

# **RECOMMENDATIONS FOR WISCONSIN LEGISLATIVE CHANGES**

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**Presented by members of the Wisconsin Institute of Certified Public Accountants:**

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*NOTE: While it is believed that many members of the WICPA agree with the principles and opinions set forth in this document and our separate testimonies, the WICPA has not formally adopted a policy regarding these matters, and therefore, the principles and opinions presented are solely those of the above authors.*

### **I. OBJECTIVE:**

**To propose legislative tax law changes to foster economic development and to encourage businesses and individuals to relocate to or stay in Wisconsin.**

### **II. GUIDING PRINCIPLES:**

**A. FOLLOW MODEL TAX LAW GUIDELINES**

**B. CONFORM TO FEDERAL TAX LAW TO THE FULLEST EXTENT POSSIBLE**

**C. APPLY LAWS CONSISTENTLY WITHOUT REGARD TO ENTITY TYPE**

**D. REDUCE TAXES TO ENCOURAGE ECONOMIC GROWTH**

**E. SIMPLIFY TAX DEDUCTIONS AND CREDITS TO REDUCE COMPLIANCE COSTS**

## A. MODEL TAX LAW GUIDELINES

We believe that state tax laws promulgated by the State Legislature should follow the guidelines set forth in the “Tax Policy Handbook for State Legislators” published by the National Conference of State Legislatures (“Handbook”), February 2010. The principles set forth in that handbook to evaluate state tax laws are:

1. **Reliability.**
2. **Equity.**
3. **Compliance and Administration.**
4. **Responsiveness to Interstate and International Competition.**
5. **Economic neutrality.**
6. **Accountability.**

These excerpts from the handbook describe the principles:

1. “**Reliability** has three primary components:
  - Stability
  - Certainty
  - Sufficiency

Stability implies that revenues are relatively constant over time and not subject to unpredictable fluctuations. Certainty means that the number and type of tax changes are kept at a minimum to allow businesses and individuals to plan for the future. Sufficiency requires that revenue sources provide the revenue growth necessary to finance the desired rate of spending growth.”

2. “**Equity** has two primary components—horizontal equity and vertical equity. Horizontal equity means that taxpayers with similar economic circumstances have similar tax burdens. Vertical equity refers to the distribution of tax burdens among taxpayers with different economic circumstances.”
3. “**Compliance and Administration.** A quality tax system facilitates taxpayer compliance by minimizing the time and effort necessary to comply with the law. It also minimizes the cost of the state administrative apparatus necessary to collect revenue, enforce the law, and audit to ensure compliance with the law. Complex taxes that are expensive to enforce reduce the yield of the tax system and result in wasted taxpayer resources.”
4. “**Responsiveness to Interstate and International Competition.** A state tax system does not operate in a vacuum—lawmakers must recognize that the tax policies of surrounding states can limit the revenue potential of some taxes. Businesses that sell in a national or global marketplace can relocate if state business taxes are too burdensome. Individuals may choose to shop in neighboring states if specific state consumption tax differentials are high.”
5. “**Economic Neutrality.** Taxes, by their very nature, are not economically neutral. Tax policy can encourage or discourage consumption of goods and services, influence decisions to save and invest, and affect fundamental business decisions about the use of labor and capital. A quality tax

system tries to minimize the effect of the tax system on the allocation of resources in the economy. When lawmakers decide to use the tax system to make budget decisions or influence behavior, these decisions should be explicit and subject to frequent evaluation and review. Taxes with broad bases and low rates, spread across a wide range of sources and economic activities, reduce the effect of taxation on economic decisions.”

6. **“Accountability.** The essence of accountability is that tax burdens should be explicit, not hidden. This principle can be applied to state taxes in two ways. First, credits and exemptions in the tax code should be minimized and reviewed frequently to determine their cost (in lost revenue) and to determine whether they are unfairly benefiting some taxpayers at the expense of others—“picking winners and losers,” as it is often described by critics. Second, taxes that are designed to be “passed through” to consumers provide less accountability than taxes that are paid directly and openly by taxpayers and should likewise be minimized.”

