

08-0590
AUDIT
TAX YEAR: 2004
SIGNED 08-05-2010
COMMISSIONERS: M. JOHNSON, D. DIXON, M. CRAGUN
RECUSED: R. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>PETITIONER 1 & PETITIONER 2,</p> <p style="text-align: center;">Petitioners,</p> <p>vs.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="text-align: center;">Respondent.</p>	<p>FINDINGS OF FACT, CONCLUSIONS OF LAW AND FINAL DECISION</p> <p>Appeal No. 08-0590</p> <p>Account No. ##### Tax Type: Income Tax Tax Years: 2004</p> <p>Judge: Phan</p>
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Presiding:

D'Arcy Dixon Pignanelli, Commissioner
Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REP. 1, Attorney at Law
PETITIONER REP. 2, Attorney at Law
PETITIONER 1
PETITIONER 2

For Respondent: RESPONDENT REP. 1, Assistant Attorney General
RESPONDENT REP. 2, Manager, Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission pursuant to Utah Code Sec. 59-1-501 and 63G-4-201 et al., for a Formal Hearing, on April 15, 2008. Based upon the evidence and testimony presented at the hearing the Tax Commission hereby makes its:

FINDINGS OF FACT

1. This matter is before the Commission on Petitioners' (the Taxpayers) appeal of an income tax audit deficiency issued against them for tax year 2004. The Statutory Notice of Estimated Income Tax had been issued on February 29, 2008. The Taxpayers filed a timely appeal of the audit and the matter proceeded to the Formal Hearing before the Commission.

2. The amount of the deficiency indicated in the statutory notice was as follows:

Year	Tax	Penalty	Interest	Total ¹
2004	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

3. The audit deficiency was based on two changes made by Respondent (the Division). The first was a small change in which the Division included \$\$\$\$\$ in taxable income, which was the Utah state tax deducted on their federal Schedule A. The Taxpayers no longer contested this change. The second item was the Division's disallowance of a deduction in the amount of \$\$\$\$\$, which the Taxpayers had taken on Line 13 of their Utah Individual Income Tax Return. The Taxpayers claimed this as an equitable adjustment pursuant to Utah Code Sec. 59-10-115. It is the disallowance of this deduction the Taxpayers contest and which is the issue before the Commission in this hearing.

4. The facts in this matter were not in dispute. The Taxpayers were Utah residents for the purposes of Individual Income Tax for the 2004 tax year. They had moved to Utah in 1998 and filed Utah resident returns since that time. The Taxpayers also operated a business in COUNTRY during these years and in 2004. They were required to file returns and pay taxes on this FOREIGN income to both COUNTRY and to PROVINCE.

5. For 2004 they claimed \$\$\$\$\$ (U.S. dollars) in federal adjusted gross income on their Utah and U.S. federal returns. For that same tax year they claimed \$\$\$\$\$ (FOREIGN CURRENCY) in what is referred to as both 'total income' and 'taxable income' on their amended T1 General 2004 FOREIGN return as well as their PROVINCE return. They paid taxes to both COUNTRY and PROVINCE based on this income. On their U.S. 1040 return they had claimed a Foreign Tax Credit in the amount of \$\$\$\$\$ on line 46 for the taxes they had paid to COUNTRY.

6. For the 2004 tax year, on their Utah Individual Income Tax Return the Taxpayers subtracted \$\$\$\$\$ on Line 13-Other Deductions.

7. The Taxpayers testified that they had relied on their tax preparer to prepare the appropriate returns which were complicated due to the fact that they involved two different countries and two different states or provinces. PETITIONER 2 testified that ACCOUNTANT 1, who had been her accountant prior to the 2004 year at issue, had told her he had spoken to the Tax Commission about taking an equitable adjustment. She acknowledged that she did not understand the tax laws and relies on the accountants she hires to prepare the returns.

8. The accountant who prepared the Taxpayers returns for the 2004 year, ACCOUNTANT 2,

CPA, testified that he had taken the \$\$\$\$ equitable adjustment based in part on how the return had been prepared for the 2003 year by ACCOUNTANT 1. He states that he did look at the tax code and discussed the matter with an accountant other than ACCOUNTANT 1. He testified that he did not contact anyone at the Tax Commission to ask if this was a correct approach. He explained that he had prepared the return to take the adjustment as it seemed to be a logical way so the Taxpayers would not suffer a double tax detriment. He also testified that if he had known the equitable adjustment was inappropriate there were two or three things that could have been done that would have reduced the tax liability. It was his contention that a note was included with the return to explain why they were taking the equitable adjustment. Although the Division stated at the hearing that they had not seen the note, the note was included in documents the Taxpayers had received from the Tax Commission when they requested their file. The note gave the following explanation.

