

06-0711  
Audit  
Signed 12/22/2006

BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER 1 & PETITIONER 2,	)	
	)	<b>ORDER</b>
Petitioner,	)	
	)	Appeal No. 06-0711
v.	)	Account No. #####
	)	Tax Type: Income
AUDITING DIVISION OF THE	)	Tax Period: 2004
UTAH STATE TAX COMMISSION,	)	
	)	
Respondent.	)	Judge: Phan

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**Presiding:**  
Jane Phan, Administrative Law Judge

**Appearances:**  
For Petitioner: PETITIONER REPRESENTATIVE, CPS  
PETITIONER 1  
For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General  
RESPONDENT REPRESENTATIVE 2, Tax Audit Manager

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing pursuant to Utah Code Sec. 59-1-502.5, on November 20, 2006. Petitioners are appealing an audit deficiency of additional Utah individual income tax and interest. The Statutory Notice of Audit Change was issued on May 15, 2006. The amount of additional tax at issue is \$\$\$\$\$. Interest as of the date of the date of the Statutory Notice was \$\$\$\$\$ and continues to accrue on any unpaid balance. No penalties were assessed with the audit. The only issue is whether Respondent properly denied a credit for taxes paid to another state.

APPLICABLE LAW

Utah allows a credit for taxes paid to another state for Utah resident individuals at Utah Code Sec. 59-10-106 as follows:

- (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.

- (2) The application of the credit provided under this section shall not operate to reduce the tax payable under this chapter to an amount less than would have been payable were the income from the other state disregarded.
- (3) The credit provided by this section shall be computed and claimed in accordance with rules prescribed by the commission.

The Commission adopted Utah Admin. Rule R 865-91-3 pursuant to Utah Code Sec. 59-10-

106. The rule provides in pertinent part:

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 tax in the other state.

#### DISCUSSION

The facts in this matter were not in dispute and the parties present a legal issue to the Commission. Petitioner had claimed a credit for taxes paid to another state in the amount of \$\$\$\$\$ on his Utah Individual Income Tax Return for tax year 2004. After auditing the return Respondent allowed only a portion of the claimed credit, an amount of \$\$\$\$\$ for taxes paid to the state of STATE 1. Respondent disallowed the remainder of the claimed credit, an amount of \$\$\$\$\$, which Petitioner had claimed as a credit for taxes paid to STATE 2.

Petitioner had filed a STATE 2 Nonresident return claiming his STATE 2 source income and he did have a STATE 2 tax liability on the income of \$\$\$\$\$. However, he had claimed a credit on the return that offset all tax liability owed to STATE 2. Petitioner had purchased from a third party a Conservation Easement Credit. In STATE 2 the state law has adopted provisions that allow a credit involving land being placed in Conservation Easements. Petitioner explained that this Conservation Easement Tax Credit could be sold by the party to whom it was initially issued and the purchaser may then apply the credit toward taxes owed

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to STATE 2. In Petitioner's case rather than pay STATE 2 the tax that he owed for that year in the traditional manner, he had paid a third party for a Conservation Easement Tax Credit, and then claimed the credit against the individual income taxes that he owed to STATE 2. On Line 23 of his STATE 2 Individual Income Tax Return, which indicates the net tax, Petitioner had claimed "none". Respondent maintains that a credit for taxes paid to STATE 2 is limited to taxes claimed on Line 23 of the STATE 2 return, after any credits have been subtracted.

The State of Utah has no similar provision. As far as the parties were aware, this was the first time the issue, of whether the STATE 2 credit would qualify as tax paid to another state for purposes of Utah Code Sec. 59-10-106, has been brought before the Utah Tax Commission in an appeal hearing. The statute indicates that the credit shall be allowed in an amount equal to the tax "imposed on him." See Utah Code Sec. 59-10-106(1). Although it is not particularly clear whether a tax paid with a credit would be tax "imposed," the rule adopted pursuant to the statute is specific. It states the credit would be limited to "the amount of tax paid to the other state." Utah Admin. Rule R865-9I-3(E). This is further clarified in Tax Bulletin 7-92. In this case before the Commission, Petitioner did not "pay" the tax to STATE 2. He did pay for the tax credit, but that payment went to a third party.

Petitioner had submitted a letter from the Chief Counsel of the Internal Revenue Services dated May 31, 2001, in which the IRS indicated that the transferee of the STATE 2 Conservation Easement Credit would be entitled to a deduction for state taxes under section 164. However, a later letter from the IRS dated July 24, 2002, indicated that the issues involving the state credits "would be best addressed in official published guidance." As far as the parties are aware there has been nothing further from the IRS. Respondent's attorney argues that based on the second letter and that the first only partially addressed the issue the first letter would not be precedent setting. Additionally Respondent notes that the IRS was considering whether the credit would be allowed as an itemized deduction, which is different from a state tax credit.

DECISION AND ORDER

Based upon the foregoing, the Commission sustains the audit deficiency of additional income tax and interest against Petitioner for tax year 2004. 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.

\_\_\_\_\_  
Jane Phan, 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