

Clearinghouse Rule 17-018

PROPOSED ORDER OF THE DEPARTMENT OF REVENUE REPEALING, RENUMBERING, RENUMBERING AND AMENDING, AMENDING, REPEALING AND RECREATING, AND CREATING RULES

The Wisconsin Department of Revenue proposes an order to: **amend** Tax 2.85 (3), (3) (c) (**Examples**), and (4) (b) (**Examples**) and 11.90 (3), (3) (c) (**Examples**), and (4) (b) (**Examples**); and **create** Tax 2.85 (2) (cm), (3) (c), and 11.90 (3) (c); **relating to** penalty for failure to produce records.

The scope statement for this rule, SS 084-16, was approved by the Governor on September 13, 2016, published in Register No. 729B on September 26, 2016, and approved by the Secretary of Revenue on October 14, 2016.

Analysis by the Department of Revenue

Statutes interpreted: ss. 71.80 (9m) and 77.61 (19), Stats.

Statutory authority: ss. 71.80 (9m) (c), 77.61 (19) (c), and 227.11 (2) (a), Stats.

Explanation of agency authority: Sections 71.80 (9m) (c) and 77.61 (19) (c), Stats., provides "The department shall promulgate rules to administer this subsection and the rules shall include a standard response time, a standard for noncompliance, and penalty waiver provisions."

Section 227.11 (2) (a), Stats., provides "[e]ach agency may promulgate rules interpreting the provisions of any statute enforced or administered by the agency, if the agency considers it necessary to effectuate the purpose of the statute..."

Related statute or rule: There are no other applicable statutes or rules.

Plain language analysis: The object of the rule is to revise ss. Tax 2.85 and 11.90 relating to procedures on imposing a penalty for failure to produce records, as provided by 2015 Wis. Act 218.

Summary of, and comparison with, existing or proposed federal regulation:

There is no existing or proposed federal regulation that is intended to address the activities to be regulated by the rule.

Comparison with rules in adjacent states: The department is not aware of a similar rule in an adjacent state.

Summary of factual data and analytical methodologies: 2015 Wisconsin Act 218 made a change to Wisconsin's penalty for failure to produce records. The department has created this proposed rule order to reflect this statutory change. No other data was used in the preparation of this proposed rule order or this analysis.

Analysis and supporting documents used to determine effect on small business: This rule order makes changes to reflect current law and current department policy. It makes no policy or other changes having an effect on small business.

Anticipated costs incurred by private sector: This proposed rule does not have a fiscal effect on the private sector.

Effect on small business: This proposed rule does not affect small business.

Agency contact person: Please contact Jen Chadwick at (608) 266-8253 or jennifer.chadwick@wisconsin.gov, if you have any questions regarding this proposed rule.

Place where comments are to be submitted and deadline for submission: Comments may be submitted to the contact person shown below no later than Tuesday, April 25, 2017 . Information as to the place, date, and time of the public hearing will be published in the Wisconsin Administrative Register.

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SECTION 1. Tax 2.85 (2) (cm) is created to read:

Tax 2.85 (2) (cm) "Summons request" means a request for records issued by the department pursuant to s. 73.03 (9), Stats.

SECTION 2. Tax 2.85 (3) is amended to read:

Tax 2.85 (3) PROCEDURES. The penalties in this section may be imposed if the records requested were not provided and the department provided the notifications in pars. (a), ~~and (b)~~, and (c) regarding the records requested. The number of days established by the department for the person to respond to the record requests should be reasonable based on the facts of each situation.

SECTION 3. Tax 2.85 (3) (c) is created to read:

Tax 2.85 (3) (c) After the time period to respond to the second written request has expired as provided in par. (b), a summons request for records where the department allowed the person a minimum of 30 days from the date of request for the records to be provided. This summons request shall be prepared on a form prescribed by the department and shall be served:

1. By certified mail, evidenced by a return receipt signed by the taxpayer or an authorized representative.
2. By personal service pursuant to sec. 801.11, Stats., if unable to obtain a signature as provided in subd. 1.

SECTION 4. Tax 2.85 (3) (c) (**Examples**) and (4) (b) (**Examples**) are amended to read:

Tax 2.85 (3) (c) **Examples:** 1) The department issues a first written request for records to Corporation A on September 1, ~~2009~~2016, allowing Corporation A until October 6, ~~2009~~2016, to provide the records requested. Corporation A does not provide the requested records to the department by October 6, ~~2009~~2016. The department issues a second written request for records to Corporation A on October 21, ~~2009~~2016, allowing Corporation A until November 30, ~~2009~~2016, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 71.80 (9m), Stats. Corporation A does not provide the requested records by November 30, ~~2009~~2016. The department issues a summons request for records to Corporation A on December 20, 2016, allowing Corporation A until January 31, 2017, to provide the records requested. Corporation A does not provide the requested records by January 31, 2017. Therefore, the department may disallow the deductions, credits, or exemptions or include in Wisconsin income the additional income to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Corporation A not providing the records requested.

