


Wisconsin TAX BULLETIN

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Electronic Filing Mandate Letters to Businesses


As part of the Wisconsin Department of Revenue's (DOR's) efforts to become more efficient, DOR will be mailing e-file mandate letters to sales and use tax accounts and withholding tax accounts that continue to file paper returns and make paper payments. The Wisconsin Administrative Code provides that DOR may require any sales and use tax return (ST-12), any withholding tax return (WT-7 and PW-1), and W2s/1099s of 250 or more (the Governor's 2009-2011 Budget Bill reduces this threshold from 250 to 50) to be filed by electronic means. The Wisconsin Administrative Code also provides that DOR may require electronic funds transfer when the aggregate amount due in the prior calendar year was \$10,000 or more for sales and use tax accounts, when the required deposits in the prior calendar year were \$10,000 or more for withholding tax accounts, and for any amount due for pass-through entities required to make withholding payments. There are provisions to request a waiver if the requirement to electronically file or pay by electronic funds transfer causes an undue hardship to the business. See the article titled "My Tax Account Debuts for Business Taxpayers" on page 4 to find an easy and secure way to e-file returns and make e-payments. 

Combined Reporting Implementation Update

For taxable years beginning on or after January 1, 2009, corporations that are commonly controlled and engaged in a unitary business are generally required to compute their Wisconsin income using combined reporting. This law change was enacted in 2009 Act 2, which was enacted February 19, 2009.

As explained in *Wisconsin Tax Bulletin* 160 (March 2009), the department has set up a web page to serve as a centralized source of information about combined reporting and how it will be administered. That web page is www.revenue.wi.gov/combrep/index.html. To access this page from the department's home page (www.revenue.wi.gov), click on "Businesses" and then click on "Combined Reporting."

The department is building a collection of frequently asked questions (FAQs) and answers about combined reporting. The available FAQs are on the combined reporting web page and will be updated on a continuing basis as implementation continues. The available FAQs as of the publication date of this *Wisconsin Tax Bulletin* are included on pages 17 to 24.

For any questions about combined reporting that are not yet answered in the FAQ collection on the web page, the department has set up a dedicated e-mail address. Send e-mail questions concerning combined reporting to dorcombinedreporting@revenue.wi.gov. 

New Field Audit Process

A field audit can consume a great deal of time and resources for both the department and the taxpayer. Therefore, reducing the amount of time and resources expended on an audit is a benefit to both the department and the taxpayer.

Based on feedback from taxpayers and practitioners, the department's field audit process will be reengineered to improve audit efficiency and completion times. Procedures used by the Internal Revenue Service were reviewed for guidance. Specifically, the Mutual Commitment Date Process used by the Small Business/Self-Employed Division (SBSE) and the Joint Audit Planning Process used by the Large and Mid-Size Business Division (LMSB) were reviewed.

The new department field audit process is called the Mutual Commitment Date Process, but it is not the same process that is used by the SBSE. However, the new department process does include components of the processes used by both the SBSE and LMSB. This new process was designed to achieve the following objectives:

1. Provide a consistent approach to the audit planning process.

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New Field Audit Process*(continued from page 1)*

2. Promote better communication between the department and the taxpayer during the audit process.
3. Establish accountability for the auditor and the taxpayer during the audit process.

The cornerstone of the Mutual Commitment Date Process is the taxpayer and auditor mutually agreeing to the establishment of three time periods relating to the conduct of the audit. These time periods are as follows:

1. The number of days a taxpayer has to respond to written information requests.
2. The deadline for the taxpayer to submit a claim for refund applying to the audit period.
3. The deadline for the auditor to provide a Notice of Proposed Audit Report to the taxpayer based on the taxpayer and auditor jointly working together on the audit, or the Mutual Commitment Date.

The department will begin using the Mutual Commitment Date Process with audits starting on or after July 1, 2009. For an audit in progress on July 1, 2009, the auditor, supervisor, and taxpayer may implement the Mutual Commitment Date Process for the audit depending on what stage the audit is in.

The department hopes that by following the policies and procedures of this new Mutual Commitment Date Process, there will be a more cooperative effort between the auditor and the taxpayer resulting in a more efficient and timely completion of the audit. [!\[\]\(e3275251d0893157c3584e20c81dc3ba_img.jpg\)](#)

Additional Guidance for Pass-Through Entities on Related Entity Expenses

Under Wisconsin law, taxpayers are required to “add back” certain expenses paid, accrued, or incurred to a related entity. These expenses may then be deducted for Wisconsin purposes if certain conditions are met. One of these conditions is that the expense be disclosed on Wisconsin Schedule RT if the total expenses paid, accrued, or incurred to all related entities are more than \$100,000. For purposes of applying this \$100,000 threshold, the taxpayer may multiply the expense amount by its Wisconsin apportionment percentage, if applicable.

For taxable years beginning on or after January 1, 2008, the expenses which must be added back are interest and rent expenses paid, accrued, or incurred to a related entity. See the summary in *Wisconsin Tax Bulletin 157* (July 2008), beginning on page 13, for details.

For taxable years beginning on or after January 1, 2009, the expenses which must be added back are interest expenses, rent expenses, intangible expenses, and management fees paid, accrued, or incurred to a related entity. See the summary in *Wisconsin Tax Bulletin 160* (March 2009), page 12, for details.

*(continued on page 3)***Wisconsin Tax Bulletin***Published quarterly by:*

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Additional Guidance for Pass-Through Entities on Related Entity Expenses

(continued from page 2)

Although the addback and disclosure requirements apply to taxpayers of all types, this article focuses on answering three frequently asked questions about how these requirements apply to pass-through entities and their members.

When are pass-through entities and their members considered to be “related entities”?

Wisconsin uses the loss disallowance rules provided in section 267 of the Internal Revenue Code (IRC) to determine if a taxpayer is a “related entity.” Section 267(b), IRC, lists relationships which are considered to be “related entities” for Wisconsin purposes. Section 267(e)(6) incorporates section 707(b), IRC, relating to partnerships. Under these sections, Wisconsin would determine that:

- A tax-option (S) corporation and its shareholder are “related entities” if the shareholder owns, directly or indirectly, more than 50 percent in value of the S corporation’s outstanding stock.
- A partnership and its partner are “related entities” if the partner owns, directly or indirectly, more than 50 percent of the capital interest or profits interest in the partnership.
- For relationships that involve estates and trusts, the relationship tests in section 267(b), IRC, apply in determining whether a trust or estate and its fiduciary, beneficiary, grantor, or executor are “related entities.”

How do pass-through entities report the addbacks?

A tax-option (S) corporation, partnership, or trust that has expenses subject to the addback requirement must make a Wisconsin addition modification for those expenses. If the expenses meet the criteria given in Schedule RT, Part II, the pass-through entity may make a subtraction modification for the qualifying amount. These modifications must be reported as follows (line references are to 2008 forms):

S Corporations – On Form 5S, Schedule 5K (and the respective Schedules 5K-1), report these modifications in two places:

- Column c of lines 1 through 12d, according to the type of pass-through item to which the expense relates (if the entire amount of expense is deductible, the addition and subtraction

modifications would cancel out and result in \$0 net adjustment), and

- Column d of lines 18a through 18d.

Partnerships – On Form 3, Schedule 3K (and the respective Schedules 3K-1), report these modifications in two places:

- Column c of lines 1 through 13d, according to the type of pass-through item to which the expense relates (if the entire amount of expense is deductible, the addition and subtraction modifications would cancel out and result in \$0 net adjustment), and
- Column d of lines 21a through 21d.

