

05-1164
Audit
Signed 10/30/2006

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)		
	)	ORDER	
Petitioner,)		
	)	Appeal No.	05-1164
v.)		
	)	Tax Type:	Individual Income Tax
AUDITING DIVISION OF THE	)	Account No:	#####
UTAH STATE TAX COMMISSION,	)	Tax Year:	2002
)		
Respondent.	)	Judge:	Chapman

Presiding:
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER
 PETITIONER REPRESENTATIVE
For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
 RESPONDENT REPRESENTATIVE 2, from the 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 September 28, 2006.

On July 13, 2005, Auditing Division (“Division”) issued a Statutory Notice of Audit Change (“Statutory Notice”) to the Petitioner, imposing additional Utah income tax for the 2002 tax year. The Division imposed \$\$\$\$ in additional tax, plus \$\$\$\$ in interest, which was calculated back to April 15, 2003, the statutory due date for a 2002 Utah income tax return. The Division did not impose any penalties.

The Petitioner contests the Division’s assessment on two bases. First, the Division recalculated the Petitioner’s credit for taxes paid to STATE and determined that the credit was overstated by \$\$\$\$\$. The Petitioner contends, however, that her calculation of the tax credit is correct. Second, should the Commission sustain the Division’s assessment of additional tax, the Petitioner asserts that the Division

imposition of interest back to April 15, 2003 is excessive because no tax underpayment existed until she filed a return on January 16, 2004 and, subsequently, was issued a refund that included the \$\$\$\$ in dispute.

Credit for Taxes Paid to STATE. The Petitioner is a Utah resident individual for 2002 income tax purposes. Because a portion of her 2002 income is taxable in STATE, Utah law provides that she is allowed a credit against her Utah tax liability for taxes paid to STATE. The Petitioner's 2002 STATE tax return included a Schedule STATE (540NR) ("STATE Schedule STATE"), on which she showed that portion of her federal adjusted gross income ("FAGI") that was subject to taxation by STATE in 2002. In Column A of this schedule, the Petitioner shows her FAGI to be \$\$\$\$\$, which is consistent with the FAGI shown on her 2002 federal and Utah returns.

Column E of STATE Schedule STATE, entitled "STATE Amounts (income earned or received as a STATE resident and income earned or received from STATE sources as a nonresident)," shows the amount of income taxed by STATE in 2002 to be \$\$\$\$\$. Nevertheless, on Schedule A -Part I ("Utah Schedule A") of her 2002 Utah tax return, the Petitioner claimed that \$\$\$\$\$ of her total FAGI was taxed by STATE, which is \$\$\$\$\$ more than the \$\$\$\$\$ shown in Column E of STATE Schedule STATE.

The Petitioner explains that the \$\$\$\$\$ in additional STATE income that she included on Utah Schedule A are losses incurred in years prior to 2002 for a rental property in STATE. Because the Petitioner did not have STATE income in these prior years to offset the losses, she did not file STATE income tax returns for these prior years. Nevertheless, she claimed the losses on her federal returns and, consequently, on her Utah returns in the years in which the losses occurred.

When she sold the STATE rental property in 2002, she realized capital gains income, which was subject to STATE taxation. The Petitioner proffers that STATE allowed an offset against the capital gains income for losses that were not taken in the prior years. For this reason, the \$\$\$\$\$ in prior years' losses is

shown in Column B of the Petitioner's 2002 STATE Schedule STATE as a "subtraction" from her 2002 FAGI. Consequently, the Petitioner's 2002 STATE tax liability was calculated on an amount from which the \$\$\$\$ had been subtracted.

The Petitioner asserts, however, that her 2002 STATE taxable income would have been \$\$\$\$\$, but for the subtraction allowed for "prior years." For this reason, the Petitioner requests that the Commission recognize that that portion of 2002 FAGI subject to taxation in STATE, without consideration of subtractions for prior years, is \$\$\$\$\$. As a result, the Petitioner requests that the Commission approve her tax return as filed and overturn the Division's assessment.

The Division asserts that the amount of FAGI on which STATE imposed its tax for 2002 income tax purposes is \$\$\$\$\$, as reported in Column E of STATE Schedule STATE. Accordingly, the Division requests that the Commission sustain its assessment of additional tax.

Calculation of Interest. If the Commission overturns the Division's assessment of additional tax, the interest the Division imposed is also overturned. However, if the Commission sustains the additional tax, the Petitioner claims that the Division's calculation of interest back to April 15, 2003 is excessive because no underpayment existed until January 29, 2004 and that this portion of interest should be abated.

An explanation of the timeline concerning the Petitioner's payment of 2002 taxes is helpful to understand the interest issue. If the Commission sustains the \$\$\$\$\$ in additional tax, the Petitioner's 2002 tax liability would be \$\$\$\$\$. On or before April 15, 2003, the statutory due date of the Petitioner's 2002 Utah tax return, the Petitioner had prepaid \$\$\$\$\$ in tax, \$\$\$\$\$ more than the total liability. However, the Petitioner did not timely file a 2002 Utah return. On January 16, 2004, the Petitioner filed her 2002 Utah return, which showed that she had overpaid her taxes by \$\$\$\$\$. The Commission refunded \$\$\$\$\$ to the Petitioner on January 29, 2004.