2) The department issues a first written request for records to Corporation B on December 21, ~~2009~~2016, allowing Corporation B until January 20, ~~2010~~2017, to provide the records requested. Corporation B does not provide the requested records to the department by January 20, ~~2010~~2017. The department issues a second written request for records to Corporation B on February 8, ~~2010~~2017, allowing Corporation B until March 10, ~~2010~~2017, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 71.80 (9m), Stats. Corporation B does not provide the requested records to the department by March 10, 2017. The department issues a summons request for records to Corporation B on March 28, 2017, allowing Corporation B until May 10, 2017, to provide the records requested. Corporation B provides records to the department by ~~March 10, 2010~~May 10, 2017, but the department determines that the taxpayer did not provide some of the records requested by ~~March 10, 2010~~May 10, 2017. Therefore, since the taxpayer did not provide all of the records requested by ~~March 10, 2010~~May 10, 2017, the department may disallow the deductions, credits, or exemptions or include in Wisconsin income the additional income to which the requested records that were not provided relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from the requested records that were not provided.

(4) (b) **Examples:** 1) Since Corporation C does not provide the records requested by the date specified in a ~~second written summons~~ request for records to support interest expense deducted, the department issues a proposed audit report to Corporation C disallowing all the interest expense previously deducted, which represents the penalty provided in s. 71.80 (9m) (a), Stats. Additional tax of \$100,000 and the penalty as provided in s. 71.80 (9m) (b), Stats., of \$25,000 results in the proposed audit report from disallowing this interest expense. Corporation C provides the records requested 26 days after the department issues the proposed audit report but before the notice of assessment is issued and explains, without any further detail, that they were too busy with other aspects of their business to respond to the ~~two~~ three written requests for records by the dates specified. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond the person's control. In addition, the records provided do not support a reduction of the interest expense disallowed in the proposed audit report. Therefore, the interest expense adjustment is

not modified so the proposed additional tax of \$100,000 and the original proposed penalty as provided in s. 71.80 (9m) (b), Stats., of \$25,000 remain.

2) Since Mr. Smith does not provide the records requested regarding his business, which primarily receives payments in cash, to support the reported gross receipts by the date specified in a ~~second written summons~~ request for records, the department issues a notice of assessment to Mr. Smith including an estimated amount into income for unreported receipts, which represents the penalty provided in s. 71.80 (9m) (a), Stats. Additional tax of \$60,000, a negligence penalty of \$15,000 and the penalty as provided in s. 71.80 (9m) (b), Stats., of \$15,000 results in the assessment from including these estimated receipts. Mr. Smith appeals the assessment, provides the records that were requested during the audit, and explains that he forgot to provide the records that were previously requested. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond the person's control. However, the records provided show that unreported receipts were only 20% of the amount previously included by the department as estimated unreported receipts. Therefore, the unreported receipts adjustment is modified to reduce the additional tax from \$60,000 to \$12,000, the negligence penalty is reduced from \$15,000 to \$3,000 and the original penalty as provided in s. 71.80 (9m) (b), Stats., is reduced from \$15,000 to \$3,000.

3) Assume the same facts as Example 2, except that Mr. Smith explains that he did not previously provide the requested records because his accountant had possession of them and was in the hospital when the records were requested during the audit. In this situation the failure to provide the records requested is reasonable or justified by factors beyond the person's control. Therefore, the unreported receipts adjustment is modified to reduce the additional tax from \$60,000 to \$12,000, the negligence penalty is reduced from \$15,000 to \$3,000 and the original penalty as provided in s. 71.80 (9m) (b), Stats., of \$15,000 is waived.

SECTION 5. Tax 11.90 (3) is amended to read:

Tax 11.90 (3) PROCEDURES. The penalties in this section may be imposed if the records requested were not provided and the department provided the notifications in pars. (a), ~~and (b),~~ and (c) regarding the records requested. The number of days established by the department for the person to respond to the record requests should be reasonable based on the facts of each situation.

SECTION 6. Tax 11.90 (3) (c) is created to read:

Tax 11.90 (3) (c) After the time period to respond to the second written request has expired as provided in par. (b), a summons request for records where the department allowed the person a minimum of 30 days from the date of request for the records to be provided. This summons request shall be prepared on a form prescribed by the department and shall be served:

1. By certified mail, evidenced by a return receipt signed by the taxpayer or an authorized representative.
2. By personal service pursuant to sec. 801.11, Stats., if unable to obtain a signature as provided in subd. 1.

