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 releases are included:

INDIVIDUAL INCOME TAX

1 Computation of Wisconsin Taxable Income From Gambling Winnings

Background: This tax release explains Wisconsin's income tax treatment of gambling winnings, and demonstrates how a nonprofessional gambler computes his or her taxable gambling winnings for Wisconsin purposes.

A taxpayer is a "professional gambler" if his or her gambling activity is a trade or business for purposes of deducting ordinary and necessary expenses under section 162(a) of the Internal Revenue Code. All other taxpayers with gambling activity are considered nonprofessional gamblers.

If a taxpayer is not a professional gambler, he or she determines the taxable amount for each gambling session. The taxpayer includes net winnings from all winning sessions in Wisconsin taxable income if the winnings have a situs in Wisconsin. If the taxpayer has a losing session, the net loss from that session is not deductible for Wisconsin income tax purposes.

A "gambling session" is a period of continual play with only a short break in play (for example, a restroom break, beverage break, table/machine change, game change, etc.).

For taxpayers that are Wisconsin residents, gambling income has a situs in Wisconsin regardless of where the gambling activity takes place. For taxpayers that are nonresidents, gambling income has a situs in Wisconsin if the net winnings are derived from any of the following:

- A casino or bingo hall located in Wisconsin and operated by a Native American tribe or band
- Pari-mutuel wagering paid by a Wisconsin racetrack
- The Wisconsin Lottery
- A multijurisdictional lottery if the ticket was purchased from a Wisconsin retailer

The taxpayer must be able to prove the amounts deducted in arriving at the "net winnings" from a gambling session. The proof could be detailed original statements from a casino showing the taxpayer's betting activities, or it could be the taxpayer's own detailed records showing all bets (including the amount bet, amount won, date, location, race, etc.) if the records were prepared at the time the betting took place.

If a taxpayer has records to substantiate his or her gambling activities, the net winnings will be different than the amount reported on the W-2G that he or she received from the casino. However, if the taxpayer has no records to prove the amount spent on the gambling session, the taxpayer must include the W-2G amount in income.

For a professional gambler, the total winnings for the year are reported on Schedule C as gross receipts, and the total amount wagered for the year is a Schedule C expense.

The following examples illustrate how taxable gambling winnings are computed for Wisconsin purposes:

Example 1:

X, a resident of Wisconsin, is a nonprofessional gambler. X plays slot machines at a casino located in Wisconsin on June 1st from 9:00 a.m. to 1:00 p.m. During that time, X bet $500, won a $2,000 jackpot, kept gambling, and then lost $400 of that jackpot.

If X has records to substantiate the losses during this gambling session, X has net gambling income of $1,100. This amount must be included in Wisconsin taxable income.

If X does not have records to substantiate the losses during this gambling session, X must include in income the $2,000 figure shown on the W-2G that X receives from the casino.

Example 2:

Assume X from Example 1 returns to the same Wisconsin casino on the evening of June 1st and plays slots from 8:00 p.m. to 11:00 p.m. During that time, X bets $700 and loses it all.

None of this loss is deductible for Wisconsin purposes and it cannot be used to reduce the winnings from earlier in the day.

Example 3:

Assume X from Examples 1 and 2 is a professional gambler and maintains adequate records to substantiate the losses. X would report $2,000 as income on Schedule C and $1,600 ($900 + $700) as a Schedule C expense. The net amount of $400 would be included in Wisconsin taxable income.

Example 4:

Y, a resident of Wisconsin, is a nonprofessional gambler. Y goes to a casino and starts playing on a slot machine. Y bets a total of $100. Y cashes out of that machine, receives a voucher for $50 and immediately puts the voucher in a second machine and starts playing. Y cashes out of the second machine, receives a voucher for $120 and immediately puts the voucher in a third machine and starts playing. Y cashes out of the third machine, receives a voucher for $80 and immediately puts the voucher in a fourth machine and starts playing. Y cashes out of the fourth machine, receives a voucher for $130, redeems the voucher for cash and leaves the casino. Y has net gambling income of $30 from this gambling session. This amount must be included in Wisconsin taxable income.

