

APPEAL # 22-1852
TAX TYPE: INDIVIDUAL INCOME TAX
TAX YEAR: 2019 AND 2020
DATE SIGNED: 10/10/2023
COMMISSIONERS: J.VALENTINE, M.CRAGUN, R.ROCKWELL, AND J.FRESQUES

BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER,</p> <p>Petitioner,</p> <p>v.</p> <p>INCOME TAX AND EDUCATION DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p>Respondent.</p>	<p>INITIAL HEARING ORDER</p> <p>Appeal No. 22-1852</p> <p>Account No: #####</p> <p>Tax Type: Audit - Individual Income Tax</p> <p>Tax Years: 2019 & 2020</p> <p>Judge: Phan</p>
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Presiding:
Jane Phan, Administrative Law Judge

Appearances:
For Petitioner: TAXPAYER, Taxpayer
For Respondent: RESPONDENT'S REP-1, Audit Manager

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on July 20, 2023 for an Initial Hearing in accordance with Utah Code Ann. §59-1-502.5. Petitioner (“Taxpayer”) timely appealed the Respondent’s (“Division”) individual income tax audits for the 2019 and 2020 tax years pursuant to Utah Code Sec. 59-1-501. For the 2019 tax year, the Division issued an audit deficiency of \$\$\$\$\$ in tax, and interest of \$\$\$\$\$ through December 17, 2022. For the 2020 tax year, the Division issued an audit deficiency of \$\$\$\$\$ in tax, and interest of \$\$\$\$\$ through December 17, 2022. Interest continues to accrue on any unpaid balance. No penalties were assessed with the audit.

APPLICABLE LAW

State tax is imposed on a Utah resident individual pursuant to Utah Code §59-10-104, as follows:¹

- (1) 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) 4.95%.

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Utah Code Ann. §59-10-103 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
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 - (g) “Federal taxable income”:
 - (i) for a resident or nonresident individual, means taxable income as defined by Section 63, Internal Revenue Code; or
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 - (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;
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“Adjusted gross income” is defined in Internal Revenue Code (“IRC”) §62, in pertinent part, to mean “in the case of an individual, gross income minus the following deductions[.]”

Utah Code Ann. §59-10-115 provides for an equitable adjustment to Utah taxable income, as follows in pertinent part:

- (1) As used in this section:
 - (a) "Net foreign source taxable income" means:
 - (i) the amount calculated on line 17 of Internal Revenue Code Form 1116, Foreign Tax Credit; or
 - (ii) if, for purposes of federal individual income taxes, the amount calculated on line 17 of Form 1116 is reported on a line other than line 17 of Form 1116, the amount on a line of a federal individual income tax form designated by the commission as being substantially similar to line 17 of the 2015 version of Form 1116.
 - (b) "Pass-through entity taxpayer" means the same as that term is defined in Section 59-10-1402.

¹ All substantive law citations are to the 2020 version of Utah law, unless otherwise noted.

- (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.
- (3) (a) For a pass-through entity taxpayer generating taxable income primarily from establishments classified in Code Section 33242, Metal Tank (Heavy Gauge) Manufacturing, of the 2002 or 2007 North American Industry Classification System of the federal Executive Office of the President, Office of Management and Budget, an adjustment described in Subsection (2) includes net foreign source taxable income generated from Metal Tank (Heavy Gauge) Manufacturing establishments.
 - (b) The adjustment described in Subsection (3)(a) applies to a taxable year beginning on or after January 1, 2017.

Utah Code Ann. §59-1-1417(1) addresses 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.

DISCUSSION

The Taxpayer was a Utah resident for purposes of Utah Code Ann. § 59-10-104, and had filed Utah individual income tax returns for the 2019 and 2020 tax years. On his 2019 return, the Taxpayer claimed an equitable adjustment in the amount of \$\$\$\$\$. On his 2020 return, the Taxpayer claimed an equitable adjustment in the amount of \$\$\$\$\$. The Division disallowed the equitable adjustment for each of the years in its audits, resulting in the audit tax deficiency. There were no other audit adjustments.

The Taxpayer explained that he was hired to work for BUSINESS-1 in 2017, but about a year and a half later the employer had started restructuring and was laying off employees. The Taxpayer stated that he tried to apply for different jobs within BUSINESS-1, but had not been offered another position before December 2018. In December 2018, BUSINESS-1 executed one payment on the severance package provided to the Taxpayer. About that time, the Taxpayer found another job within BUSINESS-1 and BUSINESS-1 said it would reverse the severance package. The amount of the severance package payment had been \$\$\$\$\$, which went into the Taxpayer's bank account, plus \$\$\$\$\$, which the employer had paid to the IRS and State of Utah for income

tax withholding. However, because the employer closed down for two weeks at the end of December 2018, the severance package was actually reversed in 2019, and the Taxpayer repaid to BUSINESS-1 the \$\$\$\$ severance package payment in 2019. BUSINESS-1 also informed the Taxpayer that he would need to repay BUSINESS-1 the amount they had paid to the federal and state governments as income tax withholding.² However, BUSINESS-1 waited until 2020 for the Taxpayer to repay the state and federal withholding amounts until after the Taxpayer filed his income tax returns and received refunds of these amounts.