Equitable Adjustments per Utah Code 59-10-115(4): “The Commission shall by rule prescribe for adjustments to state taxable income of the taxpayer in circumstances . . . where . . . the Taxpayer would . . . suffer . . . a double tax detriment.” Thus, the taxpayers are adjusting US \$\$\$\$ of income from COUNTRY where they have already paid tax of \$\$\$\$\$. And if they also paid Utah tax they would suffer a double tax Detriment. Please see Federal form 116 attached.

9. The former accountant, ACCOUNTANT 1, CPA, MBA, M.Pr.A, had prepared the Taxpayers’ returns for the 2003 tax year and for a number of prior years. He testified that at some point there had been a state law change and he had become unsure how to prepare the Utah return to avoid double taxation on the income that was already taxed to COUNTRY and the PROVINCE.

10. ACCOUNTANT 1 testified that he attended the 27th Annual Tax Practitioner’s Institute on December 11 & 12, 2003. He testified that Utah State Tax COMMISSIONER was one of the speakers at the seminar and that he met with COMMISSIONER during a break and asked him how to prepare the Utah return to avoid double taxation. He testified that COMMISSIONER said he thought you could use an equitable adjustment. ACCOUNTANT 1 states that he relied on this to prepare the 2003 Utah return for the Taxpayers and that he attached a description of why the equitable adjustment was taken to the return. ACCOUNTANT 1 further testified that he never received any comments back from the Tax Commission that this adjustment was improper.

APPLICABLE LAW

Utah imposes income tax on individuals who are residents of the state, in Utah Code §59-10-104 (2002)² as follows:

1 Interest calculated to the date of the Statutory Notices. Interest continues to accrue on any unpaid balance.
2 The Utah Individual Income Tax Act has been revised and some sections renumbered subsequent to the audit

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

For the 2004 tax year, Utah Code §59-10-106(1) (since amended and recodified as §59-10-1003) provided that a credit is allowed against a person's Utah tax liability for taxes paid to certain governmental entities, 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 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.

For the 2004 tax year, Utah Code §59-10-115 (since amended) specifically provided that a taxpayer could claim an equitable adjustment in part as follows:

(1) If any provisions of the Internal Revenue Code requires the inclusion of an item of gross income or the allowance of an item of deduction from gross income in the computation of federal taxable income of the taxpayer for any taxable year beginning on or after the effective date of this chapter, and if such item has been taken into account in computing the taxable income of the taxpayer for state income tax purpose for any prior taxable year, the commission shall make or allow such adjustments to the taxpayers' state taxable income as are necessary to prevent the inclusion for a second time or the deduction for a second time of such item for state income tax purposes.

(3) If the taxpayer receives, in any taxable year beginning on or after the effective date of this chapter, a distribution from an electing small business corporation, as defined by Section 1371(b) of the Internal Revenue Code, of a net share of the corporation's undistributed taxable income for a taxable year or years prior to the taxable year in which such distribution is made, the commission shall make such adjustment to state taxable income as will prevent escape from taxation by this state of such undistributed taxable income previously taxed to the taxpayer for federal income tax purposes but not for state income tax purposes.

(4) 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

For the 2004 tax year, Utah Admin. Rule R865-9I-4 ("Rule 4") (since repealed) addressed other amounts of income that may qualify as an equitable adjustment to Utah taxable income, as follows:

period. The Tax Commission applies and cites to the statutes and rule that were in effect during the audit period.

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.

Utah Code §59-10-543 provides that the taxpayer bears the burden of proof, with limited exceptions, in proceedings involving individual income tax before the Tax Commission, as follows:

In any proceeding before the commission under this chapter, the burden of proof shall be upon the petitioner . . .

The Commission has been granted the discretion to waive penalties and interest. Section 59-1-401(13) of the Utah Code provides, "Upon making a record of its actions, and upon reasonable cause shown, the commission may waive, reduce, or compromise any of the penalties or interest imposed under this part." Utah Code §59-1-401(13).

