

## A. INDIVIDUAL AND FIDUCIARY INCOME TAXES

1. Reference to the Internal Revenue Code Updated for 1991 for Individuals, Estates, and Trusts (1991 Act 39, amend secs. 71.01(6)(e) and 71.01(7r) and create sec. 71.01(6)(f), effective for taxable years beginning on or after January 1, 1991.)

For taxable years that begin on or after January 1, 1991, "Internal Revenue Code" for individuals, estates, and trusts (except nuclear decommissioning trust or reserve funds) means the federal Internal Revenue Code as amended to December 31, 1990. The Internal Revenue Code applies for Wisconsin purposes at the same time as for federal purposes.

For example, Public Law 101-508 expanded the exclusion from gross income for up to \$5,250 of benefits provided by an employer under an educational assistance program to include graduate level courses leading to advanced academic or professional degrees, effective for taxable years beginning on or after January 1, 1991. That same effective date applies for Wisconsin purposes.

For property placed in service in taxable years beginning on or after January 1, 1991, individuals and fiduciaries may compute depreciation or amortization under either the federal Internal Revenue Code in effect for the taxable year for which the return is filed or the federal Internal Revenue Code as amended to December 31, 1990, at the taxpayer's option.

2. Federal Laws Enacted During 1990 Adopted to Apply Simultaneously for Wisconsin Purposes (1991 Act 39, amend sec. 71.01(6)(a), (b), (c), (d), and (e) and create nonstatutory provision, effective for taxable years beginning before January 1, 1991.)

The following federal laws enacted during 1990 apply for Wisconsin income tax purposes at the same time as for federal purposes:

- Technical Changes in the Ethics Reform Act of 1989 (Public Law 101-280), enacted May 4, 1990
- Revenue Reconciliation Act of 1990 (Public Law 101-508), enacted November 5, 1990

As a result of this law change, those items identified in the instructions to the 1990 Wisconsin Schedule I as differences between federal and Wisconsin law no longer are differences for taxable years that begin after December 31, 1989. If "Schedule I adjustments" were made to a 1990 Wisconsin return that has already been filed with the Department of Revenue, Wisconsin Form 1X may be used to reverse those adjustments.

For example, Public Law 101-508 made the following changes which are effective for Wisconsin purposes at the same time as for federal purposes:

- The exclusion for up to \$5,250 of employer-provided educational assistance, which had expired on September 30, 1990, was extended through taxable years beginning before January 1, 1992.

- The exclusions for amounts contributed by an employer to a qualified group legal services plan and for benefits received under the plan, which had expired on September 30, 1990, were extended through taxable years beginning before January 1, 1992.
- The deduction for 25% of the amounts paid for health insurance on behalf of a self-employed individual and the individual's spouse and dependents, which had expired on September 30, 1990, was extended through taxable years beginning before January 1, 1992.
- Effective for transfers after October 11, 1990, percentage depletion may be claimed on transferred proven oil and gas properties.
- For transfers after August 3, 1990, the limitation on tax-free exchanges between related persons is extended to include transfers between a partner and a controlled partnership.

3. Conform Filing Requirements and Standard Deduction for Dependents with Unearned Income to Federal (1991 Act 39, amend secs. 71.03(2)(a)3 and 71.05(22)(f), effective for taxable years beginning on or after January 1, 1991.)

A person who can be claimed as a dependent on another taxpayer's Wisconsin income tax return is required to file a Wisconsin income tax return if he or she has any amount of unearned income and gross income (including both earned and unearned income) of \$550 or more. The \$550 filing requirement applies whether or not the person is actually claimed as a dependent on another taxpayer's Wisconsin income tax return.

The minimum standard deduction for a dependent with unearned income is increased from \$500 to \$550.

In prior years, this filing requirement was based exclusively on unearned income. Earned income was not considered. The change for taxable years beginning on or after January 1, 1991, conforms the Wisconsin filing requirements and standard deduction to the federal filing requirements and standard deduction.

4. Prorate Health Insurance Deduction for Self-Employed Individuals Who are Part-Year Residents or Nonresidents (1991 Act 39, amend sec. 71.05(6)(a)12, effective for taxable years beginning on or after January 1, 1991.)

The deduction allowed for 25% of the health insurance costs of self-employed individuals (sec. 162(L), Internal Revenue Code) is limited for part-year residents and nonresidents of Wisconsin. The deduction allowable for federal tax purposes must be prorated, using the ratio of the individual's net earnings from a trade or business taxable by Wisconsin to the individual's total net earnings from a trade or business.

