10-3022
INCOME
TAX YEARS: 2008 & 2009
SIGNED: 01-11-2012
COMMISSIONERS: M. JOHNSON, D. DIXON, M. CRAGUN
EXCUSED: R. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER 1 & PETITIONER 2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING ORDER** Appeal No. 10-3022 Account No. ##### Tax Type: Income Tax Years: 2008 & 2009 Judge: Chapman

Presiding:
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER 1, Taxpayer
For Respondent: RESPONDENT REP. 1, Assistant Attorney General
RESPONDENT REP. 2, from 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 January 3, 2012.

PETITIONER 1 and PETITIONER 2 ("Petitioners" or "taxpayers") have appealed Auditing Division's (the "Division") assessment of additional individual income taxes for the 2008 and 2009 tax years. On November 9, 2010, the Division issued Statutory Notices of Audit Change ("Statutory Notices") to the taxpayers, in which it imposed additional tax and interest (calculated as of December 9, 2010) for the 2008 and 2009 tax years, as follows:

Year	Tax	Penalties	Interest	Total

2008	$$$$$	$$$$$	$$$$$	$$$$$
2009	$$$$$	$$$$$	$$$$$	$$$$$
				$$$$$

The 2008 assessment arose because the Division determined that the taxpayers were not entitled to a $$$$$ "equitable adjustment" deduction and a $$$$$ "credit for increasing research activities" that they claimed on their 2008 Utah return. The 2009 assessment arose because the Division determined that the taxpayers were not entitled to a $$$$$ "credit for increasing research activities" that they claimed on their 2009 Utah return.[1]

All of the adjustments to the taxpayers' 2008 and 2009 returns involve the taxpayers' desire to take a $$$$$ credit for increasing research activities ("research credit") against their Utah tax liability. The taxpayers claimed $$$$$ of the $$$$$ research credit on their 2008 return and the remaining $$$$$ of the $$$$$ credit on their 2009 return.

At the hearing, PETITIONER 1 admitted that the $$$$$ "equitable adjustment" deduction the taxpayers also claimed for the 2008 tax year appears to be a mistake made by his income tax software. PETITIONER 1 admitted that the taxpayers would not be entitled to both an equitable adjustment deduction of $$$$$ and a research credit of $$$$$. Accordingly, for purposes of the Initial Hearing, the taxpayers concede that that portion of the 2008 assessment disallowing the $$$$$ equitable adjustment deduction of $$$$$ is correct.

Remaining at issue is whether the taxpayers qualify for the $$$$$ research credit. PETITIONER 1 proffers that he had $$$$$ in qualified research expenses for the 2008 tax year and that he was entitled to a credit equal to 5% of $$$$$ (or $$$$$), pursuant to Utah Code Ann. §59-10-1012(1)(a).

1 The Statutory Notice for the 2009 tax year showed that the Division was disallowing a "targeted business tax credit" in the amount of $$$$$. At the hearing, the Division stated it was actually a "credit for increasing research activities," not a "targeted business tax credit," that was being disallowed for 2009.

PETITIONER 1 is a (PROFESSIONAL) who is retired from the UNITED STATES BUREAU. PETITIONER 1 believes that the state should grant him the credit because of substantial (X) he performed in YEAR while he was under contract to produce (WORDS REMOVED) for the UTAH DEPARTMENT ("UTAH DEPARTMENT"). PETITIONER 1 has paid $$$$$ under the contract to produce the (X) that he delivered to UTAH DEPARTMENT. However, PETITIONER 1 stated that much more time was required to produce the (X) than was originally estimated and that the (X) he delivered to UTAH DEPARTMENT had a value in excess of $$$$$. Because part of the work was performed before his retirement, he believes that the "post-retirement" work he performed and for which he was not compensated is worth in excess of $$$$$ and should be considered a "donation" to the state. PETITIONER 1 believes that he should be allowed to claim a $$$$$ research credit, given the significant donation he has made to the state and given the public good resulting from his work to improve the (WORDS REMOVED) in the state.

