

18-1505

TAX TYPE: INCOME TAX

TAX YEAR: 2016

DATE SIGNED: 06/12/2019

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL, L. WALTERS

GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

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<p>TAXPAYERS,</p> <p style="padding-left: 40px;">Petitioners,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="padding-left: 40px;">Respondent.</p>	<p><b>INITIAL HEARING ORDER</b></p> <p>Appeal No. 18-1505</p> <p>Account No. #####</p> <p>Tax Type: Income Tax</p> <p>Tax Year: 2016</p> <p>Judge: Phan</p>
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**Presiding:**

Jane Phan, Administrative Law Judge

**Appearances:**

For Petitioner: TAXPAYER-1

For Respondent: REPRESENTATIVE FOR RESPONDENT-1, Senior Income Tax Auditor  
REPRESENTATIVE FOR RESPONDENT-2, Senior Income Tax Auditor

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on March 11, 2019 for an Initial Hearing in accordance with Utah Code §59-1-502.5. Petitioners (“Taxpayers”) are appealing a Utah income tax audit deficiency issued for the tax year 2016. Respondent (“Division”) had issued the Notice of Deficiency and Audit Change on August 2, 2018. The amount of tax deficiency was \$\$\$\$ and the interest accrued thereon was \$\$\$\$ as of the date the Notice of Deficiency was mailed. No penalties were assessed with the audit. The Taxpayers had timely appealed the audit and the matter proceeded to the Initial Hearing. At issue was the Division’s disallowance of the equitable adjustment in the amount of \$\$\$\$ that the Taxpayers had claimed on their Utah Individual Income Tax Return for tax year 2016.

APPLICABLE LAW

A tax is imposed on the state taxable income of a resident individual under Utah Code §59-10-104(1) (2016).<sup>1</sup>

Utah Code §59-10-103(1)(w)(2016) defines “taxable income” or “state taxable income” as follows, in pertinent part:

- (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 §59-10-103(1)(a)(i)(2016) provides that “adjusted gross income” for a resident individual “is as defined in Section 62, Internal Revenue Code.”

During the audit year, Utah Code §59-10-115(2016) provided for an equitable adjustment in some limited situations including:

- (2) The commission shall allow an adjustment to adjusted gross income of a resident or nonresident individual if the resident or nonresident individual would otherwise:
  - (a) receive a double tax benefit under this part; or
  - (b) suffer a double tax detriment under this part....
- (4) In accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act, the commission may make rules . . . (b) allowing for the adjustment to adjusted gross income required by Subsection (2).

Utah Code §59-10-1003(2016) provides for a credit for taxes paid to another state as follows:

- (1) Except as provided in Subsection (2), a claimant, estate, or trust may claim a nonrefundable tax credit against the tax otherwise due under this chapter equal to the amount of the tax imposed:
  - (a) on that claimant, estate, or trust for the taxable year;
  - (b) by another state of the United States, the District of Columbia, or a possession of the United States; and
  - (c) on income:
    - (i) derived from sources within that other state of the United States, District of Columbia, or possession of the United States; and
    - (ii) if that income is also subject to tax under this chapter.
- (2) A tax credit under this section may only be claimed by a:
  - (a) resident claimant;
  - (b) resident estate; or
  - (c) resident trust....

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<sup>1</sup> The Commission cites to the 2016 version of the Utah Code on the provisions of substantive law.

Utah Code §59-1-1417 provides for burden of proof and statutory construction as follows:

- (1) In a proceeding before the commission, the burden of proof is on the petitioner . . .
- (2) Regardless of whether a taxpayer has paid or remitted a tax, fee, or charge, the commission or a court considering a case involving the tax, fee, or charge shall:
  - (a) construe a statute imposing the tax, fee, or charge strictly in favor of the taxpayer; and
  - (b) construe a statute providing an exemption from or credit against the tax, fee, or charge strictly against the taxpayer.

The Commission has been granted the discretion to waive penalties and interest. Utah Code Ann. §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.”

The Commission has promulgated Administrative Rule R861-1A-42 to provide additional guidance on the waiver of 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.

