

1 **WITHHOLDING EXEMPTION FOR CERTAIN**
2 **NONRESIDENT SHAREHOLDERS**

3 2003 GENERAL SESSION

4 STATE OF UTAH

5 **Sponsor: Gordon E. Snow**

6 **This act modifies provisions relating to corporate franchise and income taxes and**
7 **individual income taxes to provide that certain S corporations exempt from state**
8 **corporate franchise or income taxes are exempt from the payment or withholding of tax**
9 **on behalf of nonresident shareholders, to apply certain provisions to nonresident**
10 **shareholders that are not individuals, and to make technical changes. This act has**
11 **retrospective operation for taxable years beginning on or after January 1, 2003.**

12 This act affects sections of Utah Code Annotated 1953 as follows:

13 AMENDS:

14 **59-7-101**, as last amended by Chapter 76, Laws of Utah 2002

15 **59-7-702**, as enacted by Chapter 169, Laws of Utah 1993

16 **59-7-703**, as enacted by Chapter 169, Laws of Utah 1993

17 **59-10-108.2**, as enacted by Chapter 169, Laws of Utah 1993

18 *Be it enacted by the Legislature of the state of Utah:*

19 Section 1. Section **59-7-101** is amended to read:

20 **59-7-101. Definitions.**

21 As used in this chapter:

22 (1) "Adjusted income" means unadjusted income as modified by Sections 59-7-105
23 and 59-7-106.

24 (2) (a) "Affiliated group" means one or more chains of corporations that are connected
25 through stock ownership with a common parent corporation that meet the following
26 requirements:

27 (i) at least 80% of the stock of each of the corporations in the group, excluding the



28 common parent corporation, is owned by one or more of the other corporations in the group;
29 and

30 (ii) the common parent directly owns at least 80% of the stock of at least one of the
31 corporations in the group.

32 (b) "Affiliated group" does not include corporations that are qualified to do business
33 but are not otherwise doing business in this state.

34 (c) For purposes of this Subsection (2), "stock" does not include nonvoting stock which
35 is limited and preferred as to dividends.

36 (3) "Apportionable income" means adjusted income less nonbusiness income net of
37 related expenses, to the extent included in adjusted income.

38 (4) "Apportioned income" means apportionable income multiplied by the
39 apportionment fraction as determined in Section 59-7-311.

40 (5) "Business income" means income as defined in Section 59-7-302.

41 (6) "Corporate return" or "return" includes a combined report.

42 (7) (a) "Common ownership" means the direct or indirect control or ownership of more
43 than 50% of the outstanding voting stock of:

44 (i) a parent-subsidiary controlled group as defined in Section 1563, Internal Revenue
45 Code, except that 50% shall be substituted for 80%;

46 (ii) a brother-sister controlled group as defined in Section 1563, Internal Revenue
47 Code, except that 50% shall be substituted for 80%; or

48 (iii) three or more corporations each of which is a member of a group of corporations
49 described in Subsection (2)(a)(i) or (2)(a)(ii), and one of which is:

50 (A) a common parent corporation included in a group of corporations described in
51 Subsection (2)(a)(i); and

52 (B) included in a group of corporations described in Subsection (2)(a)(ii).

53 (b) Ownership of outstanding voting stock shall be determined by Section 1563,
54 Internal Revenue Code.

55 (8) "Corporation" includes:

56 (a) entities defined as corporations under Sections 7701(a) and 7704, Internal Revenue
57 Code; and

58 (b) other organizations that are taxed as corporations for federal income tax purposes

59 under the Internal Revenue Code.

60 (9) "Dividend" means any distribution, including money or other type of property,
61 made by a corporation to its shareholders out of its earnings or profits accumulated after
62 December 31, 1930.

63 (10) (a) "Doing business" includes any transaction in the course of its business by a
64 domestic corporation, or by a foreign corporation qualified to do or doing intrastate business in
65 this state.

66 (b) Except as provided in Subsection 59-7-102(2), "doing business" includes:

- 67 (i) the right to do business through incorporation or qualification;
- 68 (ii) the owning, renting, or leasing of real or personal property within this state; and
- 69 (iii) the participation in joint ventures, working and operating agreements, the
70 performance of which takes place in this state.

71 (11) "Domestic corporation" means a corporation that is incorporated or organized
72 under the laws of this state.

