



JOHN J. MACCO

STATE REPRESENTATIVE • 88TH ASSEMBLY DISTRICT

Thank you Chairman Spiros and committee members for hearing AB 623. Senator Marklein and I, our staff, stake holders and in consultation with the various state departments are proud present The Taxpayer Fairness Act.

As a Wisconsin small business owner, I have firsthand knowledge of the frustration Wisconsin job creators experience in the management of their businesses. Simplification and certainty with government regulation and tax rules will allow businesses to more easily be in compliance with our tax code, lower costs of operation and increase competitiveness.

Our bill seeks to lower the burden of economic production, alleviate uncertainty, ensure against potential misuse, establish equality for instate business and make our business climate more conducive for businesses to expand in Wisconsin, be domiciled in Wisconsin and add jobs in Wisconsin.

This bill seeks to clarify and codify. The elements of this bill are complicated because our tax code is complicated, but your constituent businesses are dealing with these issues daily as they seek to compete in the 21st Century Economy. The seven main elements of the bill are:

- Clarifying depreciation as a business when claiming the Manufacturing and Agriculture tax credit.
- Applying a 10% lump sum treatment in current law to construction contracts.
- Federalizing the state economic substance statute.
- Empowering auditors familiar with Wisconsin tax law over out-of-state auditors
- Requiring the Department of Revenue to apply the same rules for businesses selling goods in Wisconsin as outside of Wisconsin.
- Strengthening certain protections for taxpayers who have been subject to past audits.
- Clarifying penalties to businesses who do not comply with documents subpoenaed.

I want to thank the committee for holding a hearing on the Taxpayer Fairness Act and I ask for your vote to bring fairness to the Wisconsin tax code.

Sincerely,

A handwritten signature in black ink, appearing to read "John J. Macco", is written over a large, stylized graphic element that resembles a signature or a large letter "J".

John J Macco
Representative
88th Assembly District



Scott Walker
Governor

Richard G. Chandler
Secretary of Revenue

January 7, 2016

Testimony to the Assembly Committee on Ways and Means on Assembly Bill 623

Chairman Spiros and members of the committee, thank you for the opportunity to testify on Assembly Bill 623, which makes several changes to statutes administered by the Department of Revenue. I'll present information about the fiscal effects and the policy aspects of the provisions in the bill.

We are always willing to work with legislators and taxpayers to help draft legislation to make our tax code simpler and less burdensome. Over the last several months, DOR has met with and discussed provisions of this bill with its supporters. We would like to present background information about some of the provisions which would be helpful to the committee in considering the bill. In other cases, we have information about how the bill's language could be revised to improve it. We have shared this information with the bill's authors.

Here are our specific comments on the omnibus bill:

- Changes to the statutes regarding reliance on past audits.

The 2013 budget established that taxpayers can rely on determinations by DOR in past audits, unless and until DOR's position is changed in writing. However, this provision does not apply if a taxpayer did not provide DOR with complete and accurate records regarding the issue, or if the issue was settled in compromise negotiations. The administration worked with legislators and taxpayers to advance this legislation, understanding that enabling clarity for taxpayers to rely on past audit determinations is a good business practice.

The provision on reliance of past audits before you today changes what was done in 2013, to say that DOR is bound by a past determination even if the taxpayer provided incomplete or inaccurate records, or if the past determination was simply a result of splitting the difference between the two parties. This would result in taxpayers having an incentive to withhold or provide

inaccurate information, and could discourage compromise settlements and prolong cases, costing the state and taxpayers more in the long run. The specific fiscal effect of this provision is unknown and will depend on the degree to which taxpayers reduce their compliance with DOR audit activities. For illustrative purposes, if the provision reduces the revenue impact of audits by 5%, it would reduce revenue by about \$13.3 million annually.

- **Definition of depreciation for manufacturing and agriculture credit.**

This provision will expand the manufacturing and agriculture credit by reducing depreciation in computing qualified production activities income. The committee should be aware that this will result in a fiscal effect of \$5.3 million annually. DOR has offered language that we believe addresses the authors' and supporters' intentions without creating this fiscal impact.

- Treatment of lump sum contracts for contractors.

We appreciate the desire to simplify tax matters for contractors, but the language requires several technical corrections to be administrable while also enhancing simplicity. We have provided the authors DOR's technical feedback on this provision. The committee should also recognize that there is a \$1.1 million annual fiscal effect.