On July 13, 2005, the Division issued its Statutory Notice, in which it assessed \$\$\$\$ in additional tax for the 2002 tax year. The State of Utah had had possession and use of the \$\$\$\$ from the due date of the 2002 return, April 15, 2003, until the amount was refunded on January 29, 2004. Nevertheless, the Division calculated and imposed interest on the \$\$\$\$ underpayment back to April 15, 2003, the original due date of the 2002 return.

The Division asserts that Utah law provides that interest on an underpayment should be calculated and imposed back to the due date of the return at issue, regardless of whether an underpayment existed for the entire period. The Division also states that imposing interest in this manner is a long-standing Commission practice. For these reasons, the Division asks the Commission to sustain the entirety of its interest assessment.

The Petitioner, however, objects to paying interest for a period during which no underpayment existed and, should the \$\$\$\$ tax assessment be sustained, asks the Commission to abate an appropriate portion of the interest.

APPLICABLE LAW

Tax Credits. For the 2002 tax year, Utah Code Ann. §59-10-106¹ provided that a taxpayer could claim, under certain circumstances, a credit against his or her Utah liability for taxes paid to other states, as follows in pertinent part:

(1) 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.

...

(3) The credit provided by this section shall be computed and claimed in accordance with rules prescribed by the commission.

1 Section 59-10-106 was amended and renumbered to UCA §59-10-1003 in 2006.

Utah Admin. Rule R865-9I-3 (“Rule 3”) was enacted to provide guidance concerning the tax credit available for taxes paid to another state and, for the 2002 tax year, provided as follows in pertinent part:

-
- B. Except to the extent allowed in D., a resident taxpayer may claim the credit provided in Section 59-10-106 by:
1. filing a resident Utah return showing the computation of tax based on total income before any credit for taxes in another state;
 2. attaching a schedule for each state to which taxes were due, properly filled in to determine each allowable credit; and
 3. attaching a signed copy of each return filed in another state for the same period.
-
- E. The credit allowable on the Utah return for taxes paid to any other state shall be the smaller of the following:
1. the amount of tax paid to the other state; or
 2. a percentage of the total Utah tax. This percentage is determined by dividing the total federal adjusted gross income into the amount of the federal adjusted gross income taxed in the other state.

Equitable Adjustments. For the 2002 tax year, UCA §59-10-115² specified a number of instances where a taxpayer’s Utah taxable income could be adjusted for equitable purposes. In addition, Subsection 59-10-115(4) provided that the Commission could specify in rule other circumstances allowing for equitable adjustment, as follows in pertinent part:

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. . . .

The Commission adopted Utah Admin. Rule R865-9I-4 (“Rule 4”) to address other amounts of income that may qualify as an equitable adjustment to Utah taxable income, 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

2 This section was also amended in 2006.

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.

Interest. In addition to any amount of tax due under the Utah Individual Income Tax Act, UCA §59-10-539(8) provides that “ there shall be added to the tax due interest payable at the rate and in the manner prescribed in Section 59-1-402 for underpayments.”

UCA §59-1-402 provides that interest shall be imposed, as follows in pertinent part:

....

(4) (a) Except as provided in Subsection (4)(c), if any overpayment of tax or fee administered by the commission is refunded within 90 days after the last date prescribed for filing the return of such tax or fee, no interest shall be allowed on the overpayment.

(b) Except as provided in Subsection (4)(c), if the return is filed after the last date prescribed for filing the return, no interest shall be allowed on the overpayment if the overpayment is refunded within 90 days after the date the return is filed.

....

(5) Interest on any underpayment, deficiency, or delinquency of any tax or fee administered by the commission shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.

UCA §59-1-401(11) authorizes the Tax Commission to waive, reduce, or compromise penalties and interest upon a showing of reasonable cause.

DISCUSSION

Two issues exist for the Commission to address. First, should the \$\$\$\$ in prior years' losses that STATE allowed to be deducted from 2002 STATE taxable income be “added back” for purposes of calculating the Utah credit for taxes paid to STATE, as the Petitioner contends; or should the prior years' losses be deducted from 2002 STATE taxable income for purposes of calculating the credit, as the Division

contends? Second, if the Commission sustains the Division's imposition of \$\$\$\$ in additional tax, should interest be assessed back to original due date of the 2002 return (i.e., April 15, 2003) or to the first date that an underpayment existed (i.e., January 29, 2004)?

I. Credit for Taxes Paid to STATE. In 2002, Section 59-10-106(1) provided that 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 . . . from sources therein which is also subject to tax under this chapter.” The \$\$\$\$ in prior years' losses that STATE allowed as a deduction in 2002 had been recognized and deducted from Utah taxable income in the prior years when the losses occurred. For this reason, the Petitioner argues that the losses are not “subject to tax under this [Utah] chapter” in 2002 and, thus, should not be deducted from STATE taxable income when calculating a tax credit under Section 59-10-106.

