft charges to which he pled guilty. Accordingly, it appears that *James* better supports the Division's position that the taxpayers failed to report $$$$$ of illegal income for the 2007 tax year than the taxpayers' position that they only failed to report $$$$$ of illegal income for this year.[19]

In conclusion, the taxpayers have not shown that the amount of their 2007 illegal income should be limited only to those amounts described in the charges of the three theft felonies to which TAXPAYER-1 pled guilty. The taxpayers have provided no ruling or other precedent to support this position. For this reason and because it appears that *James* lends support to the Division's position, the Commission should sustain the Division's assessment except for revising it to reflect only $$$$$ of additional FAGI for the 2007 tax year.

One last issue should be addressed that does not concern the taxpayers' 2007 tax liability. At the hearing, the taxpayers indicated that they have overpaid their 2006 income tax liability by approximately $$$$$ and that they want this overpayment applied to their 2007 tax liability. The 2006 tax year is not at issue in the instant appeal. Accordingly, the Commission declines to determine at this time whether the taxpayers have overpaid their 2006 tax liability and whether their request for a refund or credit of 2006 taxes at the Initial Hearing satisfies the statute of limitations deadline found in Utah Code Ann. §59-1-1410(8). Generally, a request for refund or credit is first addressed by Taxpayer Services Division, which issues a decision

19 Another federal case on which the Division relies is *US v. Swallow*, 511 F.2d 514 (10th Cir. 1975). This case does not support the taxpayers' position, nor does it show that the Division's position is incorrect. In *Swallow*, the United States Court of Appeals, Tenth Circuit, found that Swallow had income from loans he obtained in bad faith. The Court determined that Swallow obtained the loans in bad faith, in part, because he made no repayments and because he used some of the funds for personal expenditures. *Swallow* is similar to the instant matter because TAXPAYER-1 used some of NAME-1 funds for personal expenditures. However, *Swallow* is dissimilar to the instant matter because TAXPAYER-1, unlike Swallow, repaid some of NAME-1 funds to her. Furthermore, the Court appears to have left unanswered how the "amount" of the taxable income should be determined. For its purposes, the Court found that Swallow had a "substantial income tax deficiency" regardless of whether "the total funds received by Swallow and the corporations were treated as his income" or whether "the personal expenditure items alone were treated as income to Swallow." *Id.* at 520. Because of the factual differences between *Swallow* and the instant case and because the Court in *Swallow* did not address what "amount" of income Swallow failed to report, *Swallow* does not appear to be particularly helpful in determining, in the instant case, the amount of the taxpayers' illegal income for the 2007 tax year.

concerning the request that a taxpayer can appeal to the Commission. Accordingly, if the taxpayers want to pursue a refund or credit of 2006 taxes, they should put that request in writing and submit it to the Taxpayer Services Division to address in this manner.

_____

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's 2007 assessment with one exception. Specifically, the Commission orders the Division to reduce the $$$$$ of additional FAGI reflected in the assessment to $$$$$. 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 _____, 2016.

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.