Trusts – On Form 2, Schedule A, report the addition modifications on line 5 and the subtraction modifications on line 11. On the Schedules 2K-1 (where applicable), report these modifications in two places:

- Column c of lines 1 through 13, according to the type of income to which the expense relates (if the entire amount of expense is deductible, the addition and subtraction modifications would cancel out and result in \$0 net adjustment), and
- Column d of lines 14a through 14d.

How do members of pass-through entities report the addbacks from the Schedules 5K-1, 3K-1, and 2K-1?

Resident individuals report the addition modifications on Form 1, line 4, and the subtraction modifications for the allowable deductions on Form 1, line 11. If the modifications come from a tax-option (S) corporation, use code 51 for both the line 4 amount and the line 11 amount. If the modifications come from a partnership or LLC treated as a partnership, estate, or trust, use code 52 for both the line 4 amount and the line 11 amount.

Nonresident individuals include the addition and subtraction modifications in the Wisconsin amount they report on Form 1NPR, line 15. These individuals must also submit an explanation of all addition and subtraction modifications included on that line.

Corporations report the addition modifications on Schedule V, lines 3 and 4, and the subtraction modifications for the allowable deductions on Schedule W, lines 2 and 3.

Pass-through entities report these modifications as described above. [!\[\]\(1ed10657a19f9137278430c48fd18626_img.jpg\)](#)

My Tax Account Debuts for Business Taxpayers

On February 2, 2009, the Department of Revenue (DOR) debuted *My Tax Account* on-line functionality for business taxpayers. *My Tax Account* allows business taxpayers and their representatives to electronically file returns for and pay sales and use tax, premier resort area tax, local exposition center tax, rental vehicle fee, and withholding tax, as well as view information about those accounts and initiate requests. DOR will be retiring several older on-line filing options later in 2009, so it is important for taxpayers and practitioners to register for and begin to use *My Tax Account*.

Usage of *My Tax Account* has been brisk, with 13,225 taxpayers registered for access to one or more tax accounts as of April 1, 2009. These taxpayers have initiated 18,703 returns and 13,650 payments through *My Tax Account*.

Information for Business Owners

To begin using *My Tax Account*, each business owner/officer or designated employee will need his or her own individual Wisconsin User ID (WAMS ID). Once a WAMS ID is obtained, the business owner/officer or designated employee may enter the business information and the business tax accounts at the *My Tax Account* web site.

After a business tax account has been added, click on the appropriate account number and select *File a Return*. To complete the return filing process, enter contact information, click the *Next* button, enter your password and select *I Agree*. Payment options will be offered after the return is filed.

Information for Practitioners

Each practitioner using *My Tax Account* will also need his or her own individual WAMS ID. Once a WAMS ID is obtained, practitioners that own or work for an accounting firm should log into *My Tax Account* and complete the Customer Access Request using the firm's information. Independent preparers organized as sole proprietors should use their own individual information.


After successfully completing the Customer Access Request within *My Tax Account*, practitioners may request access to client accounts by logging back into *My Tax Account* and selecting *Add 3rd Party Account Access for SIP User* or *Add 3rd Party Account Access*.

Please note that practitioners will only be able to request access to business tax accounts that have already been entered in *My Tax Account*.

My Tax Account Shortcuts & Tips

- To obtain a WAMS ID, see Self-Registration at <https://on.wisconsin.gov>.
- If you already have a WAMS ID associated with your e-mail address, but you don't remember your User ID and password, go to the Account Recovery link at <https://on.wisconsin.gov/WAMS/home>.
- *My Tax Account* may be accessed at <https://tap.revenue.wi.gov>.
- A business owner that successfully completes the Customer Access Request, but doesn't see a business tax account(s) after logging into *My Tax Account*, may select *Add Access to an Account* to add a business tax account.
- An owner of multiple businesses will need multiple WAMS IDs for registration purposes (one for each business). Each WAMS ID requires a unique e-mail address.
- See the Registration Quick Start link at www.revenue.wi.gov for step-by-step registration instructions.
- If you are planning to start using *My Tax Account* for your next return filing, you should initiate the registration process a few days before the due date of the return so that you have sufficient time to feel comfortable working through the steps of this new process.

Reminders

- No new registrations are being accepted for DOR's previous sales tax on-line option, Sales Internet Process (SIP), which will be taken out of service after **June 5, 2009**. (The XML bulk file transmission process for sales tax returns and sales tax TeleFile will remain available.)
- The EFT Payment and Registration System will not be available after **December 31, 2009**, and no new registrations will be accepted after **May 15, 2009**, for the tax types covered by *My Tax Account*. 

Do Not Send Partnership Return Information by Magnetic Media


Effective January 1, 2009, the Department of Revenue no longer accepts partnership Schedules K-1 and 3K-1 on magnetic media (e.g., compact disks, etc.). If you have sent these documents by magnetic media in the past, you should now send them electronically through the department's web site.

No PIN or password is required to submit your file through our 128-bit encrypted SSL file transmission site. Follow these simple instructions:

1. Go to www.revenue.wi.gov/eserv/w-2.html.
2. Click on the link "Ready to Transfer EFW2."
3. Select "K-1s and 3K-1s in PDF" from the drop-down menu.

4. Click on "Browse" and find the appropriate file on your computer.
5. When the "Choose File" box appears, find your file and double click on it.
6. Verify the correct file in the location next to the "Browse" button and click on "Transfer" to submit your file.

A receipt number will be displayed for your records.

If you have any questions, contact the Department of Revenue by e-mail at W2Data@revenue.wi.gov or call (608) 267-3327. 



Administrative Rules in Process

Listed below are administrative rules that are currently in the rule promulgation process. The rules are shown at their stage in the process as of April 1, 2009, and at each step where action occurred during the period from January 1, 2009, through April 1, 2009.

The listing includes rule numbers and names, and whether a rule is amended (A), repealed and recreated (R&R), or a new rule (NR).

Emergency Rules Adopted and in Effect

- 8.03 Wine collectors – NR
- 8.05 Small winery cooperative wholesalers – NR

Pending Submission to Legislative Council Rules Clearinghouse


- 1.12 Electronic funds transfer – A
- 2.03 Corporation returns – A
- 2.04 Information returns and wage statements – A
- 2.08 Returns of persons other than corporations – A
- 4.001 Motor vehicle, alternate fuels, and general aviation fuel tax return and refund claim forms – NR

- 7.001 Fermented malt beverage tax return and refund claim forms – NR
- 8.001 Intoxicating liquor report, tax return, and refund claim forms – NR
- 9.001 Cigarette and tobacco products report, tax return, and refund claim forms – NR
- 11.01 Sales and use tax, local exposition tax, and premier resort area tax return forms – A

Pending Submission for Legislative Committee Review

- 8.03 Wine collectors – NR
- 8.05 Small winery cooperative wholesalers – NR

To order up-to-date administrative rules of the Department of Revenue (DOR), you can contact the Document Sales and Distribution Section of the Wisconsin Department of Administration to obtain the Tax section of the Wisconsin Administrative Code. Additional information is available at www.legis.state.wi.us/rsb/codinfo.html.

