

12-915  
TAX TYPE: INCOME TAX  
TAX YEARS: 2008 AND 2009  
DATE SIGNED: 4-15-2014  
COMMISSIONERS: B. JOHNSON, M. CRAGUN, R. PERO  
EXCUSED: D. DIXON  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

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TAXPAYER-1 & TAXPAYER-2,  Petitioners,  v.  AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,  Respondent.	<b>INITIAL HEARING ORDER</b>  Appeal No.    12-915  Account No.   ##### Tax Type:     Income Tax Year:     2008 & 2009  Judge:        Chapman
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**Presiding:**

Kerry R. Chapman, Administrative Law Judge

**Appearances:**

For Petitioner:    TAXPAYER-1, 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 January 14, 2014.

TAXPAYER-1 and TAXPAYER-2 (“Petitioners” or “taxpayers”) are appealing Auditing Division’s (the “Division”) assessment of additional individual income tax for the 2008 and 2009 tax years. On February 8, 2012, the Division issued Notices of Deficiency and Audit Change (“Statutory Notices”) to the taxpayers, in which it imposed additional tax and interest (calculated as of March 9, 2012)<sup>1</sup> for the 2008 and 2009 years, as follows:

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<sup>1</sup> Interest continues to accrue until any tax liability is paid.

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
2008	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$
2009	\$\$\$\$	\$\$\$\$	\$\$\$\$	\$\$\$\$
				\$\$\$\$

The Division made two changes to each of the amended Utah returns that the taxpayers submitted for the 2008 and 2009 tax years. The first change concerned the amount of the state tax deducted on federal Schedule A, as reported on the Utah returns. The Division determined that the taxpayers overstated these amounts on their Utah returns for each year at issue. The taxpayers do not contest this change to each of their amended returns.

The second change concerns the equitable adjustment that the taxpayers claimed on each of the amended Utah returns. The Division determined that the taxpayers were not entitled to the equitable adjustment of \$\$\$\$ that they claimed for 2008 or the equitable adjustment of \$\$\$\$ that they claimed for 2009. The taxpayers contest this portion of the audit and ask the Commission to find that they were entitled to the equitable adjustments.

The taxpayers admit that they are Utah residents. TAXPAYER-1 explained that he is employed by UNIVERSITY on a 10-month contract each year that allows him 2 months per year to pursue his own business activities (as well as 4 days per month during the 10-month contract period). For a number of years, TAXPAYER-1 has spent a portion of his “non-UNIVERSITY” time teaching executive courses at universities in FOREIGN COUNTRY and CITY IN FOREIGN COUNTRY. TAXPAYER-1 describes himself as an independent contractor, not an employee, of the universities in FOREIGN COUNTRY and CITY IN FOREIGN COUNTRY. He also indicates that his work in FOREIGN COUNTRY and CITY IN FOREIGN COUNTRY is not, in any way, associated with UNIVERSITY or his employment with UNIVERSITY.

Because none of TAXPAYER-1 activities concerning the executive courses in FOREIGN COUNTRY and CITY IN FOREIGN COUNTRY occur in Utah, TAXPAYER-1 deducted the income he earned from

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teaching these courses as equitable adjustments on the amended Utah returns. TAXPAYER-1 stated that he does not receive the income at issue through a “pass-through” entity, but receives it directly from the universities in FOREIGN COUNTRY and CITY IN FOREIGN COUNTRY. He also stated that the amounts he deducted as equitable adjustments on the amended Utah returns are reported on Schedule C of the taxpayers’ federal returns, where they report TAXPAYER-1 profits and/or losses from his business.

TAXPAYER-1 admits that the income at issue does not qualify as a deduction from Utah income under Utah Code Ann. §59-10-115, which provides for an adjustment if the taxpayer “would otherwise . . . suffer a double tax detriment under this part[.]” In addition, TAXPAYER-1 is not asking the Commission to find that he is eligible for a tax credit for tax paid to another state under UCA §59-10-1003. TAXPAYER-1 has not paid income tax on the income at issue to FOREIGN COUNTRY or CITY IN FOREIGN COUNTRY. He also stated that he recognizes that the Commission has found in prior decisions that the Section 59-10-1003 credit does not apply to income earned in foreign countries.

