

10-0462
INCOME
YEAR: 2006
SIGNED: 01-25-2012
COMMISSIONERS: M. JOHNSON, D. DIXON, M. CRAGUN
EXCUSED: R. JOHNSON

BEFORE THE UTAH STATE TAX COMMISSION

<p>PETITIONER 1 & PETITIONER 2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 10-0462</p> <p>Account No. ##### Tax Type: Income Audit Period: 2006</p> <p>Judge: Phan</p>
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Presiding:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REP. 1, Tax Representative
PETITIONER 1
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 for an Initial Hearing pursuant to Utah Code Sec. 59-1-502.5 on October 31, 2011. Petitioner (the Taxpayer) is appealing an audit deficiency issued by Respondent (the Division) for the 2006 tax year, in which the Division denied an enterprise zone credit claimed on the Utah Individual Income Tax Return filed by the Taxpayer. The Statutory Notice of Deficiency and Audit Change for the 2006 tax year had been mailed on January 12, 2010. The amount of additional tax due from the original audit had been \$\$\$\$ plus interest. No penalties were assessed. The Taxpayer timely appealed the audit.

APPLICABLE LAW

Enterprise Zone Credits are provided at Utah Code 62-38f-413(1) (2006)¹ as follows:

¹ This decision will refer to the provisions in effect for the 2006 tax year. Substantive changes were made effective January 1, 2012.

Subject to the limitations of Subsections (2) through (4), the following nonrefundable tax credits against a tax under Title 59, Chapter 7, Corporate Franchise and Income Taxes, or Title 59, Chapter 10 Individual Income Tax Act, are applicable in an enterprise zone: . . . (g) an annual investment tax credit of 10% of the first \$250,000 in investment, and 5% of the next \$1,000,000 qualify investment in plant, equipment, or other depreciable property.

A further qualification for the credit is located at Utah Code §63-38f-412 (2006) which provides that to qualify for an enterprise zone credit, a business must meet requirements as follows:

The tax incentives described in this part are available only to a business entity for which at least 51% of the employees employed at facilities of the business entity located in the enterprise zone are individuals who, at the time of employment, reside in the county in which the enterprise zone is located.

“Business entity” is defined at Utah Code 63-38f-402 as follows:

“Business entity” means an entity: (a) including a claimant, estate, or trust; and (b) under which business is conducted or transacted.

Employee is specifically defined at Utah Admin. Rule R865-9I-37 (2006) as follows:

A. Definitions: . . . 3. “Employee” means a person who qualifies as an employee under Internal Revenue Service Regulation 26 CFR 31.3401(c)(1).

D. To determine whether at least 51 percent of the business firm’s employees reside in the county in which the enterprise zone is located, the business firm shall consider every employee reported to the Department of Workforce Services for the tax year for which an enterprise zone credit is sought.

Internal Revenue Service Regulation 26 CFR 31.3401(c)(1)(2006) provides in pertinent part:

(a) The term employee includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee . . .

(b) Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished.

(e) If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus, if such relationship exists, it is of no consequence that the employee is designated as a partner, co adventurer, agent, independent contractor, or the like.

(f) All classes or grades of employees are included within the relationship of employer and employee. Thus, superintendents, managers and other supervisory personnel are employees. Generally, an officer of a corporation is an employee of the corporation. However, an officer of a corporation who as such does not perform any services or performs only minor services

and who neither receives nor is entitled to receive directly or indirectly, any remuneration is not considered to be an employee of the corporation. A director of a corporation in his capacity as such is not an employee of the corporation.

(g) The term employee includes every individual who receives a supplemental unemployment compensation benefit which is treated under paragraph (b)(14) of Sec. 31.3401(a)-1 as if it were wages.

(h) Although an individual may be an employee under this section, his services may be of such a nature, or performed under such circumstances, that the remuneration paid for such services does not constitute wages within the meaning of section 3401(a).

The burden of proof in on the Petitioner in these proceedings pursuant to Utah Code Sec. 59-1-1417 which provides:

In a proceeding before the commission, the burden of proof is on the petitioner . . .

Generally, tax exemption or tax credit statutes are strictly construed against the taxpayer. *See Parson Asphalt Prods., Inc. v. State Tax Comm'n*, 617 P.2d 397, 398 (Utah 1980) (“[s]tatutes which provide for exemptions should be strictly construed, and one who so claims has the burden of showing his entitlement to the exemption”). Tax credit statutes, like tax exemptions, “are to be strictly construed against the taxpayer.” *MacFarlane v. State Tax Comm'n*, 2006 UT 18, ¶11. “While we recognize the general rule that statutes granting credits must be strictly construed against the taxpayer, the construction must not defeat the purposes of the statute. The best evidence of that intent is the plain language of the statute.” (Citations omitted.) *See id.* at ¶19.

