

A. INDIVIDUAL AND FIDUCIARY INCOME TAXES

1. Exceptions to Definition of Internal Revenue Code for Individuals, Estates, and Trusts Provided for 1987 (1987 Act 399, amend s. 71.02(2)(d)13 and create nonstatutory provision, effective for taxable year 1987.)

For individuals, estates, and trusts, except nuclear decommissioning trust or reserve funds, for taxable year 1987, "Internal Revenue Code" means the federal Internal Revenue Code as amended to December 31, 1986, as it applies to taxable year 1987, with the following exceptions:

- a. For taxable years that end after July 1, 1987, and before December 31, 1987, "Internal Revenue Code" does not include changes to the federal Internal Revenue Code made by sections 142 (limitations on deductions for meals, travel, and entertainment), 802 (simplified dollar-value LIFO method for certain small businesses), 803 (capitalization and inclusion in inventory costs of certain expenses), and Subtitle A of Title XI (pensions and deferred compensation) of the Tax Reform Act of 1986 (P.L. 99-514).
 - b. Changes to the federal Internal Revenue Code made by the Revenue Act of 1987 (P.L. 100-203) apply for Wisconsin purposes at the same time as for federal purposes.
 - c. The transitional rules under section 10104 of the Revenue Act of 1987 (P.L. 100-203), relating to the treatment of indirect expenses passed through to shareholders of regulated investment companies, including mutual funds, apply for Wisconsin purposes as they apply for federal purposes.
2. Reference to Internal Revenue Code for Individuals, Estates, and Trusts Updated for 1988 (1987 Act 399, amend s. 71.02(2)(d)13 and create s. 71.02(2)(d)14 and 15 and (4), see effective dates below.)

The law changes described below apply to individuals, estates, and trusts, except nuclear decommissioning trust or reserve funds.

- a. For taxable years that end after July 1, 1988, and before December 31, 1988, "Internal Revenue Code" means the federal Internal Revenue Code as amended to December 31, 1986, with the following exceptions:
 - (1) Changes to the federal Internal Revenue Code made by the Revenue Act of 1987 (P.L. 100-203) apply for Wisconsin purposes at the same time as for federal purposes.
 - (2) The transitional rules under section 10104 of the Revenue Act of 1987 (P.L. 100-203), relating to the treatment of indirect expenses passed through to shareholders of regulated investment companies, including mutual funds, apply for Wisconsin purposes as they apply for federal purposes.
- b. For taxable years that begin after December 31, 1987, "Internal Revenue Code" means the federal Internal Revenue Code as amended to

December 31, 1987. At the taxpayer's option, "Internal Revenue Code" includes any revisions to section 67(c) of the Internal Revenue Code adopted after January 1, 1988, that relate to the indirect expenses of regulated investment companies, including mutual funds.

3. Small Business Stock Requirements Changed (1987 Act 399, amend s. 71.02(2)(fr)2, effective for taxable year 1988 and thereafter.)

In order for a security to qualify for 100% exclusion of capital gain as a small business stock, the issuing corporation must certify that, in addition to other requirements, it had no more than 500 employees covered by Wisconsin unemployment insurance, including employees of any corporation that owns more than 50% of the stock of the issuing corporation. Previously, the corporation could have no more than 200 employees covered by Wisconsin unemployment insurance.

4. Allocation of Negative Income Items Clarified (1987 Act 393, amend s. 71.02(2)(me), effective for taxable year 1987 and thereafter.)

There is no allocation of negative income items to the spouse who does not own the nonmarital property which generates net rents or other net returns which are marital property and which are derived from the investment, rental, licensing, or other use of nonmarital property. Negative income items include losses, depreciation, recapture of benefits, offsets, depletion, deductions, penalties, expenses, or other similar items.

This exception to the general rule of allocating negative income items in the same manner as positive income is allocated applies only to persons filing individual or separate returns. On a joint return, the allocation is not necessary because all negative income items and all net returns and rents are reportable on the return.

