

EXPLANATION OF TAX PROVISIONS IN BUDGET BILL

INCOME TAX

1. Update Reference to Internal Revenue Code to December 31, 1980 for Individuals, Estates and Trusts (Amend 71.02(2)(b)6, create 71.02(2)(b)7, effective for 1981 taxable year and thereafter.)

For the taxable year 1981 and thereafter, individuals, estates and trusts will use the Internal Revenue Code in effect on December 31, 1980 with certain exceptions. Examples of such exceptions include:

- (a) Child and dependent care expenses and political campaign contributions will remain an itemized deduction for Wisconsin rather than being a credit as for federal purposes.
- (b) Pollution control facilities must be depreciated over the useful life of the facility for Wisconsin; however, a special one year write-off provision will still be available for such facilities under s. 71.05(1)(h) or (i), Wis. Stats. (For federal, the cost of certain pollution control facilities may be amortized over a five year period.)
- (c) The foreign earned income exclusion of \$15,000 remains in effect for Wisconsin, with no deduction allowed for excess living costs. (For federal, a U.S. citizen working abroad may claim a deduction for excess foreign living costs.)
- (d) Educational assistance plan benefits must be included in Wisconsin taxable income, but the employe may claim an educational expense deduction if the education maintains or improves skills needed in the present job and does not qualify the employe for a new trade or profession. (For federal, benefits received by an employe under an employer's qualified educational plan may be excluded from the employe's federal gross income.)

NOTE: The \$200 exclusion for interest and dividends, which was enacted by the U.S. Congress in 1980 in section 404 of federal Public Law 96-223, will apply to Wisconsin for the 1981 taxable year, however, it will not apply for the 1982 taxable year and thereafter. For 1982 and thereafter, the \$100 dividend exclusion (with no exclusion for interest) will apply.

For federal purposes, single taxpayers may exclude up to \$200 of interest and dividends. Married persons filing a joint federal return may exclude up to \$400 of interest and dividends, regardless of which spouse received the interest and dividends. If married persons file separate federal returns, the exclusion for each spouse is limited to \$200 of interest and dividends received by that spouse. For Wisconsin purposes for 1981, married persons will have to compute the exclusion as if they filed separate federal returns, with each spouse limited to a \$200 exclusion.

2. Rent Credit Changed (Amend 71.53(1)(d), effective for 1981 taxable year and thereafter.)

The rent credit may be based on only rent paid for a person's principal residence and contiguous land. Also, rent paid which is deductible as a trade or business expense may not be used in determining the 12% rent credit.

3. Work Requirements Changed for Child Care Deduction (Amend 71.02(2)(b)6, create 71.02(2)(b)7, effective for 1981 taxable year and thereafter.)

An itemized deduction for work-related child and dependent care expenses will be available to individuals who are employed (including self-employment) on only a part-time basis during the month such expenses are incurred. In the case of married couples, child and dependent care expenses may also be deducted when only one spouse is employed (full-time or part-time), provided the nonworking spouse is a full-time student during at least 5 months of the taxable year.

Under prior law it was necessary for single persons and married couples (both spouses) to work at least on a three-quarter time basis during a month to qualify to deduct work-related child and dependent care expenses.

4. Prorate Personal Exemption Credits on Basis of Months (Amend 71.09(6p)(d)1, effective for 1981 taxable year and thereafter.)

Part-year residents will prorate their personal exemption credits on the basis of the number of months (days were used under prior law) of the taxable year that they were domiciled in Wisconsin. Any month during which a part-year resident is domiciled in Wisconsin for 15 days or more will be considered a full month for purposes of this proration.

5. Define "Gross Income" Relating to Requirements to File a Tax Return (Create 71.10(2)(d), effective for 1981 taxable year and thereafter.)

Existing law in s. 71.10(2) provides that a person must file a Wisconsin income tax return if his or her income exceeds a certain level. The new law in s. 71.10(2)(d) defines gross income which in effect means all income, from whatever source derived and in whatever form realized, whether in money, property, or services, which is not exempt from Wisconsin income tax.

