

14-1734
TAX TYPE: INCOME
TAX YEAR: 2011 & 2012
DATE SIGNED: 9-20-2016
COMMISSIONERS: J. VALENTINE, R. PERO, R. ROCKWELL
EXCUSED: M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER-1 & TAXPAYER-2,</p> <p style="text-align: center;">Petitioners,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="text-align: center;">Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 14-1734</p> <p>Account No. #####</p> <p>Tax Type: Income</p> <p>Tax Years: 2011 & 2012</p> <p>Judge: Chapman</p>
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Presiding:

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: TAXPAYER-1, Taxpayer (by telephone)
For Respondent: RESPONDENT-1, from Auditing Division
RESPONDENT-2, from Auditing Division
RESPONDENT-3, 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 July 13, 2016.

TAXPAYER-1 and TAXPAYER-2 (“Petitioners” or “taxpayers”) appealed Auditing Division’s (the “Division”) assessments of additional Utah individual income taxes for the 2011 and 2012 tax years. On August 13, 2014, the Division issued Notices of Deficiency and Audit Change (“Statutory Notices”) to the taxpayers, in which it imposed additional tax and interest (calculated through September 12, 2014)¹ for the 2011 and 2012 tax years, as follows:

¹ 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>
2011	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$
2012	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$	\$\$\$\$\$

At the Initial Hearing, the taxpayers stated that they are no longer contesting the Division's 2011 assessment. They are, however, still contesting the 2012 assessment. The 2012 assessment concerns the Division's disallowance of a "capital gain credit" of \$\$\$\$\$ that the taxpayers claimed on their 2012 Utah return. The taxpayers claimed the capital gain credit pursuant to Utah Code Ann. §59-10-1022 (2012), which provides a credit when capital gains are used to purchase qualifying stock in a Utah small business corporation, if certain requirements are met. The Division claims that the taxpayers have not shown that they meet all of the requirements necessary to claim the credit. As a result, the Division asks the Commission to find that it properly disallowed the credit and to sustain its 2012 assessment.

The taxpayers do not know how the \$\$\$\$\$ capital gain credit they claimed was calculated and admit that they do not know whether they meet all requirements to claim the credit. However, they indicate that their accounting software calculated the credit to be \$\$\$\$\$ and, as a result, ask the Commission to approve this credit and abate the Division's 2012 assessment.

APPLICABLE LAW

Utah Code Ann. §59-10-1022 (2012)² provides a nonrefundable tax credit when capital gains are used to purchase qualifying stock in a Utah small business corporation under certain circumstances, as follows in pertinent part:

- (1) As used in this section:
 - (a) (i) "Capital gain transaction" means a transaction that results in a:
 - (A) short-term capital gain; or
 - (B) long-term capital gain.
 - (ii) In accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act, the commission may by rule define the term "transaction."

2 Unless otherwise indicated, the 2012 version of the substantive law is cited.

- (b) "Commercial domicile" means the principal place from which the trade or business of a Utah small business corporation is directed or managed.
 - (c) "Long-term capital gain" is as defined in Section 1222, Internal Revenue Code.
 - (d) "Qualifying stock" means stock that is:
 - (i) (A) common; or
(B) preferred;
 - (ii) as defined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act, originally issued to:
 - (A) a claimant, estate, or trust; or
 - (B) a partnership if the claimant, estate, or trust that claims a tax credit under this section:
 - (I) was a partner on the day on which the stock was issued; and
 - (II) remains a partner until the last day of the taxable year for which the claimant, estate, or trust claims a tax credit under this section; and
 - (iii) issued:
 - (A) by a Utah small business corporation;
 - (B) on or after January 1, 2008; and
 - (C) for:
 - (I) money; or
 - (II) other property, except for stock or securities.
 - (e) "Short-term capital gain" is as defined in Section 1222, Internal Revenue Code.
 - (f) (i) "Utah small business corporation" means a corporation that:
 - (A) except as provided in Subsection (1)(f)(ii), is a small business corporation as defined in Section 1244(c)(3), Internal Revenue Code;
 - (B) except as provided in Subsection (1)(f)(iii), meets the requirements of Section 1244(c)(1)(C), Internal Revenue Code; and
 - (C) has its commercial domicile in this state.
 - (ii) The dollar amount listed in Section 1244(c)(3)(A) is considered to be \$\$\$\$\$.
 - (iii) The phrase "the date the loss on such stock was sustained" in Sections 1244(c)(1)(C) and 1244(c)(2), Internal Revenue Code, is considered to be "the last day of the taxable year for which the claimant, estate, or trust claims a tax credit under this section."
- (2) For taxable years beginning on or after January 1, 2008, a claimant, estate, or trust that meets the requirements of Subsection (3) may claim a nonrefundable tax credit equal to the product of:
- (a) the total amount of the claimant's, estate's, or trust's short-term capital gain or long-term capital gain on a capital gain transaction that occurs on or after January 1, 2008; and
 - (b) 5%.
- (3) For purposes of Subsection (2), a claimant, estate, or trust may claim the nonrefundable tax credit allowed by Subsection (2) if:
- (a) 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