5. Distributions That Are Taxable to Shareholders of Federal S Corporations Which Have Elected Not to Be Wisconsin Tax-Option Corporations (1987 Act 399, create s. 71.05(1)(a)31, effective for tax-option corporation shareholder's taxable year 1987 or 1988, as appropriate to conform the shareholder's treatment of income, loss, and deduction to the tax-option corporation's treatment.)

This amendment clarifies that an addition modification is required to be made by shareholders for any amount received as a proportionate share of the earnings and profits of a corporation that is an S corporation for federal purposes, but has elected not to be a tax-option corporation for Wisconsin purposes, if those earnings were accumulated during the years such a corporation elected out of tax-option status for Wisconsin purposes.

6. Subtract Modification for Exempt Interest Reduced by Related Expenses on Fiduciary Return (1987 Act 399, amend s. 71.05(1)(b)1, effective for taxable year 1988 and thereafter.)

The subtraction modification for the amount of any interest or dividend income which is by federal law exempt from state taxation must be reduced

by the related expenses in regard to both the distributable and nondistributable interest and dividend income on a fiduciary return.

7. Carryforward of Limited Farm Losses Allowed (1987 Act 399, create s. 71.05(1)(b)14, effective for taxable year 1988 and thereafter, in respect to the year when losses may be subtracted, and to taxable year 1986 and thereafter, in respect to the year losses that may be subtracted are incurred.)

Farm losses added back to income in taxable year 1986 and thereafter under s. 71.05(1)(a)26, Wis. Stats., may be carried forward for up to 15 years and subtracted from farm income in a later taxable year provided the farm income is generated by the same farm activity that generated the loss.

8. Assets Acquired From a Decedent Qualify for Capital Gain Modification Regardless of Holding Period (1987 Act 399, amend s. 71.05(1)(b)16, effective for taxable year 1987 and thereafter.)

A subtraction modification is provided for 60% of capital gain on all assets acquired from a decedent regardless of the length of time the property is held by an estate, or by persons other than the estate of the decedent.

9. Wisconsin Capital Gain Modification Does Not Apply to Sale of Dairy Cattle Under Milk Production Termination Program (1987 Act 399, amend s. 71.05(1)(b)16, effective for taxable year 1987 and thereafter.)

Section 406 of the Tax Reform Act of 1986 retained the 60% exclusion of capital gains from the sales of dairy cattle under the milk production termination program. To prevent a double 60% exclusion, s. 71.05(1)(b)16, Wis. Stats., is amended to provide that the Wisconsin 60% exclusion of capital gains is not allowed for sales of dairy cattle under the milk production termination program.

10. Nonrecognition of Gain or Loss for Exchange of Marital Property Interest Between Surviving Spouse and Distributee (1987 Act 393, create s. 71.05(1)(a)32, (b)17 and (t), effective for taxable year 1987 and thereafter.)

A surviving spouse and a distributee may exchange their one-half interests in two assets in order to achieve a whole interest in one asset. Under section 1001 of the Internal Revenue Code, a gain or loss may result because of a difference in basis. For Wisconsin tax purposes the exchange is not taxable and any gain or loss included in federal adjusted gross income shall be subtracted or added, as appropriate, in computing Wisconsin taxable income.

The basis of marital property exchanged between a surviving spouse and a distributee is determined as if the property were acquired by gift from the surviving spouse or the distributee.

11. Taxation of Lottery Winnings Received by Nonresident Individuals (1987 Act 119, amend s. 71.07(1), effective for taxable year 1987.)

Income of nonresident individuals from the Wisconsin lottery under Chapter 565 of the Wisconsin Statutes is taxable by Wisconsin.

12. Taxation of Lottery Winnings Received by Nonresident Estates and Trusts (1987 Act 399, amend s. 71.07(1), effective for taxable year 1988 and thereafter.)

Income nonresident estates and trusts receive from the Wisconsin state lottery under ch. 565, Wis. Stats., is subject to Wisconsin tax. For 1987, only nonresident individuals were subject to Wisconsin tax on income received from the state lottery.

13. Taxation of Pari-Mutuel Wager Winnings and Purses (1987 Act 354, amend s. 71.07(1), effective for taxable year 1988 and thereafter.)