6. Writ of Mandamus to File a Tax Return (Create 71.11(40m), amend 783.07, effective July 31, 1981.)

If a person, including an officer of a corporation, required by Wisconsin law to file a tax return fails to file a return within 60 days after the time required and refuses to file a return within 30 days after being requested by the Department of Revenue to file, the Department of Revenue may petition the Circuit Court to issue a writ of mandamus. Upon receipt of such petition, the Circuit Court shall issue a writ of mandamus requiring that person to file a tax return. Such person shall then respond to the writ of mandamus within 20 days after receiving service of such writ of mandamus. The petition shall be determined by the 20th day or on a later date as the Court determines, having regard for the speediest possible determination of the case.

The petition for a writ of mandamus filed by the Department shall be in the county in which the taxpayer resides.

If a person, without just excuse, refuses or neglects to file a return as instructed by the Court, the Court may impose up to a \$5,000 fine or imprisonment up to 5 years.

The department's filing of a petition for a writ of mandamus does not relieve the taxpayer from any other penalties prescribed by law.

7. Define Terms for Declaration of Estimated Tax (Create 71.21(1m), effective July 31, 1981.)

The terms "tax shown on the return" and "tax for the taxable year" as used in s. 71.21 (relating to declaration of estimated tax and addition to tax penalty for individuals) mean the net tax after reduction for exemptions and credits but before reduction by amounts withheld under s. 71.20 and before reduction for amounts paid as declarations of estimated tax.

For purposes of s. 71.21(16) (relating to an exception to the addition to tax penalty), "tax computed" means net tax after reduction for personal exemption credits and for a prorated amount of all credits shown on the return but before reduction for amounts withheld under s. 71.20 or amounts paid as declarations of estimated tax. The proration for tax credits shall be based on a fraction, the numerator of which is the number of months in a taxable year that end before the month in which the installment is required to be paid and the denominator of which is 12.

8. Exempt Income of Certain Trust Accounts of Nonresidents (Amend 71.07(7)(b)2, effective for 1981 taxable year and thereafter.)

The following trusts shall be considered to be administered in the state of domicile of the corporate trustee (person in whom power is invested to administer the trust) of the trust at any time that the grantor (person who creates the trust) of the trust is not a resident of Wisconsin:

- (a) Trusts that have any assets invested in a common trust fund (as defined in section 584 of the Internal Revenue Code) maintained by a bank or trust company domiciled in Wisconsin that is a member of the same affiliated group (as defined in section 1504 of the Internal Revenue Code, which means 80% ownership test, etc.) as the corporate trustee.
- (b) Trusts the assets of which in whole or part are managed, or about which investment decisions are made, by a corporation domiciled in Wisconsin if that corporation and corporate trustee are members of the same affiliated group, as defined in section 1504 of the Internal Revenue Code.

As an example, a resident of Arizona (grantor) establishes a trust in an Arizona affiliate of a Wisconsin bank, however, all of the administration of the trust occurs at the Wisconsin bank. This new law provides that the trust is considered to be domiciled in Arizona (state of domicile of trustee), while under prior law the trust was considered domiciled in Wisconsin (the state in which the trust is actually administered).

9. Defer Gain on Sale of Residence - Replacement Outside of Wisconsin
(Amend 71.05(1)(a)5, effective for 1982 taxable year and thereafter.)

Section 1034(a) of the Internal Revenue Code provides that part or all of the gain from the sale of a person's principal residence may be deferred if a replacement home is purchased within a certain period of time and other requirements are met. Prior Wisconsin law provided that if a residence was sold and the replacement residence was located outside Wisconsin, a gain deferred under section 1034(a) had to be included in Wisconsin income.

The new Wisconsin law provides that, beginning with the 1982 taxable year, any deferred gain under section 1034(a) will not have to be included in Wisconsin taxable income even though the replacement residence is located outside Wisconsin.

10. 5% Minimum Tax (Create 71.60, effective for 1981 taxable year and thereafter.)