PETITIONER 1 explained that he came to the Tax Commission to discuss whether he qualified for the research credit prior to claiming the credit on his 2008 return. PETITIONER 1 spoke to an employee in Taxpayer Services Division and states that the employee who reviewed his proposal for a $$$$$ research credit told him that he should file for the credit. They also discussed PETITIONER 1's need to claim part of the credit for the 2008 year and part for the 2009 year because the taxpayers had insufficient 2008 tax liability to claim the full $$$$$ credit in 2008.

PETITIONER 1 stated that after the Division issued its assessments, the Division provided him with federal and state law that shows that he does not qualify for a research credit because he did not expend any money for the work and/or research for which he is now claiming the credit. (Internal Revenue Code §41 ("IRC §41") and UCA §59-10-1012). He stated that he subsequently contacted the Internal Revenue Service

("IRS"), who confirmed the Division's determination that he does not qualify for a research credit, either for federal or state purposes.[2]

Although PETITIONER 1 stated that he now believes that he does not qualify for the $$$$$ research credit for either federal or state purposes, he asks the Commission to determine whether another state credit exists that would allow him to claim a $$$$$ credit in order that he is compensated for his donation to the state and to public health. At the very least, PETITIONER 1 asks the Commission to waive the interest that has been assessed because he took the tax credit only after seeking advice from the Commission and being told by a Tax Commission employee that he should claim the credit.

The Division asks the Commission to sustain its determination to disallow the $$$$$ equitable adjustment deduction that the taxpayers claimed in 2008 and the $$$$$ tax credit that the taxpayers claimed over the 2008 and 2009 tax years. The Division stated that the Utah research credit is based on federal definitions found in the IRC and that these definitions limit the research credit to research expenses paid or incurred by the taxpayer and does not permit the credit to be determined on the value of uncompensated work performed by a taxpayer. The Division also states that it is not aware of any other credit in Utah allow that would apply to PETITIONER 1's circumstances. Lastly, the Division states that it has no opinion on whether the Commission should grant or deny the taxpayers' request for a waiver of the interest that it has assessed.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2008)[3] defines "adjusted gross income" and "'taxable income' or 'state taxable income,'" as follows:

> (1) As used in this chapter:
> (a) "Adjusted gross income":

2 The Utah research credit is dependent on the IRC statutes used to determine whether a taxpayer also qualifies for a federal research tax credit. PETITIONER 1 stated that he did not claim a federal research credit at the time he claimed the state research credit because he was unaware that a similar federal credit existed.

3 The 2008 version of Utah law is cited in the decision, unless otherwise indicated.

(i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code; or
(ii) for a resident or nonresident estate or trust, is as calculated in Section 67(e), Internal Revenue Code.

. . . .

(w) "Taxable income" or "state taxable income":
(i) subject to Section 59-10-1404.5, for a resident individual, means the resident individual's adjusted gross income after making the:
(A) additions and subtractions required by Section 59-10-114; and
(B) adjustments required by Section 59-10-115;

. . . .

UCA §59-10-115 provides for an adjustment to adjusted gross income, as follow:

(1) The commission shall allow an adjustment to adjusted gross income of a resident or nonresident individual if the resident or nonresident individual would otherwise:

(a) receive a double tax benefit under this part; or
(b) suffer a double tax detriment under this part.
(2) In accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act, the commission may make rules to allow for the adjustment to adjusted gross income required by Subsection (1).

UCA §59-10-1012 provides for a tax credit for research activities conducted in Utah, as follows in pertinent part:

(1) (a) A claimant, estate, or trust meeting the requirements of this section may claim the following nonrefundable tax credits:
(i) a research tax credit of 5% of the claimant's, estate's, or trust's qualified research expenses for the current taxable year that exceed the base amount provided for under Subsection (3);
(ii) a tax credit for a payment to a qualified organization for basic research as provided in Section 41(e), Internal Revenue Code of 5% for the current taxable year that exceed the base amount provided for under Subsection (3); and
(iii) a tax credit equal to:
(A) for the taxable year beginning on or after January 1, 2008, but beginning on or before December 31, 2008, 5% of the claimant's, estate's, or trust's qualified research expenses for the current taxable year;
(B) for the taxable year beginning on or after January 1, 2009, but beginning on or before December 31, 2009, 6.3% of the claimant's, estate's, or trust's qualified research expenses for the current taxable year; or
(C) for taxable years beginning on or after January 1, 2010, 9.2% of the claimant's, estate's, or trust's qualified research expenses for the current taxable year.

