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## A Note from the Chair

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Donald Pike Edwards  
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**W**elcome to the State Bar of Georgia Taxation Law Section's Summer 2009 Newsletter. I would like to thank the Editorial Board for all of their work in assembling and editing the newsletter as well as for their contributions to its contents. This edition of the newsletter contains articles regarding recent significant developments in federal and state taxation. We hope that you find the articles to be timely, relevant and helpful to you in your practices in the area of tax law. We welcome any suggestions that section members have for future articles and encourage members to submit timely articles on taxation subjects for consideration.

The Taxation Law Section performs many functions for Georgia's tax lawyers which include providing continuing legal education, maintaining and strengthening relationships with the IRS and Georgia Department of Revenue, hosting social events for our members, and supporting local law schools with scholarships for outstanding tax law students. Additionally, the section also provides support to the Georgia State University Low-Income Tax Clinic which provides federal tax controversy resolution services to low-income taxpayers residing throughout the State of Georgia.

I encourage each of you to become more involved in the Taxation Law Section and ask that you be on the lookout for notices regarding upcoming Taxation Law Section events. ■

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## SUMMARY OF MAJOR 2009 GEORGIA CORPORATE INCOME TAX LEGISLATION

Clark R. Calhoun, Alston & Bird LLP  
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### Disallowance of Expenses Paid to Captive REITs (HB 379)

This bill adds a provision requiring corporations to add back any expenses paid to captive REITs. When computing taxable income, corporations must add back “all expenses paid and costs directly or indirectly paid, accrued or incurred to a captive [REIT].” Those expenses and costs must be added back before income is apportioned or allocated to Georgia. Taxpayers affected by this provision should examine the exceptions to the add-back to determine whether they might qualify.

The adjustment provided for in HB 379 is applicable to corporations filing separate returns as well as the separate taxable income computation for each member of a Georgia consolidated return. The bill is effective for all tax years beginning on or after January 1, 2010.

### Job Tax Credits (HB 438)

This bill significantly amends the existing job tax credit provisions of O.C.G.A. § 48-7-40.24. Under the prior provisions, these job tax credits were available for the creation of new manufacturing jobs. Under the new bill, all classes of businesses other than retail businesses are eligible for the credits.

Under the prior provisions, a taxpayer had to satisfy certain investment requirements (a minimum \$450 million investment) as well as job creation requirements (at least 1,800 full-time jobs within six years). Now a “qualified project” must satisfy the job creation requirement and either: (1) an investment requirement of at least \$450 million invested in the acquisition, construction, renovation, or expansion of facilities; or (2) a “payroll requirement,” which means that the new full-time employees are receiving at least \$150 million in annual Georgia W-2 payroll related to the enterprise’s project.

### Other Job Tax Credits (HB 439 & HB 485)

This bill expands several other provisions related to job tax credits and certain other credits. For the job tax credit provisions in O.C.G.A. §§

48-7-40 and 48-7-41, eligible business enterprises may begin taking the credits in the first year in which the enterprise creates new full-time employee jobs (and continue to take the credits for the immediately succeeding four years). For businesses engaged in a “competitive project”<sup>1</sup> in tier 2, 3, or 4 counties where the amount of the credit exceeds a certain percentage of the business’s income tax liability for the year, “the excess may be taken as a credit against such business enterprise’s quarterly or monthly payment under Code Section 48-7-103.” However, if an enterprise falls below the required net employment increase during a year in which it takes excess credits, then the business must forfeit those excess credits on its return for that year.

The bill amends provisions of several other statutory credit provisions: *Employee retraining credits under O.C.G.A. § 48-7-40.5*. An employer may take credits for multiple retraining programs completed by an employee, but such “retraining” programs shall not include retraining on mass-produced commercial software (e.g., Microsoft Excel).

*Qualified research expense credits under O.C.G.A. § 48-7-40.12*. The “base amount” against which expenses are measured is now measured by the enterprise’s Georgia gross receipts for the year instead of net income. Additionally, the bill eliminates the requirement that a taxpayer must have had positive taxable income for the three years preceding the taking of the credits. This change effectively overrules *Georgia Department of Revenue v. Georgia Chemistry Council, Inc.*, 270 Ga. App. 615 (2004), which upheld the validity of a regulation requiring three years of positive income to be eligible for the credits.

*Port traffic credits under O.C.G.A. § 48-7-40.15*. For all taxable years beginning on or after January 1, 2010, the base year will be the “second preceding 12 month period” instead of the 1997 calendar year. The bill also clarifies that port traffic includes products “imported into this state or exported out of” Georgia.

