

16-1545  
TAX TYPE: INCOME TAX  
TAX YEAR: 2012  
DATE SIGNED: 07/13/2018  
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL  
EXCUSED: R. PERO  
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

<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.    16-1545</p> <p>Account No.    #####</p> <p>Tax Type:       Income</p> <p>Tax Year:       2012</p> <p>Judge:           Chapman</p>
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**Presiding:**  
Kerry R. Chapman, Administrative Law Judge

**Appearances:**  
For Petitioner:    TAXPAYER-1, Taxpayer  
                              TAXPAYER-2, Taxpayer  
For Respondent:    RESPONDENT-1, from Auditing Division  
                              RESPONDENT-2, 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 May 7, 2018.

TAXPAYER-1 and TAXPAYER-2 (“Petitioners” or “taxpayers”) are appealing Auditing Division’s (the “Division”) assessment of additional Utah individual income taxes for the 2012 tax year. On September 21, 2016, the Division issued a Notice of Deficiency and Audit Change (“Statutory Notice”) to the taxpayers, in which it imposed additional tax and interest (calculated through October 21, 2016),<sup>1</sup> as follows:

<u>Year</u>	<u>Tax</u>	<u>Penalties</u>	<u>Interest</u>	<u>Total</u>
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<sup>1</sup> Interest continues to accrue until any tax liability is paid. No penalties were imposed.



IRS's reluctance to consider their information and that they were never given an opportunity to make arguments at the IRS. The taxpayers also explained that they became increasingly stressed by the bills they were receiving from the IRS and eventually decided to pay the additional federal taxes that resulted from the IRS changes instead of continuing to try to dispute them at the IRS.<sup>2</sup>

At the Initial Hearing, the taxpayers proffered that they no longer believe that they were entitled to all of the itemized deductions that their original CPA derived and that they claimed on their 2012 federal return. Nevertheless, they believe that under the Internal Revenue Code ("IRC"), they are entitled to a large portion of the itemized deductions they claimed. To support this contention, the taxpayers proffered the notebook of information that their new CPA had prepared, as well as additional information not in the notebook. During the hearing, the taxpayers discussed all of this information, after which the Division was given an opportunity to opine as to what amounts of itemized deductions this information showed that the taxpayers would be entitled to claim under the IRC.

At the hearing, the taxpayers and the Division all agreed that under the IRC, the taxpayers would be entitled to claim a total of \$\$\$\$\$ of 2012 itemized deductions, as follows:

<b>Types of Itemized Deductions</b>	<b>Amounts of 2012 Itemized Deductions the Parties Agreed that the Taxpayers Would Be Entitled to Claim Under the IRC</b>
Medical & dental expenses	\$\$\$\$\$
State and local income taxes	\$\$\$\$\$
Real estate taxes	\$\$\$\$\$
Other taxes	\$\$\$\$\$
Mortgage interest	\$\$\$\$\$
Charitable deductions	\$\$\$\$\$
2% miscellaneous deductions	<u>\$\$\$\$\$<sup>3</sup></u>

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2 After the IRS issued the federal notice of deficiency on July 13, 2015, the taxpayers stated that they sent the IRS the same notebook of information that they proffered at the Initial Hearing. On January 27, 2017, the IRS indicated that because the taxpayers had not provided adequate information, it was not going to change its original assessment and that the taxpayers could request "an Appeals conference."

3 This amount is based on total miscellaneous expenses of \$\$\$\$\$ (\$\$\$\$\$ for TAXPAYER-1 and \$\$\$\$\$ for TAXPAYER-2). When 2% of the taxpayers' 2012 federal adjusted gross income of \$\$\$\$\$ (which equates to \$\$\$\$\$) is deducted from the total miscellaneous expenses amount of \$\$\$\$\$, the allowable deduction for

Total      \$\$\$\$\$

Based on the evidence that the taxpayers proffered and the Division's admission that they would be entitled to \$\$\$\$\$ of 2012 itemized deductions under the IRC, the taxpayers ask the Commission to amend the Division's audit by allowing them to claim \$\$\$\$\$ of itemized deductions for 2012 Utah tax purposes.

The Division concedes that it does not appear that the IRS gave the taxpayers' itemized deduction information "due diligence" and that the IRS's disallowance of all itemized deductions that the taxpayers claimed for 2012 is incorrect. Nevertheless, the Division proffers that the current IRS transcript of the taxpayers' 2012 account shows that the IRS disallowed all the itemized deductions the taxpayers claimed for 2012 and allowed, instead, only a standard deduction of \$\$\$\$\$. For this reason and because it is the Division's policy to rely on amounts shown on current IRS records, the Division asks the Commission not to allow those itemized deductions to which the taxpayers may be entitled under the IRC, but to sustain its assessment that reflects current IRS records.

APPLICABLE LAW

Utah Code Ann. §59-10-103 (2012)<sup>4</sup> defines "adjusted gross 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
    - . . . .
  - (f) "Federal taxable income":
    - (i) for a resident or nonresident individual, means taxable income as defined by Section 63, Internal Revenue Code; or
    - . . . .
  - (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

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miscellaneous expenses under the IRC would be \$\$\$\$\$.

