

APPEAL # 21-1480

TAX TYPE: AUDIT - INDIVIDUAL INCOME TAX

TAX YEAR: 2017

DATE SIGNED: 07/25/2023

COMMISSIONERS: J. VALENTINE, R. ROCKWELL, M. CRAGUN AND J. FRESQUES

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. INCOME TAX AND EDUCATION DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. 21-1480 Account No: ##### Tax Type: Audit - Individual Income Tax Tax Year: 2017 Judge: Shannon Halverson
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Presiding:

Michael J. Cragun, Commissioner

Shannon Halverson, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER

For Respondent: RESPONDENT'S REP-1, Assistant Attorney General
RESPONDENT'S REP-2, Manager, Income Tax and Education Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on May 8, 2023, in accordance with Utah Code Ann. §59-1-501 and §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. The Petitioner ("Taxpayer") is appealing the Income Tax and Education Division's ("Division") audit of the Taxpayer's Utah individual income tax liability for the 2017 tax year. The Taxpayer filed a 2017 Utah individual income tax return with a status of married filing separately and did not claim any dependent exemptions on that return¹. The Taxpayer claimed \$\$\$\$ of federal adjusted gross income on his Utah income tax return for the 2017 tax year². The Taxpayer filed a Form 4852,

¹ Respondent's Exhibit R-1, pgs. AUD 009-010.

² Respondent's Exhibit R-1, pg. AUD 009.

which is the Substitute for Form W-2, with the 2017 Utah income tax return³. On the Form 4852 submitted by the Taxpayer, the Taxpayer reported \$\$\$\$ of wages, tips, and other compensation, \$\$\$\$ of Social Security tax withheld, and \$\$\$\$ of Medicare tax withheld⁴.

2. On DATE, the Division issued a Notice of Deficiency and Audit Change (“Statutory Notice”) for the 2017 tax year⁵. The Division made the audit changes based on the Division’s determination that the Taxpayer was a Utah resident individual for all of 2017 and received wages, tips, compensation, or other remuneration that qualifies as taxable income in Utah in 2017⁶. The amounts of income tax, penalty, and interest due as of the date the Statutory Notice was issued are as follows⁷:

	<u>Tax</u>	<u>Interest</u> ⁸	<u>Penalties</u>	<u>Total</u>
2017	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$

3. The Taxpayer timely appealed the Notice of Deficiency⁹. It is the Taxpayer’s position that the money he received from his employers for services provided while residing and working in Utah do not meet the definition of wages as defined in the Internal Revenue Code and, therefore, do not meet the definition of taxable income and are not subject to income tax in the state of Utah.

4. The Taxpayer stated at the Formal Hearing that he filed his Form TC-40 for the 2017 tax year per the instructions on that form. He noted that on line 4 of the Form TC-40, the instructions state that the federal adjusted gross income from the federal return should be entered on that line. He stated that his federal adjusted gross income on his 2017 federal individual income tax return was \$\$\$\$\$, so he entered \$\$\$\$\$ on line 4 of the Form TC-40. He stated that the issue in this appeal is that the Division is not accepting his federal adjusted gross income as \$\$\$\$\$.

5. The Taxpayer submitted a copy of his filed federal Form 1040 2017 U.S. Individual Income Tax Return¹⁰. He noted that a Form 4852 was submitted with his federal income tax return. He stated that the Form 4852 submitted with his individual income tax return is a substitute for a Form W-2 and is used to correct the erroneous information return that was sent by his employer to the Internal Revenue Service stating that he had taxable wages. He asserted that he did not receive wages as defined in Section 3401 of the Internal Revenue Code. He argued that he is not disputing that wages are income but asserted that he did not receive wages as defined in Section 3401 of the Internal Revenue Code. He

³ Respondent’s Exhibit R-1, pg. AUD 011.

⁴ Respondent’s Exhibit R-1, pg. AUD 011.

⁵ Respondent’s Exhibit R-1, pgs. AUD 003-004.

⁶ *Id.*

⁷ *Id.*

⁸ Pursuant to Utah Code Ann. §59-1-402, interest continues to accrue on any unpaid balance. The Statutory Notice indicated that the interest amount included in the Statutory Notice was computed to August 19, 2021.

⁹ Pleadings, Respondent’s Exhibit R-1, pgs. AUD 001-002.

¹⁰ Petitioner’s Exhibit P-A.

stated that his individual income tax return reflects his position and he is disputing the amounts of wages reported by his employer to the Internal Revenue Service (IRS) for the 2017 tax year.

6. The Taxpayer noted that on line 75 of his Form 1040 U.S. Individual Income Tax Return the refund amount was \$\$\$\$¹¹. He stated that there was no federal income tax withheld from his paycheck but indicated that he did have Social Security and Medicare taxes withheld and indicated that the refund amount is the total of the Social Security and Medicare tax amounts withheld. The Taxpayer submitted a copy of the refund check that he received from the United States Treasury, which totaled \$\$\$\$¹². He indicated that the refund check included the 2017 refund amount of \$\$\$\$ and \$\$\$\$ of interest. He argued that, according to the IRS, his 2017 filing was correct, and noted that he was issued a refund of his Social Security and Medicare taxes that were withheld.