73 (12) (a) "Farmers' cooperative" means an association, corporation, or other
74 organization that is:

75 (i) (A) an association, corporation, or other organization of:

76 (I) farmers; or

77 (II) fruit growers; or

78 (B) an association, corporation, or other organization that is similar to an association,
79 corporation, or organization described in Subsection (12)(a)(i)(A); and

80 (ii) organized and operated on a cooperative basis to:

81 (A) (I) market the products of members of the cooperative or the products of other
82 producers; and

83 (II) return to the members of the cooperative or other producers the proceeds of sales
84 less necessary marketing expenses on the basis of the quantity of the products of a member or
85 producer or the value of the products of a member or producer; or

86 (B) (I) purchase supplies and equipment for the use of members of the cooperative or
87 other persons; and

88 (II) turn over the supplies and equipment described in Subsection (12)(a)(ii)(B)(I) at
89 actual costs plus necessary expenses to the members of the cooperative or other persons.

90 (b) (i) Subject to Subsection (12)(b)(ii), for purposes of this Subsection (12), the
91 commission by rule, made in accordance with Title 63, Chapter 46a, Utah Administrative
92 Rulemaking Act, shall define:

93 (A) the terms:

94 (I) "member"; and

95 (II) "producer"; and

96 (B) what constitutes an association, corporation, or other organization that is similar to
97 an association, corporation, or organization described in Subsection (12)(a)(i)(A).

98 (ii) The rules made under this Subsection (12)(b) shall be consistent with the filing
99 requirements under federal law for a farmers' cooperative.

100 (13) "Foreign corporation" means a corporation that is not incorporated or organized
101 under the laws of this state.

102 (14) (a) "Foreign operating company" means a corporation that:

103 (i) is incorporated in the United States; and

104 (ii) 80% or more of whose business activity, as determined under Section 59-7-401, is
105 conducted outside the United States.

106 (b) "Foreign operating company" does not include a corporation that qualifies for the
107 Puerto Rico and Possession Tax Credit as provided in Section 936, Internal Revenue Code.

108 (15) "Foreign sales corporation" means a corporation as defined in Section 922,
109 Internal Revenue Code.

110 (16) "Income" includes losses.

111 (17) "Internal Revenue Code" means Title 26 of the United States Code as effective
112 during the year in which Utah taxable income is determined.

113 (18) "Nonbusiness income" means income as defined in Section 59-7-302.

114 (19) "Nonresident shareholder" means any shareholder of an S corporation who on the
115 last day of the taxable year of the S corporation, is:

116 (a) an individual not domiciled in Utah; ~~or~~

117 (b) a nonresident trust or nonresident estate, as defined in Section 59-10-103[-]; or

118 (c) an organization exempt under Section 501, Internal Revenue Code.

119 (20) "Related expenses" means:

120 (a) expenses directly attributable to nonbusiness income; and

121 (b) the portion of interest or other expense indirectly attributable to both nonbusiness
122 and business income which bears the same ratio to the aggregate amount of such interest or
123 other expense, determined without regard to this Subsection (20), as the average amount of the
124 asset producing the nonbusiness income bears to the average amount of all assets of the
125 taxpayer within the taxable year.

126 (21) "Resident shareholder" means any shareholder of an S corporation who is not a
127 nonresident shareholder.

128 (22) "S corporation" means a small business corporation as defined in Section 1361,
129 Internal Revenue Code.

130 (23) "Safe harbor lease" means a lease that qualified as a safe harbor lease under
131 Section 168, Internal Revenue Code.

132 (24) "State of the United States" includes any of the 50 states or the District of
133 Columbia and "United States" includes the 50 states and the District of Columbia.

134 (25) (a) "Taxable year" means the calendar year or the fiscal year ending during such
135 calendar year upon the basis of which the adjusted income is computed.

136 (b) In the case of a return made for a fractional part of a year under this chapter or
137 under rules prescribed by the commission, "taxable year" includes the period for which such
138 return is made.

139 (26) "Taxpayer" means any corporation subject to the tax imposed by this chapter.

140 (27) "Threshold level of business activity" means business activity in the United States
141 equal to or greater than 20% of the corporation's total business activity as determined under
142 Section 59-7-401.

143 (28) "Unadjusted income" means federal taxable income as determined on a separate
144 return basis before intercompany eliminations as determined by the Internal Revenue Code,
145 before the net operating loss deduction and special deductions for dividends received.

146 (29) (a) "Unitary group" means a group of corporations that:

147 (i) are related through common ownership; and

148 (ii) by a preponderance of the evidence as determined by a court of competent
149 jurisdiction or the commission, are economically interdependent with one another as
150 demonstrated by the following factors:

151 (A) centralized management;

152 (B) functional integration; and

153 (C) economies of scale.

154 (b) "Unitary group" does not include S corporations.

155 (30) "Utah net loss" means the current year Utah taxable income before Utah net loss
156 deduction, if determined to be less than zero.