- Multistate Tax Commission (MTC) audits.

The MTC conducts audits of companies as a representative of many states. There are currently 27 states that participate in the MTC audit program. Many people feel the concept of having states pool their resources in auditing companies that do business in many states makes sense. States can avoid duplication of effort and save money. Taxpayers only have to deal with one audit rather than multiple audits. Having said that, there have been concerns expressed by some taxpayers that MTC auditors sometimes are not as expert in Wisconsin tax law as Wisconsin auditors. It should be recognized that even if Wisconsin withdraws from the MTC, Wisconsin companies may still be audited by the MTC on behalf of other states.

The committee should recognize that there is a net fiscal effect of \$1.25 million annually. Also, if this provision is adopted, DOR would request that additional language be included allowing sufficient time for MTC audits that are currently in process to be able to be completed.

- Production of documents.

Current law requiring companies to produce documents during audits is a tool to ensure timely audits and incentivize taxpayer cooperation with an audit. The language in the bill requires DOR to have a summons issued before DOR can impose penalties for failure to produce documents. The committee should recognize that it makes the process slower and more cumbersome. The current use of this provision is limited to just a few, large out-of-state companies, so the fiscal effect is minimal.

- Nexus rulemaking language.

We believe these provisions are unnecessary. The department already has detailed rules on nexus and apportionment promulgated under existing rule-making authority found in 71.04(11) and 71.25(12). We estimate that this provision could have a fiscal effect. For illustrative purposes, if the final rules result in a reduction of 1% in amount of apportionable income for corporations with gross receipts over \$100 million, it would result in an annual reduction in income and franchise tax revenue of \$6.5 million. We would be very willing to receive specific input from taxpayers about areas they think should be revised and undertake rule-making to address these matters under our existing authority.

- Economic substance language.

The language in the current Wisconsin statutes says that business transactions will only be recognized for purposes of tax deductions if they have economic substance. There has to be an economic or business reason to engage in a transaction, not just a tax avoidance reason. The vast majority of states disallow deductions for transactions that lack economic substance, as does the federal government. Wisconsin's current language is substantially similar to the federal internal revenue code.

How the bill language is written is important. Otherwise, large companies with operations in many states and with sophisticated tax planning capabilities will structure their affairs so that income earned in Wisconsin will be shifted outside Wisconsin.

The bill summary says it replaces current language with language using the same factors as federal law, but it is written in a way that would result in large revenue impacts. We have suggested language that would federalize without a fiscal effect; however, it should be a parallel state version of the federal language. Federal law only addresses federal tax impact and does not address the impact of a transaction on state or local taxes. Some transactions may have no federal tax effect, but are designed to reduce state or local taxes. Under the proposed language, certain transactions could be used to avoid state or local taxes.

This provision as drafted has a significant \$296 million fiscal effect. We believe, based on past experience, that if this provision is passed, a small number of large multistate corporations with large tax bills would structure themselves to move large amounts of income outside of Wisconsin. It is important to note that the top 10 multi-state corporate taxpayers are responsible for nearly a quarter of all corporate income taxes in Wisconsin, and other large multi-state companies pay a large share of all corporate income taxes.

Another provision in the bill changes the evidentiary standard in Wisconsin. Wisconsin tax law uses a "clear and convincing evidence" standard of proof. This bill reduces that standard for economic substance to "preponderance of the evidence." To remain consistent with other provisions of Wisconsin tax law and avoid any fiscal effect, the state would have to maintain the current burden of proof. The burden of proof change in the bill would result in a loss of income and franchise tax of an unknown amount. For illustrative purposes, 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 \$5.7 million annually.

Thank you again for the opportunity to discuss AB 623.

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**Testimony to the
Wisconsin Legislature
Assembly Committee on Ways and Means**

**In Support of Assembly Bill 623
Tax Administration Reform**

**Ferdinand Hogroian
Senior Tax and Legislative Counsel
January 7, 2016**

Chairman Spiros, Vice-Chair Macco, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am pleased to testify today in support of Assembly Bill 623, which would make multiple changes to improve the fairness of Wisconsin's tax laws for businesses. COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Through significant economic activity, investment, and employment in Wisconsin, COST members have a vital interest in improving the fairness of the State's tax system.

Today I wish to speak to several aspects of Assembly Bill 623 directly implicating COST's policy objectives of promoting fair, efficient, and customer-focused tax systems.

