

11-409
TAX TYPE: INCOME TAX
TAX YEAR: 2007
DATE SIGNED: 4-12-2013
COMMISSIONERS: B. JOHNSON, D. DIXON, M. CRAGUN, R. PERO
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

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| <p>TAXPAYER-1 AND TAXPAYER-2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.</p> | <p>INITIAL HEARING ORDER</p> <p>Appeal No. 11-409</p> <p>Account No. #####</p> <p>Tax Type: Income</p> <p>Tax Year: 2007</p> <p>Judge: Phan</p> |
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Presiding:
Jane Phan, Administrative Law Judge

Appearances:

For Petitioners: TAXPAYER-1, By Telephone
TAXPAYER-2, By Telephone

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT-1, Manager, Income Tax Auditing
RESPONDENT-2, Senior Auditor

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code § 59-1-502.5, on January 24, 2013. Petitioners (the “Taxpayers”) are appealing the audit deficiency issued by Respondent (the “Division”) of individual income tax and the interest accrued thereon for the 2007 tax year. The audit made three changes to the Taxpayers’ Utah Individual Income Tax Return for that year. It denied the health care insurance premium deduction, the Utah capital gains deduction and increased the Utah portion of adjusted gross income by adding back a moving expense deduction. The Division issued the Notice of Deficiency and Audit Change (“Statutory Notice”) on December 16, 2010, to the Taxpayers, in which it imposed additional tax and interest, as follows:

| <u>Year</u> | <u>Tax</u> | <u>Penalties</u> | <u>Interest</u> | <u>Total</u> |
|-------------|------------|------------------|-----------------|--------------|
| 2007 | \$\$\$\$\$ | \$\$\$\$\$ | \$\$\$\$\$ | \$\$\$\$\$ |

APPLICABLE LAW

Utah Code § 59-10-114 (2007) provides for certain additions to and subtractions from the federal taxable income of an individual when calculating that person's Utah state taxable income including a limited deduction for capital gains reinvested into Utah small businesses and for amounts paid for health care insurance as follows:

- (2) There shall be subtracted from federal taxable income of a resident or nonresident individual:

....

- (g) subject to the limitations of Subsection (3)(e), amounts a taxpayer pays during the taxable year for health care insurance, as defined in Title 31A, Chapter 1, General Provisions:

- (i) for:

- (A) the taxpayer;
- (B) the taxpayer's spouse; and
- (C) the taxpayer's dependents; and

- (ii) to the extent the taxpayer does not deduct the amounts under Section 125, 162, or 213, Internal Revenue Code, in determining federal taxable income for the taxable year.

....

- (l) (i) for taxable years beginning on or after January 1, 2003, the total amount of a resident or nonresident individual's short-term capital gain or long-term capital gain on a capital gain transaction: (A) that occurs on or after January 1, 2003; (B) if 70% or more of the gross proceeds of the capital gain transaction are expended: (I) to purchase qualifying stock in a Utah small business corporation; and (II) within a 12-month period after the day on which the capital gain transaction occurs; and (C) if, prior to the purchase of the qualifying stock described in Subsection 2(1)(i)(B)(1), the resident or nonresident individual did not have an ownership interest in the Utah small business corporation that issued the qualifying stock; . . .

- (3) (e) For purposes of Subsection (2)(g), a subtraction for an amount paid for health care insurance as defined in Title 31A, Chapter 1, General Provisions, is not allowed:

- (i) for an amount that is reimbursed or funded in whole or in part by the federal government, the state, or an agency or instrumentality of the federal government or the state; and
- (ii) for a taxpayer who is eligible to participate in a health plan maintained and funded in whole or in part by the taxpayer's employer or the taxpayer's spouse's employer.

Under Utah Admin. Rule R865-9I-7(E) the deduction for moving expense is limited as follows:

Moving expenses deducted on the federal return may be deducted from the Utah portion of FAGI only to the extent that they are for moving into Utah and within Utah.

Utah Code § 59-10-537(1)(a) (2010) (prior version at § 59-10-537(1) (2007)) provides for the imposition of interest for failure to pay tax when due, as follows:

Subject to the other provisions of this section, if any amount of income tax is not paid on or before the last date prescribed in this chapter for payment, interest on such amount at the rate and in the manner prescribed in Section 59-1-402 shall be paid.

Utah Code Ann. § 59-1-1417 (2010) provides that the burden of proof is upon the petitioner (taxpayer) in income tax matters before the Commission as follows:

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

DISCUSSION

When the Division audited the Taxpayers' Utah Part-Year Individual Income Tax Return for the 2007 tax year the Division disallowed two deductions taken by the Taxpayers on the return, as well as made a change to the Taxpayers' Utah portion of federal adjusted gross income. At the hearing the Division argued that the Taxpayers had misunderstood the Utah law on all these points. The Division did not assess any penalties with the audit.

