

08-0856

AUDIT

TAX YEAR: 2004

SIGNED: 10-28-2010

COMMISSIONERS: R. JOHNSON, M. JOHNSON, D. DIXON, M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,

Petitioner,

v.

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent.

**ORDER GRANTING PETITIONER'S
MOTION FOR SUMMARY JUDGMENT
AND DENYING RESPONDENT'S MOTION
FOR SUMMARY JUDGMENT**

Appeal No. 08-0856

Account No. #####

Tax Type: Income Tax

Tax Year: 2004

Judge: Chapman

STATEMENT OF THE CASE

On February 10, 2010, Auditing Division ("Division") submitted a Motion for Summary Judgment and Memorandum in Support (Division's "Motion for Summary Judgment"). In its Motion for Summary Judgment, the Division asked the Commission to find that \$\$\$\$ of income that PETITIONER ("Petitioner" or "taxpayer") received in 2004 under a separation agreement with COMPANY A ("COMPANY A") is subject to Utah taxation. The Division contends that the \$\$\$\$ of income is subject to Utah taxation either: 1) because the taxpayer received the income from COMPANY A after she became a Utah domiciliary in early 2004; or 2) because the taxpayer was a full-year resident individual for the 2004 tax year on the basis that she was present in Utah for 183 or more days in 2004 and had a "permanent place of abode" in Utah for 2004.

On March 9, 2010, the taxpayer submitted Petitioner's Motion for Summary Judgment and Memorandum in Support, and Memorandum in Opposition to Respondent's Motion for Summary Judgment (taxpayer's "Motion for Summary Judgment"). The taxpayer asserts that on October 29, 2009, the Commission issued an Initial Hearing Order in which it found that the \$\$\$\$ of income at issue was

not subject to Utah tax, based largely on Utah Code Ann. §59-10-120(3), which provided an exception from the general taxation rules for income that “accrued” prior to a change in residency status. The taxpayer asserts that the Division is asking the Commission to overturn its Initial Hearing decision. The taxpayer asks the Commission to deny the Division’s Motion for Summary Judgment and to grant the taxpayer’s own Motion for Summary Judgment based on the analysis in the Initial Hearing Order.

On March 17, 2010, the Division submitted its Reply to the Division’s Motion for Summary Judgment (Division’s “Reply”). In its Reply, the Division asks the Commission to “correct” its Initial Hearing Order and grant the Division’s Motion for Summary Judgment. The Division also stated that the Commission’s ruling on the parties’ respective Motions for Summary Judgment should dispose the matter and that there should be no need for a hearing unless the Commission would like oral arguments in connection with the motions.

On March 23, 2010, the taxpayer submitted a Reply Memorandum in Support of Petitioner’s Motion for Summary Judgment, in which the taxpayer asked the Commission to issue a ruling on the joint Motions for Summary Judgment without a hearing. Based on both parties’ requests, this ruling is being issued without the Commission hearing oral arguments.

STATEMENT OF UNDISPUTED FACTS

1. On March 25, 2008, the Division issued a Notice of Deficiency and Audit Change (“Statutory Notice”) to the taxpayer for the 2004 tax year, in which it imposed additional individual income tax and interest (calculated through April 24, 2008), as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2004	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

2. The Commission held an Initial Hearing in the matter on June 3, 2009. The Commission issued its Initial Hearing Order on October 29, 2009, which the Division timely appealed.

3. The taxpayer worked in the United Kingdom for COMPANY A between 2001 and the end of 2003.

4. During 2003, the taxpayer began discussions with COMPANY A about terminating her employment. In late 2003, the taxpayer entered into a separation agreement with COMPANY A in which her last day of employment was set as December 31, 2003. Part of the agreement provided for the taxpayer to receive a “separation payment” of \$\$\$\$ from COMPANY A.

5. The taxpayer filed a 2004 Utah part-year resident return in which she claimed to have become a Utah resident on January 3, 2004 and to have remained a Utah resident for the remainder of 2004.

6. The taxpayer received \$\$\$\$ of the separation payment from COMPANY A while domiciled in Utah in 2004. The payments were received on, or about, January 15, 2004, February 25, 2004 and March 3, 2004.

