Tax & Employee Benefits Update

July 2009 ■ Vol 3, Issue 7

GODFREY & KAHN S.C.
ATTORNEYS AT LAW

James N. Phillips
(414) 287-9522
jphillips@gklaw.com

Sarah E. McNally
(414) 287-9446
smcnally@gklaw.com

The following is based on a summary of legal principles. It is not to be construed as legal advice. Individuals should consult with legal counsel before taking any action based on these principles to ensure their applicability in a given situation.

Wisconsin's Budget Bill Implements Several Tax Changes

By: James N. Phillips & Sarah E. McNally

On June 29, 2009, Governor Doyle signed Act 28, the biennial (2009-2011) Wisconsin state budget, into law. While the Act implements several revenue-raising provisions, it also creates incentives to encourage job creation and investment in targeted Wisconsin industries.

Income Tax Increases

- **Increase in Individual Income Tax Rate.** The Act increases Wisconsin's marginal income tax rate (which applies to ordinary income and capital gains, as reduced below) for individual taxpayers with income over certain thresholds from 6.75% to 7.75%. For single individuals, the 7.75% rate applies to all taxable income over $225,000 and for married couples, the 7.75% rate applies to all taxable income over $300,000. Effective Date: *Retroactive* to January 1, 2009.
- **Decrease in Capital Gains Exclusion.** Under prior law, Wisconsin permitted individual taxpayers to decrease the amount of their capital gains by 60% of the amount reported for federal income tax purposes. The Act decreases this exclusion to 30%. With the increase in the tax rate described above, capital gains are now effectively taxed at a maximum 5.425% tax rate (up from 2.7%) for Wisconsin purposes. Effective Date: *Retroactive* to January 1, 2009.
  - **Planning Point.** Individual taxpayers will not only incur greater Wisconsin income taxes under these provisions, but those that itemize deductions for federal income tax purposes may become subject to (or increase their exposure to) the federal alternative minimum tax ("AMT") as a result of the increased state tax payments.
- **Throwback Sales.** For businesses engaged in multi-state operations, business income is apportioned based on a single sales factor which is generally the ratio of the taxpayer's total Wisconsin sales to total sales everywhere. Pursuant to the Act, "throwback" sales, which are sales of tangible personal property by a Wisconsin location or by certain Wisconsin offices to states other than Wisconsin in which the taxpayer has no nexus, are now included as 100% Wisconsin sales (instead of 50% as under prior law). Effective Date: *Retroactive* to January 1, 2009.
  - **Planning Point.** This change in the treatment of throwback sales may create an incentive for a business to create nexus in a destination state if the destination state's tax rate is significantly lower than Wisconsin's and the additional cost of compliance is not material.
- **Elimination of Domestic Production Activities Deduction.** For federal income tax purposes, individual and corporate taxpayers are permitted to claim a deduction against a portion of the taxpayer's gross income attributable to domestic production activities. Domestic production activities generally include income from the sale or other disposition of property produced in the United States. Pursuant to the Act, this deduction has been eliminated for Wisconsin income and franchise tax purposes. Effective Date: *Retroactive* to January 1, 2009.

Tax Incentives

The Act implements several incentives to encourage the growth of Wisconsin's economy. However, to take advantage of these tax incentives, taxpayers often must receive pre-certification from the State of Wisconsin. Taxpayers should consider whether they qualify for these tax credit opportunities prior to making any new investments in their own business or in a new venture.

- **Angel and Early Stage Seed Investment Tax Credits.** Earlier this year, the Wisconsin legislature passed Act 2, which liberalized many of the requirements of the angel and early stage seed tax credit programs and also increased the total available tax credits. Angel tax credits are generally available to individual investors that invest in a qualified business, while early stage seed tax credits are available to investors in venture funds that invest in qualified businesses. Subject to some limitations, these tax credits generally equal 25% of the amount invested. Notably, pursuant to Act 2, the early stage seed tax credit may now be used to offset the gross premiums tax applicable to insurance companies, and a taxpayer unable to use an early stage seed tax credit, as may be the case for a non-Wisconsin resident, may sell or otherwise transfer the credit to a Wisconsin taxpayer. Effective Date: January 1, 2009.
- **Reinvestment of Long-Term Capital Gains.** Wisconsin will now permit, beginning January 1, 2011,

taxpayers to defer Wisconsin taxation of long term capital gain proceeds, up to $10 million, which are re-invested in qualified new business ventures, as certified by the Wisconsin Department of Commerce. Effective Date: January 1, 2011.

