

## NEW WISCONSIN TAX LAWS

The Wisconsin legislature passed several changes and clarifications to the Wisconsin tax laws in October 1986. The following are brief descriptions of the major income, corporation franchise or income, tax-option (S) corporation franchise or income, homestead, sales/use, and inheritance tax provisions. The description for each item indicates the sections of the statutes affected and the effective date of the new provisions. All of the provisions described below are contained in 1987 Wisconsin Act 92, published November 27, 1987.

### INDEX

|  | Effective Date   | Page |
|--|--|------|
| <b>A. INCOME TAXES</b>   |  |      |
| 1. Amend Definition of Earned Income for Purposes of the Standard Deduction  | 1987 tax year  | 29   |
| 2. Clarify Modification for Expenses of Administering an Estate  | Deaths occurring on or after August 1, 1987                        | 30   |
| 3. Disallow Interest Paid on Certain Secondary Home in Computing the Itemized Deduction Credit                         | 1987 tax year  | 30   |
| 4. Provide Claim of Right Credit   | 1986 tax year  | 30   |
| 5. Require Department to Adjust Filing Requirements Based on Changes in Tax Rates and Senior Citizen Credit            | November 28, 1987  | 30   |
| 6. Clarify Alternative Minimum Tax Computation   | 1987 tax year  | 30   |
| <b>B. CORPORATION FRANCHISE OR INCOME TAXES</b>  |  |      |
| 1. Change the Amount of Compensation for Which Informational Returns Must Be Filed as a Condition of Deduction         | 1987 tax year  | 31   |
| 2. Clarify That the Tax-Exempt Status of Organizations Continues to Be Determined Under Wisconsin Law, Not Federal Law | 1987 tax year  | 31   |
| 3. Clarify Requirement for Submitting Copies of Federal Approval of Changes in Accounting Periods                      | 1987 tax year  | 31   |
| 4. Clarify Adjustments Required as a Result of Method of Accounting Changes  | 1987 tax year  | 31   |
| 5. Clarify That a Capital Loss Carryback Doesn't Apply to 1986 and Prior Years   | November 28, 1987  | 31   |
| <b>C. TAX-OPTION (S) CORPORATIONS</b>  |  |      |
| 1. Clarify the Computation and Imposition of the Additional Tax on Tax-Option Corporations                             | 1987 tax year  | 31   |
| 2. Clarify the Definition of a Tax-Option Corporation  | Corporation's 1987 tax year or shareholder's 1987 or 1988 tax year | 32   |

|                             |  |   |    |
|-----------------------------|--|---|----|
| 3.                          | Clarify the Deduction for Tax-Option (S) Corporations  | Corporation's 1987 tax year and shareholder's 1987 or 1988 tax year | 32 |
| 4.                          | Clarify Election to Elect Out of Tax-Option Status and to Elect Back Into Tax-Option Status                                      | Corporation's 1987 tax year and shareholder's 1987 or 1988 tax year | 32 |
| 5.                          | Clarify the Treatment of Tax-Option Items  | November 28, 1987   | 32 |
| 6.                          | Clarify Determination of a Shareholder's Basis in Stock and Indebtedness of a Tax-Option Corporation                             | November 28, 1987   | 32 |
| 7.                          | Clarify That U.S. Government Interest Is Not Taxable to Tax-Option (S) Corporation Shareholders                                  | November 28, 1987   | 33 |
| 8.                          | Clarify Individual Income Tax Treatment of Tax-Option Items When an S Corporation Has Elected Not to Be a Tax-Option Corporation | 1987 tax year   | 33 |
| <b>D. HOMESTEAD CREDIT</b>  |  |   |    |
| 1.                          | Clarify Definition of Income for Homestead Credit Purposes   | 1987 claims filed in 1988   | 33 |
| <b>E. SALES/USE TAXES</b>   |  |   |    |
| 1.                          | Provide for Confidentiality of Use Tax Information   | November 28, 1987   | 33 |
| <b>F. INHERITANCE TAXES</b> |  |   |    |
| 1.                          | Clarify Inheritance Tax Phase-Out Language   | January 1, 1988   | 33 |
| <b>G. OTHER</b>             |  |   |    |
| 1.                          | Correct Cross Reference of Delinquent Tax Collection Fees  | November 28, 1987   | 33 |

**A. INCOME TAXES**

1. **Amend Definition of Earned Income for Purposes of the Standard Deduction** (1987 Act 92, amend s. 71.02(2)(km)6, effective for taxable year 1987).

The Wisconsin standard deduction for a dependent with unearned income may not exceed the dependent's earned income, as determined under section 911(b) of the Internal Revenue Code as of December 31, 1976, which is taxable by Wisconsin.

