

REDACTED DECISION – DK# 11-239 P

**BY: A.M. “FENWAY” POLLACK, CHIEF ADMINISTRATIVE LAWJUDGE
SUBMITTED FOR DECISION ON MAY 30, 2012
ISSUED ON JANUARY 18, 2013**

SYNOPSIS

TAXATION -- PROCEDURE AND ADMINISTRATION -- It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. *See* W. Va. Code Ann. § 11-1-2 (West 2010).

TAXATION -- PROCEDURE AND ADMINISTRATION -- “The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable.” W. Va. Code Ann. § 11-10-11(a) (West 2010).

TAXATION -- PROCEDURE AND ADMINISTRATION -- “If the Tax Commissioner believes that any tax administered under this article has been insufficiently returned by a taxpayer, either because the taxpayer has failed to properly remit the tax, or has failed to make a return, or has made a return which is incomplete, deficient or otherwise erroneous, he may proceed to investigate and determine or estimate the tax liability and make an assessment therefor.” W. Va. Code Ann. § 11-10-7(a) (West 2010).

TAXATION -- PERSONAL INCOME TAX -- The West Virginia adjusted income of a resident individual is the “federal adjusted gross income as defined in the laws of the United States” with modifications allowed by West Virginia law. *See* W. Va. Code Ann. § 11-21-12(a) (West 2010).

TAXATION -- PERSONAL INCOME TAX -- “When auditing for compliance with this article, the Tax Commissioner may change a taxpayer's computation of federal taxable income or pro forma taxable income to comply with the laws of the United States as in effect for the taxable year and incorporated by reference into this article.” W. Va. Code Ann. § 11-21-12g(d) (West 2010).

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- For tax years 2008, 2009 and 2010, the Petitioner made personal income tax returns that were erroneous in that she under-reported her West Virginia adjusted income.

WEST VIRGINIA OFFICE OF TAX APPEALS -- CONCLUSION OF LAW -- The Tax Commissioner's changes to the Petitioner's federal taxable income (and subsequent changes to her Federal adjusted gross income and her West Virginia adjusted gross income) complied with the laws of the United States as well as with West Virginia law.

WEST VIRGINIA OFFICE OF TAX APPEALS -- BURDEN OF PROOF -- In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against her is erroneous,

unlawful, void or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010); W. Va. Code. R. §§ 121-1-63.1 and 69.2 (2003).

WEST VIRGINIA OFFICE OF TAX APPEALS -- BURDEN OF PROOF NOT MET --
The Petitioner has not met her burden of showing that the assessment issued against her was erroneous, unlawful, void or otherwise invalid.

FINAL DECISION

On May 27, 2011, the Auditing Division of the West Virginia State Tax Commissioner's Office (the Tax Department or the Respondent) issued an Audit Notice of Assessment, against the Petitioner. This assessment was issued pursuant to the authority of the State Tax Commissioner, granted to him by the provisions of Chapter 11, Article 10 *et seq*, of the West Virginia Code. The assessment was for personal income tax for the period of January 1, 2008, through December 31, 2010, for tax in the amount of \$_____, interest in the amount of \$_____, and additions to tax in the amount of \$_____, for a total assessed tax liability of \$_____. Written notice of this assessment was served on the Petitioner as required by law.

Thereafter, on July 11, 2011, the Petitioner timely filed with this Tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. *See* W. Va. Code Ann. §§ 11-10A-8(1); 11-10A-9 (West 2010).

Subsequently, notice of a hearing on the petition was sent to the Petitioner, and a hearing was held in accordance with the provisions of West Virginia Code Section 11-10A-10.

FINDINGS OF FACT

1. The Petitioner owns and operates a restaurant in a West Virginia city.
2. In October of 2010, auditors from the West Virginia Tax Department traveled to the offices of the Petitioner's accountant for the purpose of conducting an audit of the Petitioner's business.
3. The audit lasted for several months. At its conclusion, the auditors were of the opinion that the books and records of the Petitioner were inadequate to accurately reflect her

business operations. As a result, the Tax Commissioner issued two assessments against the Petitioner for unremitted consumers sales and service tax and combined sales and use tax.

4. The two sales tax assessments were the subject of an evidentiary hearing before the Office of Tax Appeals. The final decision in that matter, identified as Docket Nos. 11-237 C and 11-238 CU, found that the Petitioner had failed to account for and remit to the Tax Commissioner all of the sales taxes collected from her customers. The Final Decision modified the two assessments and directed the parties to consult and arrive at a new computation of tax, interest and additions due.

