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# Utah State Legislature

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November 22, 2011

Executive Appropriations Committee  
Utah State Capitol Complex  
Salt Lake City, Utah 84114

RE: Revenue and Taxation Interim Committee report required by statute

Dear Senator Hillyard, Representative Brown, and Committee Members:

As required by Utah Code Ann. Section 59-7-701 (2011), during the 2011 interim the Revenue and Taxation Interim Committee reviewed the taxation of pass-through entities, including S corporations.

The Office of the Legislative Fiscal Analyst was unable to provide the Revenue and Taxation Interim Committee with fiscal estimates of the impact of the taxation of S corporations under Title 59, Chapter 7, Part 7, S Corporations, or Laws of Utah 2009, Chapter 312 (SB 23, Income Taxation of Pass-through Entities and Pass-through Entity Taxpayers, Niederhauser) in time for our final Committee meeting. We have been told that they are working to provide those estimates to the Executive Appropriations Committee.

At the November interim meeting, the Revenue and Taxation Interim Committee voted unanimously to allow the entity-level tax on S-corporations to expire at the end of taxable year 2012, as per current statute. No action is necessary to implement this recommendation.

Feel free to contact us with any questions.

Sincerely,

Curtis S. Bramble  
Senate Chair

Patrick Painter  
House Chair

OFFICE OF THE  
**LEGISLATIVE  
 FISCAL  
 ANALYST**

JONATHAN C. BALL  
 DIRECTOR

**MEMORANDUM FOR EXECUTIVE APPROPRIATIONS COMMITTEE**

**FROM:** Thomas Young  
**DATE:** December 6, 2011  
**SUBJECT:** Fiscal Impact of the Elimination of the S-Corporation Level Tax and Expansion of Withholding to Partners and Members of Pass-Through Entities

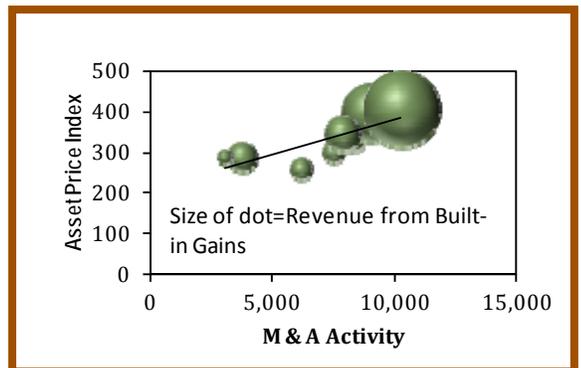
Statute (59-7-701) requires the Revenue and Taxation Interim Committee to review the taxation of pass-through entities and send a written recommendation regarding S-Corporation level taxation and withholding on certain pass-through entities. At the November Interim Committee meeting, committee members voted unanimously to eliminate the entity-level tax on S-corporations and authorize the withholding on partners and members of certain pass-through entities. Since the recommendations by the Committee are consistent with current statute, no legislative action is required to enable the Committee's recommendations. This document reviews the fiscal impact in two parts:

- Elimination of the S-Corporation entity level tax (built-in gains); and
- Expansion of withholding to business partners and members of LLCs and partnerships.

**Built-in Gains**

Elimination of the entity level tax on S-Corporations eliminates revenue from built-in gains. Built-in Gains revenue over the past 10 years is reported in the Built-in Gains table to the right. The built-in gains revenue stream, and thus fiscal impact, is largely dependent upon economic activity related to mergers and acquisition (M & A), asset price appreciation, and expected profit in converting to an S-corporation. The bottom figure on this page represents the correlation between real asset values, M & A activity, and built-in gains revenue. As is shown, the green dot (built-in gains) generally gets bigger as asset prices appreciate and M & A activity increases, and vice versa.

