11-3141
TAX TYPE: INCOME TAX
TAX YEAR: 2005, 2006, AND 2007
DATE SIGNED: 1-10-2014
COMMISSIONERS: B. JOHNSON, M. CRAGUN, R. PERO
EXCUSED: D. DIXON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER-1 AND TAXPAYER-2 Petitioners, vs. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECISION** Appeal No. 11-3141 Account No. ##### Tax Type: Income Tax Tax Years: 2005-2007 Judge: Phan

Presiding:
Michael Cragun, Commissioner
Jane Phan, Administrative Law Judge

Appearances:
For Petitioner: TAXPAYER-1, by Telephone
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT-1, Income Tax Auditing
RESPONDENT-2, Senior Auditor

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission pursuant to Utah Code Secs. 59-1-501 and 63G-4-201 et al., for a Formal Hearing, on October 21, 2013. Based upon the evidence and testimony presented at the hearing the Tax Commission hereby makes its:

FINDINGS OF FACT

1. This matter is before the Commission on Petitioners' (the Taxpayers) appeal of an income tax audit deficiency issued against them for tax years 2005 through 2007. The Statutory Notices of Estimated Income Tax had been issued on November 23, 2011. The Taxpayers filed a timely appeal of the audit and the matter proceeded to the Formal Hearing before the Commission.

2. The deficiencies indicated in the statutory notices were as follows:

Year	Tax	Penalty	Interest	Total[1]
2005	$$$$$	$$$$$	$$$$$	$$$$$
2006	$$$$$	$$$$$	$$$$$	$$$$$
2007	$$$$$	$$$$$	$$$$$	$$$$$

3. At the hearing the representative for Respondent ("Division") stipulated that there was reasonable cause for waiver of the penalties for each year at issue in this appeal.

4. During each of the years at issue, as well as prior and subsequent years, the Taxpayer was not a resident of Utah as that is defined for Utah Individual Income Tax purposes. The Taxpayer was a resident of STATE for state tax purpose for all years relevant to this appeal.

5. During the audit years, the Taxpayer received income from a Utah partnership. The Taxpayer had claimed this income on his federal returns as well as STATE resident individual income tax returns filed for each year at issue. He paid taxes to the state of STATE on this income. Although the Taxpayer did have assistance of a tax preparer during this time, he testified that he was not instructed to file a Utah Nonresident Individual Income Tax Return, nor did it occur to the Taxpayer that he should have filed the Utah Nonresident returns claiming the partnership income as Utah source income.

6. The Division issued the audits that are subject to this appeal in 2011, as well as audits for subsequent tax years. After receiving the audits the Taxpayer sought additional tax advice. The Taxpayer does not now contest that the Utah partnership income was Utah source income and he agrees that it was taxable to Utah. He does not now contest that he should have filed a Nonresident Utah return claiming the Utah source income, paying taxes to Utah on that income and then claiming on his STATE resident return the credit or deduction for taxes paid to another state. After being notified of the audit, he was able to correct his filings for the years 2008 through 2010 so that taxes were paid to Utah and he received a refund from STATE. However, when the audits were issued, the years 2005 through 2007 were beyond that statute of limitations for refund in STATE. The Taxpayer has already paid state tax on the Utah partnership income to STATE and is not able to receive a refund from that state. It is his contention that requiring him to now pay the tax to Utah, when he is not able to obtain the refund from STATE, will result in his paying state tax twice on the same income.

1 Interest calculated to the date of the Statutory Notices. Interest continues to accrue on any unpaid balance.

APPLICABLE LAW

Utah imposes income tax on nonresident individuals who have Utah source income at Utah Code §59-10-116 (2005)[2] as follows:

> Except as provided in Subsection (3), a tax is imposed on a nonresident individual in an amount equal to the product of the nonresident individual's: (a) un apportioned state tax: and (b) state income tax percentage.

For tax years 2005, Utah Code §59-10-106(1)(2005) (amended and recodified in 2006 as §59-10-1003) provided that a credit is allowed against a person's Utah tax liability for taxes paid to certain governmental entities, as follows:

> A resident individual shall be allowed a credit against the tax otherwise due under this chapter equal to the amount of the tax imposed on him for the taxable year by another state of the United States, the District of Columbia, or a possession of the United States, on income derived from sources therein which is also subject to tax under this chapter.

