20-1491
TAX TYPE: INCOME TAX
TAX YEAR: 2017, 2018 and 2019
DATE SIGNED: 9/13/2021
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL
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. 20-1491 Account No. #### Tax Type: Income Tax Tax Year: 2017, 2018 and 2019 Judge: Nielson-Larios

Presiding:
Aimee Nielson-Larios, Administrative Law Judge

Appearances:
For Petitioner: TAXPAYER

For Respondent: REPRESENTATIVE FOR RESPONDENT, Utah Assistant Attorney General
RESPONDENT, Auditing Division

I. STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on May 24, 2021, for an Initial Hearing in accordance with Utah Code Ann. § 59-1-502.5. On June 29, 2019, Respondent ("Division") issued Notices of Deficiency and Audit Change ("Notice(s) of Deficiency") for the 2017, 2018, and 2019 tax years.

For the **2017** tax year, Petitioner ("Taxpayer") had reported 0 exemptions, $0 of federal adjusted gross income, $0 for standard or itemized deductions, and $0 for a personal exemptions deduction. The Division revised those numbers to 1 exemption, $$$$$ of federal adjusted gross income, $$$$$ for standard or itemized deductions, and $$$$$ for a personal exemptions deduction. The 2017 Notice of Deficiency showed the audit tax, interest, penalty, and total amounts provided in the table below, and during the hearing, the Auditing Division provided the amount of the withholding paid but not yet applied, listed in the table below.

Tax Year	Audit Tax	Interest	59-1-401(7)(a)(iv)[1] Penalty	Total	Withholding Paid, Not Yet Applied
2017	$$$$$	$$$$$	$$$$$	$$$$$	$0

For the 2017 tax year, the Taxpayer had no Utah withholding.

For the **2018** tax year, the Taxpayer had reported $0 of federal adjusted gross income and $0 for standard or itemized deductions. The Division revised those 2018 numbers to $$$$$ of federal adjusted gross income and $$$$$ for standard or itemized deductions. The 2018 Notice of Deficiency showed the audit tax, interest, penalty, and total amounts provided in the table below, and during the hearing, the Auditing Division provided the amount of the withholding paid but not yet applied, listed in the table below.

Tax Year	Audit Tax	Interest	59-1-401(7)(a)(iv) Penalty	Total	Withholding Paid, Not Yet Applied
2018	$$$$$	$$$$$	$$$$$	$$$$$	$$$$$

For the 2018 tax year, the Taxpayer had Utah withholding of $$$$$.00, all of which has not been applied.

For the **2019** tax year, the Taxpayer had reported $0 of federal adjusted gross income and $0 for standard or itemized deductions. The Division revised those 2019 numbers to $$$$$ of federal adjusted gross income and $$$$$ for standard or itemized deductions. The 2019 Notice of Deficiency showed the audit tax, interest, penalty, and total amounts provided in the table below, and during the hearing, the Auditing Division provided the amount of the withholding paid but not yet applied, listed in the table below.

Tax Year	Audit Tax	Interest	59-1-401(7)(a)(iv) Penalty	Total	Withholding Paid, Not Yet Applied
2019	$$$$$	$$$$$	$$$$$	$$$$$	$$$$$

For the 2019 tax year, the Taxpayer had Utah withholding totaling $$$$$, of which $$$$$ was refunded, leaving $$$$$ of withholding that was retained by the Tax Commission and not yet applied.

Audit interest for the 2017, 2018, and 2019 tax years was calculated through July 29, 2020, and continues to accrue on any unpaid balance. The § 59-1-401(7)(a)(iv) penalties for the 2017, 2018, and 2019 tax years were assessed for "an underpayment . . . due to fraud with intent to evade a tax, fee, or charge" (*see* § 59-1-401(7)(a)(iv)) ("fraud penalty").

The Taxpayer disagrees with the audit assessments. She requests that the Tax Commission accept her Utah returns as filed and refund her withholding amounts of $$$$$ for 2018 and $$$$$ for 2019. The correctness of the audit tax, interest, and fraud penalties are at issue for this appeal.

[1] The Notices of Deficiency for 2017-2019 cited to "Utah Code 59-1-401 (7)(iv)."

II. APPLICABLE LAW

This Applicable Law Section includes the following subsections:

A. Assessment of tax

B. Imposition of state and federal withholding requirements on employers

C. Assessment of interest

D. Assessment of penalty

E. Burden of proof

A. Assessment of tax

For purposes of Utah income taxation for 2019, a "resident individual" is defined in Utah Code Ann. § 59-10-103(1)(q) (2019), as follows:

> "Resident individual" means an individual who is domiciled in this state for any period of time during the taxable year, but only for the duration of the period during which the individual is domiciled in this state.

For 2017 and 2018, a "resident individual" is defined in Utah Code Ann. § 59-10-103(1)(q)(i) (2017-2018), as follows:

> "Resident individual" means:
>
> (A) an individual who is domiciled in this state for any period of time during the taxable year, but only for the duration of the period during which the individual is domiciled in this state; or
> (B) an individual who is not domiciled in this state but:
> (I) maintains a place of abode in this state; and
> (II) spends in the aggregate 183 or more days of the taxable year in this state.

Utah Code Ann. § 59-10-104(1) (2017-2019) provides that "[a] **tax is imposed on the state taxable income** of a resident individual . . ." (emphasis added).

