

A. Individual and Fiduciary Income Taxes

1. Internal Revenue Code Reference Updated for 1996 for Individuals, Estates, and Trusts (1995 Act 380, repeal sec. 71.01(6)(c), amend sec. 71.01(6)(j) and (7r), and create sec. 71.01(6)(k), effective for taxable years beginning on or after January 1, 1996.)

For taxable years that begin on or after January 1, 1996, "Internal Revenue Code" for individuals, estates, and trusts (except nuclear decommissioning trust or reserve funds) means the federal Internal Revenue Code as amended to December 31, 1995, with the exceptions indicated below. The Internal Revenue Code applies for Wisconsin purposes at the same time as for federal purposes.

- Although enacted **after** December 31, 1995, the provisions of federal Public Law 104-117 also apply for Wisconsin. These provisions (1) extend the combat pay exclusion to certain members of the Armed Forces of the United States serving in a qualified hazardous duty area (Bosnia and Herzegovina, Croatia, or Macedonia) and (2) increase the combat pay exclusion for commissioned officers.
- Although enacted **before** December 31, 1995, section 13113 of federal Public Law 103-66 relating to the exclusion for 50% of the gain from the sale or exchange of qualified small business stock held for more than five years does not apply for Wisconsin.
- For property placed in service in taxable years beginning on or after January 1, 1996, individuals and fiduciaries may compute depreciation or amortization under either the federal Internal Revenue Code in effect for the taxable year for which the return is filed or the federal Internal Revenue Code as amended to December 31, 1995, at the taxpayer's option.

2. Federal Laws Enacted During 1995 and 1996 Apply Simultaneously for Wisconsin Purposes (1995 Act 380, amend sec. 71.01(6)(i) and (j), effective for taxable years beginning after December 31, 1993, and before January 1, 1996.)

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

- Public Law 104-7, enacted April 11, 1995, excluding Section 1. (**Note:** Section 1 of Public Law 104-7, relating to the self-employed health insurance deduction, was previously adopted for Wisconsin purposes for taxable years beginning in 1995 by 1995 Wisconsin Act 27 - see *Wisconsin Tax Bulletin* 93, August 1995.)
- Public Law 104-117, enacted March 20, 1996. (**Note:** For Wisconsin purposes, this federal law only affects taxable years beginning in 1995.)

As a result of the amendment to sec. 71.01(6)(i) and (j), Wis. Stats. (1993-94), in Act 380, the following changes in federal law are effective for Wisconsin purposes at the same time as for federal purposes:

- Repeal of the nonrecognition of gain provisions relating to certain sales of broadcast facilities to minority owners.
- Allow certain sales or exchanges to implement microwave reallocation policies to be treated as involuntary conversions.
- Increase in the combat pay exclusion for commissioned officers.
- Extension of the combat pay exclusion to certain members of the Armed Forces of the United States serving in a qualified hazardous duty area (Bosnia and Herzegovina, Croatia, or Macedonia).

- 3. Development and Enterprise Zone Credits Amended** (1995 Act 209, repeal secs. 71.07(2dj)(d) and (2ds)(c), amend secs. 71.05(6)(a)15, 71.07(2dd)(a)1 and 2, (2dj)(am)1, 3, and 8m and (h), (2dL)(ar), and (2ds)(h), 71.08(l)(intro.), 71.10(4)(gd), (ge), and (i), 73.03(35), and 77.92(4), and create secs. 71.07(2dj)(am)4h and 4i and (2dr) and 71.10(4)(gm), effective dates are listed below.)

Expansion of Research Credit

For taxable years beginning on or after January 1, 1997, individuals, estates, and trusts may qualify for the development and enterprise zones research credit. However, shareholders of tax-option (S) corporations continue to be ineligible for the credit. The credit is equal to 5% of the amount obtained by subtracting from the person's qualified research expenses the person's base amount.

"Qualified research expenses" are defined in section 41 of the Internal Revenue Code (IRC), with the following exceptions: (a) "qualified research expenses" include only expenses incurred by the claimant in a development or enterprise zone, and (b) "qualified research expenses" do not include (1) compensation used in computing the development or enterprise zones jobs credit nor (2) research expenses incurred before the claimant is certified for tax benefits.

The person's "base amount" is defined in IRC section 41(c), with the following exceptions: (a) gross receipts used in calculating the base amount means gross receipts from sales attributable to Wisconsin under sec. 71.04(7)(b)1 and 2 and (d), Wis. Stats., and (b) research expenses used in calculating the base amount include research expenses incurred in a development or enterprise zone before the claimant is certified for tax benefits.

The claimant must submit with his or her tax return a copy of the certification to claim tax benefits issued by the Department of Commerce and a statement from the Department of Commerce verifying the claimant's qualified research expenses for research conducted

exclusively in a development or enterprise zone.

If a research credit computed is not entirely offset against the claimant's income tax liability for the current year, the unused portion may be carried forward for up to 15 years.

The amount of development and enterprise zones research credit computed is income and must be reported on the claimant's income tax return for the year in which the credit is computed.

