

05-1341
Audit
Signed 05/31/2006

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER 1 & PETITIONER 2,	)	ORDER	
)		
Petitioners,	)	Appeal No.	05-1341
)		
v.	)	Account No.	#####
	)	Tax Type:	Income Tax
AUDITING DIVISION OF THE	)	Tax Years:	2001
UTAH STATE TAX COMMISSION,)		
	)	Judge:	Chapman
Respondent.)		

Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER 2 (by telephone)
For Respondent: RESPONDENT REPRESENTATIVE, 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 May 10, 2006.

The Petitioners are appealing an audit deficiency of additional Utah individual income tax and interest for the 2001 tax year. Auditing Division (“Division”) imposed the assessment in a Statutory Notice of Audit Change dated July 28, 2005, after it received information from the Internal Revenue Service (“IRS”) that the IRS had increased both the Petitioners’ federal adjusted gross income (“FAGI”) and amount of itemized deductions for the 2001 tax year. Although the Division did not charge penalties, it did charge interest on the unpaid income taxes.

The Petitioners admitted that they were assessed additional income by the IRS for the 2001 tax year, but were concerned that the Division had not allowed for the gambling losses that the IRS had allowed to offset their additional gambling income. The Petitioners also stated that they did not understand the audit changes made by the Division.

The Statutory Notice shows that the Division made four changes to the Petitioners' 2001 Utah state return, based on the IRS changes. First, the Division increased the Petitioners' FAGI by \$\$\$\$\$, which is the sum of the \$\$\$\$\$ of additional "Social Security/Railroad Retirement" income¹ and the \$\$\$\$\$ of additional gambling income by which the IRS increased the Petitioners' 2001 FAGI.

Second, the IRS increased the Petitioners' federal "Total Schedule A" amount by \$\$\$\$\$, which was due to its allowing \$\$\$\$\$ in "Gambling Losses" and disallowing \$\$\$\$\$ of "Medical Deduction."² To incorporating the same IRS changes, the Division increased, on the state return, the Petitioners' "Standard/Itemized Deduction" for the 2001 tax year by \$\$\$\$\$.

The third and fourth changes on the Statutory Notice relate to state income tax deductions that do not exist in federal law. Accordingly, the IRS did not make these changes for federal purposes. However, because the IRS made changes to the Petitioners' federal tax liability and FAGI, the state changes are required, as explained below. The third change relates to the deduction for federal taxes paid that Utah law permits in calculating a person's state tax liability. Utah Code Ann. §59-10-114(2)(b) provides that a taxpayer may deduct from his or her state taxable income "1/2 of the net amount of any income tax payable to the United States[.]" Because of the IRS increased the Petitioners' FAGI, the Petitioners' "Net Tax Increase" payable to the United States increased by \$\$\$\$\$. One-half of \$\$\$\$\$ is \$\$\$\$\$, which is the additional amount that the Division deducted from the Petitioner's state taxable income for this purpose, as shown on the Statutory Notice.

1 By federal law, some railroad retirement income is not taxable by a state. However, there is been no indication that this income is such non-taxable income.

2 The Division explained that the IRS decreased the Petitioners' medical deduction because this deduction is dependent on the amount of the Petitioners' FAGI, which the IRS increased. The Division explained that the medical deduction is subject to a "phaseout" that reduces the deduction as the Petitioners' FAGI increases.

The fourth Division change concerns the retirement deduction from state taxable income that is permitted under UCA §59-10-114(2)(e),(3)(b). The Division reduced this deduction by \$\$\$\$\$. Subsection 114(2)(e) provides that for taxpayers 65 years of age or over, which includes the taxpayers, each is allowed a deduction of \$7,500. Subsection 114(3)(b) provides, however, that for married taxpayers filing joint returns, which also includes the taxpayers, the retirement deduction is reduced by 50 cents for each \$1 (i.e., one-half) of FAGI over \$32,000. Because the Petitioners FAGI was more than \$32,000 both before and after the IRS changes, the retirement reduction was reduced by half of the additional \$\$\$\$\$ in FAGI that the IRS added. One-half of the additional \$\$\$\$\$ in FAGI is \$\$\$\$\$, the amount by which the Division reduced this particular deduction.

Based on the changes that the IRS made to the Petitioners' 2001 federal tax return, the Division's audit changes appear appropriate and to have properly included the gambling losses that the Petitioners were concerned about. For these reasons, the Commission sustains the Division's assessment in its entirety.

