

14-580
TAX TYPE: INCOME TAX
TAX YEAR: 2009
DATE SIGNED: 2-23-2015
COMMISSIONERS: D. DIXON, M. CRAGUN, R. PERO
RECUSED: J. VALENTINE
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	INITIAL HEARING ORDER Appeal No. 14-580 Account No. ##### Tax Type: Income Tax Year: 2009 Judge: Chapman
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Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER, Taxpayer (by telephone)
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
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 February 2, 2015.

TAXPAYER (“Petitioner” or “taxpayer”) is appealing Auditing Division’s (the “Division”) assessment of additional individual income tax for the 2009 tax year. On February 11, 2014, the Division issued a Notice of Deficiency and Audit Change to the taxpayer, in which it imposed additional tax and interest (calculated as of March 13, 2014),¹ as follows:

¹ Interest continues to accrue until any tax liability is paid.

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

The Division imposed the additional tax based on a change that the Internal Revenue Service (“IRS”) made to the taxpayer’s 2009 federal adjusted gross income (“FAGI”). Specifically, the IRS increased the taxpayer’s 2009 FAGI by \$\$\$\$\$.

The taxpayer explains that the IRS’s increase concerned a \$\$\$\$\$ alimony payment that he paid to his ex-wife in 2009 and that he had deducted to derive his 2009 FAGI. He claims that the IRS disallowed the deduction because of a sentence contained in the October 21, 2009 divorce Stipulation (“Stipulation”). The copy of the Stipulation proffered as evidence is “stamped” as having been received by the Fourth District Court of Utah on October 28, 2009. Paragraph 8 of the Stipulation provides, as follows in pertinent part:

[TAXPAYER] will pay to Respondent the sum of \$\$\$\$\$ as a lump sum payment of alimony which will be payable as follows: \$\$\$\$\$ by December 31, 2009, \$\$\$\$\$ by December 31, 2010, \$\$\$\$\$ by December 31, 2011. . . . The alimony is nonmodifiable and will not terminate on the marriage or death of either party. The amount is all designated as alimony in order to settle the case and to give [TAXPAYER] the tax benefit. . . .²

The last sentence cited above indicates that TAXPAYER was to have “the tax benefit” from the alimony payments.

The Division provided a copy of the IRS transcript for the taxpayer’s income tax account for 2009. The transcript shows that the IRS decided to examine the taxpayer’s 2009 tax return on March 8, 2012, which is after the date that the taxpayer had made the last alimony payment required under the Stipulation. During the examination, the IRS and the taxpayer corresponded about the taxpayer’s \$\$\$\$\$ deduction for the alimony payment he made in 2009. On July 17, 2012, the IRS sent the taxpayer an “Explanations of Items” letter, in which it explained that it was disallowing the deduction for 2009, as follows in pertinent part:

After reviewing your divorce stipulation, we can not (sic) allow the alimony deduction. On page 4 it says that the one-time payment each year was to continue even if you get married or

2 At issue in this appeal is the first payment of \$\$\$\$\$ that the taxpayer made on December 31, 2009.

the death of either party. IRS's stand is that in order to take the deduction the payment must terminate at death. (see enclosed documentation)

We realize that the alimony issue was completed in 2011, but we must disallow the deduction.

We have included copies from Publication 17 pages 134 and 135. . . .³

As a result, it appears that the IRS determined that the sentence in the Stipulation providing for the alimony not to terminate on the death of the taxpayer's ex-wife was controlling and that TAXPAYER could not deduct the \$\$\$\$ payment he made in 2009, even though the Stipulation specifically provided that he was receive the tax benefit.

On January 8, 2013, the taxpayer responded to the IRS's Letter of Deficiency. The taxpayer informed the IRS that his ex-wife had claimed the 2009 alimony payment as income on her 2010 return.⁴ However, it does not appear that this information changed the IRS's position. The taxpayer did not provide any additional documents that the IRS may have sent him. However, he confirms that the IRS disallowed the \$\$\$\$ alimony deduction he took for 2009. In addition, the IRS transcript shows that on April 1, 2013, the IRS assessed additional tax, penalties, and interest to the taxpayer for the 2009 tax year. It also shows that on April 18, 2013, the taxpayer submitted a payment to the IRS in the amount of \$\$\$\$ to satisfy the assessment in full.

