14-1355
TAX TYPE: MISCELLANEOUS TAXES
TAX YEARS: 2010, 2011, 2012
DATE SIGNED: 6-5-2015
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO
EXCUSED: D. DIXON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, vs. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING ORDER** Appeal No. 14-1355 Account No. ##### Tax Type: Miscellaneous Taxes Judge: Phan

Presiding:
Jane Phan, Administrative Law Judge

Appearances:

For Petitioner:	REPRESENTATIVE-1 FOR PETITIONER, Deputy County Attorney REPRESENTATIVE-2 FOR PETITIONER, Salt Lake County Risk Manager
For Respondent:	REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General RESPONDENT-1, Tax Audit Manger RESPONDENT-2, Auditor

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on February 26, 2015, for an Initial Hearing in accordance with Utah Code §59-1-502.5. Petitioner is appealing a Utah Self-Insurer's Tax audit deficiency issued by Statutory Notice dated May 1, 2014. The period subject to the audit was January 1, 2010 through December 31, 2012; however, the audit deficiency pertained solely to calendar year 2012. The amount of Self-Insurer's Tax deficiency pursuant to the audit was $$$$$. Interest as of the date of the Statutory Notice was $$$$$.

APPLICABLE LAW

Utah Law provides the following requirements regarding Workers Compensation Benefits for self-insurer employers at Utah Code Sec. 34A-2-202 in relevant part is as follows:

> (1)(a)(i) A self-insured employer, including a county, city, town or school district, shall pay annually, on or before March 31, an assessment in accordance with this section and rules made by the commission under this section.
> . . .
> (b) the assessment required by Subsection (1)(a) is: (i) to be collected by the State Tax Commission; (ii) paid by the State Tax Commission into the state treasury as provided in Subsection 59-9-101(2); and (iii) subject to the offset provided in Section 34A-2-202.5.
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> (c) The assessment under Subsection (1)(a) shall be based on a total calculated premium multiplied by the premium assessment rate established pursuant to Subjection 59-9-102(2).
> (d) The total calculated premium, for purposes of calculating the assessment under Subsection (1)(a), shall be calculated by: (i) multiplying the total of the standard premium for each class code calculated in Subsection (1)(e) by the self-insured employer's experience modification factor; and (ii) multiplying the total under Subsection (1)(d)(i) by a safety factor determined under Subsection (1)(g).
> . . .
>
> (f)(i) Each self-insured employer paying compensation direct shall annually obtain the experience modification factor required in Subsection (1)(d)(i) by using: (A) the rate service organization designed by the insurance commissioner in Section 31A-19a-404; or (B) for a self insured employer that is a public agency insurance mutual, an actuary approved by the commission.
> . . .
>
> (h) (i) A premium or premium assessment modification other than a premium or premium assessment modification under this section may not be allowed.
> (ii) if a self-insured employer paying compensation direct fails to obtain an experience modification factor as required in Subsection (1)(f)(i) within the reasonable time period established by rule by the State Tax Commission, the State Tax Commission shall use an experience modification factor of 2.00 and a safety factor of 2.00 to calculate the total calculated premium for purposes of determining the assessment.
> (iii) Prior to calculating the total calculated premium under Subsection (1)(h)(ii), the State Tax Commission shall provide the self-insured employer with written notice that failure to obtain an experience modification factor within a reasonable time period as established by rule by the State Tax Commission: (A) shall result in the State Tax Commission using an experience modification factor of 2.00 and a safety factor of 2.00 in calculating the total calculated premium for purposes of determining the assessment; and (B) may result in the division revoking the self-insured employer's right to pay compensation direct.

The Utah State Tax Commission has adopted the following rule to set out the period of time for which an employer must obtain the experience modification factor pursuant to Utah Code 34A-2-202. Utah Admin. Rule R865-11Q-1 provides:

> (A) An employer shall have until the due date of each annual return to obtain the experience modification factor.
> (B) The experience modification factor for a taxable year shall be the experience modification factor in effect on January 1 of the taxable year.
> (C) An employer that fails to obtain the annual experience modification factor within the period established in A. shall be require to use an experience modification factor of 2.0 and a safety factor of 2.0 to calculate the total calculated premium.