157 (31) "Utah net loss deduction" means the amount of Utah net losses from other taxable
158 years that may be carried back or carried forward to the current taxable year in accordance with
159 Section 59-7-110.

160 (32) (a) "Utah taxable income" means Utah taxable income before net loss deduction
161 less Utah net loss deduction.

162 (b) "Utah taxable income" includes income from tangible or intangible property located
163 or having situs in this state, regardless of whether carried on in intrastate, interstate, or foreign
164 commerce.

165 (33) "Utah taxable income before net loss deduction" means apportioned income plus
166 nonbusiness income allocable to Utah net of related expenses.

167 (34) (a) "Water's edge combined report" means a report combining the income and
168 activities of:

169 (i) all members of a unitary group that are:

170 (A) corporations organized or incorporated in the United States, including those
171 corporations qualifying for the Puerto Rico and Possession Tax Credit as provided in Section
172 936, Internal Revenue Code, in accordance with Subsection (34)(b); and

173 (B) corporations organized or incorporated outside of the United States meeting the
174 threshold level of business activity; and

175 (ii) an affiliated group electing to file a water's edge combined report under Subsection
176 59-7-402(2).

177 (b) There is a rebuttable presumption that a corporation which qualifies for the Puerto
178 Rico and Possession Tax Credit provided in Section 936, Internal Revenue Code, is part of a
179 unitary group.

180 (35) "Worldwide combined report" means the combination of the income and activities
181 of all members of a unitary group irrespective of the country in which the corporations are
182 incorporated or conduct business activity.

183 Section 2. Section **59-7-702** is amended to read:

184 **59-7-702. Taxation of shareholders.**

185 (1) Except as provided in Subsection (2), items of Utah taxable income, expenses,
186 losses, and credits shall be passed through to the shareholders and be taxed as provided in
187 Subtitle A, Chapter 1S, Part 2, Internal Revenue Code.

188 (2) (a) A resident shareholder shall recognize ~~[his]~~ the resident shareholder's
189 proportionate share of an S corporation's Utah taxable income.

190 (b) A nonresident shareholder shall recognize ~~[that]~~ the portion of an S corporation's
191 Utah taxable income derived from Utah sources ~~[as provided in]:~~

192 (i) if the nonresident shareholder is subject to this chapter, in accordance with Part 3,
193 Allocation and Apportionment of Income - Utah UDITPA Provisions; or

194 (ii) if the nonresident shareholder is subject to Chapter 10, Individual Income Tax Act,
195 in accordance with Sections 59-10-117 and 59-10-118.

196 Section 3. Section **59-7-703** is amended to read:

197 **59-7-703. Payment or withholding of tax on behalf of nonresident shareholders --**
198 **Rate.**

199 (1) As used in this section, "return" means:

200 (a) if a nonresident shareholder is required to file a return under this chapter, a return
201 filed under this chapter; or

202 (b) if a nonresident shareholder is required to file a return under Chapter 10, Individual
203 Income Tax Act, a return filed under Chapter 10, Individual Income Tax Act.

204 ~~[(+)]~~ (2) (a) [An] Except as provided in Subsection (4), an S corporation shall pay or
205 withhold a tax on behalf of any nonresident shareholder.

206 (b) The amount [remitted] paid or withheld by an S corporation under Subsection
207 (2)(a) shall be determined by:

208 (i) calculating the items of income or loss from [Schedule K of the 1120S] federal form
209 1120S, Schedule K;

210 (ii) applying the apportionment formula to determine the amount apportioned to
211 Utah \hat{h} [f] ; [3] [2]

212 ~~—— (A) if the nonresident shareholder is subject to this chapter, in accordance with Part 3,~~
213 ~~Allocation and Apportionment of Income - Utah UDITPA Provisions; or] \hat{h}~~

214 ~~h [(B) if the nonresident shareholder is subject to Chapter 10, Individual Income Tax Act,~~
 215 ~~in accordance with Sections 59-10-117 and 59-10-118;]~~ h

216 (iii) reducing the amount apportioned to Utah by the percentage of ownership
 217 attributable to resident shareholders; and

218 (iv) applying the rate to the remaining balance.

