

- The gain is treated as capital gain for federal income tax purposes. The exclusion does not apply to amounts treated as ordinary income for federal income tax purposes because of the recapture of depreciation or any other reason.
- The gain is not also excluded under the provision in Wisconsin law (sec. 71.05(6)(b)9, Wis. Stats.) which allows an exclusion for 60 percent of net capital gain on assets held more than one year.
- For shares in a corporation or trust, the following standards must be met by the corporation or trust in order for gain on the disposition of shares in the corporation or trust to qualify for the exclusion:
  - Its shareholders or beneficiaries do not exceed 15 in number. Lineal ancestors and descendants and aunts, uncles and first cousins thereof count collectively as one shareholder or beneficiary, but this collective authorization shall not be used for more than one family in a single corporation or trust.
  - It does not have more than two classes of shares.
  - All its shareholders or beneficiaries, other than any estate, are natural persons.

If the related person who purchases or otherwise receives the assets on which the gain is excluded sells or otherwise disposes of the assets within two years, the person is subject to a penalty. The penalty is equal to the following:

- The amount of the capital gains exclusion received by the transferor under this provision multiplied by a fraction, the denominator of which is 24 and the numerator of which is the difference between 24 and the number of months between the date on which the person who is liable for the penalty purchased or otherwise received the assets and the

month in which the person sells or otherwise disposes of the assets.

The department shall assess, levy, and collect the penalty as it assesses, levies, and collects taxes under Chapter 71 of the Statutes.

The Secretary of Revenue and employees of the department are authorized to examine returns for the purpose of calculating the penalty.

**12. Senior Citizen Credit Revised** (1997 Act 27, renumber 71.07(8)(a) to 71.07(8)(a)(intro.) and amend 71.07(8)(a)(intro.) as renumbered, and create sec. 71.07(8)(a)1 to 6, effective for taxable years beginning on or after January 1, 1997.)

The senior citizen credit is allowable to a taxpayer who has reached age 65 prior to the close of the taxpayer's calendar or fiscal year if one of the following applies:

- (a) If the taxpayer files an individual return and has Wisconsin adjusted gross income of less than \$30,000 in the year to which the claim relates, the credit is \$25.
- (b) If the taxpayer files an individual return and has Wisconsin adjusted gross income of at least \$30,000 but less than \$31,000 in the year to which the claim relates, the credit is equal to the amount obtained by subtracting from \$25, 2.5% of the amount by which the taxpayer's adjusted gross income exceeds \$30,000.
- (c) If the taxpayer is married, files a joint return, and has Wisconsin adjusted gross income of less than \$40,000 in the year to which the claim relates, the credit is \$25.
- (d) If the taxpayer is married, files a joint return, and has Wisconsin adjusted gross income of at least \$40,000 but less than \$41,000 in the year to which the claim relates, the credit is equal to the amount obtained by subtracting from \$25, 2.5%

of the amount by which the taxpayer's adjusted gross income exceeds \$40,000.

- (e) If the taxpayer is married, files a separate return, and has Wisconsin adjusted gross income of less than \$20,000 in the year to which the claim relates, the credit is \$25.
- (f) If the taxpayer is married, files a separate return, and has Wisconsin adjusted gross income of at least \$20,000 but less than \$21,000 in the year to which the claim relates, the credit is equal to the amount obtained by subtracting from \$25, 2.5% of the amount by which the taxpayer's adjusted gross income exceeds \$20,000.

For nonresidents and part-year residents of Wisconsin, the credit continues to be limited to the fraction of the amount that Wisconsin adjusted gross income is of federal adjusted gross income.

**13. Working Families Tax Credit Created** (1997 Act 27, create secs. 71.07(5m) and 71.10(4)(du), effective for taxable years beginning on or after January 1, 1998.)

