

TAX TYPE: INCOME TAX

TAX YEAR: 2013

DATE SIGNED: 8/28/2020

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL, L. WALTERS

GUIDED DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER,

Petitioner,

v.

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent.

**FINDINGS OF FACT, CONCLUSIONS
OF LAW, AND FINAL DECISION**

Appeal No. 17-578

Account No. #####

Tax Type: Income Tax

Tax Year: 2013

Judge: Marshall

Presiding:

Michael J. Cragun, Commissioner

Jan Marshall, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE FOR TAXPAYER, *Pro Se*

For Respondent: RESPONDANT 1, Income Tax Audit Manager

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on DATE, 2020, in accordance with Utah Code Ann. §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Taxpayer filed a federal return for the 2013 tax year with a filing status of single, claiming two dependents, and reporting adjusted gross income of \$\$\$\$\$. The Taxpayer filed an amended federal return for the 2013 tax year, correcting his adjusted gross income to \$\$\$\$\$. (Exhibit R-1, p. 27).
2. The Taxpayer filed a Utah resident individual income tax return with a filing status of single, claiming two dependents, and reporting federal adjusted gross income of \$\$\$\$\$. (Exhibit R-1, p.31).

3. On DATE, 2017, the Respondent (“Division”) issued a Notice of Deficiency and Audit Change for the 2013 tax year to the Petitioner (“Taxpayer”). The Division assessed audit tax of \$\$\$\$\$, and interest of \$\$\$\$\$ through DATE, 2017.¹ (Exhibit R-1, p. 1).
4. The Division’s DATE, 2017 Notice of Deficiency increased the Taxpayer’s federal adjusted gross income from \$\$\$\$\$ to \$\$\$\$\$ for the 2013 tax year. (Exhibit R-1, p.1).
5. Petitioner (“Taxpayer”) timely appealed the Respondent’s individual income tax audit for the 2013 tax year. (Pleadings).
6. The Division issued an amended Notice of Deficiency and Audit Change for the 2013 tax year on DATE, 2018. The Division reduced the Taxpayer’s federal adjusted gross income from \$\$\$\$\$ to \$\$\$\$\$. The amended Notice of Deficiency assessed amended audit tax of \$\$\$\$\$, and interest of \$\$\$\$\$ through DATE, 2018.² (Exhibit R-1, p. 5).
7. The Division’s representative stated the Division believes the IRS rejected the Taxpayer’s amended federal return. He noted that the IRS Account Transcript shows that in DATE of 2016 the IRS was conducting a review of unreported income. It then shows that an amended return was filed in DATE of 2015, and in DATE of 2016, additional tax assessed of \$\$\$\$\$. The Division’s representative stated that there is no indication of what the additional income was that the IRS was auditing. He noted that the IRS Account Transcript reports \$\$\$\$\$ of federal adjusted gross income, which the Taxpayer is not disputing. Rather, the Taxpayer is disputing the increase of federal adjusted gross income from \$\$\$\$\$ to \$\$\$\$\$. (Exhibit R-1, p. 9).
8. The IRS Record of Account for the 2013 tax year indicates that no pension or IRA distributions were reported on the Taxpayer’s federal return. (Exhibit R-1, p. 13).
9. The Taxpayer’s 2013 IRS Wage and Income Transcript includes four different 1099-R distributions. Each of the 1099-R forms was issued by BANK and were in the amounts of \$\$\$\$\$, \$\$\$\$\$, \$\$\$\$\$, and \$\$\$\$\$, totaling \$\$\$\$\$. (Exhibit R-1, pp. 23-26).
10. The Division’s representative explained that in its original audit, the Division had included all four of the 1099-R distributions in its adjustment to the Taxpayer’s federal adjusted gross income. However, the \$\$\$\$\$ and \$\$\$\$\$ distributions are coded “B,” which is a designated Roth account distribution. The Division’s amended audit notice removed the \$\$\$\$\$ and \$\$\$\$\$ 1099-R distributions from the Taxpayer’s federal adjusted gross income.
11. The distributions appear to be attributable to the repayment of loans the Taxpayer had borrowed from various retirement accounts. ADMINISTRATION (“ADMINISTRATION”) issued two letters to the Taxpayer on DATE, 2013. Each letter indicates that the Taxpayer had ended his

¹ Interest continues to accrue on any unpaid balance.

