

2007 DRAFTING REQUEST

Bill

Received: 11/13/2006

Received By: jkreye

Wanted: As time permits

Identical to LRB:

For: Administration-Budget

By/Representing: Easton

This file may be shown to any legislator: NO

Drafter: jkreye

May Contact:

Addl. Drafters:

Subject: Tax, Business - credits

Extra Copies:

Submit via email: NO

Pre Topic:

DOA:.....Easton, BB0161 -

Topic:

Pass-through entities withholdings simplification

Instructions:

See Attached

Drafting History:

<u>Vers.</u>	<u>Drafted</u>	<u>Reviewed</u>	<u>Typed</u>	<u>Proofed</u>	<u>Submitted</u>	<u>Jacketed</u>	<u>Required</u>
/?	jkreye 11/14/2006	kfollett 11/16/2006		_____			State Tax
/1			rschluet 11/16/2006	_____	sbasford 11/16/2006		State Tax
/2	jkreye 01/18/2007	kfollett 01/19/2007	rschluet 01/19/2007	_____	cduerst 01/19/2007		

FE Sent For:

<END>

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/?	jkreye 11/14/2006	kfollett 11/16/2006		_____			State Tax
/1		12/gf 1/20	rschluet 11/16/2006	_____	sbasford 11/16/2006		

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197
<END>

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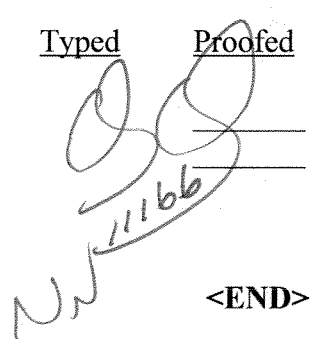
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Pass-through entities withholdings simplification

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/?	jkreye	11/16 kjf					

FE Sent For:

<END>

0721

2007-09 Budget Bill Statutory Language Drafting Request

- Topic: Passthrough Withholdings Simplification
- Tracking Code: BB0141
- SBO team: Tax and Local Government
- SBO analyst: Easton
 - Phone: 6-7597
 - Email: Darren.easton@wisconsin.gov
- Agency acronym: DOR
- Agency number: 566
- Priority (Low, Medium, High): Low

**Legislative Proposal Summary
Wisconsin Department of Revenue
IS&E Division**

August 21, 2006

**TITLE: Withholding for Nonresident Members of Pass-Through Entities:
Exemption, Clarification of Interest and Penalties, and Technical Issues**

DESCRIPTION OF CURRENT LAW AND PROBLEM

Exemption

Section 71.775, Wis. Stats., enacted on July 25, 2005 (Wisconsin Act 25), requires pass-through entities to withhold income or franchise tax on behalf of their nonresident shareholders, partners, members or beneficiaries (hereafter referred to as "nonresidents"). The statute includes limited exemptions.

Practitioners are concerned about the following circumstances which are not covered by the exemptions in the statute:

- If a nonresident has loss carryforwards or losses flowing through from other pass-through entities, the amount required to be withheld may significantly exceed the actual tax due. A nonresident may have to reimburse the pass-through entity for tax paid on his, her or its behalf when the tax was not due to begin with. The nonresident would have to wait for his, her or its income tax (or franchise tax) refund to get this money back. See Examples 1 and 2 on attached Exhibit A.
- Sometimes a member of a pass-through entity is another pass-through entity, which in turn has its own members. The first entity must withhold on the entire amount of Wisconsin income passed through to the second entity, even if some members of the second entity are not subject to withholding. The second entity must then ensure that its members who are not subject to withholding get credit for tax that the first entity withheld on their behalf anyway. See Example 3 on attached Exhibit A.
- Wisconsin resident taxpayers are able to choose the year in which they make estimated tax payments. This choice is beneficial because it can maximize federal itemized deductions. Pass-through entity withholding eliminates a nonresident's ability to make this choice. See Example 4 on attached Exhibit A.
- In some cases, the same person who prepares the pass-through entity's Wisconsin return also prepares the returns of its nonresident members. The preparer already knows the nonresidents are filing because he is filing those returns himself. Preparers in this situation do not want the administrative burden of withholding tax they know would be paid anyway.

Nonstatutory, transitional provisions allowed relief from these issues for tax years beginning in 2005. These transitional provisions have expired. No such provisions exist for tax years beginning on or after January 1, 2006.

Clarification of Interest and Penalties

Further, the interest and penalty provisions in the current law do not accomplish what the Department intended:

- Sec. 71.775(4)(b)2. imposes underpayment interest, in addition to late payment interest, on certain underpayments of the withholding tax. However, since Wisconsin does not require installment payments for this tax, the 12% underpayment interest is computed for the same time period as the 12% late payment interest (18% if delinquent). This duplication was not intended.
- Sec. 71.775(4)(b)2. imposes late payment interest of 12% (or 18%) on "the unpaid amount of the tax withheld." However, since pass-through entity withholding is based upon the income distributable to a nonresident (which is not necessarily an amount actually distributed), an unpaid amount of tax under this statute may not have been withheld from a distribution to begin with. This section does not seem to impose interest on unpaid amounts due under sec. 71.775 if those amounts were never withheld from a distribution.
- Sec. 71.775(4)(f) provides that if a pass-through entity fails to pay the withholding tax, but the nonresident member files a return and pays the tax due, the pass-through entity shall be liable for "any interest and penalties otherwise applicable for failure to withhold, as provided under ss. 71.82(2)(d) and 71.83." Problems with this paragraph are as follows:
 - Sec. 71.82(2)(d) is a duplication of the late payment interest in sec. 71.775(4)(b)2.
 - Sec. 71.83 was never amended to include a penalty for failure to comply with the pass-through entity withholding statute.

