

11-1969
INCOME TAX
TAX YEAR: 2007
SIGNED: 07-06-2012
COMMISSIONERS: R. JOHNSON, M. JOHNSON, M. CRAGUN
RECUSED: D. DIXON
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. 11-1969

Account No. #####

Tax Type: Income Tax

Tax Year: 2007

Judge: Phan

Presiding:

Jane Phan, Administrative Judge

Appearances:

For Petitioner: PETITIONER 1
PETITIONER 2

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

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing in accordance with Utah Code §59-1-502.5, on March 19, 2012. Petitioners (Taxpayers) are appealing an audit deficiency issued against them by Respondent (Division) of Utah individual income tax and interest for the tax year 2007. The Notice of Deficiency and Audit Change had been issued March 31, 2011. The amount of the additional tax indicated in the audit had been \$\$\$\$\$. As of the date of the notice the interest was \$\$\$\$\$. The issue before the Commission is the Division's denial of a portion of the Historic Preservation Tax Credit claimed by the Taxpayers on their 2007 Utah Individual Income Tax Return.

APPLICABLE LAW

Utah law provides a Historic Preservation Tax Credit at Utah Code §59-10-1006 as follows in pertinent part:

(1)(a) For tax years beginning January 1, 1993, and thereafter, there is allowed to a claimant, estate, or trust, as a nonrefundable tax credit against the income tax due, an amount equal to 20% of qualified rehabilitation expenditures, costing more than \$10,000, incurred in connection with any residential certified historic building. When qualifying expenditures of more than \$10,000 are incurred, the tax credit allowed by this section shall apply to the full amount of expenditures.

(b) All rehabilitation work to which the tax credit may be applied shall be approved by the State Historic Preservation Officer prior to completion of the rehabilitation project as meeting the secretary of the Interior's Standards for Rehabilitation so that the office can provide corrective comments to the claimant, estate, or trust in order to preserve the historical qualities of the building.

(c) Any amount of tax credit remaining may be carried forward to each of the five taxable years following the qualified expenditures.

(d) The commission, in consultation with the Division of State History, shall promulgate rules to implement this section.

. . .

(2) As used in this section:

. . .

(b) (i) "Qualified rehabilitation expenditures" means any amount properly chargeable to the rehabilitation and restoration of the physical elements of the building, including the historic decorative elements, and the upgrading of the structural, mechanical, electrical, and plumbing systems to applicable codes.

Further guidelines regarding the credit are set out at Utah Admin. Rule R865-9I-41, which provides:

A. 1. "Qualified rehabilitation expenditures" includes architectural, engineering, and permit fees.

2. "Qualified rehabilitation expenditures" does not include moveable furnishings.

. . .

B. Taxpayers shall file an application for approval of all proposed rehabilitation work with the Division of State History prior to the completion of restoration or rehabilitation work on the project. The application shall be on a form provided by the Division of State History.

. . .

D. In order to receive final certification and be issued a unique certification number for the project, the following conditions must be satisfied: 1. The project approved under B. must be completed. 2. Upon completion of the project, taxpayers shall notify the State Historic Preservation Office and provide that office an opportunity to review, examine, and audit the project. In order to be certified, a project shall be completed in accordance with the approved plan and the Secretary of the Interior's Standards for Rehabilitation.

. . .

I. Original records supporting the credit claimed must be maintained for three years following the date the return was filed claiming the credit.

Utah Code §59-1-1417 provides,

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

DISCUSSION

The Taxpayers filed their Utah Individual Income Tax Return for the 2007 tax year on October 14, 2008, by the extension deadline. On the return they claimed a Historic Preservation Tax Credit in the amount of \$\$\$\$\$. After auditing the return the Division reduced the amount of the credit to \$\$\$\$\$ based on the information that Taxpayers had been able to provide to show their rehabilitation expenditures. The Division did allow the credit for some of the expenditures it had determined qualified and were documented by the Taxpayers. At the hearing there were only two categories of items at issue, the first were kitchen cabinets and the second appliances that the Taxpayers considered to be “built-in.”

Although the Division acknowledged that purchase of and installation fees charged for kitchen cabinets would generally be qualified rehabilitation expenditures, the Division denied the portion of the credit relating to the kitchen cabinets on the basis that the Taxpayers did not have sufficient original records to support their expenditures for the cabinets. The Taxpayers had been unable to locate or obtain a receipt or invoice showing their payment for the cabinets.

The Taxpayers did provide at the hearing some evidence to support this expenditure that had not previously been submitted to the Division. After review the Division did not object to the new information being received at the hearing. It was the Taxpayers’ proffer that they had paid to COMPANY 1 \$\$\$\$\$ to purchase and have installed new cabinets in the kitchen. They provided their account statement which showed a loan advance in that amount on May 7, 2003, which was the time of the kitchen installation. The renovations had occurred prior to the 2007 tax year, but portions of the unused credit had carried forward to 2007. The Taxpayers provided photographs of the kitchen after the new cabinets had been installed. They also provided the final drawings and diagrams from COMPANY 1 that depicted the cabinets and how they would be installed. In addition they provided a work request from the cabinet installer. The Taxpayers stated that they had tried to obtain an invoice or receipt from COMPANY 1, but as this work had been completed in 2003, COMPANY 1 did not have records that far back.

The Taxpayers did submit a letter from PERSON 1, HISTORIC PRESERVATION SPECIALIST with the Utah Department of Community and Culture. The Taxpayers explained that he was the employee that they had worked with through the process of getting approval for their plan and determining that the project was completed according to the plan. In the letter, PERSON 1 states, “I cannot verify the specific amount of the claim of \$\$\$\$\$. Our office does not verify expenses as part of our review. However, this amount is consistent

with the range of costs for this type of cabinet installation.” Also of note is through the process the Taxpayers would have had to have a plan approved by PERSON 1’s department and then the work would have had to be completed according to the approved plan. The State Historic Preservation Office had certified that the Taxpayers had completed the project on June 14, 2006. A copy of that certification was provided by the Taxpayers.

