14-2016
TAX TYPE: CORPORATE FRANCHISE TAX
TAX YEAR: 01/01/08 – 12/31/12
DATE SIGNED: 11-1-2016
COMMISSIONERS: M. CRAGUN, R. PERO, R. ROCKWELL
EXCUSED: J. VALENTINE
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

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| TAXPAYER,<br><br>Petitioner,<br><br>v.<br><br>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,<br><br>Respondent. | **INITIAL HEARING ORDER**<br><br>Appeal No. 14-2016<br><br>Account No. #####<br>Tax Type: Corporate Franchise Tax<br>Audit Period: 01/01/08 – 12/31/12<br><br>Judge: Phan |

**Presiding:**
Jane Phan, Administrative Law Judge

**Appearances:**

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| For Petitioner: | REPRESENTATIVE-1 FOR TAXPAYER, Attorney at Law<br>REPRESENTATIVE-2 FOR TAXPAYER, By Telephone<br>REPRESENTATIVE-3 FOR TAXPAYER, By Telephone |
| For Respondent: | REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General<br>RESPONDENT-1, Manager, Corporate Franchise Auditing<br>RESPONDENT-2, Senior Auditor |

## STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on June 27, 2016 for an Initial Hearing in accordance with Utah Code §59-1-502.5. Petitioner ("Taxpayer") had filed an appeal under Utah Code §59-1-501 of a Statutory Notice-Corporate Franchise Tax Audit Deficiency issued on October 3, 2014, for calendar years 2008 through 2012. The amount of the deficiency was $$$$$ in tax, $$$$$ in interest and penalties of $$$$$, for a total due as of the notice date of $$$$$. Interest continues to accrue on the unpaid balance.

## APPLICABLE LAW

Utah Code Sec. 59-7-110(5)(2012)[1] provides the following:

> (a) (i) Subject to Subsection (5)(a)(ii), a corporation acquiring the assets or stock of another corporation may not deduct any net loss incurred by the acquired corporation prior to the date of acquisition.
> (ii) Subsection (5)(a)(i) does not apply if the only change in the corporation is that of the state of incorporation.
> (b) An acquired corporation may deduct the acquired corporation's net losses incurred before the date of acquisition against the acquired corporation's separate income as calculated under Subsections (6) and (7) if the acquired corporation has continued to carry on a trade or business substantially the same as that conducted before the acquisition.

Penalties are imposed under Utah Code Sec. 59-1-401. In additional to failure to timely file and failure to timely pay penalties, Utah Code Sec. 59-1-401(7)(a) provides:

> Additional penalties for an underpayment of a tax, fee, or charge are as provided in this Subsection (7)(a).
> (i) Except as provided in Subsection (7)(c), if any portion of an underpayment of a tax, fee, or charge is due to negligence, the penalty is 10% of the portion of the underpayment that is due to negligence.

Utah Code Sec. 59-1-401(14) provides:

> Upon 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.

## DISCUSSION

The issue the parties presented at this hearing was whether a corporation which acquires another corporation can utilize the pre-acquisition Utah losses of the acquired corporation on its Utah return if the acquired corporation is merged out of existence.

The facts as presented by the parties were as follows. In the fall of 2005 CORPORATION-1 ("CORPORATION-1") established a manufacturing plant in CITY-1 which was capitalized and fully operational by January 2007. CORPORATION-1 filed separate company Utah corporation franchise tax returns for tax years ending September 30, 2005, September 30, 2006, and the short period ending December 31, 2006. Utah losses were reported for two of these periods. There was a disagreement between the parties regarding these losses. The Taxpayer had described them as losses resulting from the start-up operations of the CITY-1 plant. The Division points out that this is not how these losses were reported on the CORPORATION-1 returns and the Division disagreed that these were losses resulting from the

[1] There were no substantive changes to this section during the audit years 2008 through 2012.

start up costs of the CITY-1 plant. However, the Division did agree that these were Utah losses and whether they were related to the start up of the manufacturing plant in CITY-1 or from some other cause is not something that needed to be resolved in this decision.