**Example :** A taxpayer, who is a part-year resident, can be claimed as a dependent on her parents' Wisconsin income tax return. She has \$3,000 of unearned income which is taxable by Wisconsin and \$2,000 of earned income which is not taxable by Wisconsin. The taxpayer is not allowed a standard deduction because her earned income taxable by Wisconsin is zero.

For the 1979 through 1986 taxable years, the Wisconsin standard deduction for a dependent with unearned income could not exceed the dependent's federal earned income.

2. **Clarify Modification for Expenses of Administering an Estate** (1987 Act 92, am end ss. 71.05(1)(a)28 and (b)13 and 71.09(6r)(a), effective for returns filed for deaths occurring on or after August 1, 1987).

Expenses of administering an estate may be claimed for income tax purposes to the extent that the same expenses have not or will not be claimed for Wisconsin inheritance tax purposes. If the estate or trust does not pass the deductions for administrative expenses on to the beneficiaries, the election for Wisconsin income tax purposes is made via a modification on the Wisconsin fiduciary return, Form 2. If the estate or trust passes the deductions for administering an estate to its beneficiaries and these deductions have not been used for inheritance tax purposes, the deductions may be used in computing the itemized deduction credit.

**Example:** An estate pays \$2,000 in administrative expenses. None of the expense is claimed on the federal fiduciary income tax return since the deduction was claimed for federal estate tax purposes. If the personal representative elects not to claim the expenses for Wisconsin inheritance tax purposes, a deduction may be claimed for Wisconsin income tax purposes by claiming a subtraction modification on the Wisconsin Form 2. However, if the estate had passed the right of the deduction to two beneficiaries, each of the beneficiaries may use \$1,000 in computing their Wisconsin itemized deduction credit on their individual income tax returns.

3. **Disallow Interest Paid on Refinancing Certain Secondary Homes in Computing the Itemized Deduction Credit** (1987 Act 92, amend s. 71.09(6r)(a)5, effective for taxable year 1987).

This amendment provides that interest paid to refinance secondary residences located outside of Wisconsin may not be used in computing the itemized deduction credit. In addition, the amendment clarifies interest paid to purchase secondary residences located outside Wisconsin and residences that are boats may not be used in computing the itemized deduction credit.

4. **Provide Claim of Right Credit** (1987 Act 92, amend s. 71.09(6r)(a), create s. 71.09(12cr), effective for taxable year 1986).

If a taxpayer has to repay an amount that had been properly included in his or her income in an earlier year, the taxpayer may be eligible for the claim of right credit. The credit, which is a refundable credit claimed in the year of repayment, is equal to the decrease in tax for a previous year as a result of excluding the income which was repaid. The credit is calculated in the same manner as the federal credit under section 1341 of the Internal Revenue Code. The credit may not be claimed if the amount repaid is \$3,000 or less or if the taxpayer deducted the repayment in computing Wisconsin adjusted gross income or the Wisconsin itemized deduction credit for the year of repayment.

**Example 1:** A taxpayer reported unemployment compensation of \$4,000 in 1986 and had a tax liability of \$400. In 1987, the taxpayer was required to pay back the unemployment compensation. If the taxpayer had not reported the unemployment compensation in 1986, his tax liability would have been \$300. The taxpayer may claim a credit of \$100 (\$400 1986 tax less \$300 recomputed tax) for Wisconsin tax purposes in 1987.

**Example 2:** A taxpayer reported a long-term capital gain of \$3,000 in 1985. In 1986, he was required to repay the income. On his 1986 tax return, the taxpayer elected to claim the \$3,000 repayment as a long-term capital loss. Because the taxpayer used the repayment in computing Wisconsin taxable income, he is not eligible for the claim of right credit.

5. **Require Department to Adjust Filing Requirements Based on Changes in Tax Rates and Senior Citizen Credit** (1987 Act 92, amend s. 71.10(2)(a)5, effective November 28, 1987). The department must annually adjust the dollar amounts of the filing requirements to reflect changes in the tax rates and the senior citizen credit as well as the standard deduction.
6. **Clarify Alternative Minimum Tax Computation** (1987 Act 92, amend s. 71.60(1)(a)1, effective for taxable year 1987).

Wisconsin alternative minimum taxable income is computed by starting with federal alternative minimum taxable income and adjusting it for the appropriate modifications under s. 71.05, Stats. Under federal law, a state tax refund may not be included in federal alternative minimum taxable income. Section 71.05(1)(b)11, Stats., provides for the subtraction of any recoveries of federal itemized deductions for which no Wisconsin income tax benefit was received, such as state tax refunds included in federal adjusted income. This amendment clarifies that a state tax refund or similar recovery that is not included in federal alternative minimum taxable income may not be subtracted twice in determining Wisconsin alternative minimum taxable income.