Production of Documents. Specifically, COST applauds provisions in the legislation that would allow taxpayers to comply in good faith with a summons seeking production of records and documents before application of onerous penalties, including the complete disallowance of deductions, credits, and exemptions, as well as an additional 25 percent penalty. Existing law creates an uneven playing field where the Wisconsin Department of Revenue ("Department") may assert these extreme penalties any time it deems the taxpayer fails to produce records and documents to its satisfaction, and such failure was not justified according to the Department's standards of reasonableness.

Under rules promulgated by the Department (Wis. Admin. Code Tax Section 2.85), taxpayers are provided a mere 30 days to produce records in response to the Department's requests for documents. As provided in the Department's examples, penalties are presently applied even if the taxpayer timely responds to the Department's second request for records, if the Department subsequently deems the taxpayer's response incomplete. This rule operates as an inappropriate trap for taxpayers dealing with multiple state audits, and represents an undue regulatory cost of doing business in Wisconsin.

Assembly Bill 623 provides a clear standard under which a taxpayer failing to comply in good faith with a summons seeking records or documents will be subject to the penalties described in the statute and rule. This provision would remedy a “significant procedural issue” for Wisconsin identified in COST’s Scorecard, “The Best and Worst of State Tax Administration.”¹ Addressing the standards for document production could improve Wisconsin’s Scorecard grade, reflecting fairer tax administration with lower regulatory costs to businesses.

Economic Substance Reform. Similarly, Assembly Bill 623 would address a fairness issue by providing a level playing field for taxpayers required to defend the economic substance of legitimate business transactions. Existing law creates a presumption that any intercompany transaction – essentially any business conducted within the corporate group – lacks economic substance, and the taxpayer bears the burden of proving otherwise by clear and convincing evidence. This blanket presumption has no regard for legitimate transactions, and places businesses at a significant disadvantage in defending normal business arrangements.

While Assembly Bill 623 leaves the presumption in place, it changes the burden of proof to a “preponderance of the evidence” standard. In practice, the taxpayer would be required to provide evidence establishing economic substance for those intercompany transactions challenged by the Department’s auditor – a common audit situation. However, by changing the burden from clear and convincing evidence, the taxpayer would no longer be placed at a disadvantage of an unequal burden of proof for any number of intercompany transactions, which could be arbitrarily disregarded by the Department’s auditor by citing the statutory presumption.

Nexus Equality. Assembly Bill 623 also increases fairness by requiring consistent rules for determining whether a taxpayer is taxable, or has “nexus,” in Wisconsin and other states. Wisconsin unfortunately employs a “throwback” rule harmful to in-state investment. Under this rule, businesses are penalized for selling to other states from Wisconsin. Further, the rule is inconsistent with sound tax policy. Simply put, the rule results in the wrong state taxing the wrong income at the wrong rate.

Assembly Bill 623 merely requires the Department to promulgate rules to establish the criteria to be used in determining nexus for Wisconsin and other states, and thus would provide clarity and fairness for Wisconsin businesses subject to the throwback rule. While the throwback penalty would still exist for companies investing in the State, these companies would not be subject to an arbitrary and unequal standard in determining whether the rule applies to them.

Thank you for the opportunity to discuss these important issues of fairness advanced by Assembly Bill 623. I look forward to any questions you may have.

¹ The Best and Worst of State Tax Administration, COST Scorecard on Tax Appeals and Procedural Requirements, December 2013, available at <http://www.cost.org/WorkArea/DownloadAsset.aspx?id=85976>.



Date: January 7, 2016
To: Members – Assembly Ways and Means Committee
From: Jim Boullion, Director of Government Affairs
John Schulze, Director of Government Affairs

Support AB 623 - Construction Sales Tax Simplification Included in Taxpayer Fairness Reform Act

Wisconsin's construction sales tax law is extremely complicated and difficult to administer, costing Wisconsin's businesses and taxpayers unnecessary time and money. A key provision in the Taxpayer Fairness Reform Act introduced by Senator Howard Marklein (R-Spring Green) and Representative John Macco (R-DePere) would simplify one of the most confusing provisions of that law.

Currently, a contractor is the consumer of the "real property" goods and materials that they use to construct a building such as the bricks, steel and mortar. The contractor pays the sales tax on those real property items and passes that cost on to the consumer in his final building price. However, if the contractor includes "personal property" items in his building such as curtains, desks or appliances (things that can be easily pulled out or replaced in the building) the contractor is acting as a retailer who buys the materials without sales tax and resells it to the owner who pays the sales tax in a separate transaction.