Information concerning administrative rules of DOR, as well as other state agencies, is also available at <https://apps.dhfs.state.wi.us/admrules/public/Home>. At this web site you can search for rules, view the status of current rulemaking, view documents associated with rulemaking, submit and view comments on rules, and subscribe to receive notification of rulemaking. 

Negligence Penalties May Be Imposed in Field Audits

The Field Audit Section of the Wisconsin Department of Revenue has the authority to impose various civil penalties during the field audit of a taxpayer's franchise, income, withholding, or sales and use tax returns.


The objective of the department is to administer the imposition of negligence penalties in a fair and consistent manner. Following are some of the factors considered by the department in determining whether negligence penalties should or should not be imposed. In addition, statistics are provided indicating the percentage of field audit actions in the past four years that included negligence penalties.

Factors considered by the department in determining whether negligence penalties should or should not be imposed include:

- Taxpayer's awareness of the taxable status of the items adjusted.

- Certainty or uncertainty of the taxable status of the items adjusted.
- Availability to the taxpayer of any written material on the taxable status of the items adjusted.
- Prior audit history and prior penalty imposition.
- Adequacy of the records and taxpayer's efforts to establish adequate records.
- Consistency and pattern of errors.
- Any other information that relates to whether or not there was good cause for underreporting.


Field audit negligence penalties imposed:

Fiscal Year Ending June 30...	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Number of Negligence Penalties	418	475	387	421
Number of Actions	1949	1865	1639	1726
Percentage	21.4%	25.5%	23.6%	24.4% 




Take Advantage of the Speakers Bureau

Are you planning a meeting, workshop, conference, or training program? The Department of Revenue's Speakers Bureau provides speakers who can provide information on a variety of topics to business, community, and educational organizations.

Additional information concerning the Speakers Bureau may be found in Wisconsin Publication 700, which is available at www.revenue.wi.gov/pubs/pb700.pdf. 

Reminder: Look-Up of Estimated Tax Payments


Every year, the Department of Revenue (DOR) adjusts the estimated tax payments claimed on thousands of tax returns. In an effort to minimize this type of adjustment, DOR developed an application that allows individuals, corporations, partnerships, trusts, estates, and practitioners to verify available estimated tax payments when completing a tax return.

The estimated tax application is available at <https://ww2.revenue.wi.gov/PaymentInquiry/application>. Information on how the application works may be found at www.revenue.wi.gov/faqs/pes/estpay.html. 

Updated Publications

Since the last issue of the *Wisconsin Tax Bulletin*, the following publications of the Income, Sales, and Excise Tax (IS&E) Division of the Department of Revenue have been revised:

- 102 Wisconsin Treatment of Tax-Option (S) Corporations and Their Shareholders (3/09)
- 114 Your Wisconsin Taxpayer Bill of Rights (3/09)
- 119 Limited Liability Companies (3/09)
- 123 Business Tax Credits for 2008 (4/09)
- 219 Hotels, Motels and Other Lodging Providers: How Do Wisconsin Sales and Use Taxes Affect Your Operations? (3/09)
- 400 Wisconsin's Recycling Surcharge (3/09)

All of the IS&E Division's publications may be downloaded or ordered online at www.revenue.wi.gov/html/taxpubs.html. There are over 70 publications available, covering a wide range of topics. 



Enforcement Report

Husband Follows Wife to Jail for Tax Fraud

A Waukesha man, Elfatih Ibrahim, 43, was sentenced in February 2009 in Dane County Circuit Court to serve one year in the county jail for stealing \$138,000 in sales tax money and filing a fraudulent income tax return for 2005. He was also placed on probation for five years and ordered to make restitution to the state. Ibrahim pleaded guilty on October 31, 2008. His wife, Soha Shanaa, received a one-year jail sentence in Waukesha County in April 2008 after pleading guilty to filing fraudulent income tax returns and public assistance fraud as part of the same scheme.

According to a criminal complaint filed on February 1, 2008, Ibrahim and his wife operated the Midtown Shell gas station at 641 N. Hawley Road in Milwaukee. The complaint alleged that Ibrahim filed fraudulent sales tax returns and skimmed sales tax money collected from the sales of cigarettes and groceries between 2002 and 2006.

The complaint further alleged that the couple also evaded \$10,802 in state income taxes for 2004 and 2005 by filing fraudulent income tax returns and underreporting income from their business operation. The couple reported making \$28,207 and \$37,197, respectively, while the Wisconsin Department of Revenue determined that their actual income was \$89,880 and \$113,302 in these two years.

The couple also illegally received \$15,595 in medical assistance benefits from Waukesha County between January 2003 and April 2006, based on their underreported earnings.

During these years the couple owned a \$46,000 Lexus, made accelerated payments of \$3,000 per month on their \$335,000 Waukesha home, and sent monthly checks of \$3,500 to Soha Shanaa's parents, according to the complaint. The couple also used money from their business account to pay for personal expenses including payments for credit cards, home utilities, loan repayments, and other personal expenses totaling \$72,118 in 2004 and \$60,231 in 2005.

The case was prosecuted by the State Attorney General's Office after an investigation by the Wisconsin Department of Revenue's Criminal Investigation Section.

Arizona Woman Pleads Guilty to Homestead Credit Fraud Scheme

An Arizona woman formerly from Milwaukee pleaded no contest in February 2009 in Dane County Circuit Court to three felony counts of filing fraudulent claims for credit and two felony counts of identity theft.

According to the criminal complaint filed in November 2008, Susanna Terrell, 39, filed 139 fraudulent Wisconsin homestead credit claims between 2006 and 2008. She attempted to obtain homestead credit refunds of \$133,000 by using the identities of over 90 people without their knowledge. The homestead credit is a refundable tax credit for Wisconsin renters and property owners. Terrell received a two-year prison sentence for a conviction in Milwaukee County in 2000 for a similar crime.

According to the complaint, Terrell began filing fraudulent homestead credit claims in 2006 because she had maxed out several credit cards, had unpaid bills, and had a gambling addiction. Terrell admitted to spending up to \$200 a day on lottery tickets. She confessed to the scheme in June 2008, when agents from Wisconsin executed a search warrant at her home in El Mirage, Arizona, a Phoenix suburb.

The case was investigated by agents of the Wisconsin Department of Revenue and the US Postal Inspection Service after the Department of Revenue noticed a large number of refund checks that were mailed to Wisconsin addresses had been cashed in Arizona.

Terrell told investigators that she obtained identifying information of individuals through her employment at ACE Cash Express and Circle K Convenience stores and also from the Maricopa County Arizona web site. She said that she used the Wisconsin Circuit Court System (CCAP) web site to search for eviction cases to find landlord names and addresses to use on the fraudulent homestead credit claims. Shortly after filing the fraudulent claims, Terrell would file change of address requests with the Post Office in order to have the homestead credit checks forwarded to a mailbox under her control. The complaint alleges that Terrell filed 139 false homestead credit claims using 92 different names and cashed \$79,896 of the \$133,292 she attempted to obtain.

Terrell could face up to 30 years in prison, \$50,000 in fines, or both.

Neillsville Man Sentenced on Theft and Tax Fraud Charges

Richard H. Harrison, Jr., 33, entered no contest pleas in March 2009 in Clark County Circuit Court to one felony count of theft by a contractor and one felony count of filing a fraudulent Wisconsin income tax return. As part of a plea agreement, related charges were dismissed but read into the record for sentencing.

According to the complaint, Harrison received funds from a woman who hired him to tear down her fire damaged home and erect the shell of a new home. The complaint stated that Harrison did not perform all of the work and diverted the funds he received from the woman to his personal gain.