7. The Taxpayer argued that the IRS's issuance of the refund acknowledges that the income that was reported on the Form W-2 was erroneously reported. He asserted that his adjusted gross income on his state income tax return is \$\$\$\$ based on his federal adjusted gross income on his 2017 federal individual income tax return.

8. The Taxpayer confirmed that he lived in Utah from DATE through DATE. He also confirmed that he worked for COMPANY-1 in YEAR, which he stated was a private sector company that is not federally connected. He acknowledged that he received \$\$\$\$ from COMPANY-1 but argued that he did not receive any taxable compensation from COMPANY-1. He argued that he did not receive any federally connected compensation from COMPANY-1.

9. The Taxpayer acknowledged that COMPANY-1 was his employer in YEAR and also acknowledged that COMPANY-1 issued him a Form W-2 that reported he earned \$\$\$\$ of wages. He asserted that the Form W-2 issued by COMPANY-1 was an erroneous information return.

10. The Taxpayer reported the federal income tax withheld from Forms W-2 and 1099 as \$\$\$\$ on line 64 of his 2017 federal individual income tax return¹³. He acknowledged that on his Form 4852 line 7f, the amount of federal income tax withheld was reported as \$\$\$\$¹⁴. He acknowledged that he added the amount of Social Security tax withheld, which was reported as \$\$\$\$ on his Form 4852, and the amount of Medicare tax withheld, which was reported as \$\$\$\$ on his Form 4852, to determine the deduction amount reported on line 64 of his 2017 federal income tax return. He acknowledged that on his Form 4852 he listed his Social Security wages as \$\$\$\$ and Medicare wages and tips as \$\$\$\$ but reported that Social Security taxes and Medicare taxes were withheld on that form. He argued that he had no wages as that term is defined in the Internal Revenue Code. He argued that the Social Security taxes

¹¹ Petitioner's Exhibit P-A.

¹² Petitioner's Exhibit P-B.

¹³ Petitioner's Exhibit P-A.

¹⁴ *Id.*

and Medicare taxes were withheld from his paycheck and were taken from him and erroneously provided to the IRS. He argued that he had a right to receive the Social Security and Medicare taxes that were withheld from his paycheck back because the money he received from COMPANY-1 was not wages as defined in the Internal Revenue Code. He argued that COMPANY-1 is not a federally connected company and he is not a federal employee, so he asserted that COMPANY-1 erroneously reported that he had federally connected wages.

11. The Division's Tax Examiner Manager stated at the Formal Hearing that the Division issued a Notice of Deficiency for the 2017 tax year on DATE¹⁵. The Division's representatives submitted the Notice of Deficiency as evidence in this appeal¹⁶.

12. The Division's Tax Examiner Manager indicated that the Division received the Taxpayer's 2017 Utah individual income tax return on DATE. The Division submitted a copy of the Taxpayer's 2017 Form TC-40 Utah individual income tax return as evidence in this appeal¹⁷. She noted that the Division received a copy of the Taxpayer's Form 4852 with the 2017 Utah individual income tax return that was filed¹⁸.

13. The Division's representatives submitted the Taxpayer's IRS Wage and Income Transcripts for the 2017 tax year¹⁹. The Division's Tax Examiner Manager indicated that the Division obtained that document from the IRS's transcript delivery system.

14. The Division's representatives submitted the Taxpayer's IRS Account Transcript for the 2017 tax year²⁰. The Division's Tax Examiner Manager indicated that the Division obtained those documents from the IRS's transcript delivery system. She indicated that the Division reviewed those documents in conducting the Division's audits for the year at issue in this appeal but did not use the information from those documents to calculate the figures in the audit.

15. The Division's Tax Examiner Manager indicated that the Division reviewed the Taxpayer's 2017 Utah individual income tax return and made changes to the return in their audit. She indicated that the Division increased the Taxpayer's federal adjusted gross income from \$\$\$\$ as reported by the Taxpayer to \$\$\$\$²¹. She noted that the Division assessed \$\$\$\$ of income tax, \$\$\$\$ of interest, and a \$\$\$\$ penalty in the audit for the 2017 tax year²².

16. The Division's Tax Examiner Manager indicated that the Division used the information from the Taxpayer's 2017 IRS Wage and Income Transcript to prepare the Notice of Deficiency and Audit

¹⁵ Respondent's Exhibit R-1, pgs. AUD 003-004.

¹⁶ *Id.*

¹⁷ Respondent's Exhibit R-3, pgs. AUD 009-011.

¹⁸ *Id.*

¹⁹ Respondent's Exhibit R-4, pgs. AUD 012-013.

²⁰ Respondent's Exhibit R-5, pgs. AUD 014-015.