(b) prior to the purchase of the qualifying stock described in Subsection (3)(a)(i), the claimant, estate, or trust did not have an ownership interest in the Utah small business corporation that issued the qualifying stock.

....

For purposes of defining a “Utah small business corporation” under Subsection 59-10-1022(1)(f),

Section 1244 of the Internal Revenue Code (“IRC”) provides, as follows in pertinent part:

....

(c) Section 1244 stock defined

(1) In general For purposes of this section, the term “section 1244 stock” means stock in a domestic corporation if—

....

(C) such corporation, during the period of its 5 most recent taxable years ending before the date the loss on such stock was sustained, derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interests, annuities, and sales or exchanges of stocks or securities.

....

(3) Small business corporation defined

(A) In general

For purposes of this section, a corporation shall be treated as a small business corporation if the aggregate amount of money and other property received by the corporation for stock, as a contribution to capital, and as paid-in surplus, does not exceed \$1,000,000. The determination under the preceding sentence shall be made as of the time of the issuance of the stock in question but shall include amounts received for such stock and for all stock theretofore issued.

(B) Amount taken into account with respect to property

For purposes of subparagraph (A), the amount taken into account with respect to any property other than money shall be the amount equal to the adjusted basis to the corporation of such property for determining gain, reduced by any liability to which the property was subject or which was assumed by the corporation. The determination under the preceding sentence shall be made as of the time the property was received by the corporation.

....

For the instant matter, UCA §59-1-1417(1) (2016) provides guidance concerning which party has the

burden of proof, as follows:

(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

Pursuant to Subsection 59-1-1417(1), the burden of proof in this matter is upon the taxpayers. Subsection 59-10-1022(2) provides that a taxpayer may claim a capital gain credit equal to 5% of its short-term capital gain or long-term capital gain on a capital gain transaction, if requirements set forth in Subsection 59-10-1022(3) are met. Subsection 59-10-1022(3)(a) requires a taxpayer to show that 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 12 months after the day on which the capital gain transaction occurs. In addition, Subsection 59-10-1022(3)(b) requires a taxpayer to show that prior to purchasing qualifying stock in the Utah small business corporation, he or she did not have an ownership interest in that Utah small business corporation.

The taxpayers have not shown that they qualify for the capital gain credit they claimed. First, the taxpayers did not know the date(s) when the capital gain transaction(s) on which they received capital gain(s) occurred, nor did they know the date(s) when they purchased the stock they assert to be qualifying stock in a Utah small business corporation. To qualify for the credit, Subsection 59-10-1022(3)(a)(ii) requires that the purchase of the qualifying stock must occur within a 12-month period after the date of the capital gain transaction. It appears that the taxpayers had one or more capital gain transactions in 2012 that resulted in capital gains because their 2012 Internal Revenue Service (“IRS”) transcript shows that they had \$\$\$\$ of long-term capital gains for the 2012 tax year. However, without the date(s) of the capital gain transaction(s)

and the date(s) of the purchase(s) of the qualifying stock, the taxpayers have not shown that they satisfy the requirement that the qualifying stock purchase occurred within a 12-month period after the date of the capital gain transaction.³

Second, to qualify for the capital gain credit, Subsection 59-10-1022(3)(a) provides that the taxpayers must have expended 70% of the gross proceeds of the capital gain transaction(s) to purchase the qualifying stock. The taxpayers did not know the amount of gross proceeds they received for any capital gain transaction on which they earned capital gain in 2012. While the taxpayers' 2012 IRS transcript shows that they had \$\$\$\$ of capital gain in 2012, it does not show that amount(s) of the gross proceeds on the capital gain transaction(s) giving rise to the capital gain. As a result, even if TAXPAYER-1 were considered to have purchased the CORPORATION-1 stock at various times in 2012 and 2013, as he claims, the information is insufficient to show that he expended 70% of the gross proceeds of the capital gains transaction(s) to do so.

