

**SANITIZED DEICSION – 05-431 P – BY ROBERT W. KIEFER, JR., ALJ –SUBMITTED  
for DECISION on January 24, 2006 – ISSUED on July 20, 2006**

**SYNOPSIS**

**PERSONAL INCOME TAX – 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 taxpayers to show that the assessment issued against them is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code § 11-10A-10(e) [2002] and W. Va. Code St. R. § 121-1-63.1 (Apr. 20, 2003).

**PERSONAL INCOME TAX – WEST VIRGINIA ADJUSTED GROSS INCOME** -- Pursuant to the provisions of W. Va. Code § 11-21-12(a), amounts included in taxpayers' adjusted gross income for purposes of federal income tax are required to be included in their adjusted gross income for purposes of the West Virginia personal income tax, unless excluded by one of the modifications set out in W. Va. Code §§ 11-21-12(c), 11-21-12a, 11-21-12b, 11-21-12c, 11-21-12d, or 11-21-12e.

**PERSONAL INCOME TAX – WEST VIRGINIA ADJUSTED GROSS INCOME** -- Pursuant to the provisions of W. Va. Code § 11-21-12(a), a determination by the Internal Revenue Service respecting the amount of taxpayers' federal adjusted gross income is binding upon the taxpayers, the State Tax Commissioner and the West Virginia Office of Tax Appeals.

**PERSONAL INCOME TAX – WEST VIRGINIA ADJUSTED GROSS INCOME** -- To the extent that the Internal Revenue Service determines that an amount is to be included in federal adjusted gross income, it is included in West Virginia adjusted gross income pursuant to W. Va. Code § 11-21-12(a), unless excluded by a statutory modification reducing West Virginia adjusted gross income, and neither the State Tax Commissioner nor the West Virginia Office of Tax Appeals may look behind the Internal Revenue Service's determination.

**PERSONAL INCOME TAX – WAIVER OF ADDITIONS TO TAX** -- The Petitioners have satisfied their burden of proving that reasonable cause exists for waiver of additions to tax on a portion of the additional tax assessed against the taxpayers.

**PERSONAL INCOME TAX – WAIVER OF ADDITIONS TO TAX** -- The Petitioners have failed to satisfy their burden of proving that reasonable cause exists for the waiver of additions to tax on the other items that were omitted from the taxpayers' adjusted gross income for both federal and state income tax purposes.

**FINAL DECISION**

On June 16, 2005, the Internal Auditing Division ("the Division") of the West Virginia State Tax Commissioner's Office ("the Commissioner" or "the Respondent") issued a personal

income tax assessment against the Petitioner. This assessment was issued pursuant to the authorization of the State Tax Commissioner, under the provisions of Chapter 11, Articles 10 and 21 of the West Virginia Code. The assessment was for calendar year 2002, for tax in the amount of \$, interest in the amount of \$, computed through June 16, 2005, and additions to tax in the amount of \$, for a total assessed tax liability of \$. Written notice of this assessment was served on the Petitioners.

Thereafter, by mail postmarked July 20, 2005, and received on August 1, 2005, the Petitioners timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment. W. Va. Code §§ 11-10A-8(1) [2002] and 11-10A-9 (a) - (b) [2002].

Subsequently, notice of a hearing on the petition was sent to the Petitioners and a hearing was held in accordance with the provisions of W. Va. Code § 11-10A-10 [2002].

#### **FINDINGS OF FACT**

1. The Petitioners are husband and wife residing in a certain town in West Virginia.
2. Some years prior to the 2002 tax year, the Petitioner contracted with the United States Postal Service ("USPS") to operate a rural motor delivery postal route.
3. Some time before the 2002 tax year, at a time not specified in the record, the Petitioner accepted employment with a company which rendered him unable to further perform his contract for the USPS.
4. The Petitioner subcontracted with his niece to perform the USPS contract.
5. The contract for the postal route remained in the Petitioners' name because, in order for the contract to be placed in his niece's name, it would have been necessary for the USPS to re-bid the contract.