Technical Issues

Moreover, the following elements of the statutory language do not accurately reflect how the Department intends to administer this section:

- Sec. 71.775(3)(a)2. provides that a nonresident member of a pass-through entity who has less than \$1000 of Wisconsin income from the pass-through entity, and whose only source of Wisconsin income is from that pass-through entity, is not subject to withholding. Since a pass-through entity would not necessarily know if the nonresident has other sources of Wisconsin income, the Department does not intend to require that the nonresident have only one source of Wisconsin income to meet this exemption.
- Sec. 71.775(4)(a)2., states that "limited liability companies" are required to withhold. However, not all limited liability companies are pass-through entities.
- Sec. 71.775(4)(d) states that the amount withheld is considered to be paid on the last day of the pass-through entity's taxable year. For pass-through entities other than multi-state S corporations, considering the withholding paid on the last day of the entity's taxable year would cause the nonresident members to be subject to

underpayment interest through no fault of their own. The Department does not intend this result.

RECOMMENDATION FOR ACTION

The pass-through entity withholding statute should include an exemption for nonresident members who present an affidavit, in the form and manner prescribed by the Department, whereby the nonresident member agrees to be subject to the personal jurisdiction of the Department, the Tax Appeals Commission, and the courts of Wisconsin for purposes of determining and collecting Wisconsin income and franchise taxes, estimated payments, and any related interest and penalties.

The interest and penalty provisions should be clarified and technical issues should be corrected to resolve the ambiguities discussed above.

ADMINISTRATIVE IMPACT

This proposal would allow the Department to remedy the problems explained above, while still giving the Department flexibility to administer exemptions in a way that accomplishes its goals of operating efficiently and ensuring fair and equitable tax compliance.

FAIRNESS/TAX EQUITY

Without the action recommended in this proposal:

- Excessive withholding will apply to certain members of pass-through entities.
- Double taxation might result if a tiered pass-through entity does not carefully consider how this requirement applies to its business structure.
- Inequity will result, since nonresidents will not have the same ability to maximize federal itemized deductions as residents have.

IMPACT ON ECONOMIC DEVELOPMENT

Excessive withholding may be a disincentive for some nonresident investors to maintain their investments in Wisconsin. This bill would prevent excessive withholding.

FISCAL EFFECT

The Department anticipates a minimal fiscal effect from the bill. Since the bill does not by itself limit the application of the exemption, the estimated fiscal effect is determined by the manner in which the provision would be administered. The Department intends to limit the exemptions granted to only those nonresidents who demonstrate that, after the close of the pass-through entity's tax year, they have already made sufficient estimated payments or do not have a Wisconsin tax liability.

DRAFTING INSTRUCTIONS

See attached

EFFECTIVE DATE AND/OR INITIAL APPLICABILITY

Taxable years of pass-through entities that begin on or after January 1, 2006

INTERESTED/AFFECTED PARTIES

Pass-through entities, nonresident members of pass-through entities, attorneys, tax accountants

DOR CONTACT PERSON

Diane Hardt
266-6798
dhardt@dor.state.wi.us

PREPARED BY

Wendy Miller

EXHIBIT A

Examples of Companies Affected by Legislation

Example 1: Limited liability company ABC operates several retail stores in Wisconsin. One of the members, Member D, is a corporation commercially domiciled outside Wisconsin, but which holds numerous Wisconsin investments other than its interest in ABC. The limited liability company reports \$2 million of Wisconsin income for 2006. \$1 million of that income is passed through to Member D. However, because of offsetting losses incurred in its other Wisconsin investments, Member D will have \$0 Wisconsin tax liability for 2006.

Current treatment

- ABC files Form PW-1 and pays \$79,000 in withholding on behalf of D
- D pays \$79,000 to ABC
- D files a Wisconsin return and waits for a refund of the entire \$79,000 paid to ABC

With legislation

- D presents a Department-approved affidavit to ABC
- ABC files Form PW-1 with a copy of the affidavit and no withholding payment
- D files a Wisconsin return reporting \$0 tax due

Example 2: "S" corporation XYZ is a Wisconsin manufacturing company. Shareholder Q is a Minnesota resident owning 50% of XYZ. Shareholder Q has no Wisconsin activity other than his interest in XYZ. For Wisconsin purposes, XYZ reported a \$200,000 loss in 2005 and \$150,000 of income in 2006. As a 50% shareholder, Q reports a \$100,000 loss for 2005 and \$0 income with a \$25,000 loss carryforward for 2006.

Current treatment

- XYZ files Form PW-1 and pays \$5063 in withholding on behalf of Q
- Q pays \$5063 to XYZ
- Q files a Wisconsin return and waits for a refund of the entire \$5063 withheld

With legislation

- Q presents a Department-approved affidavit to XYZ
- XYZ files Form PW-1 with a copy of the affidavit and no withholding payment
- Q files a Wisconsin return reporting \$0 tax due

Example 3: Telecommunications company DEF is a partnership commercially domiciled outside Wisconsin. However, DEF has several partners which are Wisconsin corporations (residents). DEF is a 50% partner in a second partnership, GHI. Partnership GHI has \$3 million of Wisconsin income. Partnership DEF has no Wisconsin income other than the \$1.5 million passed through from GHI.