During the period from 2005 through September 2006, CORPORATION-1 was a subsidiary of CORPORATION-2 which was a subsidiary of The CORPORATION-3, a FOREIGN COUNTRY company. In September 2006, COMPANY-1 acquired The CORPORATION-3. COMPANY-1 had other operations and subsidiaries in the United States at this time which the parties referred to as the COMPANY-1 business operations. COMPANY-1 formed COMPANY-2 (COMPANY-2) in July 2007 to operate business units of COMPANY-1 in the United States. In November 2007, COMPANY-1 along with its direct and indirect subsidiaries commenced integration efforts between the COMPANY-1 and CORPORATION-3 businesses to create a unified consolidated group of entities. Effective January 1, 2008, various CORPORATION-3 affiliates changed to the COMPANY-1 naming convention and at this time CORPORATION-2 changed its name to TAXPAYER. ("TAXPAYER" or "Taxpayer"). COMPANY-2 was a wholly owned subsidiary of TAXPAYER. CORPORATION-1 at this time merged into COMPANY-2 and operated as a division of COMPANY-2. It was no longer a separate corporate entity. After the merger, the CORPORATION-1 division maintained the same plant and operations in Utah as the original CORPORATION-1 plant. The CORPORATION-1 division has accounted for approximately 70% of TAXPAYER's Utah apportionment/presence since integration as a division under COMPANY-2.

TAXPAYER is the entity that filed the consolidated federal and Utah combined returns. On the Utah returns, TAXPAYER claimed the losses incurred by CORPORATION-1 during the 2005 through December 31, 2006 period to offset TAXPAYER's Utah taxable income for the tax years 2008 through 2012. At the hearing, the Taxpayer acknowledged that it had made an error on its returns and was asking for a correction to the net operating loss deduction to "properly utilize the separate company losses attributable to CORPORATION-1."[2] Taxpayer argues at this time that it should be allowed to deduct the separate company losses that CORPORATION-1 incurred prior to the acquisition against the separate income derived from the CORPORATION-1 division in the years 2008 through 2012. Returns have not yet been filed in this manner, but Taxpayer states that it would be able to determine the income derived from the CORPORATION-1 division from its accounting records. The Taxpayer points to Utah Code Subsection 59-7-110(5)(b) which states, "An acquired corporation may deduct the acquired corporation's net losses incurred before

[2] Petitioner's Prehearing Brief, pg. 4.

the date of acquisition against the acquired corporation's separate income as calculated under Subsections (6) and (7) if the acquired corporation has continued to carry on a trade or business substantially the same as that conducted before the acquisition."

The Taxpayer also cites to the Utah Supreme Court's decision in *Savage Industries, Inc. v. Utah State Tax Comm'n,* 811 P.2d 664 (1991). *Savage Industries* involved a situation where the acquired corporation remained a separate corporate entity from the acquiring corporation but the acquiring corporation filed consolidated returns which included the acquired corporation. In that case the Court held, "Therefore, by the plain terms of the statute, the acquired corporation is not prohibited from deducting its pre-acquisition losses merely because its stock has been purchased by another entity."[3] However, the court does go on to note in a footnote, "This situation differs from instances where the acquired corporation is merged into the acquiring corporation. There, the surviving corporation is the "acquiring" corporation, and it appears that the deduction would be prohibited. (Citations Omitted.)"[4]

The Taxpayer also asserts that in the alternative, the Utah State Tax Commission "should utilize its broad discretionary powers in order to properly determine COMPANY-1 unitary Utah tax base that is equitable and representative of CORPORATION-1 historical and current operations in Utah."[5] The Taxpayer argues that the Tax Commission has been given discretionary power under Utah Code Sec. 59-7-320 to allow alternative methods from the allocation and apportionment provisions in order to fairly represent the extent of the taxpayer's business activity within Utah. The Taxpayer argues that this indicates the Tax Commission has discretion to allow other methods than the statutory methods in determining an equitable state tax base. The Taxpayer provides no other statutory support for this argument and no case law or prior Tax Commission decision that support the contention that the Tax Commission has broad discretionary powers that would allow it to deviate from express statutory provisions.

It was the Division's position that none of the losses incurred prior to the acquisition from an acquired corporation would remain available for carry forward if the acquired corporation is merged out of existence. The Division points out that this matter is analogous to the footnote in *Savage Industries* because CORPORATION-1 was merged into the acquiring corporation and once it was merged into COMPANY-2 it no longer existed as a separate

[3] *Savage Industries, Inc. v. Utah State Tax Comm'n*, 811 P.2d 664, 670 (1991).
[4] *Id.*, Footnote 19. After the Court issued its decision in *Savage Industries*, Utah Code Subsection 59-7-110(5) was amended and Subsection 59-7-110(5)(b) was added. This provision appears to be consistent with the Court's decision in *Savage Industries.*
[5] Petitioner's Prehearing Brief, pg. 5.

