

TAX TYPE: INCOME TAX
TAX YEAR: 2002, 2003, 2004, 2005
DATE SIGNED: 11/20/2019
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL, L. WALTERS

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER 1 AND TAXPAYER 2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.</p>	<p style="text-align: center;">INITIAL HEARING ORDER</p> <p>Appeal No. 18-1945</p> <p>Account No. #####</p> <p>Tax Type: Income Tax</p> <p>Tax Years: 2002, 2003, 2004 and 2005</p> <p>Judge: Phan</p>
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Presiding:
Jane Phan, Administrative Law Judge

Appearances:
For Petitioners: REPRESENTATIVE FOR TAXPAYERS, Attorney at Law
TAXPAYER 1
For Respondent: RESPONDENT, Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on DATE, 2019 for an Initial Hearing in accordance with Utah Code Ann. §59-1-502.5. Petitioners (“Taxpayers”) had filed an appeal of Utah individual income tax audit deficiencies for tax years 2002 through 2005, which included a deficiency of tax and the interest accrued thereon for each of the tax years. No penalties were assessed with the audits. The Notices of Deficiency and Audit Change were issued on DATE, 2018. The Taxpayers filed their appeal of the Notices of Deficiency to contest the interest. The Taxpayers paid the amount of the tax as shown on each of the audit Notices of Deficiency on DATE, 2019. At the hearing, the Taxpayers indicated they did not dispute the tax and were only asking for reduction of the interest. The amount of the interest as of the date the Notices of Deficiency¹ were issued, were as follows:

	Interest per Audit Notices of Deficiency
2002	\$\$\$\$\$
2003	\$\$\$\$\$

¹ Additional interest has accrued in this matter after the Notices of Deficiency were issued.

2004 \$\$\$\$\$
2005 \$\$\$\$\$

APPLICABLE LAW

Interest is assessed on an audit deficiency pursuant to Utah Code §49-1-402 as follows in relevant part:

(6) Interest on any underpayment, deficiency, or delinquency of a tax, fee, or charge shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.

Utah Code Ann. § 59-10-536(2) addresses the requirement to file an amended state income tax return when a change is made in net income because of an action by the federal government as follows:

- (2)(a)(i) Except as provided in Subsection (2)(a)(iii), if a change is made in a taxpayer’s net income on the taxpayer’s federal income tax return because of an action by the federal government, the taxpayer shall file with the commission within 90 days after the date there is a final determination of the action:
 - (A) a copy of the taxpayer’s amended federal income tax return; and
 - (B) an amended state income tax return that conforms with the changes made in the taxpayer’s amended federal income tax return...

The Commission has discretion to waive penalties and interest pursuant to Utah Code §59-1-401(14), which 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 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 §59-1-1417 provides, “[i]n a proceeding before the commission, the burden of proof is on the petitioner...”

DISCUSSION

The Taxpayer and his representative explained at the hearing that the Taxpayers had filed their federal and Utah individual income tax returns timely within the filing extension period for each of the audit years as the returns were due and paid the tax indicated on the returns. In 2006 the IRS began to investigate the Taxpayers’ 2002 through 2005 federal returns. The IRS was not able to complete their investigation within its normal limitations period and on DATE, 2009,

submitted to Petitioners a Form 872-I to sign to extend the limitations period. The Taxpayers signed the form which allowed an extended deadline for the IRS to issue its audit. In fact, the Taxpayers signed additional agreements to extend the limitations period on DATE, 2010, and again on DATE, 2011. The Taxpayers did provide copies of each of these Form 872-I extensions. The representative for the Taxpayers represented at the hearing that the IRS audit concluded on DATE, 2017, when the parties executed a Closing Agreement on Final Determination Covering Specific Matters and a copy of this Closing Agreement was provided.

