Wisconsin Department of Administration
Division of Executive Budget and Finance

Fiscal Estimate - 2017 Session

☒ Original ☐ Updated ☐ Corrected ☐ Supplemental

LRB Number 17-2602/1	Introduction Number AB-0259

Description
the length of the recognition period for built-in gains tax; the evidentiary standard for proving a transaction has economic substance; participation by the Department of Revenue in the Multistate Tax Commission Audit Program; and reliance by a taxpayer on past audits by the Department of Revenue

Fiscal Effect

State:
☐ No State Fiscal Effect
☐ Indeterminate
- ☐ Increase Existing Appropriations
- ☐ Decrease Existing Appropriations
- ☐ Create New Appropriations
- ☐ Increase Existing Revenues
- ☒ Decrease Existing Revenues
- ☒ Increase Costs - May be possible to absorb within agency's budget ☒ Yes ☐ No
- ☐ Decrease Costs

Local:
☐ No Local Government Costs
☐ Indeterminate
1. ☐ Increase Costs ☐ Permissive ☐ Mandatory
2. ☐ Decrease Costs ☐ Permissive ☐ Mandatory
3. ☐ Increase Revenue ☐ Permissive ☐ Mandatory
4. ☐ Decrease Revenue ☐ Permissive ☐ Mandatory
5. Types of Local Government Units Affected
☐ Towns ☐ Village ☐ Cities
☐ Counties ☐ Others 0
☐ School Districts ☐ WTCS Districts

Fund Sources Affected
☒ GPR ☐ FED ☐ PRO ☐ PRS ☐ SEG ☐ SEGS

Affected Ch. 20 Appropriations

Agency/Prepared By	Authorized Signature	Date
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Fiscal Estimate Narratives

DOR 4/27/2017

LRB Number **17-2602/1**	Introduction Number **AB-0259**	Estimate Type **Original**
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Assumptions Used in Arriving at Fiscal Estimate

Built-in Gains
The bill changes the recognition period during which a tax–option corporation that sells certain assets for a profit must pay income or franchise taxes on the profit as though the tax–option corporation were a regular corporation. Under current law, the term "recognition period" is defined by reference to federal law, but the definition is not automatically updated to reflect changes to federal law. The federal Protecting Americans from Tax Hikes Act of 2015 made permanent a reduction in the recognition period under federal law from ten years to five years. The bill provides that for taxable years beginning after December 31, 2017, the recognition period for purposes of Wisconsin law is the same as under federal law in effect at the time of the sale.

Based on the fiscal estimate for the federal built-in gains recognition period change from the federal Joint Committee on Taxation, and allocating that estimate to Wisconsin and adjusting for Wisconsin's tax rate, changing the recognition period from ten to five years would result in a loss of income and franchise tax revenue of an estimated $950,000 in FY18, $800,000 in FY19, and $600,000 in FY20.

Evidentiary Standards
Under current law, for transactions between members of a controlled group (and in tax law generally), the taxpayer bears the burden of establishing by clear and convincing evidence that a transaction or a series of transactions between the taxpayer and one or more members of the controlled group has economic substance. The bill reduces the evidentiary standard related to intercompany transactions for members of a controlled group from "clear and convincing evidence" to a "preponderance of the evidence."

The provision of the bill that changes the standard of evidence for transactions between combined group members would result in a loss of income and franchise tax of an unknown amount. For illustrative purposes, for the three-year period of FY14 through FY16, large-case auditors, who generally focus on combined groups, generated an average of $60.3 million in corporate income and franchise tax revenue. If the change in evidentiary standard results in a reduction of 10% in the revenue from large-case auditors, corporate income and franchise tax revenue would be reduced by an estimated $6.0 million annually. Lowering the evidentiary standard will increase the Department's administrative expenses. A less clear evidentiary standard also makes it more probable that such transactions will not be agreed to in audit, leading to increased litigation in order to resolve.

MTC Audit Authority
Under current law, DOR is authorized to enter into a contract to participate in the Multi-State Tax Commission (MTC) audit program. Under the bill, that authority would be repealed.

The provisions of the bill related to removing the authority for DOR to participate in MTC audits would reduce income and franchise tax revenue by an estimated net $1.25 million annually.

Reliance on Past Audits
Under current law, individuals or entities subject to audits are not liable for amounts asserted by DOR if the specific tax issue under review was present in a prior audit for the same period and DOR identified or reviewed the tax issue, but did not adjust the taxpayer's treatment of the tax issue. This provision does not cover the treatment of tax issues that were not specifically addressed in the prior assessment or audit determination. Current law also contains exceptions, allowing DOR to revisit assessments for cases in which the taxpayer did not give DOR adequate and accurate information regarding the tax issue in the prior audit determination or if the tax issue was settled in the prior audit determination by a written agreement between DOR and the taxpayer.

The bill removes the current law exceptions, preventing DOR from reexamining audits in cases in which taxpayers conceal or misrepresent relevant tax information. In addition to the direct impact of the safe-haven, this bill effectively discourages taxpayers from fully cooperating with any DOR audits by providing a guarantee that if DOR obtains new information at a later date, it will not adversely affect the taxpayer's liability.

The fiscal effect of the provision is unknown and will depend on the degree to which taxpayers reduce their compliance with DOR audit activities. As an example, if the provision reduces the revenue impact of audits by 5% relative to the average revenue generated for the three-year period from FY14 to FY16 of $281.8 million, it would reduce revenue by about $14.1 million annually.

Long-Range Fiscal Implications

Wisconsin Department of Administration
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Fiscal Estimate Worksheet - 2017 Session

Detailed Estimate of Annual Fiscal Effect

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I. One-time Costs or Revenue Impacts for State and/or Local Government (do not include in annualized fiscal effect):

II. Annualized Costs:	**Annualized Fiscal Impact on funds from:**	
	Increased Costs	Decreased Costs
A. State Costs by Category		
State Operations - Salaries and Fringes	$	$
(FTE Position Changes)		
State Operations - Other Costs		
Local Assistance		
Aids to Individuals or Organizations		
TOTAL State Costs by Category	**$**	**$**
B. State Costs by Source of Funds		
GPR		
FED		
PRO/PRS		
SEG/SEG-S		

III. State Revenues - Complete this only when proposal will increase or decrease state revenues (e.g., tax increase, decrease in license fee, ets.)

	Increased Rev	Decreased Rev
GPR Taxes	$	$
GPR Earned		
FED		
PRO/PRS		
SEG/SEG-S		
TOTAL State Revenues	**$**	**$**

NET ANNUALIZED FISCAL IMPACT

	State	Local
NET CHANGE IN COSTS	$	$
NET CHANGE IN REVENUE	$See Text	$

Agency/Prepared By	**Authorized Signature**	**Date**
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