²¹ Respondent's Exhibit R-1, pgs. AUD 003-004.

²² *Id.*

Change for the 2017 tax year²³. She indicated that the sources of income included wages, tips, and compensation that was reported as \$\$\$\$\$²⁴. She stated that the \$\$\$\$\$ of wages was included in the Division's Notice of Deficiency for the 2017 tax year because that amount was reported as wages and is taxable income.

17. The Division's Tax Examiner Manager acknowledged that the Taxpayer filed a 2017 federal individual income tax return and reported \$\$\$\$\$ of income²⁵. She indicated that to her knowledge that return has not been amended by the IRS or the Taxpayer. She stated that the Division's audit does not reflect \$\$\$\$\$ of income because she stated that the Division's position is that the Taxpayer did receive taxable wages that were correctly reported by the Taxpayer's employer on the Form W-2 for the 2017 tax year. She also stated that the Division assessed a \$\$\$\$\$ furtherance of a frivolous position penalty because the Division believes that the Taxpayer frivolously filed an income tax return that reported \$\$\$\$\$ of wages or income when he did have a Form W-2 that reported he had wages. She noted that the Taxpayer filed a Form 4852 to dispute the taxable wages that were reported by the Taxpayer's employer.

18. The Division's Tax Examiner Manager acknowledged that the Taxpayer's 2017 IRS Account Transcript does show that the Taxpayer's adjusted gross income was reported as \$\$\$\$\$ on his federal income tax return and does show that the Taxpayer was issued a refund. However, she noted that the IRS could still make changes to the Taxpayer's return in the future but acknowledged that the IRS had not made changes to the Taxpayer's 2017 federal income tax return as of the date of the Formal Hearing. She argued that the fact that the IRS accepted the Taxpayer's 2017 federal income tax return is not proof that the IRS agrees with the Taxpayer's position but is only proof that the IRS processed the Taxpayer's return as filed. She stated that the Division's position is that the Taxpayer had wages and wages are included as income. She stated that the Taxpayer's 2017 IRS Wage and Income Transcript indicates that the Taxpayer did receive wages in the 2017 tax year as reported by the Taxpayer's employer.

19. The Taxpayer argued that he did not receive wages from his employer as those terms are defined in the Internal Revenue Code. He stated that 26 U.S.C. Sec. 3401 defines wages as “. . . all remuneration (other than fees paid to a public official) for services performed by an employee for his employer . . .” He argued that he does not meet the definition of employee under Section 3401 of the Internal Revenue Code because the definition of employee in 26 U.S.C. Sec. 3401 is as follows:

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.

²³ Respondent's Exhibit R-4, pgs. AUD 012-013.

²⁴ Respondent's Exhibit R-4, pgs. AUD 012-013.

²⁵ Respondent's Exhibit R-3, pgs. AUD 009-011.

20. The Taxpayer argued that the definition of employee does not include him. He stated that he is not working for the federal government. He argued that he did not receive wages according to the definitions found in 26 U.S.C. Sec. 3401. He stated that is the reason that he filed the way that he filed. He argued that the federal income tax is not a tax on income but rather is a tax on federal income. He stated that he is not a federal employee nor did he work for a federally connected company. He asserted that is why he did not receive wages per the Internal Revenue Code. He argued that he reported his adjusted gross income appropriately and argued that his position is not frivolous.

21. The Division's Tax Examiner Manager stated that the Division believes that the Taxpayer's position is a frivolous position because the Taxpayer's arguments have been presented in previous cases and rejected in those cases. She also stated that the IRS has a publication that identifies arguments that are frivolous and noted that the IRS has deemed the Taxpayer's position to be a frivolous position in that publication. She cited the IRS's publication "The Truth About Frivolous Tax Arguments" published in March of 2022 to support that assertion²⁶. She noted that the argument that an individual is not an employee because the individual does not work for the federal government has been cited as a frivolous position. She also asserted that the definitions do not specifically exclude employees of private sector employers. She stated that the Division's position is that the definition of wages includes wages received by a private sector employee.

22. The Taxpayer asserted that the IRS publication is not law and he is relying on the definitions found in federal law. He argued that he is relying on law and case law from the United States Supreme Court. He argued that in 26 U.S.C. Sec. 7701(c), it states "[t]he terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined." He argued that the term only includes things of the same general class, meaning that other government employees are included in the definition even though they are not specifically enumerated. He asserted that the United States Supreme Court has held that where general words follow specific words in a statutory enumeration, the general words are construed to embrace only objects that are similar in nature to those objects that are enumerated by the preceding specific words in *Circuit City Stores v. Adams*, 532 U.S. 105 (2001). He argued that the term "includes" is narrowing down the definition of employee and does exclude everything that is not of a similar type as the enumerated term. He argued that the definition of employee defines a government employee and includes other government employee positions that may not be enumerated in the definition. He argued that if the term employee was intended to cover everyone, there would not be a need for a statutory definition.