Current treatment

- GHI files Form PW-1 and pays \$118,500 in withholding on behalf of DEF
- DEF files Form PW-1, with \$0 payment after credit for withholding paid by GHI
- Partnership GHI obtains \$118,500 cash from Partnership DEF, who in turn obtains \$118,500 cash from its partners, including the Wisconsin corporations*
- DEF's nonresident and Wisconsin resident partners obtain credit for the amount withheld when they file returns

*Partnership DEF may choose to allocate the entire \$118,500 withholding only to its nonresident partners. In that case, DEF would have to bill the nonresidents for the residents' share allocated to them.

With legislation

- DEF presents a Department-approved affidavit to GHI
- GHI files Form PW-1 with a copy of the affidavit and no withholding payment
- DEF files Form PW-1 on behalf of its nonresident partners only, who may also present a Department-approved affidavit
- The nonresidents obtain credit for the tax withheld when they file returns

Example 4: FLP, a family limited partnership, is engaged in farming. One of FLP's partners, X, is an Illinois resident. Partner X had been making quarterly estimated tax payments on income passed through to him from FLP. For the first and fourth quarter of 2005, X made the estimated payments in January and December, respectively, so that the state tax paid during the calendar year gave him enough itemized deductions to exceed the standard deduction on his federal return. (The transitional rules for pass-through withholding, effective for 2005 only, allowed X to make these estimated payments in 2005 instead of having them withheld by FLP.)

Current treatment

- Partner X cannot make estimated payments on income from Partnership FLP for 2006
- FLP files Form PW-1 and makes a single withholding payment due April 15th, 2007, on X's behalf
- Partner X cannot change the timing of when his Wisconsin tax is paid

With legislation

- X makes estimated payments on income from FLP as he did before
- X presents a Department-approved affidavit to FLP
- FLP files Form PW-1 with a copy of the affidavit and no withholding payment
- X files a Wisconsin return

Drafting Instructions

To amend Sec. 71.775, Wis. Stats., *Withholding from Nonresident Members of Pass-Through Entities*, as created by 2005 Wisconsin Act 25:

- I. Add a provision to allow withholding exemption if the nonresident files an affidavit in the form and manner prescribed by the department:

Under sec. 71.775(3), EXEMPTIONS, add sec. 71.775(3)(a)3., to read as follows:

"3. The nonresident partner, member, shareholder, or beneficiary files an affidavit with the department, in the form and manner prescribed by the department, whereby such nonresident member agrees to file a Wisconsin income or franchise tax return and be subject to the personal jurisdiction of the department, the Tax Appeals Commission, and the courts of this state for the purpose of determining and collecting Wisconsin income and franchise taxes, including estimated tax payments, together with any related interest and penalties."

- II. Remove the language imposing underpayment interest, and clarify the late payment interest provision to include entities that have not made distributions:

Under sec. 71.775(4), ADMINISTRATION, amend sec. 71.775(4)(b)2., as follows:

~~"2. A pass-through entity that pays the tax withheld under sub. (2) as provided under subd. 1. is not subject to an underpayment of estimated tax under s. 71.09 or 71.29, if 90 percent of the tax that is due for the current taxable year is paid by the unextended due date or if 100 percent of the tax that is due for the taxable year immediately preceding the current taxable year is paid by the unextended due date and the taxable year immediately preceding the current taxable year was a 12-month period. Interest at the rate of 12 percent shall be imposed on the unpaid amount of the tax withheld due under sub. (2) during any extension period and interest at the rate of 18 percent shall be imposed on the unpaid amount of the tax withheld due under sub. (2) for the period beginning with the extended due date and ending with the date that the unpaid amount is paid in full."~~

- III. Remove the language imposing the penalty under sec. 71.82(2)(d):

Under sec. 71.775(4), ADMINISTRATION, amend sec. 71.775(4)(f), as follows:

"(f) If a pass-through entity subject to withholding under this section fails to withhold tax as pay the tax required by this section, the pass-through entity shall be liable for any tax, interest, and penalties. If a nonresident partner, member, shareholder, or beneficiary of the pass-through entity files a return and pays the tax due, the pass-through entity shall not be liable for the tax, but shall be liable for any interest and penalties otherwise applicable for failure to withhold, as provided under ss. 71.82(2)(d) and for the penalty provided in s. 71.83(1)(a)1."

- IV. Add language to section 71.83 that is already referenced by section 71.775, regarding imposition of penalties:

Under sec. 71.83, **Penalties**, amend sec. 71.83(1)(a)1., as follows:

"1. 'Failure to file.' In case of failure to file any return required under s. 71.03, 71.24, or 71.44, or 71.775 on the due date prescribed therefor, including any applicable extension of time for filing, unless it is shown that the failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on the return 5% of the amount of the tax if the failure is for not more than one month, with an additional 5% for each additional month or fraction thereof during which the failure continues, not exceeding 25% in the aggregate. For purposes of this subdivision, the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the due date prescribed for payment and by the amount of any credit against the tax which may be claimed upon the return."