#### DISCUSSION

The facts were not substantially in dispute at the hearing. The parties were in disagreement as to the application of the law regarding equitable adjustments pursuant to Utah Code Subsection 59-10-115(2). The Taxpayers had been living and working in Utah prior to 2012. In 2012, TAXPAYER-1 retired from his Utah employment. During the course of his employment in Utah TAXPAYER-1 had deferred some of his compensation. The Taxpayers then moved to STATE-1 in 2012, where TAXPAYER-1 started working for another employer. The Taxpayers received the deferred compensation from their Utah employer while in STATE-1 and stated that they filed Utah nonresident returns claiming the income and paying Utah individual income tax because it was their understating the deferred compensation was Utah source income. The Taxpayers were correct that nonresident individuals are subject to Utah individual income tax on Utah source income. While living and working in STATE-1 from 2012 to 2015, TAXPAYER-1 deferred compensation from his STATE-1 employment.

In 2015, TAXPAYER-1 retired from his STATE-1 employment and the Taxpayers both moved back to Utah. They were Utah resident individuals for purposes of Utah Code Sec. 59-10-

104 for all of 2016 and that was not in dispute. In 2016, TAXPAYER-1 received from his former STATE-1 employer \$\$\$\$ of the deferred income TAXPAYER-1 had earned while working in STATE-1. This deferred income was included on their 2016 federal return and was part of their federal adjusted gross income.

For 2016, the Taxpayers filed a Utah Individual Income Tax Return as resident individuals. However, when preparing the return TAXPAYER-1 concluded it would be inequitable for Utah to tax the deferred income because it was income he had earned while working in STATE-1 and as a STATE-1 resident. He thought since Utah had taxed the prior deferred income earned when he was working in Utah, but received when he was in STATE-1, it would be unfair for Utah to tax this income earned in STATE-1. He stated that Utah's instructions regarding the equitable adjustment were not clear and he felt taxing this income was not equitable. The instruction booklet listed an "equitable adjustment" so he subtracted the \$\$\$\$ as an "equitable adjustment" on TC-40A. He argued there was little information to explain an "equitable adjustment."<sup>2</sup> He also stated that had he known that Utah would tax this income he would not have deferred the compensation, or they would not have moved back to Utah. He assumed Utah would not tax the income because it was STATE-1 source income. He also stated he had talked to tax advisors and done some research prior to deferring the compensation and had not found any information that indicated Utah would tax the income if he received it while in Utah.

The Taxpayers are incorrect in their claiming an equitable adjustment for deferred income from a STATE-1 employer earned in a prior year but received and claimed on their federal return in 2016 when they were Utah resident individuals. Utah Code Secs. 59-10-104 and 59-10-103 impose an income tax on the state taxable income of Utah resident individuals and specifically define "state taxable income" to be the individual's federal "adjusted gross income" subject to certain adjustments, none of which are applicable in this case. The Taxpayers were Utah resident individuals in 2016. They included deferred compensation from their STATE-1 employment on their 2016 federal return in their federal adjusted gross income. The deferred compensation should have been included on their Utah return and is taxable to Utah.

Had the source of the income been a state that also had an income tax, like STATE-2 for example, they would have been required to pay state tax on that income as source income to STATE-2, but they would have been entitled to a credit against the Utah income taxes for the

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<sup>2</sup> The 2016 Utah TC-40 Instructions regarding the TC-40A-Supplemental Schedule, provided instructions for the Equitable Adjustment on page 18, line item (79). The instruction cites Utah Code Subsection 59-10-115(2) and states, "Enter any qualified equitable adjustment needed to prevent paying double tax. Attach an explanation of any equitable adjustment claimed."

income taxes they paid to STATE-2 under Utah Code Sec. 59-10-1003. However, STATE-1 does not have a state income tax. The Taxpayer pointed out that STATE-1 had sales and property tax,<sup>3</sup> but the credit for taxes paid to another state under Utah Code Sec. 59-10-1003 only applies to income tax. The Taxpayers paid no individual income tax to the State of STATE-1 on this income, so no credit for taxes paid to STATE-1 can be applied.