## **B. CONFORM TO FEDERAL TAX LAW TO THE FULLEST EXTENT POSSIBLE**

The Federation of Tax Administrators strongly supports conformity with federal law. Following are excerpts from *“Relationships between Federal and State Income Taxes”*, Submitted to the President’s Advisory Panel on Federal Tax Reform, April 2005, Harley T. Duncan, Federation of Tax Administrators:

“Conformity between state and federal tax systems serves the interests of taxpayers, state tax agencies and the overall health of the intergovernmental fiscal system. It promotes simplification for the taxpayer and increases voluntary compliance with the tax law.”

“Not conforming to changes in depreciation, for example, requires a taxpayer to maintain two (or more) sets of asset accounts and to track the different federal and state basis in each asset and to recognize different amounts upon disposition. Tracking differences over time imposes significant burdens on taxpayers. Taxpayer accuracy in such matters can usually be verified only on audit, an expensive proposition for both taxpayers and tax agencies alike.”

Wisconsin has not adopted any of the federal enhanced depreciation provisions for the past twelve years. This has created an administrative nightmare for Wisconsin businesses by requiring two additional sets of depreciation records. Most companies now have at least five depreciation books: “GAAP” (Generally Accepted Accounting Principles for financial reporting), federal regular tax, federal alternative minimum tax, Wisconsin regular tax and Wisconsin minimum tax. Each time an asset is acquired or disposed of requires additional time to set it up in the depreciation books and to compute gain or loss on disposal with potentially five different amounts of gain or loss.

Individual taxpayers are also negatively affected when Wisconsin uses a different definition of the Internal Revenue Code. For example, Schedule I is required to be completed to list the Federal – Wisconsin differences in the computation of income and deduction items. The 2011

instructions to Schedule I lists over 50 differences in the tax laws that must be reported! Over the last 5 years, the average number of differences is about 75.

### **C. APPLY LAWS CONSISTENTLY WITHOUT REGARD TO ENTITY TYPE**

Some credits are only available to certain types of entities. For example, the Wisconsin Research credit is only available to regular corporations; it can't be claimed by S corporations, partnerships or sole proprietors.

### **D. REDUCE TAXES TO ENCOURAGE ECONOMIC GROWTH**

Reduce tax rates to be competitive with other states. Also, eliminating the following taxes would make Wisconsin more competitive with other states and would reduce the compliance burden for taxpayers:

1. Minimum tax.
2. Economic Development Surcharge.
3. Personal property taxes.
4. Eliminate the potential for the Wisconsin estate tax to apply if the Federal estate tax reverts to prior provisions allowing a credit for state estate taxes.

### **E. SIMPLIFY TAX DEDUCTIONS AND CREDITS TO REDUCE COMPLIANCE COSTS**

1. Consolidation of credits:
  - i. Many highly specialized credits are available to a limited number of businesses. These could be consolidated into a few credits which would be available to all businesses. This would reduce compliance costs for both the taxpayers and Wisconsin Dept. of Revenue.
  - ii. Many Wisconsin credits are included on Schedule CR – “Other Credits.” For 2011, over 20 different credits are allowed for individuals, fiduciaries and corporations, and another 10 credits are provided for corporations only.
  - iii. Almost all of the credits on Sch. CR are intended to encourage businesses to locate in or expand in Wisconsin, but many are limited to very narrowly defined industries or to locate businesses in very specific locations. While laudable in their intentions, the proliferation of credits adds to compliance costs for both businesses and the Wisconsin Dept. of Revenue. In addition, many existing businesses in Wisconsin are unable to use any of these credits, which could put them at a competitive disadvantage to businesses moving into Wisconsin who are able to utilize such credits.

- iv. These credits should be condensed into only a few credits and made available to all businesses. For example, providing one investment credit and one jobs credit would benefit both new and existing businesses.
2. Simplify Wisconsin deductions, adjustments or credits allowed or required by basing the Wisconsin deductions, adjustments or credits on similar federal amounts. A good example of where this works well is for the Wisconsin Earned Income Credit. To determine the Wisconsin credit, the federal credit is multiplied by a percentage based on the number of dependents claimed.

