

18-417

TAX TYPE: CORPORATE FRANCHISE TAX

TAX YEAR: 2014, 2015, 2016

DATE SIGNED: 06/28/2018

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER,

Petitioner,

v.

TAXPAYER SERVICES DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent,

and

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,

Interested Party.

**ORDER DENYING PETITIONER'S
MOTION FOR SUMMARY JUDGMENT
AND GRANTING RESPONDENT'S CROSS-
MOTION FOR SUMMARY JUDGMENT**

Appeal No. 18-417

Tax Type: Corporate Franchise Tax

Account No. #####

Tax Years: 2014, 2015 & 2016

Judge: Chapman

Presiding:

Robert P. Pero, Commissioner

Rebecca L. Rockwell, Commissioner

Kerry R. Chapman, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE FOR TAXPAYER-1, Attorney

REPRESENTATIVE FOR TAXPAYER-2, Attorney

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General

STATEMENT OF THE CASE

On April 18, 2018, TAXPAYER ("Petitioner," "TAXPAYER," or "taxpayer") submitted TAXPAYER's Motion for Summary Judgment and Memorandum in Support (taxpayer's "Motion"), in which it asks the Commission to direct Taxpayer Services Division ("Respondent" or "Division") to issue, as a matter of law, refunds of withholding tax to TAXPAYER in the amount of \$\$\$\$ for the 2014 tax year, \$\$\$\$ for the 2015 tax year, and \$\$\$\$ for the 2016 tax year.

On May 16, 2018, the Division submitted Taxpayer Services Division's Cross-Motion and Memorandum in Support of Summary Judgment, and Response and Memorandum in Opposition to TAXPAYER's Motion for Summary Judgment (Division's "Cross-Motion"), in which it asks the Commission, as a matter of law, to deny the taxpayer's Motion and find that the withholding tax refunds sought by the taxpayer are not allowed by statute for the three tax years at issue.

On May 23, 2018, the taxpayer submitted TAXPAYER's (1) Reply Memorandum in Support of Motion for Summary Judgment and (2) Memorandum in Opposition to Taxpayer Services Division's Cross-Motion for Summary Judgment. On May 31, 2018, the Division submitted Taxpayer Services Division's Reply Memorandum in Support of Cross-Motion for Summary Judgment.

This matter came before the Commission for oral arguments on the parties' respective motions on June 12, 2018.

STATEMENT OF UNDISPUTED FACTS

1. TAXPAYER is an S corporation that manages and operates WORD REMOVED. TAXPAYER files Federal Form 1120 S, U.S. Income Tax Return for an S Corporation and Utah Form TC-20S on a calendar year-end basis.

2. TAXPAYER is an owner (member) of COMPANY, LLC ("COMPANY") through its 100% ownership of a Qualified Subchapter S Subsidiary, TAXPAYER of Utah ("TAXPAYER Utah"), which holds a membership interest in COMPANY but is disregarded for federal income tax purposes. COMPANY is a Utah limited liability Company that operates a WORD REMOVED located in CITY, Utah. COMPANY is treated as a partnership for federal income tax purposes and operates on a fiscal year with a year-end of April 30th.

3. Pursuant to requirements under Utah law, each year COMPANY files a Utah return (Form TC-65) and withholds tax that it pays to the Utah State Tax Commission. COMPANY reported the portion of tax it withheld on behalf of TAXPAYER on Schedules K-1 that it issued to TAXPAYER.

4. For COMPANY's fiscal year-end 4/30/2014 (TAXPAYER's calendar year-end 2014), COMPANY withheld \$\$\$\$\$ on behalf of TAXPAYER based on COMPANY's income.¹

5. For COMPANY's fiscal year-end 4/30/2015 (TAXPAYER's calendar year-end 2015), COMPANY withheld \$\$\$\$\$ on behalf of TAXPAYER based on COMPANY's income.

6. For COMPANY's fiscal year-end 4/30/2016 (TAXPAYER's calendar year-end 2016), COMPANY withheld \$\$\$\$\$ on behalf of TAXPAYER based on COMPANY's income.

