18-889
TAX TYPE: INCOME TAX
TAX YEAR: 2012, 2013 and 2014
DATE SIGNED: 7/10/2020
COMMISSIONERS: J. VALENTINE, R. ROCKWELL, M. CRAGUN, L. WALTERS
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYERR-1 and TAXPAYER-2, Petitioners, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION** Appeal No. 18-889 Account No. ##### Tax Type: Income Tax Tax Years: 2012, 2013 and 2014 Judge: Phan

Presiding:
Lawrence C. Walters, Commissioner
Jane Phan, Administrative Law Judge

Appearances:
For Petitioner: TAXPAYER-1
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT, Manager, Income Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on March 10, 2020, in accordance with Utah Code §59-1-501 and §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioners ("Taxpayers") are appealing an audit deficiency of Utah individual income tax and the interest accrued thereon issued by Respondent ("Division") for tax years 2012, 2013, and 2014. The Division issued the Notices of Deficiency and Audit Change on April 5, 2018. The Taxpayers timely appealed the Notices of Deficiency and the appeal eventually proceeded to this Formal Hearing.

2. The Notices of Deficiency[1] indicated the following tax deficiency with interest calculated through May 5, 2018[2] as follows:

Year	Tax	Penalties	Interest	Total
2012	$$$$$	$0.00	$$$$$	$$$$$
2013	$$$$$	$0.00	$$$$$	$$$$$
2014	$$$$$	$0.00	$$$$$	$$$$$

3. For the 2012, 2013, and 2014 tax years, the Taxpayers filed Utah resident returns on which they claimed "equitable adjustments" in the amounts of $$$$$ for the 2012 tax year; $$$$$ for the 2013 tax year; and $$$$$ for the 2014 tax year.[3]

4. The amounts of these equitable adjustments are equal to the taxable distributions that the Taxpayers withdrew from their retirement account in 2012, 2013, and 2014. The withdrawn amounts were all reported as part of the Taxpayers' federal adjusted gross income ("FAGI") on their 2012, 2013, and 2014 federal returns.

5. The Taxpayer testified at the hearing that he and his wife had been lifelong residents of STATE-1 prior to moving to Utah in the year 2000. He explained that STATE-1, unlike the Federal Government, did not allow any deductions for qualified IRA retirement contributions. Utah follows the federal government regarding the qualified IRA retirement contributions, so that for Utah residents the qualified traditional IRA retirement contributions are deducted from the income and not taxed in the year the contribution is made into the qualifying account. Like the IRS, in Utah the income is taxed when the taxpayer receives distributions from the retirement account.

6. The Taxpayers testified that they had made all of their contributions to their qualified retirement accounts, from which the distributions at issue had been received, while still residing in STATE-1. The Taxpayer testified that they contributed to these retirement accounts between 1975 and 1997, the years they worked and lived in STATE-1, so they were not able to deduct their contributions from their income, which was taxed by STATE-1.

7. However, after moving to Utah and during the tax years at issue in this appeal, they had received distributions from these qualified retirement accounts which they were required to claim as

1 Respondent's Exhibits AUD 013, 016 & 019.
2 Interest continues to accrue until any tax liability is paid. No penalties were imposed.

3 Respondent's Exhibits AUD 025-043. For the three years at issue, the cumulative amount of the equitable adjustments that the taxpayers claimed is $$$$$ ($$$$$ plus $$$$$ plus $$$$$).

taxable income on their federal returns and because it was in the federal adjusted gross income it flowed through and became taxable to Utah on their Utah returns. The Taxpayer testified that because they had already paid state tax on the income they contributed to these accounts to STATE-1, they claimed an equitable adjustment on their Utah returns for each tax year at issue for the total amount of the distribution received during that year. The Taxpayer argues that an equitable adjustment was needed to prevent the State of Utah from taxing income that was already taxed by the State of STATE-1.