²⁶ See <https://www.irs.gov/privacy-disclosure/the-truth-about-frivolous-tax-arguments-introduction> (last visited July 6, 2023).

23. The Taxpayer stated that his position is that he was not paid wages because he was not an employee that was working for a federally connected company. He argued that any wages outside of wages of an employee of a federally connected company are not taxable.

24. The Taxpayer argued that his 2017 IRS Account Transcript reflects his original filing where he corrected the reported wages and argued that the IRS has not challenged his filing. He argued that the IRS is agreeing with his submitted filing. He argued that this demonstrates that his filings are legitimate and his federal adjusted gross income is \$\$\$\$\$.

25. The Division's Tax Examiner Manager stated that the State of Utah is not bound by an individual's federal return and stated that the Division does not have to follow the account transcript. She indicated that the State of Utah is allowed to make an independent analysis of the taxes due to the State. She also noted that the IRS may still audit the Taxpayer's federal individual income tax returns and may issue an audit after the audit deadline if it is determined that the Taxpayer's argument was frivolous.

26. The Division's Tax Examiner Manager indicated that if a Form W-2 contains an error in the amount of wages reported, the issuing employer will typically issue a corrected Form W-2 to correct any inaccurate information. She indicated that the corrected Form W-2 will appear on the IRS Wage and Income Transcript.

27. The Division's Tax Examiner Manager indicated that the Division is relying on the information from the Taxpayer's 2017 IRS Wage and Income Transcript to prepare the Notice of Deficiency and Audit Change for the 2017 tax year²⁷. She indicated that the sources of income included wages, tips, and compensation reported on a W-2 Form in the amount of \$\$\$\$\$²⁸. She noted that the W-2 Form was the only income document that was reported for the 2017 tax year.

28. The Division's Tax Examiner Manager stated that the filing threshold for the 2017 tax year was just over \$\$\$\$\$, which she indicated was the standard deduction amount for the year plus the personal exemption that was allowed for a single individual or a married filing separate individual.

29. The Division's representatives stated that Utah, entirely independent of the federal government, imposes a state income tax. She stated that Utah Constitution, Article XIII, Section 4, allows the Utah Legislature to impose an income tax and explicitly allows the Legislature to define the amount on which the tax is imposed by reference to federal law and to modify or provide exemptions to such provisions as well.

30. The Division's representative stated that Utah Code Ann. §59-10-104(1) provides that a tax is imposed on state taxable income of a resident individual as provided in this section. She stated that Utah Code Ann. §59-10-103(1)(w) defines state taxable income and, for a resident individual, is defined

²⁷ Respondent's Exhibit R-4, pgs. AUD 012-013.

²⁸ *Id.*

as “(i) subject to Section 59-10-1404.5, 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”

31. The Division’s representatives stated that Utah Code Ann. §59-10-103(1)(a) defines adjusted gross income as follows: “(i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code” They stated that Section 62 of the Internal Revenue Code provides, “[f]or purposes of this subtitle, the term ‘adjusted gross income’ means, in the case of an individual, gross income minus the following deductions” They stated that “gross income” is defined in Section 61 of the Internal Revenue Code as “. . . 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. . . .”

32. The Division’s representatives stated that the Utah Constitution and Utah Code impose a state tax that is entirely independent of the federal tax. They indicated that it is imposed on the state taxable income of Utah residents and is imposed on the Taxpayer’s adjusted gross income, which is all income from whatever source derived. They noted that the Taxpayer stated that he was a Utah resident for YEAR. They also noted that he agreed that he worked for COMPANY-1 in YEAR. They noted that he agreed that he received money from COMPANY-1 in YEAR, and did not dispute that the amount that he received from COMPANY-1 in YEAR was the amount reported on the IRS Wage and Income Transcript. They argued that the Division’s audit is supported by Utah law and requested that the Division’s audit be upheld.

33. The Division’s representatives stated that adjusted gross income is based on the federal definition as provided in 26 U.S.C. Sec. 62. They noted that this provision does not state that adjusted gross income is based on federal returns. They noted that the Utah system is entirely separate and stated that the Utah Supreme Court has found the state is not precluded from issuing an assessment in situations where the IRS has not issued one and cited *Jensen v. State Tax Comm’n*, 835 P.2d 965, 970 (Utah 1992) and *Nelson v. Auditing Division*, 903 P.2d 939, 940 (Utah 1995) to support that assertion.

34. The Division’s representatives acknowledged that the Commission generally gives deference to the IRS in determining federal adjusted gross income. However, they noted that the Commission has held that it is appropriate to make an independent determination in certain circumstances. They noted that one of those circumstances is when it is clear that the IRS’s determination was in error and cited *Initial Hearing Order, Appeal No. 12-2963*, pg. 4, Utah State Tax Commission (February 23, 2015) to support that assertion.