Income of a nonresident individual, estate, or trust from pari-mutuel wager winnings and purses subject to s. 562.07(4)(a), Wis. Stats., is taxable by Wisconsin.

14. Tax Treatment of Income From Limited Partnership Interests Changed (1987 Act 399, repeal s. 71.07(1g)(b)2, renumber s. 71.07(1g)(b)1 to 71.07(1g)(b) and amend 71.07(1g)(b) as renumbered, effective for partners' taxable year 1988 and thereafter.)

All partners who are not full-year Wisconsin residents are subject to taxation by Wisconsin for that part of the taxable year during which they are nonresidents on their proportionate share of all items of partnership income, loss, or deduction attributable to a business in, services performed in, or rental of property in Wisconsin. Previously, limited partners who were precluded from management of the partnership and who could not act for the partnership did not recognize any items of income, loss, or deduction of the partnership for the part of the taxable year they were nonresidents of Wisconsin.

15. Rehabilitation of Nondepreciable Historic Property Credit (1987 Act 399, create ss. 71.09(12q), 71.65(1)(fr) and (2)(fh), effective for taxable years 1989 and 1990 for projects begun after December 31, 1988.)

For taxable years 1989 and 1990, any person may credit against taxes otherwise due an amount equal to 25% of the approved costs of preservation or rehabilitation of historic property, except that the credit may not exceed \$50,000 for any preservation or rehabilitation project. The preservation or rehabilitation costs must be incurred and the claim submitted by the owner of the historic property.

The credit is only allowable on nondepreciable historic property. The State Historical Society must certify the following:

- a. The property is listed on the national register of historic places in Wisconsin or the state register of historic places, or is located in a historic district which is listed in the national register of

historic places in Wisconsin or the state register of historic places, and is certified by the state historic preservation officer as being of historic significance to the district.

- b. The proposed preservation or rehabilitation complies with standards promulgated under s. 44.02(24), Wis. Stats.
- c. The property is subject to an easement, covenant, or similar restriction running with the land which is held by the State Historical Society or by an entity approved by the State Historical Society, which protects the historic features of the property and which, at the time the credit is received, will remain effective for a term of at least 20 years.

The preservation or rehabilitation work must be completed within 2 years after the commencement date, except in the case of any preservation or rehabilitation which is initially planned for completion in phases, in which case the work must be completed within 5 years after the commencement date.

The expenditures for preservation or rehabilitation of the historic property which are approved and incurred within the prescribed time period must exceed the Wisconsin adjusted basis of the historic property on the date that preservation or rehabilitation is commenced or \$1,000, whichever is greater.

The costs cannot be incurred to acquire any building or interest in a building or to enlarge an existing building and cannot be incurred before the State Historical Society approves the preservation or rehabilitation.

The Wisconsin adjusted basis of the historic property shall be reduced by the amount of any credit. A credit may be carried forward to the next 5 taxable years to the extent not offset against taxes for the year the expense was incurred and to the extent not offset by taxes otherwise due in all intervening years between the year for which the credit was computed and the year for which the carryforward is claimed.

In the case of any short taxable year, qualified expenses shall be annualized as prescribed by the department. In the case of a change in ownership or business of a corporation, section 383 of the Internal Revenue Code applies to the carryover of unused credits. The credit may not be claimed by a partnership, except a publicly traded partnership treated as a corporation under s. 71.02(1)(af), Wis. Stats., or by a tax-option corporation or by partners or shareholders of a tax-option corporation. A rehabilitation of nondepreciable historic property credit may not be claimed for any expenses which are used in computing the historic structure credit provided by s. 71.09(12p), Wis. Stats.

16. Historic Structure Credit (1987 Act 395, create ss. 71.09(12p) and 71.65(1)(fp) and (2)(fg), effective for taxable years 1989 and thereafter for projects begun after December 31, 1988.)

For taxable years 1989 and thereafter, any person may claim as a credit, up to the amount of taxes otherwise due, an amount equal to 5% of costs of qualified rehabilitation expenditures as defined in section 48(g)2 of the Internal Revenue Code, as amended to December 31, 1986, for certified structures.