Example 5:

Z, a resident of Wisconsin, is a nonprofessional gambler. Z goes to a casino and starts playing on a slot machine. Z bets a total of $100. Z cashes out of that machine, receives a voucher for $50 and immediately puts the voucher in a second machine and starts playing. Z cashes out of the second machine, receives a voucher for $120, redeems the voucher for cash and sits down at a blackjack table. Z exchanges $100 in cash for $100 in chips. Z plays for some time, leaves the table, redeems all of his chips for $150 in cash and leaves the casino. Z has net gambling income of $70 ($20 + $50) from this gambling session. This amount must be included in Wisconsin taxable income.

Example 6:

Assume the same facts as Example 5, except Z redeems all of his chips for $25 in cash. Z has a net gambling loss of $55 ($20 - $75) from the gambling session. This loss is not deductible for Wisconsin purposes and it cannot be used to reduce the net winnings from any other gambling session.

Example 7:

Assume the same facts as Example 5, except Z plays at three different blackjack tables and takes his chips with him each time. Z leaves the last table, redeems all of his chips for $150 in cash and leaves the casino. Z has net gambling income of $70 ($20 + $50) from the gambling session. This amount must be included in Wisconsin taxable income.

Example 8:

B, a resident of Wisconsin, is a nonprofessional gambler. B goes to a casino and starts playing on a slot machine. B bets a total of $100. B cashes out of that machine, receives a voucher for $50 and immediately puts the voucher in a second machine and starts playing. B cashes out of the second machine, receives a voucher for $120, and leaves the gaming area for more than a half hour (i.e., eats lunch, goes for a walk, sees a show). B has ended a gambling session and has net gambling income of $20 for that session. This amount must be included in Wisconsin taxable income.

Example 9:

C, a resident of Wisconsin, is a nonprofessional gambler. C goes to a casino and starts playing on a slot machine. C bets a total of $100. C cashes out of that machine, receives a voucher for $50 and immediately puts the voucher in a second machine and starts playing. C cashes out of the second machine, receives a voucher for $120, redeems the voucher for cash, and sits down at a blackjack table. C exchanges $100 in cash for $100 in chips. C plays for some time, leaves the table with $110 in chips and leaves the gaming area for more than a half hour (i.e., eats lunch, goes for a walk, sees a show). C has ended a gambling session and has net gambling income of $30 ($20 + $10) from that session. This amount must be included in Wisconsin taxable income.

Example 10:

D, a resident of Wisconsin, is a nonprofessional gambler. D goes to a casino and starts playing on a slot machine. D bets a total of $100. D cashes out of that machine, receives a voucher for $50, redeems the voucher for cash and sits down at a blackjack table and exchanges $50 in cash for $50 in chips. D leaves the blackjack table and redeems all of his chips for $150 in cash. D goes to a slot machine and bets $60 losing all of it. D leaves the casino. D has a net gambling loss of $10 (-$50 + $100 -$60) from this gambling session. None of this loss is deductible for Wisconsin purposes and it cannot be used to reduce the net winnings from any other gambling session.

Example 11:

Assume the same facts as Example 10, except assume D leaves the gaming area for more than a half hour (i.e., eats lunch, goes for a walk, sees a show) after leaving the blackjack table and before returning to the slot machine. D has two gambling sessions. For the first, D has net gambling income of $50. This amount must be included in Wisconsin taxable income. For the second, D has a net gambling loss of $60. None of this loss is deductible for Wisconsin purposes and it cannot be used to reduce the net winnings from any other gambling session.