This system is complicated by the fact that some items like data wiring, security systems and counter tops can be either personal property or real property depending on what the building will be used for or how it is installed. The current system creates a large amount of unnecessary paperwork and numerous headaches!

In 2013, Wisconsin clarified the sales tax law to say that if less than 10% of the purchase price of a building that is sold for a single lump sum price (the building and everything inside of it are being sold for one fixed price) is personal property, then the contractor can simply pay all of the sales taxes up front and not have to split out the personal property items from the real property items and do a separate sale to the owner and collect sales tax separately.

The Taxpayer Fairness Reform Act would expand that 10% rule to apply to all construction projects, whether they are sold under a lump sum price, a cost plus contract or any other method of purchase. The majority of construction contracts are already covered by the lump sum rule, this change would simply make the rule consistent no matter how the contract is structured.

Just to be clear, this proposal does not exempt any materials from the sales tax. The sales taxes on all of the materials are still paid, this change only simplifies the law to allow the contractor to purchase all of the materials in the project and pay the sales taxes up front.

This proposed change will be a great step forward in cutting red tape and letting contractors get back to work building Wisconsin instead of doing paperwork!

This is the language in the bill that will improve the construction sales tax law:

SECTION 24. 77.54 (60) (b) of the statutes is amended to read:

77.54 (60) (b) The sales price from the sale of and the storage, use, or other consumption of ~~tangible personal property, items and property under s. 77.52 (1) (b) and (c), and taxable services~~ construction materials that are sold by a prime contractor as part of a ~~lump-sum~~ construction contract, if the total sales price of all ~~such taxable products~~ construction materials is less than 10 percent of the total amount of the ~~lump-sum~~ construction contract. Except as provided in par. (c), the prime contractor is the consumer of such taxable products the construction materials and shall pay the tax imposed under this subchapter on the taxable products construction materials.

Taxing questions: Lawmaker seeks sharper line between real, personal property

Change to help prevent contractors from having to be part-time tax accountants

By: Dan Shaw, dan.shaw@dailyreporter.com October 14, 2015

Ryan Gartman, a certified public accountant in Sheboygan, got a prime example two years ago of the sorts of quandaries contractors regularly struggle with when it comes to deciding if they themselves should be paying sales taxes on certain building materials or if they should instead be collecting the taxes from project owners.

Now that lawmakers in Madison are preparing to propose a series of simplifications to the state's tax system, a story such as Gartman's is likely to give them an "Exhibit A."

Two years ago Gartman, who works in the Sheboygan office of the financial services firm Clifton Larson Allen, found himself helping a client who had become entangled with the state's Department of Revenue in a dispute over the tax treatment given to a security camera installed at a manufacturing warehouse.

Although security cameras all fulfill the same basic function, they fall into two distinct categories in the state's tax code. Cameras used to safeguard a building's entrance or for similar purposes are generally considered to be part of the structure itself and are thus deemed "real property."

Cameras used to monitor inventory, in contrast, are usually classified as "personal property," a designation referring to parts of a structure that are not firmly attached to a structure and are easy to cart off. The trouble for Gartman's client — which he declined to identify — was that the camera it installed could be swiveled about to keep tabs on both the warehouse's front entrance and on inventory.

That meant the same camera could be classified as real property in some instances and personal property in others. The company's initial choice was to treat the equipment as real property; officials at the state Department of Revenue disagreed, though.

Gartman and his client were eventually able to persuade the auditors to back down. But he wonders: Wouldn't a simplification of the code have made the conflict avoidable altogether?

"It was up to the installer — the contractor — to determine if it was personal property or real property,"

he said. "And in the end, how are they really supposed to determine that?"

And it's not just security cameras that are a source of bewilderment.

Electrical wiring when run behind a wall is treated as real property, but data cabling, when put in behind the same wall, is personal property. Cabinetry likewise is considered real property when installed in certain types of rooms, but personal property in others. A legislative aide to state Rep. John Macco, R-Ledgeview, said Wednesday that his boss plans in coming months to put forward a bill aimed at dispelling the confusion forever, at least for certain materials and equipment. Among other things, Macco is proposing that all security cameras and related equipment, as well as communications and data cabling, and cabinets and countertops, be classified as real property — no matter how they are used or where they are installed.