- V. Clarify the exemption for nonresidents who have less than \$1,000 Wisconsin income from a pass-through entity:

Under sec. 71.775(2), EXEMPTIONS, amend sec. 71.775(3)(a)2., as follows:

"2. ~~The partner's, member's, shareholder's, or beneficiary's has no Wisconsin income other than his or her share of income from the pass-through entity that is attributable to this state and his or her share of such income is less than \$1,000.~~"

- VI. Clarify reference to limited liability companies:

Under sec. 71.775(4), ADMINISTRATION, amend sec. 71.775(4)(a)2., as follows:

"2. For partnerships, limited liability companies treated as partnerships for tax purposes, estates, and trusts, the 15th day of the 4th month following the close of the taxable year."

- VII. Clarify when the withholding amount is considered to be paid for purposes of the nonresident's computation of underpayment interest.

Under sec. 71.775(4), ADMINISTRATION, amend sec. 71.775(4)(d), as follows:

"(d) A nonresident partner, member, shareholder, or beneficiary of a pass-through entity may claim a credit, as prescribed by the department, on his or her Wisconsin income or franchise tax return for the amount withheld under sub. (2) on his or her behalf, for the nonresident partner's, member's, shareholder's or beneficiary's tax period in which the income from the pass-through entity is reported. For purposes of this paragraph determining whether interest under s. 71.84 applies to a nonresident partner, member, shareholder, or beneficiary, the amount withheld under sub. (2) is considered to be paid on the last day of the pass-through entity's taxable year for which the tax is paid in four equal, quarterly installments."



State of Wisconsin
2007 - 2008 LEGISLATURE

LRB-0721?

JK: *kgf*

PWF

DOA:.....Easton, BB0161 - Pass-through entities withholdings
simplification

FOR 2007-09 BUDGET -- NOT READY FOR INTRODUCTION

in 11-14-06

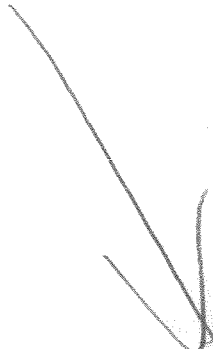
1 AN ACT ...; relating to: the budget.

Analysis by the Legislative Reference Bureau

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

2

(END)



0721/1

~~2005 BILL~~

TAXATION
INCOME TAXATION
=

1 AN ACT *to amend* 71.775 (4) (b) 2.; and *to create* 71.775 (3) (a) 3. of the statutes;
2 relating to: the withholding tax imposed on nonresident members of
3 pass-through entities.

Analysis by the Legislative Reference Bureau

Under current law, a partnership, a limited liability company, a tax-option corporation, an estate, or a trust that is treated as a pass-through entity for federal income tax purposes must withhold income or franchise taxes from the income that the entity may distribute to a nonresident partner, member, shareholder, or beneficiary. However, a nonresident partner's, member's, shareholder's, or beneficiary's share of income from the pass-through entity that is attributable to this state is not included in determining the amount of the withholding tax if the partner, member, shareholder, or beneficiary is exempt from state income and franchise taxes or if the partner, member, shareholder, or beneficiary has no state income other than his or her share of income from the pass-through entity that is attributable to this state and the amount of that income is less than \$1,000. Under this bill, income excluded from determining the amount of a pass-through entity's withholding taxes includes income of a nonresident partner, member, shareholder, or beneficiary who files an affidavit with the Department of Revenue (DOR), whereby the nonresident partner, member, shareholder, or beneficiary agrees to file a state income or franchise tax return and be subject to the personal jurisdiction of DOR, the Tax Appeals Commission, and the courts of this state for the purpose of determining and collecting state income and franchise taxes.

BILL

Current law imposes interest on certain underpayments of estimated withholding taxes imposed on pass-through entities and on late payments of withholding taxes imposed on pass-through entities. This bill eliminates the provision related to imposing interest on the underpayments of estimated withholding taxes imposed on pass-through entities.

This bill will be referred to the Joint Survey Committee on Tax Exemptions for a detailed analysis, which will be printed as an appendix to this bill.

For further information see the *state* fiscal estimate, which will be printed as an appendix to this bill.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

1 SECTION 1. 71.775 (3) (a) 3. of the statutes is created to read:

2 71.775 (3) (a) 3. The nonresident partner, member, shareholder, or beneficiary
3 files an affidavit with the department, in the form and manner prescribed by the
4 department, whereby the nonresident partner, member, shareholder, or beneficiary
5 agrees to file a Wisconsin income or franchise tax return and be subject to the
6 personal jurisdiction of the department, the tax appeals commission, and the courts
7 of this state for the purpose of determining and collecting Wisconsin income and
8 franchise taxes, including estimated tax payments, together with any related
9 interest and penalties.

10 SECTION 2. 71.775 (4) (b) 2. of the statutes, ~~as created by 2005 Wisconsin Act~~

11 ~~25,~~ is amended to read:

12 71.775 (4) (b) 2. ~~A pass-through entity that pays the tax withheld under sub.~~
13 ~~(2) as provided under subd. 1. is not subject to an underpayment of estimated tax~~
14 ~~under s. 71.09 or 71.29, if 90 percent of the tax that is due for the current taxable year~~
15 ~~is paid by the unextended due date or if 100 percent of the tax that is due for the~~
16 ~~taxable year immediately preceding the current taxable year is paid by the~~
17 ~~unextended due date and the taxable year immediately preceding the current~~

BILL

of ← plain

1

taxable year was a 12-month period. Interest at the rate 12 percent shall be imposed on the unpaid amount of the tax withheld under sub. (2) during any extension period and interest at the rate of 18 percent shall be imposed on the unpaid amount of the tax withheld under sub. (2) for the period beginning with the extended due date and ending with the date that the unpaid amount is paid in full.