Utah Code Ann. § 59-10-103(1)(a) and (1)(w) (2017-2019) defines "adjusted gross income" and "'taxable income' or 'state taxable income,'" as follows:

> 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** . . .
> . . . .
> (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;
> . . . .

(Emphasis added.) Based on the above quoted law, "adjusted gross income" for state tax purposes "is as defined in" Internal Revenue Code ("IRC") § 62 (2017-2019).

In IRC § 62 (2017-2019), "adjusted gross income" is defined federally "in the case of an individual, [as] **gross income** minus the following deductions . . ." (emphasis added).

For 2019, "gross income" is defined in IRC § 61 (2019) as follows, in 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) Annuities;
> (9) Income from life insurance and endowment contracts;
> (10) Pensions;
> (11) Income from discharge of indebtedness;
> (12) Distributive share of partnership gross income;
> (13) Income in respect of a decedent; and
> (14) Income from an interest in an estate or trust.
> . . . .

For 2017 and 2018, "gross income" is defined in IRC § 61 (2017-2018) to specifically include "alimony and separate maintenance payments" in IRC § 61(a)(8). The words quoted for IRC § 61 (2019) otherwise match those of IRC § 61 (2017-2018).

B. Imposition of state and federal withholding requirements on employers

Utah Code Ann. § 59-10-402 (2017-2019) provides withholding requirements for state income tax purposes, as follows in part:

> (1) Each employer making payment of wages shall deduct and withhold from wages an amount to be determined by a commission rule which will, as closely as possible, pay the income tax imposed by this chapter.
> . . . .
> (3) The amount withheld under this section shall be allowed to the recipient of the income as a credit against the tax imposed by this chapter. . . .

Utah Code Ann. § 59-10-401 (2017-2019) provides definitions for purposes of § 59-10-402, as follows:

> For purposes of this part:
>
> (1) "Employee" means and includes every individual performing services for an employer, either within or without, or both within or without the state of Utah, or any individual performing services within the state of Utah, the performance of which services constitutes, establishes, and determines the relationship between the parties as that of employer and employee, and includes offices of corporations, individuals, including elected officials, performing services for the United States Government or any agency or instrumentality thereof, or the state of Utah or any county, city, municipality, or political subdivision thereof.
> (2) "Employer" means a person or organization transacting business in or deriving any income from sources within the state of Utah for whom an individual performs or performed any services, of whatever nature, and who has control of the payment of wages for such services, or is the officer, agent, or employee of the person or organization having control of the payment of wages. It includes any officer or department of state or federal government, or any political subdivision or agency of the federal or state government, or any city organized under a charter, or any political body not a subdivision or agency of the state.
> (3) "Wages" means wages as defined in Section 3401 of the Internal Revenue Code.

IRC § 3402 (2017-2019) provides withholding requirements for federal income tax purposes, as follows in pertinent part:

> (a) Requirement of withholding.
> (1) In general. Except as otherwise provided in this section, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. . . .

IRC § 3401 (2017-2019) provides definitions for purposes of Title 26, Chapter 24 of the U.S. Code, as follows in part:[2]

> (a) Wages. For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer. . . ; except that such term shall not include remuneration paid—
> (8) (A) for services for an employer (other than the United States or any agency thereof)—
> (i) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911, or
> (ii) performed in a foreign country or in a possession of the United States by such a citizen if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or

[2] IRC § 3401(a)(8)(A) is included in this Applicable Law Section because the Taxpayer prepared a 2017 Form 4852 claiming wages from her employer were $0 because the employer was "an employer other than the United States and the wages are excluded . . . under IRC code section 3401(a)(8)(A)."

> possession of the United States to withhold income tax upon such remuneration,...
>
> . . . .
>
> (c) Employee. For purposes of this chapter, the term "employee" includes an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing. The term "employee" also includes an officer of a corporation.
>
> (d) Employer. For purposes of this chapter, the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that--
>
> (1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of subsection (a)) means the person having control of the payment of such wages, and
>
> (2) in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for purposes of subsection (a)) means such person.
>
> . . . .

IRC § 3401(a)(8)(A)(i), quoted above, references IRC § 911. IRC § 911 (2017-2019) is titled "Citizens or residents of the United States living abroad" and states the following in part:

> (a) Exclusion from gross income
>
> At the election of a qualified individual (made separately with respect to paragraphs (1) and (2)), there shall be excluded from the gross income of such individual, and exempt from taxation under this subtitle, for any taxable year—
>
> (1) the foreign earned income of such individual, and
>
> (2) the housing cost amount of such individual.

26 CFR § 31.3401(c)-1 (2017-2019) (last amended by Treasury Decision 7068, 35 Federal Register 17329, Nov. 11, 1970) further clarifies the meaning of "employee," which is defined in IRC § 3401(c) quoted previously in this order. 26 CFR § 31.3401(c)-1 (2017-2019) states the following in part:

> (a) **The term employee includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee.** The term includes officers and employees, whether elected or appointed, of the United States, a State, Territory, Puerto Rico, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing.
>
> (b) Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the

> employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is not an employee.
>
> . . . .

(Emphasis added.)

IRC § 7701(c) (2017-present) provides that "[t]he terms 'includes' and 'including' when used in a definition contained in this title [Title 26 of the U.S. Code] shall **not** be deemed to exclude other things otherwise within the meaning of the term defined" (emphasis added).