7. Pursuant to requirements under Utah law, TAXPAYER files a Utah return (Form TC-20S) each year and withholds tax on behalf of its 40+ shareholders.

8. For 2014, TAXPAYER withheld tax of \$\$\$\$\$² on behalf of its shareholders based on 5% of TAXPAYER's income, which was reported on the Utah Schedules K-1 that TAXPAYER issued to the TAXPAYER shareholders. TAXPAYER made the \$\$\$\$\$ withholding payment via COMPANY's withholding payment of \$\$\$\$\$. The \$\$\$\$\$ difference between the amount of withholding paid by COMPANY on behalf of TAXPAYER and the amount of withholding paid by TAXPAYER on behalf of TAXPAYER shareholders is created by a net operating loss at the TAXPAYER level. On its 2014 Form TC-20S, TAXPAYER claimed a credit for \$\$\$\$\$ against the \$\$\$\$\$ in withholding tax due from TAXPAYER on its distributions to its shareholders, resulting in a requested refund of the difference of \$\$\$\$\$. The Division denied TAXPAYER's request to receive a refund of the difference in taxes that COMPANY withheld on

1 COMPANY pays the withholding tax on behalf of TAXPAYER Utah, but because TAXPAYER Utah is 100% owned by TAXPAYER and disregarded for federal income tax purposes, the withholding flows through to TAXPAYER.

2 All tax amounts referred to in the "Statement of Undisputed Facts" are currently reflected in Tax

behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2014 tax year.

9. For 2015, TAXPAYER withheld tax of \$\$\$\$ on behalf of its shareholders based on 5% of TAXPAYER's income, which was reported on the Utah Schedules K-1 that TAXPAYER issued to the TAXPAYER shareholders. TAXPAYER made the \$\$\$\$ payment via COMPANY's withholding payment of \$\$\$\$. On its 2015 Form TC-20S, TAXPAYER claimed a credit for \$\$\$\$ against the \$\$\$\$ in withholding tax due from TAXPAYER on its distributions to its shareholders, resulting in a requested refund of the difference of \$\$\$\$\$. The Division denied TAXPAYER's request to receive a refund of the difference in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2015 tax year.

10. For 2016, TAXPAYER withheld tax of \$\$\$\$ on behalf of its shareholders based on 5% of TAXPAYER's income, which was reported on the Utah Schedules K-1 that TAXPAYER issued to the TAXPAYER shareholders. TAXPAYER made the \$\$\$\$ payment via COMPANY's withholding payment of \$\$\$\$. On its 2016 Form TC-20S, TAXPAYER claimed a credit for \$\$\$\$ against the \$\$\$\$ in withholding tax due from TAXPAYER on its distributions to its shareholders, resulting in a requested refund of the difference of \$\$\$\$\$. The Division denied TAXPAYER's request to receive a refund of the difference in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2016 tax year.

11. Because TAXPAYER claimed refunds of the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2014, 2015, and 2016 tax years, TAXPAYER did not report on its shareholders' Schedules K-1 for these years

Commission records, but could change if the Division conducts possible audits for the tax years at issue.

the full amounts withheld by COMPANY. TAXPAYER only reported the withholding that it passed through on its own income.

12. TAXPAYER recently sold COMPANY and is in the process of liquidating, which may occur at the end of June 2018. Thus, TAXPAYER will soon be filing its final 2018 tax returns and sending out final Schedules K-1 to its shareholders.

13. If the Commission upholds the Division's denial of TAXPAYER's 2014, 2015, and 2016 refund requests, TAXPAYER will be required to issue amended Schedules K-1 to its shareholders, and each of its shareholders will then be required to file original or amended 2014-2016 Utah income tax returns to claim any refunds associated with the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2014, 2015, and 2016 tax years. Under these circumstances, the statute of limitations for TAXPAYER's shareholders to file their amended or original 2014 Utah returns and claim a refund will expire on October 15, 2018 (for the 2014 tax year), October 15, 2019 (for the 2015 tax year), and October 15, 2020 (for the 2016 tax year), unless the shareholders and the Division signed a written agreement to extend any of these statute of limitations periods. *See* Utah Code Ann. §59-1-1410(8) (2016).