The tax complaint stated that Harrison failed to report all the receipts from this transaction, resulting in his income being understated by \$49,813. As a result, Harrison evaded Wisconsin income tax of \$2,907.

Judge James Mason withheld sentence and placed Harrison on probation for six years for the theft charge and three years on the tax charge to run concurrently. As a condition of probation, he was ordered to spend 343 days in jail and given credit for time served. He was also ordered to pay restitution of \$52,302.14, file an amended 2006 Wisconsin income tax return reflecting all the unreported income, and pay all taxes and penalties due. [Ⓜ](#)



Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

Individual Income Taxes

Gambling losses
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Tax-option (S) corporation losses – basis limitation
Wayne Roden and Suzanne Balistreri.....9

Sales and Use Taxes

Admissions
Milwaukee Symphony Orchestra, Inc.10

INDIVIDUAL INCOME TAXES

— Gambling losses. *Dennis C. and Jacqueline S. Mahoney vs. Wisconsin Department of Revenue* (Court of Appeals, District II, December 23, 2008). See *Wisconsin Tax Bulletin* 153 (October 2007), page 20, for a summary of the Wisconsin Tax Appeals Commission decision. The Circuit Court's prior decision was not summarized in the *Wisconsin Tax Bulletin*. The issue in this case is whether the department properly disallowed the deduction for gambling losses claimed by the taxpayers.

The department issued an income tax assessment against the taxpayers disallowing the deduction for gambling losses claimed on the 2003 Wisconsin income tax return, and the taxpayers sought review before the Commission. The taxpayers argued that although the gambling losses could not be deducted as a miscellaneous itemized deduction for Wisconsin income tax purposes, they could be subtracted from federal adjusted gross income under sec. 71.05(6)(b)5., Wis. Stats. The Commission concluded that the taxpayers failed to demonstrate that sec. 71.05(6)(b)5., Wis. Stats., allows a deduction for gambling losses and failed to show that the department's assessment was in error. The taxpayer petitioned the Circuit Court for review of the Commission's decision, and the Circuit Court affirmed the Commission.

The Court of Appeals affirmed the Commission's decision that the taxpayer was not entitled to a deduction for gambling losses under sec. 71.05(6)(b)5., Wis. Stats. The Court also rejected the taxpayers' argument that the Wisconsin Constitution does not permit the taxation of gambling income of a non-professional gambler because that income does not fall within the common, ordinary meaning of income. Therefore, the Court of Appeals affirmed the Circuit Court's order upholding the Commission.

The taxpayers have not appealed this decision.

— Tax-option (S) corporation losses – basis limitation. *Wayne Roden and Suzanne Balistreri vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 26, 2009). The issue in this case is whether the department properly disallowed the taxpayers' deduction for tax-option (S) corporation losses due to basis limitation.

By notice dated December 13, 2004, the department issued an income tax assessment against the taxpayers that, in part, disallowed the losses from Golf Fitness, Inc., a closely-held S corporation of the taxpayers. The taxpayers filed a timely petition for redetermination of the department's assessment, which was denied by the department by notice dated August 8, 2005. The taxpayers filed a timely petition for review with the Commission on September 23, 2005.

In substantiation of their basis in Golf Fitness, Inc., the taxpayers provided bank statements showing checks written on the account of Balistreri & Associates Physical Therapy, Inc., another closely-held S corporation of the taxpayers. The department concluded that the statements provided did not substantiate that the taxpayers either loaned money to or invested money in Golf Fitness, Inc.


The Commission looked to established case law, which has placed a heavy burden on shareholders who seek to rearrange the indebtedness of related closely-held S corporations. Courts have often found that when a related party funds a shareholder loan to an S corporation, the shareholder has made no economic outlay sufficient to generate basis as the necessity of repayment of the funds is uncertain. Case law has also established a narrow "incorporated pocketbook" exception, which generally

holds that an S corporation acts as an agent of the shareholder by making payments on the shareholders behalf, thus allowing the taxpayer to increase his or her basis even though the funds advanced came from a related corporate entity and not from the taxpayer directly.

The Commission concluded that the taxpayers failed to meet their burden of proof that the department erred in its determination, as they 1) did not make an actual economic outlay by transferring funds from one S corporation to another, 2) have not met the “incorporated pocketbook” exception, and 3) have not demonstrated the necessity of repayment of the funds advanced to Golf Fitness, Inc.

It was not known at the time of publication whether the taxpayers would appeal this decision.

SALES AND USE TAXES

 **Admissions.** *Milwaukee Symphony Orchestra, Inc. vs. Wisconsin Department of Revenue* (Court of Appeals, April 16, 2009). See *Wisconsin Tax Bulletin* 150 (January 2007), pages 31 and 32, and *Wisconsin Tax Bulletin* 157 (July 2008), page 23, for summaries of the Wisconsin Tax Appeals Commission and Dane County Circuit Court decisions, respectively.

The main issue in this case is whether revenues received by Milwaukee Symphony Orchestra Inc. (MSO) from admissions to its concerts are subject to Wisconsin sales tax under sec. 77.52(2)(a)2., Wis. Stats., which imposes Wisconsin sales and use tax on the sale of admissions to amusement, athletic, entertainment, or recreational events or places.

The Department of Revenue contends that MSO’s performances are *primarily entertainment* in nature. It was the assertion of MSO that its purpose of performing is *primarily educational* in nature. The Wisconsin Tax Appeals Commission previously concluded that the concerts at issue are *not primarily educational* events and the receipts from its concerts are, therefore, subject to Wisconsin sales tax.

The Wisconsin Tax Appeals Commission (the Commission) previously held that (1) MSO’s performances were properly characterized as entertainment events for purposes of imposing sales tax under sec. 77.52(2)(a)2., Wis. Stats.; and (2) sales of admissions to MSO’s performances are not immune from sales tax under *Kollasch* and its progeny.

In a judicial review of the Commission’s decision, the Circuit Court determined that the Commission’s interpretation of sec. 77.52(2)(a)2., Wis. Stats., as establishing a test based on a distinction between educational and entertainment events, had no foundation in the statute. The Circuit Court stated that the educational value of an event is not an appropriate test to determine whether an event is “entertainment.” The Circuit Court remanded the action back to the Commission to develop a standard for determining whether an event is “entertainment” within the meaning of sec. 77.52(2)(a)2., Wis. Stats., and then apply its standard to the evidence.

MSO appealed the Circuit Court’s decision, contending that a remand is unnecessary. The Department of Revenue filed a cross appeal.

The Court of Appeals concluded that the Commission’s decision is entitled to due weight deference, and applying that standard, the Commission properly interpreted sec. 77.52(2)(a)2., Wis. Stats., in deciding that MSO’s concerts are primarily entertainment events. The Commission reasonably decided that MSO’s concerts are not charitable under the definition MSO provided, notwithstanding the importance of the performing arts to communities. The Commission also reasonably decided that neither the charitable purpose of a concert nor the fact that an organization is considered “charitable” for other tax purposes precludes a concert from being considered primarily an entertainment event and therefore taxable under sec. 77.52(2)(a)2., Wis. Stats. The Court of Appeals reversed the Circuit Court’s decision ordering a remand to the Commission and directed the Circuit Court to enter an order affirming the Commission’s decision.

It was not known at the time of publication whether this decision would be appealed.