2

3

4

5

6

~~SECTION 3. Initial applicability.~~

7

~~(1) This act first applies to taxable years beginning on January 1, 2006.~~

8

(END)

INSERT
3-7

Insert 3 - 7

1 **SECTION 9341. Initial applicability; Revenue.** ✓

2 (1) WITHHOLDING ^{TAX} ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES. The
3 treatment of section 71.775 (3) (a) 3. and (4) (b) 2. of the statutes first applies
4 retroactively to taxable years beginning on January 1, 2006.

5 **SECTION 9441. Effective dates; Revenue.** ✓

6 (1) WITHHOLDING ^{TAX} ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES. The
7 treatment of section 71.775 (3) (a) 3. and (4) (b) 2. of the statutes takes effect
8 retroactively on January 1, 2006.

Kreye, Joseph

From: Easton, Darren - DOA
Sent: Thursday, January 18, 2007 2:13 PM
To: Kreye, Joseph
Subject: FW: LRB 0721 2007 leg-pass through withholding.doc

Attachments: LRB 072-1 2007 leg-pass through withholding.doc



LRB 072-1 2007
leg-pass through...

ello Joe,

I have started to get DOR's comments on some of the drafts. I'll be forwarding them as I get them.

Call me if you need to.

Darren
6-7597

-----Original Message-----

From: Timmons, Anthony [mailto:anthony.timmons@dor.state.wi.us]
Sent: Wednesday, January 17, 2007 3:32 PM
To: Easton, Darren - DOA
Cc: Gates-Hendrix, Sherrie L - DOR; Brennan, Audra D - DOR
Subject: LRB 072-1 2007 leg-pass through withholding.doc

DEPARTMENT OF REVENUE LRB DRAFT COMMENTS
LRB-0721/1

1. Bill and/or LRB Number: LRB-0721/1 – Pass-Through Entity Withholding Simplification

2. Type of Taxes Affected: (please list all that apply)

Individual income
Corporation franchise and income

3. Description of the Bill: (briefly describe the subject matter of the bill and the change/s)

This bill provides an exemption from the pass-through entity withholding required in sec. 71.775. The exemption applies to nonresident members of pass-through entities who file an affidavit with the department, in the form and manner prescribed by the department.

The bill also eliminates language of sec. 71.775(4)(b)2., imposing underpayment interest on the unpaid withholding amount. As previously written, this language created an unintended duplication of interest amounts due.

4. Statutory language problems, if any: X Yes No

(If yes, describe problems and indicate suggested corrective language. Example of problem: The bill language is unclear, does not fully accomplish the desired result, or has undesirable side effects.)

I. Further Clarification Needed for Interest Provision in sec. 71.775(4)(b)2.

The provision for interest on unpaid withholding needs further clarification than what is provided by this bill.

After the clarification provided in this bill, sec. 71.775(4)(b)2. would still impose interest on the “unpaid amount of the tax withheld.” This language implies that the interest only applies in situations where the pass-through entity withholds (but does not remit) the tax from an amount *actually distributed* to the nonresident. However, the withholding tax applies regardless of whether a distribution is actually made. If the intent is to impose interest on all taxpayers who do not make the required withholding payments on time, the language should be changed to impose interest on the “unpaid amount of the tax due.”

II. Other Clarifications Needed to Simplify sec. 71.775

This bill does not address other statutory language problems that currently exist in sec. 71.775. The administration of this law would be further simplified if these other problems were addressed in the bill. Attached to this document is proposed statutory language which resolves each of the following problems:

- A.** Sec. 71.775(4) provides that if a pass-through entity fails to withhold, but the nonresident pays the tax due, the pass-through entity is liable for interest and penalties as provided under sec. 71.82(2)(d). This interest is another unintended duplication of the interest already imposed under sec. 71.775(4)(b)2. and should be removed.

Further, the penalties in sec. 71.82(2)(d) seem to apply only in situations where the pass-through entity withholds the tax from an amount *actually distributed* to the nonresident. However, the withholding tax applies regardless of whether a distribution is actually made. If the intent is to impose penalties equally among pass-through entities who do and do not make distributions, the

reference to penalties in sec. 71.82(2)(d) should be removed and a specific penalty for pass-through entity withholding should be provided in sec. 71.83.

- B. Sec. 71.775(2) provides a withholding exemption for nonresidents who have no Wisconsin income other than their share of Wisconsin income from the pass-through entity, if that share is less than \$1,000. The pass-through entity would not necessarily know whether the nonresident has Wisconsin income from other sources. This is confidential information which the pass-through entity cannot require the nonresident to provide. To allow this exemption equally to pass-through entities whose nonresident owners do and do not provide this confidential information, the exemption should not require that the pass-through entity be the nonresident's only source of Wisconsin income.
- C. Sec. 71.775(4)(d) provides that nonresidents may claim credit for the tax withheld on their behalf, and that the tax is considered to be paid on the last day of the pass-through entity's taxable year. This language implies that the nonresidents are still required to make quarterly estimated payments on income from the pass-through entity (in order to avoid underpayment interest) and that the pass-through entity is required to make a withholding payment on that same income. If this duplication was not intended, the statute should provide that for purposes of determining whether underpayment interest applies, the withholding is deemed to be paid in four equal, quarterly installments.