Changes to Day Care Credit, Jobs Credit, Location Credit, and Sales Tax Credit

See Item B.3 on page 10 for a description of the changes and their effective dates.

- 4. Deduction for Adoption Expenses** (1995 Act 261, create sec. 71.05(6)(b)22, effective for taxable years beginning on or after January 1, 1996.)

A deduction is allowed to an adoptive parent for adoption fees, court costs, or legal fees relating to the adoption of a child, for whom a final order of adoption has been entered under sec. 48.91(3), Wis. Stats. (1993-94), during the taxable year.

The deduction is for the amount up to \$5,000 that is expended during the period that consists of the year to which the claim relates and the prior two tax years. The deduction is only available to a full-year resident of Wisconsin.

- 5. Exemption for Certain Income from Viatical Settlement Contracts** (1995 Act 371, create sec. 71.05(1)(f), effective for taxable years beginning on or after January 1, 1996.)

Income received by the original policyholder or original certificate holder from the sale of a life insurance policy or certificate, or the sale of the death benefit under a life insurance policy or certificate, under a viatical settlement contract is exempt from Wisconsin income tax.

A viatical settlement contract is a written agreement providing for the payment to the policyholder of a life insurance policy, or to the certificate holder of a group life insurance certificate, insuring the life of a person who has a catastrophic or life-threatening illness or condition, in an amount that is less than the expected death benefit under the policy or certificate, for assigning, selling, devising, or otherwise transferring the ownership of or the death benefit under the policy or certificate to the person paying the viatical settlement.

- 6. Medical Savings Accounts Established** (1995 Act 453, create secs. 71.05(6)(a)19 and (b)22, 71.07(5)(a)7, 71.10(4)(j), 71.83(1)(c) and 632.898, effective for taxable years beginning on or after January 1 of the year in which the federal government enacts a broad-based medical savings account program, as certified by the Secretary of Revenue.)

An employer that, in providing health insurance coverage for its employees, offers its employees a choice of health benefit plan options that includes a high cost-share health plan may establish a medical savings account for an employee who chooses a high cost-share health plan. "High cost-share health plan" means any health insurance policy, certificate or contract with deductibles, copayments or other cost-sharing provisions of at least \$1,500 (\$3,000 for family coverage).

The medical savings account shall be established as a separate account in the employee's name and shall be the employee's property. The account may be established with any account administrator that is approved by the Commissioner of Insurance to administer medical savings accounts.

Only the employer may make deposits in the medical savings account of an employee. The employer shall deposit in the account the difference between what the employer pays on behalf of the employee (or the employee and dependents) for the high cost-share health plan and what the employer would pay on behalf of the employee (or the employee and dependents) for the most expensive health benefit

plan that the employer offers that is not a high cost-share plan.

A self-employed person may also establish a medical savings account in his or her name. The self-employed person shall deposit in the account the difference between what the self-employed person pays for the high cost-share health plan (including dependent coverage) and what the self-employed person would pay for a more expensive health plan.

An employer or self-employed person is not required to deposit in the account more than \$2,000 per year for single coverage or more than \$2,000 per year for the employee or self-employed person, \$2,000 per year for his or her spouse, or \$1,000 per year for each non-spouse dependent for family coverage.

"Dependent" means a spouse, an unmarried child under the age of 19 years, an unmarried child who is a full-time student under the age of 21 years and who is financially dependent upon the parent, or an unmarried child of any age who is medically certified as disabled and who is dependent upon the parent.

The employer or self-employed person shall notify the Department of Revenue, in the manner prescribed by the department, of the establishment of the account, the employee's or self-employed person's name and social security number, the name and address of the account administrator and any other information the department may require.

Amounts deposited in the account and any interest, dividends, or other accrued gain may be used only for any of the following:

- (a) To pay expenses for medical care as defined in IRC sec. 213(d)(1) and as limited by sec. 213(b), including amounts treated as paid for medical care under sec. 213(d)(2).
- (b) To pay long-term care expenses of the employee or self-employed person or dependents.

- (c) To purchase a long-term care insurance policy for the employe or self-employed person or dependents.

This does not apply after the death of the employe or self-employed person.

An employe or self-employed person shall provide information about the use of account funds, in the manner prescribed by the Department of Revenue, in conjunction with the filing of his or her Wisconsin income tax return.

To the extent included in federal adjusted gross income, the employe or self-employed person may subtract the amount that is deposited each year in the medical savings account, up to \$2,000 for an individual, up to \$2,000 for his or her spouse, and up to \$1,000 for each nonspouse dependent, and any interest, dividends, or other gain that accrues in the account if it is redeposited in the account. This subtraction applies if the account is used exclusively to pay medical care expenses and long-term care expenses of the individual, his or her spouse and each minor dependent, or to purchase long-term care insurance for such individuals.

The maximum amount of deposit to an account shall be increased each year, beginning in 1998, by a percentage equal to the percentage change between the U.S. consumer price index for all urban consumers, U.S. city average, for the month of June of the current year and the U.S. consumer price index for all urban consumers, U.S. city average, for the month of June of the previous year, as determined by the U.S. Department of Labor.