A 5% minimum tax will be imposed on a natural person, trust and estate if the total of tax preference items and adjusted itemized deductions of the person, trust or estate exceeds \$10,000. The rate of tax is 5%. The tax is payable by the due date for filing the person's, trust's or estate's income tax return.

The minimum tax will be computed as follows:

- (a) Add:
 - (1) Tax preference items
 - (2) Adjusted itemized deductions

- (b) Less: \$10,000

- (c) Subtotal (Amount subject to minimum tax)

- (d) x 5% (multiply 5% times subtotal)

- (e) Amount of Minimum Tax

Tax preference items: The following are tax preference items for purposes of the minimum tax.

- Accelerated depreciation on section 1250 property (Internal Revenue Code section 57(a)(2))
- Accelerated depreciation on leased section 1245 property (Internal Revenue Code section 57(q)(3))
- Bargain element in stock options (Internal Revenue Code section 57(a)(6))
- Depletion (Internal Revenue Code section 52(a)(8))
- Intangible drilling costs (Internal Revenue Code section 57(a)(11))

For partnerships, each partner must include his or her distributive share of partnership deductions that are tax preference items. For shareholders of Sub. S, a shareholder must include his or her proportionate share of corporation deductions that are tax preference items. Tax preference items for part-year residents include only those items which relate to income received while a resident of Wisconsin, income received while a nonresident of Wisconsin but allocable to Wisconsin under s. 71.07, Wis. Stats., and Wisconsin itemized deductions as defined in s. 71.02(2)(f), Wis. Stats. Tax preference items for nonresidents include only those items which relate to income allocable to Wisconsin under s. 71.07, Wis. Stats., income relating to property located in Wisconsin and itemized deductions as defined in s. 71.02(2)(f), Wis. Stats.

Adjusted Itemized Deductions: For purposes of the minimum tax, "adjusted itemized deductions" is computed as follows:

- (a) Total Wisconsin itemized deductions claimed by taxpayer
- (b) Less: Casualty and theft losses deducted as an itemized deduction under Internal Revenue Code section 165(c)(3)
- (c) Less: Medical and dental expenses deducted as an itemized deduction under Internal Revenue Code section 213
- (d) Subtotal (This amount may not be greater than 100% of Wisconsin adjusted gross income.)
- (e) Less: 60% of Wisconsin adjusted gross income
- (f) Adjusted itemized deductions (line (d) minus line (e))

Example 1: For 1981, taxpayer claimed itemized deductions of \$29,500. Casualty and theft losses and medical and dental expenses deducted amounted to \$1,640. Taxpayer reported \$41,000 of Wisconsin adjusted gross income. Adjusted itemized deductions would be determined as follows:

\$29,500	Total Wisconsin Itemized Deductions
(1,640)	Less: Casualty & Theft Losses and Medical & Dental Expenses Deducted
\$27,860	Subtotal
(24,600)	Less: 60% of Wisconsin Adjusted Gross Income (\$41,000 x 60%)
<u>\$ 3,260</u>	Adjusted Itemized Deductions

Example 2: Assume the same facts as in Example 1, except taxpayer reported \$27,000 of Wisconsin adjusted gross income.

\$29,500	Total Wisconsin Itemized Deductions
(1,640)	Less: Casualty & Theft Losses and Medical & Dental Expenses Deducted
<u>\$27,860</u>	Subtotal (Since this amount exceeds 100% of \$27,000, Wisconsin adjusted gross income must be used in this computation.)
\$27,000	Wisconsin Adjusted Gross Income
(16,200)	Less: 60% of Wisconsin Adjusted Gross Income (\$27,000 x 60%)
<u>\$10,800</u>	Adjusted Itemized Deductions

Married persons will determine their "adjusted itemized deductions" as follows:

$$\begin{array}{l} \text{Total adjusted itemized} \\ \text{deductions claimed by} \\ \text{both spouses} \end{array} \times \frac{\begin{array}{l} \text{Wis. itemized deductions} \\ \text{claimed by spouse A} \end{array}}{\begin{array}{l} \text{Total Wis. itemized de-} \\ \text{ductions claimed by} \\ \text{both spouses} \end{array}} = \begin{array}{l} \text{Spouse A's} \\ \text{adjusted} \\ \text{itemized} \\ \text{deductions} \end{array}$$

Example: Married taxpayers filed a 1981 Wisconsin income tax return. Husband reported \$23,900 Wisconsin adjusted gross income; wife reported \$25,300 Wisconsin adjusted gross income. Medical and dental expenses and casualty and theft losses deducted by both spouses totaled \$2,400. Husband deducted \$16,050 of itemized deductions from his Wisconsin total income; wife deducted \$17,450 of itemized deductions from her income.

