



## WISCONSIN LEGISLATIVE COUNCIL AMENDMENT MEMO

**2015 Assembly Bill 623**

**Assembly Substitute  
Amendment 1**

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2015 Assembly Bill 623 (“AB 623”) makes changes relating to: (1) transactions without economic substance; (2) construction contracts; (3) the manufacturing and agriculture tax credit; (4) rule-making by the Department of Revenue (DOR); (5) failure to produce records; (6) reliance on past audits; and (7) the Multistate Tax Commission Audit Program.

Assembly Substitute Amendment 1 (“ASA 1”) to AB 623 removes the bill’s provisions relating to the manufacturing and agriculture tax credit, rule-making by DOR, and reliance on past audits, and makes various changes to the bill’s other provisions.

### TRANSACTIONS WITHOUT ECONOMIC SUBSTANCE

#### Current Law

Under current law, if a person engages in a transaction without economic substance to create a loss or to reduce taxable income, or to increase credits allowed in determining Wisconsin tax, DOR must disregard the transaction when it determines the amount of the taxpayer’s taxable income or tax. A transaction has “economic substance” only if the taxpayer demonstrates all of the following:

- The transaction changes the taxpayer’s economic position in a meaningful way, apart from federal, state, local, and foreign tax effects.

- The taxpayer has a substantial nontax purpose<sup>1</sup> for entering into the transaction and the transaction is a reasonable means of accomplishing the substantial nontax purpose.

In addition, current law provides that with respect to transactions between members of a controlled group, as defined under the Internal Revenue Code, such transactions are presumed to lack economic substance and the taxpayer bears the burden of establishing by clear and convincing evidence that a transaction or a series of transactions between the taxpayer and one or more members of the controlled group has economic substance.

### **AB 623**

AB 623 provides that a transaction has “economic substance” only if the transaction is treated as having economic substance under the Internal Revenue Code. AB 623 repeals the two criteria, described in the bulletpoints above, that determine economic substance.

In addition, AB 623 lowers the burden of proof in transactions between members of a controlled group from clear and convincing evidence to preponderance of the evidence.

### **ASA1**

Like the bill, ASA 1 provides that a transaction has “economic substance” only if the transaction is treated as having economic substance under the Internal Revenue Code. However, ASA 1 also provides that the tax effect must be determined using federal, state, local, or foreign taxes, rather than only the federal income tax effect.

In addition, ASA 1 removes the change to the burden of proof in transactions between members of a controlled group, thus retaining the clear and convincing evidence standard in current law.

## **CONSTRUCTION CONTRACTS**

### **Current Law**

Current law provides a tax exemption, for purposes of sales and use taxes, for property, items, and services that are sold by a contractor as part of a lump sum contract,<sup>2</sup> if the total sales price of all such taxable products is less than 10% of the total amount of the lump sum contract. The contractor is the consumer of such taxable products and must pay the sales and use tax imposed on the products. If the lump sum contract is entered into with an entity that is exempt

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<sup>1</sup> Under current law, a transaction has a “substantial nontax purpose” if it has substantial potential for profit, disregarding any tax effects.

<sup>2</sup> Under current law, “lump sum contract” means a contract to perform real property construction activities and to provide property, items, or services and for which the contractor quotes the charge for labor, subcontractor services, property, items, and services as one price, including a contract for which the contractor itemizes the charges for labor, subcontractor services, property, items, and services as part of a schedule of values or similar document.

from taxation (such as the state or a municipality), the contractor may purchase without tax, for resale, property, items, and services that are sold by the contractor as part of the lump sum contract with the entity and that are not consumed by the contractor in real property construction activities.

### AB 623

AB 623 provides that the tax exemption applies to construction materials<sup>3</sup> and applies to any construction contract,<sup>4</sup> not only lump sum contracts. Specifically, AB 623 provides a tax exemption, for purposes of sales and use taxes, for construction materials that are sold by a prime contractor as part of a construction contract, if the total sales price of all construction materials is less than 10% of the total amount of the construction contract. Under this exemption, the prime contractor is the consumer of the construction materials and must pay the sales and use tax imposed on the construction materials.

In addition, AB 623 provides a tax exemption, for purposes of sales and use taxes, for construction materials that are sold by a subcontractor as part of a construction contract, if any of the following applies: (1) the sales price is exempted under the prime contractor tax exemption, described above; or (2) the sales price is less than 10% of the total amount of the construction contract. Under this exemption, the subcontractor is the consumer of the construction materials and must pay the sales and use tax imposed on construction materials.

The provisions in AB 623 relating to construction contracts first apply to a contract entered into or extended, modified, or renewed on the first day of the third month beginning after publication.

### ASA1

ASA 1 makes the following changes to the bill:

- Replaces the phrase “construction materials” with “products.”<sup>5</sup>
- Provides that the subcontractor tax exemption applies to products that are sold by a subcontractor **to a prime contractor or another subcontractor**.
- Modifies the first criteria under the subcontractor tax exemption to provide that the sales price is exempted under the prime contractor tax exemption **for the products resold by the prime contractor**.