8. The Taxpayer also testified that they had previously received a distribution and claimed the equitable adjustment on their Utah Individual Income Tax Returns, and that was found to be proper in a prior administrative appeal proceeding. He stated that there had been a prior audit and he stated that eventually the Tax Commission had agreed with their position, so he argues that the issue has been previously decided by the Tax Commission. The Tax Commission was able to find that there had been a prior appeal filed by TAXPAYER-1, Appeal No. #####. This appeal was resolved by an Order of Dismissal issued by the Tax Commission on August 30, 2005. The appeal was dismissed because the Taxpayer and Auditing Division had reached a settlement that reduced the tax balance to $0 and had both signed a Memorandum of Understanding on August 12, 2005. The Tax Commission records indicate that no hearing had been scheduled or held in Appeal No. #####. Appeal No. ##### had been set for a Telephone Status Conference on June 23, 2005. It is unclear whether or not the Taxpayer met with members of the Auditing Division separately from the appeals hearing process because there are no records in the appeal file for Appeal No. #####.[4]

9. The Taxpayers submitted a copy of a number of documents from the appeal file for Appeal No. #####.[5] In addition to the Tax Commission's Order of Dismissal and the Memorandum of Understanding signed by the Audit Manager and the Taxpayer, was the Answer to Petition for Redetermination that was filed by the Auditing Division. The Auditing Division's answer states, "The petitioner converted a traditional IRA into a Roth IRA while a resident of STATE-1. The petitioner elected for federal purposes to include the amount of the distribution from the IRA as income ratably over the next four years." Because there are very different tax consequences regarding the contributions and distributions from a Roth IRA as from a traditional IRA, which is what is at issue in the subject appeal, there may have been very real factual differences between the two audits.

10. Before issuing the audit in the subject appeal for tax years 2012 through 2014, the auditor had sent a letter to the Taxpayers on March 7, 2018, asking for more information regarding the equitable

4 The Taxpayer testified at the subject hearing that in regards to the final resolution of Appeal No. ##### he had attended a hearing at the Tax Commission before a judge who wore a judge's robe and had a gavel. It was his testimony that the judge had ruled in his favor. However, Tax Commission Administrative Law Judges do not wear judge's robes or have gavels and the only order issued by the Tax Commission in Appeal No. ##### had been the Order of Dismissal based on the fact that the Taxpayer and Auditing Division had reached an agreement.

5 Petitioner's Exhibit 2.

adjustment.[6] In the letter the auditor cites to Utah Code Ann. 59-10-115(1) regarding the equitable adjustment and states, "The funds you contributed to your IRA have already been taxed by STATE-1. Accordingly, when the funds upon which you paid STATE-1 state income taxes are withdrawn, Utah will allow an "equitable adjustment" to your Utah taxable income." The letter seems to indicate that the Division would allow the equitable adjustment for the funds that the Taxpayers contributed to the IRA, which were taxed to STATE-1 at the time of contribution, and not for funds representing the appreciable growth generated over the years by the contributed funds, because the appreciable growth had not been taxed by STATE-1 or any other state. The letter from the Auditor asked that the Taxpayers provide additional information to establish which portion of the funds came from the contributions and which from the appreciation, suggesting that the Taxpayers provide all federal tax returns and all STATE-1 state income tax returns for all of the years the Taxpayers were claiming they had paid tax to STATE-1 on their IRA contributions. The letter stated, "with this information, I should be able to track the amount of IRA contributions on which you paid STATE-1 state income tax against the amount of "equitable adjustments" you claim on your Utah income tax returns."[7] The Taxpayers were not able to provide their returns for the years 1975 through 1997. The audit was issued on April 5, 2018, and the audit disallowed all of the equitable adjustments for all three years at issue.

11. At the Formal Hearing the Taxpayer was able to provide some statements from COMPANY-1 for the tax years at issue in this matter,[8] but these statements were not from the years when the Taxpayers had made contributions into their qualified IRA accounts while in STATE-1 and also do not establish which portion of the account was from the contributions and which from the appreciation on the investment. Given that the contributions were made from 1975 to 1997 it would be very difficult for the Taxpayers to now provide their state and federal tax returns from so long ago.

APPLICABLE LAW

Under Utah Code §59-10-104(1) (2014)[9], "a tax is imposed on the state taxable income of a resident individual . . . ."

6 Respondent's Exhibit AUD 023-024.

7 The Tax Commission takes administrative notice that the Auditing Division had a longstanding practice, which was discussed more fully in the Initial Hearing Order issued in this appeal, of allowing an equitable adjustment on distributions from a qualified IRA in situations where the contributions were taxed at the time of the contribution by a state such as STATE-1, as long as the taxpayer was able to provide sufficient documentation that the contributions were taxed by the other state and the adjustment was allowed only up to the amount of the actual contribution, not the untaxed appreciation. The Division's practice changed after the Utah Supreme Court issued its decision in *Steiner v. Utah State Tax Comm'n*, 2019 UT 47, which applied Utah's equitable adjustment provisions more narrowly in a manner that would disallow the longstanding practice.