However, Section 59-10-106(3) gives the Commission authority to adopt rules to govern the tax credit. Section E. of Rule 3 provides that when the credit allowed is a “percentage of the total Utah tax,” as in this case, the “percentage is determined by dividing the total federal adjusted gross income into the amount of the federal adjusted gross income taxed in the other state.” The amount of federal adjusted gross income taxed in STATE in 2002 is the \$\$\$\$ amount shown in Column E of the STATE Schedule STATE. For this reason, the Division argues that only that amount of FAGI actually taxed by STATE (i.e., \$\$\$\$) should be used for purposes of determining the percentage of the total Utah tax and the allowable tax credit.

The Commission concurs with the Division. Even were the language of Section 59-10-106 and Rule 3 interpreted in favor of the taxpayer, Section 59-10-115 and Rule 4 provide for an “equitable adjustment” to Utah taxable income under certain circumstances. Section A. of Rule 4 specifically provides

for 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.”

In prior years, the Petitioner was allowed to deduct the \$\$\$\$ in losses from her FAGI, which also resulted in these amounts being deducted from her Utah taxable income in these years. Accordingly, Utah has already allowed the Petitioner to reduce her Utah tax liability by the \$\$\$\$ that could not be deducted in STATE until 2002. Were the Commission to allow the Petitioner to add the \$\$\$\$ to her 2002 STATE taxable income, as reported on Column E of the STATE Schedule STATE, it would impact the amount of the tax credit at issue in such a way that Utah would be allowing a deduction for these amounts a second time. Such an outcome would require an equitable adjustment “to prevent the . . . deduction for a second time[.]” One way to prevent this second deduction is to calculate the tax credit in the manner the Division recommends. Accordingly, the Commission sustains the Division’s recalculation of the Petitioner’s credit for taxes paid to STATE and its assessment of \$\$\$\$ in additional tax to the Petitioner.

II. Interest Assessment. The Commission has sustained the Division’s assessment of \$\$\$\$ in additional tax. Because the \$\$\$\$ was included in the refund the Petitioner was issued on January 29, 2004, an underpayment of \$\$\$\$ existed from January 29, 2004 until the Petitioner paid the assessment in August 2005. In its Statutory Notice, the Division assessed interest back to April 15, 2003, the original due date of the Petitioner’s 2002 income tax return. The Petitioner asserts that the Commission should not assess interest for a period during which no underpayment existed.

UCA §59-10-539(8) provides that “there shall be added to the tax due interest payable at the rate and in the manner prescribed in Section 59-1-402 for underpayments.” Section 59-1-402(4)(b) provides that “if the return is filed after the last date prescribed for filing the return, no interest shall be allowed on the overpayment if the overpayment is refunded within 90 days after the date the return is filed.” The Petitioner

Appeal No. 05-1164

filed her 2002 Utah return on January 16, 2004, which is “after the last date prescribed for filing the return.” Accordingly, she did not receive interest on the overpayment that was refunded on January 29, 2004. However, this statute does not specifically provide for the assessment of interest on underpayments. Accordingly, the Commission does not find that it pertains to the circumstances in this matter.

Section 59-1-402(5) provides that “[i]nterest on any underpayment . . . shall be computed from the time the original return is due, excluding any filing or payment extensions, to the date the payment is received.” In this matter, the \$\$\$\$ became an underpayment not on the due date of the original return, but later, when a refund was issued on January 29, 2004. Pursuant to the statute, however, the Division imposed interest computed from the time the original return was due, April 15, 2004, until the date the Petitioner paid the assessment. The Division recognizes that its assessment imposes interest for a period during which no underpayment existed, but states that its imposition of interest under these circumstances is consistent with long-standing practice.

The Commission believes that a purpose of Section 59-1-402(5) is to guarantee that interest is charged back to the original due date of a return when a return filed after this date shows an underpayment that existed back to the original due date. The Commission does not find it reasonable, however, to impose interest for a period during which an underpayment did not exist. Although it may be long-standing practice, the Commission finds that in circumstances such as those in this appeal, interest should not be imposed for a period during which an underpayment does not exist. Accordingly, the Commission waives the interest that was imposed for the period in which an overpayment existed, specifically, that period from April 15, 2003 to January 29, 2004, the date the Commission’s refund resulted in an underpayment. The remainder of the interest assessment is sustained.

DECISION AND ORDER

Appeal No. 05-1164

Based upon the foregoing, the Commission sustains the Division's imposition of \$\$\$\$ in additional tax for the 2002 tax year. However, the Commission waives that portion of interest imposed for the period beginning April 15, 2003 and ending on January 29, 2004. The remainder of the interest assessment is sustained. 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

BY ORDER OF THE UTAH STATE TAX COMMISSION.

Appeal No. 05-1164

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

Notice: If a Formal Hearing is not requested as discussed above, failure to pay any remaining balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty.

KRC/05-1164.int