6. Because the contract remained in the Petitioners' name, the USPS paid the contract price to him.

7. Every year, the Petitioner received a Form 1099-MISC from the USPS showing the amount of compensation received by him for performance of the contract.

8. Subsequent to the time that the niece undertook performance of the contract with the USPS, all compensation received by the Petitioner for performance of the contract for the USPS was paid by him to his niece.

9. Every year the Petitioner would provide a Form 1099-MISC to his niece, showing that he was paying to her the amount received by him for performing the contract.

10. The Petitioner would also provide the Internal Revenue Service with a Form-1096, which showed that the compensation received by him from the USPS was not claimed by him, but was reported to his niece on a Form-1099, who then reported said income on her Form 1040.

11. Each year the Form 1099-MISC provided to the niece and the Form 1096 were required to be filed on or before February 28, 2006.

12. The Petitioner's cousin has done the Petitioners' taxes for a number of years.

13. Each year the cousin would prepare and file the Forms 1099-MISC & 1096 with the IRS on or before February 28.

14. Each year, the Petitioner would include a statement with the Petitioners' Form 1040 explaining that the income received from the USPS was, in turn, paid by him to his niece.

15. The cousin testified that the statement was provided to the IRS with the Petitioners' Form 1040, so that the IRS could match the Forms 1099-MISC and 1096 to the Petitioners' Form 1040.

16. The cousin would attach the letter of explanation to the top of the Form 1040, in the manner of a cover letter, in order to draw it to the attention of the IRS.

17. For 2002, the Petitioners had their taxes prepared by a certain commercial tax return preparer, because they needed a rapid refund.

18. That commercial preparer electronically filed the Form 1040 with the Internal Revenue Service. The cousin surmised that because the Form 1040 was filed electronically, the commercial preparer did not file the letter of explanation with the Internal Revenue Service.

19. The cousin surmised that this was the reason that the IRS treated the USPS payment as income to the Petitioners.

20. The Petitioners' Form 1040 for 2002, filed by the commercial preparer, also omitted the following items in the following amounts: . . . .

21. On or about February 4, 2004, subsequent to receipt of a notice from the IRS respecting certain adjustments to their income resulting from these omitted items, the Petitioner filed a Form 1040X, with a letter of explanation attached, to show why the USPS contract receipts were not reported on the Form 1040.

22. With the exception of the compensation from the USPS contract, the Petitioners conceded that the omitted items should properly have been reported on their Form 1040 for 2002.

23. By request dated August 5, 2005, the State Tax Commissioner requested return information from the Internal Revenue Service for tax year 2002. *See* State's Exhibit No. 4.

24. For tax year 2002, in matching the Petitioners' adjusted gross income to federal adjusted gross income, the State Tax Commissioner determined that there was a discrepancy in

the amount of their adjusted gross income as reported to the State Tax Commissioner and the amount of their adjusted gross income as determined by the Internal Revenue Service.

25. By letter dated August 1, 2005, the Petitioners were notified of specific increases that the State Tax Commissioner intended to make in their taxable income, based on information received from the Internal Revenue Service.

26. One of the items which resulted in an increase in the adjusted gross income reported to the State Tax Commissioner was \$ which was reported as income to the Petitioners by the United States Postal Service, St. Louis Postal Data Center. *See State's Exhibit No. 3.*

27. The Petitioners have filed a protest with the Internal Revenue Service, in which they seek to have their adjusted gross income reduced by the amount of the distribution by the United States Postal Service because, although that amount was paid to the Petitioners, he paid that amount to his niece for performance of the contract.

28. As of the date of the evidentiary hearing, no evidence was presented by either party to show that the Internal Revenue Service has reduced the Petitioners' adjusted gross income by the amount paid by the United States Postal Service.

29. The State Tax Commissioner takes the position that the additions to tax will not be waived because the Petitioners failed to report changes by the Internal Revenue Service increasing their income.

## **DISCUSSION**

The issue presented in this matter is whether the amount paid to the Petitioners for the performance of his contract with the United States Postal Service, which he in turned paid to his niece, who actually performed the contract, is subject to West Virginia personal income tax.