14. If the Commission does uphold the Division's position, TAXPAYER will be able to send amended 2014-2016 Schedules K-1 to its shareholders, with instructions to its shareholders to file amended 2014, 2015 and 2016 Utah returns before any applicable statute of limitations to claim a refund. TAXPAYER admits that this approach would ultimately refund any overpaid taxes back to its shareholders. However, TAXPAYER contends that this approach would be more burdensome and time-consuming for the Tax Commission, TAXPAYER, and the TAXPAYER shareholders than: 1) refunding to TAXPAYER the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on

behalf of TAXPAYER shareholders for the 2014, 2015, and 2016 tax years; and 2) allowing TAXPAYER to distribute the refunded amounts directly to its shareholders as part of its liquidation.

15. As a result, TAXPAYER asks the Commission to refund directly to TAXPAYER the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2014, 2015, and 2016 tax years directly. TAXPAYER argues that Utah Code Ann. §59-10-1103(2) (2016) authorizes these refunds to TAXPAYER, in part, because TAXPAYER is both a “pass-through entity” (as defined in Utah Code Ann. §59-10-1402(10) (2016)) and a “pass-through entity taxpayer” (as defined in Subsection 59-10-1402(11)).

16. The Division admits that TAXPAYER is a “pass-through entity,” but contends that TAXPAYER is not a “pass-through entity taxpayer,” in part, because Utah Code Ann. §§59-10-1403(1) and (2) (2016) provide that “a pass-through entity is not subject to a tax imposed by this chapter” and that “[t]he income, gain, loss, deduction, or credit of a pass-through entity shall be passed through to one or more pass-through entity taxpayers as provided in this part.” The Division contends that if TAXPAYER is not a “pass-through entity taxpayer,” Subsection 59-10-1103(2) does not authorize TAXPAYER to receive refunds of the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2014, 2015, and 2016 tax years. In addition, the Division argues that until Senate Bill 158 (2017) (which became effective on May 9, 2017) was enacted, the Utah Legislature did not authorize the type of refund that TAXPAYER is seeking in this appeal, and then it only approved certain refunds for tax years ending on or after July 1, 2017 (which would not include the 2014, 2015, and 2016 tax years at issue in this appeal). For these reasons, the Division asks the Commission to sustain its actions denying TAXPAYER’s refund requests.

APPLICABLE LAW

1. Utah Code Ann. §63G-4-102(4) (2016)³ provides that the Tax Commission can issue orders on motions for summary judgment in Tax Commission appeals that are governed under the Utah Administrative Procedures Act, as follows:

(4) This chapter does not preclude an agency, prior to the beginning of an adjudicative proceeding, or the presiding officer during an adjudicative proceeding from:

(a)

(b) granting a timely motion to dismiss or for summary judgment if the requirements of Rule 12(b) or Rule 56 of the Utah Rules of Civil Procedure are met by the moving party, except to the extent that the requirements of those rules are modified by this chapter.

2. Rule 56(a) of the Utah Rules of Civil Procedure provides that summary judgment shall be rendered “if the moving party shows that there is no genuine dispute as to any material fact and the moving party is entitled to judgment as a matter of law.”

3. Facts and inferences to be drawn by the Commission in a summary judgment proceeding must be viewed in the light most favorable to the party opposing the summary judgment. *See Broadwater v. Old Republic Sur.*, 854 P.2d 527 (Utah 1993).

4. UCA §59-10-1103 provides guidance concerning a tax credit for a “pass-through entity taxpayer,” as follows in pertinent part:

. . . .

(2) A pass-through entity taxpayer may claim a refundable tax credit against the tax otherwise due under this chapter if that pass-through entity taxpayer is a:

(a) claimant;

(b) estate; or

(c) trust.

(3) The tax credit described in Subsection (2) is equal to the amount paid or withheld by the pass-through entity on behalf of the pass-through entity taxpayer described in Subsection (2) in accordance with Section 59-10-1403.2.

. . . .

