

13-1773

TAX TYPE: INCOME TAX

TAX YEAR: 2010

DATE SIGNED: 8-31-2015

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER-1 AND TAXPAYER-2, Petitioner, vs. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. 13-1773 Account No. ##### Tax Type: Income Tax Tax Year: 2010 Judge: Marshall
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Presiding:

Robert Pero, Commissioner

Jan Marshall, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER-1, *Pro Se*
TAXPAYER-2, *Pro Se*

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT, Income Tax Audit Manager

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on February 27, 2014, in accordance with Utah Code Ann. §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The issue before the Commission is the Petitioners' ("Taxpayers") appeal of income tax and interest deficiencies issued for the 2010 tax year.
2. Taxpayers timely filed a married filing joint form TC-40 for the 2010 tax year. Taxpayers claimed a credit in the amount of \$\$\$\$ for contributions to UESP. (AUD 000093 – 000096).

3. On June 26, 2013, the Respondent (“Division”) issued a Request for Verification on the UESP credit claimed by the Taxpayers for the 2010 tax year. (FH-2).¹
4. On July 23, 2013, the Division issued a Notice of Deficiency and Audit Change for the 2010 tax year. The audit disallowed a Health Benefit Plan Credit in the amount of \$\$\$\$\$, and reduced the Utah Educational Savings Plan Credit (“UESP”) from \$\$\$\$\$ to \$\$\$\$\$. (AUD 000009).
5. Taxpayers are not disputing the denial of the Health Benefit Plan Credit, only the reduction of the UESP Credit. (AUD 000002).
6. Taxpayers created a revocable living trust in 1997, prior to moving to Utah. The assets held in trust include the Taxpayers’ home, vehicles, and mutual funds. Taxpayers report income from the mutual funds on their individual income tax returns. The Trust does not file a federal Form 1041 or a state Form TC-41. (FH-1).
7. In December 2010, the Taxpayers opened a UESP 529 plan, with three of their grandchildren as beneficiaries.
8. Taxpayers named their living trust as the “account owner”. For the tax identification number of the account owner, the Taxpayers used TAXPAYER-1’S social security number.
9. In 2010, Taxpayers contributed \$\$\$\$\$ for each of the three beneficiaries to the UESP 529 plan, for a total of \$\$\$\$\$.
10. UESP issued a Form TC-675H for the 2010 tax year showing a total qualified contribution amount of \$\$\$\$\$. (FH-4).
11. Taxpayers did not timely receive the 2010 TC-675H, and were unaware that the total qualified contribution amount did not match their actual contribution amount. Taxpayers requested a copy of the 2010 TC-675H after receiving the Division’s audit assessment.
12. The Taxpayers did receive the 2011 Form TC-675H in 2012, showing a qualified contribution amount less than their actual contributions. At that time, they contacted UESP regarding the living trust as the account owner and the tax credit.
13. The Taxpayers changed the account ownership in 2012 or 2013 from TAXPAYER-1 as a trustee of the living trust to TAXPAYER-1 as an individual.
14. The Form TC-675H for the 2010 and 2011 tax years were designated as “Institutional”. The TC-675H included instructions for trusts, as follows:

¹ The Division has also issued a Request for Verification for the 2011 tax year. The Division’s audit of the 2011 tax year is being held pending the Commission’s decision in this appeal.

Trusts: The maximum qualified contribution amount is \$1,710 per qualified beneficiary. The income tax credit is calculated by multiplying the qualified contribution amount by 5%. *The maximum tax credit for 2010 is limited to \$85.50 per qualified beneficiary.* For more information, refer to page 7 in the Utah TC-41 instruction booklet.²

(DH-2 and FH-5.)

15. Taxpayers provided a copy of the Form TC-675H they received for the 2013 tax year, to demonstrate the different instructions for “Institutional” and “Individual” UESP accounts. The instructions on the 2013 TC-675H read, in part:

If you are claiming a UESP income tax credit on a 2013 Utah Individual Income Tax Return (form TC-40), please refer to page 17 in the Utah TC-40 instruction booklet.