5. Regarding the personal income tax assessment that is the subject of this matter, the Tax Commissioner's investigation of the restaurant led to an investigation of the Petitioner's personal income tax filings. Tax Department employees determined that the Petitioner had not reported all of her taxable income.

6. The auditors applied the amount of under-reported sales from the restaurant to the Petitioner's personal income. Specifically, they took the Petitioner's Federal Schedule C and added the amount of under-reported sales. They attempted to reduce this amount by questioning the Petitioner's accountant regarding any additional cost of goods sold. However, no additional receipts for goods sold were provided. The auditors then recalculated the Petitioner's self-employment deduction and arrived at a new Federal adjusted gross income amount. This amount was then carried over to the first line of the Petitioner's West Virginia personal income tax return. The increased income obviously led to additional income tax due and that additional tax led to the issuance of the assessment in this matter.

DISCUSSION

This matter generates three questions. Did the Petitioner have income that she failed to report; can the Tax Commissioner make adjustments to the amounts a person reports to the

Federal government and did the Tax Commissioner calculate these Federal adjustments correctly?

The answer to question number two is easy. It is obvious that the Tax Commissioner could not enforce the tax laws if he or she was unable to make adjustments of the type made in this matter. The Legislature has given the Tax Commissioner broad investigatory powers; and regarding income taxes, specific powers to do precisely what was done in this matter. The broad powers are contained in West Virginia Code Section 11-10-7(a), which states:

If the tax commissioner believes that any tax administered under this article has been insufficiently returned by a taxpayer, either because the taxpayer has failed to properly remit the tax, or has failed to make a return, or has made a return which is incomplete, deficient or otherwise erroneous, he may proceed to investigate and determine or estimate the tax liability and make an assessment therefor.

W. Va. Code Ann. § 11-10-7(a) (West 2010).

Under West Virginia Code Section 11-21-12(a), the West Virginia adjusted income of a resident individual is the “federal adjusted gross income as defined in the laws of the United States” with modifications allowed by West Virginia law. *See* W. Va. Code Ann. § 11-21-12(a) (West 2010). Additionally, the Legislature provided a specific avenue for adjustment to the personal income tax, by providing:

When auditing for compliance with this article, the Tax Commissioner may change a taxpayer's computation of federal taxable income or pro forma taxable income to comply with the laws of the United States as in effect for the taxable year and incorporated by reference into this article.¹

W. Va. Code Ann. § 11-21-12g(d) (West 2010).

In this matter, the Tax Commissioner undertook an investigation which led him to believe that the Petitioner filed deficient personal income tax returns for tax years 2008, 2009 and 2010.

¹ The computation for West Virginia taxable income begins with a taxpayer's Federal Adjusted Gross Income. Section 12G (d) allows the Tax Commissioner to change the computation of federal taxable income, not adjusted gross. However, in this case, as in most cases, the change in the Petitioner's federal taxable income created a corresponding change in her federal adjusted gross income.

Specifically, the Tax Commissioner believed that the Petitioner had additional business income, which should have been reported on her Federal Schedule C. As a result, he, as the Legislature has authorized him to do, changed the Petitioner's Federal taxable income, which changed the Petitioner's Federal adjusted gross income, which changed her West Virginia adjusted income.

The answer to question number one is guided by this Tribunal's decision in Docket Nos. 11-237 C and 11-238 CU. There, we ruled that the Petitioner failed to account for and remit all of the sales taxes collected from the restaurant's customers.² As a result, it is readily apparent that the restaurant generated more business than the Petitioner's records revealed. In reviewing the Petitioner's personal income tax returns, it became apparent that the Petitioner had not accounted for that additional revenue/income.

Finally, we must decide if the Tax Commissioner has followed Federal (and State) law by how he adjusted the Petitioner's Federal income. While obvious, it should be re-stated that the Petitioner disagrees with the Tax Commissioner's assessment against the restaurant. Once the restaurant's under-reported sales are taken as a given, the Petitioner's arguments regarding her personal income become more problematic. The problem for the Petitioner, as evidenced by the testimony at the evidentiary hearing, is that she was caught in a classic catch-22. At the hearing the Petitioner complained (through her accountant's testimony) that the auditors, in adjusting her Federal schedule C business income, did not also adjust her expenses accordingly. Given the fact that the Petitioner is a restaurateur, much of the testimony focused on the Petitioner's cost of goods sold. And it is here that the Petitioner gets tripped up. One of the auditors testified that they asked the Petitioner's accountant for additional invoices to reflect the additional goods purchased and none were provided. The auditor succinctly explained the Petitioner's dilemma; if