The taxpayer stated that because of the IRS's action, he hired an attorney to modify the original divorce Stipulation. The taxpayer and his ex-wife signed a Stipulation Addendum dated April 30, 2013 ("Addendum"), approximately two weeks after he had paid the IRS's assessment for 2009. The Addendum

3 IRS Publication 17 (2009) (pp. 134-135) provides that a payment is *not* alimony and, thus, does not qualify for deduction if any one of a number of facts are true, including "[p]ayments are required after death of the recipient spouse."

See also Internal Revenue Code §71(b)(1) (2009), which provides, as follows in pertinent part:

(1) In general

The term "alimony or separate maintenance payment" means any payment in cash if -

. . . .

(D) there is no liability to make any such payment for any period after the death of the payee spouse and there is no liability to make any payment (in cash or property) as a substitute for such payments after the death of the payee spouse.

4 TAXPAYER explained that because he gave his ex-wife a check in the amount of \$\$\$\$ on December 31, 2009, she did not cash it until early January 2010. As a result, he stated that his ex-wife claimed this \$\$\$\$ as income not on her 2009 tax return, but on her 2010 tax return.

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modified the Stipulation by eliminating the sentence that read: “The alimony is nonmodifiable and will not terminate on the marriage or death of either party.” However, the Addendum retained the remainder of paragraph 8 from the Stipulation, including the sentence indicating the TAXPAYER was to have the tax benefit. The Addendum, though signed on April 30, 2013, provides that it is effective as of October 21, 2009, which is the date that the original Stipulation was signed. The copy of the Addendum proffered at the Initial Hearing is not stamped as having been received by the Fourth District Court. As a result, it is unclear whether the Fourth District Court approved the Addendum.

The taxpayer contends that the Addendum adequately modifies the alimony provision of the Stipulation so that all alimony payments he made under the Stipulation, including the 2009 payment at issue in this appeal, qualify as alimony that may be deducted from FAGI. As a result, he asks the Commission to reverse the Division’s assessment.

The taxpayer proffers that he telephoned the IRS sometime after the Addendum was signed, but was told that he had gone past the examination period and that the IRS would not consider any additional information. However, the taxpayer has not received any written statement from the IRS indicating that the statute of limitations to request a refund of the \$\$\$\$ payment he made on April 18, 2013 has expired. The taxpayer stated that he approached a tax consultant about submitting the Addendum to the IRS, but the consultant wanted a retainer of over \$\$\$\$\$. The taxpayer also stated that the IRS has not disallowed the \$\$\$\$ alimony deduction he has taken for each of the 2010 and 2011 tax years. As a result, he has decided to challenge the disallowance of his 2009 alimony deduction at the state level, but not at the federal level.

The Division asks the Commission to sustain its assessment for several reasons. First, the Division relies on Utah Code Ann. §§59-10-103(1)(w) and 59-10-103(1)(a), which provide that Utah taxable income means a taxpayer’s adjusted gross income, as defined in the Internal Revenue Code. Pursuant to these statutes, the Division contends that the Tax Commission should rely on the FAGI shown on the IRS’s records when

determining the taxpayer's Utah taxable income. Because the IRS records show that it disallowed the \$\$\$\$ alimony deduction for 2009, the Division contends that the Commission should not allow it when determining the taxpayer's Utah taxable income.

Second, the Division acknowledged that on occasion, the Commission has decided to address federal taxable income independently instead of giving deference to the IRS's determination of this income. The Division contends, however, that the Commission has only done so when the IRS has not considered the taxpayer's information because the federal statute of limitations has expired or because of some other circumstance where the taxpayer has not had the opportunity for a determination from the IRS. The Division contends that such circumstances are not present in this case because the statute of limitations for TAXPAYER to request a refund of the additional 2009 taxes he paid in April 2013 has not expired.

The Division claims that the Internal Revenue Code allows a taxpayer to request a refund of federal income taxes within two years of paying those taxes.⁵ The Division asserts that TAXPAYER made a payment of \$\$\$\$ to the IRS on April 18, 2013, after the IRS disallowed his 2009 alimony deduction. The taxpayer does not refute this assertion. As a result, the Division claims that TAXPAYER has until April 18, 2015 (i.e., two years after the April 18, 2013 payment) to submit a refund claim to the IRS and to have the IRS consider the modification made in the Addendum.⁶ Because the taxpayer still has an opportunity to have the IRS decide what effect the Addendum would have on the deductibility of his 2009 alimony payment, the Division asks the

5 The Division's assertion appears to be correct. Internal Revenue Code §6511(a) provides that a "[c]laim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later. . . ."