*How to compute the credit.*

The working families tax credit is determined as follows:

*If the claimant's filing status is single, head of household, or married filing separate return —*

- (a) If the claimant's Wisconsin adjusted gross income is less than \$9,000 in the year to which the claim relates, the credit is equal to his or her net tax liability (gross tax less dependent credit, senior citizen credit, itemized deduction credit, school property tax credit, and the historic rehabilitation credits).
- (b) If the claimant's Wisconsin adjusted gross income is at least \$9,000 but less than \$10,000 in the year to which the

claim relates, the credit is an amount calculated as follows:

1. Calculate the value of a fraction, the denominator of which is \$1,000 and the numerator of which is the difference between the claimant's Wisconsin adjusted gross income and \$9,000.
2. Subtract from 1.0 the amount that is calculated under (b)1.
3. Multiply the amount of the claimant's net income tax liability by the amount calculated under (b)2.

*If the claimant's filing status is married filing joint return —*

- (a) If the sum of the claimant's Wisconsin adjusted gross income and his or her spouse's Wisconsin adjusted gross income is less than \$18,000 in the year to which the claim relates, the credit is equal to his or her net tax liability.
- (b) If the claimant's Wisconsin adjusted gross income and his or her spouse's Wisconsin adjusted gross income is at least \$18,000 but less than \$19,000 in the year to which the claim relates, the credit is an amount calculated as follows:

1. Calculate the value of a fraction, the denominator of which is \$1,000 and the numerator of which is the difference between the married couple's Wisconsin adjusted gross income and \$18,000.
2. Subtract from 1.0 the amount that is calculated under (b)1.
3. Multiply the amount of the married couple's net income tax liability by the amount that is calculated under (b)2.

Only one credit is allowed per household (husband and wife) each year on a joint return.

***Who may not claim the credit.***

Part-year residents and nonresidents of Wisconsin are not eligible for the credit.

The credit may not be claimed by a person who may be claimed as a dependent on the individual income tax return of another taxpayer.

***When to claim the credit.***

The credit must be claimed within four years of the unextended due date of the income tax return for the year to which the claim relates.

***Assessments, refunds, appeals, collection, etc.***

The Department of Revenue may enforce the credit and may take any action, conduct any proceeding and proceed as it is authorized in respect to taxes under Chapter 71, Wis. Stats. The income tax provisions relating to assessments, refunds, appeals, collection, interest and penalties apply to the credit.

- 14. Married Couple Credit Increased** (1997 Act 27, amend sec. 71.07(6)(a) and (b) and create sec. 71.07(6)(am), effective for taxable years beginning on or after January 1, 1998.)

The married couple credit is increased over a four-year period as follows:

- For taxable years beginning in 1998, the credit is 2.17% of the earned income of the spouse with the lower earned income, but not more than \$304.
- For taxable years beginning in 1999, the credit is 2.5% of the earned income of the spouse with the lower earned income, but not more than \$350.
- For taxable years beginning in 2000, the credit is 2.75% of the earned income of the spouse with the lower earned income, but not more than \$385.

- For taxable years beginning in 2001 and thereafter, the credit is 3% of the earned income of the spouse with the lower earned income, but not more than \$420.

- 15. Manufacturer's Sales Tax Credit Extended to Individuals, Partners, and Tax-Option (S) Corporation Shareholders** (1997 Act 27, repeal sec. 71.07(10)(a), renumber sec. 71.07(10)(b) to 71.07(10), amend sec. 71.05(6)(a)15, and create secs. 71.07(3s) and 71.10(4)(de), effective for taxable years beginning on or after January 1, 1998.)

See Item B.7.

- 16. Development Zones Credit Created** (1997 Act 27, amend secs. 71.05(6)(a)15 and 71.08(1)(intro.) and create secs. 71.07(2dd)(e), (2de)(d), (2di)(i), (2dj)(i), (2dL)(h), (2dr)(i), (2ds)(i), (2dx) and 71.10(4)(gu), effective for taxable years beginning on or after January 1, 1998.)

See Item B.8.

- 17. Alternative Computation of Development Zones Research Credit Permitted** (1997 Act 27, amend sec. 71.07(2dr)(a), effective for taxable years beginning on or after January 1, 1997.)