. . . .

(2) Except as specifically provided for in this section:

(a) the tax credits authorized under Subsection (1) shall be calculated as provided in Section 41, Internal Revenue Code; and
(b) the definitions provided in Section 41, Internal Revenue Code, apply in calculating the tax credits authorized under Subsection (1).
(3) For purposes of this section:
. . . .
(b) "basic research" is as defined in Section 41(e)(7), Internal Revenue Code, except that the term includes only basic research conducted in this state;
(c) "qualified research" is as defined in Section 41(d), Internal Revenue Code, except that the term includes only qualified research conducted in this state;
(d) "qualified research expenses" is as defined and calculated in Section 41(b), Internal Revenue Code, except that the term includes only:
(i) in-house research expenses incurred in this state; and
(ii) contract research expenses incurred in this state; and
. . . .
(4) (a) If the amount of a tax credit claimed by a claimant, estate, or trust under Subsection (1)(a)(i) or (ii) exceeds the claimant's, estate's, or trust's tax liability under this chapter for a taxable year, the amount of the tax credit exceeding the tax liability:
(i) may be carried forward for a period that does not exceed the next 14 taxable years; and
(ii) may not be carried back to a taxable year preceding the current taxable year.
(b) A claimant, estate, or trust may not carry forward the tax credit allowed by Subsection (1)(a)(iii).
. . . .

Internal Revenue Code ("IRC") §41 provides a federal tax credit for increasing research activities and includes many of the definitions incorporated into Section 59-10-1012, as follows in pertinent part:

(a) General rule. For purposes of section 38, the research credit determined under this section for the taxable year shall be an amount equal to the sum of-
(1) 20 percent of the excess (if any) of-
(A) the qualified research expenses for the taxable year, over
(B) the base amount,
(2) 20 percent of the basic research payments determined under subsection (e)(1)(A) . . .
. . . .
(b) Qualified research expenses
For purposes of this section—
(1) Qualified research expenses
The term "qualified research expenses" means the sum of the following amounts which are paid or incurred by the taxpayer during the taxable year in carrying on any trade or business of the taxpayer—
(A) in-house research expenses, and
(B) contract research expenses.
(2) In-house research expenses
(A) In general
The term "in-house research expenses" means—

(i) any wages paid or incurred to an employee for qualified services performed by such employee,
(ii) any amount paid or incurred for supplies used in the conduct of qualified research, and
(iii) under regulations prescribed by the Secretary, any amount paid or incurred to another person for the right to use computers in the conduct of qualified research.

. . . .

(3) Contract research expenses

(A) In general

The term "contract research expenses" means 65 percent of any amount paid or incurred by the taxpayer to any person (other than an employee of the taxpayer) for qualified research.

(B) Prepaid amounts

If any contract research expenses paid or incurred during any taxable year are attributable to qualified research to be conducted after the close of such taxable year, such amount shall be treated as paid or incurred during the period during which the qualified research is conducted.

. . . .

(e) Credit allowable with respect to certain payments to qualified organizations for basic research

For purposes of this section—

(1) In general

In the case of any taxpayer who makes basic research payments for any taxable year—

(A) the amount of basic research payments taken into account under subsection (a)(2) shall be equal to the excess of—

(i) such basic research payments, over

(ii) the qualified organization base period amount, and

(B) that portion of such basic research payments which does not exceed the qualified organization base period amount shall be treated as contract research expenses for purposes of subsection (a)(1).