6 The Division also proffered two emails that NAME, a Division employee, sent to TAXPAYER on August 19, 2014 and October 28, 2014. These emails show that the Division has previously informed TAXPAYER that he was still within the statute of limitations period to have the IRS consider a refund of the taxes he paid on April 18, 2013. In these emails, NAME encouraged TAXPAYER to submit the issue to the IRS for reconsideration because it would be the Division's position that the IRS audit is correct unless you prove that you have exhausted all available efforts with the IRS.

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Commission not to make an independent determination about the deduction. Instead, the Division asks the Commission to find the taxpayer's Utah taxable income should reflect his FAGI as shown on IRS records.

Third, if the Commission decides to make an independent determination about the taxpayer's alimony deduction, the Division asks the Commission to find that the taxpayer has not met his burden of proof to show that the deduction is allowable. The Division acknowledges that the Addendum modifies the Stipulation and removes the sentence to which the IRS referred when disallowing the alimony deduction. The Division, however, contends that it is possible that the Addendum may not change the IRS's original determination that the deduction is not allowable.

The Division suggests that the Addendum may have been sufficient to guarantee that any alimony payment made after the Addendum was executed would qualify for deduction. But, because all of the taxpayer's alimony payments, including the 2009 payment, were made before the Addendum was executed (i.e., when the original Stipulation was in effect), the Division contends that the IRS may find that the Addendum does not control the deductibility of the 2009 alimony payment. The Division contends that it is unknown whether the IRS would find that the Addendum is applicable not only to payments made after the Addendum was executed, but also to payments made before its execution. The Division admitted that it had not conducted research into this issue. However, the Division asserts that it is a question that raises reasonable doubt as to whether the IRS would change its disallowance of the 2009 alimony deduction because of the Addendum. In addition, the Division notes that the Addendum, by itself, does not show that it was received by the Fourth District Court. For these reasons, the Division asks the Commission to sustain its assessment.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2009) 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

....

(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;

....

UCA §59-1-1417 (2014) 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

The Division proffered evidence showing that the IRS disallowed a \$\$\$\$ alimony deduction that the taxpayer claimed for the 2009 tax year. The Division has made a similar change to the taxpayer's 2009 Utah taxable income. The taxpayer, however, proffered a 2013 Addendum to his divorce Stipulation that eliminates the sentence on which the IRS had relied when it disallowed the deduction. The taxpayer contends that this modification is sufficient to show that the IRS would now allow the deduction and to prove that the Division's assessment should be reversed.

The taxpayer, however, has not made a refund claim and submitted the Addendum to the IRS. As a result, the IRS has not determined whether this "new" information would change its original determination,

even though it appears that the taxpayer still has an opportunity to obtain such a determination from the IRS through a refund request.⁷ The Division asks the Commission to sustain its assessment primarily because it reflects the taxpayer's FAGI, as shown on IRS records. However, the Division also asks the Commission to consider that the taxpayer still has an opportunity to have the IRS decide this issue and that it is unclear whether the IRS would reverse its prior decision because of the modification in the Addendum. Lastly, the Division questions whether it would be the original Stipulation or the Addendum that would control the deductibility of an alimony payment made when the original Stipulation was in effect and before the Addendum was executed. For these reasons, the Division contends that the taxpayer has not met his burden to show that the state assessment is incorrect.

Sections 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),⁸ 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:

⁷ The Division's position is that the taxpayer has until April 18, 2015 to submit a refund request to the IRS in regards to the deductibility of the alimony payment, which has not been refuted.

⁸ The decision for this appeal, as well as other selected Commission decisions, can be viewed in a redacted format on the Tax Commission's website at <http://www.tax.utah.gov/commission-office/decisions>.

The Utah Code sections specify that state taxable income is federal taxable income **as defined in the Internal Revenue Code**, (sic) 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).

However, in *USTC Appeal No. 08-1313* (Initial Hearing Order Mar. 19, 2009), the Commission indicated a willingness to independently review federal taxable income 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 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 Sections 59-10-111 and 59-10-112. 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.⁹ In the instant case, the Division refutes TAXPAYER'S

⁹ 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

assertion that an error exists on the IRS records. The Division states that it is possible that an error does not exist on IRS records, depending on what effect the IRS would give the Addendum in regards to alimony payments made before its execution. In addition, the Division noted that the Addendum, unlike the Stipulation, does not show that it was submitted to the Fourth District Court for approval.