SECTION 7. Tax 11.90 (3) (c) (**Examples**) and (4) (b) (**Examples**) are amended to read:

Tax 11.90 (3) (c) **Examples: 1)** The department issues a first written request for records to Corporation A on September 1, ~~2009~~2016, allowing Corporation A until

October 6, ~~2009~~2016, to provide the records requested. Corporation A does not provide the requested records to the department by October 6, ~~2009~~2016. The department issues a second written request for records to Corporation A on October 21, ~~2009~~2016, allowing Corporation A until November 30, ~~2009~~2016, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 77.61(19), Stats. Corporation A does not provide the requested records by November 30, ~~2009~~2016. The department issues a summons request for records to Corporation A on December 20, 2016, allowing Corporation A until January 31, 2017, to provide the records requested. Corporation A does not provide the requested records by January 31, 2017. Therefore, the department may disallow the deductions, credits, or exemptions or include the additional taxable sales or additional taxable purchases to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Corporation A not providing the records requested.

2) The department issues a first written request for records to Corporation B on December 21, ~~2009~~2016, allowing Corporation B until January 20, ~~2010~~2017, to provide the records requested. Corporation B does not provide the requested records to the department by January 20, ~~2010~~2017. The department issues a second written request for records to Corporation B on February 8, ~~2010~~2017, allowing Corporation B until March 10, ~~2010~~2017, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 77.61 (19), Stats. Corporation B does not provide the requested records to the department by March 10, 2017. The department issues a summons request for records to Corporation B on March 28, 2017, allowing Corporation B until May 10, 2017, to provide the records requested. Corporation B provides records to the department by ~~March 10, 2010~~May 10, 2017, but the department determines that the taxpayer did not provide some of the records requested by ~~March 10, 2010~~May 10, 2017. Therefore, since the taxpayer did not provide all of the records requested by ~~March 10, 2010~~May 10, 2017, the department may disallow the deductions, credits, or exemptions or include the additional taxable sales or additional taxable purchases to which the requested records that were not provided relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from the requested records that were not provided.

(4) (b) **Examples: 1)** Since Corporation C does not provide the records requested by the date specified in a second written summons request for records to support deductions for exempt sales, the department issues a proposed audit report to Corporation C disallowing all the deductions for exempt sales previously claimed, which represents the penalty provided in s. 77.61 (19) (a), Stats. Additional tax of \$100,000 and the penalty as provided in s. 77.61 (19) (b), Stats., of \$25,000 results in the proposed audit report from disallowing the deductions for exempt sales. Corporation C provides the records requested 26 days after the department issues the proposed audit report but before the notice of assessment is issued and explains, without any further detail, that they were too busy with other aspects of their business to respond to the ~~two~~ three written requests for records by the dates specified. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond the person's control. In addition, the records provided do not support a reduction of the exempt sales deductions disallowed in the proposed audit report. Therefore, the deductions for exempt sales adjustment is not modified so the proposed additional tax of \$100,000 and the original proposed penalty as provided in s. 77.61 (19) (b), Stats., of \$25,000 remain.

2) Since Mr. Smith does not provide the records requested regarding his business, which primarily receives payments in cash, to support the reported gross

receipts by the date specified in a ~~second written~~ summons request for records, the department issues a notice of assessment to Mr. Smith including an estimated amount into taxable sales for unreported receipts, which represents the penalty provided in s. 77.61 (19) (a), Stats. Additional tax of \$60,000, a negligence penalty of \$15,000 and the penalty as provided in s. 77.61 (19) (b), Stats., of \$15,000 results in the assessment from including these estimated receipts. Mr. Smith appeals the assessment, provides the records that were requested during the audit, and explains that he forgot to provide the records that were previously requested. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond the person's control. However, the records provided show that unreported receipts were only 20% of the amount previously included by the department as estimated unreported receipts. Therefore, the unreported receipts adjustment is modified to reduce the additional tax from \$60,000 to \$12,000, the negligence penalty is reduced from \$15,000 to \$3,000 and the original penalty as provided in s. 77.61 (19) (b), Stats., is reduced from \$15,000 to \$3,000.

3) Assume the same facts as example 2, except that Mr. Smith explains that he did not previously provide the requested records because his accountant had possession of them and was in the hospital when the records were requested during the audit. In this situation the failure to provide the records requested is reasonable or justified by factors beyond the person's control. Therefore, the unreported receipts adjustment is modified to reduce the additional tax from \$60,000 to \$12,000, the negligence penalty is reduced from \$15,000 to \$3,000 and the original penalty as provided in s. 77.61 (19) (b), Stats., of \$15,000 is waived.

SECTION 8. EFFECTIVE DATE; GENERAL. This rule shall take effect on the first day of the month following publication in the Wisconsin Administrative Register as provided in s. 227.22 (2) (intro.), Stats.

DEPARTMENT OF REVENUE

Dated: _____

By: _____

Richard G. Chandler
Secretary of Revenue