² Interest continues to accrue on any unpaid balance.

employment and did not pay off his loan(s) within 60 days, resulting in the default of his loan. The first letter indicated that outstanding loan principal and accrued interest of \$\$\$\$ was distributed to the Taxpayer as a taxable event. The second letter indicated that outstanding loan principal and accrued interest of \$\$\$\$ was distributed to the Taxpayer as a taxable event. (Exhibit R-1, pp. 26-37).

12. The Division's representative stated that the two distribution amounts from ADMINISTRATION total \$\$\$\$\$, which is \$\$\$\$\$ higher than the total of the four 1099-R forms issued by BANK. He believes this is attributable to differences in rounding.
13. The Taxpayer's ex-wife was awarded the Taxpayer's ADMINISTRATION account pursuant to the Decree of Divorce. (Exhibit P-1).
14. A Qualified Domestic Relations Order ("QDRO") was issued by the Court on DATE, 2012.
15. The ADMINISTRATION QDRO processing statement shows that \$\$\$\$\$ was distributed to the Taxpayer's ex-wife. (Exhibit R-1, p.53).
16. Paragraph (8)(b) of the QDRO indicates that the Taxpayer's "Thrift Plan" (which is also referred to as the 401(k)) is payable to the Taxpayer's ex-wife. Specifically, it provides (EXHIBIT R-1, pp. 55-59):

The PARTICIPANT'S³ THRIFT PLAN benefit payable to the ALTERNATE PAYEE under this QDRO is #####%. ALTERNATE PAYEE is entitled to receive all benefits and rights under said Thrift Plan and PARTICIPANT relinquishes all benefits to and in favor of ALTERNATE PAYEE. ALTERNATE PAYEE is not responsible for any obligation that may be owed to the Plan.

17. The Taxpayer's ADMINISTRATION Account Statement for the period of DATE, 2013 through DATE, 2013 shows a beginning balance of \$\$\$\$\$, a QDRO fee of \$\$\$\$\$, a QDRO distribution of \$\$\$\$\$, and distributions/withdrawals of \$\$\$\$\$. The Division's representative noted that the \$\$\$\$\$ distribution amount matches the amount in the ADMINISTRATION letter that was being reported to the IRS as taxable. (Exhibit R-1, p. 38).
18. The Taxpayer stated that he agrees with the Division that the source of the amount in question was attributable to the 401(k) loan being repaid, and the remainder of the 401(k) being distributed to his ex-wife.
19. The Taxpayer explained that he and his ex-wife borrowed from his 401(k) to make improvements to their house. He stated that each pay period a certain amount would go toward the repayment of the loan. The Taxpayer stated that as a result of the divorce, he was terminated from his EMPLOYMENT. Because he was no longer employed, the repayment of the loan stopped. The Taxpayer stated that the 401(k) was awarded to his ex-wife as part of the divorce proceedings,

³ The QDRO identifies the Petitioner as the "PARTICIPANT" and his ex-wife as the "ALTERNATE PAYEE."

and that she chose to cash it out. He argued that he did not benefit from the 401(k) loan, and believes it is fundamentally unfair that his ex-wife has not been taxed.

20. The Taxpayer stated that he does not have the background to argue the legal aspects of this case. However, the Taxpayer noted that the IRS did launch an investigation, and made no increase to his adjusted gross income. He stated that the IRS did not impute the income from the distributions to him. The Taxpayer stated that when he received the IRS audit, he sent the IRS a copy of the Decree of Divorce, and they determined that no additional tax was owed.
21. The Taxpayer argued that under the Decree of Divorce, his ex-wife is required to pay “[a]ny and all taxes and penalties duly assessed and due and owing because of the liquidation of said 401K [sic].…” The Taxpayer argued that “any and all” does not leave anything for interpretation, and that he believes his ex-wife should be responsible for at least half of the tax liability, as she was the one who actually benefitted from the loan.
22. The Taxpayer stated that the process has been fundamentally unfair, and that he was confused throughout the process. He stated that when he first received the Division’s audit notice, he was unable to discern the source of the income. The Taxpayer explained that he met with RESPONDANT 2⁴ in prior phone conferences, who indicated that the increase in adjusted gross income was attributable to a 401(k) distribution. He stated that Judge Chapman, who presided over the Initial Hearing in this matter, had ordered RESPONDANT 2 to provide documentation supporting the Division’s increase to the Taxpayer’s adjusted gross income. The Taxpayer stated that it was not until the Initial Hearing, when RESPONDANT 1 became involved in the case, that he received an explanation and/or documentation that the increase in federal adjusted gross income was attributable to the repayment of the 401(k) loan.
23. The Division’s representative stated that he reviewed the Division’s file, and it appears that RESPONDANT 2 just forgot to send the information to the Taxpayer. He stated that he does not know why the information was not sent, and acknowledges the file indicates the Taxpayer asked for supporting information several times.
24. The Taxpayer argued it is unfair that he should have to comply with the Commission’s orders, when the Division failed to comply with Judge Chapman’s order to provide him with information.
25. The Taxpayer stated that he never intended to not pay his tax liability to the State of Utah. He stated that he is asking for understanding, and hoping to move forward after having this process last several years. He stated that he is trying to get back on his feet, and has had a lot of financial

