

**WISCONSIN DEPARTMENT OF REVENUE
DIVISION OF INCOME, SALES, AND EXCISE TAX**

NOTICE OF PROPOSED GUIDANCE DOCUMENTS

Pursuant to sec. 227.112, Wis. Stats., the Wisconsin Department of Revenue, Division of Income, Sales, and Excise Taxes hereby seeks comment on the proposed guidance document listed in the table below.

SUBMITTING PUBLIC COMMENTS

Public comments on proposed or adopted guidance documents may be submitted online at: <https://www.revenue.wi.gov/Pages/contactUs/proposed-Guidance.aspx>.

DEADLINE FOR SUBMISSION

The period for public comment for proposed guidance documents ends 21 days after publication in the Administrative Register, unless the Governor approves a shorter commenting period.

Document Number	Document Title
100179	Pass-Through Entity-Level Tax_Partnership Determining Income and Computing Tax - Common Questions

State of Wisconsin
Department of Revenue

Pass-Through Entity-Level Tax: Partnership Determining Income and Computing Tax

This is a proposed guidance document. The document has been submitted to the Legislative Reference Bureau for publication in the Administrative Register for public comment as provided by sec. 227.112(1), Wis. Stats.

Effective for taxable years beginning on or after January 1, 2019

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2. What is the entity-level tax rate?
3. Are long-term capital gains taxed at a different rate?
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18. Can an electing partnership pass through credits to its partners?
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20. How does an electing partnership compute the credit for taxes paid to another state?
21. Can an electing partnership claim a credit for taxes paid to another state if the taxes paid to the other state are paid by a partner on an individual income tax return?
22. Is withholding tax paid by an electing partnership in another state (e.g., Illinois) on behalf of its members considered a "composite return" for purposes of the Wisconsin entity-level credit for taxes paid to another state?
23. Can a partnership making the election to pay tax at the entity level exclude income at the entity level if the income is attributable to a tax-exempt partner?
24. For Wisconsin purposes, how will the partnership entity-level tax election affect the deductible amount of a partner's interest expense related to a debt-financed acquisition of a partnership?
25. For Wisconsin purposes, how will the partnership entity-level tax election affect the deductible amount of a partner's unreimbursed partnership expenses (UPE) reported on federal Schedule E, page 2?
26. Is an electing partnership subject to Wisconsin franchise tax on federal, state, and municipal government interest that would otherwise be taxable to a partner that is a tax-option (S) corporation?
27. How are guaranteed payments treated when calculating the partnership's Wisconsin taxable income?
28. If a partnership makes the entity-level tax election, who may claim a deduction for payments made by the partnership for a partner's health insurance?
29. If a partnership makes the entity-level tax election, who may claim a deduction for contributions made by the partnership in a partner's retirement plan?
30. If a partner of an electing partnership had a suspended loss from a prior year due to basis limitations, may the electing partnership use the partner's suspended loss to reduce its Wisconsin taxable income in the current year?

1. **How does an electing partnership determine the situs of income?**

The situs of income for an electing partnership is determined as if the election under sec. 71.21(6)(a), Wis. Stats., was not made. Therefore, an electing partnership must determine income attributable to Wisconsin pursuant to sec. 71.04, 71.14, 71.25, 71.362, or 71.45 Wis. Stats., depending on the type of partner.

Example 1 - Determining Wisconsin Sourced Income in a Single-Tiered Structure:

Facts

- Partners A and B each have 50-percent ownership interest in Partnership
- Partner A was a Wisconsin resident for the entire year in 2019
- Partner B was a nonresident of Wisconsin for the entire year in 2019
- In 2019, 25 percent of the partnership's income is earned in Wisconsin and 75 percent is earned in other states
- Partnership has \$100,000 of net ordinary business income in 2019 from the sale of tangible personal property
- Partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level for 2019

Computation of income attributable to Wisconsin

	Partner A (resident)	Partner B (nonresident)
Portion of business income from partnership	\$50,000	\$50,000
Wisconsin apportionment % (situs of income)	100%	25%
Partnership's Wisconsin source income	\$50,000	\$12,500

The electing partnership's Wisconsin income is **\$62,500** (\$50,000 + \$12,500).