corporation. The Division argues once this occurred, there was no longer an acquired corporation that could deduct its own pre-acquisition net losses against its own post-acquisition income. It was the Division's position that once CORPORATION-1 "no longer existed as a corporation, it also could not 'continue to carry on a trade or business substantially the same as that conducted before the acquisition.' Rather, the operations were now integrated into a corporate entity that included the COMPANY-1."[6] The Division indicates that the Tax Commission has in two prior appeals interpreted the provisions of Utah Code Subsection 59-7-110(5) to bar the acquiring corporation from deducting losses incurred by an acquired corporation prior to the acquisition where the acquired corporation was merged into the acquiring corporation. The Division cites to *Utah State Tax Commission Findings of Fact, Conclusions of Law, and Final Decision* in Appeal No. 97-1296 (January 5, 2000) and Appeal No. 89-2305 (May 12, 1992).[7] The Division's representatives also state that they have been consistently applying the law in this manner.

Additionally, it was the Division's position that the Taxpayer's reliance on Utah Code Sec. 59-7-320 was misplaced as this matter does not involve apportionment and allocation issues. The Division points out that Utah Code Sec. 59-7-320 has specific application to the allocation and apportionment provisions of the Uniform Division of Income for Tax Purposes Act. The Division notes that the Taxpayer cites no other statutory provision that would provide the Tax Commission discretion to ignore the statutory framework addressing the use of pre-acquisition losses of acquired companies.

After reviewing the facts and the arguments presented by the parties, the Division's interpretation and application of the law is appropriate and the audit tax and interest should be upheld. Under a plain reading, Utah Code Subsection 59-7-110(5) provides that a corporation that acquires another corporation may not deduct losses incurred by the acquired corporation prior to the acquisition unless the provisions of Utah Code Subsection 59-7-110(5)(b) have been met. In this matter, the Taxpayer's situation did not comply with Utah Code Subsection 59-7-110(5)(b) because CORPORATION-1 was merged out of existence and so the "acquired corporation" did not "continue to carry on a trade or business substantially the same as that conducted before the acquisition." Additionally, the Tax Commission does not have broad general discretion to deviate from the specific statutory provisions as argued by the Taxpayer in this matter. As noted by the Division, Utah Code Sec. 59-7-320 is limited to standard allocation or apportionment

[6] Auditing Division's Prehearing Brief, pg. 4, citing Utah Code Subsection 59-7-110(5)(b).
[7] These and many other Utah State Tax Commission decisions are available for review in a redacted format at tax.utah.gov/commission-office/decisions.

factors. These factors are not at issue in this appeal. The Taxpayer cites to no other statutory provisions or case law that would provide the Tax Commission discretion to ignore the express provisions of Utah Code Sec. 59-7-110 and find for the Taxpayer in this matter.

The Division also explained the basis for assessing the 10% penalties against the Taxpayer. The Division had previously audited Taxpayer for tax years 2008 and 2009 in which it disallowed the carry forward of CORPORATION-1 separate company losses. This previous audit was issued sometime in 2011, was not appealed and the asserted deficiency was paid by Taxpayer. The Internal Revenue Service then had made audit adjustments. Taxpayer filed amended returns for 2008 and 2009, which reported the federal audit adjustments and once again attempted to use the CORPORATION-1 separate company losses against the Taxpayer's income. Because the Division had previously disallowed this in the prior audit, the Division imposed a 10% negligence penalty based on the Taxpayer's continued attempt to utilize CORPORATION-1 pre-acquisition separate company losses. The Division imposed the 10% penalty for each of the tax years at issue.

Utah Code Subsection 59-1-401(14) provides that if reasonable cause is shown the Commission may waive, reduce or compromise penalties or interest imposed under this part. Utah Admin. Rule R861-1A-42 provides guidance on what constitutes reasonable cause. The Taxpayer did not provide a basis or argument at the hearing to support waiver of the penalties.

After review of the law and the facts that were presented in this matter, the Taxpayer's appeal should be denied.

Jane Phan
Administrative Law Judge

## DECISION AND ORDER

Based on the foregoing, the Commission denies the Taxpayer's appeal of the Utah Corporate Franchise Tax Audit Deficiency issued for the period from January 1, 2008 through December 31, 2012. 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
CITY-1City, 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

**Notice of Payment Requirement: Any balance due as a result of this order must be paid within thirty (30) days of the date of this order, or a late payment penalty could be applied.**