7. The taxpayer did not report the \$\$\$\$ of payments as Utah source income on her 2004 Utah part-year resident return.

8. In its Initial Hearing Order, the Commission determined that the taxpayer was domiciled outside of Utah until, at the earliest, January 4, 2004. The Division has not argued that this portion of the Initial Hearing Order is incorrect. Furthermore, as domicile is a factual issue, the Division’s filing of a Motion for Summary Judgment would be inconsistent with a contention that domicile was still at issue. As a result, the Commission considers it an undisputed fact that the taxpayer was not domiciled in Utah in 2004 until January 4, 2004.

9. During 2001, the taxpayer purchased residential real property located at ADDRESS in CITY, Utah (the “CITY home”). She owned the CITY home for the entirety of 2004.

10. The taxpayer has received the 45% “primary residential” exemption from property taxes on the CITY home since she purchased it in 2001, even though she claimed that it was a “vacation home” until moving into it permanently after changing her domicile to Utah on January 4, 2004.

11. The taxpayer was present in Utah approximately 15 days per year for 2001, 2002 and 2003.

APPLICABLE LAW

1. Under rule 56(c) of the Utah Rules of Civil Procedure, a summary judgment shall be rendered “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.” Facts and inferences to be drawn by the Commission in the summary judgment proceeding must be viewed in the light most favorable to the party opposing the summary judgment. *See Broadwater v. Old Republic Sur.*, 854 P.2d 527 (Utah 1993).

2. Utah Code Ann. 59-10-104(1)¹ provides that “a tax is imposed on the state taxable income . . . of every resident individual[.]”

3. For purposes of Utah income taxation, a “resident individual” is defined in UCA §59-10-103(1)(q), as follows in pertinent part:

- (i) “Resident individual” means:
 - (A) an individual who is domiciled in this state for any period of time during the taxable year, but only for the duration of the period during which the individual is domiciled in this state; or
 - (B) an individual who is not domiciled in this state but:
 - (I) maintains a permanent place of abode in this state; and
 - (II) spends in the aggregate 183 or more days of the taxable year in this state.

.....

4. Utah Admin. Rule R865-9I-2(B) (“Rule 2”) provides guidance concerning “permanent place of abode,” as follows in pertinent part:

Permanent place of abode does not include a dwelling place maintained only during a temporary stay for the accomplishment of a particular purpose. For purposes of this provision, temporary may mean years.

¹ All citations are to the 2004 version of Utah law, unless otherwise indicated.

5. UCA §59-10-120² governs an individual's change of status as a resident or nonresident, as follows:

- (1) If an individual changes his status during his taxable year from resident to nonresident or from nonresident to resident, the commission may by rule require him to file one return for the portion of the year during which he is a resident and another return for the portion of the during which he is a nonresident.
- (2) Except as provided in Subsection (3) the taxable income of the individual described in Subsection (1) shall be determined as provided in this chapter for residents and for nonresidents as if the individual's taxable year for federal income tax purposes were limited to the period of his resident and nonresident status respectively.
- (3) There shall be included in determining taxable income from sources within or without the state, as the case may be, income, gain, loss, or deduction accrued prior to the change of status, even though not otherwise includable or allowable in respect of the period prior to such change, but the taxation or deduction of items received or accrued prior to the change of status shall not be affected by the change.

6. Utah Administrative Rule R865-9I-7 ("Rule 7")³ provides guidance in regards to Section 59-10-120, as follows in pertinent part:

A. Definitions.

1. "Part-year resident" means an individual that changes status during the taxable year from resident to nonresident or from nonresident to resident.
2. "FAGI" means federal adjusted gross income, as defined by Section 62, Internal Revenue Code.

B. The state taxable income of a part-year resident shall be a percentage of the amount that would have been state taxable income if the taxpayer had been a full-year resident as determined under Section 59-10-112. This percentage is the Utah portion of FAGI divided by the total FAGI, not to exceed 100 percent.

C. The Utah portion of a part-year resident's FAGI shall be determined as follows:

1. Income from wages, salaries, tips and other compensation earned while in a resident status and included in the total FAGI shall be included in the Utah portion of the FAGI.
2. Dividends actually or constructively received while in resident status shall be included in the Utah portion of FAGI. Any dividend exclusion shall be deducted from the Utah portion of FAGI using the percentage of excludable dividends received while in resident status, compared to the total excludable dividends.

