

11-2658

TAX TYPE: INCOME TAX

TAX YEAR: 2008

DATE SIGNED: 4-13-2012

COMMISSIONERS: B. JOHNSON, M. JOHNSON, D. DIXON

EXCUSED: M. CRAGUN

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER 1 AND TAXPAYER 2, Petitioners,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p>Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 11-2658</p> <p>Account No. #####</p> <p>Tax Type: Income</p> <p>Tax Year: 2008</p> <p>Judge: Chapman</p>
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Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER REPRESENTATIVE, CPA
TAXPAYER 1, Taxpayer
TAXPAYER 2, Taxpayer

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT, 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 April 2, 2012.

TAXPAYER 1 and TAXPAYER 2 (“Petitioners” or “taxpayers”) are appealing Auditing Division’s (the “Division”) assessment of additional Utah individual income tax for the 2008 tax year. On July 26, 2011, the Division issued a Notice of Deficiency and Audit Change to the taxpayers, in which it imposed additional tax and interest (calculated as of August 25, 2011) for the 2008 year, as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2008	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

The Division imposed the additional tax after determining that the taxpayers did not qualify for an “equitable adjustment” in the amount of \$\$\$\$ that they had claimed as a deduction on their 2008 Utah return.

In 2008, the taxpayers realized capital gains income of \$\$\$\$ on the sale of a lot that they owned in FOREIGN COUNTRY. Because the taxpayers paid tax to FOREIGN COUNTRY on this income, they were able to claim a credit against their 2008 United States federal income tax liability. When the taxpayers’ CPA was preparing their 2008 Utah return, she called the Tax Commission for guidance on how to handle the capital gains income for Utah tax purposes where income tax had already been paid to FOREIGN COUNTRY.

The taxpayers indicate that the Tax Commission employee with whom their CPA spoke told her that “because capital gains taxes had been paid already on the sale, the net proceeds of \$\$\$\$ should be deducted as an Equitable Adjustment on the TC-40A.” The taxpayers’ CPA also stated that the Tax Commission employee told her to attach a number of documents to the Utah return, including documents showing the purchase price and the sales price of the property in FOREIGN COUNTRY and showing how the taxes paid to FOREIGN COUNTRY were calculated. When the CPA prepared the taxpayers’ Utah return, she included the following statement with the return:

Taxpayer sold a parcel of land in FOREIGN COUNTRY which resulted in a \$\$\$\$ (sic) capital gain. Capital gain tax in the amount of \$\$\$\$ was paid in FOREIGN COUNTRY on this transaction, see attached documentation. An equitable adjustment is being claimed, per telephone instructions by the Utah Department of Revenue agent, to avoid double taxation on this transaction.

The taxpayers ask the Commission to reverse the Division’s assessment in its entirety either because they qualify for the \$\$\$\$ equitable adjustment under Utah law or, if they do not, because the Division should be equitably estopped from now disallowing a deduction that a Tax Commission employee told the taxpayers’ CPA that they could claim. The taxpayers assert that they would be injured if they now have to pay the additional taxes. The taxpayers claim that although they had the money to pay Utah taxes on the capital gains

income in 2009, when their return was prepared, they no longer have liquid assets to pay the taxes because they have used the money to improve their home. In addition, should the Commission sustain the Division's assessment of additional tax, the taxpayers ask the Commission to at least waive the interest that has been imposed because of the erroneous advice their CPA received from a Tax Commission employee.

The Division asks the Commission to sustain its assessment of additional tax and interest. First, the Division asserts that it is well-established that for Utah tax purposes, a taxpayer is not entitled to an equitable adjustment for income earned in another country if the taxpayer opts to claim a U. S. federal tax credit in regards to that income. Second, the Division asserts that the Tax Commission should not be equitably estopped from assessing the tax at issue because the taxpayers have not met the three criteria necessary for equitable estoppel to apply. Third, the Division contends that interest should not be waived because the taxpayers have not provided "tangible evidence" to prove that a Tax Commission employee gave their CPA erroneous advice.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2008)¹ defines "adjusted gross income" and "'taxable income' or 'state taxable income,'" as follows:

- (1) As used in this chapter:
 - (a) "Adjusted gross income":
 - (i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code; or
 -
 - (f) "Federal taxable income":
 - (i) for a resident or nonresident individual, means taxable income as defined by Section 63, Internal Revenue Code; or
 -
 - (w) "Taxable income" or "state taxable income":
 - (i) . . . 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

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

(B) adjustments required by Section 59-10-115;

....