Example 2 - Determining Wisconsin Sourced Income in a Multi-Tiered Structure:

Facts

- Partnership A operates a unitary business in California, New Jersey, and Wisconsin.
- Partnership A has three partners:
 - Partnership B is a 50% partner
 - Individual C is a 25% partner and a resident of New Jersey
 - Individual D is a 25% partner and a resident of Wisconsin
- Partnership A has \$20,000,000 of federal ordinary business income, no Wisconsin adjustments, and sales of tangible personal property as follows:
 - California sales (has nexus) \$15,000,000 30%
 - New Jersey sales (has nexus) \$7,500,000 15%
 - Wisconsin sales (has nexus) \$27,500,000 55%
 - Sales to other states \$0
 - Total sales \$50,000,000
- Partnership A elects to pay tax at the entity-level under sec. 71.21(6)(a), Wis. Stats.
- Partnership B has four partners
 - Corporation E is a 40% partner
 - Corporation F is a 35% partner
 - Individual G is a 15% partner and a resident of Wisconsin
 - Individual H is a 10% partner and a resident of Minnesota
- Partnership B has no additional entity level activity other than its interest in Partnership A.
- All income and expense amounts of Partnerships A and B are allocated to each partner on a pro-rata basis based on ownership percentage.
- Corporations E and F both conduct business in Wisconsin and New York. The Wisconsin apportionment percentages for these corporations are as follows, after combining their share of the partnership's apportionment data with their own apportionment data:
 - Corporation E 30%
 - Corporation F 40%

Taxable Income: If Partnership A makes the election, it will owe tax on \$12,400,000 of Wisconsin taxable income. See the computations in Tables 1 and 2 below.

Organizational Structure:

Table 1: Partnership A's Computation of Income Attributable to Wisconsin:

	Partnership B	Individual C NJ Resident	Individual D WI Resident	Total
Ownership % in Partnership A	50%	25%	25%	100%
Business income	\$10,000,000	\$5,000,000	\$5,000,000	\$20,000,000
WI apportionment	N/A	55%	N/A	
WI taxable income	\$4,650,000 (see Table 2)	\$2,750,000	\$5,000,000	\$12,400,000

Table 2: Partnership B's Partners' Computation of Income Attributable to Wisconsin:

	Corporation E	Corporation F	Individual G WI Resident	Individual H MN Resident	Total
Ownership % in Partnership B	40%	35%	15%	10%	100%
Business income	\$4,000,000	\$3,500,000	\$1,500,000	\$1,000,000	\$10,000,000
WI apportionment	30%	40%	N/A	55%	
WI taxable income	\$1,200,000	\$1,400,000	\$1,500,000	\$550,000	\$4,650,000

2. What is the entity-level tax rate?

The net income reportable to Wisconsin is taxed at 7.9% as provided in sec. 71.21(6)(a), Wis. Stats., and is computed on [Schedule 3-ET, Entity-Level Tax Computation](#).

3. Are long-term capital gains taxed at a different rate?

No, there is no separate tax rate for long-term capital gains.

4. Can an electing partnership claim the 30-percent or 60-percent long-term capital gain deduction for Wisconsin?

Yes, an electing partnership may claim the Wisconsin 30-percent or 60-percent long-term capital gain deduction.

Pursuant to sec. 71.21(6)(d)1, Wis. Stats., an electing partnership computes net income as provided in secs. 71.21(1) to (5), Wis. Stats. Pursuant to sec. 71.21(1), Wis. Stats., net income of a partnership is computed in the same manner and on the same basis as provided for computation of the income of persons other than corporations. Therefore, the partnership may claim the 30-percent and 60-percent long-term capital gain deductions under secs. 71.05(6)(b)9 and 9m., Wis. Stats.

5. Can an electing partnership register to be a qualified Wisconsin business?

Yes, an electing partnership may register to be a qualified Wisconsin business if they otherwise qualify. See [common questions](#) on the department's website.

6. Can an electing partnership claim a deduction for charitable contributions?

No, an electing partnership may not deduct charitable contributions except for charitable contributions that would otherwise be allowed as a deduction for a fiduciary as provided in [sec. 642](#), Internal Revenue Code (IRC).

Pursuant to [sec. 71.21\(6\)\(d\)1](#), Wis. Stats., an electing partnership computes net income as provided in secs. 71.21(1) to (5), Wis. Stats. Pursuant to [sec. 71.21\(1\)](#), Wis. Stats., net income of a partnership is computed in the same manner and on the same basis as provided for computation of the income of persons other than corporations. [Section 71.01\(9\)](#), Wis. Stats., defines person as a natural person or fiduciary.

7. Can an electing partnership pass through charitable contributions to its partners?

No, an electing partnership may not pass through charitable contributions to its partners.

Pursuant to secs. [71.21\(6\)\(d\)1](#), [71.21\(1\)](#), [71.01\(9\)](#), Wis. Stats., and [sec. 642](#), IRC, charitable contributions are included in an electing partnership's net income, and therefore may not pass through to the partners.