The starting point for determining West Virginia taxable income is W. Va. Code § 11-21-12(a), which provides that West Virginia adjusted gross income equals federal adjusted gross income, subject to the modifications set out in W. Va. Code §§ 11-21-12(c), 11-21-12a, 11-21-12b, 11-21-12c, 11-21-12d, or 11-21-12e. None of these modifications are applicable to this matter. Thus, any determination by the Internal Revenue Service respecting the amount of adjusted gross income for purposes of the federal income tax constitutes the starting point for any determination respecting West Virginia adjusted gross income. By making any determination by the Internal Revenue Service respecting the amount of adjusted gross income for purposes of the federal income tax the starting point for any determination respecting West Virginia adjusted gross income, the West Virginia Legislature has made the Internal Revenue Service's determination binding on both the State Tax Commissioner and the West Virginia Office of Tax Appeals. This Office has no authority to overrule the Internal Revenue Service's determination respecting federal adjusted gross income. A consequence of this is that this Office may not overrule the Internal Revenue Service's determination respecting the starting point for determining West Virginia adjusted gross income.

The Petitioners contend that the Internal Revenue Service's determination respecting the proceeds from the USPS contract was incorrect. Their explanation for why the Internal Revenue Service determination is erroneous is certainly plausible. They maintain that for each year for which the Petitioners' niece performed the USPS contract, they provided documentation to the Internal Revenue Service necessary to show that the income reported to the Petitioner by the USPS was duly and properly reported by the niece and was taxable to her. However, because the commercial tax return preparer electronically filed their return for 2002, so as to take advantage of a rapid refund, it appears that the usual documentation explaining that the income should be

properly reported to the Internal Revenue Service by the niece was not filed. The apparent consequence of this was that the Internal Revenue Service attributed the USPS contract price as income to Petitioners.<sup>1</sup> Thus, the Petitioners contend that the Internal Revenue Service's attribution of income to them for 2002 was erroneous.

It is difficult to say that the Petitioners are wrong in asserting that the USPS contract price should not be treated as income to them, but instead should be treated as income to Petitioners' niece. On their Form 1040 for 2002 they reported the income from the USPS contract in the same manner as it was reported for the other years that the contract was performed by the niece. The Internal Revenue Service apparently concurred in this treatment for a number of years both prior and subsequent to the 2002 tax year. However, because the proper back up information was not filed for 2002, the contract price for that year was taxed as income to the Petitioners'. The Petitioners attempted to "correct" this determination by the Internal Revenue Service by filing a Form 1040X, appending thereto the explanation that was omitted from the original return. The appended explanation was in a form that had apparently satisfied the Internal Revenue Service for other tax years. However, the Internal Revenue Service has not issued anything to the Petitioners indicating acceptance or denial of their Form 1040X. Thus, the Internal Revenue Service's determination, as it presently stands, is that receipts from the USPS contract are taxable income to the Petitioners.

The Tax Commissioner, being bound by the Internal Revenue Service's determination respecting federal adjusted gross income, issued the assessment based on that determination. The Petitioners are asking this Office to amend the Tax Commissioner's assessment. In doing so they are, in effect, asking this Office to go behind the Internal Revenue Service's determination

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<sup>1</sup> If the niece reported the income, it has been subject to tax twice.

respecting federal adjusted gross income. Stated differently, they are asking this Office to disregard W. Va. Code § 11-21-12(a). Absent a legal basis for concluding that a statute has been declared unconstitutional as applied to a given set of facts, this Office has no authority to disregard a valid statutory provision. The Petitioners have not asserted that the statute is unconstitutional as applied to them. There is no clear or obvious reason for this Office to conclude that the statute is unconstitutional as applied to the Petitioners. Therefore, the assessment of tax must be affirmed.<sup>2</sup>

The Petitioners also have requested a waiver of additions to tax with respect to the additional tax assessed as a result of the increase in income due to attribution of the proceeds of the USPS contract to the Petitioners'. The basis for this request is the fact that the income, while attributed to the Petitioner, is attributed to him in error. Because it is attributed to him in error, they argue, there should be no additional tax and, therefore, no additions to tax thereon.