5. UCA §59-10-1402 defines “pass-through entity” and “pass-through entity taxpayer,” as

3 The 2016 version of Utah law will be cited. Unless otherwise noted, the “Applicable Law” has remained the same since the 2014 tax year.

follows in pertinent part:

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- (10) "Pass-through entity" means a business entity that is:
 - (a) the following if classified as a partnership for federal income tax purposes:
 - (i) a general partnership;
 - (ii) a limited liability company;
 - (iii) a limited liability partnership; or
 - (iv) a limited partnership;
 - (b) an S corporation;
 - (c) an estate or trust with respect to which the estate's or trust's income, gain, loss, deduction, or credit is divided among and passed through to one or more pass-through entity taxpayers; or
 - (d) a business entity similar to Subsections (10)(a) through (c):
 - (i) with respect to which the business entity's income, gain, loss, deduction, or credit is divided among and passed through to one or more pass-through entity taxpayers; and
 - (ii) as defined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act.
 - (11) "Pass-through entity taxpayer" means a resident or nonresident individual, a resident or nonresident business entity, or a resident or nonresident estate or trust:
 - (a) that is:
 - (i) for a general partnership, a partner;
 - (ii) for a limited liability company, a member;
 - (iii) for a limited liability partnership, a partner;
 - (iv) for a limited partnership, a partner;
 - (v) for an S corporation, a shareholder;
 - (vi) for an estate or trust described in Subsection (10)(c), a beneficiary; or
 - (vii) for a business entity described in Subsection (10)(d), a member, partner, shareholder, or other title designated by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act; and
 - (b) to which the income, gain, loss, deduction, or credit of a pass-through entity is passed through.

....

6. UCA §59-10-1403⁴ provides guidance concerning the income tax treatment of a “pass-through entity,” as follows in pertinent part:

4 Effective May 9, 2017, Subsection 59-10-1403(2) was amended to read: “Except as provided in Section 59-10-1403.3, the income, gain, loss, deduction, or credit of a pass-through entity shall be passed through to one or more pass-through entity taxpayers as provided in this part.” This amendment was made in Senate Bill 158 (2017) (“SB 158”), in which the Utah Legislature also enacted UCA §59-10-1403.3 (2017),

- (1) Subject to Subsection (3), a pass-through entity is not subject to a tax imposed by this chapter.
- (2) The income, gain, loss, deduction, or credit of a pass-through entity shall be passed through to one or more pass-through entity taxpayers as provided in this part.
-

7. UCA §59-10-1403.2 provides for a pass-through entity to pay or withhold tax on behalf of a pass-through entity taxpayer, as follows in pertinent part:

- (1) (a) Except as provided in Subsection (1)(b), for a taxable year, a pass-through entity shall pay or withhold a tax:
 - (i) on:
 - (A) the business income of the pass-through entity; and
 - (B) the nonbusiness income of the pass-through entity derived from or connected with Utah sources; and
 - (ii) on behalf of a pass-through entity taxpayer.
-
- (2) (a) Subject to Subsection (2)(b), the tax a pass-through entity shall pay or withhold on behalf of a pass-through entity taxpayer for a taxable year is an amount:
 - (i) determined by the commission by rule made in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act; and
 - (ii) that the commission estimates will be sufficient to pay the tax liability of the pass-through entity taxpayer under this chapter with respect to the income described in Subsection (1)(a)(i) of that pass-through entity for the taxable year.
-

which provides as follows in pertinent part:

- (1) As used in this section:
 -
 - (b) "Qualifying excess withholding" means an amount that:
 - (i) is paid or withheld:
 - (A) by a pass-through entity that has a different taxable year than the pass-through entity that requests a refund under this section; and
 - (B) on behalf of the pass-through entity that requests the refund, if the pass-through entity that requests the refund also is a pass-through entity taxpayer; and
 - (ii) is equal to the difference between:
 - (A) the amount paid or withheld for the taxable year on behalf of the pass-through entity that requests the refund; and
 - (B) the product of 5% and the income, described in Subsection 59-10-1403.2(1)(a)(i), of the pass-through entity that requests the refund.
- (2) For a taxable year ending on or after July 1, 2017, a pass-through entity may claim a refund of qualifying excess withholding, if the amount of the qualifying excess withholding is equal to or greater than \$250,000.
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8. UCA §59-1-1410(8) provides the timeframes within which a taxpayer can generally request a refund or credit of taxes, as follows in pertinent part:

- (8) (a) Except as provided in Subsection (8)(b) or Section 19-12-203, 59-7-522, 59-10-529, or 59-12-110, the commission may not make a credit or refund unless a person files a claim with the commission within the later of:
 - (i) three years from the due date of the return, including the period of any extension of time provided in statute for filing the return; or
 - (ii) two years from the date the tax was paid.
- (b) The commission shall extend the time period for a person to file a claim under Subsection (8)(a) if:
 - (i) the time period described in Subsection (8)(a) has not expired; and
 - (ii) the commission and the person sign a written agreement:
 - (A) authorizing the extension; and
 - (B) providing for the length of the extension.

9. For the instant matter, UCA §59-1-1417(1) provides guidance on which party has the burden of proof, with limited exceptions as follows:

- (1) In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:
 - (a) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
 - (b) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and
 - (c) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income:
 - (i) required to be reported; and
 - (ii) of which the commission has no notice at the time the commission mails the notice of deficiency.

DISCUSSION

The primary issue is whether Utah law allows TAXPAYER to receive refunds of the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for the 2014, 2015, and 2016 tax years. There are no material facts in genuine dispute that would preclude the Commission from answering this question as a matter of law.

Subsection 59-10-1403.2(1)(a) requires a “pass-through entity” to pay or withhold a tax “on behalf of a pass-through entity taxpayer,” while Subsection 59-10-1103(2) allows a “pass-through entity taxpayer” to claim a refundable tax credit against the tax otherwise due under Title 59, Chapter 10 of the Utah Code. Both parties concede that COMPANY and TAXPAYER are both “pass-through entities” that withheld taxes on behalf of “pass-through entity taxpayers.” However, the parties disagree whether TAXPAYER is a “pass-through entity taxpayer” that can claim the credit authorized under Subsection 59-10-1103(2).

Prior to the enactment of SB 158, the law was ambiguous as to whether a “pass-through entity” (as defined in Subsection 59-10-1402(10)) that submitted withholding taxes on behalf of its partners, members, or shareholders was also considered to be a “pass-through entity taxpayer” (as defined in Subsection 59-10-1402(11)). Upon the enactment of SB 158, however, the Legislature removed any ambiguity concerning this issue by clarifying in Subsection 59-10-1403.3(1)(b)(i) (2017) that a “pass-through entity” may also be a “pass-through entity taxpayer.” As a result, TAXPAYER may be a “pass-through entity taxpayer” for the 2014, 2015, and 2016 tax years.

However, regardless of whether TAXPAYER is or is not a “pass-through entity taxpayer” for the 2014, 2015, and 2016 tax years at issue, the Commission is not prepared to find that TAXPAYER is entitled to claim a refund of the differences in taxes that COMPANY withheld on behalf of TAXPAYER and that TAXPAYER withheld on behalf of TAXPAYER shareholders for these years. In Subsection 59-10-1403.3(2) (2017), the Legislature made clear that the type of refund that TAXPAYER is seeking for the 2014, 2015, and 2016 tax years may only be refunded for “a taxable year ending on or after July 1, 2017.” The three tax years for which TAXPAYER is seeking a refund in this appeal ended on December 31, 2014, December 31, 2015, and December 31, 2016. Because all three tax years at issue ended before July 1, 2017, the plain language of Subsection 59-10-1403.3(2) (2017) provides that TAXPAYER is not entitled to receive the refunds it is seeking for the 2014, 2015, and 2016 tax years.

Appeal No. 18-417

DECISION AND ORDER

Based on the foregoing, the Commission denies TAXPAYER's Motion for Summary Judgment and grants Taxpayer Services Division's Cross-Motion.

DATED this _____ day of _____, 2018.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Appeal Rights: 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.