

Proposed Draft Permanent Rule Order
March 20, 2024

**STATE OF WISCONSIN
DEPARTMENT OF REVENUE**

PROPOSED ORDER OF THE DEPARTMENT OF REVENUE ADOPTING RULES

PROPOSED RULE ORDER

The Wisconsin Department of Revenue proposes an order to create Tax 3.10 relating to a commercial loan income exemption.

The statement of scope for this rule, SS 068-23, was approved by the Governor on September 7, 2023, published in Register No. 813A2 on September 11, 2023, and approved by the Secretary of Revenue on September 27, 2023.

ANALYSIS BY THE DEPARTMENT OF REVENUE

Statutes interpreted: ss. 71.05(1)(i) and 71.26(1)(i), Stats.

Statutory authority: ss. 71.80(1)(c) and 227.11(2), Stats.

Explanation of agency authority: Section 71.80(1)(c) provides that the department may make such regulations as it shall deem necessary in order to carry out chapter 71 of the Wisconsin Statutes, relating to income and franchise taxes.

Section 227.11 (2), Stats., provides statutory rule-making authority as follows:

(a) "Each agency may promulgate rules interpreting the provisions of any statute enforced or administered by the agency, if the agency considers it necessary to effectuate the purpose of the statute..."

(c) "Each agency authorized to exercise discretion in deciding individual cases may formalize the general policies evolving from its decisions by promulgating the policies as rules ..."

Related statute or rule: There are no other applicable statutes or rules.

Plain language analysis: Section 325 and 341 of 2023 Wisconsin Act 19 create new statutory language stating that financial institutions as defined in s. 69.30(1)(b) may claim an income tax exemption for income derived from qualifying loans that meet the following criteria:

- The loan is a commercial loan.
- The loan is for five million dollars or less.
- The loan is provided to a person residing or located in Wisconsin.
- The loan is used primarily for a business or agricultural purpose.

Clarification is needed to describe what entities, loans, and income qualify for the new income exemption.

Summary of, and comparison with, existing or proposed federal regulation: There is no existing or proposed federal regulation that is intended to address the activities to be regulated by the rule.

Summary of comments received during preliminary comment period and public hearing on the statement of scope: No preliminary public hearing was requested and no comments from the public were received on the statement of scope (SS 068-23).

Comparison with rules in adjacent states: There is no existing or proposed similar rule in any of the adjacent states.

Summary of factual data and analytical methodologies: 2023 Wisconsin Act 19 provided income, including interest, fees, and penalties, financial institutions derive from commercial loans of five million dollars or less made to a person residing or located in this state and used primarily for a business or agricultural purpose would be exempt from Wisconsin income and franchise taxes. The Act provides uncertainty with certain terms used in the statute. The Wisconsin Department of Revenue collaborated with the Wisconsin Department of Financial Institutions on their expertise in financial institutions to establish a starting base of knowledge on these terms. The Department of Revenue reviewed Title 12 of the United States Code, federal regulations, and the Federal Deposit Insurance (FDIC) website to understand banking regulations, terminology, and reporting requirements. The Department of Revenue also reviewed existing Wisconsin statutes and administrative rules to find terms and definitions that could be used to clarify this new income exemption.

Analysis and supporting documents used to determine effect on small business: This rule order clarifies the income exemption created by 2023 Wis. Act 19. No additional analysis or supporting documents were used to determine the effect on small business.

Anticipated costs incurred by private sector: There may be a small increase in administrative costs by financial institutions to create and maintain records to substantiate their income exclusion reported on their Wisconsin tax return; however, such recordkeeping costs are required by law to substantiate deductions, exclusions, credits, and other items reported on federal and state tax returns.

Fiscal Estimate and Economic Impact Analysis: The fiscal estimate and economic impact analysis are attached.

Environmental Impact Statement: This rule order clarifies the income exemption created by 2023 Wisconsin Act 19. Income eligible for the exemption must be derived from a loan used primarily for a business or agricultural purpose. The department has concluded this rule will not have significant or substantial impact on the environment.