*Port traffic credits under newly enacted O.C.G.A. § 48-7-40.15A*. For certain qualifying business enterprises located in less economically developed (tier two or tier three) Georgia counties, a job tax credit of \$1,250 may be taken for a specified increase in their port traffic of products. If the increase in port traffic of products reaches a specified benchmark, the jobs tax credit of newly enacted § 48-7-40.15A and that of § 48-7-40.15 may both be taken if the business enterprise otherwise qualifies for both.

<sup>1</sup> A project is a “competitive project” if the commissioner of economic development certifies that “but for some or all of the tax incentives” provided, the business enterprise would have located or expanded outside Georgia.



Georgia's "headquarters" credit. Under the prior version of the headquarters credit in O.C.G.A. § 48-7-40.17, taxpayers could receive credits for the creation of new full-time jobs in Georgia in conjunction with the establishment or relocation of the taxpayer's "headquarters" into Georgia. The amended statute now makes no reference to a taxpayer's "headquarters" and is essentially an alternative job tax credits provision. Thus, the Section 48-7-40.17 credits are available for the creation of new "quality" jobs that were not already located in Georgia, without regard to the taxpayer's "headquarters." ■

## You Gotta Know When To (With)hold 'Em

Ashley F. Giles, *Ernst & Young LLP*  
Pamela L. Mable, *Ernst & Young LLP*

On December 8, 2008, IRS Commissioner Douglas Shulman announced that "U.S. Withholding Taxes" would be added to the Service's list of Tier I issues. In January, 2009, the Service clarified Commissioner Shulman's announcement by posting "U.S. Withholding Agents - §1441: Reporting and Withholding on U.S. Source FDAP Income" to its Tier I issue list.

Tier I issues are those that the Service believes pose the highest compliance risk across multiple industries and generally include large numbers of taxpayers, significant dollar risk, substantial compliance risk, or are high visibility. Once an issue is designated as Tier I, Service-wide coordination and executive oversight is required to ensure appropriate examination coverage and a consistent approach to the development and resolution of the issue. An Issue Management Team with an executive champion has been identified to oversee the development of withholding tax examinations, and there will likely be mandatory risk assessment of withholding tax issues. Taxpayers, therefore, should understand whether they are "withholding agents" and the responsibilities that come with being one.

Under I.R.C. §§ 871(a) and 881, nonresident aliens and foreign corporations are generally subject to a 30% withholding tax on certain U.S. source "fixed or determinable, annual or periodical" ("FDAP") income. I.R.C. §§ 1441 and 1442 impose a requirement on "withholding agents" to withhold the tax and pay it to the U.S. government. The withholding agent is liable if they do not withhold and pay over the proper amount. A "withholding agent" is anyone having control, receipt, custody, disposal, or payment

responsibilities of any of the items of income subject to withholding. See I.R.C. § 1441(a) and Treas. Reg. § 1.1441-7(a)(1).

A withholding agent is generally required to withhold 30% of an amount paid if: (1) there is a payment made to a foreign person; (2) the amount paid is FDAP income; (3) the FDAP income paid is U.S. source income; and (4) the amount paid is not effectively connected with the conduct of a U.S. trade or business (ECI). The standard 30% withholding rate may be reduced or eliminated by an applicable treaty or by other Internal Revenue Code provisions. FDAP income includes interest, dividends, rents, royalties, salaries, wages, premiums, and annuities; however, FDAP income generally does not include capital gains.

Withholding agents are required to file IRS Forms 1042 and 1042-S to report payments of FDAP income to foreign persons and to remit the required withholding tax. These forms are filed

### Upcoming Events

On December 3, 2009, the section will hold a one-day seminar on hot topics in dealing with the IRS, including recent developments in audits and appeals. Recent developments related to the work-product doctrine (*Textron*) and foreign bank account reporting (the FBAR rules) will be discussed. CLE will include trial practice and ethics credits. Location will be the State Bar of Georgia headquarters.

*For more information, call ICLE at 770.466.0886 (Atlanta) or (800) 422.0893 (outside Atlanta).*

even if an exception to the applicable withholding rate applies (for example, where the amount paid is ECI or where a treaty reduces or eliminates the withholding rate). Withholding agents are also required to maintain proper documentation to substantiate any reduction or elimination of the withholding rate.

The Service's examiners have a roadmap to audit withholding tax issues. Prior to adding U.S. Withholding Taxes to its list of Tier I issues, the IRS published Internal Revenue Manual ("IRM") provision 4.10.21, "U.S. Withholding Agent Examinations – Form 1042." Before the release of that IRM provision, the IRS typically focused its withholding tax examinations on financial institutions; however, with the new IRM provision, procedures are now in place to also examine non-financial institutions, including multi-national corporations ("MNC").