The credit may not be carried forward. Any credit awarded will reduce the Wisconsin adjusted basis of the property. The provisions regarding annualization, change of business or ownership, administration, and timely claim for the research credit under s. 71.09(12r), Wis. Stats., will apply to the historic structure credit.

Individual partners and shareholders in a tax-option (S) corporation may claim the credit based on eligible costs incurred by a partnership or tax-option (S) corporation, in proportion to the ownership interest of each partner or shareholder.

17. Development Zones - Tax Benefits for Taxpayers Located in Development Zones (1987 Act 328, amend ss. 71.02(1)(bg)15 and (c)(intro.), 71.09(12r)(a), 71.60(1)(intro.) and 71.65(1)(L) and (2)(g) and create ss. 71.05(1)(a)32 and (b)17, 71.09(12di), (12dj), (12dL), (12ds), and (12r)(h), 71.11(44)(c)13, 71.65(1)(go) and (gp) and (2)(fb) and (fc), and 73.03(35), effective for taxable year 1988, except that ss. 71.11(44)(c)13, 71.60(1)(intro.), and 73.03(35) are effective April 28, 1988.)

A development zone program administered by the Department of Development (DOD) is created. DOD may designate up to 8 development zones in Wisconsin based on evaluation of areas nominated by local governments. Businesses which locate or expand in the zone or qualified incubators located near the zones are eligible to receive certain state tax credits.

An area will be designated as a development zone for a period of 84 months. However, DOD may also grant three 12-month extensions upon application by a local governing body. An area's status as a development zone may end sooner. The bill provides that an area's designation as a development zone expires when tax credits attributed to the development zone exceed the zone's share (allocated under rules promulgated by DOD) of \$14,000,000.

DOD will have access to income and franchise tax information to facilitate its administration of the program.

DOD is required to certify businesses as eligible to receive tax credits for operation within the development zone, after considering criteria based on the business's effect on the economy of the development zone.

DOD is required to set limits on the amount of tax credits a business may receive for operating in a development zone, after reconsidering certain of the criteria on which certification is based. In addition, DOD must set the limit reasonably near to a recommended amount established by

rule, based on the number and kind of jobs affected. DOD may increase a limit in tax benefits by following the procedure for establishing the original limit. DOD may reduce a limit on tax benefits if the limit was based on misestimated or inaccurate data.

The following income and franchise tax credits are created, based on business activities in a development zone.

- a. Investment Credit. Eligible persons may claim a credit of 2.5% of the amount expended to purchase tangible personal property or 1.75% of the amount expended to purchase tangible personal property that is expensed under section 179 of the Internal Revenue Code (IRC). The credit will be available only for qualified new and used property that is used in the conduct of a business operation at a location within a development zone. If the property is mobile, the base of its operations will have to be in the zone. Only the person who purchases the property can claim the credit and if the credit is claimed for used property, it cannot be used at a location outside of the zone. No investment credit will be allowed for amounts expended to purchase property used as a basis for the development zones location credit.

The investment credit and any carryforwards can only be used to offset taxes due on income attributed to business operations of the claimant in the development zone or the taxes on income from directly related business operations. The credit will be passed through to S corporation shareholders and partners proportionate to their ownership interests in the business. Federal recapture provisions will apply to the credit in normal recapture situations and in cases where the property for which the credit was claimed or its base of operations is moved out of the zone. If the certification for tax benefits is revoked or the development zone ceases to exist, credits may not be claimed for that year and unused credits may not be carried forward to succeeding years. Also, if the claimant ceases business operations in the zone, unused credit amounts may not be carried forward to succeeding years. In order to receive the investment credit, a claimant must submit, along with the tax return, a copy of the certification for tax benefits and a statement by the Department of Development verifying both the amount of investment and the eligibility of the investment.

- b. Jobs Tax Credit. A refundable tax credit is provided for the amount of the federal targeted jobs tax credit for qualified wages of employees who work for the claimant within a development zone. Under the federal targeted jobs tax credit, a tax credit may be claimed by employers who hire individuals from certain target groups with respect to wages and salaries paid to these individuals. The credit is equal to 40 percent of the first \$6,000 of qualified first-year wages paid to each such individual during the taxable year. Qualified wages are the wages paid (or incurred) during the tax year to members of the targeted group. The credit can be claimed for qualified wages paid in the first two years the employee works for the claimant and the definition of eligible target groups is expanded to include:

(1) Dislocated Farmers

These individuals are defined as persons who immediately before becoming unemployed were farmers and also meet the federal definition of dislocated workers.