Questions remain as to whether the IRS would reverse its disallowance of the \$\$\$\$ deduction TAXPAYER claimed for the 2009 tax year on the basis of the modification found in the Addendum he and his ex-wife signed in 2013. Neither party provided any legal authority to show whether the deductibility of an alimony payment is based on an Addendum executed after the payment was made or on the original Stipulation in effect at the time of payment. However, IRS Revenue Ruling 71-416, 1971-2 C.B. 83 (“Rev. Rul. 71-416”) addresses whether the IRS will recognize for tax purposes the “retroactive effect of a nunc pro tunc order of a state court which corrects a mathematical mistake in a divorce decree.”¹⁰

Rev. Rul. 71-416 involves the following facts. It was the intention of the parties and the attorneys drafting the alimony agreement at issue in the ruling that payments would be taxable to the wife and deductible by the husband. Also, it was the intention of the judge who granted the divorce decree that the payments be payable over a period of time that would comply with the requirements of the Internal Revenue Code so as to be taxable to the wife and deductible by the husband. However, due to a mistake in computation, the payments were one short of the payment period required by the Internal Revenue Code for this tax result to occur. The error was discovered two years after the date of the divorce decree. These facts were incorporated into affidavits executed by the judge and by the attorneys for the parties and into an instrument entitled Addendum to Alimony Agreement. Subsequently, a motion for a modification nunc pro tunc of the divorce decree was

incorrect and found in favor of the Division.

10 Black’s Law Dictionary 964 (5th ed. 1979) defines “nunc pro tunc,” in part, as “[a] phrase applied to acts allowed to be done after the time when they should be done, with a retroactive effect, *i.e.*, with the same effect as if regularly done. Nunc pro tunc entry is an entry made now of something actually previously done to have effect of former date. . . . Nunc pro tunc signifies now for then, or, in other words, a thing is done now, which shall have same legal force and effect as if done at time when it ought to have been done. . . .

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made on the above grounds. The nunc pro tunc entry acknowledged the error and restated the amount of the alimony to satisfy the Internal Revenue Code requirement to achieve the desired tax result. The nunc pro tunc order was granted in the same court in which the divorce was granted, and was issued by the same judge. The court determined that under state law, an entry nunc pro tunc was proper as it would merely reflect the true original decision of the court.

In Rev. Rul. 71-416, the IRS stated that the “Tax Court has given retroactive effect to nunc pro tunc amendments only where it has found as a fact that there was an error of a clerical nature in the original written decree, and as a result the payments ordered by the decree were not properly described and the true decision of the court was not expressed.” Based on the facts recited in the prior paragraph, the IRS found that there was “ample factual evidence to support the conclusion that the original decree was intended to read as modified by the nunc pro tunc order” and that the “mistake in the original decree was not based on a misconception of Federal tax law, but was merely a mathematical error[.]” As a result, the IRS ruled that the nunc pro tunc entry would be given retroactive effect for federal income tax purposes and that the husband would be allowed to deduct the payment.

It is not clear that the IRS would make a similar ruling in the instant case on the basis of TAXPAYER’S Addendum. The Addendum that TAXPAYER and his ex-wife signed does not indicate that it was executed because of an “error” in the Stipulation that did not reflect the parties’ and the judge’s intention at the time the Stipulation was executed and approved by the Fourth District Court. It is possible that the intention at the time the Stipulation was executed and approved was for the alimony payments *not* to terminate at the death of the taxpayer’s ex-spouse. It is not inconceivable that the sentence in the Stipulation about alimony payments not terminating at death and the other sentence about TAXPAYER receiving the tax benefits were both in the Stipulation because of a misconception of federal tax law. In addition, the Addendum the taxpayer proffered as evidence was not stamped as having been received by the Fourth District Court. It is

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also unknown whether a “motion for a modification nunc pro tunc of the divorce decree” was made to Fourth District Court. As a result, the facts of the instant case appear different from the facts of Rev. Rul. 71-416. For these reasons, it is unclear whether the IRS would reverse its original determination and now allow the \$\$\$\$ alimony deduction that TAXPAYER claimed on his 2009 federal tax return.

As a result, the instant case is similar to *USTC Appeal No. 07-0365*, in which the Division stated that it is possible that the federal taxable income determined by the IRS was incorrect, but that it did not have sufficient information to make such a determination. In that case, the Commission sustained the Division’s assessment. For this reason and because it appears that the taxpayer still has an opportunity to have the IRS consider what effect the Addendum would have on TAXPAYER’S 2009 alimony deduction, the Commission should deny the taxpayer’s appeal and sustain the Division’s assessment.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's assessment. 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: 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.