

State of Louisiana
Department of Revenue

JOHN BEL EDWARDS
Governor



KIMBERLY LEWIS ROBINSON
Secretary

November 27, 2019

Via E-mail/R.R.R. to:

apa.h-wm@legis.la.gov

The Honorable Neil Abramson, Chairman
House Committee on Ways & Means
P.O. Box 94062
Baton Rouge, Louisiana 70804

apa.s-r&f@legis.la.gov

The Honorable Jean-Paul J. Morrell, Chairman
Senate Committee on Revenue & Fiscal Affairs
P.O. Box 94183
Baton Rouge, Louisiana 70804

RE: Proposed Regulation LAC 61:I.1001- Election of Pass-Through Entities

Dear Chairman Abramson and Chairman Morrell:

On October 10, 2019, a copy of the *Notice of Intent* issued by the Department of Revenue ("Department") for promulgation of the proposed regulation, LAC 61:I.1001, *Election of Pass-Through Entities*, was sent to your committee for review. The primary purpose of this proposed regulation is to implement Act 442 of the 2019 Regular Legislative Session ("Act 442") and to provide for the following: 1) the procedure for how pass-through entities, who in order to elect to be taxed as C corporations for Louisiana income tax purposes, make such election, 2) a list of the documents that must be submitted by an electing entity with their election, 3) guidance to electing entities and their owners on how to file their income taxes, including all required additional documentation, and 4) the procedure for terminating the election.

The *Notice of Intent* was published in the October 2019 issue of the *Louisiana Register*. A public hearing was held on Tuesday, November 26, 2019. There were two attendees (excluding Department staff) at the public hearing (a copy of the sign-in sheet is included). Written comments were received from the Society of Louisiana Certified Public Accountants. No attendees made public comments at the hearing.

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617 North Third Street, Post Office Box 44098, Baton Rouge, Louisiana 70804-4098
Telephone (225) 219-2780 • Fax (225) 219-2759
www.revenue.louisiana.gov

Written Comments

Department Response to Comments from Attachment 1. Society of Louisiana Certified Public Accountants:

Summary of Comment #1: The language of the proposed regulation and the statute are not consistent as it relates to the entities eligible to make the election.

Response #1: The language cited in the comment is actually from the title of Act 442 and not the statute itself. As provided in LA R.S. 1:13(B), “...other words and phrases not contained in the section or sections of the bill following the enacting clause do not constitute part of the law.” The language of the regulation and the substantive language of the statute are, in fact, consistent. The Department does not intend to change the regulation based upon this comment.

Summary of Comment #2: The proposed regulation requires an election be made by the 15th day of the 4th month after the close of the taxable year to which the election is effective and the required documentation to accompany the election is extensive and may not be available by this date.

Response #2: The statute provides the deadline for filing a timely election and actually allows a taxpayer three options as to when to make the election: either during the preceding taxable year, during the taxable year, or on or before the 15th day of the fourth month after the close of the taxable year. The Department does not have the authority to extend the deadline beyond the statutory provisions. The statute and proposed regulation allow the Department to treat an election made after the 15th day of the 4th month after the close of the taxable year as timely upon evidence of reasonable cause. Additionally, all required documentation for the election is either (1) factual documentation such as a list of owners and other information or (2) documentation related to previous tax years for which tax returns should have already been filed by the due date for a timely election. The Department does not intend to change the regulation based upon this comment.

Summary of Comment #3: The documentation requirements for making the election as well as the documentation to be submitted with the electing company’s entity-level return are beyond the information required to effectively administer the statute and is burdensome on the electing entity and the Department. Specifically, the comment addresses the following:

- a. Some documentation such as a list of owners, their addresses, tax identification numbers and copies of the Federal S election forms should already be in the possession of the Department;
- b. Some entities may not have formation documents and the relevance of this information is unknown;
- c. The relevance of submitting audit reports is unknown; and
- d. Many electing entities are small businesses who may not have all the required documentation in the proposed regulation

Response #3: The documentation is necessary to ensure the organization and ownership of the entity in order to verify the election was authorized by the requisite percentage of ownership. The documentation required with both the election and the entity-level return enable the Department to ensure that taxes are filed and paid in accordance with the statute and allow the Department to, with some degree of accuracy, report to the Legislature the net impact to the state treasury as required by LA R.S. 47:1517 for all incentives, credits, deductions, etc. As discussed during legislative committee hearings during the 2019 Regular Session, the state revenue impact of this election is entirely unknown, but will have to be reported in the future.

The Department does not intend to change the regulation based upon this comment. Specifically, the Department responds to the illustrated concerns in this comment as follows:

- a. Certain documentation may have been previously submitted to the Department but is not readily available for review with this application. If the documentation is not already in the possession of the Department, the election approval process will be delayed pending submission of these documents by the electing entity.
- b. Any entity with limited liability protection, such as an LLC or LLP, must have a formation document on file with the Louisiana Secretary of State. Providing this documentation should not be burdensome.
- c. Audit reports as used in the proposed regulation are audited financial reports generally issued by a certified public accountant. The Department expects that the majority of these electing entities will not have previously filed Louisiana entity-level returns. Additionally, the electing entities may not be required to file federal entity-level returns. The purpose of the submission of audit reports ensures that the Department will have the necessary financial information to calculate the revenue impact to the state treasury in the event such information is not available from other required documentation.
- d. Many of the documentation requirements state the documents are required “if applicable”. If the electing entity does not have the documentation, the electing entity would inform the Department that such information is not applicable.

Summary of Comment #4: The comments include various additional points in an “Additional Questions” section such as:

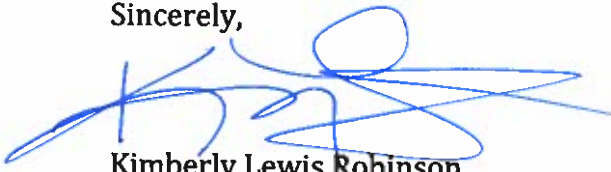
- a. the proposed regulation should include clarification/guidance on whether the election imposes any franchise tax obligation on the electing entities;
- b. the proposed regulation indicates that ownership interest is determined by capital account balances and that some electing entities such as S corporations might need guidance on how to calculate capital account balances; and

- c. the proposed regulation does not mention how the Department will acknowledge receipt and processing of the election form.

Response #4: The applicability of the franchise tax to an entity would be more appropriately addressed through other policy guidance. The Department has previously issued Revenue Rulings explaining the applicability of franchise tax to passthrough entities and plans to update that guidance to include entities making an election. The other comments raise procedural questions more appropriately answered in Revenue Information Bulletins. Thus, the Department does not feel a delay in the rule promulgation process is necessary to address these comments.

This report is made in accordance with LA R.S. 47:968(D)(1)(b) of the Administrative Procedure Act. The Department of Revenue has considered the public comments to the proposed regulation. After careful review and analysis of the public comments, the Department of Revenue has concluded such comments do not require a substantive change in the regulation as originally published. Therefore, unless otherwise directed, the proposed rule will be submitted for publication as a final rule in the January 2020 edition of the **Louisiana Register**. Should you have any questions or need additional information, please contact Danielle B. Clapinski, Attorney, Policy Services Division at danielle.clapinski2@la.gov or (225) 219-2784.

Sincerely,



Kimberly Lewis Robinson
Secretary

Enclosure