If any amount of money or other assets in the account is withdrawn for any reason other than the payment of medical care expenses or long-term care expenses or the purchase of long-term care insurance for the account holder, his or her spouse and all nonspouse dependents, an addition to federal adjusted gross income must be made for any principal that is withdrawn and any interest, dividends, or other gain that accrues during the taxable

year in which a withdrawal occurs. This does not apply after the death of the account holder.

If a person is required to add any amount to federal adjusted gross income, the person shall pay a penalty equal to 10% of the amount that is withdrawn from the account. The penalty does not apply and up to 25% of the balance in the account may be withdrawn each year if either of the following occurs:

- (a) The account holder or his or her spouse reaches the age of 59.5 years during the year in which the withdrawal occurs.
- (b) The balance in the account exceeds \$100,000.

Medical care expenses paid for with amounts withdrawn from a medical savings account cannot be used in the computation of the Wisconsin itemized deduction credit.

7. Subtraction for Increase in Value of Investment in Prepaid Tuition Plan (1995 Act 403, create sec. 71.05(6)(b)22, effective July 1, 1996.)

To the extent included in federal adjusted gross income, a subtraction from federal adjusted gross income is allowed for any increase in value of a tuition unit purchased under a tuition contract under sec. 16.24 of the Wisconsin Statutes (College Tuition Prepayment Program).

8. Credit for Taxes Paid to Another State by a Limited Liability Company (1995 Act 400, amend sec. 71.07(7)(b), effective for taxable years of a limited liability company that begin on or after January 1, 1996, and for the appropriate taxable year of a member of a limited liability company to conform the member's treatment of the credit to the limited liability company's treatment.)

A Wisconsin resident who is a member of a limited liability company (LLC) that is treated as a partnership may claim a credit against

Wisconsin net income tax for income and franchise taxes paid to another state by the LLC. The credit is allowed only if the income taxed by the other state is also considered income for Wisconsin tax purposes.

Example: John Smith files his Wisconsin income tax returns on a calendar year basis. He is a member of an LLC treated as a partnership whose taxable year ends on June 30. For its taxable year ending June 30, 1997, the LLC pays tax to Iowa. John may claim credit for his share of the Iowa tax on his Wisconsin income tax return for the 1997 calendar year.

9. Exemption from Interest During Extension Period for Certain Persons for Operation Balkan Endeavor, etc. (1995 Act 255, renumber sec. 71.03(7) to 71.03(7)(intro.) and amend as renumbered and create sec. 71.03(7)(b), effective for taxable years beginning on or after January 1, 1995.)

For taxable years beginning after December 31, 1994, and before January 1, 1997 (1995 and 1996 tax returns), certain persons are exempt from interest during the period of time an extension for filing a Wisconsin income tax return is in effect. The exemption from interest applies to the following:

- Persons who served in support of Operation Balkan Endeavor or a successor operation.
- Persons who served in Croatia, Bosnia and Herzegovina, Serbia, Macedonia, Montenegro, Hungary, Austria, Slovakia, Czech Republic, or Slovenia.
- Persons who qualify for a federal extension of time to file under sec. 7508 of the Internal Revenue Code (extension due to service in a combat zone), who served outside the United States because of their participation in Operation Balkan Endeavor or a successor operation in the Balkan Endeavor theater of operations.

10. Deduction Denied to Partnerships for State Taxes Paid (1995 Act 400, create sec. 71.21(5), effective for the entity's taxable year beginning on or after January 1, 1996, and for the appropriate taxable year of the member to conform the member's treatment to the entity's treatment.)

The net income of a partnership or limited liability company treated as a partnership is computed under the Internal Revenue Code in effect for Wisconsin purposes, with certain exceptions. For taxable years beginning on or after January 1, 1996, sec. 164(a)(3) of the Internal Revenue Code is modified so that state taxes and taxes of the District of Columbia that are value-added taxes, single business taxes, or taxes on or measured by all or a portion of net income, gross income, gross receipts, or capital stock are not deductible.

B. Corporation Franchise or Income Taxes

1. Internal Revenue Code References Updated for 1996 for Corporations, Tax-Option (S) Corporations, Insurance Companies, Non-profit Organizations, Regulated Investment Companies, Real Estate Investment Trusts, and Real Estate Mortgage Investment Conduits (1995 Act 380, repeal secs. 71.22(4)(c) and (4m)(a), 71.26(2)(b)3, 71.34(1g)(c), and 71.42(2)(b), amend secs. 71.22(4)(j) and (4m)(h), 71.26(2)(b)10 and (3)(y), 71.34(1g)(j), 71.365(lm), 71.42(2)(i), and 71.45(2)(a)13, and create secs. 71.22(4)(k) and (4m)(i), 71.26(2)(b)11, 71.34(1g)(k), and 71.42(2)(j), effective for taxable years beginning on or after January 1, 1996.)

For taxable years that begin on or after January 1, 1996, "Internal Revenue Code" for corporations, tax-option (S) corporations, insurance companies, nonprofit organizations, regulated investment companies (RICs), real estate investment trusts (REITs), and real estate mortgage investment conduits (REMICS) means the federal Internal Revenue Code as amended to December 31, 1995, with