\$33,500 Total Wisconsin Itemized Deductions Deducted by Both Spouses
 Less: Medical and Dental Expenses and Casualty and Theft Losses of Both Spouses (2,400)
 \$31,100 Subtotal
 Less: 60% of Total Wisconsin Adjusted Gross Income of Both Spouses ((23,900 + 25,300) x 60%) (29,520)
 \$1,580 Total Adjusted Itemized Deductions of Both Spouses

Husband's Adjusted Itemized Deductions are:

$$\begin{array}{r} \$ 1,580 \end{array} \times \frac{\begin{array}{l} \$16,050 \\ \$33,500 \end{array}}{\begin{array}{l} \$33,500 \end{array}} = \begin{array}{r} \$ 757 \end{array}$$

Wife's Adjusted Itemized Deductions are:

$$\begin{array}{r} \$1,580 \end{array} \times \frac{\begin{array}{l} \$17,450 \\ \$33,500 \end{array}}{\begin{array}{l} \$33,500 \end{array}} = \begin{array}{r} \$ 823 \end{array}$$

The minimum tax may not be deducted in determining a person's, trust's or estate's Wisconsin taxable income or tax.

11. Capital Gain and Loss Changes (Amend 71.05(1)(a)2, 5, 6 and 13 and 71.05(1)(j), create 71.05(2m), effective for 1982 taxable year and thereafter.)

The following changes are made in the treatment of capital gain and loss income:

- a. Long-term capital gains will be taxable as follows: 80% in 1982 taxable year, 60% in 1983 taxable year and 40% in 1984 taxable year and thereafter.
- b. Only one-half (50%) of a net long-term capital loss incurred in taxable year 1982 and thereafter will be allowable as a deduction from other income. However, if a long-term capital loss which was incurred prior to taxable year 1982 is carried forward to taxable year 1982 or thereafter, such loss continues to be 100% deductible.

- c. The annual limitation which will apply when pre-1982 capital losses are deducted as a subtraction modification in 1982 and subsequent taxable years is \$3,000 per year for single persons and \$1,500 each for spouses.
 - d. The 80%, 60% and 40% taxation of capital gains for 1982, 1983 and 1984 and thereafter, which is described in item "a" above, will also apply to:
 - (1) Nonresidents who must include in Wisconsin income a net long-term capital gain from the involuntary conversion of Wisconsin property which has been replaced with property located outside Wisconsin.
 - (2) Nonresident aliens who must include in Wisconsin income a net long-term gain from the sale of assets having a situs in Wisconsin.
12. Accelerated Depreciation for Individuals, Estates and Trusts (Amend 71.02(2)(b)6 and create 71.02(2)(b)7, effective for 1981 taxable year and thereafter. In certain situations the effective date for fiscal year taxpayers may be the 1980 taxable year, as described below.)

In computing Wisconsin income for the 1981 taxable year and thereafter, an individual, estate or trust may elect to use amendments to the Internal Revenue Code adopted after December 31, 1980 which affect the computation of depreciation or of adjusted basis. (NOTE: The effect of this provision is that if Congress in 1981 enacts changes to depreciation, such changes will also apply to Wisconsin. The federal effective date for such depreciation changes, as provided in the Internal Revenue Code, will also be the effective date for Wisconsin. For example, if federal depreciation changes apply to purchases after July 1, 1981, this July 1 effective date will also apply for Wisconsin. If the federal effective date for depreciation changes applies to purchases made on or after January 1, 1981, then the new federal depreciation provisions will also be available with respect to the 1980 taxable year of individuals, estates and trusts having a 1980 fiscal year ending after the effective date. For example, with an April 1 effective date, the new depreciation rates could be used for taxable year 1980 by fiscal year filers with 1980 taxable years ending in April, May and June of 1981.)