⁴ RESPONDANT 2 previously worked for the Division as an Income Tax Audit Manager. Upon his retirement, RESPONDANT 1 filled his position.

struggles and challenges the last few years. The Taxpayer stated that right now, he is supporting # children, # of whom are attending COLLEGE. He noted that he provides the support for his stepchildren, noting that his current wife is owed a significant sum of child support by her ex-husband.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2013)⁵ 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...
 - (f) “Federal taxable income”:
 - (i) for a resident or nonresident individual, means taxable income as defined by Section 63, 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...

For tax year 2013 and all years since, Utah Code Ann. §59-1-1406(1) has provided that the Tax Commission can inspect a person’s books and records in regards to their tax liability, as follows:

- (1) A person subject to a tax, fee, or charge shall:
 - (a) keep in a form prescribed by the commission books and records that are necessary to determine the amount of a tax, fee, or charge the person owes;
 - (b) keep books and records described in Subsection (1)(a) for the time period during which an assessment may be made under Section 59-1-1408; and
 - (c) open the person's books and records for examination at any time by:
 - (i) the commission; or
 - (ii) an agent or representative the commission designates.

For tax year 2013 and all years since, Utah Admin. Rule R865-9I-18 (“Rule 18”) provides that a taxpayer will keep income tax records and make them available to the Tax Commission, as follows:

- (1) Every taxpayer shall keep adequate records for income tax purposes of a type which clearly reflect income and expense, gain or loss, and all transactions necessary in the conduct of business activities.
- (2) Records of all transactions affecting income or expense, or gain or loss, and of all transactions for which deductions may be claimed, should be preserved by the taxpayer to enable preparation of returns correctly and to substantiate claims. All records shall be made available to an authorized agent of the commission when requested, for review or audit.

⁵ The 2013 version of the substantive law is cited in the decision, unless otherwise indicated.

The Commission has been granted the discretion to waive penalties and interest. Utah Code Ann. §59-1-401(14) 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 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.

Utah Code Ann. §59-1-1417(1) (2020) provides guidance concerning which party has the burden of proof, as follows:

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

CONCLUSIONS OF LAW

- A. The Taxpayer has the burden of proof in this matter, pursuant to Utah Code Ann. §59-1-1417(1).
- B. The Commission is not limited by the federal adjusted gross income reported on IRS transcripts. The Commission has previously been willing to make an independent determination regarding an individual’s federal taxable income, under certain circumstances. As noted in appeal No. 06-1408⁶,

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

⁶ Prior Commission decisions are available online at tax.utah.gov/commission-office/decisions.

In this case, the Division has identified 401(k) distributions in the amounts of \$\$\$\$ and \$\$\$\$ that it believes are taxable. The Taxpayer has indicated that he agrees with the Division that the source of the additional income is attributable to the repayment of loans he had borrowed against the 401(k) plan through his employer. The Taxpayer argued that the IRS made no increase to his adjusted gross income after completing its review. However, the Taxpayer did not provide any documentation from the IRS explaining what its review included, or any specific finding regarding the 401(k) distributions. Administrative Rule R865-9I-18 requires a taxpayer to make records concerning income, expenses, and deductions available to an authorized agent of the Tax Commission upon request. Thus, the Division can review and, if necessary, make changes, for state tax purposes, to an item that appears on an individual's federal or Utah individual income tax returns. Thus, the Commission concludes, it should make an independent determination of whether the \$\$\$\$ and \$\$\$\$ distributions are includable in the Taxpayer's adjusted gross income for the 2013 tax year for state tax purposes.