Utah Code §59-10-1003(1) and (2) effective May 1, 2006 provide:

> (1) Except as provided in Subsection (2), a claimant, estate, or trust may claim a nonrefundable tax credit against the tax otherwise due under this chapter equal to the amount of the tax imposed: (a) on that claimant, estate, or trust for the taxable year; (b) by another state of the United States, the District of Columbia, or a possession of the United States; and (c) on income: (i) derived from sources within that other state of the United States, District of Columbia, or possession of the United States; and (ii) if that income is also subject to tax under this chapter. (2) A tax credit under this section may only be claimed by a (a) resident claimant: (b) resident estate; or (c) resident trust.

In 2005 Utah Code §59-10-115 (amended effective May 1, 2006) provided that a taxpayer could claim an equitable adjustment in part as follows:

> (1) If any provisions o f the Internal Revenue Code requires the inclusion of an item of gross income or the allowance of an item of deduction from gross income in the computation of federal taxable income of the taxpayer for any taxable year beginning on or after the effective date of this chapter, and if such item has been taken into account in computing the taxable income of the taxpayer for state income tax purpose for any prior taxable year, the commission shall make or allow such adjustments to the taxpayers' state taxable income as are necessary to prevent the inclusion for a second time or the deduction for a second time of such item for state income tax purposes.
> . . .

2 The Utah Individual Income Tax Act has been revised and some sections renumbered subsequent to the audit period. The Tax Commission applies and cites to the statutes and rules that were in effect during the audit period.

> (3) If the taxpayer receives, in any taxable year beginning on or after the effective date of this chapter, a distribution from an electing small business corporation, as defined by Section 1371(b) of the Internal Revenue Code, of a net share of the corporation's undistributed taxable income for a taxable year or years prior to the taxable year in which such distribution is made, the commission shall make such adjustment to state taxable income as will prevent escape from taxation by this state of such undistributed taxable income previously taxed to the taxpayer for federal income tax purposes but not for state income tax purposes.
> (4) The commission shall by rule prescribe for adjustments to state taxable income of the taxpayer in circumstances other than those specified by Subsection (1), (2), and (3) of this section where, solely by reason of the enactment of this chapter, the taxpayer would otherwise receive or have received a double tax benefit or suffer or have suffered a double tax detriment . . . .

Effective May 1, 2006, Utah Code §59-10-115 provides:

> (1) The Commission shall allow an adjustment to state taxable income of a taxpayer if the taxpayer would otherwise: (a) receive a double tax benefit under this part; or (b) suffer a double tax detriment under this part.
> (2) In accordance with Title 63, chapter 46a, Utah Administrative Rulemaking Act, the commission may make rules to allow for the adjustment to state taxable income required by Subsection (1).

During the audit period, Utah Admin. Rule R865-9I-4 ("Rule 4") (since repealed) addressed the equitable adjustment, as follows:

> A. Every taxpayer shall report and the Tax Commission shall make or allow such adjustments to the taxpayer's state taxable income as are necessary to prevent the inclusion or deduction for a second time on his Utah income tax return of items involved in determining his federal taxable income. Such adjustments shall be made or allowed in an equitable manner as defined in Utah Code Ann. 59-10-115 or as determined by the Tax Commission consistent with provisions of the Individual Income Tax Act.
> B. In computing the Utah portion of a nonresident's federal adjusted gross income; any capital losses, net long-term capital gains, and net operating losses shall be included only to the extent that these items were not taken into account in computing the taxable income of the taxpayer for state income tax purposes for any taxable year prior to January 2, 1973.

Utah Code §59-1-1417 provides that the taxpayer bears the burden of proof, with limited exceptions, in proceedings involving individual income tax before the Tax Commission, as follows:

> In any proceeding before the commission under this chapter, the burden of proof shall be upon the petitioner . . .

The Commission has been granted the discretion to waive penalties and interest. Section 59-1-401(13) of the Utah Code provides, "Upon making a record of its actions, and upon reasonable cause shown,

the commission may waive, reduce, or compromise any of the penalties or interest imposed under this part." Utah Code §59-1-401(13).

ANALYSIS

The facts listed in the findings above were not in dispute and the issues before the Commission in this matter present questions of law. The Taxpayer has two arguments, the first that Utah should allow him a credit for the taxes that he paid to STATE on this Utah source income for the years 2005 through 2007. The Taxpayer's second argument is, in the alternative, that the Commission should allow him to take an equitable adjustment for this income under Utah Code Ann. 59-10-115.