2 Telecommuting and Mobile Employees

Statutes: Sections 71.02(1), 71.03(2), 71.05(2), 71.07(7), 71.63(2), and 71.64(6), Wis. Stats. (2009-10)

Background: Section 71.02(1), Wis. Stats. (2009-10), imposes a net income tax on all net incomes of individuals residing within Wisconsin and, for nonresident individuals, upon such income as is derived from property located or business transacted within Wisconsin and upon such income as is derived from the performance of personal services within Wisconsin.

Section 71.03(2), Wis. Stats. (2009-10), provides that "Every nonresident person and every person who changes domicile into or out of this state during the taxable year shall file a return if the person is unmarried and has gross income of $2,000 or more, or if the person is married and the combined gross income of the person and his or her spouse is $2,000 or more."

Section 71.05(2), Wis. Stats. (2009-10), provides that "All payments received by natural persons domiciled outside Wisconsin who derive income from the performance of personal services in Wisconsin shall be excluded from Wisconsin gross income to the extent that it is subjected to an income tax imposed by the state of domicile; provided that the law of the state of domicile allows a similar exclusion of income from personal services earned in such state by natural persons domiciled in Wisconsin, or a credit against the tax imposed by such state on such income equal to the Wisconsin tax on such income." (**Note:** Wisconsin currently has reciprocity agreements with Illinois, Indiana, Kentucky, and Michigan.)

Section 71.07(7), Wis. Stats. (2009-10), provides a credit for tax paid to another state. "If a resident individual . . . pays a net income tax to another state, that resident individual . . . may credit the net tax paid to that other state on that income against the net income tax otherwise payable to the state on income of the same year. The credit may not be allowed unless the income taxed by the other state is also considered income for Wisconsin tax purposes."

Section 71.63(2), Wis. Stats. (2009-10), provides " 'Employee' means a resident individual who performs or performed services for an employer anywhere or a nonresident individual who performs or performed such services within this state. . ."

Section 71.64(6)(a), Wis. Stats. (2009-10), provides "At the time of payment of wages to a nonresident employee which wages were derived from the performance of services both within and without the state, the employer shall deduct and withhold from the wages derived from the performance of services within the state the amount as reflected by the proper withholding table." Paragraph (b) provides "No amount shall be withheld from the wages paid to a nonresident employee for services performed in this state if the employer reasonably estimates that during the calendar year the employee will earn less than $1,500; but whenever it appears that the employee will earn more than $1,500 in this state during the calendar year, the employer shall withhold, from wages paid thereafter, such additional amounts as the employer reasonably estimates will be required to offset the amounts not withheld from previous payments."

Wisconsin has historically used the physical presence test to determine whether an employee's income is sourced to Wisconsin. An employee who is a resident of another state and who telecommutes for a Wisconsin employer would be subject to income taxation in Wisconsin on the amount earned for the days the employee is present in Wisconsin. A Wisconsin employer would be required to withhold tax from the telecommuting employee's pay if the total amount of Wisconsin income is over $1,500 per year.

For an employee who is a resident of Wisconsin and telecommutes for an out-of-state employer, the employee's income would be sourced to Wisconsin.

Facts and Question 1:

An individual is a Wisconsin resident (i.e., is domiciled in Wisconsin). The individual commutes daily to her job in another state. Is the income earned in the other state taxable to Wisconsin?

Answer 1:

Yes, the income earned in the other state is taxable to Wisconsin. Section 71.04(1)(a), Wis. Stats., provides that all income or loss of resident individuals shall follow the residence of the individual.

If the individual is required to pay an income tax to the other state on the same income that is taxable to Wisconsin, the individual may be allowed a credit on the Wisconsin income tax return for tax paid to that other state.

Facts and Question 2:

An individual is a resident of Minnesota. The individual performed services for a Wisconsin corporation during the entire calendar year. The individual received total compensation of $60,000. During this period of time, the individual telecommuted from his home office located in Minnesota for 230 business days. The individual worked at the employer's Wisconsin site for 10 business days during the year. What amount of income earned by the individual is taxable to Wisconsin?