DISCUSSION

The parties did not present a dispute as to the facts or the relevant events that occurred in this appeal, instead the issue is an interpretation of law. It is also a matter of first impression before the Tax Commission as the legal questions have not been previously appealed. Both parties provided prehearing briefs that outlined their positions and the applicable law.

Petitioner, ("PETITIONER"), is a self insured employer for the purposes of Workers Compensation. Self insured employers are required to calculate their premium, file an annual Self-Insured Employers TC-420 Return and pay the assessment to the Utah State Tax Commission on March 31 for the proceeding calendar year. The return that is at issue in this appeal is the PETITIONER's 2012 return, which was due March 31, 2013. The PETITIONER had filed its original 2012 return on April 12, 2013. This was late and a late filing penalty in the amount of $$$$$ was assessed against the PETITIONER. The PETITIONER had filed a waiver request regarding this penalty and it was waived by the Waiver Unit of the Taxpayer Services Division.

Utah Code Sec. 34A-2-202(1)(d) provides the calculation for determining the premium. Under this section the premium is calculated by multiplying the total of the standard premium for each class code by the "experience modification factor" (E-mod), and then multiplying the total by a safety factor. It is the E-mod factor that has caused the issue in this appeal. The E-mod factor affects the self insured employer's rate based upon its history of claims filed. If the self insured employer's loss history is better than the expected average, the employer receives an E-mod of less than 1.0. If the employer's history is worse than the expected average the E-mod is greater than 1.0.

Under Utah Code Sec. 34A-2-202(1)(f)(i)(A), the self insured employer obtains the E-mod factor from "the rate service organization designated by the insurance commissioner in

Section 31A-19a-404." The designated rate service organization is the National Council on Compensation Insurance ("NCCI"). The PETITIONER had obtained an E-mod factor from NCCI for at least the two years prior to the 2012 year in question and filed its Self-Insured Employers TC-420 Returns for 2010 and 2011. The PETITIONER had obtained on March 22, 2013, an E-mod factor of .95 from NCCI, which the PETITIONER had used on the return it had filed on April 12, 2013, for the tax year 2012 to calculate the premium. It was later determined that this E-mod factor was in error for the 2012 filing.

When NCCI issues an E-mod, it considers the employer's compensation claims for three consecutive years, but not the year immediately prior to the tax year at issue. This means to calculate the E-mod with an effective date of January 1, 2012, NCCI considers the claim information for the years 2008, 2009 and 2010. However, inadvertently the PETITIONER had provided to NCCI the compensation claims for the years 2009, 2010 and 2011. The PETITIONER explained that it had provided this information through the consultants the PETITIONER retains at BANK to assist with the process. Neither the PETITIONER nor the consultants realized they had provided the information from the wrong three year period. When NCCI had used the data from the years 2009, 2010 and 2011, it calculated the .95 E-mod, which it provided to the PETITIONER on March 22, 2013, but it noted on the E-mod the "Rating Effective Date" was January 1, 2013. No one from the PETITIONER or the bank caught that the E-mod they had used on their original 2012 Self-Insured Employers TC-420 Return had the wrong effective date. The PETITIONER also argued the Instructions for the Self-Insured Employers TC-420 Return were not helpful either on this point and were confusing. Therefore, the PETITIONER'S original filing was in error as it had been calculated with an incorrect E-mod.