C. Assessment of interest

Utah Code Ann. § 59-10-537(1)(a) provides that "[s]ubject to the other provisions of this section, if any amount of income tax is not paid on or before the last date prescribed in this chapter for payment, interest on the amount at the rate and in the manner prescribed in Section 59-1-402 shall be paid."

Utah Code Ann. § 59-1-402(6) (2017–present) provides that "[i]nterest 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."

D. Assessment of penalty

Utah Code Ann. § 59-1-401(7)(a) and (9) (2017-current) provide for certain penalties, as follows:

> (7) (a) Additional penalties for an underpayment of a tax, fee, or charge are as provided in this Subsection (7)(a).
>
> (i) Except as provided in Subsection (7)(c), if any portion of an underpayment of a tax, fee, or charge is due to negligence, the penalty is 10% of the portion of the underpayment that is due to negligence.
>
> (ii) Except as provided in Subsection (7)(d), if any portion of an underpayment of a tax, fee, or charge is due to intentional disregard of law or rule, the penalty is 15% of the entire underpayment.
>
> (iii) If any portion of an underpayment is due to an intent to evade a tax, fee, or charge, the penalty is the greater of $$$$$per period or 50% of the entire underpayment.
>
> (iv) If any portion of an underpayment is due to fraud with intent to evade a tax, fee, or charge, the penalty is the greater of $$$$$per period or 100% of the entire underpayment.
>
> . . . .
>
> (9) If a person, in furtherance of a frivolous position, has a prima facie intent to delay or impede administration of a law relating to a tax, fee, or charge and files a purported return that fails to contain information from which the correctness of reported tax,

> fee, or charge liability can be determined or that clearly indicates that the tax, fee, or charge liability shown is substantially incorrect, the penalty is $$$$$.
>
> . . . .

E. Burden of proof

For the instant matter, Utah Code Ann. § 59-1-1417(1) provides the burden of proof, as follows:

> 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.

III. DISCUSSION

This Discussion Section includes the following subsections:

A. Facts

B. Taxpayer's arguments

C. Division's arguments

D. The audit tax and interest should be sustained.

E. Fraud Penalty

A. Facts

The Taxpayer signed a 2017 federal tax return on April 16, 2018. The 2017 federal return included $0 of federal adjusted gross income, claimed withholding of $$$$$, and requested a refund of $$$$$. The Taxpayer prepared and signed on April 16, 2018, a 2017 Form 4852 showing the Taxpayer "corrected" her wages from SCAM CREDIT CHARGE("SCAM CREDIT CHARGE")[3] to be $0, with the Taxpayer explaining on that form that the employer was "an employer other than the United States and the wages are excluded . . . under IRC code section 3401(a)(8)(A)." The 2017 IRS Account Transcript shows that on May 25, 2018, the IRS issued a refund of $$$$$, as the Taxpayer requested.

[3] On the 2017 Form 4852, the Taxpayer reported "SCAM CREDIT CHARGE" as "SCAM CREDIT CHARGE."

The Taxpayer filed her 2017 state tax return showing 0 exemptions, $0 of federal adjusted gross income, $0 for standard or itemized deductions, and $0 for a personal exemptions deduction. The copy of the 2017 state return the parties submitted has a signature date of April 19, 2020. Through the Notice of Deficiency dated June 29, 2020, the Division revised those numbers to 1 exemption, $$$$$ of federal adjusted gross income, $$$$$ for standard or itemized deductions, and $$$$$ for a personal exemption deduction. According to the 2017 IRS Wage and Income Transcript, SCAM CREDIT CHARGE issued to the Taxpayer a 2017 W-2 showing wages of $$$$$, which is $$$$$ different from the $$$$$ of federal adjusted gross income used in the audit assessment.

The Taxpayer signed a 2018 federal tax return on February 10, 2019. The federal return included $0 of federal adjusted gross income, claimed withholding of $$$$$, and requested a refund of $$$$$. The Taxpayer prepared and signed on February 10, 2019, two 2018 Form 4852 documents showing the Taxpayer "corrected" her wages from SCAM CREDIT CHARGE to be $0 and "corrected" her wages from BUSINESS-1 ("BUSINESS-1") to be $0, with the Taxpayer explaining that she made her "corrections" based on "records provided by [the employers]." The 2018 IRS Account Transcript shows that on April 26, 2019, the IRS issued a refund of $$$$$, as the Taxpayer requested.

The Taxpayer filed her 2018 state tax return showing $0 of federal adjusted gross income and $0 for standard or itemized deductions. On Form TC-40W of that return, the Taxpayer reported $0 of Utah wages or income from W-2 box 16 for the income earned from BUSINESS-1.[4] The state return has a signature date of April 7, 2019. Through the Notice of Deficiency dated June 29, 2020, the Division revised the 2018 numbers reported by the Taxpayer to $$$$$ of federal adjusted gross income and $$$$$ for standard or itemized deductions. According to the 2018 IRS Wage and Income Transcript, SCAM CREDIT CHARGE issued to the Taxpayer a 2018 W-2 showing wages of $$$$$, and BUSINESS-1 issued a 2018 W-2 showing wages of $$$$$. $$$$$ plus $$$$$ equals $$$$$, which is $$$$$ different from the $$$$$ of federal adjusted gross income used in the audit assessment.