- C. The Taxpayer has not shown that the \$\$\$\$ and \$\$\$\$ distributions were not taxable to him. The Taxpayer argued that his ex-wife was responsible for any taxes attributable to distributions made from his 401(k) account. He provided a copy of the Decree of Divorce, and specifically noted that in Paragraph 14, which awards the 401(k) plan to his ex-wife, that she is responsible for "any and all taxes and penalties." Paragraph 14 specifically provides, "[the Taxpayer's ex-wife] shall withdraw from said 401K an amount sufficient to pay herself the sum of \$\$\$\$ plus any and all taxes and penalties duly assessed and due and owing because of the liquidation of said 401K and then apply any remaining balance on the consumer debt referenced in paragraph 12 above." Paragraph 12 of the Decree of Divorce identifies credit card debt, and additional consumer loans with CREDIT UNION and BUSINESS. There is no indication that the loans borrowed from the Taxpayer's 401(k) were intended to be included in the referenced "consumer debt."

The Court issued a QDRO in the divorce proceeding. Paragraph 8(b) of the QDRO addresses the distribution of the 401(k) to the Taxpayer's ex-wife, specifically providing:

The PARTICIPANT'S⁷ THRIFT PLAN benefit payable to the ALTERNATE PAYEE under this QDRO is #####%. ALTERNATE PAYEE is entitled to receive all benefits and rights under said Thrift Plan and PARTICIPANT relinquishes all benefits to and in favor of ALTERNATE PAYEE. ALTERNATE PAYEE is not responsible for any obligation that may be owed to the Plan.

It appears that the Taxpayer's ex-wife is not responsible for the repayment of the loans that the Taxpayer had borrowed from his 401(k). Further, paragraph 16 of the QDRO provides that the

⁷ The QDRO identifies the Petitioner as the "PARTICIPANT" and his ex-wife as the "ALTERNATE PAYEE."

Taxpayer's ex-wife "[a]ssumes sole responsibility for the tax consequences of the distributions to her under this QDRO..." The distribution to the Taxpayer's ex-wife was \$\$\$\$\$, which appears to be the remaining balance in the account after the loans were repaid. As the Taxpayer's ex-wife did not receive the distribution of the amounts used to pay off the loans, she is not responsible for the tax liability associated with the repayment of the loans. As noted previously, the Taxpayer has the burden of proof in this matter. He has not shown any evidence that the IRS has reviewed both the Divorce Decree and the QDRO and determined that the Taxpayer is not responsible for tax liability on the \$\$\$\$\$ and \$\$\$\$\$ distributions.

- D. Some of the assessed interest should be waived due to inappropriate action on the part of the tax commission. Utah Code Ann. §59-1-401(14) grants the Commission discretion to waive penalties and interest, upon reasonable cause shown. The Commission has promulgated Administrative Rule R861-1A-42 to provide additional guidance on the waiver of penalties and interest. Subsection (2) of Rule 42 specifically provides, "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." In this case, the Taxpayer testified that he had requested information from the Division, and that the Administrative Law Judge assigned to the Initial Hearing had ordered the Division to provide that information to the Taxpayer. However, the Division failed to provide that information to the Taxpayer. The Taxpayer stated that it was not until the initial hearing, held DATE 2019, that the Division provided the requested information. The Division's representative confirmed that the Division's file does indicate the Taxpayer had requested the information, and he did not know why the prior audit manager failed to provide it to the Taxpayer. The Commission finds that there was inappropriate action on the part of the tax commission that contributed to the accrual of interest in this matter. The interest that has accrued from the date the Taxpayer filed his Petition for Redetermination, DATE, 2017, through thirty days from the date of the issuance of this order shall be waived. Interest assessed from the due date of the return to the date the Petition for Redetermination was filed, and any interest that may accrue after 30 days from the issuance of this order is sustained.



Jan Marshall

Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's assessment of tax on the DATE, 2018 Notice of Deficiency, as well as the interest accrued from the due date of the return through DATE, 2017. The Commission waives the interest accrued from DATE, 2017 through 30 days from the issuance of this Order.

DATED this _____ day of _____, 2020.



John L. Valentine
Commission Chair



Michael J. Cragun



Commissioner



Rebecca L. Rockwell
Commissioner

Lawrence C. Walters
Commissioner

Notice of Appeal Rights and 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 assessed. You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §59-1-601 et seq. and §63G-4-401 et seq.