Example: The taxpayer is self-employed and a part-year resident of Wisconsin for 1991. His/her total self-employment income for 1991 is \$20,000 of which \$5,000 is taxable to Wisconsin. The deduction for federal tax purposes for health insurance costs under section 162(L), Internal Revenue Code is \$800. The deduction allowable for Wisconsin is \$200 computed as follows:

$$\$800 \times \frac{\$5,000}{\$20,000} = \$200$$

5. Prorate Deduction for Self-Employment Taxes for Part-Year Residents or Nonresidents (1991 Act 39, amend sec. 71.05(6)(a)12, effective for taxable years beginning on or after January 1, 1991.)

The deduction for one-half of federal self-employment taxes (sec. 164(f), Internal Revenue Code) is limited for part-year residents and nonresidents of Wisconsin. The deduction allowable for federal income tax purposes must be prorated, using the ratio of the individual's net earnings from a trade or business taxable by Wisconsin to the individual's total net earnings from a trade or business.

Example: The taxpayer is self-employed and a part-year resident of Wisconsin for 1991. His/her total self-employment income for 1991 is \$30,000 of which \$10,000 is taxable to Wisconsin. The deduction for federal tax purposes for one-half of the self-employment tax (sec. 164(f), Internal Revenue Code) is \$2,119. The deduction allowable for Wisconsin is \$706 computed as follows:

$$\$2,119 \times \frac{\$10,000}{\$30,000} = \$706$$

6. Eliminate Penalty on Distribution From Retirement Plan When Distribution is Exempt From Wisconsin Tax (1991 Act 39, amend sec. 71.83(1)(a)6, effective for taxable years beginning on or after January 1, 1991.)

For federal tax purposes, a penalty is imposed on certain distributions from retirement plans. For example, a 10% penalty is imposed on an early distribution.

For Wisconsin tax purposes, any person who is liable for a federal penalty on a distribution from a retirement plan is also liable for a Wisconsin penalty equal to 33% of the federal penalty. However, effective for taxable years beginning on or after January 1, 1991, retirement plan distributions which are exempt from Wisconsin income tax under sec. 71.05(1)(a), Wis. Stats., are not subject to the Wisconsin penalty.

7. Change State Historic Rehabilitation Credit (1991 Act 39, consolidate and renumber sec. 71.74(8)(d)(intro.) and 1 to 71.74(8)(d) and amend as renumbered, repeal secs. 71.07(9r)(b)3.c. and 7 and (h) and 71.74(8)(d)2, amend sec. 71.07(9r)(a), (b)2 and 5, (c), (f), (g), (i), and (j)(intro.) and 2, and create sec. 71.07(9r)(b)1m and (k), effective for taxable years beginning on or after January 1, 1991.)

The state historic rehabilitation credit is modified as follows:

- a. The credit is available only for property owned by individuals. Under prior law, the credit was also available for property owned by corporations, estates, trusts, partnerships and tax-option corporations.
- b. The historic property must be an owner-occupied personal residence which is not actively used in a trade or business, held for the production of income, or held for sale or other disposition in the ordinary course of the claimant's trade or business. Under prior law, the credit also applied to human burial sites, archaeological sites, and other property which was not eligible for the supplement to the federal historic rehabilitation credit.
- c. The expenditures for the preservation or rehabilitation of the historic property must exceed \$10,000. Under prior law, the qualified rehabilitation expenditures were to exceed the greater of \$1,000 or the adjusted basis of the building, if the historic property was a building, or of the entire property, if the historic property was not a building.
- d. The costs to be included in the claim can relate only to preservation or rehabilitation work done to any of the following:
  - (1) The exterior of the historic property.
  - (2) The interior of a window sash if work is done to the exterior of the window sash.
  - (3) Structural elements of the historic property.
  - (4) The heating or ventilating systems.
  - (5) Electrical or plumbing systems, but not electrical or plumbing fixtures.
- e. Eliminate the requirement that the property be 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, for a term of 20 years.
- f. Eliminate the requirement that costs had to be incurred after the State Historical Society approved the proposed preservation or rehabilitation plan.
- g. A person who receives the state historic rehabilitation credit shall add to his or her Wisconsin tax liability an amount equal to the amount of credits received if, within 5 years after the date on which the preservation or rehabilitation work that was the basis of the credit is completed, the person either (1) sells or conveys the property by deed or land contract, or (2) the State Historical Society certifies to the department that the historic property has been altered to the extent that it does not comply with prescribed standards.

8. Penalties on Distributions From Retirement Plans (1991 Act 39, amend sec. 71.83(1)(a)6, effective for taxable years beginning on or after January 1, 1991.)

