Instructions for 2017 Schedule 4W: Wisconsin Subtractions from Federal Income

Purpose of Schedule 4W

Corporations complete Schedule 4W to report subtraction modifications that are needed to account for differences between taxable income under Wisconsin law and under federal law. The corporation files Schedule 4W with its Wisconsin Form 4.

Line-by-Line Instructions

■ **Line 1. Wisconsin Subtraction Modification for Dividends –** Enter the total from line 4 of Schedule 4Y. See the Schedule 4Y instructions for an explanation of dividends that are eligible for the subtraction.

■ **Line 2. Related Entity Expenses –** If the corporation made an addition modification for related entity expenses on Schedule 4V, line 3, this is where you report the amount that qualifies for a deduction. Enter the amount of the expenses from Schedule 4V, line 3, that are deductible using the criteria described in *Conditions for Deducting Related Entity Expenses*, below.

For corporations that are partners, members, or beneficiaries of pass-through entities, also include the amount of allowable related entity expense reported on line 21b of Schedule 3K-1 and on line 14b of Schedule 2K-1, as applicable.

Conditions for Deducting Related Entity Expenses. Section 71.80(23)(a)3., Wis. Stats., provides that a related entity expense that was added back on Schedule 4V, line 3, qualifies for a deduction if all of the following conditions are met:

- The primary motivation for the transaction was one or more business purposes other than the avoidance or reduction of state income or franchise taxes;
- The transaction changed the economic position of the taxpayer in a meaningful way apart from tax effects; and
- The expenses were paid, accrued, or incurred using terms that reflect an arm's length relationship.

Factors that may indicate that the expense does not qualify for a deduction include the following:

- There was no actual transfer of funds from the taxpayer to the related entity, or the funds were substantially returned to the taxpayer, either directly or indirectly.
- If the transaction was entered on the advice of a tax advisor, the advisor's fee was determined by reference to the tax savings.
- The related entity does not regularly engage in similar transactions with unrelated parties on terms substantially similar to those of the subject transaction.
- The transaction was not entered into at terms comparable to arm's length as determined by Treas. Reg. 1.482-1(b).
- There was no realistic expectation of profit from the transaction apart from the tax benefits.
- The transaction resulted in improper matching of income and expenses.
- An expense for the transaction was accrued under FIN 48.

The statutes (sec. 71.80(23)(a)1. and 2., Wis. Stats.) provide some additional conditions under which a related entity expense may qualify for a deduction, subject to some important exceptions. Those conditions are:

- If the expense was paid to a related entity that is merely acting as a conduit between the taxpayer and an unrelated entity, or
- If the related entity was subject to a tax measured by net income or receipts and the net income or receipts of the transaction were included in its tax base.

More Information on Related Entity Expenses. For more information on the deductibility of related entity expenses, see the Schedule RT instructions. Even if you weren't required to file Schedule RT for the expenses you added back on Schedule 4V, the instructions to Schedule RT provide helpful information regarding deductibility of related entity expenses.

■ **Line 3. Income from Related Entities Whose Expenses Were Disallowed –** If the corporation has income from a related entity which paid, accrued, or incurred expenses to the corporation, and that related entity could not deduct those expenses according to the instructions for line 2, the corporation may subtract the corresponding income from its taxable income.

In order to claim a subtraction on line 3, the corporation must obtain Schedule RT-1 from the related entity and submit Schedule RT-1 with Schedule 4W. See the Schedule RT-1 instructions for further details.

■ **Line 4. Subpart F Income –** Enter income from controlled foreign corporations under Subpart F of the Internal Revenue Code as reported on Form 1120, Schedule C, line 14.

■ **Line 5. Foreign Dividend Gross-Up –** Enter foreign dividend gross-up reported on Form 1120, Schedule C, line 15.

■ **Line 6. Nontaxable Income –** Enter nontaxable income included in computing federal taxable income. Include a schedule with your return showing the payers and amounts of nontaxable income and explaining why that income isn't taxable.

Interest, dividends, and capital gains from the disposition of intangible assets are nontaxable if both of the following are true:

- The operations of the payer are not unitary with those of the payee, and
- The payer and payee are not related as parent company and subsidiary or affiliates and the investment activity from which the income is received is not an integral part of a unitary business.

Income may also be nontaxable under the principles of the U.S. Supreme Court decision in *Allied-Signal v. Director, Div. of Taxation*, 504 U.S. 768 (1992), if the investment is passive and does not serve an operational function.

For corporations subject to the Wisconsin income tax rather than the franchise tax, nontaxable income also includes interest on United States government obligations.

CAUTION: Expenses related to nontaxable income aren't deductible and must be added to federal taxable income on Schedule 4V, line 5.

■ **Line 7. Foreign Taxes –** Enter foreign taxes paid or accrued during the year, but only if the income on which the tax is based is included in Wisconsin taxable income. Do not enter amounts that were deducted from federal taxable income or amounts included on Schedule 4W, line 5.