In 2020, the Taxpayer paid BUSINESS-1 the \$\$\$\$ for the state and federal withholding payments. He said he worked with a tax accountant, who advised him to claim an equitable adjustment on the Utah returns and a claim of right credit on the federal returns for the amounts that he repaid his employer each year. This was why he claimed equitable adjustments on his 2019 return in the amount of \$\$\$\$ and on his 2020 return in the amount of \$\$\$\$.

The Division later audited the Taxpayer's 2019 and 2020 Utah individual income tax returns and denied the equitable adjustments the Taxpayer claimed. At the hearing, the Division's representative stated that Utah Code Ann. §59-10-115 allows for an equitable adjustment to adjusted gross income if the individual suffers a double tax detriment "under this part." The Division's representative stated the Taxpayer did not suffer a double tax detriment "under this part," which is the Individual Income Tax Act, and the Division did not find this to be a situation of double taxation. The Division pointed out that the Taxpayer was only being taxed once by the State of Utah on the severance income, although the Taxpayer did later have to pay the income back.

The Division's representative stated that he also looked at the way the Taxpayer had filed his federal returns. He explained that based on the federal account history transcript, the Taxpayer had claimed a claim of right credit on his 2019 federal income tax return in the amount of \$\$\$\$, and was issued a refund for tax year 2019 by the IRS.³ The Division's representative pointed out to the Taxpayer that for tax year 2020, the Taxpayer did not claim a claim of right credit on his 2020 federal income tax return for the \$\$\$\$ that the Taxpayer had paid back to his employer during that year. The Division's representative stated that the Taxpayer had the option of claiming the repayment as an itemized deduction on the federal return, but indicated he would

² Based on the information presented at the Initial Hearing, the employer issued a corrected W-2 to correct the amount of Social Security wages and Social Security taxes, but did not change the W-2 to reverse the severance payment.

³ The Taxpayer had provided a copy of a 2019 federal return. The Division stated at the Initial Hearing that the copy did not appear to be the final return actually filed by the Taxpayer based on the IRS's account history transcript. The account history transcript showed that the Taxpayer had made a claim of right in tax year 2019 and received a refund based on that.

likely not get any benefit on the Utah return for accounting for the repayment as an itemized deduction. Generally, this would also result in a smaller refund on the federal return than if he claimed a claim of right credit on the federal return.

It is the Division's position that the Taxpayer did not qualify to claim the equitable adjustments on his Utah individual income tax returns for tax years 2019 and 2020. Upon review of the facts presented in this case and the evidence submitted by the parties, the Division's position is consistent with Utah law. The Utah Individual Income Tax Act imposes an income tax on the "state taxable income" of Utah resident individuals. *See* Utah Code Subsection 59-10-104(1)(w). "State taxable income" is specifically defined as the individual's federal adjusted gross income subject to certain additions, subtractions and adjustments. *See* Utah Code Subsections 59-10-103(1)(a) & (w). An equitable adjustment is provided under Utah Code Ann. §59-10-115 to adjusted gross income, but the statute specifically provides that the adjustment is only available to an individual income taxpayer if the individual would otherwise receive a double tax benefit or "suffer a double tax detriment" under this part. "This part" refers to Part 1 of Chapter 10, Individual Income Tax Act.⁴ The Taxpayer has only been taxed once on this income by the State of Utah.

The employer's handling of the reversal of the severance package is unfortunate for the Taxpayer, because the law in Utah was well settled. The Division's position is consistent with how the Utah State Tax Commission has interpreted and applied Utah Code Ann. §59-10-115. The Taxpayer did not meet the criteria to claim an equitable adjustment on his Utah individual income tax returns based on the express statutory requirements of Utah Code Ann. §59-10-115 because he did not "suffer a double tax detriment under this part." The Tax Commission addressed this issue in *Utah State Tax Commission Initial Hearing Order, Appeal No. 09-2968* (May 26, 2010). In that case, one spouse had started receiving Social Security Benefits one year, then the next year decided to voluntarily cancel his benefits and repay the amount he had received for both years. The spouses in *Appeal No. 09-2968* claimed a claim of right credit on their federal return under IRC Sec. 1341, rather than deducting the payment as an itemized deduction. The Commission in that case disallowed the equitable adjustment under Utah Code Ann. §59-10-115, finding that the taxpayers were not being taxed twice on the same income, but were instead "being taxed only once, on money they were not able to retain."⁵ This is a similar situation as in

⁴ *Steiner v. Utah State Tax Comm'n*, 2019 UT 47.

⁵ *See also Utah State Tax Commission Initial Hearing Order, Appeal No. 10-0481* (May 11, 2011); and *Initial Hearing Order, Appeal No. 17-225*, (January 17, 2018). These and other decisions issued by the Tax Commission are published in a redacted format at tax.utah.gov/commission-office/decisions. *See also Steiner v. Utah State Tax Comm'n*, 2019 UT 47.

the subject appeal. Furthermore, Utah does not allow a claim of right deduction or credit similar to IRC Sec. 1341. The federal claim of right credit does not carry over into Utah taxable income. The Taxpayer is not allowed to claim the Utah equitable adjustment and the audit should be upheld.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds that the Division's disallowance of the Taxpayer's claimed equitable adjustments for tax years 2019 and 2020 was proper. The Commission sustains the Division's audit deficiency of income tax and interest for tax years 2019 and 2020. 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 _____, 2023.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Rebecca L. Rockwell
Commissioner

Jennifer N. Fresques
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.