Some examples of deductions, adjustments or credits that could be based on the federal calculations are:

- i. Taxation of unemployment compensation.
  - ii. Exclusion of gain on the sale of small business stock.
    - Both Wisconsin and federal law allow exclusions of certain amounts of gain on the sale of certain small business stock, but different criteria apply at both levels. By adopting the federal rules, Wisconsin small businesses would still benefit from the exclusion, but compliance costs would be reduced because there would be only one set of rules to follow.
  - iii. College tuition deductions and credits.
    - Federal allows either a deduction or a credit based on different levels of tuition expenses and other income reported. Taxpayers can use whichever method reduces their net taxes the most.
  - iv. Energy efficient commercial buildings deduction.
  - v. Domestic production activities deduction.
    - Was allowed for Wisconsin until 2009, disallowed for 2009-2012, but Wisconsin will allow a credit starting in 2013.
  - vi. Farm loss limitations.
  - vii. Medical care and long term care insurance deductions.
  - viii. Adoption expenses deduction.
  - ix. Disability income exclusion.
  - x. Reporting of marital property income for spouses getting divorced.
3. Eliminate deductions or credits which are limited in application due to other provisions in the tax law, or which affect only a very few individuals or businesses. A comprehensive

list of the usage of various deductions and credits are included in the DOR's "Individual Income Tax Statistics Report for Tax Year 2009", (the most recent report available).

This includes the following:

<b>Credit/Deduction</b>	<b># of Returns Claimed On</b>	<b>Total Dollar Amount of Credits Allowed</b>
Working Families Credit	790	\$180,000
Historic Rehabilitation Credits	418	\$1,410,000
Development Zone Credit	155	\$2,050,000
Seed Investment Credit	260	\$950,000
Technology Zone Credit	95	\$670,000
Internet Equipment Credit	22	\$10,000
Health Ins Risk Sharing Plan Credit	less than 6	too small to report
Film Production Co Invstmnt Credit	less than 6	too small to report
Film Production Services Credit	6 to 10	\$40,000
Manufacturing Investment Credit	178	\$280,000
Ethanol & Biodiesel Fuel Pump Credit	27	\$30,000
Economic Development Tax Credit	6 to 10	\$10,000
Enterprise Zone Jobs Credit	less than 6	too small to report
Dairy Manufacturing Facility Credit	85	\$270,000
Dairy Cooperatives Credit	109	\$60,000
Meat Processing Facility Investment	13	\$80,000
Film Prod Co Inv Credit - refundable	6 to 10	\$20,000
Film Prod Services Credit	less than 6	too small to report

To put this in perspective, a total of 2,831,473 returns were filed for tax year 2009, with total taxes of \$1,930,377,000.

### **III. SPECIFIC RECOMMENDATIONS FOR STATUTORY CHANGES TO ACHIEVE OBJECTIVES:**

#### **A. CHANGES TO REDUCE COMPLIANCE BURDENS FOR BUSINESS AND INDIVIDUAL TAXPAYERS:**

1. Adopt rolling conformity with the federal tax code.
  - a. Currently Wisconsin follows a fixed-date approach which is usually one year behind the federal law changes, and requires annual legislative action.
  - b. In addition, even when adopting federal changes, Wisconsin has in many cases not adopted specific provisions. This creates lasting differences between federal and Wisconsin laws. For example, for several years Wisconsin did not adopt federal Health Saving Account (“HSA”) provisions. The federal law has now been adopted starting in 2011, but it took separate Wisconsin legislation to make it happen.
2. Adopt federal tax changes arising in prior years that had been selectively excluded in Wisconsin’s adoption of the federal code.
3. Keep working on trying to reinstate reciprocity with Minnesota to allow residents of one state but who work in the other to pay taxes only to their state of residence. [We recognize the Wisconsin Department of Revenue's efforts in this matter and that at this point it is Minnesota that is balking on coming to an agreement.]
4. Consider a total overhaul of Wisconsin's tax structure by using federal taxable income as the starting point, and limiting the adjustments to the greatest extent possible.
5. If Wisconsin retains its current structure of starting the computation of Wisconsin income with federal adjusted gross income, consider adopting the federal definitions and computations of various deductions as listed above.

#### **B. CHANGES TO PROMOTE ECONOMIC GROWTH AND COMPETIVENESS WITH OTHER STATES:**

1. Adopt all federal depreciation provisions effective for tax years ending after December 31, 2011 including the enhanced Sec. 179 expensing provisions and 100% bonus depreciation.
  - i. If Wisconsin continues to use the prior year's Internal Revenue Code provisions (as is currently the practice), an exception should be made so all federal depreciation rules apply for Wisconsin purposes at same time as for federal.