219 (3) (a) For a nonresident shareholder who is required to file a return under this chapter:

220 ~~[(b) A]~~ (i) the nonresident shareholder [is entitled to] may claim a credit on the ~~[Utah~~
 221 ~~individual]~~ nonresident shareholder's return for the amount of tax paid or withheld by the S
 222 corporation on behalf of the nonresident shareholder[-];

223 ~~[(c) A]~~ (ii) if the nonresident shareholder [who is an individual and] has no other Utah
 224 source income, the nonresident shareholder may [forego] elect:

225 (A) not to claim the credit provided under Subsection ~~[(b)]~~ (3)(a)(i); and

226 (B) not to file a [Utah individual income tax] return for the taxable year[-. If the
 227 individual is entitled to credits under Utah law, an individual income tax]; and

228 (iii) if the nonresident shareholder may claim credits other than the credit described in
 229 Subsection (3)(a)(i), the nonresident shareholder shall file a return [must be filed] to claim
 230 those credits.

231 (b) If a nonresident shareholder is required to file a return under Chapter 10, Individual
 232 Income Tax Act, the nonresident shareholder is subject to Section 59-10-108.2.

233 (4) Notwithstanding Subsection (2), the obligation to pay or withhold a tax under
 234 Subsection (2) does not apply to an organization that is exempt under Subsection
 235 59-7-102(1)(a) from the taxes imposed by this chapter.

236 ~~[(2) The]~~ (5) (a) In accordance with Title 63, Chapter 46a, Utah Administrative
 237 Rulemaking Act, the commission[-, by rule,-] shall by rule determine the rate [that] at which an
 238 S corporation shall withhold for nonresident shareholders.

239 (b) The rate described in Subsection (5)(a) shall be consistent with the composite tax
 240 rate paid by partnerships.

241 ~~[(3)]~~ (6) (a) If ~~[the]~~ an S corporation fails to pay or withhold [the] a tax as provided in
 242 this section, and thereafter the income subject to payment or withholding is reported and the
 243 resulting tax is paid by [the] a nonresident shareholder, any tax required to be paid or withheld
 244 [shall] may not be collected from the S corporation. [However, the]

245 (b) A nonresident shareholder's payment under Subsection (6)(a) does not relieve the S
 246 corporation from liability for penalties or interest associated with failure to pay or withhold
 247 ~~[the]~~ a tax as provided in this section.

248 ~~[(4)] (7)~~ Penalties, refunds, assessments, and required records for S corporations shall
 249 be governed by ~~[Title 59;]~~:

250 (a) this chapter if a nonresident shareholder is subject to this chapter; or

251 (b) Chapter 10, Individual Income Tax Act, if a nonresident shareholder is subject to
 252 Chapter 10, Individual Income Tax Act.

253 ~~[(5) The]~~ (8) (a) An S corporation shall furnish each nonresident shareholder a
 254 statement showing:

255 (i) the amount of the nonresident shareholder's share of the corporate earnings from
 256 Utah sources; and

257 (ii) the amount of the withholding from ~~[it and]~~ the nonresident shareholder's share of
 258 the corporate earnings from Utah sources.

259 (b) An S corporation shall pay the commission the amount withheld~~;~~ under this
 260 section:

261 (i) by the due date of the corporation's return, not including extensions~~;~~; and

262 (ii) on forms furnished by the commission.

263 Section 4. Section **59-10-108.2** is amended to read:

264 **59-10-108.2. Credit for nonresident shareholders of S corporations.**

265 (1) (a) A nonresident shareholder of an S corporation who is an individual ~~[shall be~~
 266 ~~allowed]~~ may claim a credit against the tax otherwise due under this chapter.

267 (b) The credit described in Subsection (1)(a) is equal to the amount paid or withheld by
 268 the S corporation on behalf of the individual ~~[as provided]~~ in accordance with Section
 269 59-7-703.

270 (2) A nonresident shareholder of an S corporation who is an individual ~~[of an S~~
 271 ~~corporation]~~ and who has no other Utah source income may ~~[forego]~~ elect:

272 (a) not to claim the credit provided in Subsection (1); and

273 (b) not to file a Utah individual income tax return for ~~[that]~~ the taxable year.

274 (3) If ~~[the individual is entitled to credits under Utah law;]~~ a nonresident shareholder
 275 may claim credits other than the credit described in Subsection (1), the nonresident shareholder

276 shall file an individual income tax return [~~must be filed~~] to claim those credits.

277 Section 5. **Retrospective operation.**

278 This act has retrospective operation for taxable years beginning on or after January 1,

279 2003.

Legislative Review Note

as of 1-6-03 10:01 AM

A limited legal review of this legislation raises no obvious constitutional or statutory concerns.

Office of Legislative Research and General Counsel

Fiscal Note**Withholding Exemption for Certain Nonresident Shareholders***14-Jan-03***Bill Number HB0073***2:04 PM*

State Impact

No fiscal impact.

Individual and Business ImpactNo fiscal impact.

Office of the Legislative Fiscal Analyst