² Subsection 59-10-120(3) was deleted in 2008. Nevertheless, the subsection existed in and must be given effect for the 2004 tax year.

³ Rule 7 was amended on October 22, 2009. The version of Rule 7 in effect for the 2004 tax year is cited and given effect in this decision.

3. All interest actually or constructively received while in resident status shall be included in the Utah portion of the FAGI.

4. All FAGI derived from Utah sources while in a nonresident status, as determined under Section 59-10-117, shall be included in the Utah portion of FAGI.

....

H. Other income, losses or adjustments applicable in determining total FAGI may be allowed or included in the Utah portion of his FAGI only when the allowance or inclusion is fair, equitable, and would be consistent with other requirements of the act or these rules as determined by the Tax Commission.

7. UCA §59-10-123 addresses a taxpayer's method of accounting, as follows:

(1) For purposes of the tax imposed by this chapter, a taxpayer's method of accounting shall be the same as the method employed for federal income tax purposes.

(2) If a taxpayer's method of accounting is changed for federal income tax purposes, his method of accounting shall be similarly changed and reflected in each return filed for Utah individual income tax purposes for any taxable year for which such change is reflected in his return for federal income tax purposes.

8. UCA §59-1-1417 (2009) provides that the burden of proof is upon the petitioner

in proceedings before the Commission, with limited exceptions as follows:

In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:

(1) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;

(2) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and

(3) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income;

(a) required to be reported; and

(b) of which the commission has no notice at the time the commission mails the notice of deficiency

DISCUSSION

There are two issues. The first issue is whether the \$\$\$\$ of separation agreement payments that the taxpayer received in 2004 when she was domiciled in Utah are subject to Utah income tax. If the Commission finds that the payments are subject to Utah tax because they were received while

the taxpayer was domiciled in Utah, the second issue need not be addressed. However, if the Commission sustains its Initial Hearing Order and finds that the payments are not subject to tax pursuant to the exception in Section 59-10-120(3), the second issue must also be addressed.

The second issue is whether the \$\$\$\$ of separation agreement payments received by the taxpayer in 2004 are subject to Utah tax because she was a full year statutory resident individual of Utah in 2004 under Section 59-10-103(1)(q)(i)(B) (which provides that for a person not domiciled in the state, a person is a Utah resident individual if he or she: 1) maintains a permanent place of abode in the state; and 2) spends in the aggregate 183 or more days of the taxable year in this state).

ISSUE I: Does Exception in Section 59-10-120(3) Apply to Taxpayer's Circumstances?

The taxpayer indicates that although she received income in 2004 while domiciled in Utah, that income was made on the basis of 2003 employment and was therefore “earned” in 2003. The taxpayer argues that in 2004, she was a part-year resident of Utah and does not owe Utah income tax on income earned outside the state before she became a Utah resident, even if she received it after becoming a resident.

As stated earlier in Undisputed Fact #8, the taxpayer was not domiciled in Utah in 2004 until January 4, 2004. Thus, she is not a full-year resident for the 2004 tax year under Subsection 59-10-103(1)(q)(i)(A) (which provides that a person is a Utah resident individual for that portion of time the person is domiciled in Utah). If the taxpayer is a part-year resident, it is necessary for the Commission to consider whether the \$\$\$\$ of income that the taxpayer received from COMPANY A in 2004 was taxable to Utah.

In support of her position that the Division should not count certain income in the year she received it, the taxpayer relies on the definition of federal adjusted income in Rule 7(C)(1), which provides that for part-year residents of Utah, federal adjusted income (“FAGI”), includes “[i]ncome from wages, salaries, tips and other compensation earned while in a resident status. . . .” The taxpayer contrasts the use of the word “earned” in subsection (C)(1) with other subsections of Rule 7(C). For example, subsections (C)(2) and (C)(3) make reference to dividends “actually or constructively received while in

resident status,” and interest “actually or constructively received while in resident status” as a part of FAGI for state tax purposes. The taxpayer uses this difference to indicate that for part-year residents of Utah, Rule 7 requires that taxpayers should count wages and other compensation at the time it is accrued or earned rather than wait until it is received.