Federal penalties imposed on certain retirement plan distributions to a 5% owner (sec. 72(m)(5), IRC) and on early distributions from modified endowment contracts (sec. 72(v), IRC) also apply for Wisconsin purposes. The Wisconsin penalty is equal to 33% of the federal penalty.

9. Require Reduction In Wisconsin Tax Attributes When Discharge of Indebtedness Income Is Excluded From Gross Income (1991 Act 39, create sec. 71.10(7m), effective for taxable years beginning on or after January 1, 1991.)

Section 108 of the Internal Revenue Code provides an exclusion from gross income for discharge of indebtedness income (cancellation of debts) when (1) the debt is discharged in bankruptcy under Title 11 of the U.S. Code, (2) the discharge occurs when the taxpayer is insolvent outside bankruptcy, or (3) the discharge consists of indebtedness that is qualified farm indebtedness.

When a taxpayer excludes income under section 108, IRC, the taxpayer is required to reduce certain federal tax attributes and the basis in qualified property by the amount of indebtedness discharged. Tax attributes are reduced dollar for dollar except for federal carryover credits which are reduced 33 1/3 cents for each dollar excluded. Tax attributes are reduced in the following order:

- a. Net operating loss
- b. General business credit
- c. Capital loss carryovers
- d. Basis reduction
- e. Foreign tax credit carryovers

Effective for taxable years beginning on or after January 1, 1991, a taxpayer who excludes income from discharge of indebtedness from gross income must use the Wisconsin net operating loss, Wisconsin carry-over credits, and the Wisconsin capital loss carryover to reduce tax attributes for Wisconsin purposes. The reduction rate for Wisconsin credit carry-overs is 6.93%.

Example: An insolvent taxpayer had \$15,000 of debt discharged in 1991. The taxpayer had the following tax attributes:

	<u>Federal</u>	<u>Wisconsin</u>
Net operating loss carryover	\$ 10,000	\$ 5,000
Business credit carryover	1,000	-0-
Capital loss carryover	-0-	1,000
Basis of qualified assets	100,000	100,000

For federal purposes, the taxpayer reduces his or her net operating loss to zero, business credit carryover to zero, and the basis of qualified assets to \$98,000. Thus the \$15,000 reduction in federal tax attributes consists of a \$10,000 reduction in the net operating loss carryover, a \$3,000 reduction resulting from decreasing the business credit carryover by \$1,000, and a \$2,000 reduction in the basis of qualified assets.

For Wisconsin purposes, the taxpayer reduces his or her net operating loss to zero, the capital loss carryover to zero, and the basis of the qualified assets to \$91,000. Thus the \$15,000 reduction in tax attributes consists of a \$5,000 reduction in the net operating loss carryover, a \$1,000 reduction in the capital loss carryover, and a \$9,000 reduction in the basis of qualified assets.

10. Wisconsin Earned Income Credit Based on Percentage of Federal Basic Credit (1991 Act 39, amend sec. 71.07(9e)(a)(intro.), effective for taxable years beginning on or after January 1, 1991.)

A person who qualifies for a federal earned income credit and has at least one dependent child qualifies for the Wisconsin earned income credit. The Wisconsin earned income credit is equal to a percentage of the federal basic credit, adjusted for family size. For eligible claimants, the Wisconsin credit is 5% of the federal basic credit if the claimant has one dependent child, 25% of the federal basic credit if the claimant has two dependent children, and 75% of the federal basic credit if the claimant has three or more dependent children.

Congress made changes to the federal earned income credit for taxable years beginning in 1991 and thereafter. The federal earned income credit will consist of three parts:

Part 1. Basic credit

Part 2. Health insurance credit

Part 3. Young child credit

Any portion of an individual's federal earned income credit which is attributable to the health insurance credit or the young child credit may not be used to calculate the Wisconsin earned income credit.

Example: The taxpayer has two dependent children and computes a federal earned income credit totalling \$1,664. The federal earned income credit is comprised of the following three parts:

\$1,017	Basic credit
353	Health insurance credit
294	Young child credit
<u>\$1,664</u>	Total federal credit

The taxpayer's Wisconsin earned income credit is \$254.25.  
( $\$1,017 \times .25 = \$254.25$ )

11. Clarify That Farmland Tax Relief and Farmland Preservation Credits Are Includable in Income (1991 Act 39, create sec. 71.05(6)(a)17, effective August 15, 1991.)

Under current law, secs. 71.07(3m)(d) and 71.61(2), Wis. Stats. (1989-90) require that the entire amount of farmland preservation credit and farmland tax relief credit allowable must be included in Wisconsin taxable income in the year of receipt.