Answer 2:

The individual's total compensation for the year was $60,000 for 240 days (230 days in Minnesota and 10 days in Wisconsin). The compensation was $250 per day ($60,000 ÷ 240 = $250). Because the individual worked 10 days in Wisconsin, $2,500 ($250 x 10) is taxable to Wisconsin. Because the amount subject to Wisconsin income tax is more than $1,500, the employer must withhold Wisconsin income tax from the individual's wages. The individual must file a nonresident Wisconsin income tax return (Form 1NPR) to report the $2,500 of income taxable to Wisconsin. The individual must also file a Minnesota income tax return to report the $60,000 to Minnesota. Minnesota may allow a credit for tax paid to Wisconsin.

Note: The answer would be different in these examples if the individual was a resident of a state with which Wisconsin has a reciprocity agreement. Under a reciprocity agreement, Wisconsin will not tax the wages of an individual who is a resident of the other state working in Wisconsin, and the other state will not tax the wages of a Wisconsin resident working in that other state. If, for example, the individual was a resident of Illinois instead of Minnesota, the wages earned in Wisconsin by the Illinois resident would not be taxable to Wisconsin. (Wisconsin formerly had a reciprocity agreement with Minnesota, but that agreement ended on January 1, 2010.)

Facts and Question 3:

An individual is a resident of Wisconsin who generally works in Wisconsin. The individual's employer temporarily assigns her to work in Minnesota for four months to complete a project. The individual continues to receive her pay from her Wisconsin employer. The individual earns $5,000 per month. How much of the individual's income is taxable to Minnesota?

Answer 3:

Because the individual performed four months of service in Minnesota, $20,000 ($5,000 x 4 months) of her compensation is sourced to Minnesota and taxable to Minnesota. The total income for the year, $60,000 ($5,000 x 12 months) is taxable to Wisconsin. The individual must file a nonresident income tax return in Minnesota to report the $20,000 taxable to Minnesota. The individual must also file a resident Wisconsin income tax return (Form 1) and report the $60,000 of income taxable to Wisconsin. The individual may be able to claim a credit on the Wisconsin return for tax paid to Minnesota.

Facts and Question 4:

An individual is a resident of Minnesota and works for a Minnesota company. The individual has a second home in Wisconsin. The individual telecommutes from her second home on Fridays and then spends the weekend in Wisconsin. During the year, the individual works 52 Fridays in Wisconsin. Her total annual salary is $50,000. What portion of the individual's income is taxable to Wisconsin?

Answer 4:

$10,000. The individual works 1/5 of her total work time in Wisconsin ($50,000 ÷ 5 = $10,000). If the Minnesota company does business in Wisconsin (has nexus in Wisconsin) and is required to file a Wisconsin income or franchise tax return, the employer must withhold Wisconsin income tax from the Wisconsin wages as those wages are more than $1,500. If the Minnesota company does not have nexus in Wisconsin, the employer is not required to withhold Wisconsin income tax but may voluntarily register and withhold Wisconsin income tax. If the employer does not withhold Wisconsin tax, the individual may be required to make estimated payments of Wisconsin income tax if the individual expects to owe $200 or more with her Wisconsin income tax return.

In this case, as a nonresident of Wisconsin the individual is required to file a Wisconsin income tax return using Form 1NPR to report the income taxable to Wisconsin ($10,000). The individual is also required to file a Minnesota income tax return to report the Minnesota income ($50,000). Minnesota may allow a credit for the tax paid to Wisconsin.

Facts and Question 5:

An individual is a resident of Wisconsin and works for a Wisconsin company. The individual has a second home in Minnesota. The individual telecommutes from her second home in Minnesota on Fridays. During the year, the individual works 52 Fridays in Wisconsin. Her total annual salary is $50,000. What portion of the individual's income is taxable to Wisconsin?