(2) Persons Unemployed as a Result of a Business Facility Closing

This group includes persons who are not currently employed in a full-time job and who have been unemployed for a period of 60 days or more within the last two years as a result of a business facility closing in the state. "Business facility closing" is defined as the termination, within one year, of at least 50% of the employees of a business that before termination had at least 20 full-time employees.

(3) Persons Whose Unemployment Benefits Have Expired

This group includes persons who are not currently employed in a full-time job who have received unemployment compensation benefits for at least 60 days within the last two years and whose unemployment compensation benefits have expired.

An employee can be certified at any time within 30 days after being hired. Wages of leased or rented employees can only be claimed by their employer. The credit will be passed through to S corporation shareholders and partners in proportion to their ownership interest. Unused credit amounts will be refundable. No credit will be provided if a claimant's certification is revoked, the development zone ceases to exist, or the claimant ceases business operations in the development zone.

To receive the credit, a claimant is required to include along with his or her tax return:

- (1) A copy of the certification of eligibility for tax benefits.
- (2) Federal withholding forms or equivalent information concerning the wages paid to target group employees.
- (3) A statement of verification from the Department of Development of the information provided and verification that the employees are working or based in the development zone.
- (4) A copy of federal targeted jobs tax credit returns.

- c. Location Credit. Eligible persons may claim a tax credit of 2.5% of amounts expended on projects begun after the designation of a development zone to acquire, construct, rehabilitate, remodel, or repair real property in a development zone. However, no credit is allowed for amounts expended to purchase property used as a basis for the development zones investment credit.

The location credit and any carryforwards can only be used to offset taxes due on income attributed to business operations of the claimant in the development zone or the taxes on income from directly related business operations. The credit passes through to S corporation shareholders and partners proportionate to their ownership interests in such business. If the certification for tax benefits is revoked or the development zone ceases to exist, the credit may not be claimed for that year and unused credits may not be carried forward to succeeding years. Also, if the claimant ceases business operations in the zone, unused credit amounts may not be carried forward to succeeding years. In order to receive the location credit, a claimant must submit, along with the tax return, a copy of the certification for tax benefits and a statement by the Department of Development verifying both the amount of investment and the eligibility of the investment.

d. Sales Tax Credit

A refundable income tax credit will be available for the amount of sales taxes paid on investment credit property that is used in a development zone and also for the amount of sales taxes on the claimant's purchase, lease, or rental of construction materials and supplies and other materials used to construct, rehabilitate, repair, or remodel real property located in a development zone. The credit is first used to offset taxes otherwise due on or measured by the claimant's income. Unused credit amounts are refundable. The credit passes through to S corporation shareholders and partners based on their proportionate share of ownership in such business. No credit will be provided if a claimant's certification is revoked, the development zone ceases to exist, or the claimant ceases business operations in the development zone. A credit may not be claimed unless the claimant submits, along with the tax return, a certification of eligibility for tax benefits, a statement from the Department of Development verifying the amount of eligible sales taxes paid, and copies of invoices, receipts, or other records which show the amount of eligible sales taxes paid.

The current tax credit of 5% of eligible research expenditures for corporations is increased to 10% for eligible expenditures on research conducted in a development zone. The current research and development credit is equal to 5% of the difference between a company's noncapital research expenditures in Wisconsin in the current year and the average of such expenditures in Wisconsin in the "base period," defined to be the previous three years.

The 10% research credit and any carryforwards may only be used to offset taxes due on income attributed to business operations of the claimant in the development zone or the taxes on income from directly related business operations. If the certification for tax benefits is revoked or the development zone ceases to exist, credits may not be claimed for the year and unused credits may not be carried forward to succeeding years. Also, if the claimant ceases business operations in the zone, unused credit amounts may not be carried forward to succeeding years.