In the fall of 2013, the Division began an audit of the PETITIONER'S Self-Insured Employers TC-420 Returns. At some point during the audit the Division became aware that something was wrong with the E-mod for the 2012 return. The PETITIONER representatives assert that they thought they were working with the Division and that they were trying to better understand what they needed to do. The PETITIONER provided an email sent on October 28, 2013, from its consultant NAME-1 at BANK that seemed to indicate that the E-mod amount of .95 was correct for the 2012 return, that it was just the stated effective date January 1, 2013, that was in error. This information was passed on to RESPONDENT-2 of the Auditing Division on October 29, 2013, by email from NAME-2 of Salt Lake PETITIONER. In that email NAME-2 indicates that he has forwarded on the email from BANK and states, "The effective date of 1/1/13 on the experience rating that was submitted with the 2012 Self-Insurers Tax Return was an error and should have been listed as 1/1/12. The data that was used in the experience rating to

calculate the e-mod, however, was from the years 2009, 2010, 2011 and was correct. The only problem was the date. If we have the Workers' Compensation Experience Rating revised with a corrected date of 1/1/12, the e-mod valuation of .95 will not change." He does indicate that if the Tax Commission wanted the E-mod corrected and reissued that could be done. As indicated by these emails, it was not understood by the PETITIONER at this point that this error was more than a matter of NCCI listing the wrong effective date. At this point the PETITIONER was still assuming that the E-mod effective 1/1/2012 should have been based on the data for the years 2009, 2010 and 2011.

The Division's Auditor, RESPONDENT-2, responded back by email dated October 29, 2013. This email seems to indicate that the Division was also not aware of the actual error with the 2012 E-mod, but the response is confusing. In his response RESPONDENT-2 states, "The Commission will be satisfied if you can supply the "real" 2013 e-mod with a different score as REPRESENTATIVE-2 FOR PETITIONER suggested." Apparently, at this time RESPONDENT-2 was willing to accept that the effective date had been misstated for the 2012 E-mod, if when the E-mod was calculated for 2013 it indicated a different rate. RESPONDENT-2 goes on to state in his email, "However, we would like to get the real 2013 e-mod before March 2014 when the return is due. How soon will you be able to get the new rating from the NCCI? Ideally we would like to have it by the end of the year, if that is not possible we can work something else out."

The representatives for the PETITIONER indicated they thought that they were working with the Division to get the issue corrected, but on April 11, 2014, without prior warning and opportunity to correct, RESPONDENT-2 of the Division issued a letter to the PETITIONER which stated, "In accordance with the Utah Labor Code 34A-2-202(1)(h)(iii), this letter serves as written notification that an experience modification factor was not obtained within a reasonable time period for the 2012 taxable year. The letter goes on to state, "the State Tax Commission shall use an experience modification factor of 2.00 and a safety factor of 2.00 to calculate the total calculated premium for purposes of determining the assessment." The letter does not state or allow a time period for the PETITIONER to provide the correct E-mod for 2012, before determining the assessment on this basis. The Statutory Notice making the assessment with the 2.00 and 2.00 factors was issued on May 1, 2014, and the additional tax owed based on these factors, over and above what had previously been paid with the original return filing, was $$$$$. Although, the PETITIONER refers to this as a penalty assessment in its filing, it is not technically a penalty under tax codes, but instead an assessment of tax.

After the April 11, 2014 letter, the PETITIONER did obtain a correct E-mod for the effective date of 1/1/2012, having finally figured out that the wrong year's information had been provided to NCCI. The PETITIONER'S representatives indicate that there was some delay on the part of the PETITIONER getting the correct years' data to NCCI due to a new computer system but on May 6, 2014, NCCI issued the E-mod with the effective date of 1/1/2012. This E-mod was 1.03, higher than the .95 factor the PETITIONER had used on its original return, but certainly lower than the 2.00 E-mod used by the Division in its assessment. After appealing the audit, on September 23, 2014 the PETITIONER did file an amended Self-Insured Employers TC-420 Return for 2012, using the correct 1.03 E-mod. Because this was a higher E-mod it did result in $$$$$, in additional tax due which the PETITIONER paid with the filing of the amended return. The Division did not accept the amended return and maintains that the PETITIONER be held to the $$$$$ amount calculated in the audit. The Division did indicate, however, that the PETITIONER should be given credit for the payment of $$$$$ against the audit.