Answer 5:

$50,000. All income earned by a Wisconsin resident is taxable to Wisconsin. The individual works 1/5 of her total work time in Minnesota. Thus $10,000 ($50,000 ÷ 5 = $10,000) is also taxable to Minnesota.

Facts and Question 6:

In the previous questions and answers, it is assumed the individual earns the income evenly throughout the year. What happens if income is not earned evenly throughout the year?

Answer 6:

If income is not earned evenly throughout the year, the amount of income taxable to a state may have to be determined on a monthly, weekly, or hourly basis.

For example, a Minnesota resident earned $54,000 during the year. He was paid $4,000 a month for the first six months of the year and $5,000 a month for the last six months. The individual was required to work five months of the year in Wisconsin. During the first month he worked in Wisconsin, the individual was paid at the rate of $4,000 per month. He was paid $5,000 per month for the remaining four months he worked in Wisconsin. The amount of income taxable to Wisconsin is $24,000 (1 month x $4,000 + 4 months x $5,000).

CORPORATION FRANCHISE AND INCOME TAX

3 Entities Included in a Combined Report and Combined Group – Subsidiaries of Foreign Insurance Companies

Statutes: Sections 71.255(1) and (2) and 71.45(1), Wis. Stats., (2009-010)

Background: This tax release clarifies which entities are included in the combined report and combined group for Wisconsin franchise tax purposes.

A group of companies sells non-life insurance products such as property and casualty insurance. Some of the entities perform non-insurance related activities as their trade or business. Insurance companies may be part of the same unitary group as non-insurance companies, provided the domestic (Wisconsin) insurance company meets the unitary standards found in ch. 71, Wis. Stats. (2009-10). Foreign (non-Wisconsin) insurance companies are not included in the combined group under s. 71.45(1), Wis. Stats. (2009-10).

Question: Is an investment company that is a third-tier subsidiary under a Foreign Insurance Operation Company a member of the Wisconsin combined unitary return, even though its parent, a non-Wisconsin insurance company, is not part of the Wisconsin combined filing group?

Answer: The investment company subsidiary is a part of the unitary filing group if it is unitary with any member of the filing group, including the exempt parent.

Analysis: Section 71.255(1)(c)1., Wis. Stats. (2009-10), defines "commonly controlled group" and refers to "chains" of corporations with "direct" or "indirect" ownership. There is no mention of taxability or exemption from taxation as being criteria in determining a "commonly controlled group."

Similarly, in sec. 71.255(1)(n), Wis. Stats. (2009-10), in defining "unitary business," there is no mention of the taxability of an entity or of the taxability of any part of its income. The statute addresses the unitary principles of functional integration, centralized management and economies of scale in the description of the kinds of relationships that create unitariness.

Section 71.255(2)(a), Wis. Stats. (2009-10), requires corporations to use combined reporting. This statute provides that a corporation, other than the one whose income is exempt, must file a combined report if unitary with "one or more members in the same . . . group."

If the subsidiary investment company is unitary with any other corporation in the combined group, as defined in sec. 71.255(1)(n), Wis. Stats. (2009-10), it must file a Wisconsin tax return.

4 Non-Stock Corporations Subject to Combined Reporting

Statutes: Sections 71.255(1)(c) and (2)(a), 71.26(1)(a), and 71.45(1)(a), Wis. Stats. (2009-10)

Wis. Adm. Code: Sections Tax 2.60(2) and 2.61(2)(d) and (3), Wis. Adm. Code (November 2010 Register)

Background: Section 71.255(1)(c), Wis. Stats. (2009-10), provides that a corporation is in a controlled group if the "…parent corporation and any one or more corporations or chains of corporations that are connected to the parent corporation by direct or indirect ownership by the parent corporation, if the parent corporation owns stock representing more than 50 percent of the voting power of at least one of the connected corporations or if the parent corporation or any of the connected corporations own stock that cumulatively represents more than 50 percent of the voting power of each of the connected corporations."