Effect on small business: The department does not expect a negative economic impact on small business. The law provides a Wisconsin tax benefit to financial institutions that derive income from commercial loans of \$5 million or less. This rule order clarifies the tax benefits allowed by law. Small businesses seeking commercial loans of \$5 million or less may see lower interest rates from their financial institution because of the Wisconsin tax benefit allowed to the financial institution; however, the law does not require a financial institution to pass their Wisconsin tax benefit on to their customers in the form of lower interest rates.

Agency contact person: Please contact Ann DeGarmo at (608) 266-7179 or ann.degarmo@wisconsin.gov if you have any questions regarding this proposed rule.

Place where comments are to be submitted and deadline for submission: Comments may be submitted to the contact person shown below no later than the date on which the public hearing on this proposed rule is conducted. Information as to the place, date, and time of the public hearing will be published in the Wisconsin Administrative Register.

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TEXT OF RULE

SECTION 1. Tax 3.10 is created to read:

Tax 3.10 Commercial loan income exemption

(1) PURPOSE. This section clarifies the commercial loan income exemption under ss. 71.05(1)(i) and 71.26(1)(i), Stats., and prescribes how the \$5,000,000 loan limitation is computed.

(2) DEFINITIONS. In this section and in ss. 71.05(1)(i) and 71.26(1)(i), Stats.:

(a) "Agricultural purpose" means the preparation of plant or animal products for use in a business or for sale or distribution to markets. "Agricultural purpose" includes agriculture, horticulture, viticulture, dairy, livestock, wildlife, poultry, bees, forest products, fish and shellfish, and any products thereof, and all products raised or produced on farms and any processed products thereof. "Agricultural purpose" does not include fishing preserves, recreational uses, or personal uses.

(b) "Business purpose" means activities undertaken for an industrial, commercial, or professional purpose. "Business purpose" does not include the following:

1. Investment in stocks, bonds, and other securities or ownership interests in entities including the borrower's own stock or ownership interests, unless such assets are regularly held for sale in a trade or business;

2. Personal or consumer expenditures;

3. The purchase, expansion, or improvement by an owner of a one to four unit residential facility if such owner or their parent or child uses all or a portion of the facility as their personal residence.

4. Activities conducted by any unit of government or any agency or instrumentality of one or more units of government.

5. Activities conducted by nonprofit organizations, unless one of the following apply:

i. The commercial loan proceeds are used in this state for activities in which the nonprofit organization reports unrelated business taxable income on Form 990-T to the federal department of the treasury.

ii. The nonprofit organization has over 50 full-time employees in the calendar year immediately preceding the calendar year in which the commercial loan is issued, and the loan proceeds are used in this state for activities regularly conducted by such employees.

(c) "Commercial loan" means a loan issued to a borrower and the proceeds of which are used primarily for a business or agricultural purpose in this state.

(d) "Commercial domicile" means the location from which a trade or business is principally managed and directed. It shall be rebuttably presumed that the location from which a trade or business is principally managed and directed is the location where the greatest number of the business's employees have their office or their base of operations from which they regularly work and are directed or controlled.

(e) "Financial Institution" means a financial institution defined in s. 69.30 (1) (b) that is authorized to do business under state or federal laws relating to financial institutions and is one of the following:

1. A bank as defined under 12 USC 1841(c), including a national bank organized and existing as a national bank association pursuant to provisions of 12 USC ch. 2 and a state bank organized and operating under ch. 221, Stats, or a comparable law in another state.

2. A savings bank organized under ch. 214, Stats., or a comparable law in another state.

3. A savings and loan association organized and operating under ch. 215, Stats., or a comparable law in another state; or organized according to federal law.

4. Any credit union to the extent not exempt under s. [71.26 \(1\) \(a\)](#), Stats., and s. [186.113 \(20\)](#), Stats.

(f) "Income" means all income, including interest, fees, and penalties, derived from a commercial loan. "Income" does not include income derived from persons other than the borrower of the commercial loan, including income derived from the sale of a commercial loan or income derived from another financial institution for a loan participation agreement.