**Example:** A taxpayer has federal adjusted gross income of \$35,000 which includes a state tax refund. The taxpayer's federal alternative minimum taxable income is \$119,000 after subtracting the \$1,000 state tax refund. Assuming the taxpayer has no other modifications for Wisconsin tax purposes, Wisconsin alternative minimum taxable income is also \$119,000; it isn't adjusted a second time for the state tax refund.

## **B. CORPORATION FRANCHISE OR INCOME TAXES**

1. **Change the Amount of Compensation for Which Informational Returns Must Be Filed as a Condition of Deduction** (1987 Act 92, amend s. 71.02(1)(bg)5, effective for taxable year 1987).

Payments for wages, salaries, commissions, and bonuses of employees and officers may be deducted only if the name, address, and amount paid to each resident of Wisconsin to whom compensation of \$600 or more has been paid during the taxable year is reported to the department. Prior law required the information return to be filed as a condition of deduction if the amount paid during the taxable year was \$500 or more.

2. **Clarify That the Tax-Exempt Status of Organizations Continues to Be Determined Under Wisconsin Law, Not Federal Law** (1987 Act 92, repeal and recreate s. 71.02(1)(bg)17, effective for taxable year 1987).

Sections 501 to 528 of the Internal Revenue Code are excluded from Wisconsin's definition of the Internal Revenue Code and exemptions from Wisconsin's franchise or income tax are limited to those allowed under s. 71.01(3).

3. **Clarify Requirement for Submitting Copies of Federal Approval of Changes in Accounting Periods** (1987 Act 92, amend s. 71.10(3m)(a), effective for taxable year 1987).

A corporation may not change its basis of reporting from a calendar year to a fiscal year, from a fiscal year to a calendar year, or from one fiscal year to another without first obtaining the approval of the department unless the Internal Revenue Service has approved the change or requires the change. If the change is based on a change approved by the IRS, a copy of the federal approval must be attached to the first Wisconsin return affected by the change. If prior federal approval is not required or if the change is required by the IRS, a copy of the federal requirement or an explanation of the change must be attached to the first Wisconsin return affected by the change.

4. **Clarify Adjustments Required as a Result of Method of Accounting Changes** (1987 Act 92, amend s. 71.11(8)(b), effective for taxable year 1987).

A corporation that changes its method of accounting, while subject to taxation by Wisconsin, shall make the adjustments required under the Internal Revenue Code, except that in the last year that a corporation is subject to taxation by Wisconsin it must take into account all of the remaining adjustments required as a result of the change.

5. **Clarify That a Capital Loss Carryback Doesn't Apply to 1986 and Prior Years** (1987 Act 92, create a nonstatutory provision, effective November 28, 1987).

Even though Wisconsin has adopted the federal capital loss carryforward and carryback provisions for the 1987 taxable year and thereafter, capital losses cannot be carried back to 1986 and prior years.

## **C. TAX-OPTION (S) CORPORATIONS**

1. **Clarify the Computation and Imposition of the Additional Tax on Tax-Option Corporations** (1987 Act 92, amend s. 71.016, effective for taxable year 1987).

This amendment clarifies that a Wisconsin tax will be imposed on tax-option (S) corporations in the same manner as the federal built-in gains tax imposed by section 1374 of the Internal Revenue Code, except that the tax rate is Wisconsin's corporate franchise or income tax rate, the recognized built-in gain is computed using the Wisconsin basis of the assets and the Wisconsin apportionment percentage for the current taxable year, the taxable income is the Wisconsin taxable income, and the credit and net operating losses are those allowed by Wisconsin rather than those allowed for federal purposes.

In addition, the Wisconsin built-in gains tax doesn't apply to a corporation that has always been a tax-option corporation nor does it apply if the return is filed pursuant to a federal S corporation election made before January 1, 1987, and the corporation has not elected to opt out of tax-option status for Wisconsin for any intervening year.

2. **Clarify the Definition of a Tax-Option Corporation** (1987 Act 92, repeal and recreate s. 71.02(1)(g), effective for the corporations' taxable year 1987 and to their shareholders' taxable year 1987 or 1988, as appropriate).

This provision clarifies that a tax-option corporation is a corporation which is treated as an S corporation under Subchapter S of the Internal Revenue Code and has not elected out of tax-option corporation status for Wisconsin for the current taxable year.

3. **Clarify the Deduction for Tax-Option (S) Corporations** (1987 Act 92, amend s. 71.042(1) and (2), effective for the corporations' taxable year 1987 and their shareholders' taxable year 1987 or 1988, as appropriate).

These amendments clarify that the shareholders of tax-option corporations are to include in their Wisconsin adjusted gross income their proportionate share of the corporation's items of income, loss, and deduction. These items, including capital gains and losses, retain the character they would have if attributed to the corporation, including their character as business income.