Section 71.255(2)(a), Wis. Stats. (2009-10), states: "A corporation, not including a corporation of which all its income is exempt from taxation under s. 71.26 (1) or 71.45 (1), engaged in a unitary business with one or more other corporations in the same commonly controlled group shall report its share of income from that unitary business in the amount determined by a combined report filed by a designated agent of the unitary business…"

Section 71.26(1)(a), Wis. Stats. (2009-10), provides there shall be exempt from taxation the income "…of corporations organized under ch. 185, except income of a cooperative health care association organized under s. 185.981, or of a service insurance corporation organized under ch. 613, that is derived from a health maintenance organization as defined in s. 609.01 (2) or a limited service health organization as defined in s. 609.01 (3), or operating under subch. I of ch. 616 which are bona fide cooperatives operated without pecuniary profit to any shareholder or member, or operated on a cooperative plan pursuant to which they determine and distribute their proceeds in substantial compliance with s. 185.45, and the income, except the unrelated business taxable income as defined in section 512 of the internal revenue code and except income that is derived from a health maintenance organization as defined in s. 609.01(2) or a limited service health organization as defined in s. 609.01(3), of all religious, scientific, educational, benevolent or other corporations or associations of individuals not organized or conducted for pecuniary profit…."

Section 71.45(1)(a), Wis. Stats. (2009-10), provides there shall be exempt from taxation the income "…of insurers exempt from federal income taxation pursuant to section 501(c)(15) of the internal revenue code, town mutuals organized under or subject to ch. 612, foreign insurers, and domestic insurers engaged exclusively in life insurance business, domestic insurers insuring against financial loss by reason of nonpayment of principal, interest and other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust or other instrument constituting a lien or charge on real estate and corporations organized under ch. 185, but not including income of cooperative health care associations organized under s. 185.981, or of a service insurance corporation organized under ch. 613, that is derived from a health maintenance organization as defined in s. 609.01(2) or a limited service health organization as defined in s. 609.01 (3), or operating under subch. I of ch. 616 which are bona fide cooperatives operated without pecuniary profit to any shareholder or member, or operated on a cooperative plan pursuant to which they determine and distribute their proceeds in substantial compliance with s. 185.45. This paragraph does not apply to income that is realized from the sale of or purchase and subsequent sale or redemption of lottery prizes if the winning tickets were originally bought in this state."

Facts and Question 1:

A unitary business group consists solely of tax-exempt entities with no unrelated business taxable income. Is this group of entities considered part of a commonly controlled group and required to file combined Wisconsin income or franchise tax returns?

Answer 1:

Provided the unitary business group consists of only tax exempt entities that have no unrelated business taxable income, the unitary group is not subject to combined reporting.

Section 71.255(2)(a), Wis. Stats. (2009-10), excludes corporations from combined reporting that are exempt from taxation under sec. 71.26(1)(a), Wis. Stats. (2009-10), [corporations or associations of individuals not organized or conducted for pecuniary profit] or sec. 71.45(1)(a), Wis. Stats. (2009-10), [certain insurance companies]. Section Tax 2.61(2)(d), Wis. Adm. Code (November 2010 Register), further clarifies that a corporation that is exempt from tax under sec. 71.26(1)(a) or 71.45(1)(a), Wis. Stats. (2009-10), is not an includable corporation in the combined group except to the extent it has unrelated business taxable income as defined in section 512 of the Internal Revenue Code.

Facts and Question 2:

A unitary business group consists solely of tax-exempt entities that have unrelated business taxable income. Is this group of unitary businesses required to use combined reporting?

Answer 2:

A group composed exclusively of tax- exempt, nonstock corporations would not be subject to combined reporting even if they have unrelated business taxable income.