² While we ruled that the Petitioner had failed to remit all sales taxes due, we also ruled that the amount of the assessments needed modifying. As a result, the matter was given back to the parties for a new computation of tax, interest and additions due.

you show more food purchased than as reported on your schedule C, then you have essentially admitted that you have underreported your sales. This is why the Petitioner's accountant was forced to contradict herself during the hearing, first suggesting that the auditors failed to take certain costs into account. "Income tax was calculation based on the sales tax audit. Right. If you increase the sales, don't you think that the cost of goods sold, wages, operation overheads and all other business-related costs?"³ See Transcript p. 25. However, mere minutes later she was forced to adopt a different position.

JUDGE POLLACK: So what you're saying is that even though your clients maintain there is no increase to cost of goods sold, what they reported is exactly what they bought?

PETITIONER'S WITNESS: Correct

See Transcript p. 31. As stated above, the auditors did adjust what they could of the Petitioner's business income, specifically adjusting her self-employment deduction. Based upon what little credible information was received from the Petitioner and her accountant, the Tax Commissioner did comply with the laws of the United States when he changed the Petitioner's computation of federal taxable income.

CONCLUSIONS OF LAW

1. It is the duty of the Tax Commissioner to see that the laws concerning the assessment and collection of all taxes and levies are faithfully enforced. See W. Va. Code Ann. § 11-1-2 (West 2010).

2. "The Tax Commissioner shall collect the taxes, additions to tax, penalties and interest imposed by this article or any of the other articles of this chapter to which this article is applicable." W. Va. Code Ann. § 11-10-11(a) (West 2010).

³ While the witness did not artfully pose the question, it is clear that she was questioning the auditor's failure to increase the Petitioner's expenses.

3. “If the Tax Commissioner believes that any tax administered under this article has been insufficiently returned by a taxpayer, either because the taxpayer has failed to properly remit the tax, or has failed to make a return, or has made a return which is incomplete, deficient or otherwise erroneous, he may proceed to investigate and determine or estimate the tax liability and make an assessment therefor.” W.Va. Code Ann. § 11-10-7(a) (West 2010).

4. The West Virginia adjusted income of a resident individual is the “federal adjusted gross income as defined in the laws of the United States” with modifications allowed by West Virginia law. *See* W.Va. Code Ann. § 11-21-12(a) (West 2010).

5. “When auditing for compliance with this article, the Tax Commissioner may change a taxpayer's computation of federal taxable income or pro forma taxable income to comply with the laws of the United States as in effect for the taxable year and incorporated by reference into this article.” W. Va. Code Ann. § 11-21-12g(d) (West 2010).

6. For tax years 2008, 2009 and 2010 the Petitioner made personal income tax returns that were erroneous in that she under-reported her West Virginia adjusted income.

7. The Tax Commissioner’s changes to the Petitioner’s federal taxable income (and subsequent changes to her Federal adjusted gross income and her West Virginia adjusted gross income) complied with the laws of the United States as well as with West Virginia law

8. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioner to show that any assessment of tax against her is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code Ann. § 11-10A-10(e) (West 2010); W. Va. Code. R. §§ 121-1-63.1 and 69.2 (2003).

9. The Petitioner has not met her burden of showing that the assessment issued against her was erroneous, unlawful, void or otherwise invalid.

FINAL DISPOSITION

Based upon the above, it is the **FINAL DECISION** of the West Virginia Office of Tax Appeals that the personal income tax assessment issued against the Petitioner on May 27, 2011, was not erroneous, unlawful, void or otherwise invalid. However, because the May 27, 2011, consumer sales and service tax and combined sales and use tax assessments issued against the Petitioner were ordered modified by this Tribunal and because the assessment amount in this matter is governed by the sales tax assessment amounts, the assessment in this matter is hereby **MODIFIED** to reflect, as of December 15, 2012, a tax due of \$_____, interest due of \$_____ and additions to tax of \$_____ for a **TOTAL** tax liability of \$_____.

Interest continues to accrue on this unpaid tax until this liability is fully paid. W. Va. Code Ann. § 11-10-17(a) 2010).

WEST VIRGINIA OFFICE OF TAX APPEALS

By: _____
A. M. "Fenway" Pollack
Chief Administrative Law Judge

Date Entered