05-1787
AUDIT
TAX YEAR: 2002, 2003
SIGNED 09-05-2006
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,	)		
	)	**ORDER**	
Petitioner,	)		
	)	Appeal No.	05-1787
v.	)		
	)	Tax Type:	Individual Income Tax
AUDITING DIVISION OF THE	)	Account No:	#####
UTAH STATE TAX COMMISSION,	)	Tax Year:	2002 & 2003
	)		
Respondent.	)	Judge:	Chapman

Presiding:
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER
For Respondent: RESPONDENT REP. 1, Assistant Attorney General
RESPONDENT REP. 2, 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 August 31, 2006.

On December 9, 2005, Auditing Division ("Division") issued Statutory Notices of Audit Change ("Statutory Notices") to the Petitioner, imposing additional Utah income tax for the 2002 and 2003 tax years. The Division imposed $$$$$ in additional tax for the 2002 tax year, plus interest, and $$$$$ in additional tax for the 2003 tax year, plus interest. The Division did not impose any penalties.

The Petitioner is a FOREIGN 1 citizen who retired from the FOREIGN 1 Air Force and moved to Utah in 1995 with his wife. The Petitioner is a permanent resident of the United States and was a Utah resident individual during the years at issue in this appeal. Specifically at issue is whether the pension

income he received from COUNTRY 1 while a Utah resident individual in 2002 and 2003 is subject to Utah income taxation.

For the tax years at issue, the Petitioner filed Utah resident returns as a married taxpayer filing separately from his wife. On his returns, he deducted as an "equitable adjustment" the pension income he had received from COUNTRY 1, which reduced his Utah tax liability to zero for both years. The Petitioner claims that he believed the deduction was justified pursuant to the Double Taxation Convention ("Convention"), a treaty signed by the United States and COUNTRY 1 to avoid the double taxation of income. Because COUNTRY 1 taxed the pension income he received in the 2002 and 2003 tax years, the Petitioner believed that Utah was prohibited under the terms of the Convention from taxing the income as well. The Petitioner believes it would be unfair to impose Utah tax on him for these two years and asks the Commission to overturn the Division's assessment. In the alternative, should the Commission determine the taxes to be due, he requests that the Commission waive the interest that was imposed.

The Division determined otherwise. The Division contends that although the Convention prohibits the United States from imposing federal income tax on income that is also taxed by COUNTRY 1, it makes no mention of taxes imposed by the individual states of the United States and, thus, allows a state to tax income that is also taxable in COUNTRY 1. In addition, the Division argues that Utah law does not provide a credit for taxes paid to another country to be applied against a person's Utah tax liability.

APPLICABLE LAW

Under Utah Code Ann.§59-10-104(1), "a tax is imposed on the state taxable income . . . of every **resident individual**" (emphasis added). "State taxable income" is defined in UCA §59-10-112 to mean "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 . . ."

Equitable Adjustments. For the 2002 tax year, UCA §59-10-115 specifically provided that a taxpayer could claim an equitable adjustment where: 1) an item of gross income in the taxpayer's current year federal adjusted gross income was taxed by a state in a prior year; 2) the taxpayer reports certain gains or losses associated with the ownership of property; and 3) the taxpayer receives certain distributions from an electing small business corporation. 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 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.

Credit for Taxes Paid to Another State. During the tax years at issue, UCA §59-10-106(1) provides that a credit may be allowed against a person's Utah tax liability for taxes paid to another governmental entity, 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 Stated, 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.

Waiver of Penalty and Interest. In those situations where penalty and interest have been properly imposed, Section 59-1-401(11) authorizes the Commission to waive, reduce, or compromise penalties and interest upon a showing of reasonable cause.

DISCUSSION

The Petitioner is a permanent resident of the United States and was a Utah resident individual for the 2002 and 2003 tax years. The Petitioner received pension income from COUNTRY 1 in each of the years at issue and paid FOREIGN 1 taxes on the income. When filing his Utah returns for these years, he claimed an equitable adjustment to Utah taxable income equal to the amount of pension income he received, thus reducing his Utah income tax liability to zero.

While Section 59-10-115 and Rule 4 provide for an "equitable adjustment" to Utah taxable income under certain circumstances, the taxation of income by a foreign country is not one of the circumstances listed. Accordingly, it was improper for the taxpayer to claim an equitable adjustment in this manner. However, the Commission must still determine whether Utah is barred from taxing the Petitioner's pension income under the Convention that the United States and COUNTRY 1 signed in 1989. If the Commission finds that Utah is prohibited under the Convention from taxing the income at issue, it will grant the Petitioner's appeal and overturn the assessment.