(FH-7).

16. Taxpayers provided copies of current UESP Account Agreements for both “Individual” and “Institutional” accounts. The Taxpayers pointed out that on the Individual Account Agreement there was only space for one owner, not a married couple. Additionally, they noted that the only space to identify a trust was on the Institutional Account Agreement. (FH-11a and FH-11b).
17. The Division provided a copy of the 2010 Individual Account Agreement. Section 1, “Account Type” indicates that definitions of different account types can be found in the Program Participation Information section of the Program Description. (AUD 000023-000030).
18. The Division provided a copy of the 2010 Program Description. The Program Description includes a section on State Tax Considerations, as follows in relevant part:

Utah taxpayers who are account owners, including Utah trusts, may take a tax credit on a portion of their contributions to UESP from Utah taxable income...

Utah Individuals

For the 2010 tax year, Utah taxpayers filing an individual tax return can claim a 5 percent state tax credit per beneficiary for contributions up to \$1,710.

Joint Tax Return

Utah taxpayers filing an individual tax return can claim a 5 percent state tax credit per beneficiary for contributions up to \$3,420.

Married couples taking the tax benefits are not required to have separate UESP accounts to claim the joint tax benefits. However, if both spouses own separate accounts for the same beneficiary, they will each receive a TC-675H form for their accounts. In this case, their aggregated maximum tax credit is limited to one joint tax credit per beneficiary.

² For the 2011 tax year, the maximum qualified contribution amount was \$1,740 per qualified beneficiary, and the maximum credit was limited to \$87 per qualified beneficiary.

Utah Trusts

For the 2010 tax year, Utah-based trusts can claim a 5 percent state tax credit for contributions up to \$1,710 per beneficiary. A joint tax credit is not allowed for institutional accounts, including trusts.

(AUD 000081-000082).

APPLICABLE LAW

Utah Code Ann. §59-10-104³ imposes an income tax on resident individuals' state taxable income, as follows:

- (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%.

Utah Code Ann. §59-10-103(1)(w)(i) defines state taxable income for a resident individual, as follows:

- "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. . .

Utah Code Ann. §59-10-103(1)(a)(i) defines adjusted gross income for an individual, as set forth below:

"Adjusted gross income": (i) for a resident or nonresident individual, is as defined in Section 62, Internal Revenue Code...

Utah Code Ann. §59-10-1017 provides a credit for UESP contributions as follows, in pertinent part:

- (1) As used in this section:
 - (a) "Account owner" is as defined in Section 53B-8a-102...
 - (c) "Maximum amount of a qualified investment for the taxable year" means, for a taxable year:
 - (i) for a claimant, estate, or trust that is an account owner, if that claimant, estate, or trust is other than husband and wife account owners who file a single return jointly, the maximum amount of a qualified investment:
 - (A) listed in Subsection 53B-8a-106(1)(e)(ii); and

³ The Commission cites to the 2010 version of the Utah Code.

- (B) increased or kept for that taxable year in accordance with Subsections 53B-8a-106(1)(f) and (g); or
- (ii) for claimants who are husband and wife account owners who file a single return jointly, the maximum amount of a qualified investment:
 - (A) listed in Subsection 53B-8a-106(1)(e)(iii); and
 - (B) increased or kept for that taxable year in accordance with Subsections 53B-8a-106(1)(f) and (g)...
- (2) Except as provided in Section 59-10-1002.2,⁴ a claimant, estate, or trust that is an account owner may claim a nonrefundable tax credit equal to the product of:
 - (a) the lesser of:
 - (i) the amount of a qualified investment the claimant, estate, or trust:
 - (A) makes during the taxable year; and
 - (B) does not deduct:
 - (I) for a claimant, on the claimant's federal individual income tax return; or
 - (II) for an estate or trust, on the estate's or trust's federal income tax return for estates and trusts; or
 - (ii) the maximum amount of a qualified investment for the taxable year if the amount described in Subsection (2)(a)(i) is greater than the maximum amount of a qualified investment for the taxable year; and
 - (b) 5%...