An equitable adjustment is provided under Utah Code Sec. 59-10-115 to adjusted gross income, but the statute specifically provides that the adjustment is only available if the individual would otherwise receive a double tax benefit or “suffer a double tax detriment *under this part*” (emphasis added). “This part” refers to Part 1 of Chapter 10, Individual Income Tax Act. The Taxpayers have only been taxed once on this income by the State of Utah. Additionally, because they were not taxed by STATE-1 on this income, it is only taxed once and the Taxpayers have not suffered a “double tax detriment.” The Tax Commission has uniformly interpreted the “equitable adjustment” provision of law to limit the adjustment to situations where the individual would be taxed twice by the State of Utah under Part 1 of the act, and has not allowed the adjustment in situations where the individual was taxed only once by the State of Utah, but also taxed by a foreign jurisdiction or by another state on the same income. *See Utah State Tax Commission Findings of Fact, Conclusions of Law and Final Decisions, Appeal No. 15-235* (November 15, 2016); *Appeal No. 08-0590* (August 5, 2010); *Appeal No. 14-374* (November 11, 2015); *Utah State Tax Commission Order, Appeal No. 05-1787* (September 5, 2006); *Utah State Tax Commission Initial Hearing Orders, Appeal No. 12-915* (April 15, 2014); *Appeal No. 15-1332* (June 27, 2016); and *Appeal No. 17-286* (January 17, 2018).<sup>4</sup>

The Division’s position is consistent with how the Utah State Tax Commission has interpreted and applied Utah Code Secs. 59-10-104, 59-10-103(1) and 59-10-115 in Utah for many years. The Taxpayers’ argument that even though they are Utah resident individuals, they are not subject to tax on income from a STATE-1 source is incorrect. The Tax Commission has been consistent in its application of these provisions. In order to find that the Taxpayers are entitled to take an equitable adjustment, the Tax Commission would have to expand the equitable adjustment beyond what the Utah Legislature has specifically allowed at Utah Code Sec. 59-10-115. The Tax Commission declines to do so, especially in light of the fact that the Utah Legislature had in 2016 considered Utah Code Sec. 59-10-115 with respect to foreign source income and revised that section in a very limited and specific manner. Certainly, the Utah

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<sup>3</sup> Utah also has sales and property taxes, as well as income tax.

<sup>4</sup> These and other decisions issued by the Utah State Tax Commission are available for review in a redacted format at [tax.utah.gov/commission-office/decisions](http://tax.utah.gov/commission-office/decisions).

Legislature could have made a broader applicable change to this section but chose not to do so. The tax deficiency should be sustained.

No penalties were assessed with the audit. Interest was assessed with the audit pursuant to Utah Code Sec. 59-1-402 from the date the tax was due and accrues until the balance is paid. Under Utah Code Subsection 59-1-401(14) the Tax Commission may waive penalties or interest for reasonable cause and Utah Admin. Rule R861-1A-42(2) provides that interest is waived only if the taxpayer proves that the Tax Commission gave the taxpayer erroneous information or took inappropriate action that contributed to the error. The Taxpayer has argued that the instructions regarding the equitable adjustment were not clear. However, the 2016 TC-40 Instructions, pg. 18, line (79) did cite to Utah Code Subsection 59-10-115(2) and noted “Enter any **qualified** equitable adjustment needed to prevent paying double tax.” If the Taxpayers found this to be unclear, they should have looked at the underlying statute and it is hard to see why they thought they were preventing a double tax because they were only being taxed once on this income. The Taxpayers have not demonstrated Tax Commission error in this matter and there is no basis for waiver of the interest. There is also no basis to abate the tax itself based on ignorance of the law.

The audit deficiency for tax year 2016 of the Utah individual income tax and the interest accrued thereon should be upheld.

Jane Phan  
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Tax Commission denies the Taxpayers’ appeal of the Utah individual income tax audit deficiency for tax year 2016 and sustains the audit in its entirety. 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

Appeal No. 18-1505

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 \_\_\_\_\_, 2019.

John L. Valentine  
Commission Chair

Michael J. Cragun  
Commissioner

Rebecca L. Rockwell  
Commissioner

Lawrence C. Walters  
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.**