A taxpayer may elect to calculate the development zones research credit using the alternative computation method provided under sec. 41(c)(4) of the Internal Revenue Code. Once the election is made, it applies until the Department of Revenue permits its revocation.

- 18. Standard Deduction Indexed** (1997 Act 27, create sec. 71.05(22)(ds), effective for taxable years beginning on or after January 1, 1999.)

The dollar amounts of the standard deduction and all of the dollar amounts of Wisconsin adjusted gross income used in determining the standard deduction shall be increased each year by a percentage equal to the per-

centage change between the U.S. consumer price index for all urban consumers, U.S. city average, for the month of August of the previous year and the U.S. consumer price index for all urban consumers, U.S. city average, for the month of August of the year before the previous year, as determined by the federal Department of Labor. Each amount that is revised shall be rounded to the nearest multiple of \$10 if the revised amount is not a multiple of \$10 or, if the revised amount is a multiple of \$5, such amount shall be increased to the next higher multiple of \$10.

The Department of Revenue shall annually adjust the changes in dollar amounts and incorporate the changes into the income tax forms and instructions.

**19. Farm Loss Limitations Revised** (1997 Act 27, amend sec. 71.05(6)(a)10, effective for taxable years beginning on or after January 1, 1999.)

The farm loss limits apply only for persons who are not "actively engaged in farming," as that term is used in 7 CFR 1497.201. Under prior law, the farm loss limits applied whether or not a person was actively engaged in farming.

The amount of nonfarm income a person may have before no loss is allowed is increased from \$400,000 to \$600,000.

**20. "Multistate" Lottery Reference Changed** (1997 Act 27, amend secs. 71.02(1) and 71.04(1)(a), effective October 14, 1997.)

Income received by a nonresident of Wisconsin from any multijurisdictional lottery is taxable by Wisconsin if the winning lottery ticket or lottery share was purchased from a retailer located in Wisconsin or from the department. Under prior law, the statutes referred to "multistate" instead of "multijurisdictional."

**B. Corporation Franchise or Income Taxes**

**1. Internal Revenue Code References Updated for 1997 for Corporations, Insurance Companies, Nonprofit Organizations, Regulated Investment Companies, Real Estate Mortgage Investment Conduits, and Real Estate Investment Trusts** (1997 Act 27, repeal secs. 71.22(4)(d) and (4m)(b), 71.26(2)(b)4., and 71.42(2)(c), amend secs. 71.22(4)(k) and (4m)(i), 71.26 (2)(b)11. and (3)(y), 71.42(2)(j), and 71.45 (2)(a)13., and create secs. 71.22(4)(L) and (4m)(j), 71.26(2)(b)12., 71.42(2)(k), and 71.45(2)(a)10m., and a nonstatutory provision, effective for taxable years beginning on or after January 1, 1997.)

For taxable years that begin on or after January 1, 1997, "Internal Revenue Code" for corporations, insurance companies, nonprofit organizations, regulated investment companies (RICs), real estate mortgage investment conduits (REMICs), and real estate investment trusts (REITs) means the federal Internal Revenue Code as amended to December 31, 1996, with the exceptions indicated below. The Internal Revenue Code applies for Wisconsin purposes at the same time as for federal purposes.

- a. The Internal Revenue Code excludes section 1311 of Public Law 104-188, relating to the elimination of earnings and profits from pre-1983 S corporation years from an S corporation's accumulated earnings and profits.
- b. For corporations (except nonprofit organizations, RICs, REMICs, and REITs) and insurance companies, for property placed in service in taxable years beginning on or after January 1, 1997, depreciation or amortization may be computed under either the federal Internal Revenue Code in effect for the taxable year for which the return is filed or the federal Internal Revenue Code as amended to December 31, 1996, at the taxpayer's option.