The first item noted as disallowed on the Statutory Notice was the amount of \$\$\$\$ the Taxpayers had claimed as a health care insurance premium deduction. The Taxpayers explained that TAXPAYER-1 had worked for BUSINESS-1 in Utah from prior to the beginning of 2007 and up through September 2007. While working for BUSINESS-1, the employer did provide a health insurance plan to the Taxpayers, although TAXPAYER-1 did have to pay a portion of the premium. Then in MONTH 2007, TAXPAYER-1 changed employers to BUSINESS-2 and the Taxpayers moved out of state. TAXPAYER-1 stated that although the employer provided a company health insurance plan, for the first three months the new employer only paid %%% of the premium and TAXPAYER-1 had to pay %%%%. It was the Taxpayers' calculation that the total premiums paid for their health insurance for 2007 had been \$\$\$\$\$, although some of this had been paid by the employers and only a portion was paid out of pocket by the Taxpayers. The total amount of \$\$\$\$\$

claimed as a health care premium deduction actually included a number of other medical expenses that would not be allowed under this deduction.

The Division explained that the health care insurance premium deduction is limited by Utah Code § 59-10-114 (3) and is not allowed for a taxpayer who is eligible to participate in a health plan maintained and funded in whole or in part by the taxpayer's employer or the taxpayer's spouse's employer.¹ In this case there was no dispute that the Taxpayers were eligible under both BUSINESS-1 and BUSINESS-2 to participate in a plan sponsored by the employer and funded in part by the employer. Under this limitation, none of the premium amounts claimed by the Taxpayers qualified for this deduction, not even the portion that the Taxpayers had to pay out of pocket for the insurance premiums. The Taxpayers claimed this deduction in error on their Utah Individual Income Tax return and it was properly disallowed by the Division.

The second deduction disallowed in the audit was the Utah Capital Gains Deduction. At the hearing the Taxpayers explained that they had cashed out some BUSINESS-1 stock from a stock incentive plan. They had claimed a deduction in the amount of \$\$\$\$ on their Utah return, which represented the total cost or transaction expense. They explained that the sale price of the shares had been \$\$\$\$\$, but their expenses in the transaction had been the \$\$\$\$\$, which is the amount that they deducted. Their total net proceeds had been only \$\$\$\$\$. The Taxpayer acknowledged that they did not use the proceeds from this sale to purchase stock in a Utah small business corporation.

The Division pointed out that the deduction that they had claimed on their Utah Individual Income Tax return had been under Utah Code Sec. 59-10-114(2)(1) and that provision allows a deduction only if 70% or more of the gross proceeds of the capital gain transaction are expended to purchase qualifying stock in a Utah small business corporation within a 12-month period after the transaction and if the taxpayer did not previously have an ownership interest in the Utah small business. Again it was the Division's position that the Taxpayers did not qualify for this deduction under the statutory provisions.

The final item was a \$\$\$\$ difference in the Utah portion of the Taxpayers' adjusted gross income, due to a subtraction for moving expenses. The Taxpayers had moved out of Utah in MONTH 2007 when TAXPAYER-1 began work for BUSINESS-2. They had deducted moving expenses from their Utah portion of adjusted gross income on their part-year resident return. The Division pointed to Utah Admin. Rule R865-9I-

1 The Division did cite to prior Tax Commission decisions on this point including Utah State Tax Commission Initial Hearing Order 11-296, issued October 14, 2011, that case in turn cites to Appeal No. 03-1675, 06-0036, 06-0788, 08-1534. Many decisions issued by the Tax Commission are available to the public in a redacted format at tax.utah.gov/commission-office/decisions.

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7(E) which provides that moving expenses deducted on the federal return may be deducted from the Utah portion of FAGI only to the extent that they are for moving into Utah and within Utah. In this case the expenses were for moving out of the state and the Taxpayers are not allowed to deduct them from their Utah portion of federal adjusted gross income.

Upon review of the information and the law at issue, it appears that the Taxpayers did not understand the Utah law in claiming the deductions or revision to their Utah portion of federal adjusted gross income which they had claimed on their return. There was no indication that this was intentional disregard of the law on the part of the Taxpayers and no penalties to that affect were assessed with the audit. The audit tax and interest should be sustained in its entirety for the 2007 tax year.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based upon the foregoing, the Commission sustains the Division's audit deficiency of both tax and the interest accrued there on for the 2007 tax year. The Taxpayers' appeal is denied. 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 _____, 2013.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
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.