4 The 2012 version of the substantive law is cited in the decision, unless otherwise indicated.

(B) adjustments required by Section 59-10-115;

....

UCA §59-10-1018 authorizes taxpayers to claim a nonrefundable tax credit against Utah income taxes otherwise due for amounts of standard or itemized deductions, as follows in pertinent part:<sup>5</sup>

....

(2) Except as provided in Section 59-10-1002.2, and subject to Subsections (3) through (5), a claimant may claim a nonrefundable tax credit against taxes otherwise due under this part equal to the sum of:

- (a) (i) for a claimant that deducts the standard deduction on the claimant's federal individual income tax return for the taxable year, 6% of the amount the claimant deducts as allowed as the standard deduction on the claimant's federal individual income tax return for that taxable year; or
- (ii) for a claimant that itemizes deductions on the claimant's federal individual income tax return for the taxable year, the product of:
  - (A) the difference between:
    - (I) the amount the claimant deducts as allowed as an itemized deduction on the claimant's federal individual income tax return for that taxable year; and
    - (II) any amount of state or local income taxes the claimant deducts as allowed as an itemized deduction on the claimant's federal individual income tax return for that taxable year; and
  - (B) 6%; and
- (b) the product of:
  - (i) 75% of the total amount the claimant deducts as allowed as a personal exemption deduction on the claimant's federal individual income tax return for that taxable year, plus an additional 75% of the amount the claimant deducts as allowed as a personal exemption deduction on the claimant's federal individual income tax return for that taxable year with respect to each dependent adult with a disability or dependent child with a disability; and
  - (ii) 6%.

....

For the instant matter, UCA §59-1-1417(1) (2018) 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

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<sup>5</sup> Effective tax year 2018, Section 59-10-1018 was amended. However, it is the 2012 version of Section 59-10-1018 that is applicable to this appeal.

- (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 taxpayers have the burden of proof in this matter. The Division proffered current IRS records to show that the IRS has disallowed all itemized deductions that the taxpayers claimed for the 2012 tax year. The taxpayers, however, proffered evidence to show that under the IRC, they are entitled to \$\$\$\$ of itemized deductions for the 2012 tax year. At issue is whether the Commission should allow the taxpayers to claim the \$\$\$\$ of 2012 itemized deductions to which they are entitled under the IRC or only allow them to claim the \$\$\$\$ standard deduction that the IRS allowed for 2012 federal tax purposes.

Subsections 59-10-103(1)(a) and (w) provide that Utah “state taxable income” is based, in part, on the definition of “adjusted gross income” found in the IRC. As a result, the Commission generally relies on amounts shown in IRS records when determining an individual’s Utah taxable income. Nevertheless, the Commission has, on occasion, independently reviewed a petitioner’s evidence of adjusted gross income instead of relying on IRS records when determining the petitioner’s Utah taxable income, especially where the petitioner was unable to contest the matter at the IRS or where a federal deadline had expired and it is too late for the IRS to consider the matter.<sup>6</sup>

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<sup>6</sup> However, where a taxpayer has appealed an IRS change to the IRS and where the IRS has made a “decision on the merits of the [federal] appeal” the Commission has declined to establish an amount that is contrary to the IRS’s decision. *See USTC Appeal No. 15-917* (Initial Hearing Order Apr. 16, 2018). This and other selected Commission decisions can be viewed in a redacted format on the Tax Commission’s website at <http://www.tax.utah.gov/commission-office/decisions>.

One case where the Commission independently determined a taxpayer's Utah taxable income instead of relying on IRS records is *USTC Appeal No. 06-1408* (Initial Hearing Order Nov. 5, 2007). In that case, the IRS had disallowed some or all of the itemized deductions that the taxpayer had claimed for federal and Utah tax purposes, and the Division's assessment reflected the IRS's action. The petitioner in that case was told that the IRS considered the federal matter final and closed, and the petitioner proffered documentation to the Commission showing that the IRS's disallowance of itemized deductions she had claimed was incorrect. The Commission reversed the Division's assessment, stating that:

The Utah Code sections specify that state taxable income is federal taxable income **as defined in the Internal Revenue Code**, they do not tie the state taxable income to the federal taxable income **as determined by the IRS**. Certainly the Tax Commission will give great deference in the interpretation of the Internal Revenue Code to the IRS, as they are the experts in this area. However, where there is a clear error and the taxpayer was unable to have the merits reviewed by the IRS due to the statute of limitations or for other procedural reasons, the Commission concludes that it is appropriate to give consideration to the definitions provided in the Internal Revenue Code. (emphasis added).<sup>7</sup>

Furthermore, in *USTC Appeal No. 08-1313* (Initial Hearing Order Mar. 19, 2009) (a 2004 tax year case), the Commission indicated a willingness to independently review federal taxable income in certain situations where a petitioner might still be able to have the IRS review the federal matter. In this case, the Division suggested that the IRS's action that increased the petitioner's FAGI was incorrect because the petitioner had merely reported his unemployment insurance income on the wrong line of his federal return. Given these circumstances, the Commission held:

The taxpayer in this appeal has not been told that the federal matter is closed. . . . Regardless, the Commission finds that the evidence proffered by the Division shows that the taxpayer's original Utah return reflects the correct amount of "federal taxable income" as defined in Sections 59-10-111 and 59-10-112. Accordingly, under these specific circumstances, the

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<sup>7</sup> *Appeal No. 06-1408* concerned the 2003 and 2004 tax years, years during which an individual's Utah taxable income was defined to mean "federal taxable income" (as defined in the IRC). As a result, for the 2003 and 2004 tax years at issue in *Appeal No. 06-1408*, Utah taxable income reflected an individual's federal adjusted gross income ("FAGI") minus the individual's standard or itemized deductions. Effective for tax year 2008 (and applicable to the 2012 tax year at issue in this appeal), however, Utah law was amended so that an individual's standard or itemized deductions are no longer reflected in the individual's Utah taxable income, but are considered separately as part of a credit against tax otherwise due.

Commission finds that the Division's assessment is incorrect, even though it reflects the FAGI currently recognized by the IRS. As a result, the Commission reverses the Division's assessment.

However, in other cases where the Commission has decided to make an independent determination of federal taxable income, the Commission has sustained the Division unless clear and uncontroverted evidence showed the IRS records to be incorrect or unless the Division either agreed with or failed to refute the petitioner's assertion that an error existed on the IRS records.<sup>8</sup>

In addition, since Utah taxable income was amended effective tax year 2008 to exclude itemized deductions, the Commission has continued to make an independent determination of IRS changes to itemized deductions under certain circumstances. *See, e.g., USTC Appeal No. 14-1809* (Initial Hearing Order Feb. 21, 2017), in which the Commission stated that “[b]ecause it did not appear the IRS was going to reconsider the itemized deductions, the Taxpayer was given the opportunity to establish to the Utah State Tax Commission that the deductions claimed on Schedule A of his federal return were correct.” Furthermore, for tax years subsequent to the 2008 tax year, the Division, at least in one instance, has asked the Commission to disallow itemized deductions claimed by a taxpayer on his federal and Utah returns, even though IRS records showed that the deductions had been allowed for federal tax purposes.<sup>9</sup>

Moreover, although “itemized deduction” or “itemized deductions” is not specifically defined in the Utah Individual Income Tax Act (Title 59, Chapter 10 of the Utah Code), “federal taxable income” (which is

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<sup>8</sup> For cases in which the Commission found that IRS records were incorrect and found in favor of the petitioner, *see USTC Appeal No. 03-0586* (Initial Hearing Order May 24, 2004), *USTC Appeal No. 03-0510* (Initial Hearing Order Oct. 1, 2005), *USTC Appeal No. 08-0515* (Initial Hearing Order May 14, 2009), and *USTC Appeal No. 11-827* (Initial Hearing Order Jul. 12, 2012).

For cases in which the Commission found that the evidence was insufficient to show that IRS records were incorrect and found in favor of the Division, *see USTC Appeal No. 04-1077* (Initial Hearing Order Feb. 25, 2005), *USTC Appeal No. 07-1036* (Initial Hearing Order Jul. 17, 2008), *USTC Appeal No. 07-0365* (Findings of Fact, Conclusions of Law, and Final Decision Feb. 23, 2010), and *USTC Appeal No. 11-2709* (Initial Hearing Order Sept. 16, 2013).

<sup>9</sup> *See USTC Appeal No. 13-1292* (Findings of Fact, Conclusions of Law, and Final Decision Dec. 3, 2015).

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derived with FAGI and with standard or itemized deductions) is still defined for 2008 and subsequent tax years in Section 59-10-103 to mean “taxable income” as defined in the IRC. For these reasons, the Commission may, in some circumstances, still make an independent determination of itemized deductions for 2008 and subsequent tax years, including the 2012 tax year at issue in this appeal. Where the Division concedes that the taxpayers would be entitled to claim \$\$\$\$\$ of 2012 itemized deductions under the IRC, the Commission believes that making an independent determination of the itemized deductions that the taxpayers are able to claim for Utah tax purposes is warranted, regardless of what is shown on current IRS records. For these reasons, the Commission should order the Division to revise its assessment to reflect \$\$\$\$\$ of 2012 itemized deductions instead of an \$\$\$\$\$ standard deduction.

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Kerry R. Chapman  
Administrative Law Judge

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DECISION AND ORDER

Based on the foregoing, the Commission finds that the taxpayers are entitled to claim \$\$\$\$ of itemized deductions for 2012 Utah income tax purposes. The Division is ordered to amend its assessment accordingly.

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 \_\_\_\_\_, 2018.

John L. Valentine  
Commission Chair

Michael J. Cragun  
Commissioner

Robert P. Pero  
Commissioner

Rebecca L. Rockwell  
Commissioner

**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.