CORPORATE FRANCHISE/INCOME TAXES

1. Update Internal Revenue Code Reference to December 31, 1980 for Insurance Companies, Regulated Investment Companies and Real Estate Investment Trusts (Amend 71.01(4)(g)4 and 71.02(1)(a)5, create 71.01(4)(g)5 and 71.02(1)(a)6, renumber 71.01(4)(g)5 to 71.01(4)(g)9, effective for 1981 taxable year and thereafter.)

For the 1981 taxable year and thereafter, insurance companies, regulated investment companies and real estate investment trusts will compute their income under the Internal Revenue Code in effect on December 31, 1980.

2. Clarify That Federal Income Taxes Are Not Deductible (Amend 71.02(1)(c), 71.04(3) and 71.11(8)(b), effective for 1975 taxable year and thereafter.)

The statutes are clarified that no deduction is allowed for taxes on income, excess or war profits and capital stock taxes imposed by the federal government.

3. Clarify the Limitation for Deductible Dividends (Create 71.04(4)(intro.), effective for 1980 taxable year and thereafter.)

Under existing law, s. 71.04(4)(a) provides that dividends received by a corporation may be deducted in full if the payor corporation meets certain requirements. Section 71.04(4)(b) permits a corporation to deduct 50% of the cash dividends received from a subsidiary corporation (80% or more ownership).

The new law clarifies that if a dividend qualifies for deduction under both s. 71.04(4)(a) and (b), only one deduction is allowable.

4. Eliminate Deduction for State Taxes (Amend 71.01(4)(a)6, 71.04(3), repeal 71.01(4)(a)8, effective for 1981 taxable year and thereafter.)

No deduction will be allowed to corporations for taxes imposed by any state or the District of Columbia on or measured by net income, gross income, gross receipts or capital stock. Gross receipts taxes assessed in lieu of property taxes will still be deductible from gross income.

5. Eliminate Deduction for Windfall Profits Tax (Amend 71.04(3), effective 1981 taxable year and thereafter.)

No deduction will be allowed to corporations for the federal Windfall Profits Tax.

6. Addition to Tax Penalty Not Deductible (Amend 71.23, effective for 1981 taxable year and thereafter.)

No deduction will be allowed to corporations for any addition to tax penalty imposed under s. 71.22.

7. Accrual of Real Estate Taxes (Amend 71.04(3), effective for 1981 taxable year and thereafter.)

Corporations will be permitted an accrual election for real estate taxes similar to that permitted under the Internal Revenue Code. Under the Internal Revenue Code an accrual basis taxpayer may elect to ratably accrue any real property tax which is related to a definite period of time.

Under prior law, an accrual basis corporation could only accrue real estate taxes after the amount of such taxes had been determined by the local assessing authority. In effect this limited the accrual of current year's real estate taxes to corporations who reported on a calendar year basis or a fiscal year ending November 31. Corporations whose fiscal year ended in any month from January through October could not accrue real estate taxes for any months of the current calendar year.

8. Involuntary Conversions - Replacement Property Outside Wisconsin
(Amend 71.03(1)(g)3, effective for involuntary conversions occurring in 1981 taxable year and thereafter.)

Nonrecognition of gain on involuntarily converted property will apply if the replacement property is outside Wisconsin and the taxpayer is subject to Wisconsin tax jurisdiction both before and after the property has been replaced.

Prior law provided nonrecognition of gain on such property only if the property converted was replaced by similar property located in Wisconsin.

9. Imputed Interest (Create 71.04(15)(h), effective for purchases made in 1981 taxable year and thereafter.)

An interest deduction will be permitted for the amount treated as imputed interest under section 483 of the Internal Revenue Code. The Wisconsin basis shall be reduced by the amount of such interest deduction.