Tax Releases

“Tax Releases” are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those in a tax release, the answers may not apply. Unless otherwise indicated, tax releases apply for all periods open to adjustment, and all references to section numbers are to the Wisconsin Statutes. (Caution: Tax releases reflect the position of the Wisconsin Department of Revenue, of laws enacted by the Wisconsin Legislature as of the date published in this Bulletin. Laws enacted after that date, new administrative rules, and court decisions may change the answers in a tax release.)

The following tax release is included:

Sales and Use Tax

1. Purchases Made by a Person Under a Contract with the Federal Government for the Sale of Real Property, Tangible Personal Property, or Services 11

SALES AND USE TAX

1 Purchases Made by a Person Under a Contract with the Federal Government for the Sale of Real Property, Tangible Personal Property, or Services

Statutes: Sections 77.51(5), (14r), and (14)(g); 77.52(2m)(a) and (b) and (15); and 77.55(1), Wis. Stats. (2007-08).

Wis. Adm. Code: Section Tax 11.67(2) and (3)(e)2., Wis. Adm. Code (April 2000 Register).

Background: Section 77.51(5), Wis. Stats. (2007-08), defines the term “incidental” to mean “...depending upon or appertaining to something else as primary; something necessary, appertaining to, or depending upon another which is termed the principal; something incidental to the main purpose of the service. Tangible personal property transferred by a service provider is incidental to the service if the purchaser's main purpose or objective is to obtain the service rather than the property, even though the property may be necessary or essential to providing the service.”

Section 77.51(14r), Wis. Stats. (2007-08), provides that a sale of tangible personal property takes place when and where the possession of the property is transferred by the seller or the seller's agent to the purchaser or the purchaser's agent.

Section 77.51(14)(g), Wis. Stats. (2007-08), provides that the definition of “sale,” “sale, lease or rental,” “retail sale,” and “sale at retail” includes a sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States or its instrumentalities for the construction of improvements on or to real property.

Section 77.52(2m)(a) and (b), Wis. Stats. (2007-08), provides the following:

“(a) With respect to the services subject to tax under sub. (2), no part of the charge for the service may be deemed a sale or rental of tangible personal property if the property transferred by the service provider is incidental to the selling, performing or furnishing of the service, except as provided in par. (b).

(b) With respect to the services subject to tax under sub. (2) (a) 7., 10., 11., and 20., all property physically transferred to the customer in conjunction with the selling, performing or furnishing of the service is a sale of tangible personal property separate from the selling, performing or furnishing of the service.”

Section 77.52(15), Wis. Stats. (2007-08), states, in part, that “(i)f a purchaser who gives a resale certificate makes any use of the property other than retention, demonstration or display while holding it for sale, lease or rental in the regular course of the purchaser's operations, the use shall be taxable to the purchaser under s. 77.53 as of the time the property is first used by the purchaser, and the sales price of the property to the purchaser shall be the measure of the tax. ...”

Section 77.55(1), Wis. Stats. (2007-08), provides that the sale of any tangible personal property or services to the United States and its unincorporated agencies and instrumentalities is exempt from Wisconsin sales tax.

Question: What is the proper sales and use tax treatment of purchases made by a person under contract with the federal government for the sale of real property, tangible personal property, or services?

Answer: The general sales and use tax treatment is as follows:

- A. Sales of tangible personal property and taxable services that are made directly to the federal government are exempt from sales and use tax.
- B. Property physically transferred to the federal government, except property used in real property construction (see Part G) or transferred incidentally with a service (see Part C), may be purchased by the contractor without tax for resale (or as an ingredient or component part of property manufactured and destined for sale).

NOTE: Property that is transferred in the performance of certain services is deemed to be sold separately from the selling, performing or furnishing of the service. These services are photographic services subject to tax under sec. 77.52(2)(a)7., Wis. Stats.; repair or other services to tangible personal property subject to tax under sec. 77.52(2)(a)10., Wis. Stats.; producing, fabricating, processing, printing or imprinting of tangible personal property subject to tax under sec. 77.52(2)(a)11., Wis. Stats.; and landscaping services subject to tax under sec. 77.52(2)(a)20., Wis. Stats. The property transferred in the performance of these specific services is not transferred incidentally with these services and may be purchased by the contractor without tax for resale.

- C. Property transferred incidentally with a service is consumed by the contractor in performing its service; therefore, the contractor is liable for sales or use tax on its purchases of such property. (See Parts B and G.)

Section Tax 11.67(2)(a), Wis. Adm. Code (April 2000 Register), provides that persons engaged in the business of furnishing services are consumers, not retailers, of the tangible personal property which they use incidentally in rendering their services and tax applies to the sale of the tangible personal property to them. Specifically, sec. Tax 11.67(3)(e)2., Wis. Adm. Code (April 2000 Register), provides that a person performing research and development services is the consumer of materials used in providing

those services. As such, the person performing the services is subject to Wisconsin sales or use tax on materials used in research and development, including items transferred incidentally with the service. (See the NOTE in Part B for property that is deemed to be sold separately from the service and, therefore *not* transferred incidentally with the service.)

- D. A contractor may not purchase without tax, for resale, property that is never transferred to the federal government.

Only property that is actually transferred to the federal government may be purchased without tax for resale by the contractor. Section 77.51(14r), Wis. Stats. (2007-08), states that a sale involving transfer of ownership of property shall be deemed to have been completed at the time and place when and where possession is transferred by the seller or the seller's agent to the purchaser or the purchaser's agent.

- E. If the contractor makes any use before transferring possession to the federal government, the contractor is liable for Wisconsin sales or use tax on its purchase of the property.

A contractor who gives a resale certificate and makes any use of the property other than retention, demonstration or display while holding it for sale, lease or rental in the regular course of the contractor's operations, is liable for sales or use tax when the property is first used by the contractor (sec. 77.52(15), Wis. Stats. (2007-08)).

- F. *Prototypes* - When developing a prototype for the federal government, it must be determined whether the primary objective of the federal government is to receive the prototype or the information resulting from the production of the prototype.

- If the federal government's primary objective is to receive the prototype, the developer may purchase, without tax for resale, the materials used in the prototype that it transfers to the federal government without tax for resale. The sale of the prototype to the federal government is exempt from Wisconsin sales and use tax, since sales to the federal government are exempt from tax.

- If the federal government's primary objective is to obtain the information resulting from the production of the prototype, the prototype is transferred to the federal government incidentally with the research and development services provided. The person developing the prototype is the consumer of the materials that it purchases and uses to construct the prototype and is liable for tax on its purchase of such materials.

G. *Real Property Construction* – The contractor is the consumer of materials that it uses in real property construction activities for the federal government and is liable for Wisconsin sales or use tax on its purchase of such materials. The real property construction contractor may not purchase materials without paying sales or use tax and sell such materials to the federal government if the contractor is also the person performing the real property construction activity in which the materials are to be used. (NOTE: When a contractor hires a subcontractor to install materials, the contractor is considered to be the installer of the materials.)

If the federal government purchases the building materials **directly** from a supplier who does not install such materials, the federal government's purchase of such materials is exempt from Wisconsin sales or use tax, even though the materials are later used by a contractor in the erection of a building or structure, or in the alteration, repair, or improvement of real property for the exempt entity. Suppliers of building materials and equipment may presume that a sale is made **directly** to an exempt entity if the supplier receives a purchase order from the exempt entity, and payment for the building materials and equipment is received from the exempt entity.

