

**WITHHOLDING EXEMPTION FOR CERTAIN
NONRESIDENT SHAREHOLDERS**

2003 GENERAL SESSION

STATE OF UTAH

Sponsor: Gordon E. Snow

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

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

AMENDS:

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

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

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

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

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

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

59-7-101. Definitions.

As used in this chapter:

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

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

(i) at least 80% of the stock of each of the corporations in the group, excluding the common parent corporation, is owned by one or more of the other corporations in the group;
and

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(8) "Corporation" includes:

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

(b) other organizations that are taxed as corporations for federal income tax purposes under the Internal Revenue Code.

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

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

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

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

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

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

- (i) (A) an association, corporation, or other organization of:
 - (I) farmers; or
 - (II) fruit growers; or
- (B) an association, corporation, or other organization that is similar to an association, corporation, or organization described in Subsection (12)(a)(i)(A); and
- (ii) organized and operated on a cooperative basis to:
 - (A) (I) market the products of members of the cooperative or the products of other producers; and
 - (II) return to the members of the cooperative or other producers the proceeds of sales less necessary marketing expenses on the basis of the quantity of the products of a member or producer or the value of the products of a member or producer; or

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

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

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

(A) the terms:

(I) "member"; and

(II) "producer"; and

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

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

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

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

(i) is incorporated in the United States; and

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

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

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

(16) "Income" includes losses.

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

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

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

- (a) an individual not domiciled in Utah; ~~or~~
- (b) a nonresident trust or nonresident estate, as defined in Section 59-10-103~~[-];~~ or
- (c) an organization exempt under Section 501, Internal Revenue Code.

(20) "Related expenses" means:

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

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

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

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

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

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

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

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

(27) "Threshold level of business activity" means business activity in the United States equal to or greater than 20% of the corporation's total business activity as determined under

Section 59-7-401.

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

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

(i) are related through common ownership; and

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

(A) centralized management;

(B) functional integration; and

(C) economies of scale.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

59-7-702. Taxation of shareholders.

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

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

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

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

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

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

59-7-703. Payment or withholding of tax on behalf of nonresident shareholders --

Rate.

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

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

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

~~(1)~~ (2) (a) [Am] Except as provided in Subsection (4), an S corporation shall pay or withhold a tax on behalf of any nonresident shareholder.

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

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

(ii) applying the apportionment formula to determine the amount apportioned to Utah;

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

(iv) applying the rate to the remaining balance.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(b) An S corporation shall pay the commission the amount withheld[;] under this section:

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

(ii) on forms furnished by the commission.

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

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

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

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

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

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

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

(3) If [~~the individual is entitled to credits under Utah law;~~] a nonresident shareholder may claim credits other than the credit described in Subsection (1), the nonresident shareholder shall file an individual income tax return [must be filed] to claim those credits.

Section 5. **Retrospective operation.**

This act has retrospective operation for taxable years beginning on or after January 1, 2003.