For the reasons set forth above, this Office is of the opinion that the assessment of additional tax based on the income attributed to the Petitioner is valid, at least pending a final determination by the IRS to the contrary. This Office so holds because it is statutorily constrained to do so. This Office is of the opinion that this attribution is, in all likelihood an error. However, it is an error of the Petitioners' making and one which neither the Tax Commissioner nor this Office has the authority to rectify. Only the Internal Revenue Service is in a position to correct the problem.

Although the problem can only be rectified by the Internal Revenue Service, this Office is not required to further compound the problem by upholding additions to tax on that portion of

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<sup>2</sup> If, at a later date, the Internal Revenue Service determines that the proceeds of the USPS contract are taxable to the niece, and not to the Petitioners', then the Petitioners should be eligible to timely apply to the State Tax Commissioner for a refund of any tax paid on those proceeds.

the assessment which, while apparently technically valid, in all likelihood really is in error. Therefore, even though this Office is constrained to uphold the assessment of additional tax on the proceeds of the USPS contract, the additions to tax thereon, in the amount of \$, will be waived.

The remainder of the additions to tax is attributable to the failure of the Petitioners to report income on their return that was reported to them. Therefore, the additions to tax on those amounts will not be waived.

### **CONCLUSIONS OF LAW**

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for reassessment, the burden of proof is upon the Petitioners to show that the assessment issued against them is erroneous, unlawful, void or otherwise invalid. *See* W. Va. Code § 11-10A-10(e) [2002] and W. Va. Code St. R. § 121-1-63.1 (Apr. 20, 2003).

2. Pursuant to the provisions of W. Va. Code § 11-21-12(a), amounts included in the Petitioners' adjusted gross income for purposes of federal income tax, including the proceeds of the USPS contract, are required to be included in their adjusted gross income for purposes of the West Virginia personal income tax, unless excluded by one of the modifications contained in W. Va. Code §§ 11-21-12(c), 11-21-12a, 11-21-12b, 11-21-12c, 11-21-12d, or 11-21-12e.

3. Pursuant to the provisions of W. Va. Code § 11-21-12(a), a determination by the Internal Revenue Service respecting the amount of the Petitioners' federal adjusted gross income is binding upon the Petitioners, the State Tax Commissioner and the West Virginia Office of Tax Appeals.

4. To the extent that the Internal Revenue Service determines that an amount is to be included in federal adjusted gross income, it is presumptively included in West Virginia adjusted gross income pursuant to W. Va. Code § 11-21-12(a), and neither the State Tax Commissioner nor the West Virginia Office of Tax Appeals may look behind the Internal Revenue Service's determination.

5. The latest determination of the Internal Revenue Service is that the proceeds of the contract performed for the United State Postal Service are included in federal adjusted gross income and, therefore, pursuant to the provisions of W. Va. Code § 11-21-12(a), they are included in West Virginia adjusted gross income.

6. The Petitioners have not satisfied their burden of proving that the proceeds of the USPS contract are not to be included in West Virginia adjusted gross income pursuant to W. Va. Code § 11-21-12(a).

7. Reasonable cause exists for waiver of additions to tax on the tax attributable to the additional tax on the proceeds of the USPS contract.

8. The Petitioners have failed to satisfy their burden of proving that reasonable cause exists for the waiver of additions to tax on the other items that were omitted from the Petitioners' adjusted gross income for both federal and state income tax purposes.

#### **DISPOSITION**

**WHEREFORE**, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the personal income tax assessment issued against the Petitioners for the year of 2002, for tax in the amount of \$, interest in the amount of \$, through June 16, 2003, and additions to tax in the amount of \$, totaling \$, should be and is hereby **AFFIRMED** as to the tax

in the amount of \$, interest in the amount of \$, and additions to tax in the amount of \$, for a total liability of \$. However, additions to tax in the amount of \$, attributable to the additional tax on the proceeds of the USPS contract, are **VACATED**.

**Interest continues to accrue** on this unpaid tax until this liability is fully paid.