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<sup>3</sup> Under AB 623, “construction materials” means tangible personal property or items the selling, licensing, leasing, or renting of which are taxable under retail sales tax; property the leasing of which is taxable under retail sales tax; and services the selling, licensing, performing, or furnishing of which are taxable under retail sales tax.

<sup>4</sup> Under AB 623, “construction contract” means a contract to perform real property construction activities and to provide construction materials.

<sup>5</sup> Under current law, “product” includes tangible personal property, and items, property, and goods under s. 77.52 (1) (b), (c), and (d), Stats., and services.

- Provides that if a construction contract is between a prime contractor and an entity that is exempt from taxation (such as the state or a municipality), the subcontractor of the prime contractor may purchase without tax, for resale, products that are sold by the subcontractor to the prime contractor or another subcontractor, as part of the subcontractor's contract, for resale to the entity and that are not consumed by the subcontractor in real property construction activities.
- Provides that the provisions relating to construction contracts first apply to a contract entered into or extended, modified, or renewed on the day after publication of the bill.

## **MANUFACTURING AND AGRICULTURE TAX CREDIT**

### **Current Law**

Under current law, a claimant may claim a manufacturing and agriculture tax credit, for purposes of income and franchise taxes, for a certain percentage of eligible qualified production activities income, including certain direct and indirect costs. "Direct costs" and "indirect costs" generally include all of the claimant's ordinary and necessary expenses paid or incurred during the taxable year in carrying on the trade or business that are deductible as business expenses under the Internal Revenue Code.

### **AB 623**

AB 623 amends the definitions of "direct costs" and "indirect costs" to also include a reasonable allowance for the exhaustion and wear and tear, including a reasonable allowance for obsolescence, of property that is deductible as depreciation under the Internal Revenue Code.

### **ASA1**

ASA 1 removes the changes in the bill relating to the manufacturing and agriculture tax credit.

## **RULE-MAKING BY DOR**

### **AB 623**

Under AB 623, DOR must promulgate rules, for purposes of income and franchise taxes, that establish the criteria to determine: (1) whether a business, property, or service is located in Wisconsin; and (2) to which states' jurisdiction a taxpayer is subject for tax purposes for any part of a taxable year.

In addition, AB 623 provides that DOR may not consider criteria that is not specified in those rules when it determines whether a business, property, or service is located in Wisconsin or whether a taxpayer is subject to the jurisdiction of Wisconsin or another state for a taxable year.

## ASA1

ASA 1 removes the bill's provisions that require DOR rule-making.

## FAILURE TO PRODUCE RECORDS

### Current Law

Current law provides that a person who fails to produce records or documents that support amounts or other information on a tax return is subject to certain penalties.

### AB 623

Under AB 623, to be subject to the penalties under current law, a person must also fail to comply in good faith with a summons issued by DOR seeking the records or documents.

## ASA1

ASA 1 makes no changes to the bill's provisions relating to failure to produce records or documents.

## RELIANCE ON PAST AUDITS

### Current Law

Under current law, a person who is subject to an audit determination by DOR is not liable for any amount that DOR asserts that the person owes if all of the following conditions are satisfied:

- The liability asserted by DOR is the result of a tax issue during the period associated with a prior audit determination for which the person is subject to and the tax issue is the same as the tax issue during the period associated with the current audit determination.
- A DOR employee who was involved in the prior audit determination identified or reviewed the tax issue before completing the prior audit determination and DOR did not adjust the person's treatment of the tax issue.
- The liability asserted by DOR as described under the first bulletpoint, above, was not asserted in the prior audit determination.

Current law provides that this provision does not apply to any period associated with an audit determination if the taxpayer did not give the DOR employee adequate and accurate information regarding the tax issue in the prior audit determination or if the tax issue was settled in the prior audit determination by a written agreement between DOR and the taxpayer.

### **AB 623**

AB 623 repeals the exception, described above, under which current law does not apply if the taxpayer did not give the DOR employee adequate and accurate information or if the tax issue was settled by a written agreement.

### **ASA1**

ASA 1 removes the bill's repeal of the exception, thus retaining the current law exception for a taxpayer who did not give the DOR employee adequate and accurate information or for a tax issue that was settled by a written agreement.

## **MULTISTATE TAX COMMISSION AUDIT PROGRAM**

### **Current Law**

Under current law, DOR has authority to enter into a contract to participate in the Multistate Tax Commission Audit Program.

### **AB 623**

AB 623 repeals DOR's authority to participate in the Multistate Tax Commission Audit Program. Under AB 623, the repeal first applies to a contract entered into or extended, modified, or renewed on the day after publication.

### **ASA1**

ASA 1 retains the repeal of DOR's authority to participate in the Multistate Tax Commission Audit Program. However, under the substitute amendment, the repeal first applies to a contract entered into or extended, modified, or renewed on July 1, 2017.

## **BILL HISTORY**

ASA 1 was offered by Representative Macco on January 26, 2016. On February 3, 2016, the Assembly Committee on Ways and Means recommended adoption of ASA 1, and passage of AB 623, as amended, on votes of Ayes, 8; Noes, 5.

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