The Taxpayer signed a 2019 federal tax return on March 4, 2020. The federal return included $0 of federal adjusted gross income, claimed withholding of $$$$$, and requested a refund of $$$$$. The Taxpayer prepared and signed on March 4, 2020, three 2019 Form 4852 documents showing the Taxpayer "corrected" her wages from SCAM CREDIT CHARGE to be $0, "corrected" her wages from BUSINESS-1 to be $0, and "corrected" her wages from BUSINESS-2 (BUSINESS-2")[5] to be $0, with the Taxpayer explaining that she made her "corrections" based on "records provided by [the employers]." The 2018 IRS Account Transcript does not indicate a return filed or a federal refund issued.

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[4] For 2018, BUSINESS-1 did not withhold Utah income taxes from the Taxpayer's wages, and the Taxpayer did not report BUSINESS-1 information on the 2018 Form TC-40W.

[5] On the 2019 Form 4852, the Taxpayer used "BUSINESS-2" as the employer's name.

The Taxpayer filed her 2019 state tax return showing $0 of federal adjusted gross income and $0 for standard or itemized deductions. On Form TC-40W of that return, the Taxpayer reported $0 of Utah wages or income from W-2 box 16 for the income earned from SCAM CREDIT CHARGE and BUSINESS-1.[6] The state return has a signature date of March 4, 2020. Through the Notice of Deficiency dated June 29, 2020, the Division revised those 2019 numbers to $$$$$ of federal adjusted gross income and $$$$$ for standard or itemized deductions. According to the 2019 IRS Wage and Income Transcript, SCAM CREDIT CHARGE issued a 2019 W-2 to the Taxpayer showing wages of $$$$$; BUSINESS-1 issued a 2019 W-2 showing wages of $$$$$; and BUSINESS-2 issued a 2019 W-2 showing wages of $$$$$. $$$$$ plus $$$$$ plus $$$$$ equals $$$$$, which is $$$$$ different from the $$$$$ of federal adjusted gross income used in the audit assessment.

On or about July 30, 2020, the Taxpayer timely appealed the 2017-2019 audit assessments explaining, "Is the available information that is the cause of the audit change from a taxing authority i.e. government? I'm contesting this audit change. The relief I'm seeking is to restore my form tc40 as a return with no tax due, and to pay the claim of $$$$$ [and $$$$$]."

On October 1, 2020, the Division issued its Answer to Petition for Redetermination, explaining the following, in part:

> [T]he Internal Revenue Service (IRS) and other sources indicat[ed] that discrepancies existed in what Petitioner was reporting as FAGI on the Utah returns. [The Division] made the appropriate changes and issued Notices of Deficiency and Audit Changes for the 2017, 2018, and 2019 tax years on June 29, 2020. . . . Pursuant to Utah Code §59-1-401(7)(a)(iv), Petitioner has been assessed a 100% of tax penalty for filing a fraudulent return with the intent to evade a tax **because Petitioner filed a return with $0 income when she received taxable income**.

(Emphasis added.)

B. Taxpayer's arguments

The Taxpayer asks the Commission to answer the following questions:

1. Are her employers correct in withholding federal and state income taxes from their employees' wages?
2. If they were correct in withholding income taxes, is that obligation lawful?

The Taxpayer argued that her employers are not authorized to tax her and that Division has not shown that her employers have "taxing authority" or are "taxing authorities." She stated that her employers are not government entities and that she did not work for the government in 2017-2019. She said that her employers' W-2 forms were statements by her employers, but not by her.

[6] For 2019, BUSINESS-2 did not withhold Utah income taxes from the Taxpayer's wages, and the Taxpayer did not report BUSINESS-2 information on the 2019 Form TC-40W.

For her claim that her W-2 wages are not subject to tax, the Taxpayer said she is relying on an IRS Tax Topic, but she did not provide a copy of that Tax Topic. During the hearing, the parties and Judge discussed the IRS webpage titled "What are Government Entities and Their Federal Tax Obligations." Nothing on that webpage supports the Taxpayer's argument that her W-2 wages are not taxable because she is not a government employee.

The Taxpayer cited to § 34-28-3(1)(e), which states, "Wages shall be paid in full to an employee." Section 34-28-3 also includes Subsection (4), which states, "If a deduction is made from the wages paid, the employer shall . . . furnish the employee with a statement showing the total amount of each deduction" and Subsection (6), which states, "An employer may not withhold or divert part of an employee's wages unless: (a) the employer is required to withhold or divert the wages by: . . . (ii) state or federal law." For Subsections (4) and (6), the Taxpayer asserted that "employer" means a government entity, which is an employer who has taxing authority.

The Taxpayer received a partial refund for 2019. The Division said that was due to the Tax Commission's computer software. The Taxpayer asserted that the software was programmed that way because the programmers recognized that people in her situation do not have a tax obligation. The Taxpayer explained that the IRS has refunded her federal withholding for 2017, 2018, and 2019, and that the IRS did so because the IRS recognized that her employers were not taxing authorities so she does not owe tax based on the W-2 forms they issued. The Taxpayer characterized income tax as a public salary tax. During the Initial Hearing, she questioned why the Tax Commission does not recognize that the W-2 forms issued to her were not issued by taxing authorities.

The Taxpayer responded to the Division's arguments about the definition of employer found in § 59-10-401(2), which states in part, "'[e]mployer' means a person or organization transacting business in or deriving any income from **sources** within the state of Utah . . ." (emphasis added). The Taxpayer noted the word "sources" in the above quotation then asserted that "sources" indicates a government employer.

The Taxpayer argued that she has not evaded tax, but instead legally arranged her life to avoid incurring taxes, and that no "taxing obligation" has been shown. The Taxpayer asked the Commission to dismiss the audit assessment with prejudice and return her money for 2018 and 2019.