Utah Code Sec. 34A-2-202(1)(h) provides if the self insured employer "fails to obtain an experience modification factor . . . within a reasonable time period established by rule by the State Tax Commission" then the State Tax Commission shall use an E-mod of 2.00 and safety factor of 2.00 to calculate the total premium. One point that the PETITIONER makes is that it did provide an E-mod with its original return filed April 12, 2014. This E-mod was later determined to be incorrect, but it was provided. The PETITIONER also notes the inadvertent nature of the error, the fact that the Division is not allowing an amended return to correct the error and is assessing what the PETITIONER refers to as a penalty charge in the amount of $$$$$, when the additional premium from the corrected E-mod would have been only $$$$$. The amount of "penalty" calculated by the Division using the 2.00 E-mod and 2.00 safety factor is more than ten times the tax shortfall that resulted from the PETITIONER'S error.

The Division argues that the PETITIONER did not provide an E-mod with its original filing for purposes of this statutory requirement because the E-mod provided had an effective date of January 1, 2013. The Division argues, therefore, the PETITIONER never provided an E-mod with the effective date of January 1, 2012, until much later in May 2014. The Division also argues that under Utah Admin. Rule R865-11Q-1(A) the "employer shall have until the due date of each annual return to obtain" the E-mod. The Division relies on Utah Admin. Rule R865-11Q-1(B) for the assertion that the PETITIONER did not provide the E-mod with its original filing as that subsection states, "the experience modification factor for a taxable year shall be the experience modification factor in effect on **January 1 of the taxable year** (Emphasis Added)." The PETITIONER had in error submitted an E-mod effective January 1, 2013, not the correct date of

January 1, 2012. The Division also notes that in Subsection (C) of the rule "An employer that fails to obtain the annual experience modification factor within the period established in A. shall be required to use an experience modification factor of 2.0 and a safety factor of 2.0 . ." Therefore, the Division argues based on the rule, if the E-mod is not provided at the time the return is due, the 2.0 E-mod and 2.0 safety factors are to be used to determine the premium.

The PETITIONER argues in the event the Commission agrees with the Division on the point that no E-mod was filed with the original return, under the statute the Division has to give the self insured employer notice and a reasonable period of time to provide the E-mod prior to making the 2.0-2.0 assessment. The PETITIONER notes that although Utah Code Sec. 34A-2-202(1)(h)(ii) provides that if the self insured employer "fails to obtain an experience modification factor . . . within a reasonable time" the Commission shall use the 2.0-2.0 calculation, Subsection (1)(h)(iii) of that statute provides a requirement for the Commission to issue written notice to the employer and time for the employer to provide the E-mod prior to making the calculation. In fact, Subsection (1)(h)(iii) states, "Prior to calculating the total calculated premium under Subject (1)(h)(ii), the State Tax Commission shall provide the self-insured employer with written notice that failure to obtain an experience modification factor within a reasonable time period as established by rule by the State Tax Commission: (A) shall result in the State Tax Commission using an experience modification factor of 2.00 and a safety factor of 2.00 in calculating the total calculated premium . . ."

It is the PETITIONER'S position that the statute is clear that the Division must give the employer written notice and the opportunity to provide the E-mod prior to assessing the "penalty" 2.0-2.0 premium. However, in its Prehearing Brief the PETITIONER also cites several cases supporting the well established principal of statutory construction, including *Ivory Homes, Ltd. v. Utah State Tax Comm'n*, 266 P.3d 751, 759-60 (Utah 2011) which held, "It is an established rule in the construction of tax statues that if any doubt exists as to the meaning of the statute, our practice is to construe taxation statutes liberally in favor of the taxpayer, leaving it to the legislature to clarify an intent to be more restrictive if such intent exists."[1] In this matter the Division's calculation and imposition of a premium is similar to a tax imposition statute and it is imposed by the State Tax Commission.