IRM 4.10.21 identifies certain industries as “likely” to have withholding and reporting requirements, though the list provided is not exhaustive. The industries listed include professional services providers (e.g., law, accounting, architecture), high tech industries (e.g., computer software and hardware providers, medical equipment), intellectual products providers (e.g., entertainment industry, publishing industry), the pharmaceutical industry, and the real estate industry. During MNC withholding examinations, the examiner will apply a three-step process to determine the taxpayer’s compliance with its obligations: (1) identify payments made to foreign vendors; (2) determine if the payment constitutes FDAP; and (3) determine if the FDAP income is U.S. source.

Regulatory presumptions in this area are generally unfriendly to taxpayers. So, for example, if a taxpayer does not know whether the income is U.S. source and lacks documentation to show that there is a reduced tax rate, the income is presumed to be U.S. source and the examiner will apply the 30% withholding tax rate. The withholding agent may, however, correct any deficiencies by obtaining the necessary documentation.

IRS examiners are further instructed to request and review the taxpayer’s written withholding procedures and processes and to assert penalties where appropriate. Additionally, examiners are instructed to review IRS Forms 5471 and 5472 for payments that may give rise to withholding requirements and to look for discrepancies between those forms and any Forms 1042 or 1042-S. ■

## Georgia’s Recognition of IRC § 338(h)(10) Election to be Reviewed by State Supreme Court

*By Timothy L. Fallaw II, Alston & Bird LLP*

On June 29, 2009, the Supreme Court of Georgia granted certiorari to review the Court of Appeals’ decision in *Trawick Construction Co. Inc. v. Department of Revenue*. Case No. S09G1045. The Supreme Court will review the lower court’s decision issued on February 23, 2009, holding that a federal election made under IRC § 338(h)(10) by non-resident shareholders of a federal Subchapter S corporation is effective for Georgia state income tax purposes, and that Georgia may therefore tax the gain reported by the S corporation for federal tax purposes as a result of the fictional sale of its assets.

The basic facts of the case are as follows: Trawick Construction Co., Inc. (“Trawick”) was a Florida S-corporation doing business in Georgia and other Southeastern states. The Trawick shareholders, all members of the Trawick family and all Florida residents, sold the outstanding shares of the company to Quanta Services, Inc. (“Quanta”) in 1999. The Trawick shareholders and Quanta agreed to make the federal Section 338(h)(10) election and thereby treat the stock sale as an asset sale for federal income tax purposes.

Because the Trawick shareholders were not subject to tax in Georgia, Trawick was treated as a C corporation for Georgia state income tax purposes under O.C.G.A. § 48-7-21(b)(7). On its Georgia corporate income tax return for 1999, Trawick treated the gain realized for federal income tax purposes from the deemed sale of its assets under Section 338(h)(10) as income allocable outside Georgia. The Commissioner issued an assessment treating the \$29 million gain from the deemed asset sale as business income apportionable to Georgia. Trawick appealed the assessment to the Office of State Administrative Hearings, and the ALJ ultimately recommended that the Commissioner withdraw his assessment based on a number of determinations, including that an election by Trawick’s shareholders under IRC § 338(h)(10) was not an election by Trawick that could be respected for Georgia income tax purposes under O.C.G.A. § 48-7-21(b)(7).

The Commissioner declined to follow the ALJ’s recommendation, and issued a final decision against Trawick on the basis that the IRC § 338(h)(10) election made by Trawick’s shareholders and Quanta was to be respected for Georgia tax purposes under O.C.G.A. § 48-7-21(b)(7). Trawick appealed, and on March 4, 2008, the Fulton County Superior Court reversed the Commissioner’s final decision, holding that O.C.G.A. § 48-7-21(b)(7) must be interpreted to recognize for Georgia income tax purposes only those federal tax elections “made by the corporate taxpayer obligated to file the return and pay the tax [to Georgia].” Opinion (Mar. 4, 2008), at p. 9. Thus the Court held that because Trawick—the Georgia corporate taxpayer whose tax liability was at issue—did not make the IRC § 338(h)(10) election (its shareholders and Quanta did), the election could not be respected for Georgia tax purposes under a plain reading of O.C.G.A. § 48-7-21(b)(7).

The Court of Appeals reversed the decision of the Superior Court, holding that although “only Trawick’s shareholders and Quanta could make the election as a matter of law . . . it is undisputed that Trawick joined in making the election as a matter of fact.” Opinion



at p. 11. In addition, the Court of Appeals held that even though the Section 338 election in this case was entirely “conditioned upon the prior existence of a Subchapter S election” (the latter of which is not recognized for Georgia tax purposes under O.C.G.A. § 48-7-21(b)(7)), the former election was to be recognized in computing Trawick’s Georgia income tax liability.