Section 71.255(1), Wis. Stats. (2009-10), requires combined reporting for corporations that are in the same commonly controlled group, engaged in a unitary business operation with one or more corporations, and derive less than 80 percent of its worldwide income from foreign source income. The commonly controlled group test is based on common ownership of stock representing more than 50 percent of the voting power of the corporations. Tax-exempt entities generally do not issue stock so the commonly controlled group test cannot be applied; as sec. Tax 2.61(3), Wis. Adm. Code (November 2010 Register), requires common ownership or control of stock representing more than 50 percent of the voting power of the corporations in the group.

Facts and Question 3:

A unitary group of businesses consists of stock corporations and tax-exempt entities that do not have unrelated business taxable income. Is this group of unitary businesses required to use combined reporting?

Answer 3:

Tax-exempt entities generally do not issue stock so the commonly controlled group test cannot be performed and therefore is not met. As long as the tax-exempt entity has no unrelated business taxable income, it is not subject to combined reporting. The remaining stock corporations may be a combined group and would have to apply the three combined group tests (commonly controlled group, unitary business, and water's edge) in order to determine if a combined group exists.

Section 71.255(1), Wis. Stats. (2009-10), requires combined reporting for corporations that are in the same commonly controlled group, engaged in a unitary business operation with one or more corporations, and derive less than 80 percent of its worldwide income from foreign source income. In order for a group of corporations to be in a commonly controlled group, common ownership representing more than 50 percent of the voting power of stock must exist.

Facts and Question 4:

A unitary group of businesses consists of stock corporations and tax-exempt parent that has unrelated business taxable income. Is this group of unitary businesses required to use combined reporting?

Answer 4:

In this situation, the tax-exempt entity is required to be included in the combined group because of the unrelated business taxable income and the fact that it owns more than 50 percent of the for-profit corporation's stock.

Section Tax 2.61(2)(d), Wis. Adm. Code (November 2010 Register), provides that a corporation that is exempt from income and franchise taxes under sec. 71.26(1)(a) or 71.45(1)(a), Wis. Stats. (2009-10), is a nonincludable corporation for combined reporting purposes except to the extent it has unrelated business taxable income as defined in section 512 of the Internal Revenue Code. The net unrelated business taxable income and any corresponding apportionment factors are subject to combination to the extent the net income or loss is derived from the unitary business and is otherwise subject to combination under the water's edge rules.

Alternatively, if the for-profit stock corporation was the parent company and the tax-exempt entities were subsidiaries with unrelated business taxable income, the tax-exempt entities would not be subject to combined reporting because the parent stock corporation does not meet the commonly controlled group test of owning more than 50 percent of the voting power of the exempt entity corporations because the exempt entities do not issue stock.

5 Wisconsin Tax Treatment of Corporations With Net Operating Loss and Charitable Contribution Carryovers

Note: Additional information on the Wisconsin tax treatment of corporations with net operating loss and charitable contribution carryovers is available in the tax release with the same title that was published in *Wisconsin Tax Bulletin* 68 (July 1990), page 32. The example from that tax release is revised in the next column to clarify that the charitable contributions are not deductible on the current year's federal income tax return.

Statutes: Section 71.26(2)(a), (3), and (4), Wis. Stats. (2009-10)

Background: Internal Revenue Code (IRC) sec. 170(b)(2) provides that a corporation's deduction for charitable contributions generally may not exceed 10% of taxable income computed without regard to:

- any deduction for contributions;
- the special deductions under IRC sec. 241-247 and 249-250;
- the deduction for domestic production activities under IRC sec. 199;
- any NOL carryback to the tax year under IRC sec. 172; and
- any capital loss carryback to the tax year under IRC sec. 1212(a)(1).

Special rules apply if the corporation has a net operating loss (NOL) carryover to the tax year. In determining the charitable contributions deduction for the current tax year, the 10% limit is applied using taxable income after taking into account any deduction for the NOL.