The Division argues that the taxpayer’s interpretation of Rule 7 would mandate accrual accounting for a specific class of taxpayers. This, the Division argues, is in conflict with Utah and federal law. Utah Code Section 59-10-123 requires that a taxpayer’s accounting methods for Utah state tax “shall be the same as the method employed for federal income tax purposes.” For federal tax purposes, the tax code allows various methods of accounting, including both cash and accrual accounting. *See* 26 U.S.C. §446. The Division maintains that the taxpayer’s interpretation would mandate accrual accounting for part-time residents, which would conflict with these provisions. On that basis, the Division asks for a ruling that Rule 7(C)(1) does not require accrual accounting and that Utah Code Section 59-10-123 and applicable federal law govern a taxpayer’s choice of accounting methods. Because the taxpayer used cash accounting on her federal tax forms for 2004, the Division argues that she is precluded from attributing any income she received in that year to the efforts of any other year. On that basis, the Division maintains there is no relevance to the taxpayer’s status as a full-year or part-year resident of Utah for 2004.

For purposes of Utah income tax, Section 59-10-120 governs the effect of a change in a person’s status as a Utah resident or nonresident. Subsection 59-10-120(2) provides as a general rule that when a person changes from nonresident to resident status, the individual’s income shall be determined “as if the individual’s taxable year for federal income tax purposes were limited to the period of his resident and nonresident status respectively.” If the general rule in Subsection 59-10-120(2) were the only rule, the Commission would be more likely to adopt the Division’s position. However, Subsection 59-10-120(3) provides an exception to the general rule. The specific exception of Subsection 59-10-120(3) provides that “there shall be included in determining taxable income from sources within or without the state” any income “accrued prior to the change of [Utah residential] status, even though not

otherwise includable or allowable in respect of the period prior to such change, but the taxation or deduction of items received or accrued prior to the change of status shall not be affected by the change.” Utah law includes Subsection 59-10-120(3) as an explicit exception to the general rule found in Subsection 59-10-120(2) for situations involving taxpayers who are part-year residents.

It is undisputed that the taxpayer’s income in question was accrued prior to her change of status from nonresident to resident. The income was accrued by the time she ended her employment on December 31, 2003, in accordance with the separation agreement. It is also undisputed that the income was “not otherwise includable . . . in respect of the period prior to the change” because the taxpayer was on a cash basis. The taxpayer could not include the income at issue before January 4, 2004, the date she became a Utah resident, because she did not receive the income until after this date. Thus, this income is exactly the type of income addressed by Subsection 59-10-120(3). That subsection goes on to provide that “the taxation . . . of items . . . accrued prior to the change of status shall not be affected by the change.” Accordingly, accrued income that would not have been taxable by Utah prior to the change of status shall not be taxable by Utah after the change of status.

The Commission finds no conflict between Section 59-10-120 and other Utah laws relating to accrual, cash, or other accounting methods. The income is still taxable when received, as required by the cash basis method of accounting. In the absence of a special exception, the income would still be taxable by Utah because persons domiciled in Utah are generally taxed on income from whatever source derived. The taxpayer’s income is not, however, taxable by Utah because of the special exemption in Subsection 59-10-120(3). For these reasons, the Division’s argument that “Utah law does not allow an exception for a part-year resident to the general rule that state taxable income includes federal taxable income” should be rejected.

The Division also argues that Subsection 59-10-120(3) should be interpreted “narrowly” and found only to apply in situations where the income is from a pass through entity or from a business activity that has corresponding deductions. The Division, however, has provided no support to show why

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the Commission should apply Section 59-10-120(3) only in these limited situations. As discussed above, the taxpayer's situation meets the plain language of Subsection 59-10-120(3). As a result, the Division's proposed, alternative interpretation is unconvincing. The Division also provides another alternative. The Division argues that Subsection 59-10-120(3) should be given no effect because it was subsequently repealed, "presumably because it was unnecessary." This argument is also unconvincing.