35. The Division’s representatives stated that several courts have found that a \$\$\$\$ return where a Taxpayer has a Form W-2 showing income is incorrect on its face. They cited *Sisemore v. United*

States, 797 F.2d 268, 269 (6th Cir. 1986) to support that assertion and noted that the Court held that a return showing no income “on its face clearly showed that their assessment of their taxes was substantially incorrect and that their position on the matter was frivolous.”

36. The Division’s representatives argued that, to the extent the Taxpayer is arguing that the Taxpayer’s wages are not income in any other respect, the definition of wages is broad and noted that 26 U.S.C. Sec. 61 defines gross income as all income from whatever source derived and specifically identifies compensation for services. They noted that the United States Supreme Court in *Comm’r v. Glenshaw Glass Company*, 348 U.S. 426, 429-430 (1955) held that the definition is broad and covers all accessions to wealth. They also noted that in *United States v. Mann*, 884 F.2d 532 (10th Cir. 1989), the Petitioners made a number of arguments as to why wages are not income and noted that the Court held that wages are income in that case.

37. The Division’s representatives noted that the Taxpayer asserted that he was not an employee as that term is defined in the Internal Revenue Code because he did not work for the government. They noted that the Taxpayer relies on the definition of employee in 26 U.S.C. Sec. 3401. However, they argued that 26 U.S.C. Sec 3401 is not incorporated into any of the relevant provisions of the Utah Code, and noted that the definition he cites by its own language applies only to Chapter 24 of the Internal Revenue Code, whereas 26 U.S.C. Sec. 61 and 62 are the two provisions that are incorporated into the Utah Code and are found in Chapter 1 of the Internal Revenue Code. They argued that the plain language of 26 U.S.C. Sec. 3401 does not define “employee” but states that it includes certain types of individuals. They stated that 26 U.S.C. Sec. 7701(c) states that the word “includes” shall not be deemed to exclude other things that are otherwise within the meaning of the term and indicates that Section 7701 applies to the entire Title 26. They argued that this means that the word “includes” is a term of enlargement, not limitation, so federal employees and officials are a part of the definition of employee, which generally includes private citizens as well.

38. The Division’s representatives indicated that the Taxpayer’s argument has been repeatedly rejected by the courts and cited *Waltner v. Commissioner of Internal Revenue*, T.C. Memo, 2014-35, pg. 49 (2014), which rejected the argument that the definition of employee only includes federal employees and persons who are not federal employees are not taxed, to support that assertion. They also cited *United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985), which rejected a jury instruction stating that an employee does not include privately employed wage earners, and held “[i]t is obvious that within the context of both statutes 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.” They cited *Sullivan v. United States*, 788 F.2d 813, 815 (1st Cir. 1986), which found that the argument is meritless, and *Montero v. Comm’r*, 354 Fed. Appx 173, 174 fn. 1 (5th Cir. 2009), which noted that the Sixth Circuit has found the

theory that private sector compensation is not "wages" and therefore not taxable "to be a frivolous tax-protestor argument" as further support of its position.

39. The Division's representatives noted that the Division assessed a \$\$\$\$ furtherance of a frivolous position penalty. They stated that, with regard to the waiver of this penalty and interest, Utah Administrative Code R861-1A-42(2) 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." They argued that no evidence has been presented that would demonstrate that the Commission gave erroneous information or took inappropriate action. They also noted that Utah Administrative Code R861-1A-42(2) outlines circumstances that would establish reasonable cause for the waiver of penalties. They noted that the rule also states that "[i]ntentional disregard, evasion, or fraud does not constitute reasonable cause for waiver under any circumstance."

40. The Division's representatives concluded by stating that based on the evidence and testimony provided at the Formal Hearing, the Division is requesting that the Division's audit of the Taxpayer's income tax liability for the 2017 tax year be upheld.

41. The Taxpayer concluded by arguing that the Division cited a lot of lower court opinions to support their position but he is citing United States Supreme Court decisions to support his position about the interpretation of the terms "include" and "including". He argued that the terms include and including are not terms of enlargement and are not all encompassing terms. He argued that, as the United States Supreme Court has stated, the terms actually restrict the defined terms. He requested that the Commission consider that the cases cited by the Division are all lower court rulings. He argued that it is clear that the definition of employee in 26 U.S.C. Sec. 3401 does not include employees outside of government employees. He argued that he did not receive wages according to the definitions in the Internal Revenue Code. He argued that he prepared his 2017 Utah Individual Income Tax Return per the instructions on the TC-40 Form. He argued that there was nothing frivolous about how his income tax return was prepared.

42. The Taxpayer stated that 26 U.S.C. Sec. 61 defines gross income as "all income from whatever source derived. . ." He argued that the language in the Constitution and decapitation rules mean that the language cannot include as taxable anything that does not involve the exercise of a federal privilege, no matter what it might appear to say. He argued that income does not mean what comes in in the tax laws. He argues that it only means whatever income can be taxed under the rules of excise and apportionment under the United States Constitution. He argued that the Sixteenth Amendment of the United States Constitution did not increase the taxing powers. He argued that there is no specific

definition of income. He argued that he did not receive compensation for providing service to any government entity.