Instead, TAXPAYER-1 asks the Commission to find that the income at issue is not subject to Utah taxation under UCA §59-10-118, which provide for a division of income for state tax purposes. TAXPAYER-1 stated that he recognizes that UCA §§59-10-116 and 59-10-117, which precede Section 59-10-118, concern nonresident taxpayers only. However, because there is no language in Section 59-10-118 specifically stating that this statute applies only to Utah nonresidents, TAXPAYER-1 asks the Commission to allow him, as a Utah resident, to use Section 59-10-118 to divide his “business income” between that portion earned in Utah and that portion that earned in FOREIGN COUNTRY and CITY IN FOREIGN COUNTRY. For these reasons, the taxpayers ask the Commission to reverse that portion of the assessments in which the Division disallowed the equitable adjustments they claimed.

The Division stated that it does not know if Section 59-10-118 applies to both Utah residents and Utah nonresidents or only to Utah nonresidents. The Division, however, stated that it does know that the

Commission has ruled that a Utah resident is not entitled to a credit for taxes paid to another country. Furthermore, the Division believes that the controlling statute is UCA §59-10-103, which provides that all income earned by a Utah resident is subject to Utah taxation. For these reasons, the Division asks the Commission to deny the taxpayers' appeal and to sustain its assessments.

APPLICABLE LAW

1. Utah Code Ann. §59-10-103 (2008)<sup>2</sup> defines “adjusted gross income,” “federal taxable 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
      - (B) adjustments required by Section 59-10-115;
    - (ii) for a nonresident individual, is an amount calculated by:
      - (A) determining the nonresident individual's adjusted gross income for the taxable year, after making the:
        - (I) additions and subtractions required by Section 59-10-114; and
        - (II) adjustments required by Section 59-10-115; and
      - (B) calculating the portion of the amount determined under Subsection (1)(w)(ii)(A) that is derived from Utah sources in accordance with Section 59-10-117;
    - ....

2. UCA §59-10-104 provides for the taxation of a resident individual, as follows in pertinent part:

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

(1) For taxable years beginning on or after January 1, 2008, a tax is imposed on the state taxable income of a resident individual as provided in this section.

(2) For purposes of Subsection (1), for a taxable year, the tax is an amount equal to the product of:

- (a) the resident individual's state taxable income for that taxable year; and
- (b) 5%.

....

3. UCA §59-10-116(1) provides for the taxation of a nonresident individual, as follows in

pertinent part:

(1) Except as provided in Subsection (2), a tax is imposed on a nonresident individual in an amount equal to the product of the:

- (a) nonresident individual's state taxable income; and
- (b) percentage listed in Subsection 59-10-104(2).

....

4. UCA §59-10-117 provides guidance in determining the tax imposed on a nonresident under

Section 59-10-116, as follows in pertinent part:

(1) For purposes of Section 59-10-116, state taxable income derived from Utah sources includes those items includable in state taxable income attributable to or resulting from:

....

(b) the carrying on of a business, trade, profession, or occupation in this state;

....

(2) For the purposes of Subsection (1):

....

(d) a nonresident shareholder's distributive share of ordinary income, gain, loss, and deduction derived from or connected with Utah sources shall be determined under **Section 59-10-118**; (emphasis added)

....

(f) if a trade, business, profession, or occupation is carried on partly within and partly without this state, an item of income, gain, loss, or a deduction derived from or connected with Utah sources shall be determined in accordance with **Section 59-10-118**; (emphasis added)

....

5. For purposes of Section 59-10-117(2)(d) and (f), UCA §59-10-118 provides for income to be

divided, as follows in pertinent part:

(1) As used in this section:

(a) "Business income" means income arising from transactions and activity in the regular course of a taxpayer's trade or business and includes income from tangible and intangible

property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer's regular trade or business operations.

....