The Georgia Supreme Court granted certiorari to review the specific question of “What are the Georgia corporate tax implications of an election under Internal Revenue Code (“IRC”) § 338(h)(10) by the shareholders of a federal sub-chapter S corporation.” The case has been assigned to the Supreme Court’s October 2009 oral argument calendar. ■

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## New Property Tax Appeal Procedure Effective in 2009

*Mary T. Benton, Alston & Bird LLP*

One of the more significant pieces of property tax legislation enacted during the past legislative session establishes a new path to appeal property tax assessments for real property where valuation is at issue – binding arbitration – and it is applicable to all property tax appeals filed after the effective date (SB 240 – effective April 29, 2009).

### The Appeal

Under the new statute – § 48-5-311(f)(4) – the taxpayer has the option to appeal a notice of assessment where the value of the real property is at issue, to binding arbitration. The appeal is effected by filing a written notice electing binding arbitration that specifically states the grounds therefor, with the county board of tax assessors.

### Certification Process

Within 30 days of filing the appeal, and before an arbitrator is appointed, the taxpayer must provide to the BTA a copy of the value certified by a professional real estate appraiser. The BTA has 30 days to consider the appraisal and if it accepts the appraisal, that value becomes the final value. If the BTA rejects the appraisal, then it must certify the appeal, within 30 days, to the Superior Court. The judge will issue an order authorizing arbitration within 15 days of certification.

## Arbitration Procedure

Specific procedures govern the arbitration. The parties may select and agree to a single arbitrator. However, if the parties cannot agree on an arbitrator, one will be chosen for the parties by the chief judge. A qualified arbitrator must be classified as a State Certified General Property Appraiser.

Within 30 days of appointment, the arbitrator will set the time and place for the hearing and provide written notice to the parties. The

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## City of Atlanta Business Tax License

This summer and fall, the City of Atlanta is sending out revenue agents to every business location in the city to verify that each business is current on its business tax license. For those locations found not to have a valid and current license, the City is writing arrest citations and requiring a company representative to appear in court to plead to the charge, pay a fine of approximately \$1,400, and then pay the tax (with interest and penalties) for any year in which the business did not have a valid business tax license. If a business registers for the tax and pays any back taxes before the City’s agents come to audit the location, the business can avoid the citation and may be able to avoid the corresponding fines and penalties. Forms and information related to filing are available on the City’s website at [www.atlantaga.gov/government/finance/treasury\\_091903.aspx](http://www.atlantaga.gov/government/finance/treasury_091903.aspx). ■

arbitrator may postpone the arbitration hearing, but the chief judge may direct the arbitrator to promptly hold the hearing upon petition by a party. At the hearing, the parties can present documents, testimony and cross-examine witnesses. A record must be maintained, and the proceedings may be transcribed.

### The Decision

At the conclusion of the hearing, the parties must submit a single value to the arbitrator. Within 30 days of the hearing, the arbitrator must render a decision by selecting one of the two values submitted based upon the evidence presented. The party whose value is



not selected by the arbitrator bears the responsibility for fees and costs of the arbitrator.

### Related Procedural Issues

The statute provides that the county has the burden of proving its value by a preponderance of the evidence and that the provisions of O.C.G.A. § 48-5-299 apply to the value determined by the arbitrator (so under O.C.G.A. § 48-5-299(c) the value would hold for the current year and two subsequent years under the terms of the subsection). Bills issued prior to a determination are based on the higher of the taxpayer's return value or 85% of the current value determined by the BTA. The arbitrator's decision rendered pursuant to this binding arbitration procedure may not be appealed.

### Three Appeal Methods

With the enactment of this binding arbitration procedure, there are now three methods of appeal to consider when a taxpayer does not agree with the value established by the BTA for a taxpayer's real property: (1) appeal to the BTA and then to the Board of Equalization if the BTA makes no change or the taxpayer is not satisfied with the change (O.C.G.A. § 48-5-311(3)); (2) appeal to arbitration under O.C.G.A. § 48-5-311(f)(1)-(3), which decision may be appealed to the Superior Court; and (3) binding arbitration under the new provisions of § 48-5-311(f)(4). In essence, a taxpayer may go before the BOE and then appeal to the Superior Court, or a taxpayer may bypass the BOE through either binding or non-binding arbitration under the auspices of the superior court.

### Effective Date

The new binding arbitration method is available for all appeals filed after April 29, 2009, and should be seriously considered by taxpayers disputing the value of their real property based on 2009 notices of assessment, where the appeal deadline is subsequent to April 29, 2009. ■

### Newsletter Editorial Board

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