C. Division's arguments

The Division explained that the Taxpayer's employers meet the definition of "employer" found in § 59-10-401(2) and that the Taxpayer meets the definition of "employee" found in § 59-10-401(1). The Division explained that § 59-10-402(1) requires employers to withhold Utah taxes on behalf of their employees and to remit those taxes to the State of Utah. The Division explained that the withholding requirement is for all employers in Utah, including private companies, not just for government entities.

The Division asserted that the Taxpayer's question about whether her employers have taxing authority is irrelevant, and that government entities are not the only entities that withhold tax.

The Division asserted that the Taxpayer had the obligation to correctly report her W-2 wages on her income tax returns. The Division disagreed with the Taxpayer's assertions that the IRS recognized that her W-2 forms were not issued by a taxing authority, that she owed no tax, and that she was thus entitled to the federal refunds the IRS issued. Instead, the Division asserted that the IRS has not rejected the correctness of the W-2 forms, but instead refunded the federal withholding because the Taxpayer incorrectly reported her federal adjusted gross income as $0. The Division explained that the Tax Commission is not obligated to follow the IRS in accepting a federal adjusted gross income of $0 because the Tax Commission has its own standing on state tax issues.

For the fraud penalty, the Division asserted that the Taxpayer made wrongful efforts to avoid paying taxes that she knew she owed based on the W-2 forms. The Division asserted that the Taxpayer unilaterally decided that the tax rules do not apply to her, picked a random section on the IRS website for "government entities," claimed it supported her position, and filed $0 income tax returns which include the Form 4852 documents she prepared. The Division noted that the IRS website gives instructions for "individuals" and for "companies" next to the instructions for "government entities," yet the Taxpayer did not review or apply those instructions, even though those sections describe her situation; she was an individual working for a company; she was not a government entity or an employee of a government entity. The Division questioned why the Taxpayer did not do more research, but instead concluded that she is the one person free from the obligation of paying income taxes.

The Judge questioned the Division about whether there was an "underpayment" for purposes of the fraud penalty for the 2019 tax year because the Taxpayer had unapplied withholding for 2019 of $$$$$ and was assessed a 2019 audit tax of $$$$$. The two amounts for 2019 could offset to $0. The Division asserted there was an underpayment because the Taxpayer's fraudulent actions caused the audit and if the Division had delayed the audit, the full amount of the 2019 withholding would have been refunded, including the $$$$$ of 2019 withholding that is not yet applied.

D. The audit tax and interest should be sustained.

The Taxpayer's employers correctly withheld federal and state income taxes from the Taxpayer's wages in accordance with IRC § 3402 and § 59-10-402, and the employers' federal and state withholding obligations are lawful. For purposes of federal income tax, the Taxpayer's employers meet the definition of "employer" found in IRC § 3401(d); the Taxpayer clearly meets the definition of "employee" found in IRC 3401(c) and 26 CFR § 31.3401(c)-1; and the Taxpayer's employers are required by federal law to withhold and remit federal taxes in accordance with IRC § 3402.

As mentioned in the III. A. Facts Subsection, the Taxpayer asserted on a 2017 Form 4852 that her "corrected" wages from SCAM CREDIT CHARGE were $0 because her employer was "an employer other than the United States and the wages are excluded . . . under IRC code section 3401(a)(8)(A)." However, the Taxpayer's wages clearly do not meet IRC § 3401(a)(8)(A); the Taxpayer was working and living in Utah, not outside of the United States. The Taxpayer asserted on the 4852 Forms for 2018 and 2019 that her "corrected" wages from SCAM CREDIT CHARGE, BUSINESS-1, and/or BUSINESS-2 were $0 based on "records provided by [the employers]." However, the employers' records did not show her wages to be $0. The Taxpayer improperly filed 4852 Forms for the 2017, 2018, and 2019 tax years.

For purposes of state income taxes, the Division is correct that the Taxpayer's employers meet the definition of "employer" found in § 59-10-401, that the Taxpayer meets the definition of "employee" found in § 59-10-401, and that the Taxpayer's employers are required to withhold and remit Utah taxes in accordance with § 59-10-402. The Taxpayer had a clear obligation under § 59-10-104(1) to pay state income tax based on her state taxable income, regardless of her reporting $0 income on her federal and state returns. "State taxable income" is defined in terms of federal "adjusted gross income" as defined in IRC § 62. IRC § 62 defines "adjusted gross income" in terms of "gross income." IRC § 61 defines "gross income" as "all income from whatever source derived including (but not limited to) . . . compensation for services . . ." The Taxpayer's W-2 wages are clearly part of her "gross income," "adjusted gross income," and "state taxable income," regardless of the Taxpayer's insistence that her "gross income," "adjusted gross income," and "state taxable income" are $0 because she is not a government employee.

In support of its audit assessments, the Division has shown that the federal adjusted gross income amounts used for its audits are within $$$$$ of the W-2 wages reported on the IRS Wage and Income Transcripts. The Taxpayer has not shown the audit tax and interest amounts to be incorrect. In accordance with § 59-1-1417(1), the Taxpayer has the burden of proof concerning the audit tax and interest amounts. Thus, the audit tax and interest amounts should be sustained.