DISCUSSION

In this case the Taxpayer, PETITIONER 1, began to develop a business as a sole proprietorship in 2006. The business was a (X) farm. He had no employees. In 2006, the Taxpayer invested in a sprinkler system, backhoe and farm truck for this enterprise and he planted a number of acres in (X) on land that he previously owned. It was his intent that the (X) would be sold in subsequent years at wholesale to another family business. It would be two or three years before the planted (X) would be ready to sell.

The investment credit that the Taxpayer claimed on his return, under Utah Code 62-38f-413(1)(g)(2006),² was for the sprinkler system, backhoe and truck. During 2006 there was no building or structure on the (X) farm. The Taxpayer pointed out that none was needed at that time for the (X) operation as the (X) needed to grow for a couple years before it could be harvested. At some point it was

² In his appeal the Taxpayer cited to Utah Code Sec. 63M-1-413(g) which was the code provision in effect in 2010 when the appeal was filed, However, the change was in renumbering, as the 2006 and 2010 Subsection (g)

his intent to construct a barn on the property. The Taxpayer owned other businesses and had an office at one of those locations.

The Taxpayer understood that one of the reasons the Division had disallowed the credit was for the fact that the Taxpayer did not have any employees. The Taxpayer argued that the credit under Utah Code 62-38f-413(1)(g) was not related to hiring additional employees as were the provisions in Utah Code 62-38f-413(1)(a) through (f). The Taxpayer is correct that Subsections (a) through (f) provide various credits for hiring additional employees, while Subsection (g) is a credit for investment in plant, equipment or other depreciable property.

The Taxpayer argued that if employees were required, he should be considered an employee as he did all the work of the business. He acknowledged that he was not an employee reported to the Department of Workforce Services under Utah Admin. Rule R865-9I-37(D) but argued that if he had earned any income from the business during that year it would have to have been reported as self employment income and subject to the self employment tax. The Taxpayer lived in Cleveland, Utah which was located in the same County as his (X) farm operation and in the enterprise zone. The Taxpayer did not provide any argument that he would qualify as an employee under Internal Revenue Service Regulation 26 CFR 31.3401(c)(1), which is the definition provided for employee at Utah Admin. Rule R865-9I-37.

An additional argument made by the Taxpayer and his representative was that employees from the Office of Economic Development had come to the County and had provided information about the credit to many people in the enterprise zones. It was their understanding from that office that the Taxpayer would qualify for the credit and they felt the State Tax Commission had a different interpretation than the Office of Economic Development.

At the hearing the Division stated that the Taxpayer did not qualify for the credit because of the lack of employees as well as the fact that the business had no facilities. The Division pointed to Utah Code §63-38f-412 for support for the position that in order to qualify for an enterprise zone credit, a business must have employees as well as facilities located in the enterprise zone. It was the Division's contention that "facilities" meant some type of building or structure. The Taxpayer's business was land planted in (X) and there was no building.

Upon review of the evidence and information presented by the parties at the hearing the Division properly disallowed the enterprise zone credit for items purchased by the Taxpayer. Generally tax credit statutes are strictly construed against the taxpayer. *See Parson Asphalt Prods., Inc. v. State Tax Comm'n*, 617

provisions are identical. .

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P.2d 397, 398 (Utah 1980); and *MacFarlane v. State Tax Comm'n*, 2006 UT 18. In this matter it is clear upon review of the statute that the intent of the legislature was that the credit be provided to business entities that conducted or transacted business and had employees working in a facility of the business located in the enterprise zone. See Utah Code §63-38f-412. Further, the statutory provisions require that at least 51% of the employees reside in the county in which the zone was located. The Taxpayer argues that he is not required to have employees in order to qualify the investment credit under Utah Code 62-38f-413(1)(g). However, this is a misreading of the statutory provisions. The requirements at Utah Code 63-38f-412 apply equally to credits for adding additional employees as to the investment credit. See *Tax Commission Initial Hearing Decision Appeal No. 09-2689, issued October 5, 2010*.

The Tax Commission Rule defines employee at Utah Admin. Rule R865-91-37(A)(3) (2006) as a person who qualifies as an employee under 26 CFR 31.3401(c)(1). Then the rule further clarifies that for purposes of determining the 51% of employees, every employee reported to the Department of Workforce Services for the tax year should be considered. See Utah Admin. Rule R865-91-37(D). The Taxpayer was not an employee under Regulation 31.3401(c)(1) because he is self employed and there is no employer/employee relationship. The Division's position in this matter is consistent with prior Tax Commission decisions issued in *Appeal Nos. 08-1928 and 09-2689*. The credit was properly denied by the Division. Because the credit was properly denied on the basis of there being no employees, the Commission need not address the question of whether a building or structure was required to comprise a "facility" for purpose of Utah Code §63-38f-412.

Jane Phan
Administrative Law Judge

ORDER

On the basis of the foregoing, the Commission sustains the audit deficiency issued by the Division for the 2006 tax year. 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

Appeal No. 10-0462

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 _____, 2012.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
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.