For purposes of UESP, "Account owner" is defined in Utah Code Ann. §53B-8a-102, as follows:

As used in this chapter:

- (2) "Account owner" means a person, estate or trust, if that person, estate or trust has entered into an account agreement under this chapter to save for the higher education costs on behalf of a beneficiary.

Utah Code Ann. §53B-8a-106(1)(e) sets forth the maximum qualified contribution amount under the terms of the UESP account agreements, below:

Subject to Subsections (1)(f) and (g),⁵ the maximum amount of a qualified investment that may be used as the basis for claiming a tax credit in accordance with Section 59-10-1017, is:

- (i) for a resident or nonresident estate or trust that is an account owner, \$1,710 for each individual beneficiary for the taxable year beginning on or after January 1, 2010, but beginning on or before December 31, 2010;
- (ii) for a resident or nonresident individual that is an account owner, other than a husband and wife who are account owners and file a single return jointly under Title 59, Chapter 10, Individual Income Tax Act, \$1,710 for each individual beneficiary for the taxable year beginning on or after January 1, 2010, but beginning on or before December 31, 2010; or
- (iii) for a husband and wife who are account owners and file a single return jointly under Title 59, Chapter 10, Individual Income Tax Act, \$3,420 for each individual beneficiary:

⁴ Utah Code § 59-10-1002.2 provides for the apportionment of tax credits for nonresident or part-year resident individuals, estates, or trusts.

⁵ Utah Code Ann. §53B-8a-102(1)(f) and (g) provide for annual increases, but not decreases, of the maximum amount of qualified investment based on the consumer price index.

- (A) for the taxable year beginning on or after January 1, 2010, but beginning on or before December 31, 2010; and
- (B) regardless of whether the plan has entered into:
 - (I) a separate account agreement with each spouse; or
 - (II) a single account agreement with both spouses jointly.

Administrative Rule R865-9I-49 requires the UESP trust to prepare and file Form TC-675H as follows in relevant part:

- (1) "Trust" means the Utah Educational Savings Plan Trust created pursuant to Section 53B-8a-103.
- (2) The trustee of the trust shall file a form TC-675H, Statement of Account with the Utah Educational Savings Plan Trust, with the commission, for each trust account owner. The TC-675H shall contain the following information for the calendar year:
 - (a) the amount contributed to the trust by the account owner; and
 - (b) the amount disbursed to the account owner pursuant to Section 53B-8a-109...

Internal Revenue Code § 671 provides as follows:

Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

Internal Revenue Code §§673-677 are titled as follows:

- §673. Reversionary interests
- §674. Power to control beneficial enjoyment
- §675. Administrative powers
- §676. Power to revoke
- §677. Income for benefit of grantor

Internal Revenue Code §§673-677 include the following language: "The grantor shall be treated as the owner of any portion of a trust" in which he or she has retained the rights and benefits described in §§673-677.

CONCLUSIONS OF LAW

- A. Taxpayer's trust is a disregarded entity for tax purposes, and thus the Taxpayers are treated as the owners of the trust property, including the UESP account. The Taxpayers' revocable living trust is a grantor trust. The Taxpayers retain sufficient control over the trust property, can revoke the trust, and are entitled to the income of the trust. U.S. Tax Court in *Kaplan v. Commissioner*, T.C.