See the tax release titled "Purchases of Building Materials by Exempt Entities for Use by Contractor in Real Property Construction," which was published in *Wisconsin Tax Bulletin* 115 (October 1999) beginning on page 27, for additional information about sales to exempt entities.

H. *Purchasing Agent for the Federal Government* - For Wisconsin sales and use tax purposes, a third-party, such as a contractor, may act as a purchasing agent for the federal government, separate and apart from its other activities, under common law. In order to show that a true agency relationship exists, the following conditions must be met:

- There must be some written indication, such as a contract or agency agreement that the contractor, in purchasing materials for a federal government project, is acting in good faith as a fiduciary of and for the welfare of the federal government. The purchasing agent must make known to suppliers that it is acting as the purchasing agent for the federal government.
- An agent cannot deal for its own benefit without the consent and the full knowledge of the federal government. An agent cannot act in two distinct and opposite characters in the same transaction.
- The written contract must contain a clause stating that all property belongs to the federal government and title passes to the federal government upon the contractor's receipt of the materials.
- The agency agreement must disclose that any advantages (such as savings or term discounts) or risks (such as defective materials) of the purchase of the materials must belong to, and must be passed on to, the federal government. The agency agreement must also provide that the federal government must approve all of its agent's purchases and be aware of the amount that the agent is paying for materials. When transferring the materials to the federal government, the agent may not make a profit and, with regard to its purchase of materials, the agent may only collect from the federal government the amount it paid for the purchase of those materials. The agency agreement must also provide that the liability for payment of materials ultimately belongs to the federal government in the event that full payment is not received by suppliers from the agent.

While a supplier is not required to determine whether a true agency relationship exists between a contractor and the federal government, the supplier may accept an exemption certificate in good faith from a contractor claiming exemption as a purchasing agent for the federal government if (1) the supplier receives written notice signed by an authorized person of the federal government that the contractor is acting as a purchasing agent for the federal government; (2) the supplier receives written notice that all liabilities relating to the sale rest with the federal government*; and (3) the supplier has no reason to believe that these statements are not true.

*If the bill for the materials is not paid (or paid with insufficient funds), the federal government is liable for the payment to the supplier.



Private Letter Rulings

“Private letter rulings” are written statements issued to a taxpayer by the department, that interpret Wisconsin tax laws based on the taxpayer’s specific set of facts. Any taxpayer may rely upon the ruling to the extent the facts are the same as those in the ruling.

The ruling number is interpreted as follows: The “W” is for “Wisconsin”; the first four digits are the year and week the ruling becomes available for publication (80 days after it is issued to the taxpayer); the last three digits are the number in the series of rulings issued that year. The date is the date the ruling was issued.

Certain information that could identify the taxpayer has been deleted. Additional information is available in Wisconsin Publication 111, “How to Get a Private Letter Ruling From the Wisconsin Department of Revenue.”

The following private letter ruling is included:

Sales and Use Taxes

Sales of yearbooks through a third-party sales agency
W 0907003 (p. 15)

✱ **W 0907003** ✱

November 25, 2008

Type Tax: Sales and Use Taxes

Issue: Sales of yearbooks through a third-party sales agency

Statutes: Section 77.54(4), Wis. Stats. (2005-06)

This letter responds to a request for a private letter ruling dated July 22, 2008.

Facts, as provided:

- Company A manufactures school yearbooks.
- The school purchasing the yearbooks from Company A is responsible for the content of the yearbooks.
- The school purchasing the yearbooks is responsible for the sale and delivery of the yearbook to the student or other purchaser.
- In addition to taking orders for the yearbooks itself, a school can also contract with Company A for any one or all of the optional programs that Company A offers to assist the school in marketing and taking orders of the yearbooks.
- The optional programs are (1) school order day; (2) a home order mailing; and (3) a website and call center for taking orders.
- Under the “school order day” program, students fill out the order forms at school and then up to 3 invoices will be mailed to the student’s home for payment.
- Under the “home order mailing” program, the school selling the yearbooks provides a list of all of the student’s names and addresses and order forms are sent directly to the student’s homes.
- Under the “school support” program, orders are allowed to be placed online and via the telephone.
- If a school enters into a contract with Company A for one of the optional programs described above, Company A hires a third party to fulfill its responsibilities under the contract related to the optional program(s) that Company A entered into with the school.
- All yearbooks ordered through these optional programs are delivered to the school for distribution, in the same manner as yearbooks that were not ordered through these optional programs.
- The selling price of the yearbooks offered through these optional programs is set by the school.
- Payments for the yearbooks ordered through any of these optional programs are collected by either Company A or another third party and offer various payment alternatives (i.e., pay by credit card, check, or make installment payments).

- All of the amounts collected by Company A or another third party under the optional programs are fully credited to the school's account on a daily basis and are treated as payments made by the school to Company A for its purchases of yearbooks from Company A. (Note: With respect to these payments, if a check is returned for insufficient funds, the school is still responsible for paying for that yearbook and for collecting the payment from the customer in the event Company A or the third party hired by Company A cannot obtain the payment.)
- If the total amount collected by Company A or the third parties hired by Company A exceeds the school's total cost of all of the yearbooks it is purchasing, the excess amount is refunded to the school.
- Company A invoices the school for all of the yearbooks sold to them, including the yearbooks in which orders were placed through one of the optional programs offered by Company A or a third party hired by Company A.
- If a school has chosen to participate in one or more of the optional programs offered by Company A, an additional per-unit charge is added to the amount charged to the school for yearbooks ordered through these programs for Company A's handling of these orders. An additional per-unit charge is not added for those yearbooks where the orders and payments were handled solely by the school.

Request:

You are asking if the orders that are received by Company A or a third party hired by Company A, under the facts described above, are subject to Wisconsin sales or use tax.

Ruling:

The yearbook orders that are taken by Company A or a third party hired by Company A under the facts above are not subject to Wisconsin sales or use tax, provided the school on whose behalf the orders are taken is an elementary or secondary school that is exempt as such from payment of income or franchise tax under ch. 71, Wis. Stats.

Company A or the third party hired by Company A is just taking orders and collecting the amounts due on behalf of the school, based on the prices set by the school. The school is the retailer of these yearbooks and under sec. 77.54(4), Wis. Stats. (2005-06), an exemption is provided from Wisconsin sales and use tax for the "Gross receipts from the sale of tangible personal property, and the storage, use or other consumption in this state of tangible personal property which is the subject of any such sale, by any elementary school or secondary school, exempted as such from payment of income or franchise tax under ch. 71, whether public or private."

(Note: If the school or entity selling the yearbooks is someone other than an elementary or secondary school that is exempt from payment of income or franchise tax under ch. 71, Wis. Stats., sales by those schools may be subject to Wisconsin sales or use tax depending on the specific facts and circumstances.)

Wisconsin Department of Revenue

**Frequently Asked Questions:
Combined Reporting**

For taxable years beginning on or after January 1, 2009, corporations that are commonly controlled and engaged in a unitary business are generally required to compute their Wisconsin income using combined reporting. The department is building a collection of frequently asked questions (FAQs) and answers about combined reporting and will make them available on its combined reporting web page, at <http://www.revenue.wi.gov/comb rept/index.html>.