Utah Code Secs. 59-10-106(1)(2005) and 59-10-1003(1)(2006-2007) provided that a resident individual of Utah could claim a credit on his or her Utah Individual Income Tax Return for taxes paid to another state. These provisions make it clear that this credit is available only to Utah resident individuals. This credit is provided because Utah and many other states impose tax both on a resident individual and the state source income of a non resident. Generally the source income state has precedence over the state where the tax is based solely on residency. Had the Taxpayer been a Utah resident receiving partnership income that would be sourced to STATE, the Taxpayer would be required under Utah law to claim that income on his Utah Resident Individual Income Tax Return. He would also presumably have to file a nonresident STATE return claiming the STATE source income and paying tax to the state of STATE. The credits under Utah Code Secs. 59-10-106(1)(2005) and 59-10-1003(1)(2006-2007) then come into play and he would have received a credit on the Utah Return for the taxes he was required to pay to STATE. The facts in this matter are reversed. Utah is the source state for the income at issue, STATE the state where the tax is based on residency. Utah should have received the tax and STATE allowed a credit or deduction based on taxes paid to another state.

As noted by the Division, there is no basis under Utah Code Secs. 59-10-106(1)(2005) and 59-10-1003(1)(2006-2007) to allow the credit to a nonresident and Utah should have been receiving the tax while it was STATE that should have been allowing the credit. Tax credit statues are strictly construed against the Taxpayer.[3] *See Parson Asphalt Prods., Inc. v. State Tax Comm'n,* 617 P.2d 397, 398 (Utah 1980)("[s]tatutes which provide for exemptions should be strictly construed, and one who so claims has the burden of showing his entitlement to the exemption"). Tax credit statutes, like tax exemptions, "are to be strictly construed against the taxpayer." *MacFarlane v. State Tax Comm'n*, 2006 UT 25, ¶11. "While we recognize the general rule that statutes granting credits must be strictly construed against the taxpayer, the construction must not defeat the purposes of the statute. The best evidence of that intent is the plain language of the statute."

3 This has recently been codified by the Utah Legislature at Utah Code 59-1-

(Citations omitted.) *See id. at* ¶19. In this situation that language of the statute is clear and there is no plain reading that would support the Taxpayer's contention that the credit could be allowed for a nonresident.

In the alternative the Taxpayer requested he be allowed an equitable adjustment under Utah Code Sec. 59-10-115. The statutory language of this provision was revised in 2006. However, both the 2005 version and the 2006-2007 versions did provide for the Commission to adopt rules to allow an adjustment to state taxable income if the taxpayer suffered a double tax detriment by the enactment of "this part" or under "this part."[4] Both statutes specifically provide the Commission rule making authority to allow for this adjustment. Utah Admin. R 865-9I-4 (2005-2007) was unchanged during the audit period, although repealed later. This rule provided that the, "Tax Commission shall make or allow such adjustments to the taxpayer's state taxable income as are necessary to prevent the inclusion or deduction for a second time on his Utah income tax return . . ." The Division argues that this provision only allows the adjustment if it would be taxed twice on the Utah return, that this provision does not apply in situations where there was a tax applied by two different states or different entities. Under the facts before the Commission the Taxpayer is being taxed only once on this income by the State of Utah, but the Taxpayer has also paid tax on this income to the State of STATE.

The Division points to the Utah Third District Court's interpretation of the provision in *Flemming v. Utah State Tax Commission, Case No. 100917302* (2012). In *Flemming*, prg. 20, it states, "The Court determines that [Utah Code Sec. 59-10-115(2005)] subsection (4) is limited to situations where the taxpayer would otherwise be taxed twice on the same income on his or her Utah tax return." This Division also cites to *Initial Hearing Order, Appeal No. 11-2830,* in which the Commission disallowed any offset or credit for a nonresident of Utah who had paid taxes in the state of residency during the audit years, but had failed to file a Utah Nonresident Individual Income Tax Return and pay tax on Utah source income. The facts in Appeal 11-2830 are in fact, very similar to those in this matter before the Commission. However, as pointed out by the Taxpayer, the equitable adjustment provided in Utah Code Sec. 59-10-115 was not argued by the parties or addressed by the Commission in that decision.