To figure the amount of any remaining NOL carryover to later years, taxable income must be modified (IRC sec. 172(b)). To the extent that charitable contributions are used to reduce taxable income for this purpose and increase an NOL carryover, a charitable contributions carryover is not allowed (IRC sec. 170(d)(2)(B)). The following example illustrates how a federal NOL carryover and charitable contribution carryover are determined under these special rules:

Example:

Corporation X, which reports its income on a calendar-year basis, earned federal taxable income of $80,000 in 2010 before taking into account $10,000 of charitable contributions made in 2010 and a net operating loss carryover from 2009 of $100,000. After taking into account the net operating loss deduction of $80,000, Corporation X is not allowed any deduction for charitable contributions on its 2010 federal income tax return.

For purposes of determining Corporation X's federal NOL carryover to 2011, 2010 taxable income is modified as follows:

- The NOL deduction of $80,000 is disregarded.
- A charitable contribution deduction of $8,000 (10% of $80,000) is allowed based on the taxable income figured without regard to the NOL deduction.

Corporation X's 2010 taxable income as modified is $72,000 ($0 + $80,000 - $8,000), resulting in a $28,000 ($100,000 - $72,000) NOL carryover to 2011.

Corporation X's charitable contributions have been used to modify taxable income and increase its NOL carryover from $20,000 to $28,000. Therefore, $8,000 of Corporation X's charitable contribution carryover to 2011 is not allowed. Corporation X's charitable contribution carryover to 2011 is $2,000 ($10,000 - $8,000).

Facts and Question 1:

In addition to the facts in the above example:

- All of Corporation X's 2010 income is attributable to Wisconsin.
- Due to differences in depreciation and section 179 expensing, taxable income for 2010 and the NOL carryover from 2009 differ for federal and Wisconsin purposes. Wisconsin net income before net business loss offset for 2010 is $90,000 and the Wisconsin NOL carryover from 2009 is $115,000.

What are Corporation X's Wisconsin NOL and charitable contribution carryovers to 2011?

Answer 1:

The federal charitable contribution deduction and carryover are used for Wisconsin purposes unless a) a corporation makes a different election for federal and Wisconsin purposes or b) a provision of the Internal Revenue Code, other than depreciation or section 179 expensing, does not apply for Wisconsin. (For example, a corporation that claims a Wisconsin deduction for expenses for which a federal tax credit is allowed must recompute its charitable contribution deduction.) Therefore, the Wisconsin NOL carryover to 2011 is increased by $8,000 to $33,000 ($115,000 - $90,000 + $8,000) and the Wisconsin charitable contribution carryover to 2011 is $2,000.

Facts and Question 2:

Assume the same facts as in Facts and Question 1, except 2010 Wisconsin net income before net business loss offset is $50,000 and the Wisconsin NOL carryover from 2009 is $10,000. What are Corporation X's Wisconsin NOL and charitable contribution carryovers to 2011?

Answer 2:

The Wisconsin NOL carried forward from 2009 and deducted in 2010 is increased by $8,000 to $18,000, resulting in 2010 Wisconsin net income of $32,000. As the Wisconsin NOL is used in full in 2010, there is no carryover to 2011. The Wisconsin charitable contribution carryover to 2011 is $2,000.

Facts and Question 3:

Assume the same facts as in Facts and Question 1, except 2010 Wisconsin net income before net business loss offset is $70,000 and there is no Wisconsin NOL carryover from 2009. What are Corporation X's Wisconsin NOL and charitable contribution carryovers to 2011?

Answer 3:

As the $8,000 of charitable contributions may not be used to create a Wisconsin NOL deduction or carryover, Corporation X's 2010 Wisconsin net income is $70,000. Since the charitable contributions are not used to increase a Wisconsin NOL, the Wisconsin charitable contribution carryover is not reduced. Corporation X has no Wisconsin NOL carryover to 2011, and a Wisconsin charitable contribution carryover to 2011 of $10,000.

Question 4:

Do Answers 1 to 3 change if Corporation X is subject to combined reporting?

Answer 4:

No. Each entity in the combined group computes its own Wisconsin income, charitable contribution deduction and carryover, and NOL deduction and carryover.