



State of Wisconsin

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February 19, 2008

MEMORANDUM

To: Senator Kreitlow

From: Joseph T. Kreye, Sr. Legislative Attorney, (608) 266-2263

Subject: Technical Memorandum to **2007 SB 499** (LRB-3941/1) by **DOR**

We received the attached technical memorandum relating to your bill. This copy is for your information and your file.

If you wish to discuss this memorandum or the necessity of revising your bill or preparing an amendment, please contact me.

MEMORANDUM

February 18, 2008

TO: Joseph Kreye
Legislative Reference Bureau

FROM: Rebecca Boldt
Department of Revenue

SUBJECT: Technical Memorandum on SB 499 – Research and Development Credit and Exemptions

The Department has the following technical concerns with the above referenced bill:

INCOME AND FRANCHISE TAX CREDIT

A. Reference to Sec. 41(h) of Internal Revenue Code

Secs. 71.28(4m)(a) and 71.47(4m)(a) provide that “qualified research expenses’ means qualified research expenses as defined in section 41 of the Internal Revenue Code, not including section 41(h) of the Internal Revenue Code.” However, section 41(h) of the Internal Revenue Code (IRC) is not part of the definition of “qualified research expenses.” Rather, section 41(h), IRC provides for the sunset date of the research credit for federal purposes (currently December 31, 2007).

If the intent is not to conform to the federal sunset provision, a more straightforward way to achieve that intent would be to delete the text “not including section 41(h) of the Internal Revenue Code,” and instead add a sentence to the end of this paragraph indicating that “Section 41(h) of the Internal Revenue Code does not apply to the credit under this paragraph.”

B. Contract Research

Does this bill intend to allow credit to a company performing research on a contract basis for another company? For the federal research credit provided in sec. 41, IRC, the credit is not allowed to a company performing contract research for another company, but the company for which the research is performed may include 65% of the research fees in “qualified research expenses.” This is the same way Wisconsin is administering its existing research expense credit under sec. 71.28(4), Stats.

If the intent is to treat contract research in the same manner as treated for the federal research credit and the existing Wisconsin research expense credit, the language in secs. 71.28(4m)(a) and 71.47(4m)(a) should be consistent with the existing language of sec. 71.28(4). To accomplish this (along with the recommendation mentioned above), secs. 71.28(4m)(a) and 71.47(4m)(a) should read as follows:

“In this subsection, ‘qualified research expenses’ means qualified research expenses as defined in section 41 of the Internal Revenue Code, ~~not including section 41(h) of the Internal Revenue Code,~~ that are paid or incurred by the claimant for research conducted

in this state. Section 41(h) of the Internal Revenue Code does not apply to the credit under this paragraph."

SALES AND USE TAX EXEMPTIONS

A. "In this State"

Applying the exemptions only to manufacturing and biotechnology activities primarily in Wisconsin could violate the Commerce Clause of the United States Constitution. Further, the phrase "persons who are engaged primarily in manufacturing or biotechnology in this state" is unclear. To correct these problems, the phrase "in this state" could be deleted from page 7, lines 21 and 24 of the bill.

Following are examples of how the phrase "persons who are engaged primarily in manufacturing or biotechnology in this state" is unclear:

1. The phrase might be interpreted to mean that the exemptions only apply to persons whose business activities are primarily manufacturing or biotechnology activities and **all** of these manufacturing and biotechnology activities are in Wisconsin.

Example 1: Of Corporation A's activities total activities, 60% are manufacturing or biotechnology activities, and **all** of these manufacturing and biotechnology activities are in Wisconsin.

2. The phrase might also be interpreted to mean that the exemptions only apply to persons whose business activities are primarily manufacturing or biotechnology activities and such manufacturing or biotechnology activities are **primarily** in Wisconsin.

Example 2: Of Corporation B's activities total activities, 60% are manufacturing or biotechnology activities, and of these manufacturing and biotechnology activities, 55% of them are in Wisconsin.

3. The phrase could also be interpreted to mean that the exemptions apply to a person who, in Wisconsin, is engaged primarily in manufacturing or biotechnology. The person's activities outside Wisconsin do not factor into the determination.

Example 3: Corporation C has only 20% of its business activities in Wisconsin, but of these Wisconsin activities, 55% of them are manufacturing or biotechnology activities. Corporation C's activities outside Wisconsin are not at all related to manufacturing or biotechnology.

B. Attachments, Parts and Accessories

It is unclear whether the attachments, parts, and accessories are exempt if sold separately from the machinery and equipment. The exemption could be interpreted to apply only if these items are sold in conjunction with the machinery and equipment.

It is suggested that line 19 of the bill be amended by inserting "therefor" immediately after "accessories." This would make it clear that attachments, parts, and accessories are exempt, even if sold separately from the machinery and equipment. This is consistent with other exemptions currently in the sales and use tax law. For example, the exemption in sec.

77.54(5)(a), Wis. Stats. (2005-06), is for "Aircraft, including accessories, attachments, fuel and parts therefor..."

PROPERTY TAX EXEMPTIONS

Given the technical nature of the terms that define biotechnology on the bill, the Wisconsin Property Assessment Manual would need revision in order to provide examples on the types of equipment and operations that would qualify. Additionally, Department staff and local municipal assessors would need training in the new exemptions. There would not be sufficient time to update the manual and provide training before the provisions of the bill take effect.

The property tax exemptions apply to property used by a person engaged primarily in manufacturing or biotechnology in this state. The bill defines "primarily" as greater than 50%. It may be difficult for assessors to determine whether the activities performed by the taxpayer reach the 50% threshold.

If you have any questions regarding this technical memorandum, please contact Michael Oakleaf at 261-5173 or via email at Michael.Oakleaf@revenue.wi.us.

cc: Sen. Kreitlow