E. Fraud Penalty

In accordance with § 59-1-1417(1)(a), the burden of proof is on the Division to show the correctness of the fraud penalty. The fraud penalty is found in § 59-1-401(7)(a)(iv) and states the following:

> If any portion of an underpayment is due to fraud with intent to evade a tax, fee, or charge, the penalty is the greater of $$$$$ per period or 100% of the entire underpayment.

The fraud penalty requires an **underpayment**. For the 2017 tax year, there was an underpayment of tax of $$$$$ when the fraud penalty was imposed. The $$$$$ underpayment equals the audit tax imposed. For the 2018 tax year, there was an underpayment of tax of $$$$$ when the fraud penalty was imposed. The $$$$$ underpayment is comprised of the audit tax of $$$$$ less the unapplied 2018 withholding of $$$$$. For the 2019 tax year, there was no underpayment of tax when the fraud penalty was imposed. For the 2019 tax year, the audit tax was $$$$$ and the unapplied 2019 withholding was $$$$$. This order finds that there were underpayments of $$$$$ for the 2017 tax year and $$$$$ for the 2018 tax year, but there was no underpayment for the 2019 tax year. Because the Division did not show an underpayment for the 2019 tax year, the fraud penalty should not be applied to that tax year.[7] The fraud penalty must be analyzed further for the 2017 and 2018 tax years.

The fraud penalty further requires that the underpayment be "due to fraud with intent to evade a tax." The Utah Supreme Court provided the following explanation about the fraud penalty in its decision for *Jensen v. Utah State Tax Commission*:[8]

> In the income tax arena, fraud is an **actual intentional wrongdoing with the specific intent to evade tax believed to be owing**. *Fahy v. Commissioner*, 43 T.C.M. (CCH) 387, 394 (1982). Tax fraud is a question of fact to be resolved by consideration of the entire record. *Kotmair v. Commissioner*, 86 T.C. (CCH) 1253, 1259 (1986); *Famularo v. Commissioner*, 47 T.C.M. (CCH) 948, 952 (1984); *Fahy*, 43 T.C.M. (CCH) at 394. Where fraud is asserted for several years, the Commission's burden must be met separately for each of those years. *Fahy*, 43 T.C.M. (CCH) at 393.
>
> Because direct evidence of a taxpayer's intent is often nonexistent, specific intent must be drawn from the surrounding facts, including the reasonable inferences drawn therefrom. The mere failure to file an income tax return is not sufficient to prove fraud. *Kotmair*, 86 T.C. (CCH) at 1260-61. However, the failure to file a return while aware of the obligation, combined with other factors such as the concealing of assets and records or the failure to maintain proper records to indicate income, may support a finding of fraud. *Famularo*, 47 T.C.M. (CCH) at 953; *Fahy*, 43 T.C.M. (CCH) at 394-95; *Cummings v. Commissioner*, 26 T.C.M. (CCH) 273, 279 (1968). The United States Supreme Court has stated with respect to the federal crime of willful intent to evade income tax:
>
> > By way of illustration, and not by way of limitation, we would think affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal.

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[7] The Division did not assess a penalty in accordance with § 59-1-401(9).

[8] *Michael K. and Karen Jensen v. Utah State Tax Commission*, 835 P.2d 965, 972-973 (Utah 1992). For the tax year of 1987, the fraud penalty was located in a combination of Utah Code Ann § 59-10-539(3), which penalized a deficiency "due to fraud," and Utah Code Ann § 59-1-401(3)(d), which provided that the civil penalty for "fraud with intent to evade" is 100% of the deficiency. *See Jensen* at 972.

> *Spies v. United States*, 317 U.S. 492, 499 (1943). Although the acts referred to in the quotation evidence the crime of fraud, they may also evidence the conduct that is subject to civil fraud. The Tax Court has found similar conduct subject to civil penalties for income tax fraud. *See, e.g., Famularo*, 47 T.C.M. (CCH) at 953-54 (failure to file returns, combined with noncredible excuses for failing to file, failing to produce business records without an acceptable excuse, and misleading tax agents in interviews); *Fahy*, 43 T.C.M. (CCH) at 394-95 (failure to file tax returns while aware of the obligation, combined with customers' agreement not to withhold income tax for petitioner, attempts to conceal assets and records and failure to keep records, and noncredible explanation for receipt of federal reserve notes as not constituting receipt of income); *Cummings*, 27 T.C.M. (CCH) at 279 (failure to file returns without reasonable explanation, combined with failure to maintain proper records of income and refusal to cooperate with tax agents).

(Footnote removed and emphasis added.)

The above quote states in part that "fraud is an **actual intentional wrongdoing** . . ." (emphasis added). The Taxpayer participated in actual intentional wrongdoing, as explained below. The Taxpayer incorrectly filed zero-income federal and state returns for the 2017-2018 tax years even though she had taxable W-2 wages. Additionally, for the 2017 federal returns, she filed a Form 4852, incorrectly "correcting" her wages from SCAM CREDIT CHARGE to be $0 based on her reason that the employer was "an employer other than the United States and the wages are excluded . . . under IRC code section 3401(a)(8)(A)," when IRC § 3401(a)(8)(A) clearly does not apply to her. For the 2018 federal returns, she filed Form 4852 documents incorrectly "correcting" her wages from SCAM CREDIT CHARGE to be $0 and "correcting" her wages from BUSINESS-1 to be $0 based on her reason that she made "corrections" based on "records provided by [the employers]"; however, the employers' records clearly did not show her wages to be $0. Furthermore, for her state return, she incorrectly reported on Form TC-40W that her Utah wages or income from SCAM CREDIT CHARGE and BUSINESS-1 as reported in W-2 box 16 were $0, when the W-2 forms from those employers did not report her wages as $0. Thus, the Taxpayer reported incorrect information to the IRS and Tax Commission through several forms she prepared and filed. The Taxpayer deliberately, not accidentally, took the actual, wrongful actions discussed above in this paragraph.

