

98-1371
AUDIT
Signed 10-18-2001

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)	AMENDED
)	ORDER
Petitioner,)	
v.)	Appeal No. 98-1371
)	
AUDITING DIVISION OF)	Tax Type: Corporate Franchise Tax
THE UTAH STATE TAX)	
COMMISSION,)	Judge: Phan
)	
Respondent.)	

Presiding:

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REP 1
 PETITIONER REP 2
For Respondent: RESPONDENT REP 1, Assistant Attorney General
 RESPONDENT REP 2, Manager, Income Tax Auditing
 RESPONDENT REP 3, Senior Auditor, Income Tax Auditing

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 3, 2001.

Petitioner is appealing an audit assessment of additional corporate franchise tax for the period of April 1, 1994 to March 31, 1997. The Statutory Notice of Audit change was issued on November 10, 1998. Petitioner timely filed its appeal in this matter. The parties present two issues

Appeal No. 98-1371

to the Commission at the Initial Hearing. The first issue concerns a loss carry forward which arose in pre-audit years. The second issue concerns a gain from the distribution of appreciated property.

The facts surrounding the first issue of the loss carry forward from the pre-audit years are complicated to the extent that there were a number of corporations and partnerships and several reorganizations. Basically the losses had been incurred in the pre-audit years by three subsidiaries and were determined on a separate return basis. Petitioner argues that it should be allowed to use the losses on a combined return basis during the audit years. It is Respondent's position that Petitioner cannot take the losses determined on a separate return basis and deduct them from the combined return. However, Respondent indicates that Petitioner could calculate the losses on a combined return basis for the pre audit years and then take those losses during the audit years on its combined return.

The losses had been incurred prior to the audit by three separate corporations, COMPANY A, COMPANY B, and COMPANY C. During these pre audit years and through fiscal year 1994, each of these corporations filed separate returns. These three corporations were wholly owned subsidiaries of COMPANY D ("COMPANY D"). COMPANY D also had several other subsidiaries including COMPANY E. In the pre-audit period, COMPANY A and COMPANY B, each owned a 50% partnership interest in COMPANY F ("Partnership"). Partnership owned both the CITY 1 plant and the CITY 2 Terminal. COMPANY D subsidiaries also owned three other partnerships which operated (X) plants. In anticipation of taking COMPANY D public, each subsidiary which held an interest in the partnerships transferred 95% of its interest to COMPANY D on April 6, 1994. For federal tax purposes, the transfer of interest in Partnership and the other (X)

Appeal No. 98-1371

plant partnerships were treated as a distribution of appreciated property to COMPANY D. Recognition of the gain was initially deferred.

COMPANY D went forward with its initial public offering on April 19, 1994. In June 1995, COMPANY D transferred its 95% ownership interest in Partnership to COMPANY C. Immediately thereafter COMPANY A, COMPANY B, and an inactive corporation named PETITIONER, merged into COMPANY C. COMPANY C was the surviving entity. However, its name was changed from COMPANY C to PETITIONER. After this transfer, both the CITY 1 Plant and the CITY 2 Terminal were owned by the new PETITIONER

Some of the loss at issue came from COMPANY C. COMPANY C had acquired stock and made loans to a company called COMPANY G beginning in 1987. COMPANY G filed for Bankruptcy on February 13, 1991. COMPANY C claimed a bad debt expense on both its federal and Utah tax returns for the unpaid loans.

During the pre-audit period, COMPANY D provided a centralized management for itself and its subsidiaries. There were shared officers and directors. The other subsidiaries were in the same line of business. There were inter-company transactions. Subsidiaries shared the cost of the salaries and benefits of officers and managers on a net revenue basis. The subsidiaries used common insurance carries, common operations manual, common accounting procedures and there was some use of related companies' stock option plan.

In considering this first issue, it is the Commission's determination that Utah Code Ann. 59-7-110 (5)(1994) prohibits Petitioner from claiming pre-audit losses determined on a separate return basis against its **combined** returns for the audit years. There were sufficient shared ownership;

functional integration and economies of scale such that Petitioner should have been filing a combined return as a unitary group during the loss years. The Commission concludes that if Petitioner were to calculate the losses on a combined basis from the pre-audit years, these losses could be deducted in the audit years on a combined basis. Petitioner maintains that it has not made this calculation and does not know the financial impact. The Commission is not suggesting that Petitioner re-file the returns for the pre-audit loss years on a unitary or combined basis. The Commission would just require that Petitioner recalculate the amount of the loss on a **combined** basis and provide reasonable support for the basis of its calculation. [...]

In looking at the second issue, that of the gain of approximately \$\$\$\$\$ from the transfer of Partnership from COMPANY A, and COMPANY B., to COMPANY D, COMPANY D went forward with its initial public offering on April 19, 1994. This event triggered recognition of the gain of \$\$\$\$\$, for federal tax purposes related to the transfer of the 95% interest in Partnership. COMPANY D received a step up in basis of its assets so that it could take future depreciation deductions based on the full appreciated value of the property. COMPANY D treated the gain as non-business income on its Utah return, but took depreciation deductions as a business expense on the Utah return based on the stepped up basis of the property. The information presented at the Initial Hearing indicated that this gain constituted business income and therefore Respondent's audit assessment on this issue was also appropriate.

APPLICABLE LAW

(a) Corporations 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. This subsection

Appeal No. 98-1371

does not apply if the only change in the corporation is that of the state of incorporation. (b) An acquired corporation may deduct its net losses incurred before the date of acquisition against its separate income if the acquired corporation has continued to carry on a trade or business substantially the same as that conducted before such acquisition. (Utah Code Ann. 59-7-110 (5)(1994).)

In the case of a corporation liable to report under this part owning or controlling, either directly or indirectly, another corporation, or other corporations and in the case of a corporation liable to report under this part and owned or controlled, either directly or indirectly by another corporation and meeting the definition of a unitary business, there shall be filed a combined report showing the combined net income of all such corporations. (Utah Code Ann. Sec. 59-7-304(1)(1992).)

“Business income” means income arising from transactions and activities in the regular course of the taxpayer’s trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitutes integral parts of the taxpayer’s regular trade or business operations. (Utah Code Ann. 59-7-302(1).)

... For purpose of administration of the Uniform Division of Income for Tax Purposes Act, the income of the taxpayer is business income unless clearly classifiable as non-business income. (1) Non-business income means all income other than business income and shall be narrowly construed....(3) (b) Gains or Losses from Sales of Assets. Gain or loss from the sale,

Appeal No. 98-1371

exchange or other disposition of real or tangible or intangible personal property constitutes

business income if the property while owned by the taxpayer was used in the taxpayer's trade or

business. However, if the property was utilized for the production of non-business income the

gain or loss will constitute non-business income... (Utah Admin. Rule R865-6F-8.)

DECISION AND ORDER

Based on the foregoing, the audit assessment for the period of April 1, 1994 to March 31, 1997, is sustained. 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 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

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

DATED this _____ day of _____, 2001.

Jane Phan, Administrative Law Judge

Appeal No. 98-1371

BY ORDER OF THE UTAH STATE TAX COMMISSION.

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2001.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

JKP/ckl/98-1371.cao.int