UCA §59-10-115 provides for an adjustment to a taxpayer's adjusted gross income, as follows in pertinent part:

- (1) The Commission shall allow an adjustment to state taxable income of a taxpayer if the taxpayer would otherwise:
 - (a) receive a double tax benefit under this part; or
 - (b) suffer a double tax detriment under this part.

...

UCA §59-1-401(13) (2012) 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”) (2012) provides guidance concerning the waiver of penalties and interest, as follows in pertinent part:

- (2) Reasonable Cause for Waiver of Interest. 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 (2012) 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

Equitable Adjustment. The first issue is whether the taxpayers were entitled, under Utah law, to the \$\$\$\$ equitable adjustment that they claimed as a deduction on their 2008 Utah return. Section 59-10-103(1)(w) provides that the \$\$\$\$ of capital gains is included in the taxpayer's Utah taxable income unless it can be deducted pursuant to Section 59-10-114 or Section 59-10-115. The taxpayers have deducted the income pursuant to Section 59-10-115(1)(b), which provides for an equitable adjustment if a taxpayer "suffer a double tax detriment under this part."

The Commission has considered a number of cases where a Utah resident has earned income in and paid income tax to another country, has taken a credit against his or her U.S. federal tax liability for the taxes paid to the other country, and has taken an equitable adjustment on his or her Utah return to avoid Utah taxing the income. Under such circumstances, the Commission has determined that the Utah resident does not suffer a double tax detriment because the income has not been taxed twice by the State of Utah. As a result, the Commission has found that the Utah resident is not entitled to claim a Section 59-10-115 equitable adjustment in order to deduct the foreign income from his or her Utah taxable income.² For these reasons, the Division correctly determined that the taxpayers were not entitled, under Utah law, to the \$\$\$\$ equitable adjustment that they claimed as a deduction on their 2008 Utah income tax return.

² See *USTC Appeal No. 08-0590* (Findings of Fact, Conclusions of Law and Final Decision ("FOF"), Aug. 5, 2010); *USTC Appeal No. 06-1424* (FOF, Nov. 11, 2006); *USTC Appeal No. 05-1787* (Initial Hearing Order, Sept. 5, 2006); *USTC Appeal No. 03-0723* (FOF, Mar. 22, 2004). Tax Commission decisions can be reviewed at <http://tax.utah.gov/commission/decisions>.

Equitable Estoppel. Even though the taxpayers may not have been entitled, under Utah law, to claim the \$\$\$\$ equitable adjustment that they deducted on their Utah return, they assert that the Division should be equitably estopped from now disallowing a deduction that a Tax Commission employee told their CPA that they could claim.

The elements necessary to invoke “equitable estoppel” are: (1) a statement, admission, act, or failure to act by one party inconsistent with a claim later asserted; (2) reasonable action or inaction by the other party taken on the basis of the first party's statement, admission, act, or failure to act; and (3) injury to the second party that would result from allowing the first party to contradict or repudiate such statement, admission, act, or failure to act. *Eldredge v. Utah State Retirement Bd.*, 795 P.2d 671, 675 (Utah App. 1990).

Utah courts have found that “equitable estoppel” should only be applied against a state agency in unusual situations. In *Holland v. Career Serv. Review Bd.*, 856 P.2d 678 (Utah App. 1993), the Utah Court of Appeals found that “it is well settled that equitable estoppel is only assertible against the State or its institutions in unusual situations in which it is plainly apparent that failing to apply the rule would result in manifest injustice.” The Court further stated that in such cases, “the critical inquiry is whether it appears that the facts may be found with such certainty, and the injustice to be suffered is of sufficient gravity, to invoke the exception.”

In *USTC Appeal No. 11-297* (Revised Initial Hearing Order, Aug. 25, 2011), the Commission recently found that the Tax Commission should be equitably estopped from imposing additional income tax that the Division had assessed to a Utah resident. *Appeal No. 11-297* concerned a taxpayer who had received written information from an employee of the Tax Commission’s Taxpayer Services Division in regards to whether the taxpayer could claim a credit against her Utah income tax liability for income taxes paid to a township in

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STATE 1. The Tax Commission employee erroneously informed the taxpayer that she could claim a credit against her Utah tax liability for the taxes paid to the township.