The combined reporting FAQs are currently divided into the following categories:

- A. Who Must Use Combined Reporting
- B. Income Includable in Combined Report
- C. Apportionment
- D. Business Losses
- E. Credits
- F. Forms, Payments, and Administrative Issues
- G. Other Issues Affecting Combined Filers

This collection will grow as implementation of the new law continues. Below are answers to some FAQs that are currently available.

A. Who Must Use Combined Reporting

Question A1: What types of entities are required to use combined reporting?

Answer A1: Only regular “C” corporations are required to use combined reporting. Tax-option (S) corporations and individuals must file separate returns. Income earned by a pass-through entity such as a partnership, limited liability company, estate, or trust is included in a combined report to the extent the income passes through to a corporation.

However, the Department of Revenue has authority to require entities other than “C” corporations to use combined reporting in cases where separately reporting those entities would result in an avoidance or evasion of tax (sec. 71.255(2)(f), Wis. Stats.).

Question A2: Are any industries or specific types of corporations exempt from combined reporting?

Answer A2: No, except for corporations that are specifically exempt from Wisconsin income and franchise taxes altogether. For example, tax exempt organizations under sec. 71.26(1), Wis. Stats., or foreign insurers exempt under sec. 71.45(1), Wis. Stats., are not required to include any of their income in a combined report. For more about how combined reporting affects domestic insurance companies, see Question A8.

Question A3: How does a corporation know if combined reporting applies?

Answer A3: The corporation must use combined reporting if three tests are met:

- **Test 1:** The corporation is in a *commonly controlled group* of corporations (see Question A4 for details),
- **Test 2:** The corporation and at least one other member of the commonly controlled group are engaged in a *unitary business* (see Question A5 for details), and
- **Test 3:** The corporation meets the “*water’s edge*” test (see Question A6 for details).

Question A4: What is a “commonly controlled group” of corporations?

Answer A4: A corporation may be required to use combined reporting if it is in a “commonly controlled group” of corporations. A “commonly controlled group” is defined in the combined reporting statute (sec. 71.255(1)(c), Wis. Stats.). Under this definition, corporations are in a commonly controlled group if:

- There is common ownership (either directly or indirectly) of stock representing more than 50% of the voting power of each corporation in the group, or
- Stock representing more than 50% of the voting power in each corporation are interests that cannot be separately transferred.

Question A5: What is a “unitary business”?

Answer A5: A “unitary business” is defined in the combined reporting statute (sec. 71.255(1)(n), Wis. Stats.) as a single economic enterprise made up of one or multiple related entities which are sufficiently interdependent, integrated, and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.

The statute provides that entities are presumed to be a unitary business if the entities have unity of ownership, operation, and use as indicated by the presence of one or more specific factors. These factors include:

- Centralized management;
- Centralized executive force;
- Centralized purchasing, advertising, or accounting;
- Intercompany sales or leases;
- Intercompany services, including administrative, employee benefits, human resources, legal, financial, or cash management services;
- Intercompany debts;
- Intercompany use of proprietary materials;
- Interlocking directorates or corporate officers.

However, the statute provides that these factors are not an all-inclusive list.

Question A6: What is the “water’s edge” test?

Answer A6: Under Wisconsin’s combined reporting law, the “water’s edge” test determines whether a foreign corporation is includable in a combined report. (A foreign corporation means a corporation incorporated outside the United States). The water’s edge test also determines whether any of a domestic corporation’s foreign-source income is includable in the combined report.

A corporation meets the water’s edge test (and may be required to be included in a combined report) if less than 80% of its worldwide income is “active foreign business income” as defined in section 861(c)(1)(B) of the Internal Revenue Code.

“Active foreign business income” is income which is:

- Derived from non-U.S. sources, and
- Attributable to the active conduct of a trade or business by a corporation (or its subsidiary) in a foreign country or possession of the U.S.

For more information on how the water’s edge test affects the types of income includable in a combined report, see Questions B1 and B2.

Question A7: Will the Wisconsin combined group be the same as the federal consolidated group?

Answer A7: The Wisconsin combined group may be larger or smaller than the federal consolidated group. There are three differences between the Wisconsin combined group and federal consolidated group. These differences are:

- The Wisconsin combined group must only include companies that are engaged in the same unitary business, while the federal consolidated group may include companies that are not unitary. This may cause the Wisconsin combined group to be smaller than the federal consolidated group.
- The Wisconsin combined group includes companies that are more than 50% commonly controlled, while the federal consolidated group includes only companies that are more than 80% commonly owned or controlled. This may cause the Wisconsin combined group to be larger than the federal consolidated group.
- The Wisconsin combined group includes foreign corporations that meet the “water’s edge” test, while the federal consolidated group generally does not include foreign corporations. This may cause the Wisconsin combined group to be larger than the federal consolidated group.

However, in some cases, the Wisconsin combined group and federal consolidated group may be the same group of corporations.

Question A8: How does combined reporting affect insurance companies?

Answer A8: Domestic insurers compute their Wisconsin income or franchise tax liability using the lesser of two computations: 1) 7.9% of Wisconsin net income or 2) 2% of gross premiums as defined in sec. 76.62, Wis. Stats. A domestic insurer must use combined reporting to determine the amount of Wisconsin net income under computation 1). However, computation 2) is not affected by combined reporting.

Thus, if a domestic insurer’s income or franchise tax liability based on 2% of gross premiums is less than its income or franchise tax liability based on Wisconsin net income using combined reporting, the insurer may use the 2% of gross premiums computation.

Foreign insurers exempt from taxation under sec. 71.45(1), Wis. Stats., are not affected by combined reporting.

Question A9: If a corporation is not included in a combined report because it doesn't meet the three tests (described in Question A3), is it still required to file a Wisconsin return?

Answer A9: Yes, if it has nexus in Wisconsin. If a corporation is not includable in a combined report, it must still file a Wisconsin return on a separate entity basis if it has nexus in Wisconsin.

B. Income Includable in a Combined Report

Question B1: When do I have to include foreign sourced income in a combined report?

Answer B1: The answer depends on whether the corporation earning the income is a domestic corporation (i.e. incorporated in the U.S.) or a foreign corporation.

- **For foreign corporations:** Do not include foreign source income (or loss) of a foreign corporation in a combined report. You must also exclude the expenses associated with the foreign source income (or loss).
- **For domestic corporations:** In general, you must include foreign source income (or loss) of a domestic corporation if it is taxable under the Internal Revenue Code as modified for Wisconsin purposes. However, if 80% or more of the domestic corporation's worldwide income is active foreign business income as described in Question A6, you should not include foreign source income (or loss) or the expenses associated with that income (or loss).

Any income excluded from a combined report but which is still taxable under the Internal Revenue Code as modified for Wisconsin purposes must be reported to Wisconsin on a separate entity basis if the corporation has nexus in Wisconsin.

Also, the Department of Revenue has authority to require this income to be included in the combined report in cases where excluding it would result in an avoidance or evasion of tax (sec. 71.255(2)(f), Wis. Stats.).

Question B2: When do I have to include income of a foreign corporation in a combined report?

Answer B2: It depends on whether the foreign corporation meets the water's edge test described in Question A6. If a foreign corporation does not meet the water's edge test (in other words, if 80% or more of its income is active foreign business income), it can be considered to be on the "foreign side of water's edge."

- **If on foreign side of water's edge:** None of the foreign corporation's income (or loss) is includable in the combined report. You must also exclude expenses associated with this income (or loss).
- **If on U.S. side of water's edge:** Include the foreign corporation's income (or loss) in the combined report, along with the associated expenses. However, only include this income (or loss) and associated expenses to the extent they are U.S. sourced.