- c. For corporations (except nonprofit organizations, RICs, REMICs, and REITs), the Internal Revenue Code is modified by sec. 71.26(3), Wis. Stats.
- d. For insurance companies, the Internal Revenue Code excludes IRC sec. 847, relating to an additional deduction for insurers required to discount unpaid losses.
- e. For RICs, REMICs, and REITs, property depreciated for taxable years 1983 to 1986 under the Internal Revenue Code as amended to December 31, 1980, must continue to be depreciated under the Internal Revenue Code as amended to December 31, 1980. Additions or subtractions must be made to reflect differences between the depreciation or adjusted basis for federal and Wisconsin tax purposes of property disposed of during the taxable year.

Any increase in estimated tax payments that are due before October 14, 1997, solely because of this Act shall be prorated among, and paid with, estimated payments that are due after October 14, 1997.

- 2. Federal Laws Enacted During 1996 Apply Simultaneously for Wisconsin Purposes** (1997 Act 27, amend secs. 71.22(4)(e), (f), (g), (h), (i), (j), and (k) and (4m)(c), (d), (e), (f), (g), (h), and (i), 71.26(2)(b)5., 6., 7., 8., 9., 10., and 11., 71.42(2)(d), (e), (f), (g), (h), (i), and (j), and 71.77(3) and (5), effective for taxable years beginning before January 1, 1997, at the same time as for federal tax purposes.)

The changes made to the Internal Revenue Code by the federal Small Business Job Protection Act of 1996 (Public Law 104-188), the federal Health Insurance Portability and Accountability Act of 1996 (Public Law 104-191), and the federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Public Law 104-193) apply for Wisconsin franchise and income tax purposes at the same time as for federal purposes.

For example, Public Law 104-188 liberalized the involuntary conversion replacement property rules for Presidentially declared disasters, effective for disasters declared after December 31, 1994, in taxable years ending after that date. This provision also applies for Wisconsin purposes for Presidentially declared disasters after December 31, 1994, in taxable years ending after that date.

- 3. Federal S Corporation Law Changes Adopted** (1997 Act 27, repeal secs. 71.01(15) and 71.34(1g)(d), renumber sec. 71.125 to 71.125(1) and amend sec. 71.125(1) as renumbered, amend secs. 71.05(6)(intro.), 71.22(1), 71.34(1g)(e), (f), (g), (h), (i), (j), and (k), 71.365(1m) and (4)(a), 77.51(10), and 77.58(3)(a), and create secs. 71.122, 71.125(2), 71.34(1)(i) and (1g)(L), and 71.365(7), and a nonstatutory provision, effective for taxable years beginning on or after January 1, 1997, except as indicated below.)

For taxable years that begin on or after January 1, 1997, "Internal Revenue Code" for tax-option (S) corporations means the federal Internal Revenue Code as amended to December 31, 1996, except that —

- the Internal Revenue Code excludes section 1311 of Public Law 104-188, relating to the elimination of earnings and profits from pre-1983 S corporation years from an S corporation's accumulated earnings and profits, and
- Internal Revenue Code sec. 1366(f), relating to the reduction in passthroughs for taxes at the S-corporation level, is modified by substituting the built-in gains tax under sec. 71.35, Wis. Stats., for the taxes under IRC secs. 1374 and 1375.

The changes made to the Internal Revenue Code by the federal Small Business Job Protection Act of 1996 (Public Law 104-188), federal Health Insurance Portability and Accountability Act of 1996 (Public Law

104-191), and federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Public Law 104-193) apply for Wisconsin franchise and income tax purposes at the same time as for federal purposes. These changes include the following:

- S corporations may have 75 shareholders.
- S corporations may have 80%-or-more-owned C corporation subsidiaries.
- S corporations may have wholly owned S corporation subsidiaries.

If a tax-option (S) corporation elects to treat a subsidiary as a qualified subchapter S subsidiary (QSSS) for federal purposes, that election also applies for Wisconsin purposes. The QSSS will be disregarded as a separate corporation for Wisconsin purposes, and its assets, liabilities, and items of income, deduction, and credit will be treated as those of the parent tax-option (S) corporation. If Wisconsin has jurisdiction to impose franchise or income taxes on the QSSS, Wisconsin has the jurisdiction to impose these taxes on the parent tax-option (S) corporation. A federal S corporation that has a qualified subchapter S subsidiary may not elect out of Wisconsin tax-option (S) corporation status.