This new provision in sec. 71.05(6)(a)17 clarifies this requirement as it pertains to individuals, estates and trusts, by providing an add modification for the amount of farmland preservation credit and farmland tax relief credit that is not included in federal adjusted gross income.

12. Change Cross-Reference Appearing in Definition of Net Operating Loss (1991 Act 39, amend sec. 71.01(14), effective for taxable years beginning on or after January 1, 1991.)

The definition of "Wisconsin net operating loss" includes a cross-reference to sec. 71.05(6)(b)(intro.), 1 to 8 and 10 to 12. This provision changes this specific cross-reference to sec. 71.05(6)(b), except sec. 71.05(6)(b)9. The change means that any new subtraction modifications that are created will automatically be included in the computation of a Wisconsin net operating loss.

13. Clarify Statutes Related to Taxation of Nonresidents on Lottery and Pari-Mutuel Wager Winnings (1991 Act 39, amend sec. 71.02(1), effective August 15, 1991.)

Under current law, income which nonresident individuals, estates, and trusts receive from the Wisconsin lottery, multistate lottery tickets purchased in Wisconsin, and pari-mutuel wagers made in Wisconsin has a taxable situs in Wisconsin. Income having a situs in Wisconsin is taxable by Wisconsin.

This provision conforms the statute relating to imposition of tax to that of taxable situs by providing that tax is imposed on nonresident individuals, estates, and trusts on income derived from the Wisconsin lottery, multistate lottery tickets purchased in Wisconsin, and pari-mutuel wagers made in Wisconsin.

This provision does not change the taxability of this income. Income which nonresident individuals, estates, and trusts receive from the Wisconsin lottery, multistate lottery tickets purchased in Wisconsin and pari-mutuel wagers made in Wisconsin is still taxable to Wisconsin.

14. Jobs Credit Reference to Federal Definition of a "Dislocated Worker" Corrected (1991 Act 39, amend sec. 71.07(2dj)(am)1, effective for taxable years beginning on or after July 1, 1989.)

For purposes of the Wisconsin development zones job credit, this provision provides that a "dislocated worker" is defined in 29 USC sec. 1651(a). Prior law referenced 29 USC sec. 1652(a). However, the federal definition of dislocated worker was renumbered from sec. 1652(a) to sec. 1651(a) by Public Law 100-418.

15. Repeal Deduction for Inheritance and Estate Tax Administration Expenses (1991 Act 39, repeal sec. 71.05(6)(a)11, 71.05(6)(b)7 and 71.07(5)(a)8, effective for expenses related to transfers because of deaths occurring on or after January 1, 1992.)

Under prior law, an estate could claim administration expenses either for Wisconsin inheritance tax purposes or for Wisconsin income tax purposes. Federal law permits a similar election for federal tax purposes. Different treatment could be elected for Wisconsin purposes from federal treatment.

The election for Wisconsin income tax purposes is repealed for deaths on or after January 1, 1992. Thus, whatever election is made for administration expenses for federal tax purposes will also control for Wisconsin.

16. Income Tax Exemption Repealed for Railroads, Sleeping Car Companies, and Car Line Companies (1991 Act 39, amend secs. 71.04(4) and 71.04(8)(title) and (c) and create nonstatutory provision, effective for taxable years beginning on or after January 1, 1991).

Income from railroads, sleeping car companies, and car line companies (companies which lease railroad cars) is no longer exempt from Wisconsin income taxes. A multistate railroad, sleeping car company, or car line company must apportion its income to Wisconsin based on rules to be promulgated by the Department of Revenue

17. Net Operating Loss Carryforward Limited (1991 Act 39, amend sec. 71.05(8)(b), effective for taxable years beginning on or after January 1, 1991).

In computing its Wisconsin taxable income, a taxpayer may not carry forward a net operating loss sustained in a taxable year in which the taxpayer was not subject to Wisconsin income taxation.

18. Small Business Stock Capital Gains Exclusion Modified (1991 Act 39, amend sec. 71.05(6)(b)6., effective for stock issued on or after August 16, 1991.)

For stock issued on or after August 16, 1991, the original purchaser of small business stock that is purchased at the time that the business is incorporated may claim the exclusion for net capital gains on small business stock if the taxpayer has not acquired the stock by gift, has not acquired the stock in a stock-for-stock exchange, and submits with his or her income tax return a copy of the certification received from the corporation.

Note: A tax release explaining the differences between the old and new laws will be published in a future issue of the Wisconsin Tax Bulletin. If you have questions about the small business stock exclusion, please write to the Technical Services Staff, Wisconsin Department of Revenue, P.O. Box 8933, Madison, WI 53708.