These provisions also provide that a tax-option corporation may deduct from its net income all amounts included in the Wisconsin adjusted gross income of its shareholders, the capital gain deduction allowed to its shareholders, and all amounts not taxable to nonresident shareholders under s. 71.07(2) and (2m). Interest on federal obligations, which is exempt for individual income tax purposes, is not considered as included in the Wisconsin adjusted gross income of its shareholders. Therefore, the corporation cannot deduct interest on federal obligations which is attributable to Wisconsin.

4. **Clarify Election to Elect Out of Tax-Option Status and to Elect Back Into Tax-Option Status** (1987 Act 92, amend s. 71.042(4)(a) and (b), effective for the corporations' taxable year 1987 and their shareholders' taxable year 1987 or 1988, as appropriate).

These sections clarify that if persons who hold more than 50% of the shares on the day this election is made consent, a corporation that is an S corporation for federal income tax purposes may elect, on or before the due date or extended due date of its Wisconsin corporate franchise or income tax return, not to be a tax-option corporation for Wisconsin. The election, once made, is effective for at least 5 taxable years for that corporation.

If, after 5 taxable years, persons who, on the day on which the election occurs, hold more than 50% of the shares of a corporation that has elected out of tax-option status consent, a corporation that is an S corporation for federal income tax purposes may elect, on or before the due date or extended due date of its Wisconsin corporate franchise or income tax return, to be a tax-option corporation for Wisconsin.

5. **Clarify the Treatment of Tax-Option Items** (1987 Act 92, amend s. 71.042(5)(d), effective November 28, 1987).

This amendment provides that any notice of determination by the department of any tax-option item (item of income, loss, or deduction) may be contested by a tax-option corporation under s. 71.12. A tax-option corporation must timely notify all shareholders of any administrative or judicial proceeding regarding the determination of any tax-option item. Each shareholder may participate in any administrative or judicial proceeding and is bound by the final determination of that proceeding.

6. **Clarify Determination of a Shareholder's Basis in Stock and Indebtedness of a Tax-Option Corporation** (1987 Act 92, create s. 71.042(6), effective November 28, 1987).

This amendment clarifies that the Wisconsin adjusted basis of a shareholder in the stock and indebtedness of a tax-option corporation is determined in the manner prescribed by the Internal Revenue Code for a shareholder of an S corporation, except that the nature and amount of items affecting that basis is determined under Chapter 71. This provision does not apply to 1978 and earlier taxable years of corporations which were S corporations for federal income tax purposes or to taxable years of corporations which have elected to opt out of Wisconsin tax-option status.

7. **Clarify That U.S. Government Interest Is Not Taxable to Tax-Option (S) Corporation Shareholders** (1987 Act 92, amend s. 71.05(1)(b)(intro.), effective November 28, 1987).

This amendment clarifies that interest on U.S. government obligations which is passed through to a shareholder from a tax-option (S) corporation is not taxable for individual income tax purposes.

8. **Clarify Individual Income Tax Treatment of Tax-Option Items When an S Corporation Has Elected Not to Be a Tax-Option Corporation** (1987 Act 92, create s. 71.05(1)(a)31 and (f)5, effective for taxable year 1987).

These provisions clarify that a shareholder of an S corporation that has elected not to be a tax-option corporation for Wisconsin must add to federal adjusted gross income any distribution received from earnings and profits accumulated during a year which the corporation was not a tax-option corporation. The shareholder must also add to or subtract from federal adjusted gross income any item of income, loss, or deduction passed through from the S corporation for any year in which the corporation was not a tax-option corporation.

#### D. HOMESTEAD CREDIT

1. **Clarify Definition of Income for Homestead Credit Purposes** (1987 Act 92, amend s. 71.09(7)(a)6, effective for 1987 claims filed in 1988 ).

The definition of household income is reworded to group similar income and deduction items together.

#### E. SALES/USE TAXES

1. **Provide for Confidentiality of Use Tax Information** (1987 Act 92, amend s. 77.61(5)(b)(intro.) and (c), effective November 28, 1987).

The same confidentiality provisions that apply for sales tax information, including who can examine returns, apply for use tax information.

#### F. INHERITANCE TAXES

1. **Clarify Inheritance Tax Phase-Out Language** (1987 Act 92, amend s. 72.18, effective January 1, 1988).

1987 Wisconsin Act 27 phases out the inheritance tax over several years. The phaseout is effective for transfers because of deaths occurring in 1988 through 1992. The statute did not previously include the words "because of death" in all instances.

#### G. OTHER

1. **Correct Cross Reference of Delinquent Tax Collection Fees** (1987 Act 92, amend s. 20.566(1)(hq), effective November 28, 1987).

The reference to delinquent tax collection fees in s. 20.566, Stats., is changed from s. 73.03(32), Stats., to 73.03(33), Stats.