Memo. 2014-43, 107 T.C.M. 1226, page 17 (March 13, 2014), summarized federal law for grantor trusts, as follows:

A grantor trust is created when a person contributes cash or property to a trust but retains certain interests such that he is treated as the owner of the trust. *See* secs. 671-679. “When a grantor or other person has certain powers in respect of trust property that are tantamount to dominion and control over such property, the Code ‘looks through’ the trust form and deems such grantor or other person to be the owner of the trust property and attributes the trust income to such person.” *Estate of O’Connor v. Commissioner*, 69 T.C. 165, 174 (1977). Under section 671, the grantor of a grantor trust is treated “as the owner of the trust assets, thus making the trust assets taxable to the grantor, until those trust assets are distributed to the grantee.” *Resolution Trust Corp. v. MacKenzie*, 60 F.3d 972, 976-977 (2d Cir. 1995). A grantor trust is disregarded as a separate taxable entity to the extent of the grantor’s retained interest, and the grantor must report the trust’s income on his own return. Sec. 671; sec. 1.671-2(b), Income Tax Regs.

Internal Revenue Code §671 explains that when the grantor is treated as the owner of the trust, then the “items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust” are to be taken into account in computing the taxable income or credits against the tax of an individual. As the Taxpayers’ revocable living trust is a grantor trust, they are treated as the owners of the trust property. The Taxpayers should properly report income and/or credits on their federal return. The grantor trust, and its income, are treated the same for federal and state tax purposes. When grantors submit their Utah Form TC-40, the trust income carries over from the federal Form 1040 to the Utah Form TC-40 as part of the adjusted gross income, which is used to calculate the state taxable income. *See* § 59-10-103(1)(a)(i) (defining adjusted gross income for state and federal purposes to be the same for a resident individual), § 59-10-103(1)(w)(i) (defining state taxable income to include a resident individual’s adjusted gross income), and § 59-10-104 (imposing income tax on a resident individual’s state taxable income).

- B. Taxpayers have a maximum qualified contribution under Utah Code Ann. §59-10-1017 and §53B-8a-106(1)(e)(i) of \$1,710 per beneficiary. Under Utah Code Ann. §53B-8a-106(1)(e)(i), if the account owner is a trust, the maximum qualified contribution per beneficiary was \$1,710 for the 2010 tax year. The Taxpayers argued that because their living trust is a grantor trust, they are entitled to calculate the maximum qualified contribution under Utah Code Ann. §53B-8a-106(1)(e)(iii). However, on its face, the statute does not distinguish between grantor trusts and any other type of trust. The legislature addressed Taxpayer’s situation in the 2015 session. S.B.64 specifically allows the grantors who file a single married filing joint return, who made qualified contributions to a UESP account “owned” by a grantor trust, to claim the credit amount that other married couples who file a single married filing joint return would be allowed to claim. The

discussion on the Senate floor of this bill specifically noted that it was a change in the law to correct an unintended consequence.⁶ Because there are three beneficiaries of Taxpayers' UESP account, for the 2010 tax year, the Taxpayers' maximum qualified contribution was \$5,130.

- C. Taxpayers are entitled to a UESP credit in the amount of \$\$\$\$\$. Utah Code Ann. §59-10-1017 provides that an account owner may claim a nonrefundable tax credit equal to the product of (a) the lesser of: (i) the amount of a qualified investment the claimant, estate, or trust makes during the taxable year and does not deduct on the federal return or (ii) the maximum amount of a qualified investment for the taxable year; and 5%. The Taxpayers are allowed a UESP credit equal to 5% of the qualified investment up to the maximum amount of a qualified investment for the taxable year. As previously determined, the Taxpayers' maximum qualified contribution for 2010 was \$5,115. Thus, the 5% limitation corresponds to a credit amount of \$\$\$\$\$.

Jan Marshall
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's disallowance of the health benefit plan credit, and finds that the Taxpayers' UESP credit for the 2010 tax year is \$\$\$\$\$. The Division is ordered to revise its audit to reflect this amount, and recalculate the audit tax and interest due. It is so ordered.

DATED this _____ day of _____, 2015.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Appeal Rights: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §59-1-601 et seq. and §63G-4-401 et seq.

⁶ The discussion of S.B. 64 is available online at <http://le.utah.gov/~2015/bills/static/SB0064.html>. The provision is effective for the 2015, and subsequent, tax years.