- **Jobs Tax Credit.** Beginning January 1, 2010, an employer, other than a retail store owner, that increases its total number of employees may claim a tax credit up to 10% of the amount of wages paid to each qualified individual. A tax credit may also be claimed to offset any qualified training expenses incurred by the employer. Jobs tax credits must be pre-certified by the Wisconsin Department of Commerce. Effective Date: January 1, 2010.
- **Super Research and Development Tax Credit.** Beginning January 1, 2011, C corporations may claim a super research and development credit against corporate income and franchise tax in exchange for significantly increasing qualified research activities. Effective Date: January 1, 2011.
- **Film Production Tax Credits.** The Act, as a result of Governor Doyle's partial veto, significantly scales back the film production tax credit program, which was originally implemented in 2005, to $500,000 of annual tax credits. Effective Date: January 1, 2009.
- **Wisconsin Supplement to Federal Historic Rehabilitation Tax Credit.** Wisconsin provides a tax credit for the rehabilitation of certified historic structures. The tax credit, which equals 5% of certain rehabilitation expenses, is a supplement to the federal rehabilitation credit. Previously, if a pass-through entity incurred expenses that qualified for the Wisconsin tax credit, the pass-through entity was required to allocate the credit among its owners in proportion to their ownership interest. Now, Wisconsin will permit the partners of a partnership, or members in a limited liability company (but not the shareholders of an S corporation), to allocate the Wisconsin tax credit amongst themselves by written agreement. Effective Date: First Applies to Property Placed in Service on or after June 30, 2008.

Miscellaneous Provisions

- **Application of Sales and Use Tax Provisions to Disregarded Entities.** Previously, entities that were disregarded for federal and Wisconsin *income tax* purposes, such as single member LLCs and qualified subchapter S subsidiaries ("QSubs"), were recognized and treated as separate entities for *sales tax* purposes. This distinction enabled some businesses to take advantage of certain sales tax provisions. For example, some businesses established a separate transportation entity (sometimes referred to as "transportation subs") solely to haul products for the business. The transportation entity, as a "common or contract carrier," did not owe sales tax on its purchase or repair of trucks, trailers, and other hauling equipment. To limit these planning opportunities, the Act provides that disregarded entities will now be disregarded for income tax, *as well as sales tax*, purposes. Effective Date: June 30, 2009.
  - **Planning Point.** Taxpayers that have established transportation subs should analyze their current arrangements. Taxpayers should consider the tax impact, as well as possible liability issues, of liquidating the entity versus making the entity a stand-alone entity for tax purposes (for example, by adding an additional member to the LLC or electing to be taxed as a C corporation).
- **Non-Resident Withholding by Pass-Through Entities.** Previously, Wisconsin required pass-through entities, such as partnerships, LLCs, and S corporations, to withhold income taxes attributable to the pass-through entity's business activity on an *annual* basis on behalf of the non-resident partners, members, or shareholders of such entity, provided an exception to the withholding requirement did not apply. The Act now requires pass-through entities to withhold and remit estimated income taxes to Wisconsin on behalf of their non-resident partners, members, or shareholders on a *quarterly* basis where applicable. Effective Date: January 1, 2009 with the first withholding payments due September 15, 2009.
  - **Planning Point.** Prior to September 15, 2009, pass-through entities should prepare for the new burden of estimating and remitting taxes for non-Wisconsin partners, members, or S corporation shareholders on a quarterly, rather than annual basis.
- **Financial Institution Matching Program.** The Act creates a program whereby the Wisconsin Department of Revenue will enter into agreements with financial institutions doing business in Wisconsin to locate the accounts of delinquent state taxpayers for the purpose of levying the accounts. Effective Date: December 1, 2009.

Conclusions

While the preceding summary highlights many of the Act's significant tax provisions, the Act also implements several other changes to Wisconsin's tax rules which may be material to certain taxpayers. If you have any questions regarding the impact of the Act on you or your business, please contact a member of Godfrey & Kahn's Tax Team.

Tax & Employee Benefits Team Members

Madison office:
Thomas Hoffner
(thoffner@gklaw.com)
Jed Roher
(jroher@gklaw.com)

Milwaukee office:
Todd Cleary
(tcleary@gklaw.com)
John Donahue
(jdonahue@gklaw.com)
Daniel Geraghty
(dgeraghty@gklaw.com)
Lecia Johnson
(ljohnson@gklaw.com)
Debra Koenig Sadow
(dkoenig@gklaw.com)
Richard Marcus
(rmarcus@gklaw.com)
Sarah McNally
(smcnally@gklaw.com)
Douglas Patch
(dpatch@gklaw.com)
James Phillips
(jphillips@gklaw.com)
Wendy Richards
(wrichards@gklaw.com)
Mark Shiller
(mshiller@gklaw.com)
Sven Skillrud
(sskillrud@gklaw.com)

Waukesha office:
Scott Fabry
(sfabry@gklaw.com)
Jennifer Hanneman
(jhanneman@gklaw.com)