■ **Line 8. Cost Depletion –** For taxable years beginning on or after January 1, 2014, Wisconsin allows percentage depletion, so an adjustment is generally not required.

■ **Line 9. Basis, Section 179, Depreciation Difference, Amortization of Assets –**
Difference in federal and Wisconsin basis of depreciated or amortized assets:

Starting with the first taxable year beginning in 2014, adjustments are to be made over a 5-year period for the difference between the Wisconsin adjusted basis and the federal adjusted basis of assets owned on the last day of the taxable year beginning in 2013. The assets must have been depreciated or amortized for both Wisconsin and federal tax purposes. As a result of these adjustments, the Wisconsin adjusted basis and the federal adjusted basis of these assets is deemed to be equal on the first day of the taxable year beginning in 2014.

You must first determine the difference between the Wisconsin adjusted basis and the federal adjusted basis of all assets that are being depreciated or amortized on the last day of your taxable year beginning in 2013. This would be on December 31, 2013, if you file your tax return on a calendar-year basis.

If the total federal adjusted basis of the assets is less than the total Wisconsin adjusted basis, a subtraction must be claimed to adjust for this difference. As result of this subtraction, your Wisconsin adjusted basis of all depreciated or amortized assets on the first day of your taxable year beginning in 2014 (January 1, 2014, for calendar-year filers) will be the same as the federal adjusted basis.

Note: If the total Wisconsin adjusted basis is less than total federal adjusted basis, see the instructions for Schedule 4V, line 6.

Worksheet for Difference in Basis
(Keep for your records)

1. Combined Wisconsin adjusted basis of all depreciated and amortized assets as of the last day of the taxable year beginning in 2013………………..._______________
2. Combined federal adjusted basis of all depreciated and amortized assets as of the last day of your taxable year beginning in 2013…………….…._______________
3. Subtract line 2 from line 1……..…_______________
4. Multiply line 3 by .20 (20%). This is your subtraction for 2017……..…_______________

Also enter the amount by which the Wisconsin deduction for depreciation or amortization exceeds the federal deduction for depreciation or amortization. Include a schedule showing the computation details.

These differences can happen because of IRC sections not adopted for Wisconsin purposes and electing a different depreciation method under the Internal Revenue Code in effect for Wisconsin purposes.

■ **Line 10. Basis Differences –** Enter the amount by which the Wisconsin basis of assets disposed of exceeds the federal basis. See the instructions for Schedule 4V, line 7, for an example. Provide a schedule showing the computation details.

■ **Line 11. Federal Work Opportunity Credit Wages –** Enter wages that aren't deductible in computing federal income because they are being used in computing the federal work opportunity tax credit.

■ **Line 12. Federal Research Credit Expenses –** Enter research expenses that aren't deductible in computing federal income because they are being used in computing the federal credit for increasing research activities.

■ **Line 13. Other Subtractions –** Enter any other subtractions from federal income that are not specifically listed in lines 1-12 above, except for the insurance company adjustment, which is reported on line 14.

CAUTION: Do not enter subtractions on line 13 that are specifically designated on lines 1 -12 above. For example, if a depreciation adjustment is passed through from a partnership on Schedule 3K-1, enter the amount on Schedule 4W, line 9, not on line 13.

These other subtractions may include:

- Adjustments required as a result of changes made to the Internal Revenue Code which don't apply for Wisconsin.
- Adjustments required as a result of making different elections for Wisconsin and federal purposes.
- Separately stated items of expense and adjustments for differences between the federal and Wisconsin treatment of any items of an S corporation that opts out of Wisconsin tax-option status.
- For credit unions, an adjustment to remove income from non-public deposits from Wisconsin income as described in the instructions to Schedule CU-1.
- The amount of net income of an out-of-state business from performing disaster relief work. See Publication 411 – *Disaster Relief*, for more information

■ **Line 14. Nontaxable Income from Life Insurance Operations –** If the corporation is an insurance company that has both life insurance operations and nonlife insurance operations, enter the amount of nontaxable income from life insurance operations as computed on Schedule 4I, line 13. See the Schedule 4I instructions for details.

Additional Information and Assistance

Web Resources. The Department of Revenue has a web page with a library of common questions on general business tax topics, available at: revenue.wi.gov/faqs/index.html

Contact Information. If you cannot find the answer to your question in the resources available on the Department of Revenue's web page, contact the Department using any of the following methods:

- E-mail your question to: revenue.wi.gov/Pages/ContactUs/dorhelp.aspx?subject=dorfranchise
- Call (608) 266-2772
  (Telephone help is also available using TTY equipment. Call the Wisconsin Telecommunications Relay System at 711 or, if no answer, (800) 947-3529. These numbers are to be used only when calling with TTY equipment.)
- Send a fax to (608) 267-0834
- Write to the Audit Bureau, Wisconsin Department of Revenue, Mail Stop 3-107, PO Box 8906, Madison, WI 53708-8906