The Division representatives pointed out that Under Utah Admin. Rule R865-9I-41(I) the Taxpayers were required to retain original records supporting the credit claimed and argued that the Taxpayers had not done so. It was the Division’s position that it could not accept testimony from Taxpayers regarding the cost of the work and they needed concrete documentation, like the receipts or invoices.

In addition to the kitchen cabinets, the Division had disallowed as a qualifying expenditure some \$\$\$\$ for appliances. At the hearing, the Taxpayers explained that this had been the costs for the appliances they considered to be “built-in” and they did not include the costs for the refrigerator or dishwasher because they considered these to be moveable. They state that they had been told by the State Historic Preservation Office that the credit would apply to “built-in” appliances. The “built-in” appliances include a gas stove top, wall ovens and a range hood. The Taxpayers provided a photograph of these items that showed that the cabinetry and counter had been customized so that these appliances could be installed into the cabinetry. The Taxpayers point out that as they are physically attached by bolts or other fasteners and one could not just pick up and move these appliances.

The Division’s representatives noted that they were not aware of any appeal hearing decision issued by the Tax Commission regarding the Historic Preservation Tax Credit and “built-in” appliances. They indicated that they were looking for guidance on whether the “built-in” appliances would qualify and that this appeared to be a matter of first impression before the Tax Commission. The Division representatives pointed to Utah Admin. Rule R865-9I-41(A)2, which states that the qualifying expenditures did not include “moveable furnishings.”

Upon review of the information and evidence submitted by the parties at the hearing the Taxpayers should be allowed the credit claimed for the kitchen cabinets. The Taxpayers have provided credible evidence and documentation, including their personal testimony, photographs, diagrams, bank statement, installation information that coincided with the date on the bank statement, certification that the work had been both approved and was completed and a letter from a Historic Preservation Program Specialist to support the cost of their kitchen cabinets. There was no dispute from the Division that the kitchen cabinets themselves were physical elements that qualified for the credit as a restoration or rehabilitation.

“Built-in” appliances are attached to real property in a manner similar to which the cabinets themselves are attached, and accordingly could be considered physical elements. Utah law provides a Historic

Preservation Tax Credit for “qualified rehabilitation expenditures” and provides that rehabilitation expenditures are “the rehabilitation and restoration of the physical elements of the building” at Utah Code 59-2-1006(2)(b)(i). “Physical elements of the building” is not defined, and the statute’s only specific provision is that it includes historic decorative elements. This list is not all inclusive as there are numerous other physical elements of a residential property not mentioned. The Division does not dispute that kitchen cabinets, counters, flooring, sinks, showers, windows, doors and wall coverings all qualify for the credit. As with the statute, Utah Admin. Rule R865-9I-41(A) fails to provide a comprehensive definition of qualified rehabilitation expenditure. The only guidance it provides is that movable furnishings do not qualify for the rehabilitation expenditure.

Because there is no substantive question that the built-in appliances are physical elements of a building, once they have been attached, the only issue in this proceeding is whether the installation of the appliances constitutes a rehabilitation or restoration. The Commission has no case law or precedent to follow in determining what is a rehabilitation and restoration of the physical elements of a building. The Taxpayers in this matter had filed a plan and obtained approval for their work with the State Historic Preservation Office in order to qualify under Utah Code Sec. 59-10-1006. The kitchen remodel was part of the plan. The Taxpayers completed the work and obtained a certification from that office. Further they represent that they had been told by that office that the built-in appliances would qualify, while the movable ones would not.

The statute provides two general qualifying expenditures. The first is the “the rehabilitation and restoration of the physical elements of the building” (emphasis added).¹ This expenditure is itself constituted of two parts: 1) whether the expenditure is for a physical element, and 2) whether the physical element is being rehabilitated or restored. The critical issue here is the rehabilitation or restoration. Countertops and cabinets, like doors, windows, and fixtures are always considered part of the building. Accordingly, they can be rehabilitated or restored. Built-in appliances are almost exclusively replacing moveable appliances, if anything at all. Certainly installing built-in appliances does not restore anything, with the clear exception of appliances that were already built-in to the structure.² Even a building addition or installing a new fixture in a new location might possibly be considered rehabilitation by extension of pre-existing physical elements. There is no basis to find that the expenditure for built-in appliances was for rehabilitation or restoration. Rather, in the absence of information to the contrary, the built-in appliances were an addition, or enhancement.

1 The second qualified expenditure is the “upgrading of the structural, mechanical, electrical, and plumbing systems to applicable codes.” This provision is not at issue in this proceeding.

2 The Commission does not consider an entire kitchen, which could arguably be rehabilitated by adding appliances, to be a physical element of building.

Furthermore, given the well recognized principle of narrowly construing statutes against exemptions (or credits),³ there is no statutory or other legal provision that the installation of built-in appliances is a qualified rehabilitation expenditure.

DECISION AND ORDER

Based on the foregoing, it is the decision and order of the Commission that the Division should adjust its 2006 Utah individual income tax audit to allow credit for the expenditures of the kitchen cabinets. The purchases of the “built-in” appliances are not qualified rehabilitation expenditures. 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

RECUSED

D'Arcy Dixon Pignaneli
Commissioner

Michael J. Cragun
Commissioner

³ 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. However, the court did explain in that case, “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.

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