In *Appeal No. 11-297*, the taxpayer relied on the erroneous information to determine that she would not need to sell her Utah residence or move her domicile to STATE 1. The taxpayer claimed that had the Tax Commission employee given her the correct information, she would have sold her Utah residence and moved to STATE 1 because she could not afford to pay tax twice on the same income. The Commission determined that the taxpayer “arranged her living arrangements for 2007 in reliance on the advice.”

In *Appeal 11-297*, the Commission determined that the all three elements of equitable estoppel existed because the written statement from the Tax Commission employee made “clear what advice was given and that the advice was specific to the facts of [that taxpayer’s] situation,” because the taxpayer took reasonable action on the advice for the year at issue, and because “she relied on this advice to decide that she would continue to maintain her Utah domicile, rather than sell her house and move.” The Commission specifically pointed out that “[h]ad she changed domicile, she would not have this tax liability. There is injury to the [taxpayer] that would result if the Commission now repudiates the statement based on her reliance.”

In the current case, however, the taxpayers sold their property in FOREIGN COUNTRY prior to seeking advice from the Tax Commission. They did not base their decision to sell their property in FOREIGN COUNTRY on erroneous information from a Tax Commission employee. As a result, the taxes at issue in this case did not arise from a decision the taxpayers made because of erroneous Tax Commission information. The taxpayers’ Utah tax liability arose prior to their CPA seeking any advice from the Tax Commission. For these reasons, the taxpayers in the current case have not suffered the same injury as the taxpayer in *Appeal No. 11-297*.

The circumstances in the current case appear to be more similar to those in *Orton v. State Tax Comm'n*, 864 P.2d 904 (Utah App. 1993), a case in which the Utah Court of Appeals found that equitable estoppel should not be applied. In that case, the Tax Commission imposed income tax liability on the Ortons even though a Tax Commission employee had previously and erroneously determined that Mr. Orton was not subject to Utah income taxation for the years at issue. Although the Court stated that the Tax Commission's prior decision was based on inadequate information provided by the Ortons, the Court also stated that "the Ortons have not established that they will suffer a grave injustice if estoppel is not granted. . . , since the Ortons' injury, if any, does not arise from the Tax Commission's correction of its earlier erroneous assessment, but from the fact that they did not pay state income taxes that they are lawfully required to pay."

In the current case, the taxpayers are being asked to now pay the taxes that they that are lawfully required to pay on income that they earned before any Commission advice was given. The taxpayers state that they will be injured because their assets are no longer as "liquid" as they were in 2009, when their CPA called for advice. They claim that although they could have written a check for the full tax liability in 2009, they cannot now and would now have to pay the liability in installments. Given these circumstances, however, any injustice that the taxpayers would suffer would not be of "sufficient gravity" to "invoke the exception" to apply equitable estoppel. For these reasons, the taxpayers' request for the Commission to find that equitable estoppel should apply in this case should be denied. Accordingly, the Commission should sustain the Division's assessment of additional tax.

Waiver of Interest. The last issue is whether the taxpayers are entitled to a waiver of the interest that the Division has imposed. Section 59-1-401(13) authorizes the Commission to waive, reduce, or compromise interest upon a showing of "reasonable cause." The Commission has adopted Rule 42 to set forth the circumstances that qualify as "reasonable cause" to waive interest. Rule 42 provides that in order for

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“reasonable cause” to waive interest to exist, “the taxpayer must prove that the commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error.”

The Division asks the Commission to find that the taxpayers have not shown that “reasonable cause” exists to waive interest. Specifically, the Division contends that the taxpayers have not proved that a Tax Commission employee gave their CPA erroneous information because there is no written document to show what facts the CPA gave to the Tax Commission employee and what advice the employee gave to the CPA. Nevertheless, the taxpayers’ CPA proffered that the Tax Commission employee told her that the taxpayers could claim the \$\$\$\$ in order to avoid “double taxation” and gave her a list of documents to submit with the Utah return. The testimony that the CPA proffered is supported by a statement that she wrote and included on the taxpayers’ 2008 Utah return. The Division has not indicated whether it has investigated to see if a record exists of the telephone call described by the taxpayers’ CPA. Based on the evidence available at the Initial Hearing, the taxpayers have shown that their CPA received erroneous information from a Tax Commission employee. Accordingly, the interest at issue in this appeal should be waived.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission waives the interest at issue in the appeal. Otherwise, the Division's assessment is sustained. The taxpayers may contact Taxpayer Services Division at 801-297-7703 to inquire about setting up payment arrangements. 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.