(c) "Nonbusiness income" means all income other than business income.

....

(2) A taxpayer having business income that is taxable both within and without this state, shall allocate and apportion the taxpayer's net income as provided in this section.

....

(8) All business income shall be apportioned to this state using the same methods, procedures, and requirements of Sections 59-7-311 through 59-7-320.

6. UCA §59-1-1417 (2014) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions as follows in pertinent part:

(1) 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:

- (a) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
- (b) 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
- (c) 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:
  - (i) required to be reported; and
  - (ii) of which the commission has no notice at the time the commission mails the notice of deficiency.

....

#### DISCUSSION

Both taxpayers are Utah resident individuals for the 2008 and 2009 tax years. At issue is whether Section 59-10-118 provides that the income a Utah resident individual earns while working as an independent contractor in another country is not subject to Utah taxation. For the reasons explained below, such income is subject to Utah taxation if earned by a Utah resident individual.

First, Utah imposes tax on all "state taxable income." See Section 59-10-104(2)(a) for a resident individual and Section 59-10-116(1)(a) for a nonresident individual. "State taxable income," however, is defined differently for a resident individual and a nonresident individual. See Subsection 59-10-103(1)(w)(i)

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for a resident individual and Subsection 59-10-103(1)(w)(ii) for a nonresident individual. While the “state taxable income” of a nonresident individual is derived from Utah sources in accordance with Section 59-10-117, no such limitation is found for the “state taxable income” of a resident individual.

For a resident individual, Section 59-10-103(1)(w)(i) provides that “state taxable income” is federal adjusted gross income subject to additions and subtractions made under Section 59-10-114 and adjustments made under Section 59-10-115. TAXPAYER-1 admits that the income he deducted on the amended Utah returns as equitable adjustments is income that is includable in federal adjusted gross income. As a result, this income is also Utah state taxable income for a resident individual, unless it meets the criteria for subtraction under Section 59-10-114 or adjustment under Section 59-10-115. TAXPAYER-1 admits that the income at issue does not meet the criteria for adjustment under Section 59-10-115. Furthermore, none of the various subtractions in Section 59-10-114 is applicable to the income at issue. For these reasons and because TAXPAYER-1 is a Utah resident individual, the income he earned in FOREIGN CONTINENT is subject to Utah taxation, regardless of whether he earned it as an independent contractor.

Second, the taxpayers contend that Sections 59-10-118(2) and (8) provide that a Utah resident can apportion his or her business income between business income that is “within this state” and subject to Utah taxation and business income that is “without this state” and not subject to Utah taxation. This argument is not convincing. Such an interpretation would be contrary to Section 59-10-103(1)(w)(i), which as explained above, provides that all income earned by a Utah resident individual is subject to Utah taxation, with limited exceptions that do not exist in this case. Furthermore, Section 59-10-117, which expressly relates to Utah nonresident individuals, provides in Subsections (2)(d) and (2)(f) that the allocation of a nonresident’s income to Utah will be determined using Section 59-10-118. Accordingly, Section 59-10-118 relates to Utah nonresident individuals, not Utah resident individuals.

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This conclusion is also supported by the Utah Supreme Court's ruling in *Benjamin v. Utah State Tax Comm'n*, 250 P.3d 39 (Utah 2011), in which the Court addressed the Benjamins' argument that even though they were Utah resident individuals, they were not subject to Utah taxation on some of their income pursuant to Section 59-10-118. The Court found otherwise, stating in footnote 6 of the ruling that "the Benjamins fail to note that [Section 59-10-118] is in reference to taxing nonresident individuals." The taxpayers have the burden of proof in this matter and have not shown that the Division's assessments are incorrect. Accordingly, the Division's assessments for 2008 and 2009 should be sustained.

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Kerry R. Chapman  
Administrative Law Judge

**DECISION AND ORDER**

Based on the foregoing, the Commission denies the taxpayers' appeal and sustains the Division's assessments for the 2008 and 2009 tax years. 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:



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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 \_\_\_\_\_, 2014.

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.