

## TAX REVIEW COMMISSION STUDY REQUEST

### **Background:**

In the 2009 General Session, the Utah Legislature enacted S.B. 23, *Income Taxation of Pass-Through Entities and Pass-Through Entity Taxpayers* (Niederhauser). S.B. 23 instituted the requirement that pass-through entities must generally withhold Utah tax on income passed through to a pass-through entity taxpayer who is not a Utah resident individual. However, under certain circumstances, the withholding requirement can be waived if the pass-through entity taxpayer files a return and pays the tax due by the pass-through entity's return filing due date.

### **Issues:**

Concern has been raised that certain pass-through entity structures have been unable to utilize the withholding waiver option when the filing period of the pass-through entity taxpayer differs from that of the pass-through entity. This is the case because it is difficult for a pass-through entity taxpayer to file a return by the pass-through entity's due date if that due date is before the end of the pass-through entity taxpayer's tax year. This may lead to excessive withholding which under current law<sup>1</sup> cannot be refunded to the pass-through entity.

This situation often arises when a pass-through entity taxpayer is also a pass-through entity that has current year losses or a net operating loss carryover that offsets income received from another pass-through entity. In this situation, excessive withholding will result because the upper-tier pass-through withholding credit will exceed 5% of pass-through income after the loss is subtracted.

Recently, this issue has been further complicated by federal partnership audit reform enacted under the Bipartisan Budget Act of 2015. This reform is meant to simplify IRS audits of complex pass-through structures by allowing tax to be assessed against a top tier pass-through entity who must then obtain contribution from downstream entities. This assessment will be effective in the year the IRS makes the adjustment rather than in the year being reviewed on audit. It is unclear what impact these federal changes will have on Utah both under current law and in conjunction with any changes to the pass-through entity provisions.

Options for the TRC to consider in addressing this withholding issue, which require study due to numerous attendant concerns, include:

- Allowing pass-through entities to claim refundable credits for excess pass-through withholding provided that sufficient withholding is paid based on the income/gains of the pass-through entity.
- Modify the withholding waiver requirements so that any pass-through entity can reasonably utilize the waiver regardless of filing period.

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<sup>1</sup> See Utah Code § 59-10-1403.2(2) and Administrative Rule R865-9I-13