The Division also points out that the Commission has ruled in other cases that income earned for services performed in another state or country, but subsequently received by a taxpayer once he or she has become a Utah resident, is subject to Utah income tax. The Division specifically points to Commission rulings in *USTC Appeal No. 99-1011* (Int. Hearing Order Jul. 26, 2000) and *USTC Appeal o. 00-1527* (Findings of Fact, Conclusions of Law and Final Decision Feb. 15, 2002). However, in these cases, the taxpayers were **full-year** residents of Utah at the time they received the payments. Thus, the exception expressly limited to part-year residents in Subsection 59-10-120(3) could not apply in those cases.

Finally, the Division claims that the Initial Hearing Order in this matter is inconsistent with subsequent decisions of the Commission, specifically citing *USTC Appeal No. 08-1636* (Findings of Fact, Conclusions of Law and Final Decision Mar. 4, 2010). The decision in *Appeal No. 08-1636*, however, is consistent with the Initial Hearing Order that the Commission issued in this matter. *Appeal No. 08-1636* concerned a part-year resident who had moved from STATE to Utah. The Commission determined that the debt cancellation income he received in connection with the sale of his STATE home was subject to Utah income tax because the home was sold and the income accrued only after the taxpayer had become a Utah resident. Had the income accrued prior to that taxpayer becoming a Utah resident, the circumstances would have been similar to those of this case, and Section 59-10-120(3) would have precluded the income from being subject to Utah tax.

For these reasons, the \$\$\$\$ of income is not subject to Utah income tax if the taxpayer is a part-year resident of Utah for the 2004 tax year.

ISSUE II: Is the Taxpayer a Full-Year Resident for 2004 under Subsection 103(1)(q)(i)(B)? The Division concedes that the taxpayer is not a full-year resident for 2004 under Subsection 103(1)(q)(i)(A), which concerns domicile. However, the Division makes a new argument in its Motion for Summary Judgment that was addressed in the Commission's Initial Hearing Order. The Division argues that the taxpayer was a full-year resident in accordance with Subsection 103(1)(q)(i)(B), because the taxpayer was present in Utah for 183 days during 2004 and because the taxpayer maintained a permanent place of abode in Utah in 2004. If the taxpayer is found to be a full-year resident individual under this portion of Section 59-10-103(1)(q)(i), the taxpayer would not be deemed to have changed her status from nonresident to resident in 2004. If the taxpayer did not change her status in 2004, the exception in Section 59-10-120(3) would not apply, and the \$\$\$\$ of income would be subject to Utah income tax.

The taxpayer has owned a home in CITY, Utah since 2001. She sometimes used it as a vacation home until changing her domicile to Utah on January 4, 2004. The taxpayer states that she moved into the CITY home on January 6, 2004 (Division's Motion to Dismiss, Ex. B, p. 2). Regardless, the taxpayer is not deemed to be a full-year resident under Subsection 59-10-103(1)(q)(i)(B), even if she was present in Utah for 183 or more days in 2004. The two criteria listed in Section 59-10-103(1)(q)(i)(B) are to be considered for "an individual who is not domiciled in this state." In this appeal, the taxpayer was domiciled in the state in 2004. She became domiciled in Utah on January 4, 2004 and remained domiciled in Utah for the remainder of the year. No evidence exists to show that the taxpayer moved into the CITY home and used it as a permanent place of abode until she was domiciled in Utah. The fact that the taxpayer obtained a primary residential exemption for the CITY home for 2004 is not controlling. Under these circumstances, the taxpayer is deemed to be a part-year, not a full-year, resident individual under both subsections of Section 59-10-103(1)(q)(i). For these reasons and as previously discussed, the exception in Section 59-10-120(3) applies to the \$\$\$\$ of income at issue. In conclusion,

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the Commission's Initial Hearing Order in this matter should be sustained and the \$\$\$\$ of income at issue should not be subject to Utah income tax.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds that the taxpayer was a part-year Utah resident individual for the 2004 tax year and that the \$\$\$\$ of income at issue is not subject to Utah income tax pursuant to the Section 59-10-120(3) exception. Accordingly, the Petitioner's Motion for Summary Judgment is granted, and the Division's Motion for Summary Judgment is denied. It is so ordered.

DATED this _____ day of _____, 2010.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Notice of Appeal Rights: 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 Ann. §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 Ann. §§59-1-601et seq. and 63G-4-401 et seq.

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