APPLICABLE LAW

Utah imposes income tax on individuals who are residents of the state, in Utah Code Ann. §59-10-104(1)²⁹ as follows:

... a tax is imposed on the state taxable income of a resident individual as provided in this section
....

“Resident individual” effective for the 2017 tax year is defined in Utah Code Ann. §59-10-103(1)(q) as follows:

(q)(i) "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.

The term “state taxable income” is defined in Utah Code Ann. §59-10-103(1)(w), below in relevant part:

(w) “Taxable income” or “state taxable income”:
(i) subject to Section 59-10-1404.5, 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

“Adjusted gross income” is defined in Utah Code Ann. §59-10-103(1)(a), as follows in relevant part:

“Adjusted gross income”:
(i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code

Section 62 of the Internal Revenue Code provides, “[f]or purposes of this subtitle, the term ‘adjusted gross income’ means, in the case of an individual, gross income minus the following deductions”

“Gross income” is defined in Section 61 of the Internal Revenue Code as follows:

(a) 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;

²⁹ All substantive law citations are to the 2017 version of Utah law, unless otherwise indicated.

- (2) Gross income derived from business;
- (3) Gains derived from dealings in property;
- (4) Interest;
- (5) Rents;
- (6) Royalties;
- (7) Dividends;
- (8) Alimony and separate maintenance payments;
- (9) Annuities;
- (10) Income from life insurance and endowment contracts;
- (11) Pensions;
- (12) Income from discharge of indebtedness;
- (13) Distributive share of partnership gross income;
- (14) Income in respect of a decedent; and
- (15) Income from an interest in an estate or trust.

A penalty is assessed under Utah Code Ann. §59-1-401(9) if a person files a return in furtherance of a frivolous position as follows:

(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 \$500.

Utah Code Ann. §59-10-537 imposes interest if tax is not paid on or before the due date, as follows in pertinent part:

(1) (a) Subject 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.

In accordance with Utah Code Ann. §59-1-402, interest is computed as follows in pertinent 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. §59-1-1417 provides, "in a proceeding before the commission, the burden of proof is on the petitioner... ."

CONCLUSIONS OF LAW

1. In accordance with Utah Code Ann. §59-1-1417(1), the Taxpayer has the burden of proof in this appeal to demonstrate that there was an error in the Division's audit deficiency for the 2017 tax year.

2. Utah Code Ann. §59-10-103(1)(q)(i) provides that a person is a Utah resident individual under either of two scenarios: 1) if the person is domiciled in Utah; or 2) if the person maintains a place of abode in Utah and spends 183 or more days of the taxable year in Utah. The Taxpayer acknowledged that he resided in Utah in 2017 and did not dispute that he was domiciled in Utah during that year. Thus, the Commission finds that the Taxpayer was domiciled in Utah and was, therefore, a “resident individual” of Utah as that term is defined in Utah Code Ann. §59-10-103(1)(q).

3. Utah imposes a tax on the state taxable income of a resident individual in Utah Code Ann. §59-10-104(1). “State taxable income” is defined in Utah Code Ann. §59-10-103(1) as the resident individual’s “adjusted gross income,” subject to certain adjustments that are not applicable in this case. Utah Code Ann. §59-10-103(1)(a) provides that “adjusted gross income” is as defined in Section 62 of the Internal Revenue Code, subject to certain additions or subtractions that are not at issue in this case. Internal Revenue Code Section 62, which has been incorporated into the Utah Code by reference, specifies that “adjusted gross income” is “gross income” with some specified deductions. “Gross Income” is defined by Section 61 of the Internal Revenue Code. Under Section 61 of the Internal Revenue Code, “gross income” is defined as “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”

4. The Taxpayer filed federal and Utah individual income tax returns for the 2017 tax year with a status of married filing separately and reported his federal adjusted gross income as \$\$\$\$ on both the federal and state returns for the 2017 tax year. However, the Division’s representatives submitted the Taxpayer’s IRS Wage and Income Transcript for 2017, which showed that the Taxpayer’s employer Blu Company reported that the Taxpayer received wages, tips, and other compensation in 2017. The Taxpayer filed a Form 4852, which is the Substitute for Form W-2, and testified that it was necessary to file a Form 4852 to correct information in which the Taxpayer’s employer erroneously reported that he had taxable income in 2017. The Taxpayer acknowledged that he provided labor to COMPANY-1 and received money from that company in YEAR. However, he asserted that he did not receive wages as that term is defined in Section 3401 of the Internal Revenue Code from COMPANY-1 because the definition of employee does not include him and because he is not working for the federal government. The Division’s representatives argued that the compensation that the Taxpayer received from COMPANY-1 meets the definition of gross income as that term is defined in Section 61 of the Internal Revenue Code and, therefore, should be included in the Taxpayer’s adjusted gross income as state taxable income.