The Taxpayer did argue two prior Tax Commission decisions supported his position in this matter. *Tax Commission Order in Appeal No. 95-1624* (1996) and *Order Appeal No. 95-0564* (1997). In *Order in Appeal No. 95-1624* the facts were not well laid out and it was unclear whether the decision did support the Taxpayer's position. The Commission's decision, however, in *Order Appeal No. 95-0564* (1997) appears

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1417(2).
4 Part 1, Individual Income Tax Act.

inconsistent with the Commission's more recent decisions. In addition to the Tax Commission decisions cited by the parties, the Commission has considered and denied an equitable adjustment in two additional cases which are consistent with the Division's interpretation in this appeal. *Utah State Tax Commission Initial Hearing Orders*, *Appeal Nos. 05-1355 and 11-2380 (2012)*.[5] The equitable adjustment set out at Utah Code 59-10-115 is limited by rule to actions where the income would have been included twice in the Utah taxable income under Utah Admin. Rule R865-9I-4 and does not allow for the adjustment in instances where the income is taxed in two separate states. Utah Admin. Rule R865-9I-4 provides for equitable relief where the income would otherwise be taxed twice by the State of Utah. There is nothing in the statute or rule that would suggest double taxation occurs when a source of income is taxed by more than one taxing jurisdiction.

Another point in determining whether the equitable adjustment should be allowed is the plain language of the statute providing the adjustment. It appears the adjustment was intended for situations where following the law resulted in the double tax. In the facts before the Commission in this matter, it was the Taxpayer's failure to follow the law that resulted in being taxed in two different states. Utah Code Sec. 59-10-115(4) (2005) was more direct on this point stating the Commission may adopt rules allowing the adjustment, "where, solely by reason of the enactment of this chapter, the taxpayer would otherwise receive or have received a double tax benefit or suffer or have suffered a double tax detriment. . . ." The Taxpayer's paying tax in both states resulted from his failing to properly file returns, not due "solely" to the enactment of the Individual Income Tax Act. Utah Code Sec. 59-10-115(4) (2006-2007) is less direct but does limit the adjustment to where there is a "double tax benefit under this part . . ." and provided the Tax Commission authority to promulgate rules to allow for the adjustment. In this case it was not the application of the law 'under this part,' but instead a failure to follow the law that resulted in the tax paid to both states. Had the Taxpayer properly filed state returns he would have paid tax to the State of Utah and gotten a credit or deduction from STATE, so that he would not be paying tax to both states.

After reviewing the facts and the law in this matter, the Division properly disallowed the Taxpayer's credit and/or equitable adjustments, although there is a basis for waiver of penalties. The Taxpayer had a tax adviser during the years 2005 through 2007. He testified that his advisor had not told him he should file a Utah return and it did not occur to him on his own that he should have filed a Utah Nonresident Return for the years at issue. The difficulty for the Taxpayer in this situation is that because no Utah returns were filed for

5 These and other prior Tax Commission decisions are available for review in a redacted format at tax.utah.gov/commission-office/decisions.

2005 through 2007, the Division was not restricted by statute of limitations from issuing an audit in 2011 for those years. However, the Taxpayer was limited from requesting a refund of taxes paid in error to the State of STATE. Regardless, it was the State of Utah where the tax should have been paid, and STATE may have issued a credit or deduction had the Taxpayer properly filed his returns for these tax years.

CONCLUSIONS OF LAW

1. Utah Code Secs. 59-10-106(1)(2005) and 59-10-1003(1)(2006-2007) make it clear that only a Utah resident individual may claim a credit for taxes paid to another state. A Utah resident individual may claim this credit on his or her Utah Individual Income Tax Return. Taxpayer was not a Utah resident during the years at issue and may not claim this credit on his Utah Nonresident Individual Income Tax Return. The credit or deduction, however, may have been allowed by STATE, the state of his residency.

2. The Taxpayers are not entitled to take an equitable adjustment under the provisions of Utah Code §59-10-115 or Utah Admin. Rule R865-9I-4 based on the fact that the income at issue had also been taxed by STATE. Those sections provide equitable relief where income would otherwise be taxed twice by Utah pursuant to operation of the Individual Income Tax Act of the State of Utah.

3. The Commission may waive interest or penalties "upon making a record of its actions, and upon reasonable cause shown." Utah Code §59-1-401(13). At the hearing the parties stipulated to the waiver of the penalties and on that basis they should be waived. The facts do not provide cause for waiver of the interest.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Tax Commission sustains the individual income tax audit deficiencies as they pertain to tax and the interest accrued thereon, for the tax years 2005 through 2007. The Commission waives the penalties for all three years at issue. It is so ordered.

DATED this _____ day of _____, 2014.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Notice: Failure to pay within thirty days the balance that results from this order may result in additional penalties and interest. You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Sec. 63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. 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 Sec. 59-1-601 et seq. & 63G-4-401et seq.