[1] This long standing principle of statutory construction was codified by the Utah Legislature after the Court's decision in *Ivory Homes, Ltd. v. Utah State Tax Comm'n*, 266 P.3d 751 (Utah 2011). Utah Code Sec. 59-1-1417(2) provides "the commission or a court considering a case involving the tax, fee or charge shall: (a) construe a statute imposing the tax, fee, or charge strictly in favor of the taxpayer; and (b) construe a statute providing an exemption from or credit against the tax, fee or charge strictly against the taxpayer.

As the PETITIONER noted, Utah Code Sec. 34A-2-202(1)(h) is similar to a tax imposition statute. Taking into account plain reading of the language the most reasonable interpretation of Subsection (1)(h)(iii) is that the Commission must give the employer written notice and the opportunity to provide the E-mod prior to making the assessment based on the 2.0-2.0 factors. The statute provides the Commission "shall provide . . . written notice that failure to obtain an experience modification factor within a reasonable time period . . . shall result" in the 2.0-2.0 calculation. Even if it was deemed to have some ambiguity, a liberal construction in favor of the PETITIONER supports the PETITIONER'S interpretation of this requirement that notice had to be given and the employer then had a reasonable time to provide the E-mod prior to the imposition of the "penalty."

Furthermore, it should be noted that the amount of the premium calculated by the Division is more than ten times the amount of the premium that resulted from the corrected E-mod. The Divisions of the Commission assess penalties under Utah Code Sec. 59-1-401 for late filing of returns or late payment of tax, which are generally 10% of the tax due. Penalties for negligence are 10% of the tax due under 59-1-401(7) and for intentional disregard of law 15% due. If the Division shows that there is fraud with intent to evade the tax the penalty is as high as 100% of the deficiency under 59-1-401(7). In the subject case, the showing was an inadvertent error; there was no evidence from the Division that this was fraud with intent to evade. However, the Division's audit deficiency results in an amount that would equate to more than 1000% of the deficiency that resulted from the error. Essentially, if this was a "penalty," it would be greater than a 1000% penalty.

The Division reads the Commission rule Utah Admin. R865-11Q-1 in conjunction with Utah Code Sec. 34A-2-202(1)(h)(iii) to mean that because the "reasonable time period" for providing the E-mod is the due date of the return, if the employer fails to provide the E-mod by the due date, the 2.0-2.0 calculation shall be imposed. With this interpretation, the only purpose of the notice required by Utah Code Sec. 34A-2-202(1)(h)(iii) is to let the employer know that the 2.0-2.0 calculation is imposed. So, after the due date of the return, according to the Division there is no chance for the employer to provide the E-mod or correct an error in the E-mod provided such as occurred in this appeal, without this huge increase in premium. In this appeal the Division provided its written notice on April 11, 2014, to the PETITIONER to inform the PETITIONER it was making the 2.00-2.00 calculation, not to give the PETITIONER a reasonable opportunity to correct its E-mod before imposing the calculation. The Division's interpretation of the rule is inconsistent with the notice requirement provided by Utah Code Sec. 34A-2-202(1)(h)(iii).

Utah Admin. R865-11Q-1 could be read consistently with Utah Code Sec. 34A-2-202(1)(h)(iii) by saying that the Division would have to issue written notice to an employer prior to the due date of the return, letting the employer know if the employer failed to provide the E-mod on the due date of the return, the Division would make the 2.00-2.00 calculation. There was no prior written notice provided to the PETITIONER. Furthermore, the PETITIONER did file an E-mod with its original return. There was an inadvertent error. It took both the PETITIONER and the Division who audited the return some time to figure out what was wrong with the E-mod. The Division's Statutory Notice of additional premium issued for the 2012 tax year should be abated and the Division should accept the amended return filed by the PETITIONER.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission abates the Division's audit deficiency as issued in the Statutory Notice dated May 1, 2014. The Division should review and if there are no other problems, accept the PETITIONER'S amended return for the 2012 tax year.

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 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.