8. Is an electing partnership subject to passive activity loss limitations?

Yes, an electing partnership is subject to passive activity loss limitations as provided in [sec. 469](#), IRC.

Pursuant to [sec. 71.21\(6\)\(d\)1](#), Wis. Stats., an electing partnership computes net income as provided in secs. 71.21(1) to (5), Wis. Stats. Pursuant to [sec. 71.21\(1\)](#), Wis. Stats., net income of a partnership is computed in the same manner and on the same basis as provided for computation of the income of persons other than corporations. [Section 71.01\(9\)](#), Wis. Stats., defines person as a natural person or fiduciary. Pursuant to [sec. 469\(a\)\(1\) and \(2\)](#), IRC, passive activity loss limitations apply to any individual estate, or trust.

9. How does the electing partnership determine the characterization of passive income or loss?

The electing partnership must determine the characterization of passive income or loss as if the election under [sec. 71.21\(6\)\(a\)](#), Wis. Stats., was not made. Therefore, an electing partnership must determine how each partner would characterize the income or loss as if the election was not made. Passive losses may not be passed through to the partners; however, suspended losses may be carried forward by the electing partnership to be used to offset income in a subsequent year in which the election is made.

The electing partnership must complete a pro forma federal Form 8582, *Passive Activity Loss Limitations*, for Wisconsin in order to determine the allowable passive activity losses it may claim.

Pursuant to [sec. 71.21\(6\)\(d\)1](#), Wis. Stats., an electing partnership computes net income as provided in secs. 71.21(1) to (5), Wis. Stats. Pursuant to [sec. 71.21\(1\)](#), Wis. Stats., net income of a partnership is computed in the same manner and on the same basis as provided for computation of the income of persons other than corporations. [Section 71.01\(9\)](#), Wis. Stats., defines person as

a natural person or fiduciary. Pursuant to sec. 71.21(6)(b), Wis. Stats., it is the intent that an electing partnership must pay tax on items that would otherwise be taxed if the election was not made.

10. Is an electing partnership subject to the \$500 Wisconsin capital loss limitation or the \$3,000 federal capital loss limitation?

An electing partnership is subject to the \$500 Wisconsin capital loss limitation, not the \$3,000 federal capital loss limitation. Capital losses may not be passed through to the partners; however, suspended losses may be carried forward by the electing partnership to be used to offset income in a subsequent year in which the election is made, to the extent allowed under Wisconsin law.

Pursuant to sec. 71.21(6)(d)1, Wis. Stats., an electing partnership computes net income as provided in secs. 71.21(1) to (5), Wis. Stats. Pursuant to sec. 71.21(1), Wis. Stats., net income of a partnership is computed in the same manner and on the same basis as provided for computation of the income of persons other than corporations. Section 71.01(9), Wis. Stats., defines person as a natural person or fiduciary.

11. Is an electing partnership subject to federal section 179 expense limitations?

Yes, an electing partnership is subject to federal section 179 expense limitations as provided in sec. 71.98, Wis. Stats. The limit is applied at the entity level.

12. Is an electing partnership allowed the federal special depreciation allowance or "bonus depreciation" under sec. 168(k), Internal Revenue Code (IRC)?

No, pursuant to secs. 71.01(6)(L) and 71.98, Wis. Stats., an electing partnership may not claim the federal special depreciation allowance provided in sec. 168(k), IRC.

13. How will depreciation that results from a partnership's election under sec. 754, IRC, be treated if the partnership makes an election to be taxed at the entity level?

The partnership includes the depreciation in the calculation of its Wisconsin income pursuant to secs. 71.01(6)(L) and 71.98, Wis. Stats., regardless if the entity-level tax election is made.

14. Can an electing partnership carry forward suspended capital and passive activity losses?

Yes, an electing partnership may carry forward suspended capital and passive activity losses. When the election is made, such losses may not pass through to partners; they are suspended until such time that the partnership may use them to offset income in a subsequent year in which the election is made.

15. Can an electing partnership carry back or carry forward net operating losses?

No, pursuant to sec. 71.21(6)(d)2, Wis. Stats., an electing partnership may not claim net operating losses under sec. 71.05(8), Wis. Stats.

16. Can an electing partnership pass through net operating or business losses to its partners?

No, partners of an electing partnership may not include in their Wisconsin adjusted gross income their proportionate share of items of income, gain, loss, or deduction of the partnership, pursuant to sec. 71.21(6)(b), Wis. Stats.