8 Petitioner's Exhibit 3.

9 All substantive law citations are to the 2014 version of Utah law, except as otherwise noted. The substantive law remained the same during the 2012, 2013, and 2014 tax years.

Utah Code §59-10-103 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
> (B) adjustments required by Section 59-10-115;
> . . . .

"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 §59-10-115 provides for an equitable adjustment to Utah taxable income, as follows in pertinent part:[10]

> (1) 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.
> (2) In accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act, the commission may make rules to allow for the adjustment to adjusted gross income required by Subsection (1).

Utah law allows for a credit for individual income tax imposed by another state at Utah Code §59-10-1003, but that is limited to tax imposed for the same taxable year 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.

10 This statute was amended in 2016. However, it is the version of the statute that was in effect for the 2012, 2013, and 2014 tax years that is applicable to this appeal.

For the instant matter, Utah Code §59-1-1417(1)(2020) provides guidance concerning burden of proof and statutory construction in relevant part:

> (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.

CONCLUSIONS OF LAW

1. 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). "State taxable income" is specifically defined as the individual's federal adjusted gross income subject to certain additions, subtractions and adjustments. Utah Code Subsections 59-10-103(1)(a) & (w). These provisions tax the resident individual on income included in his or her federal adjusted gross income whether it comes from sources outside of Utah or sources from within the state.

2. Utah law does allow under Utah Code Sec. 59-10-1003 a credit for taxes imposed by other states during the same tax year, but in this situation, the taxes that the Taxpayers had paid to STATE-1 were paid during the years 1975 through 1997 and not the tax years at issue in this appeal, tax years 2012 through 2014. For the audit period, there was no provision in the law to allow a credit for taxes imposed by another state in a different tax year from the year for which the credit was being claimed.

3. As the Taxpayers did not qualify for a credit for taxes imposed by another state or qualify for a deduction, the Taxpayers instead claimed on their Utah returns for each of the tax years at issue an equitable adjustment under Utah Code Sec. 59-10-115, "adjusting" or subtracting from their federal adjusted gross income the distributions that they had received each year from their traditional IRAs to which they testify all contributions had been made while they resided in STATE-1 and contributions were taxed to the state of STATE-1. These distributions are taxable federally in the year they were received and were included in the Taxpayers' federal adjusted gross income for each of the tax years at issue in this appeal. As noted above, under Utah Code Subsections 59-10-103(1)(a) & (w), because the distributions are included in the Taxpayers' federal adjusted gross income, they are also included in the Taxpayers "state taxable income" unless there is a statutory adjustment, deduction or addition. From what was presented in this matter, it appears that the Division was considering allowing an equitable adjustment under Utah Code Ann. §59-10-115 (2012-2014) if the Taxpayers had been able to provide adequate

information not only to show the amounts of income that were contributed to a retirement account, but also to show that the other state had taxed the income that was contributed during the tax years that the contributions were made. The Division policy at the time of the audit had been to allow equitable adjustments until the total of the distributions exceeded the total of the contributions that were taxed by the other state. However, the Taxpayers were no longer able to obtain their tax returns from 1975 through 1997, and the Division disallowed the equitable adjustments that the Taxpayers claimed for the 2012, 2013, and 2014 tax years. The Commission cautions that there may be less onerous ways for the Taxpayers to document the portion of their IRA contributions upon which they paid STATE-1 state income taxes than providing to the Division 22 years of federal and STATE-1 tax returns. However, as explained below, for the tax years at issue in this appeal an equitable adjustment was not available to the Taxpayers.

