

05-0835
Audit
Signed 11/20/2006

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER 1 & PETITIONER 2,	)	ORDER	
)		
Petitioners,	)	Appeal No.	05-0835
)		
v.	)	Account No.	#####
	)	Tax Type:	Individual Income
AUDITING DIVISION OF THE	)	Tax Years:	2003
UTAH STATE TAX COMMISSION,)		
	)	Judge:	Chapman
Respondent.)		

Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER 1 (by telephone)
PETITIONER REPRESENTATIVE, Attorney for Petitioner
For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
RESPONDENT REPRESENTATIVE 2, from Auditing Division
RESPONDENT REPRESENTATIVE 3, from the Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on November 8, 2006.

At issue is the assessment of additional Utah individual income tax by Auditing Division (“Division”) to the Petitioners for the 2003 tax year. On May 26, 2005, the Division issued a Statutory Notice of Audit Change (“1st Statutory Notice), in which it determined that the Petitioners’ Utah portion of federal adjusted gross income (“FAGI”) was \$\$\$\$\$, not \$\$\$\$\$ as the Petitioners reported on their 2003 Utah part-year resident tax return. On September 18, 2006, the Division issued another Statutory Notice of Audit Change (2nd Statutory Notice) to the Petitioners for the 2003 tax year, in which it determined that the Petitioners’ Utah portion of FAGI was \$\$\$\$\$, based on Internal Revenue Service (“IRS”) Form W-2’s related to the Petitioners’

employment in Utah during the 2003 tax year. Although no penalties were imposed, the assessment of additional tax and interest totaled \$\$\$\$\$.

Around 1994, PETITIONER 1 moved to Utah and began working at HOSPITAL in CITY, Utah (“HOSPITAL”), a hospital owned by COMPANY (“COMPANY”). PETITIONER 1 remained employed at the HOSPITAL until March 2003. During his employment at the HOSPITAL, PETITIONER 1 received non-qualified stock options from COMPANY. In February 2003, PETITIONER 1 began work with a different employer in STATE and for approximately one month, he commuted between his jobs in Utah and STATE. In March 2003, PETITIONER 1 sold his Utah home and purchased a home in STATE. For purposes of the Initial Hearing, the Division does not contest PETITIONER 1’s claim that he changed his domicile from Utah to STATE as of February 15, 2003.

Between February and May 2003, PETITIONER 1 exercised the COMPANY non-qualified stock options he had earned while employed in Utah. At issue is whether all income PETITIONER 1 received in 2003 that is related to his being employed at the HOSPITAL (including his gains from exercising the COMPANY stock options) are subject to Utah income tax, even though all or a portion of the income may have been realized or received after he changed his domicile to STATE.

The Petitioner asserts that all “non-salary” income¹ that PETITIONER 1 received after changing his domicile to STATE, and specifically the gains he received from exercising the COMPANY stock options, should be subject to taxation by the state of domicile at the time the income is received (or the non-qualified stock options are exercised). Because the Petitioners assert that the additional income that the

¹ PETITIONER 1’s 2003 Form W-2 from COMPANY shows total wages of \$\$\$\$\$. \$\$\$\$\$ of this amount represents PETITIONER 1’s regular salary, which the Petitioners reported on their 2003 Utah tax return. However, the Petitioners maintain that the remaining income (approximately \$\$\$\$\$ in gains from the exercise of stock options, \$\$\$\$\$ in deferred compensation, and \$\$\$\$\$ in a pay-out of leave balances) was received after PETITIONER 1 changed his domicile to STATE and, thus, is not subject to Utah tax.

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Division assessed was “non-salary” income received after PETITIONER 1 changed his domicile to STATE, they ask the Commission to overturn the Division’s assessment.

The Division asks the Commission to sustain its assessment as shown in its 2nd Statutory Notice. First, the Division asserts that it has produced evidence that the income on which it assessed tax was received during 2003 from the Petitioners’ Utah employers. Second, the Division asserts that the income is considered Utah source income, even if realized and received after PETITIONER 1 changed domicile to STATE.

APPLICABLE LAW

UCA §59-10-117 provides those items comprising federal adjusted gross income that are considered to be derived from Utah sources and, as a result, are included in Utah state taxable income, pertinent parts of follows:

(1) For the purpose of Section 59-10-116, federal adjusted gross income derived from Utah sources shall include those items includable in federal "adjusted gross income" (as defined by Section 62 of the Internal Revenue Code) attributable to or resulting from:

...

(b) the carrying on of a business, trade, profession, or occupation in this state.

(2) For the purposes of Subsection (1):

(a) Income from intangible personal property, including annuities, dividends, interest, and gains from the disposition of intangible personal property shall constitute income derived from Utah sources only to the extent that such income is from property employed in a trade, business, profession, or occupation carried on in this state.

...

DISCUSSION

The additional income that the Division assessed in its 2nd Statutory Notice is income that PETITIONER 1 would not have received, had he not been employed by COMPANY at its HOSPITAL. At issue is whether the income he received after changing his domicile from Utah to STATE is considered Utah

source income and, thus, subject to Utah taxation. Section 59-2-117(1)(b) provides that any income includable in FAGI that is “attributable to or resulting from . . . the carrying on of a business, trade, profession, or occupation” in Utah is treated as Utah source income for taxation purposes.

PETITIONER 1 received deferred compensation, as well as compensation for accrued leave, from COMPANY in 2003, due to his employment at the HOSPITAL. This income was includable in his 2003 FAGI and is “attributable to or resulting from” PETITIONER 1’s carrying on his profession in Utah. PETITIONER 1 did not proffer that any portion of this compensation was earned from services performed in another state. As a result, these amounts are considered Utah source income for the 2003 tax year, even though he may have received the compensation after changing his domicile from Utah to STATE.

PETITIONER 1 also exercised non-qualified stock options he received from COMPANY during his employment in Utah. The Petitioner is correct that the gains from the exercise of the non-qualified stock options are not includable in FAGI until they are exercised. However, when PETITIONER 1 exercised the options and received taxable gains from them, the income was includable in his 2003 FAGI. Furthermore, the gain from the stock options are “attributable to or resulting from” PETITIONER 1’s carrying on his profession in Utah and, thus, is considered Utah source income, even though he may have exercised the options after changing his domicile from Utah to STATE.

This conclusion is consistent with the findings of other jurisdictions, which have held that the compensation received from stock options remains source income from the state where it was earned, notwithstanding the change of domicile of the employee prior to vesting or exercise. *See McBroom v. Dep’t Revenue*, 969 P.2d 380 (Or. 1998); *Michaelson et al. v. New York State Tax Commission*, 496 N.E.2d 674 (N.Y. Ct. App. 1986).

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For these reasons, the Commission finds that the Division has shown evidence to support its assessment in its 2nd Statutory Notice. Furthermore, based on the evidence and testimony proffered at the Initial Hearing, the Commission finds that the Petitioners have not shown that the assessment is incorrect. Accordingly, the Commission sustains the assessment imposed in the Division's 2nd Statutory Notice.

DECISION AND ORDER

Based upon the foregoing, the Commission denies the Petitioners' appeal and sustains the Division's assessment of additional income tax for the 2003 tax year, as imposed in its 2nd Statutory Notice. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2006.

Kerry R. Chapman
Administrative Law Judge

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BY ORDER OF THE UTAH STATE TAX COMMISSION.

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2006.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

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