17. Can an electing partnership claim credits to offset taxable income at the entity level?

Pursuant to sec. 71.21(6)(d)3, Wis. Stats., an electing partnership may only claim a credit for other state taxes paid as provided under sec. 71.07(7)(b)3, Wis. Stats.

18. Can an electing partnership pass through credits to its partners?

Yes, an electing partnership may pass through credits to its partners, except for the credit for taxes paid to other states by the partnership as provided in sec. 71.07(Z)(b)2., Wis. Stats.

19. How is the manufacturing and agriculture (M&A) credit included in Wisconsin income if a partnership makes an election to pay tax at the entity level in the year the M&A credit is computed and does not make the election to pay tax at the entity level in the following year?

The M&A credit must be added to the partnership's income for the year following the year in which the credit was computed as provided in sec. 71.21(4)(b)., Wis. Stats., regardless of whether the partnership makes the election to pay tax at the entity level.

20. How does an electing partnership compute the credit for taxes paid to another state?

An electing partnership must use Schedule ET-OS to compute the allowable credit for taxes paid to another state. See Schedule ET-OS instructions for additional information.

21. Can an electing partnership claim a credit for taxes paid to another state if the taxes paid to the other state are paid by a partner on an individual income tax return?

No, in order for an electing partnership to receive credit for taxes paid to another state, the partnership must pay the taxes owed to the other state on a partnership income or franchise tax return, or pay tax to the other state on a composite return filed on behalf of its partners as provided in sec. 71.07(Z)(b)3., Wis. Stats.

22. Is withholding tax paid by an electing partnership in another state (e.g., Illinois) on behalf of its members considered a "composite return" for purposes of the Wisconsin entity-level credit for taxes paid to another state?

A partnership may claim a credit for withholding taxes paid to another state on behalf of a Wisconsin resident partner as provided in sec. 71.07(Z)(b)3., Wis. Stats., if all of the following apply:

- o The law in the other state provides that the Wisconsin resident is not required to file an individual income tax return because the individual's net income tax liability is considered paid in full as a result of the withholding tax paid by the entity on the Wisconsin partner's income attributable to the other state.
- o The Wisconsin resident does not file an individual income tax return in the other state.
Caution: Although the individual is not required to file an Illinois income tax return, the individual may file such return with Illinois.
- o The income taxed by the other state is attributable to amounts that would be reportable to Wisconsin if the entity-level tax election was not made.
- o The partnership pays the liability shown on the other state's withholding tax return. Amounts paid to the other state are considered paid to that other state only in the year in which the withholding tax return for that state was required to be filed.
- o The partnership attaches a copy of the other state's withholding tax return to its Wisconsin Form 3.
- o The credit is claimed within four years of the unextended due date of the entity's return.

For example, Illinois law provides that a nonresident of Illinois who has had Illinois income tax withheld by a partnership is not required to file an Illinois individual income tax return if the nonresident's income tax liability is paid in full after taking into account the withholding.

23. Can a partnership making the election to pay tax at the entity level exclude income at the entity level if the income is attributable to a tax-exempt partner?

No, pursuant to sec. 71.21(6)(d)1. Wis. Stats., an electing partnership computes net income as provided in secs. 71.21(1) to (5), Wis. Stats. Pursuant to sec. 71.21(1). Wis. Stats., net income of a partnership is computed in the same manner and on the same basis as provided for computation

of the income of persons other than corporations. Section 71.01(9), Wis. Stats., defines person as a natural person or fiduciary.

24. For Wisconsin purposes, how will the partnership entity-level tax election affect the deductible amount of a partner's interest expense related to a debt-financed acquisition of a partnership?

The interest paid by the partner is an expense incurred by the partner; it is not an expense of the partnership. The deductibility of the interest expense on the partner's Wisconsin income tax return is determined under the Internal Revenue Code (IRC) in effect for Wisconsin. The partner may deduct the interest expense to the extent allowable under Internal Revenue Service Treas. Reg. sec. 1.163-8T and secs. 163(d) and 469, IRC, in effect for Wisconsin, regardless of whether the partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level.

25. For Wisconsin purposes, how will the partnership entity-level tax election affect the deductible amount of a partner's unreimbursed partnership expenses (UPE) reported on federal Schedule E, page 2?

The UPE paid by the partner is an expense incurred by the partner; it is not an expense of the partnership. The deductibility of the UPE expense on the partner's Wisconsin income tax return is determined under the IRC in effect for Wisconsin. The partner may deduct the UPE to the extent allowable under the IRC in effect for Wisconsin, regardless of whether the partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level.