For sales and use tax purposes, if a QSSS is disregarded as a separate entity for Wisconsin franchise and income tax purposes, the owner of that subsidiary shall include the information for that subsidiary on the owner's sales and use tax return.

- Electing small business trusts (SBTs) may be S corporation shareholders.

The portion of an electing SBT that consists of stock of one or more S corporations is treated as a separate trust. The net income for that portion is determined under IRC sec. 641(d), as modified by sec. 71.05(6) to (12), (19), and

(20), Wis. Stats. The separate trust is taxed on its Wisconsin taxable income at the highest rate under sec. 71.06(1) or (1m), Wis. Stats., as applicable.

- The post-death period during which grantor and testamentary trusts may hold S corporation stock is increased to 2 years.
- Financial institutions not using bad debt reserves may be S corporations.
- Financial institutions may hold "straight debt" for the one-class-of-stock safe harbor rule.
- Internal Revenue Service has retroactive authority to waive inadvertent terminations of S corporation status and to treat late or nonexistent S corporation elections as timely. (Applies to elections for taxable years beginning after December 31, 1982.)
- The election to terminate the S corporation's taxable year on termination of a shareholder's interest requires only the agreement of the corporation and all affected shareholders.
- If a trust or estate terminates before the end of the S corporation's taxable year, the S corporation's income is apportioned to the trust or estate. (Applies under prior law.)
- The post-termination transition period of S corporations is expanded.
- The adjusted basis of an S corporation shareholder's stock for purposes of computing the limitation on the amount of deductible S corporation losses is determined after the basis has been reduced by the year's nontaxable distributions made to the shareholder.
- S corporations may liquidate their 80%-or-more-owned C corporation subsidiaries on a tax-free basis.

- The basis of inherited S corporation stock is reduced by the corporation's income items treated as income in respect of a decedent. (Applies to decedents dying after August 20, 1996.)
- Corporations that terminated S corporation status before 1997 may reelect S corporation status within 5 years.

For property placed in service in taxable years beginning on or after January 1, 1997, depreciation or amortization may be computed under either the federal Internal Revenue Code in effect for the taxable year for which the return is filed or the federal Internal Revenue Code as amended to December 31, 1996, at the taxpayer's option.

Any increase in estimated tax payments that are due before October 14, 1997, solely because of this Act shall be prorated among, and paid with, estimated payments that are due after October 14, 1997.

A corporation that may be treated as a tax-option corporation or a QSSS because of this Act may treat any portion of a payment of estimated taxes for its taxable year that begins in 1997 that the corporation or its QSSS makes before October 14, 1997, as a payment made by a shareholder of the corporation on October 14, 1997, if the corporation so elects on or before the original due date of the corporation's franchise or income tax return for its taxable year that begins in 1997, in the manner that the Department of Revenue prescribes. That election is irrevocable.

**4. Federal Treatment of Financial Asset Securitization Investment Trusts (FASITs) Adopted** (1997 Act 27, amend sec. 71.26(2)(b)(title) and create sec. 71.26(2)(b)12., effective for taxable years beginning on or after January 1, 1997.)

The federal Small Business Job Protection Act of 1996 (Public Law 104-188) created a new type of statutory entity called a financial asset securitization investment trust (FASIT)

to facilitate the securitization of debt obligations such as credit card receivables, home equity loans, and auto loans. The federal FASIT provisions generally are effective September 1, 1997.

For a common law trust which qualifies as a FASIT under the Internal Revenue Code as amended to December 31, 1996, "net income" means the federal FASIT taxable income of the trust as determined under the Internal Revenue Code as amended to December 31, 1996.

**5. Alternative Computation of Research Credit and Development Zones Research Credit Permitted** (1997 Act 27, amend secs. 71.07(2dr)(a), 71.28(4)(a) and (am)1., and 71.47(4)(a) and (am), effective for taxable years beginning on or after January 1, 1997.)