5. The Commission finds that the compensation that the Taxpayer received from COMPANY-1, a private sector employer, which was provided as compensation for services provided is “gross income” as that term is defined in Section 61, Internal Revenue Code, which means that the

compensation is “state taxable income” under Utah Code Ann. §59-10-103. The Commission finds that the argument that wages or compensation from a private-sector employer are not subject to income tax has been soundly rejected by the courts.³⁰ The Commission also finds that the arguments that wages or compensation for services are not subject to income tax are also contrary to the applicable statutory provisions noted above. Based on the express terms of Utah law, compensation for services is included in Utah taxable income regardless of whether it is referred to as “wages” or “compensation” and regardless of whether it is earned in the public or private sector.³¹ The Commission also notes the Courts have also previously held that assertions similar to the Taxpayer’s assertions regarding the Sixteenth amendment of the United States Constitution have been sanctioned as frivolous³². As noted by the Division, 26 U.S.C. Sec 3401 is not incorporated into any of the relevant provisions of the Utah Code and that definition only applies to Chapter 24 of the Internal Revenue Code, whereas 26 U.S.C. Sec. 61 and 62 are the two provisions that are incorporated into the Utah Code and are found in Chapter 1 of the Internal Revenue Code.

³⁰ See *Waltner v. Commissioner of Internal Revenue*, T.C. Memo, 2014-35, pg. 49 (2014)(which rejected the argument that the definition of employee only includes federal employees and persons who are not federal employees are not taxed); *United States v. Latham*, 754 F.2d 747, 750 (7th Cir. 1985)(the court rejected a jury instruction stating that an employee does not include privately employed wage earners, and held “[i]t is obvious that within the context of both statutes 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”); *Sullivan v. United States*, 788 F.2d 813, 815 (1st Cir. 1986), which found that the argument is meritless; *Montero v. Comm’r*, 354 Fed. Appx 173, 174 fn. 1 (5th Cir. 2009),(the court noted that the Sixth Circuit has found the theory that private sector compensation is not “wages” and therefore not taxable “to be a frivolous tax-protestor argument” as further support); *United States v. Connor*, 898 F.2d 942, 944 (3rd Cir. 1990)(the court held that wages are income within the meaning of the Sixteenth Amendment); *Briggs v. Commissioner*, T.C. Memo 2016-86, pg. 10 (2016),(the United States Tax Court held “[p]etitioners’ assertions that wages from private-sector employers are not ‘income’ for Federal income tax purposes are frivolous . . . ,” (citing *Grunsted v. Commissioner*, 136 T.C. 455, 459-460 (2011)); *Pohl v. Commissioner*, T.C. Memo. 2013-291)(the court found that the Petitioners did not have substantial authority or a reasonable basis for their position and their arguments lacked any legal or factual basis to constitute a reasonable misunderstanding of the law).

³¹ See *Stelly v. Commissioner*, 761 F.2d 1113, 1115 (5th Cir. 1985). See also *Grantor v. C.I.R.*, 739 F.2d 265, 267 (7th Cir. 1984) in which the Seventh Circuit Court of Appeals stated: “It is well settled that wages received by taxpayers constitute gross income within the meaning of Section 61 (a) of the Internal Revenue Code . . . and that such gross income is subject to taxation.” In *United States v. Koliboski*, 732 F.2d 1328, 1329 fn. 1 (7th Cir. 1984), the Seventh Circuit Court of Appeals stated “the defendant’s entire case at trial rested on his claim that he in good faith believed that wages are not income for taxation purposes. Whatever his mental state, he, of course, was wrong, as all of us already are aware. Nonetheless, the defendant still insists that no case holds that wages are income. Let us now put that to rest: WAGES ARE INCOME.” See also *United States v. Collins*, 920 F.2d 619 (10th Cir. 1990), cert. denied, 500 U.S. 920 (1991); *United States v. Lonsdale*, 919 F.2d 1440 (10th Cir. 1990); *United States v. Sloan*, 939 F.2d 499, 501 (7th Cir. 1991), cert. den. 112 S.Ct. 940 (1992); *Cox v. Commissioner of Internal Revenue*, 99 F.3d 1149 (10th Cir. 1996).

³² See *United States v. Mundt*, 29 F.3d 233, 237 (6th Cir. 1994), holding “. . . For seventy-five years, the Supreme Court has recognized that the sixteenth amendment authorizes a direct nonapportioned tax upon United States citizens throughout the nation, not just in federal enclaves, see *Brushaber v. Union Pac. R.R.*, 240 U.S. 1, 12-19, 36 S. Ct. 236, 239-42, 60 L. Ed. 493 (1916); efforts to argue otherwise have been sanctioned as frivolous” (citing *United States v. Collins*, 920 F.2d 619 (10th Cir. 1990), cert. denied, 500 U.S. 920 (1991)).