4. The law providing what has been referred to as an "equitable adjustment" is Utah Code 59-10-115. Subsection 59-10-115(1) provides an adjustment to the federal adjusted gross income "of a resident or nonresident individual if the resident or nonresident individual would otherwise: . . . (b) suffer a double tax detriment under this part." For purposes of this subsection, "this part" is Part 1 of the Utah Individual Income Tax Act. Prior to the subject appeal coming to a hearing before the Tax Commission, the Tax Commission had not issued a decision regarding the Division's treatment of an equitable adjustment under the STATE-1 retirement distribution fact pattern that is now before the Commission. However, the Commission has issued decisions involving fact patterns that are different from the facts presented in this case where the Commission has denied an equitable adjustment where an individual would be taxed once by Utah and a second time by another taxing jurisdiction. *See Utah State Tax Commission Findings of Fact, Conclusions of Law and Final Decision, Appeal No. 08-0590* (August 5, 2010); [11] *Utah State Tax Commission Order, Appeal No. 05-1787* (September 5, 2006); *Utah State Tax Commission Initial Hearing Order, Appeal No. 12-915* (April 15, 2014); *Utah State Tax Commission Findings of Fact, Conclusions of Law, and Final Decision, Appeal No. 14-374* (November 11, 2015); and *Utah State Tax Commission Initial Hearing Order Appeal No. 15-1332* (June 27, 2016).[12] *Steiner v. Utah State Tax Comm'n*, 2019 UT 47 is one such case, where the Steiners claimed an equitable adjustment to exclude foreign income from their Utah taxable income. In ruling against the Steiners' equitable

11 The Petitioners in *Appeal No. 08-0590* appealed the Commission's ruling to the Utah Third District Court, which upheld the Tax Commission's decision disallowing the equitable adjustment for income that was subject to tax in FOREIGN COUNTRY. *See XXXX v. Utah State Tax Comm'n*, Case No. 100917302. The District Court ruling was appealed to the Utah Supreme Court, which sent the matter to the Utah Court of Appeals where it was eventually settled. *See XXXX v. Utah State Tax Comm'n*, Case No. 20120708 (Utah Ct. App).

12 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.

adjustment claim, in *Steiner* at ¶60, the Court ruled that the Subsection 59-10-115(1)(b) equitable adjustment is "available only if the Utah tax code itself imposes double taxation."[13]

5. Although this was not addressed in detail by the parties during the hearing and certainly the Taxpayer may have been unaware of the background information on this issue, the Tax Commission takes administrative notice that the Auditing Division had a longstanding practice of allowing an equitable adjustment on distributions from a qualified IRA in situations where the contributions were taxed at the time of the contribution by a state such as STATE-1, as long as the taxpayer was able to provide sufficient documentation that the contributions were taxed by the other state and the adjustment was allowed only up to the amount of the actual contribution, not the untaxed appreciation. The Division's practice was discontinued after the issuance of the *Steiner* decision. Because the Commission generally alerts the Utah Legislature to changes in longstanding practice, the Commission notified the Utah Legislature of the discontinuance of the equitable adjustment under the STATE-1 fact pattern. The Legislature, in turn, enacted a deduction to address the STATE-1 fact pattern in Section 59-10-114.1. This new deduction took effect beginning with tax year 2020. The Legislature did not make the legislation retrospective to tax years prior to 2020, so the Tax Commission cannot apply the new law to the Taxpayers' 2012 through 2014 returns.

6. The Taxpayers' position that for tax years 2012 through 2014 they should be allowed an equitable adjustment or other deduction for income that is taxed only once to Utah, but had been taxed in previous years to another state is contrary to the Utah Supreme Court's decision in *Steiner v. Utah State Tax Comm'n*, 2019 UT 47, which requires that the equitable deduction be disallowed for the tax years at issue in this appeal. After review of the facts and the law presented at the Formal Hearing, the Taxpayers' appeal should be denied and the audit deficiencies of tax and the interest accrued thereon upheld.

Jane Phan
Administrative Law Judge

13 Subsection 59-10-115(1) (2012-2014) was renumbered to Subsection 59-10-115(2) in 2016. In *Steiner*, the Court referred to Subsection 59-10-115(2) (even though that case involved the 2011, 2012, and 2013 tax years). Regardless, the Court's ruling in *Steiner* is applicable to Subsection 59-10-115(1) as it was numbered during the 2012, 2013, and 2014 tax years at issue in the instant case.

DECISION AND ORDER

Based on the foregoing, the Commission sustains the audit deficiencies of Utah individual income tax and the interest accrued thereon for the 2012, 2013, and 2014 tax years. It is so ordered.

DATED this _____day of _____, 2020.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Rebecca L. Rockwell
Commissioner

Lawrence C. Walters
Commissioner

Notice of Appeal Rights and 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 assessed. You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §59-1-601 et seq. and §63G-4-401 et seq.