A taxpayer may elect to calculate the research credit using the alternative computation method provided under sec. 41(c)(4) of the Internal Revenue Code. Once the election is made, it applies until the Department of Revenue permits its revocation.

**6. Statute of Limitations Provided for Assessments Relating to Public Water Utilities** (1997 Act 27, create sec. 71.77(2m), effective for deficiencies caused by notices received by the Department of Revenue on or after October 14, 1997.)

One of the federal law changes adopted by Wisconsin is the amendment to IRC sec. 118(c). Under this provision, a regulated public utility that provides water or sewage disposal services treats certain contributions in aid of construction as tax-free contributions to its capital.

The Department of Revenue may assess a deficiency related to a contribution to the capital of the taxpayer, as defined in IRC sec. 118(c), within 4 years after the department receives notice by the taxpayer, in the manner that the department prescribes, of any of the following:

- The amount of the expenditure under IRC sec. 118(c)(2)(A).
- The intent of the person against whom the deficiency is to be assessed not to make the expenditure under IRC sec. 118(c)(2)(A).
- Expiration of the time period under IRC sec. 118(c)(2)(B) and failure of the person against whom the deficiency is to be assessed to make the expenditure under IRC sec. 118(c)(2)(B).

**7. Manufacturer's Sales Tax Credit Extended to Individuals, Partners, and Tax-Option (S) Corporation Shareholders** (1997 Act 27, repeal secs. 71.07(10)(a), 71.28(3)(d), 71.365(3)(b), and 71.47(3)(d), renumber sec. 71.07(10)(b) to 71.07(10), sec. 71.28(3)(c) to 71.28(3)(c)1., sec. 71.365(3)(a) to 71.365(3), and sec. 71.47(3)(c) to 71.47(3)(c)1., amend secs. 71.05(6)(a)15., 71.21(4), 71.28(3)(b), 71.34(1)(g), 71.47(3)(b), and 77.92(4), and create secs. 71.07(3s), 71.10(4)(de), 71.28(3)(c)2. to 6., 71.34(1)(j), and 71.47(3)(c)2. to 6., effective for taxable years beginning on or after January 1, 1998.)

Individuals, partners, and tax-option (S) corporation shareholders shall claim a credit against their Wisconsin income or franchise tax for Wisconsin state, county, and stadium sales and use taxes paid in the taxable year on fuel and electricity consumed in manufacturing tangible personal property in Wisconsin.

***Individuals***

The credit, including any credits carried over, may be offset only against the amount of tax imposed upon or measured by the business operations of the claimant in which the fuel and electricity are consumed.

***Partners***

Partners may claim the credit based on eligible sales and use taxes paid by the partnership, in proportion to their ownership

interests. The partnership must calculate the amount of the credit which may be claimed by each partner and provide that information to the partner.

For partners, the credit may be offset only against the tax imposed on the partner's distributive share of partnership income.

***Tax-Option (S) Corporation Shareholders***

Tax-option (S) corporation shareholders may claim the credit based on eligible sales and use taxes paid by the corporation, in proportion to their ownership interests. The corporation must calculate the amount of the credit which may be claimed by each shareholder and provide that information to the shareholder.

For tax-option (S) corporation shareholders, the credit may be offset only against the tax imposed on the shareholder's prorated share of the tax-option corporation's income.

If a tax-option corporation becomes liable for tax, the corporation may offset the credit against the tax due, with any remaining credit passing through to the shareholders.

***Unused Credits***

If the credit computed is not entirely offset against taxes otherwise due, the unused balance must be carried forward and credited against taxes otherwise due for the following 15 years to the extent not offset by taxes otherwise due in all intervening years.

If a corporation that is not a tax-option corporation has a carryover credit and becomes a tax-option corporation before the credit carried over is used, the unused portion of the credit may be used by the tax-option corporation's shareholders on a prorated basis. If the shareholders of a tax-option corporation have carryover credits and the corporation becomes a regular (C) corporation before the credits carried over are used, the unused portion of the credits may be used by the corporation.