It was the Taxpayers' request that the state of Utah suspend the interest for the same period that the IRS had been required to suspend interest due to the length of time it took to complete its investigation. The Taxpayers provided a Memorandum dated DATE, 2018 from attorney REPRESENTATIVE FOR TAXPAYERS, in which he detailed the IRS' interest suspension for tax years 2002 and 2003. REPRESENTATIVE FOR TAXPAYERS explained under IRC. Sec. 6404(g) in effect for tax years 2002 and 2003, taxpayers were entitled to a suspension of interest when the IRS did not timely provide notice of the taxpayers' liability after the taxpayers filed a return. He indicated that for tax years 2002 and 2003, because of the length of time and that the Taxpayers executed the Forms 872-I, under IRC Sec. 6404, the IRS could not issue interest or penalty during the time period in which the IRS was conducting its investigation. He states the federal law had changed for tax years 2004 and 2005 so there was no interest suspension by IRS for those years. In his letter REPRESENTATIVE FOR TAXPAYERS indicated that the IRS suspended interest under Section 6404(g) for the Taxpayers for tax years 2002 and 2003 for the periods from 18 months after the Taxpayers sent in their tax returns through 21 days after the summary reports of the audit were sent by the IRS. He went on to say that for tax year 2002 the Taxpayers mailed their federal tax return on DATE, 2003, and the IRS report was sent on DATE, 2010. For tax year 2003 the Taxpayers mailed their return on DATE, 2004, and the IRS report was sent on DATE, 2010.

Using these parameters set out by REPRESENTATIVE FOR TAXPAYERS it appears the IRS would have suspended interest for tax year 2002 from DATE, 2005 to DATE, 2010. For Tax year 2003 the interest suspension would have been from DATE, 2006 to DATE, 2011.

The Taxpayers did appeal the federal audits for all four tax years; the matter proceeded to Federal Tax Court and was finally resolved in DATE 2017 with the Closing Agreement which was signed by the Taxpayers and a representative for the IRS.

The result of the settlement with the IRS was that the IRS had increased the Taxpayers' federal adjusted gross income substantially for each year. The Utah audit deficiencies increased the Taxpayers' federal adjusted gross income for each year based on the Federal changes and this

increased the Utah individual income tax due for each year. The amount of federal adjusted gross income the Taxpayers had originally claimed on their Utah returns and the amount this was raised to in the Utah audit, as provided in the Notices of Deficiency, plus the Utah audit tax amount due resulting from the audit changes were the following:

Year	FAGI Claimed On Taxpayers' Original Return	FAGI after Utah Audit	Utah Audit Tax
2002	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2003	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2004	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2005	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

At the hearing the Taxpayers' representative also pointed out that the Taxpayers had filed original state returns timely and they did not have the final amount from the IRS to know what they would owe Utah until the final Closing Agreement on DATE, 2017. He argued that until they had the final amounts from the IRS there was no additional state tax liability owed and until the IRS audit was resolved, the additional state tax amount resulting from the audit could not be computed. It was his representation that even if the Taxpayers had tried to make some prepayment to Utah it would have been refunded back to the Taxpayers because there was no additional Utah tax due on their account until after the federal audit was concluded. The Taxpayers did pay the Utah audit deficiency tax amounts on DATE, 2019.

The Taxpayers' representative points out that Utah Code §59-1-401(14) provides that the Tax Commission may waive interest “[u]pon making a record of its actions, and upon reasonable cause shown.” He argued that there was reasonable cause shown to reduce the interest in this matter because of the length of time it took the IRS to finish its audit, which caused the accrual of interest and the fact that under federal law a portion of the interest was suspended. He acknowledges that Administrative Rule R861-1A-42(2) limited reasonable cause for waiver of interest to Tax Commission error, but argued the rule was more stringent than the statutory provision.

It was the Division's position in this matter that there was no basis for waiver of interest because, based on Administrative Rule R861-1A-42(2), interest may be waived only upon a showing of Tax Commission error. There was no such showing in this appeal.