John Schulze, director of government relations for the Associated Builders and Contractors of Wisconsin, said the simple change would help prevent contractors from having to act like part-time tax accountants. "Just tell them what they are supposed to pay and they'll pay it," he said. "And then let them go do what they are supposed to do, which is build stuff."

Jim Boullion, director of government affairs at the Associated General Contractors of Wisconsin, said larger companies many times have staff employees who specialize in tax compliance. Still, even for them, "It's so convoluted and difficult, it's hard to come out of an audit without there being a mistake." The distinction between the two types of property makes a big difference for tax purposes.

When building materials are deemed real property, it's contractors themselves who are expected to pay sales and use taxes. When it comes to personal property, though, contractors are considered to be acting like a retailer selling something to a customer and thus are supposed to collect taxes from the project owner and then pass the money on to the state.

The real trouble comes when a contractor assumes that certain building materials fall into the real-property category and pay sales taxes, only to be told later by state auditors that they were in fact dealing with personal property. That puts the contractor in the difficult position of either having itself to pay the sales tax for the personal property or of trying to get the money from the project owner, sometimes years after the work has been completed.

What's more, personal-property taxes apply not only to the building materials themselves, but also any labor and related expenses that went into their installation. For that reason, taxes on personal property tend to be higher than those on real property.

Because of the likelihood of confusion, some have worried that contractors might be paying taxes twice for the same set of building materials. The state does offer reimbursements meant to eliminate the chance of double taxation, but it's unclear if contractors always know to take advantage of the system.

Besides drawing a sharper distinction between real and personal property, lawmakers are considering extending an exemption that prevents contractors from having to collect sales taxes on personal property in certain instances. Now, construction companies who enter into so-called lump-sum contracts need not collect sales taxes if the value of the personal property that they are installing is less than 10 percent of the total project.

The proposed change would make that exemption apply not only to lump-sum contracts but all sorts of contracts, including cost-plus agreements. A further change would let contractors take advantage of the exemption if they can show they stayed below the 10 percent threshold for a project in its entirety, rather than having to worry about the proportion of personal property to real property in each individual subcontract.



Wisconsin Independent Businesses Inc.

The voice of independent business in state government

January 7, 2016

**TO: Members
Assembly Committee on Ways and Means**

**FR: Brian Dake
Legislative Director
Wisconsin Independent Businesses**

RE: 2015 Assembly Bill (AB) 623 relating to: individual and corporate income and franchise taxes; sales and use taxes; administration of tax laws; providing an exemption from emergency rule-making authority; and requiring the exercise of rule-making authority.

Chairman Spiros and committee members, thank you for the opportunity to testify in support of 2015 Assembly Bill 623.

By way of background, Wisconsin Independent Businesses was formed nearly forty years ago to provide small, independent businesses with a voice in the legislative and administrative activities of state government. We have more than 4,000 members – the vast majority of whom own businesses with fewer than 25 employees and annual gross revenues of less than \$5 million.

While I will defer to the bill's author, the Department of Revenue and Legislative Council on the specifics of this legislation, I want to provide you with information, commentary and perspective on why WIB is supportive of AB 623.

1. Prior to the start of the 2013-2014 Legislative Session, we surveyed our members on public policy issues of importance to help guide our advocacy efforts. One question asked members to indicate which state government functions lawmakers should address to improve Wisconsin's regulatory climate for small businesses. 57% of responding members thought it was either very important or quite important to improve the regulations used by the Department of Revenue to enforce the state's tax code.

2. Wisconsin's tax code is complex in part because there are provisions within it which are inconsistent with the federal tax code. This lack of conformity forces small employers to spend more time and money filling out and filing their tax returns.
3. From our perspective, the actions taken by the Wisconsin Department of Revenue to enforce the state's tax code should be spelled out in law and/or administrative rule. Small business owners, like all other taxpayers, rely on guidance from the Department – that guidance should be unambiguous and consistent.

2015 Assembly Bill (AB) 623 puts Wisconsin's tax code more in line with the federal tax code thereby making it simpler to follow for smaller employers. Furthermore, AB 623 brings greater clarity and certainty to the regulations used by the Department of Revenue to enforce the state's tax code.

Over the past four years, state lawmakers and the Department of Revenue have taken meaningful action to improve Wisconsin's tax code. Our members appreciate that, but there is more that should be done. AB 623 is another step in the right direction and we respectfully ask for your support of this legislation.