The wrongfulness of the Taxpayer's actions of filing zero-income federal returns and "correcting" her W-2 information is also shown by the IRS's document, "The Truth About Frivolous Tax Arguments" (March 2018), available through the IRS webpage, https://www.irs.gov/privacy-disclosure/the-truth-about-frivolous-tax-arguments-introduction. In "The Truth About Frivolous Tax Arguments," Subsection I.A.3., the IRS explains the following as frivolous:

> ***3. Contention: Taxpayers can reduce their federal income tax liability by filing a "zero return".***

> Some taxpayers attempt to reduce their federal income tax liability by **filing a tax return that reports no income and no tax liability (a "zero return") even though they have taxable income. Many of these taxpayers also request a refund of any taxes withheld by an employer. These individuals typically attach to the zero return a "corrected" Form W-2 or another information return that reports income and income tax withholding**, relying on one or more of the frivolous arguments discussed throughout this outline to support their position.
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> . . . .
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> **The Law:** A taxpayer that has taxable income cannot legally avoid income tax by filing a zero return. Section 61 provides that gross income includes all income from whatever source derived, including compensation for services. Courts have repeatedly penalized taxpayers for making the frivolous argument that the filing of a zero return can allow a taxpayer to avoid income tax liability or permit a refund of tax withheld by an employer. Courts have also imposed the frivolous return and failure to file penalties because these forms do not evidence an honest and reasonable attempt to satisfy the tax laws or contain sufficient data to calculate the tax liability, which are necessary elements of a valid tax return. See *Beard v. Commissioner*, 82 T.C. 766, 777-79 (1984). Furthermore, including the phrase "nunc pro tunc" or other legal phrase has no legal effect and does not serve to validate a zero return. See Rev. Rul. 2006- 17, 2006-1 C.B. 748; Notice 2010-33, 2010-17 I.R.B. 609. The IRS warned taxpayers of the consequences of making this frivolous argument in Rev. Rul. 2004-34, 2004-1 C.B. 619.

(Emphasis added.) Subsection I.A.3. of "The Truth About Frivolous Tax Arguments" also includes subsections of "Relevant Case Law" and "Other Cases," which cite and/or discuss many court cases. Consistent with the frivolous argument described by Subsection I.A.3., the Taxpayer filed zero returns even though she had taxable income; she requested a refund of the taxes withheld by her employers, and she attached to the zero return, "corrected" Form W-2 information.

In "The Truth About Frivolous Tax Arguments," Subsection I.C.4., the IRS explains the following as frivolous:

> ***4. Contention: The only "employees" subject to federal income tax are employees of the federal government.***
>
> This contention asserts that **the federal government can tax only employees of the federal government; therefore, employees in the private sector are immune from federal income tax liability. This argument is based on a misinterpretation of section 3401, which imposes responsibilities on employers to withhold tax from "wages."** That section establishes the general rule that "wages" include all remuneration for services performed by an employee for his employer. Section 3401(c) goes on to state that the term "employee" includes "an officer, employee, or elected official of the United States, a State, or any political subdivision thereof . . . ."
>
> **The Law:** Section 3401(c) defines "employee" and states that the term "includes an officer, employee or elected official of the United States . . . ." This language does not address how other employees' wages are subject to withholding or taxation. Section 7701(c) states that the use of the word "includes" "shall not be deemed to exclude other things otherwise within the meaning of the term defined." Thus, the word "includes" as used in the definition of "employee" is a term of enlargement, not of limitation. It makes

federal employees and officials a part of the definition of "employee," which generally includes private citizens. The IRS has warned taxpayers of the consequences of making this frivolous argument. Rev. Rul. 2006-18, 2006-1 C.B. 743.

Relevant Case Law:
Taliaferro v. Freeman, 595 F.App'x 961, 962-63 (11th Cir. 2014) – the 11th Circuit rejected as frivolous the taxpayer's argument that the federal income tax applies only to federal employees, and ordered sanctions against him up to and including double the government's costs.

Montero v. Commissioner, 354 F. App'x 173 (5th Cir. 2009) – the 5th Circuit affirmed a $20,000 section 6673(a) penalty against the taxpayer for advancing frivolous arguments that he is not an employee earning wages as defined by sections 3121 and 3401.

Sullivan v. United States, 788 F.2d 813 (1st Cir. 1986) – the 1st Circuit imposed sanctions on the taxpayer for bringing a frivolous appeal and rejected his attempt to recover a civil penalty for filing a frivolous return, stating "to the extent [he] argues that he received no 'wages'. . . because he was not an 'employee' within the meaning of 26 U.S.C. § 3401(c), that contention is meritless. . . . The statute does not purport to limit withholding to the persons listed therein."

United States v. Latham, 754 F.2d 747, 750 (7th Cir. 1985) – calling the instructions the taxpayer wanted given to the jury "inane," the court said, "[the] instruction which indicated that under 26 U.S.C. § 3401(c) the category of 'employee' does not include privately employed wage earners is a preposterous reading of the statute. It is obvious within the context of [the law] the word 'includes' is a term of enlargement not of limitation, and the reference to certain entities or categories is not intended to exclude all others."