On the other hand, if the Commission determines that the Convention does not prohibit the Commission from taxing the income, it must then determine whether the Petitioner is allowed to take a credit for the taxes he paid to COUNTRY 1 against his Utah tax liability. If the Commission determines that no

credit is allowed, the Petitioner's appeal will be denied and the Division's assessments of tax will be sustained. Lastly, the Commission will consider whether exists reasonable cause to waive the interest in this matter.

I. Double Taxation Convention. Article 2 on the Convention provides that its prohibitions against taxation shall apply to "aa) the federal income taxes imposed by the Internal Revenue Code (but excluding the accumulated earnings tax, the personal holding company tax, and social security taxes); and bb) the excise tax imposed on insurance premiums paid to foreign insurers. . . ." Because the treaty does not specifically prohibit the imposition of state income tax, including Utah's income tax, on income that COUNTRY 1 has also taxed, the Division argues that Utah may impose its income tax on the pension income at issue.

The Petitioner states that the Division may be correct, but asks the Commission to determine otherwise because the Convention is more favorable to United States citizens living in COUNTRY 1 than to FOREIGN 1 citizens living in the United States. The Commission, however, does not have the authority to alter provisions of federal treaties. In addition, the Commission was faced with a similar issue in *XXXXX v. Auditing Division, Utah State Tax Commission Appeal No. 03-0723* (2004) ("Appeal No. 03-0723"). In that appeal, the Petitioner took a credit against his Utah income tax liability for taxes paid on his retirement income to COUNTRY 2. The Petitioner argued that the United States – COUNTRY 2 Income Tax Convention of August 16, 1984 ("FOREIGN 2 Convention") precluded Utah from taxing the retirement income because it had been taxed by COUNTRY 2. Like the Convention between the United States and COUNTRY 1, the FOREIGN 2 Convention specifically applied to federal taxes imposed by the Internal Revenue Service, but did not mention taxes imposed by a state of the United States.

The Commission's decision in Appeal No. 03-0723 is further supported by a STATE decision in AIRLINE *v. Commissioner of Rev.*, 1979 WL 1100 (STATE. Tax 1979), which interpreted a prior, but

similar, Convention between the United States and COUNTRY 1 as allowing the state to impose its taxes upon the FOREIGN 1 entity. For these reasons, the Commission finds that Utah is not barred from imposing its income tax on the Petitioner's pension income for the years at issue.

II. Credit for Taxes Paid to Another Country. No credit against a taxpayer's Utah liability is allowed for taxes paid to another governmental entity unless a specific statute or other authority provides for such a credit. Section 59-10-106(1) provides that a taxpayer may apply a credit for taxes paid to "another state of the United Stated, the District of Columbia, or a possession of the United States," but does not provide for a credit for taxes paid to another country. In Appeal No. 03-0723, the Commission decided that the statute is limited to those credits specifically listed, thus barring a credit for taxes paid to another country. Accordingly, the Commission finds that the Petitioner may not apply a credit against his Utah taxes for the taxes he paid to COUNTRY 1.

III. Interest. Pursuant to Section 59-10-401(11), interest may be waived upon a showing of reasonable cause. Interest is charged because the taxpayer has had the use of the tax dollars during a period when the state should have had that use. For this reason, interest is only waived if the imposition of interest arose from a Commission employee's error. The assessments at issue arose because the Petitioner believed the income at issue to be barred from taxation, not because of a Tax Commission employee's error. In addition, the Petitioner states that he should not be charged interest for the period between the issuance of the Statutory Notices and the Initial Hearing, as this delay was part of the Commission's appeal system. However, the Petitioner had the option to pay the assessment at the time the Statutory Notice was issued, which would have tolled the accrual of interest during this period, and had he prevailed, had his payment, with interest, refunded to him. For these reasons, the Commission finds that none of the interest that has accrued was the fault of the

Tax Commission or its employees. Accordingly, the Commission finds that reasonable cause to waive interest does not exist, and it denies the Petitioner's request for waiver of interest.

DECISION AND ORDER

Based upon the foregoing, the Commission finds that the pension income that the Petitioner received during the 2002 and 2003 tax years and that was taxable in COUNTRY 1 is also subject to Utah taxation. In addition, the Commission finds that the taxes the Petitioner paid to COUNTRY 1 may not be applied as a credit against his Utah income tax liability. Lastly, the Commission finds that reasonable cause to waive the interest imposed in this matter does not exist. For these reasons, the Commission denies the Petitioner's appeal and sustains the Division's assessments of tax and interest for the 2002 and 2003 tax years. 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.

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.

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