ANALYSIS

The facts were not substantially in dispute and the issues before the Commission in this matter present questions of law. The first issue is whether the Taxpayers' equitable adjustment in the amount of \$\$\$\$ was appropriate as a matter of law and should have been allowed by the Division. The second issue raised by the Taxpayers is independent of whether they were entitled as a matter of law to take the adjustment. They argue in the alternative they should be allowed the adjustment based on the principle of estoppel.

Regarding the first issue, the Taxpayers argue the adjustment is necessary to avoid double taxation of this income. They have shown that they were taxed on the income by COUNTRY and the PROVINCE. They then were required to claim this same income on their U.S. federal return, but there are two options provided by federal law that alleviate the tax burden on this income that has already been taxed in another country. On the federal return they could have taken a deduction on their federal return for the taxes paid to another Country, which would have flowed through to their Utah return. They chose instead the second option on their federal return, which was to take a credit for the taxes paid to another Country. Unlike the deduction, this option of taking a credit does not flow through to the Utah return.

For their Utah return the law requires that taxpayers start with their federal taxable income "with the

modifications, subtractions, and adjustments provided in Section 59-10-114.” See Utah Code §59-10-112 (2004). There is no specific modification or deduction provided in the statute for income upon which taxes have been paid to another country or a state or province in another country. The law does, however, provide a credit for taxes paid to another state at Utah Code §59-10-106(1), but specifically limits the credit to taxes paid to another state of the United States, the District of Columbia, or a possession of the United States. The Commission must follow the laws as they are adopted and to expand this credit to taxes paid to another country or state or province in another country would require an action on the part of the Utah Legislature.

The Taxpayers’ representatives acknowledge that they are not entitled to a credit under Utah Code §59-10-106(1) and argue instead that to avoid double taxation they should be allowed to take an equitable adjustment under Utah Code. §59-10-115, which provides for adjustments when specified circumstances are met. However, in arguing double taxation, the Taxpayers apply a different definition than does the Division. The Taxpayers argue it is double taxation to be taxed by the State of Utah on income that had also been subject to tax by COUNTRY and the PROVINCE. The Division argues that double taxation under Utah Code §59-10-115 is limited to situations where the income is taxed twice by the State of Utah. The Division points out that the same income is routinely taxed by more than one jurisdiction; it is subject to tax by both the federal government and the State of Utah. According to the Division, the Taxpayers’ interpretation that double taxation occurs if the same income is taxed to more than one jurisdiction, would prohibit the state from taxing income also taxed by the federal government.

The Commission notes that the Division’s interpretation is supported by the provisions of Utah Code §59-10-115 and the Tax Commission’s rule promulgated under the authority of that provision, Utah Admin. Rule R865-9I-4. Those sections provide equitable relief where income would otherwise be taxed twice by the State of Utah. There is nothing in the statute or rule that would suggest double taxation occurs when a source of income is taxed by more than one taxing jurisdiction. Further, the Commission has previously concluded that taxpayers may not make an equitable adjustment under Utah Code §59-10-115 for income that was subject to tax in another Country. The decisions on this point have been consistent. See Utah Tax Commission Appeal Nos. 03-0723, 05-1787, and 06-1424.

The second issue argued by the Taxpayers was that under the particular facts of this case, the Tax Commission should be equitably estopped from denying the Taxpayers an equitable adjustment. The Taxpayers’ representatives do note that equitable estoppel against a state agency is the exception rather the rule, but cite to *Eldredge v. Utah State Retirement Bd.*, 795 P.2d 671, 675 (Utah Ct. App. 1990) for the

position that it would be applied “where it is plain that the interest of justice so require.”³ The Taxpayers argue that the elements of equitable estoppels are set out in *Eldredge*, at 675, as follows: 1) a statement, admission, act, or failure to act by one party inconsistent with a claim later asserted; 2) reasonable action or inaction by the other party taken on the basis of the first party’s statement, admission, act, or failure to act; and 3) injury to the second party that would result from allowing the first party to contradict or repudiate such statement admission, act, or failure to act.

It is the Taxpayers’ position that all elements of estoppel were met in this case. There was the statement made during a break at a tax seminar by COMMISSIONER to ACCOUNTANT 1 that he thought taxpayers could use an equitable adjustment. Additionally they argue inaction on the part of the Commission by not responding to the prior returns when filed, to let the Taxpayers know that the adjustment was erroneous. The Taxpayers then acted on this statement through their reliance on their tax preparer. The Taxpayers’ action caused them injury because had they known that the adjustment would be disallowed, there were other options they could have taken that would have reduced or eliminated the liability.