Third, Subsection 59-10-1022(3)(a)(i) requires that the gross proceeds of the capital gain transaction be expended to purchase qualifying stock in a "Utah small business corporation." The taxpayers provided information to show that TAXPAYER-1 acquired common shares in CORPORATION-1, a Utah corporation directed and managed in Utah. As a result, the taxpayers have shown that CORPORATION-1 has its commercial domicile in Utah, which is one of the requirements to be considered a "Utah small business corporation."⁴

However, the taxpayers have not shown that CORPORATION-1 meets the other requirements to be considered a "Utah small business corporation" under Subsection 59-10-1022(1)(f) and IRC Section 1244.

3 The taxpayers proffered a Stock Purchase and Shareholder's Agreement, which indicates that TAXPAYER-1 purchased stock in CORPORATION-1. ("CORPORATION-1") on December 1, 2009, by executing and delivering a promissory note to MasterContol. The taxpayers claim that they paid off the note in 2012 and 2013. As a result, even if MasterContol is considered a "Utah small business corporation" and the CORPORATION-1 stock is considered "qualifying stock" for purposes of Section 59-10-1022, it appears that TAXPAYER-1 may have purchased the stock in 2009 (i.e., not in 2012 and 2013 when the note was paid).

4 See Subsection 59-10-1022(1)(f)(i)(C).

Specifically, the taxpayers provided no information about CORPORATION-1's aggregate gross receipts and, thus, have not shown that CORPORATION-1 derived more than 50 percent of its aggregate gross receipts from sources other than royalties, rents, dividends, interests, annuities, and sales or exchanges of stocks or securities.⁵ Furthermore, they have provided no information about the aggregate amount of money and other property CORPORATION-1 received for stock, as a contribution to capital, and as paid-in-surplus, and, thus, have not shown that this aggregate amount does not exceed \$\$\$\$\$.⁶ Without this information, the taxpayers have not shown that CORPORATION-1 meets all requirements to be considered a "Utah small business corporation."

Lastly, even had the taxpayers provided evidence to show that they met all of the requirements in Section 59-10-1022 and IRC Section 1244 to qualify for a capital gain credit, they have not shown that they were entitled to a credit in the amount of \$\$\$\$\$. As shown on the taxpayers' 2012 IRS transcript, they have \$\$\$\$\$ of 2012 capital gain. Even if this entire \$\$\$\$\$ of capital gain qualified for the credit, the \$\$\$\$\$ amount would have needed to be multiplied by 5% to determine the credit, pursuant to Subsection 59-10-1022(2)(b). Multiplying \$\$\$\$\$ by 5% would result in a credit of only \$\$\$\$\$. As a result, even had the taxpayers shown that they met all requirements to qualify for the credit, the \$\$\$\$\$ credit calculated by their accounting software is incorrect. Regardless, the taxpayers have not shown that any amount of capital gain they received in 2012 is eligible for the credit.

Based on the foregoing, the taxpayers have not met their burden of proof to show that they qualify for the \$\$\$\$\$ credit they claimed. Accordingly, the Division's 2012 assessment should be sustained in its entirety.

Because the taxpayers no longer contest the 2011 assessment, it should also be sustained in its entirety.

5 See Subsection 59-10-1022(1)(f)(i)(A) and IRC Subsection 1244(c)(1)(C).

6 See Subsection 59-10-1022(1)(f)(i)(B), Subsection 59-10-1022(1)(f)(ii), and IRC Subsection 1244(c)(3)(A).

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission sustains the Division's 2011 and 2012 assessments in their entireties. 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, or emailed, 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

or emailed to:

taxappeals@utah.gov

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2016.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Appeal No. 14-1496

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.