(2) Basic research payments defined

For purposes of this subsection—

(A) In general

The term "basic research payment" means, with respect to any taxable year, any amount paid in cash during such taxable year by a corporation to any qualified organization for basic research but only if—

(i) such payment is pursuant to a written agreement between such corporation and such qualified organization, and

(ii) such basic research is to be performed by such qualified organization.

. . . .

UCA §59-1-401(13) (2011) provides that "[u]pon 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 Admin. Rule R865-1A-42(2) ("Rule 42") (2011) provides that reasonable cause to waive interest exists, as follows: "Grounds for waiving interest are more stringent than for penalty. To be granted a waiver of interest, the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error."

UCA §59-1-1417 (2011) 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

The taxpayers concede that the Division properly disallowed the $$$$$ equitable adjustment deduction that they claimed for the 2008 tax year. Remaining at issue is whether they qualify for the $$$$$ research credit they claimed over the 2008 and 2009 tax years and, if not, whether another credit is available to them under the circumstances. Lastly, the taxpayers' request for a waiver of interest will be addressed.

Section 59-10-1012 authorizes a state research credit for a taxpayer's qualified research expenses or basic research payments, which are defined in IRC §41 for purposes of the Utah credit. "Qualified research

expenses" are defined in IRC §41(b) and "basis research payments" are defined in IRC §41(e). Although the definitions are quite lengthy and complex, it appears from a review of them that the research credit is limited to certain percentages of a taxpayer's expenses or payments and not the value of time that a taxpayer may have expended or the value of (X)s or research that has been donated. Even assuming that the taxpayer's work is the type of research that qualifies under IRC §41, which was not discussed at the Initial Hearing, it appears that the taxpayer's donation of either research time or of a research (X) is not an expense or payment that can qualify for the research credit authorized by IRC §41 for federal purposes and Section 59-10-1012 for state purposes.

The taxpayers, who have the burden of proof, have not shown that they qualify for the $$$$$ state research credit that they claimed. Furthermore, PETITIONER 1 states that he now believes that they do not qualify for the $$$$$ research credit at issue. He also states that the IRS has confirmed that his donation, regardless of its value, does not qualify for the research credit under the provisions of IRC §41. For these reasons, the taxpayers have not shown that they qualify for the $$$$$ research credit they claimed for 2008 and the $$$$$ research credit they claimed for 2009.

PETITIONER 1, nevertheless, believes that he should be compensated in some way for his donation and asks the Commission to determine whether another state credit exists that is applicable to these circumstances. The Division stated that it is unaware of such a credit. For state purposes, UCA §59-10-114(2) (2008) allows for certain subtractions to a taxpayer's federal adjusted gross income when determining state taxable income. None of these deductions appear to apply in this case. Additional credits are found in UCA §§59-10-1003 through 59-10-1024 (2008). None of the credits appear to apply. For these reasons, the Division has properly disallowed not only the $$$$$ equitable adjustment for 2008, but also the $$$$$ research credit for 2008 and the $$$$$ research credit for 2009.

The last issue is whether any interest should be waived. Rule 42(2) requires the taxpayers to prove that the commission gave them erroneous information or took inappropriate action that contributed to the error before interest is waived. The $$$$$ equitable adjustment issue appears to be an error made by the taxpayers, not the Tax Commission. Accordingly, any interest associated with this portion of the 2008 assessment should not be waived.

However, the taxpayers did not claim the $$$$$ research credit over the 2008 and 2009 tax years before bringing the issue to the Tax Commission for approval. PETITIONER 1 contends that a Tax Commission employee told him to claim the credit and explained to him how he would need to take the credit over a two- year period, which the Division did not refute. For these reasons and because the Division did not object to a waiver, any interest associated with the $$$$$ research credit claimed in 2008 and the $$$$$ research credit claimed in 2009 should be waived.

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Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission waives that portion of interest associated with the $$$$$ research credit that was disallowed for 2008 and the $$$$$ research credit that was disallowed for 2009. Otherwise, the Division's assessments for both tax years are sustained. If the taxpayers would like to discuss payment arrangements, they may contact the Collections Section at 801-297-7703. 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 _____, 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.

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