5. Effective date problems, if any, including transitional problems: Yes No
(If yes, describe problem and suggested effective date or transitional language needed.)

The provisions of this bill are retroactive to January 1, 2006. Since the affidavits necessary for the exemption are to be filed "in the form and manner prescribed by the Department," the Department would be authorized to develop transitional rules for 2006 allowing affidavits to be filed after the exemption is claimed on a 2006 return.

Statutory Language for Clarifications Recommended for this Bill

I. Further Clarification of Interest Provision in sec. 71.775(4)(b)2.

71.775(4)(b)2.: ~~“A pass-through entity that pays the tax withheld under sub. (2) as provided under subd. 1. is not subject to an underpayment of estimated tax under s. 71.09 or 71.29, if 90 percent of the tax that is due for the current taxable year is paid by the unextended due date or if 100 percent of the tax that is due for the taxable year immediately preceding the current taxable year is paid by the unextended due date and the taxable year immediately preceding the current taxable year was a 12-month period. Interest at the rate of 12 percent shall be imposed on the unpaid amount of the tax withheld due under sub. (2) during any extension period and interest at the rate of 18 percent shall be imposed on the unpaid amount of the tax withheld due under sub. (2) for the period beginning with the extended due date and ending with the date that the unpaid amount is paid in full.”~~

II. Other Clarifications Needed to Simplify sec. 71.775

A. Interest and Penalties

71.775(4)(f): ~~“If a pass-through entity subject to withholding under this section fails to withhold tax as pay the tax required by this section, the pass-through entity shall be liable for any tax, interest, and penalties. If a nonresident partner, member, shareholder, or beneficiary of the pass-through entity files a return and pays the tax due, the pass-through entity shall not be liable for the tax, but shall be liable for any interest and penalties otherwise applicable for failure to withhold, as provided under ss. 71.82(2)(d) and for the penalty provided in s. 71.83(1)(a)1.”~~

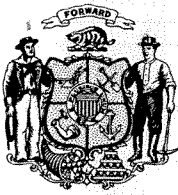
71.83(1)(a)1.: ~~“Failure to file.’ In case of failure to file any return required under s. 71.03, 71.24, or 71.44, or 71.775 on the due date prescribed, including any applicable extension of time for filing, unless it is shown that the failure is due to reasonable cause and not due to willful neglect, there shall be added to the amount required to be shown as tax on the return 5% of the amount of the tax if the failure is for not more than one month, with an additional 5% or each additional month or fraction thereof during which the failure continues, not exceeding 25% in the aggregate. For purposes of this subdivision, the amount of tax required to be shown on the return shall be reduced by the amount of any part of the tax which is paid on or before the due date prescribed for payment and by the amount of any credit against the tax which may be claimed upon the return.”~~

B. Exemption for Less Than \$1,000 Wisconsin Income from Pass-Through Entity

71.775(3)(a)2.: ~~The partner’s, member’s, shareholder’s, or beneficiary’s has no Wisconsin income other than his or her share of income from the pass-through entity that is attributable to this state and his or her share of such income is less than \$1,000.”~~

C. Timing of Withholding Payments

71.775(4)(d): "A nonresident partner, member, shareholder, or beneficiary of a pass-through entity may claim a credit, as prescribed by the department, on his or her Wisconsin income or franchise tax return for the amount withheld under sub. (2) on his or her behalf, for the nonresident partner's, member's, shareholder's or beneficiary's tax period in which the income from the pass-through entity is reported. For purposes of ~~this paragraph~~ determining whether interest under s. 71.84 applies to a nonresident partner, member, shareholder, or beneficiary, the amount withheld under sub. (2) is considered to be paid ~~on~~ the last day of the pass-through entity's taxable year for which the tax is paid in four equal, quarterly installments."



State of Wisconsin
2007 - 2008 LEGISLATURE

LRB-0721/1

JK:kjf/1

RMR

DOA:.....Easton, BB0161 - Pass-through entities withholdings simplification

FOR 2007-09 BUDGET -- NOT READY FOR INTRODUCTION

1-18-07

D-N

Don't Gen

1 AN ACT ...; relating to: the budget.

Analysis by the Legislative Reference Bureau

TAXATION

INCOME TAXATION

Under current law, a partnership, a limited liability company, a tax-option corporation, an estate, or a trust that is treated as a pass-through entity for federal income tax purposes must withhold income or franchise taxes from the income that the entity may distribute to a nonresident partner, member, shareholder, or beneficiary. However, a nonresident partner's, member's, shareholder's, or beneficiary's share of income from the pass-through entity that is attributable to this state is not included in determining the amount of the withholding tax if the partner, member, shareholder, or beneficiary is exempt from state income and franchise taxes or if the partner, member, shareholder, or beneficiary has no state income other than his or her share of income from the pass-through entity that is attributable to this state and the amount of that income is less than \$1,000. Under this bill, income excluded from determining the amount of a pass-through entity's withholding taxes includes income of a nonresident partner, member, shareholder, or beneficiary who files an affidavit with DOR, whereby the nonresident partner, member, shareholder, or beneficiary agrees to file a state income or franchise tax return and be subject to the personal jurisdiction of DOR, the Tax Appeals Commission, and the courts of this state for the purpose of determining and collecting state income and franchise taxes.