Any income excluded from a combined report but which is still taxable under the Internal Revenue Code as modified for Wisconsin purposes must be reported to Wisconsin on a separate entity basis if the corporation has nexus in Wisconsin.

Also, the Department of Revenue has authority to require this income to be included in the combined report in cases where excluding it would result in an avoidance or evasion of tax (sec. 71.255(2)(f), Wis. Stats.).

Question B3: How do I know if income is U.S. sourced or foreign sourced?

Answer B3: The combined reporting statute uses sections 861 through 865 of the Internal Revenue Code to distinguish U.S. sourced income from foreign sourced income.

Question B4: Are intercompany transactions between members of the combined group eliminated for purposes of determining the combined group's income?

Answer B4: In general, yes. Since the incomes of the corporations are combined before apportionment, intercompany transactions generally "wash out" in the same manner they would in a federal consolidated return.

C. Apportionment

Question C1: How is a corporation's share of the combined group's Wisconsin income computed?

Answer C1: Each corporation in the group multiplies the combined group's unitary business income by an apportionment fraction. The numerator of the fraction is the numerator of the corporation's modified sales factor. The denominator of the fraction is the sum of the denominators of all group members' modified sales factors. The "modified sales factor" is a single apportionment factor equal to a corporation's sales apportionment factor, receipts factor, or premiums factor – whichever applies to that corporation.

For companies that use multiple-factor formulas under the Department of Revenue's administrative rules, those multiple-factor formulas are converted to a modified sales factor as described in Question C4.

Question C2: Is there any apportionment computation for 100% Wisconsin corporations?

Answer C2: It depends on whether there is at least one member of the combined group that is engaged in business outside Wisconsin. If there is at least one member of the combined group that is engaged in business outside Wisconsin (and at least one member that is engaged in business in Wisconsin), the entire combined group uses the apportionment computation described in Question C1. However, if no corporation in the group is engaged in business in any state other than Wisconsin, the combined group does not apportion its income.

Question C3: Are intercompany transactions eliminated when computing the apportionment factors?

Answer C3: Yes, you must eliminate intercompany transactions in computing the apportionment factors of each member of the combined group.

Question C4: How does a corporation that uses a multiple-factor apportionment formula convert it to a modified sales factor for purposes of combined reporting?

Answer C4: The combined reporting statute (sec. 71.255(5)(a)5, Wis. Stats.) provides a formula that converts a multiple-factor apportionment formula into a modified sales factor. The steps to this formula are as follows:

- **Step 1:** Compute the corporation's apportionment percentage on a separate entity basis, using the multiple-factor formula that applies under current administrative rules. Exclude from these factors any intercompany transactions between members of the combined group.

- **Step 2:** Compute the corporation's total company sales on a separate entity basis. For this purpose, "sales" means sales as defined in sec. 71.25(9)(e), Wis. Stats. Exclude any transactions between members of the combined group.
- **Step 3:** Compute the corporation's modified sales factor numerator. The modified sales factor numerator is the apportionment percentage from Step 1 multiplied by the total company sales from Step 2.
- **Step 4:** The corporation's modified sales factor denominator is the total sales amount from Step 2. Add this amount to the denominators of the other members of the group to arrive at the combined group's modified sales factor denominator.

D. Business Losses

Question D1: If a corporation has net business loss carryforwards as of the beginning of its 2009 taxable year, what happens to those net business loss carryforwards under combined reporting?

Answer D1: Losses generated by a combined group member for taxable years beginning before January 1, 2009 are allowed only to that member. In other words, Wisconsin's combined reporting law does not allow members of the combined group to share net business losses that were generated in taxable years beginning before January 1, 2009.

E. Credits

Question E1: If a corporation has credit carryforwards as of the beginning of its 2009 taxable year, what happens to those credit carryforwards under combined reporting?

Answer E1: Credits and any credit carryforwards are available only to the separate corporation that generated them. However, credits from prior year estimated tax overpayments or excess withholding may be shared at the group level.

F. Forms, Payments, and Administrative Issues

Question F1: Is there a registration process for the combined group?

Answer F1: A combined group does not have to pre-register as a combined group. The return filed by the designated agent of the combined group will identify the members of the combined group included in the return.

Question F2: Who is the "designated agent" of the combined group?

Answer F2: The designated agent plays an important role and has significant responsibilities. The designated agent is generally the parent corporation, but may also be appointed by the members.

The designated agent does the following duties on behalf of the entire combined group, to the extent those duties relate to the unitary business:

- Files the combined return, any extensions, amended returns, and claims for refund or credit;
- Remits all taxes, including estimated taxes;

- Sends and receives correspondence;
- Participates in audits of the combined return, including the production of documents for audit;
- Executes waivers, POAs, and closing agreements; and
- Receives notices and refunds.

Also, an appeal filed by the designated agent is considered filed by all members of the group.

Question F3: Before a combined group files a combined return for the first time, will the designated agent have to register with the department as the designated agent?

Answer F3: The designated agent does not have to register in advance. The department will be able to identify the designated agent at the time the designated agent files the combined return on behalf of the combined group.

Question F4: When should I start considering combined reporting in my computation of estimated tax payments?

Answer F4: The law provides a grace period for the designated agent to make any estimated payments for the combined group that are due less than 45 days after March 6, 2009. The due date of these payments is extended to the next subsequent installment due date. Thus, the following due dates apply:

- For combined groups on a calendar year, the first estimated payment is due on June 15, 2009. This payment must take into account the combined group's first and second installment payments.
- For combined groups on a fiscal year beginning February 1, 2009, the first estimated payment is due on July 15, 2009. This payment must take into account the combined group's first and second installment payments.
- For combined groups on a fiscal year beginning March 1, 2009, the first estimated payment is due on May 15, 2009. This payment only needs to take into account the combined group's first installment payment.

Question F5: How does a designated agent make an estimated payment on behalf of the entire combined group?

Answer F5: The designated agent should use electronic funds transfer or a Form 4-ES, *Corporation Estimated Payment Voucher*, in the same manner as it would make payments under separate entity filing.

The designated agent is not required to register as the designated agent in order to submit estimated payments on behalf of the group. The designated agent is also not required to identify the members of the group at the time that it makes an estimated payment on behalf of the group. Rather, when the designated agent files the group's combined return, it will submit a department-prescribed form with the return to identify the corporations included. The designated agent's payments will be deemed to be made on a pro rata basis by all members of the combined group unless the designated agent specifies otherwise.

Question F6: How would the combined group determine its taxable year when members of the combined groups have taxable years beginning on different dates?

Answer F6: If two or more members of a combined group file in the same federal consolidated return, the combined group's taxable year is the taxable year of the federal consolidated group. In all other cases, the taxable year is the taxable year of the corporation that is the designated agent.

G. Other Issues Affecting Combined Filers

Question G1: How does combined reporting affect the applicability and determination of the recycling surcharge?

Answer G1: Each corporation in a combined group is considered a separate corporation for purposes of imposing the recycling surcharge. Therefore, the \$4,000,000 gross receipts threshold, the \$25 minimum recycling surcharge, and the \$9800 maximum recycling surcharge are determined separately for each entity in the combined group. However, since the recycling surcharge for corporations is based on the corporation's gross tax liability under Chapter 71, Wis. Stats., combined reporting may impact the amount of the surcharge owed by each corporation in the combined group.