APPLICABLE LAW

Utah imposes income tax on individuals who are residents of the state, in Utah Code Ann. §59-10-104 as follows:

... a tax is imposed on the state taxable income, as defined in §59-10-112, of every resident individual...

State taxable income is defined in Utah Code Ann. §59-10-112 as follows:

"State taxable income" in the case of a resident individual means his federal taxable income (as defined by §59-10-111) with the modifications, subtractions, and adjustments provided in §59-10-114 . . .

Federal taxable income is defined in Utah Code Ann. §59-10-111 as follows:

"Federal taxable income" means taxable income as currently defined in Section 63, Internal Revenue Code of 1986.

The Utah Legislature has required that the taxpayer file an amended Utah return in the event the Internal Revenue Service adjusts the amount of federal taxable income in Utah Code Ann. §59-10-536(5) as follows:

- (a) If a change is made in a taxpayer's net income on his or her federal income tax return, either because the taxpayer has filed an amended return or because of an action by the federal government, the taxpayer must notify the commission within 90 days after the final determination of such change. The taxpayer shall file a copy of the amended federal return and an amended state return that conforms to the changes on the federal return. No notification is required of changes in the taxpayer's federal income tax return that do not affect state tax liability.
- (b) The commission may assess any deficiency in state income taxes within three years after such report or amended return was filed. The amount of such assessment of tax shall not exceed the amount of the increase in Utah tax attributable to such federal change or correction. The provision of this Subsection (b) does not affect the time within which or the amount for which an assessment may otherwise be made. However, if the taxpayer fails to report to the commission the correction specified in this Subsection (b) the assessment may be made at any time within six years after the date of said correction.

Utah Code Ann. §59-10-114 provides for certain additions to and subtractions from the federal taxable income of an individual when calculating that person's Utah state taxable income. A subtraction for $\frac{1}{2}$ of the net amount of income tax paid or payable to the United States is allowed in accordance with Subsection 59-10-114(2)(b), as follows:

- (2) There shall be subtracted from federal taxable income of a resident or nonresident individual:
 - (b) (i) except as provided in Subsection (2)(b)(ii), $\frac{1}{2}$ of the net amount of any income tax paid or payable to the United States after all allowable credits, as reported on the United States individual income tax return of the taxpayer for the same taxable year; and
 - (ii) notwithstanding Subsection (2)(b)(i), for taxable years beginning on or after January 1, 2001, the amount of a credit or an advance refund amount reported on a resident or nonresident individual's United States individual income tax return allowed as a result of the acceleration of the income tax rate bracket benefit for 2001 in accordance with Section 101, Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, may not be used in calculating the amount described in Subsection (2)(b)(i);

Pursuant to Subsections 59-10-114(2)(e) and (3)(b), the legislature has provided that for Utah taxable income purposes, there shall be subtracted from federal taxable income of a resident or nonresident individual:

(2) (e) for each taxpayer age 65 or over before the close of the taxable year, a \$7,500 personal retirement exemption;

....

(3)(b) For purposes of Subsection (2)(e), the amount of the personal retirement exemption shall be further reduced according to the following schedule:

(i) for married taxpayers filing joint returns, for each \$1 of adjusted gross income earned over \$32,000, the amount of the personal retirement exemption shall be reduced by 50 cents;

....

The Utah Legislature has specifically provided that the taxpayer bears the burden of proof, with limited exceptions, in proceedings involving individual income tax before the Tax Commission. UCA §59-10-543 provides, as follows:

In any proceeding before the commission under this chapter, the burden of proof shall be upon the petitioner except for the following issues, as to which the burden of proof shall be upon the commission:

- (1) whether the petitioner has been guilty of fraud with intent to evade tax;
- (2) whether the petitioner is liable as the transferee of property of a taxpayer, but not to show that the taxpayer was liable for the tax; and
- (3) whether the petitioner is liable for any increase in a deficiency where such increase is asserted initially after a notice of deficiency was mailed and a petition under Title 59, Chapter 1, Part 5 is filed, unless such increase in deficiency is the result of a change or correction of federal taxable income required to be reported, and of which change or correction the commission had no notice at the time it mailed the notice of deficiency.

In those situations where penalty and interest have been properly imposed, the Tax Commission is granted the authority to waive, reduce, or compromise penalties and interest upon a showing of reasonable cause. Utah Code Ann. §59-1-401(10).

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's audit assessment and denies the Petitioners' appeal. 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.

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

DATED this _____ day of _____, 2006.

Appeal No. 05-1341

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

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

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