The Internal Revenue Code provides that if a part of the purchase price of a depreciable asset is attributable to imputed interest, the basis of the property is reduced by such amount. This also affects the amount of depreciation because of a lower cost basis. Since under prior law Wisconsin did not have a provision similar to section 483 of the Internal Revenue Code, the cost basis of the property was higher for Wisconsin than federal, although the amount of depreciation allowed for Wisconsin was limited to that permitted for federal tax purposes. The difference in basis was then only recoverable in the year in which the asset was disposed of. This new provision will result in the same basis applying for both Wisconsin and federal purposes.

10. Capitalize Intangible Drilling Costs (Create 71.04(2)(b)4, effective for intangible drilling and development costs incurred in 1981 taxable year and thereafter.)

Operators of oil and gas wells and geothermal wells shall capitalize the related intangible drilling and development costs which are deductible under section 263(c) of the Internal Revenue Code. Such taxpayers may recover their Wisconsin adjusted basis through annual deductions for cost depletion or depreciation or, in the case of costs related to nonproductive wells, as a loss, as provided under the December 31, 1980 Internal Revenue Code.

11. Eliminate Requirement to File Extension Form 7005 Within Ten Days
(Amend 71.10(5)(a), effective for 1981 taxable year and thereafter.)

Corporations will no longer be required to submit a copy of federal extension form 7005 (the federal form which is used for an additional three month extension) to the Department of Revenue within ten days after it is received from the Internal Revenue. However, corporations will still be required to furnish a copy of form 7005 with the Wisconsin tax return when it is filed with the Department.

12. Six Month Extensions for DISCs and Cooperatives (Amend 71.10(5)(a), effective for 1981 taxable year and thereafter.)

The Department of Revenue may grant DISCs and cooperatives extensions of time to file a corporate tax return for up to six months. Under prior law, only 30 day extensions could be granted.

13. Corporate Reorganization (Amend 71.358(5), 71.362(2), 71.368(1)(a)2, 71.368(1)(b)3 and 71.368(2), create 71.368(1)(b)4 and 5, effective for 1981 taxable year and thereafter.)

The Wisconsin tax treatment of corporate reorganizations is changed to conform more closely to the federal treatment.

14. 60% Payment of Tax Liability Required to Meet Exception to Addition to Tax (Amend 71.22(10)(a) and (b), and create SECTION 2045(1) of the non-statutory provisions, effective July 31, 1981 except that amounts that would have been due before July 31, 1981 should be pro-rated equally among and paid with installments of estimated taxes beginning with the payment for the calendar quarter beginning October 1, 1981.)

Prior to the amendments to 71.22(10)(a) and (b), a corporation would not be assessed the addition to tax penalty if it paid an amount at least equal to the tax shown on the return of the corporation for the preceding taxable year under 71.22(10)(a) or paid an amount at least equal to the tax computed at the rates applicable to the taxable year, but otherwise on the basis of the return of the corporation for and the law applicable to the preceding year under 71.22(10)(b).

As a result of the amendments to ss. 71.22(10)(a) and (b), a corporation will now have to pay in timely estimated tax payments at least 60% of the tax due for the current taxable year in order to meet the exceptions to the addition to tax penalty in ss. 71.22(10)(a) and (b).

15. Define Declaration of Estimated Tax Terms (Create 71.22(1m), effective July 31, 1981.)

The terms "tax shown on the return" and "tax for the taxable year" in s. 71.22 (relating to declaration of estimated tax by corporations and addition to tax penalty) mean net tax after reduction by credits but before reduction by amounts paid as declaration of estimated tax.

16. Accelerated Depreciation (Amend 71.01(4)(g)4, 71.02(1)(a)5 and 71.04(15)(a), create 71.01(4)(g)5 and 71.02(1)(a)6, effective for 1981 taxable year and thereafter. In certain situations the effective date for fiscal year filers may be the 1980 taxable year, as described below.)

The new law provides that insurance companies, real estate investment trusts and regulated investment companies may apply any federal law changes related to depreciation which are enacted after December 31, 1980 in computing their depreciation.