19. Tax Treatment of Income From Limited Partnership Interests Changed for Nonresidents and Part-Year Residents (1991 Act 39, amend secs. 71.02(1) and 71.04(1)(a), effective for the partnership's taxable year beginning on or after January 1, 1991, and the limited partner's taxable year as appropriate to conform the limited partner's treatment of the income from the partnership to the partnership's tax treatment.)

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. For any part of the taxable year a partner is a resident of Wisconsin, these same items of partnership income, loss, or deduction are subject to taxation by Wisconsin, regardless of whether attributable to business, services or property in Wisconsin or outside 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.

20. Exempt Interest Income From Certain WHEDA Bonds (1991 Act 37, create sec. 71.05(1)(c), effective August 2, 1991, and 1991 Act 39, create sec. 71.05(1)(d), effective August 15, 1991.)

Interest income from bonds issued by the Wisconsin Housing and Economic Development Authority (WHEDA) to fund loans under secs. 234.65 (professional sports and entertainment home stadiums exempt from property tax under sec. 70.11(36)) and 234.935 of the Wisconsin Statutes is exempt from Wisconsin income tax.

21. Provide Exclusion for Compensation Received by Members of the Reserves for Operation Desert Shield or Desert Storm (1991 Act 2, create sec. 71.05(6)(b)13 and 14, effective March 28, 1991.)

To the extent included in federal adjusted gross income, a member of a reserve component of the U.S. Armed Forces may subtract all or a portion of basic, special and incentive pay income or compensation received from the federal government for services performed for Operation Desert Shield or Operation Desert Storm in the Desert Shield or Desert Storm theater of operations.

"Services performed for Operation Desert Shield or Operation Desert Storm" means service in a unit of the U.S. Armed Forces if the service is performed by a person who is a member of a reserve component of the U.S. Armed Forces and is activated for Operation Desert Shield or Operation Desert Storm, and the service occurs during the period that there is in effect a designation by the President of the United States that the service is part of Operation Desert Shield or Operation Desert Storm.

The subtraction is limited to \$500 per month for a commissioned officer. There is no limitation for a person below the grade of commissioned officer.

22. Provide Exemption From Interest During Extension Period for Certain Persons (1991 Act 3, amend sec. 71.03(7), effective March 28, 1991.)

For taxable years beginning after December 1, 1989, and before January 1, 1991 (1990 tax returns), certain persons are exempt from interest during the period of time an extension for filing a Wisconsin tax return is in effect. The exemption from interest applies to the following:

- a. Persons who served in support of Operation Desert Shield, Operation Desert Storm, or a successor operation, in the United States.
- b. Persons who served in Egypt, Israel, Diego Garcia, or Germany.
- c. Persons who qualify for a federal extension of time to file under IRC sec. 7508 (extension due to service in a combat zone), who served outside the United States because of their participation in Operation Desert Shield, Operation Desert Storm, or a successor operation, in the theater of operations.

23. Clarify Exclusion for Compensation Received By Members of the Reserves for Operation Desert Shield or Desert Storm (1991 Act 39, amend sec. 71.05(6)(b)13.(intro.) and a. and 14.(intro.) and a., as created by 1991 Act 2, effective August 15, 1991.)

1991 Wisconsin Act 2 provided that a member of a reserve component of the U.S. Armed Forces may exclude from taxable income the amount received (limited to \$500 per month for a commissioned officer) from the federal government for services performed for Operation Desert Shield or Operation Desert Storm in the Desert Shield or Desert Storm theater of operations.

This provision clarifies that the exclusion applies to any member of a reserve component who was called to active duty specifically for Operation Desert Shield or Operation Desert Storm, regardless of where he or she was stationed.

24. Repeal the \$1,200 Limitation on Certain Interest Used in the Computation of the Itemized Deduction Credit (1991 Act 39, repeal sec. 71.07(5)(a)7, effective for taxable years beginning on or after January 1, 1993.)

Effective for taxable years beginning on or after January 1, 1993, the \$1,200 limitation on certain interest which is used in the computation of the Wisconsin itemized deduction credit is repealed. Therefore, all interest which is allowable as an itemized deduction on federal Schedule A is used in the computation of the Wisconsin itemized deduction credit except the following:

- a. Interest paid to purchase or hold securities issued by the federal government which is exempt from Wisconsin tax.
- b. Interest incurred to purchase or refinance a residence that is not a principal residence and is not located in Wisconsin.
- c. Interest incurred to purchase or refinance a residence that is a boat.