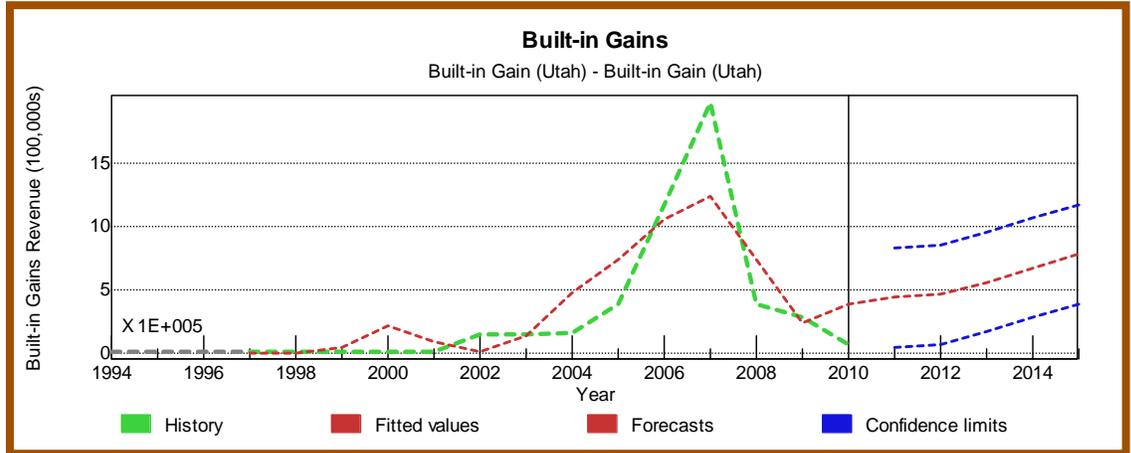
Built-in		Built-in	
Year	Gains	Year	Gains
2002	\$143,777.00	2007	\$1,984,640
2003	\$144,248	2008	\$379,405
2004	\$153,310	2009	\$274,061
2005	\$376,722	2010 (e)	\$62,204
2006	\$1,167,922		



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Given the state of the economy and assumptions on mergers and acquisitions for the near term, built-in gains revenue likely would have hovered around \$300,000 ± \$250,000 through 2015. This is shown in the figure that follows.



### Expansion of Withholding to Partners and Members of LLCs and Partnerships

By expanding the withholding requirement to partners and members of LLCs and Partnerships, the Education Fund may or may not see increased revenue through the capture of revenue previously not captured.

#### Pass-Through Withholding, Refunds, and Tax Reported by Resident and Non-Resident Filers on Their 1040

	# of Returns	CY 2009 Withholding	CY 2009 Refunds	CY 2009 Taxes Paid
All Returns	10,134	\$35,592,699	\$20,720,119	\$50,758,138
Refund < Withholding	8,522	\$30,997,147	\$10,588,310	\$39,543,808
Refund > Withholding	1,612	\$4,595,552	\$10,131,808	\$11,214,330
	# of Returns	CY 2010 Withholding	CY 2010 Refunds	CY 2010 Taxes Paid
All Returns	9,771	\$28,156,421	\$14,642,513	\$43,522,382
Refund < Withholding	8,533	\$26,297,562	\$8,256,965	\$30,855,021
Refund > Withholding	1,238	\$1,858,859	\$6,385,548	\$12,667,361

The withholding requirements took effect for CY 2009 returns, although, the change was mid-year. The first full year of withholding requirements began in CY 2010. Since the withholding took effect in CY 2010 and no audits have been performed on the new requirements, it's still too early to get an estimate based on actual data of whether the increased compliance costs on partners and members of LLCs and Partnerships increased ongoing revenue. The table above represents individual returns reporting pass-through income. The new withholding requirement doesn't show up as increasing revenue on the aggregate data – the number of returns, withholding, and refunds all declined from CY 2009 to CY 2010. The withholding requirement could be showing up in “new” returns, where 4,694 “new” filers reported pass-through withholding, with \$4,430,614 in refunds and \$7,113,019 in withholding. The “new” filers could be due to the expansion of withholding or could be due to the natural growth of the economy. Overall, the new withholding requirement may increase revenue from certain taxpayers by capturing taxes earlier than has previously been the case, but the data do not yet indicate this.