Current law imposes interest on certain underpayments of estimated withholding taxes imposed on pass-through entities and on late payments of withholding taxes imposed on pass-through entities. This bill eliminates the provision related to imposing interest on the underpayments of estimated withholding taxes imposed on pass-through entities.

This bill will be referred to the Joint Survey Committee on Tax Exemptions for a detailed analysis, which will be printed as an appendix to this bill.

For further information see the *state* fiscal estimate, which will be printed as an appendix to this bill.

The people of the state of Wisconsin, represented in senate and assembly, do enact as follows:

1 **SECTION 1.** 71.775 (3) (a) 3. of the statutes is created to read:

2 71.775 (3) (a) 3. The nonresident partner, member, shareholder, or beneficiary
3 files an affidavit with the department, in the form and manner prescribed by the
4 department, whereby the nonresident partner, member, shareholder, or beneficiary
5 agrees to file a Wisconsin income or franchise tax return and be subject to the
6 personal jurisdiction of the department, the tax appeals commission, and the courts
7 of this state for the purpose of determining and collecting Wisconsin income and
8 franchise taxes, including estimated tax payments, together with any related
9 interest and penalties.

10 **SECTION 2.** 71.775 (4) (b) 2. of the statutes is amended to read:

11 71.775 (4) (b) 2. ~~A pass-through entity that pays the tax withheld under sub.~~
12 ~~(2) as provided under subd. 1. is not subject to an underpayment of estimated tax~~
13 ~~under s. 71.09 or 71.29, if 90 percent of the tax that is due for the current taxable year~~
14 ~~is paid by the unextended due date or if 100 percent of the tax that is due for the~~
15 ~~taxable year immediately preceding the current taxable year is paid by the~~
16 ~~unextended due date and the taxable year immediately preceding the current~~
17 ~~taxable year was a 12-month period. Interest at the rate of 12 percent shall be~~

INSERT
2-1

1 imposed on the unpaid amount of the tax ~~withheld~~ ^{due} under sub. (2) during any
 2 extension period and interest at the rate of 18 percent shall be imposed on the unpaid
 3 amount of the tax ~~withheld~~ ^{due} under sub. (2) for the period beginning with the extended
 4 due date and ending with the date that the unpaid amount is paid in full.

SECTION 9341. Initial applicability; Revenue.

5 (1) WITHHOLDING TAX ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES. The
 6 treatment of section 71.775 (3) (a) ^{2, and} 3. and (4) (b) 2. ^{(d), and (f), and 71.83(1)(a) 1.} of the statutes first applies
 7 retroactively to taxable years beginning on January 1, 2006.
 8

SECTION 9441. Effective dates; Revenue.

9 (1) WITHHOLDING TAX ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES. The
 10 treatment of section ^s 71.775 (3) (a) ^{2, and} 3. and (4) (b) 2. ^{(d), and (f), and 71.83(1)(a) 1.} of the statutes takes effect
 11 retroactively on January 1, 2006.
 12

(END)

INSERT
3-4

O-Note

Insert 2 - 1

1 **SECTION 1.** 71.775 (3) (a) 2. of the statutes is amended to read:

2 71.775 (3) (a) 2. ~~The partner, member, shareholder, or beneficiary has no~~
3 ~~Wisconsin income other than his or her partner's, member's, shareholder's, or~~
4 beneficiary's share of income from the pass-through entity that is attributable to this
5 state ~~and his or her share of such income~~ is less than \$1,000.

History: 2005 a. 25, 254.

Insert 3 - 4

6 **SECTION 2.** 71.775 (4) (d) of the statutes is amended to read:

7 71.775 (4) (d) A nonresident partner, member, shareholder, or beneficiary of a
8 pass-through entity may claim a credit, as prescribed by the department, on his or
9 her Wisconsin income or franchise tax return for the amount withheld under sub. (2)
10 on his or her behalf for the tax period for which the income of the pass-through entity
11 is reported. For purposes of this paragraph determining whether interest under s.
12 71.84 applies to a nonresident partner, member, shareholder, or beneficiary, the
13 amount withheld under sub. (2) is considered to be paid ~~on the last day of the~~
14 ~~pass-through entity's taxable year for which the tax is paid~~ in 4 equal quarterly
15 installments.

History: 2005 a. 25, 254.

16 **SECTION 3.** 71.775 (4) (f) of the statutes is amended to read:

17 71.775 (4) (f) If a pass-through entity subject to withholding under this section
18 fails to ~~withhold~~ pay the tax as required by this section, the pass-through entity shall
19 be liable for any tax, interest, and penalties. If a nonresident partner, member,
20 shareholder, or beneficiary of the pass-through entity files a return and pays the tax
21 due, the pass-through entity shall not be liable for the tax, but shall be liable for any

1 interest and penalties otherwise applicable for failure to withhold, as the penalty
2 provided under ~~ss. 71.82 (2) (d) and s. 71.83 (1) (a) 1.~~

3 History: 2005 a. 25, 254.

3 **SECTION 4.** 71.83 (1) (a) 1. of the statutes is amended to read:

4 71.83 (1) (a) 1. 'Failure to file.' In case of failure to file any return required
5 under s. 71.03, 71.24 ~~or~~, 71.44, or 71.775 on the due date prescribed therefor,
6 including any applicable extension of time for filing, unless it is shown that the
7 failure is due to reasonable cause and not due to willful neglect, there shall be added
8 to the amount required to be shown as tax on the return 5% of the amount of the tax
9 if the failure is for not more than one month, with an additional 5% for each
10 additional month or fraction thereof during which the failure continues, not
11 exceeding 25% in the aggregate. For purposes of this subdivision, the amount of tax
12 required to be shown on the return shall be reduced by the amount of any part of the
13 tax which is paid on or before the due date prescribed for payment and by the amount
14 of any credit against the tax which may be claimed upon the return.