- ii. Even if Wisconsin federalizes the depreciation rules, there will be a need to keep separate depreciation records for years to come because of depreciation differences for assets placed in service for prior years. To avoid the need to keep separate state depreciation records, Wisconsin should allow or require companies to recognize the difference between the two methods as either additional Wisconsin income or deduction. Adjustments totaling more than a certain amount, for example \$25,000 would be required to be recognized over 3 or 4 years. The effect of this is to allow Wisconsin businesses to "catch up" to the federal depreciation schedules.
2. Lower the corporate and individual tax rates to be more competitive with other states.
  - i. According to the 5/29/2012 "Focus" newsletter published by the Wisconsin Taxpayer's Alliance:

"State-local tax burden is a publicized shortcoming of the state. [This includes income, property, sales and miscellaneous taxes.] Relative to personal income, taxes here (2009) were above the national average and ninth highest nationally. After falling to 11.3% of state personal income in recessionary 2009, the tax burden rose to 11.7% in 2010 and 11.9% in 2011 due to a combination of tax increases in 2009-11 state budget and renewed revenue growth.

"The state's comparatively high tax burden is due primarily to individual income and property taxes, both of which are about 25% above the U.S. average."
  - ii. Wisconsin's top tax rate was increased to 7.75% in 2010 and is now the 13<sup>th</sup> highest in the country.
  - iii. The reduction in the long-term capital gain exclusion in 2010 from 60% to 30% along with an increase in the top income tax rate increased the effective tax rate on capital gains from 3.1% (7.75% X 40%) to 5.425% (7.75% X 70%), resulting in a 75% increase in the effective rate.
3. All business related credits should be allowed for all types of entities.
  - i. For example, under current law Research and Development ("R&D") credits can only be claimed by regular corporations. S corporations and partnerships should be allowed to flow through the credit so they can be taken by individual shareholders and partners similar to all other tax credits (see Sec 71.07(10)). Also allow sole-proprietors to claim the R&D credit.
  - ii. The DOR's Publication 123, Business Tax Incentives for 2011, lists most of the credits available and which entities can claim them.
4. Eliminate the Wisconsin Alternative Minimum Tax. If it is not eliminated, allow a Wisconsin minimum tax credit carry forward for AMT generated because of deferral preferences (like depreciation), as is provided under federal law.



- i. In 2009, only 4,451 returns out of 2,831,473 returns filed had the Wisconsin AMT, and it generated less than 0.3% of the state's revenue.
  - ii. But all businesses other than regular corporations must keep separate depreciation books in order to determine if the Wisconsin AMT even applies. This is a compliance burden the cost of which may exceed the amount of tax being generated by the AMT.
5. Eliminate personal property taxes on business assets.
6. Federalize capital loss allowances. Currently federal allows \$3,000 of excess capital losses to offset other income, but WISCONSIN allows only \$500 per year.
7. Allow Net Operating Losses (“NOLs”) and credit carrybacks to mirror federal rules; i.e., two year carryback of NOLs and one year for credits.
8. Exempt municipal interest on all Wisconsin bonds. Currently, only some bonds are exempt and it is difficult to distinguish which ones are exempt for Wisconsin and which ones are taxable. Exempting all Wisconsin bonds will encourage investment in Wisconsin and will greatly simplify compliance.

**C. OTHER CHANGES TO PROMOTE EQUITY AND FAIRNESS:**

1. Adopt the same installment sales rules as allowed for federal. Currently, Wisconsin only allows the use of the installment method to cash basis taxpayers; accrual basis taxpayers must recognize 100% of gains on installment sales in the year of sale. Since only businesses use the accrual method, not allowing the use of the installment method is a burden on small businesses, and in turn its owners.
2. The interest rate charged on underpayments of 12% and paid on overpayments of 9% are not in line with current interest rates. When audit adjustments occur several years after returns have been filed, an annual rate of 12% will be 48% on balances due on returns filed four years ago. This is a huge burden for taxpayers.

More equitable rates would be those used by the IRS which currently provides a 3% rate for both underpayments and overpayments.