Briggs v. Commissioner, T.C. Memo 2016-86, 111 T.C.M. (CCH) 1389 (2016) – the court rejected the taxpayer's frivolous argument that wages from private-sector employers are not "income" for Federal income tax purposes. The court imposed a $3,000 penalty against the taxpayer for "persist(ing) in raising frivolous arguments."

Waltner v. Commissioner, T.C. Memo. 2014-35, 107 T.C.M. (CCH) 1189 (2014) – the court debunked the argument that only federal employees are taxed and imposed [a] $2,500 sanction against the taxpayer for making frivolous arguments contained in Peter Hendrickson's book "Cracking the Code."

States v. Hendrickson, 100 A.F.T.R.2d (RIA) 2007-5395 (E.D. Mich. 2007) – the court permanently barred Peter and Doreen Hendrickson, who filed tax returns on which they falsely reported their income as zero, from filing tax returns and forms based on frivolous claims in Hendrickson's book, "Cracking the Code," that only federal, state, or local government workers are liable for federal income tax or subject to the withholding of federal taxes.

Other Cases: *Peth v. Breitzmann*, 611 F. Supp. 50 (E.D. Wis. 1985); *Pabon v. Commissioner*, T.C. Memo. 1994-476, 68 T.C.M. (CCH) 813 (1994).

(Emphasis added.) Consistent with the frivolous argument described by Subsection I.C.4., the Taxpayer's argument is that the government can tax only government employees; therefore, employees in the private sector are immune from income tax liability.

The Supreme Court in *Jensen* stated that "fraud is an actual intentional wrongdoing **with the specific intent to evade tax believed to be owing**" (emphasis added). *See Jensen* at 972 (quoted earlier in this order). The Taxpayer committed the actual intentional wrongdoing with the specific intent to evade tax believed to be owing. The facts surrounding the actual, intentional wrongful actions described previously in this order show the Taxpayer's specific intent to evade tax believed to be owing. She received correct W-2 information, but she actively chose to file "corrected" W-2 information. She filed a 2017 Form 4852, "correcting" her wages to be $0, claiming the employer was "an employer other than the United States and the wages are excluded . . . under IRC code section 3401(a)(8)(A)," when the argument was identified as being frivolous by the IRS and when IRC § 3401(a)(8)(A) clearly did not apply to her. She filed 2018 Form 4852 documents "correcting" her wages to be $0, claiming she made "corrections" based on "records provided by [the employers]" when the employers' records clearly did not show her wages to be $0. She claims to have filed zero returns consistent with information from an IRS Tax Topic, but she has not provided a copy of that IRS Tax Topic or any other IRS information that remotely supports her actions. Additionally, she did not explain why she failed to rely on the extensive IRS information indicating that her W-2 wages are subject to income taxes. Furthermore, "The Truth about Frivolous Tax Arguments" (March 2018), which is readily available on the IRS website, identifies her arguments as being frivolous as of March 2018, before she filed her 2017 federal tax return on or after April 19, 2020. In addition, the Division personally notified the Taxpayer of the incorrectness of her zero returns through its Notices of Deficiency and through its Answer to Petition for Redetermination, but the Taxpayer continued to assert, with no legal basis, that her W-2 wages are not taxable. Overall, for the 2017-2018 tax years, the information shows the Taxpayer had an underpayment due to her actual intentional wrongdoing with the specific intent to evade tax believed to be owing. The Taxpayer did not simply have a misunderstanding or make a mistake in good faith. Thus, the fraud penalty applies to the 2017 and 2018 tax years.

Subsection 59-1-401(7)(a)(iv) provides the **amount of the fraud penalty** as follows:

> If any portion of an underpayment is due to fraud with intent to evade a tax, fee, or charge, **the penalty is the greater of $$$$$ per period or 100% of the entire underpayment**.

(Emphasis added.) The underpayment for the 2017 tax year was $$$$$. For 2017, the Division correctly imposed a $$$$$ fraud penalty in accordance with § 59-1-401(7)(a)(iv) because the $$$$$ underpayment was less than $$$$$. The underpayment for the 2018 tax year was $$$$$, which equals the audit tax of

$$$$$ less the unapplied 2018 withholding of $$$$$. For 2018, the Division incorrectly imposed a $$$$$ fraud penalty. In accordance with § 59-1-401(7)(a)(iv), the correct amount of the 2018 fraud penalty is $$$$$, the amount of the underpayment. Thus, the 2017 fraud penalty should be sustained, and the 2018 fraud penalty should be found to be $$$$$.

In summary, the fraud penalty is $$$$$ for the 2017 tax year; $$$$$ for the 2018 tax year; and $0 for the 2019 tax year.

Aimee Nielson-Larios
Administrative Law Judge

IV. DECISION AND ORDER

Based on the foregoing, the Commission sustains in full the Division's audit assessment for the 2017 tax year. For the 2018 tax year, the Commission sustains the audit tax and interest, but finds the amount of the 2018 fraud penalty to be $$$$$. For the 2019 tax year, the Commission sustains the audit tax and interest, but finds the 2019 fraud penalty to be $0.[9] 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 _____, 2021.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Rebecca L. Rockwell
Commissioner

[9] The Division may still amend its audit for the 2019 tax year to impose the penalty found in § 59-1-401(9) if the Division determines that penalty applies to the Taxpayer's situation.

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.