History: 1987 a. 312; 1989 a. 31, 90; 1991 a. 39, 190, 269, 315; 1993 a. 16, 112, 213; 1995 a. 428, 453; 1997 a. 27, 237, 283, 323; 1999 a. 32; 2001 a. 109.

STATE OF WISCONSIN - LEGISLATIVE REFERENCE BUREAU

LRB

Research (608-266-0341)

Library (608-266-7040)

Legal (608-266-3561)

LRB

D-N
Date

0721/2dm
JK:lgf

Darrenⁿ:

This draft incorporates the ^{changes} changes recommended
= by DOR.

JK

**DRAFTER'S NOTE
FROM THE
LEGISLATIVE REFERENCE BUREAU**

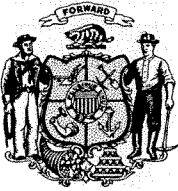
LRB-0721/2dn
JK:kjfrs

January 19, 2007

Darren:

This draft incorporates the changes recommended by DOR.

Joseph T. Kreye
Legislative Attorney
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State of Wisconsin
2007 - 2008 LEGISLATURE

LRB-0721/2

JK:kjf:rs

DOA:.....Easton, BB0161 - Pass-through entities withholdings
simplification

FOR 2007-09 BUDGET -- NOT READY FOR INTRODUCTION

1 AN ACT ...; relating to: the budget.

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TAXATION

INCOME TAXATION

Under current law, a partnership, a limited liability company, a tax-option corporation, an estate, or a trust that is treated as a pass-through entity for federal income tax purposes must withhold income or franchise taxes from the income that the entity may distribute to a nonresident partner, member, shareholder, or beneficiary. However, a nonresident partner's, member's, shareholder's, or beneficiary's share of income from the pass-through entity that is attributable to this state is not included in determining the amount of the withholding tax if the partner, member, shareholder, or beneficiary is exempt from state income and franchise taxes or if the partner, member, shareholder, or beneficiary has no state income other than his or her share of income from the pass-through entity that is attributable to this state and the amount of that income is less than \$1,000. Under this bill, income excluded from determining the amount of a pass-through entity's withholding taxes includes income of a nonresident partner, member, shareholder, or beneficiary who files an affidavit with DOR, whereby the nonresident partner, member, shareholder, or beneficiary agrees to file a state income or franchise tax return and be subject to the personal jurisdiction of DOR, the Tax Appeals Commission, and the courts of this state for the purpose of determining and collecting state income and franchise taxes.

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4 ~~beneficiary's share of income from the pass-through entity that is attributable to this~~
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4 unextended due date and the taxable year immediately preceding the current
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16 71.84 applies to a nonresident partner, member, shareholder, or beneficiary, the
17 amount withheld under sub. (2) is considered to be paid on the last day of the
18 pass-through entity's taxable year for which the tax is paid in 4 equal quarterly
19 installments.

20 **SECTION 5.** 71.775 (4) (f) of the statutes is amended to read:

21 71.775 (4) (f) If a pass-through entity subject to withholding under this section
22 fails to withhold pay the tax as required by this section, the pass-through entity shall
23 be liable for any tax, interest, and penalties. If a nonresident partner, member,
24 shareholder, or beneficiary of the pass-through entity files a return and pays the tax
25 due, the pass-through entity shall not be liable for the tax, but shall be liable for any

1 ~~interest and penalties otherwise applicable for failure to withhold, as the penalty~~
2 ~~provided under ss. 71.82 (2) (d) and s. 71.83 (1) (a) 1.~~

3 **SECTION 6.** 71.83 (1) (a) 1. of the statutes is amended to read:

4 71.83 (1) (a) 1. 'Failure to file.' In case of failure to file any return required
5 under s. 71.03, 71.24 ~~or~~, 71.44, or 71.775 on the due date prescribed therefor,
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8 to the amount required to be shown as tax on the return 5% of the amount of the tax
9 if the failure is for not more than one month, with an additional 5% for each
10 additional month or fraction thereof during which the failure continues, not
11 exceeding 25% in the aggregate. For purposes of this subdivision, the amount of tax
12 required to be shown on the return shall be reduced by the amount of any part of the
13 tax which is paid on or before the due date prescribed for payment and by the amount
14 of any credit against the tax which may be claimed upon the return.

15 **SECTION 9341. Initial applicability; Revenue.**

16 (1) WITHHOLDING TAX ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES. The
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18 (a) 1. of the statutes first applies retroactively to taxable years beginning on January
19 1, 2006.

20 **SECTION 9441. Effective dates; Revenue.**

21 (1) WITHHOLDING TAX ON NONRESIDENT MEMBERS OF PASS-THROUGH ENTITIES. The
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23 (a) 1. of the statutes takes effect retroactively on January 1, 2006.

24 (END)