After reviewing the facts presented and the applicable law in this matter, it is apparent that the IRS took a long period of time to audit the Taxpayers' federal filings, but as a result of that audit, when it was finally concluded, the IRS found the Taxpayers had substantially underreported

their federal adjusted gross income and, therefore, their federal tax liability. Because their federal adjusted gross income flows through to their Utah return, their Utah tax was substantially underreported and underpaid on their original Utah returns as well. This means that the State of Utah was deprived the time value of money from the time this tax was due, which was DATE of the year following each tax year, until it was actually paid in DATE 2019. Utah law makes it clear that interest is assessed on an audit deficiency “from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.” See Utah Code §59-1-402. If the IRS makes a change to a taxpayer’s federal adjusted gross income that would result in increased state tax, a Taxpayer is required to file an “amended state return” under Utah Code Ann. § 59-10-536(2). These provisions make it clear, in situations where the IRS makes a change that affects the Utah tax liability, interest is assessed back to the due date of the original Utah return and not the date of the IRS change. This is how the Division has assessed the interest in this matter.

Although the Tax Commission does have discretion to waive interest under Utah Code Sec. 59-1-401(14) upon a showing of reasonable cause, the Commission has adopted Utah Admin. Rule R861-1A-42(2) as to what would constitute reasonable cause for waiver of interest. As set out at Subsection R861-1A-42(2) “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.” Interest is assessed to compensate the state for the time value of money. The Taxpayers retained the time value of money for all of the lengthy audit period. The Tax Commission has applied its rule limiting waiver of interest to situations where it was shown to be a Tax Commission error except that the Tax Commission has on occasion extended a waiver of interest to situations where it was the IRS and not the Tax Commission that had made an error. See *Utah State Tax Commission Initial Hearing Orders, Appeal No. 18-2067 (5/6/2019)* and *Appeal No. 11-2852 (3/7/2012)*.² The Tax Commission has also in prior decisions concluded the Tax Commission’s failure to issue a decision within a reasonable period of time to be an error for purposes of interest waiver. See *Utah State Tax Commission Initial Hearing Order, Appeal No. 16-1429 (8/8/18)*. In the present case the IRS did take a long time to complete its investigation, so long in fact that it would have been outside the IRS’s limitations period except for the fact that the IRS asked the Taxpayers to extend the deadline and the Taxpayers agreed to this extension. Because the IRS would otherwise have been outside its limitations period, for tax years 2002 and 2003 the IRS was required to suspend interest for the period of time set out in REPRESENTATIVE FOR TAXPAYERS memo. For the Tax Commission to impose interest for the lengthy time period

² This and other Tax Commission decisions are available in a redacted format at tax.utah.gov/commission-office/decisions.

that it took the IRS to complete its review when the IRS was required to waive interest because the Taxpayers were amenable to the extension, would constitute error on the part of the Tax Commission. This is reasonable cause for applying a suspension of the interest for the same period as had been done by the IRS for tax years 2002 and 2003, due to the fact that the State of Utah was following the federal audit in this matter. There was no suspension of interest for the two later audit years by the IRS, and therefore there is not the same reasonable cause for those years. The Taxpayers' representative at this hearing was arguing for a more broad interpretation of the suspended interest period but the best information on the period for which the interest was actually suspended by the IRS appears to be that contained in REPRESENTATIVE FOR TAXPAYERS memorandum. Therefore, for tax year 2002 the interest should be suspended for the period from DATE, 2005 to DATE, 2010, and be upheld for the rest of the period from when the tax was due DATE, 2003, until paid. For tax year 2003 the interest should be suspended for the period from DATE, 2006 to DATE, 2011, and upheld for the rest of the period from when the tax was due DATE, 2004, until when it was paid. The interest for tax years 2004 and 2005 should be upheld.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Tax Commission finds there is reasonable cause for waiver of a portion of the interest for tax years 2002 and 2003 for the period of time subject to the IRS interest suspension as noted above, with the remainder of the interest upheld for both of those tax years. There was not sufficient reasonable cause for waiver of any portion of the interest for tax years 2004 and 2005. 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

Appeal No. 18-1945

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2019.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Rebecca L. Rockwell
Commissioner

Lawrence C. Walters
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.