26. Is an electing partnership subject to Wisconsin franchise tax on federal, state, and municipal government interest that would otherwise be taxable to a partner that is a tax-option (S) corporation?

Yes, pursuant to sec. 71.26(6)(b), Wis. Stats., an electing partnership must pay tax on items that would otherwise be taxed if the election was not made. Therefore, if one of the partners is a corporation that would otherwise be subject to a franchise tax on the federal, state, and municipal government interest, the electing partnership must pay tax on this income.

27. How are guaranteed payments treated when calculating the partnership's Wisconsin taxable income?

Pursuant to sec. 71.21(6)(b), Wis. Stats., the partnership shall pay tax on items that would otherwise be taxed if the election was not made. Accordingly, to the extent a partner would otherwise include the guaranteed payments in Wisconsin taxable income, the electing partnership must include the guaranteed payments in Wisconsin taxable income.

28. If a partnership makes the entity-level tax election, who may claim a deduction for payments made by the partnership for a partner's health insurance?

If the payments are considered guaranteed payments, to the extent an individual partner would otherwise include guaranteed payments in Wisconsin income, the electing partnership must include the guaranteed payments in Wisconsin taxable income. The deductibility of self-employed health insurance as provided in sec. 162(l), of the Internal Revenue Code, is allowed on the partner's Wisconsin income tax return to the extent allowable under the IRC in effect for Wisconsin, regardless of whether the partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level.

If the payments are not considered guaranteed payments, then the health insurance payments are not an expense of the electing partnership. The deductibility of self-employed health insurance as provided in sec. 162(l), of the Internal Revenue Code, is allowed on the partner's Wisconsin

income tax return to the extent allowable under the IRC in effect for Wisconsin, regardless of whether the partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level.

29. If a partnership makes the entity-level tax election, who may claim a deduction for contributions made by the partnership in a partner's retirement plan?

If the payments are considered guaranteed payments, to the extent an individual partner would otherwise include guaranteed payments in Wisconsin income, the electing partnership must include the guaranteed payments in Wisconsin taxable income. The deductibility of retirement plan contributions as provided in sec. 404(a)(8), IRC, are allowed on the partner's Wisconsin income tax return to the extent allowable under the IRC in effect for Wisconsin, regardless of whether the partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level.

If the payments are not considered guaranteed payments, then the retirement plan contribution payments are not an expense of the electing partnership. The deductibility of retirement plan contributions as provided in sec. 404(a)(8), IRC, are allowed on the partner's Wisconsin income tax return to the extent allowable under the IRC in effect for Wisconsin, regardless of whether the partnership makes an election under sec. 71.21(6)(a), Wis. Stats., to pay tax at the entity level.

30. If a partner of an electing partnership had a suspended loss from a prior year due to basis limitations, may the electing partnership use the partner's suspended loss to reduce its Wisconsin taxable income in the current year?

No, an electing partnership may not use a partner's suspended loss from prior years when computing Wisconsin taxable income. Suspended loss due to a basis limitation occurs when a partner is disallowed business loss passed-through from a partnership because the partner does not have enough tax basis in the entity.

Note: Pursuant to sec. 71.21(6)(d)4., Wis. Stats., a partner's adjusted basis of the partner's interest in an electing partnership is determined as if the election was not made. Therefore, a partner with prior year suspended losses due to basis limitations may be able to deduct a portion of the suspended losses in a year the partner's basis in the partnership increases, regardless if the partnership makes the entity-level tax election.

Applicable Laws and Rules

This document provides statements or interpretations of the following laws and regulations in effect as of January 23, 2020: Sections 71.01, 71.04, 71.05, 71.07, 71.21, 71.25, 71.26, 71.34, 71.98 and 73.03, Wis. Stats., secs. Tax 2.08 and 2.955, Wis. Adm. Code, 26 U.S. Code §§ 162, 404, 469 and 642, and 26 CFR § 163-1.

Laws enacted and in effect after January 23, 2020, new administrative rules, and court decisions may change the interpretations in this document. Guidance issued prior to January 23, 2020, that is contrary to the information in this document is superseded by this document, pursuant to sec. 73.16(2)(a), Wis. Stats.

FOR QUESTIONS OR COMMENTS CONTACT:

MS 5-77

WISCONSIN DEPARTMENT OF REVENUE

Customer Service Bureau

PO Box 8949

Madison, WI 53708-8949

Phone: (608) 266-2772

Fax: (608) 267-1030

Email additional questions to DORIncome@wisconsin.gov

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