6. The Commission also notes that the Taxpayer asserted that the Utah state income tax is based on the federal adjusted gross income and asserted that the IRS's acceptance of his federal income tax return that reported wages, tips, and other compensation as \$\$\$\$\$ demonstrates that his Substitute Form 4852 is legitimate and that his federal adjusted gross income, which is used on the state income tax form, is accurate and should be accepted by the state. The Commission finds that Utah's imposition of an income tax on a resident individual's state taxable income is entirely separate from the imposition of the federal tax based on the definitions outlined in the Utah Code, and finds that the State of Utah is not bound to accept the Taxpayer's adjusted gross income as \$\$\$\$\$ because that amount was reported as his federal adjusted gross income on his federal income tax return. Additionally, the Utah Supreme Court has previously held that the state is not precluded from issuing an assessment in situations where the IRS has not issued one³³. Although the Commission generally gives deference to the IRS in determining a Taxpayer's federal adjusted gross income, it is appropriate for the Division to make an independent determination in certain circumstances, including when it is clear that the IRS's determination was in error³⁴. Furthermore, several courts have found that a \$\$\$\$\$ return where a Taxpayer has a Form W-2 showing income is incorrect on its face³⁵.

7. The Division assessed a \$\$\$\$\$ furtherance of a frivolous position penalty in the Statutory Notice under Utah Code Ann. §59-1-401(9). Utah Code Ann. §59-1-401(9) provides "[i]f 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 \$\$\$\$." The Commission finds that the Taxpayer filed a purported return that clearly indicated the tax liability shown was substantially incorrect in furtherance of a frivolous position. Thus, the Commission finds that the Division properly assessed a \$\$\$\$\$ penalty pursuant to Utah Code Ann. §59-1-401(9).

8. The Commission has discretion to waive penalties under Utah Code Ann. §59-1-401(14). The Commission has promulgated Administrative Rule R861-1A-42 and Publication 17 to outline the circumstances the Commission may consider "reasonable cause" justifying a waiver of penalties. However, Subsection (4)(d) of Rule 42 provides:

³³ See *Jensen v. State Tax Comm'n*, 835 P.2d 965, 970 (Utah 1992); *Nelson v. Auditing Division*, 903 P.2d 939, 940 (Utah 1995).

³⁴ *Initial Hearing Order, Appeal No. 12-2963*, pg. 4, Utah State Tax Commission (February 23, 2015).

³⁵ See *Sisemore v. United States*, 797 F.2d 268, 269 (6th Cir. 1986) (holding that a return showing no income "on its face clearly showed that their assessment of their taxes was substantially incorrect and that their position on the matter was frivolous"); *Davis v. United States Government*, 742 F.2d 171, 172 (5th Cir. 1984); *Kelly v. United States*, 789 F.2d 94 (1st Cir. 1986).

(d) Intentional disregard, evasion, or fraud does not constitute reasonable cause for waiver under any circumstance.

The Commission finds that, under the circumstances, there is no reasonable cause to waive the audit penalty assessed for the 2017 tax year due to the fact that the Commission finds there was an intentional disregard of rule or law, and intentional disregard does not constitute reasonable cause for a waiver of penalties under any circumstance.

9. The Commission finds that the Division properly assessed interest in the audit assessment in this appeal in accordance with §59-1-402. The Commission has discretion to waive penalties or interest under Utah Code Ann. §59-1-401(14). The Commission has promulgated Administrative Rule R861-1A-42 and Publication 17 to outline the circumstances the Commission may consider as “reasonable cause” justifying a waiver of interest. With regard to the waiver of interest, Rule R861-1A-42 specifically provides, “[g]rounds 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.” Interest is not assessed to punish taxpayers. Instead, interest is assessed to compensate the state for the time value of money. The State of Utah was denied the use of the funds from the time the taxes were originally due. In this appeal, the Taxpayer has the burden of proof and has not provided any information to show that the Commission gave him erroneous information or took inappropriate action that contributed to the error. Thus, the Taxpayer has not demonstrated sufficient grounds for the waiver of interest in this appeal.

10. For the reasons stated above, the Commission finds that the Division’s audit that imposes an income tax on the Taxpayer’s wages, tips, and other compensation as reported by the Taxpayer’s employer on Forms W-2 that is evidenced by the Taxpayer’s IRS Wage and Income Transcript for the 2017 tax year and assesses a \$\$\$\$ penalty and interest should be sustained.

Shannon Halverson
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds the Taxpayer was a resident individual whose income was subject to tax in Utah for the 2017 tax year. The Commission sustains the Division's audit of income tax, penalty, and interest for the 2017 tax year. It is so ordered.

DATED this _____ day of _____, 2023.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Rebecca L. Rockwell
Commissioner

Jennifer N. Fresques
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 applied. If you disagree with this order you have twenty (20) days after the date of this order to file a Request for Reconsideration with the Commission in accordance with Utah Code Ann. §63G-4-302. 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.