Upon review of the facts in this case, the Commission concludes that the second element of equitable estoppel has not been met. The alleged conversation in which COMMISSIONER had stated he thought the Taxpayers could use an equitable adjustment was not between COMMISSIONER and ACCOUNTANT 2 who prepared the tax return at issue. The conversation occurred between ACCOUNTANT 1, who had prepared prior returns, and COMMISSIONER. There was no evidence to indicate that ACCOUNTANT 2 was even aware of the statement from COMMISSIONER. ACCOUNTANT 2’s testimony was he saw that an equitable adjustment had been taken on the return for the prior year, he discussed the issue with an accountant other than ACCOUNTANT 1, reviewed the law and determined it was reasonable. He did not personally contact the Tax Commission to ask if the adjustment would be appropriate under the facts and circumstances of this matter. The Taxpayers testified that they relied on the accountants they hired to prepare their returns. ACCOUNTANT 2 who prepared the 2004 returns did not act on the basis of the statement of COMMISSIONER.

Further, courts have disallowed claims for equitable estoppel against the Tax Commission based on public policy concerns.⁴ These same types of concerns should preclude estoppel against the Tax Commission

3 The Taxpayers representatives also cite as support for applying equitable estoppels under the facts in this matter *Celebrity Club, Inc. v. Utah Liquor Control Comm’n*, 602 P.2d 689, 694 (Utah 1979); and *Utah State Univ. v. Sutro & Co.*, 646 P.2d 715, 718 (Utah 1982).

4 See *O’Rourke v. Utah State Tax Commission*, 830 P2d230 (Utah 1992) in which the Court stated “sound public

for the asserted inaction or failure to audit the return or previous years' returns sooner or respond to a note attached to the return. The Tax Commission does not audit every return as it is filed. The fact that a taxpayer's error in a prior year was not caught by a Tax Commission employee should not preclude the Tax Commission from taking action in a year when the Tax Commission audits the return.

No penalties were assessed with the audit. The Commission may waive penalties if reasonable cause is shown. Interest is generally waived only in the event an error on the part of the Tax Commission or Tax Commission employee caused the underpayment or late payment. Failure to audit a return sooner or to audit prior years' returns is not basis for waiver under this criterion. Further, the accountant who prepared the tax return for the year at issue was not the one who had allegedly received the advice to file in this manner from a Tax Commissioner. There is not reasonable cause for waiver of the interest.

CONCLUSIONS OF LAW

1. The Taxpayers are not entitled to take an equitable adjustment under the provisions of Utah Code §59-10-115 or Utah Admin. Rule R865-9I-4. Those sections provide equitable relief where income would otherwise be taxed twice by the State of Utah. The Commission has previously concluded that taxpayers may not make an equitable adjustment under Utah Code §59-10-115 for income that was subject to tax in another County as a matter of law.⁵

2. The Taxpayers did not meet the technical requirements of equitable estoppel based on a discussion between a Tax Commissioner and their former tax preparer, when the accountant for the year at issue was not a party to the discussion. Policy concerns should preclude estoppel on the basis of inaction where the Tax Commission did not audit and catch the error previously or in prior returns.

3. The Commission may waive interest or penalties "upon making a record of its actions, and upon reasonable cause shown." Utah Code §59-1-401(13). No penalties were assessed in this matter. The facts do not provide cause for waiver of the interest.

Jane Phan
Administrative Law Judge

policy precludes the assertion of estoppels against the Commission for an incorrect assessment made by its auditor based upon inadequate facts." Also *TAXPAYER v. Utah State Tax Comm'n*, 864 P.2d 904 (Ut. Cr. App. 1993) in which the Court stated, "...the TAXPAYERS have not established that they will suffer a grave injustice if estoppels is not granted, (citation omitted) since the TAXPAYERS' injury, if any, does not arise from the Tax Commission's correction of its earlier erroneous assessment, but from the fact that they did not pay state income taxes that they are lawfully required to pay."

⁵ Utah Tax Commission Appeal Nos. 03-0723, 05-1787, and 06-1424.

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DECISION AND ORDER

Based on the foregoing, the Tax Commission sustains the individual income tax audit deficiency in its entirety for the tax year 2004. It is so ordered.

DATED this ____ day of _____, 2010.

R. COMMISSIONER
Commission Chair

Marc B. COMMISSIONER
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Notice: Failure to pay within thirty days the balance that results from this order may result in additional penalties and interest. You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Sec. 63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Sec. 59-1-601 et seq. & 63G-4-401 et seq.

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