(g) "Loan" means money given in exchange for an obligation to pay back such money that results from direct negotiation between a financial institution and a borrower. "Loans" do not include unsecured open-end lines of credit such as credit cards and other unsecured revolving credit plans and letters of credit; conversions; sales or leases of property; futures or forward contracts; options; notional principal contracts such as swaps; credit card receivables, including credit card relationships; non-interest bearing balances; cash items in the process of collection; federal funds sold; securities purchased under agreements to resell; assets held in a trading account; securities; interest in a real estate mortgage investment conduit, or other mortgage-backed or asset-backed security; and other similar items.

(h) "Primarily" means the loan proceeds are used 75 percent or more for a business or agricultural purpose in this state.

(i) "Residing in this state" means any of the following, determined for the person's taxable year in which the loan origination occurs:

1. A natural person or fiduciary who is a resident of this state as determined under s. 71.01(1n) or 71.14, Stats.

2. A person whose commercial domicile of their business or agricultural activity is in this state.

(j) "Located in this state" means a person (including a natural person or fiduciary) who has a fixed business location in this state such as a commercial office, warehouse, or manufacturing facility.

(3) QUALIFYING BORROWERS. A commercial loan may qualify for the exemption in ss. 71.05(1)(i) and 71.26(1)(i), Stats., if the loan is provided to a person residing or located in this state.

(4) **PROCEEDS USED IN THIS STATE.** A commercial loan may qualify for the exemption in ss. 71.05(1)(i) and 71.26(1)(i), Stats., if the loan proceeds are used primarily for a business or agricultural purposes in this state.

Example: Financial Institution A issues a loan to Business B for \$4,000,000. Business B uses \$3,000,000 of the loan proceeds to expand their manufacturing facility in Wisconsin and \$1,000,000 to renovate their headquarters office in Illinois. The loan is used primarily for a business purpose in Wisconsin since 75% of the loan proceeds (\$3,000,000 / \$4,000,000) were used to expand the Wisconsin facility.

(5) **COMMERCIAL LOAN LIMITATION.** A commercial loan may qualify for the exemption in ss. 71.05(1)(i) and 71.26(1)(i), Stats., if the commercial loan is \$5,000,000 or less. This subsection interprets the \$5,000,000 limitation.

(a) *General.*

1. The original full amount of the loan obligation is used to determine the \$5,000,000 limitation. In the case of secured open-end lines of credit and other secured revolving credit plans and letters of credit, the full amount of the loan obligation is the maximum amount of credit available to the borrower.

2. Costs and fees rolled into the loan are included as part of the original loan obligation.

3. Charge-offs or amounts not expected to be recoverable from a borrower do not reduce the original loan obligation.

Examples: 1) A borrower is issued a commercial loan with an obligation of \$4,900,000 and incurs costs and fees of \$150,000 on that loan. The borrower does not pay the \$150,000 up front but instead rolls the amount into the loan. Since the loan obligation and costs and fees equal an original loan obligation of \$5,050,000, income from the loan does not qualify for the exemption.

2) A bank lends a borrower \$6,000,000 on an original commercial loan but charges off \$2,000,000 and keeps track of the charged-off balance. Since the original borrowed obligation is \$6,000,000, income from the loan does not qualify for the exemption.

(b) *Commercial loan refinancing.* A commercial loan that is refinanced is considered a new original loan obligation and the \$5,000,000 limitation is computed based on the facts contained in the refinanced loan documentation.

(c) *Loan participation and assignment.* A commercial loan with an original loan obligation over \$5,000,000 to a single borrower does not qualify for the exemption, regardless of whether the loan is sold or assigned, in whole or in part, to another financial institution for \$5,000,000 or less. A financial institution that acquires a commercial loan through a purchase, assignment, or participation agreement may not exempt the income derived from the acquired loan if the original loan obligation is more than \$5,000,000.

Examples: 1) Bank A issues a commercial loan of \$7,000,000. Bank B purchases a loan participation of \$3,000,000 in the commercial loan. The income derived from the commercial loan does not qualify for the exemption for Bank A or Bank B because the original loan obligation is over \$5,000,000.

2) Assume the same facts as Example 1, except that \$3,000,000 of the original loan obligation is assigned by Bank A to Bank B. The income derived from the commercial loan does not qualify for the exemption for Bank A or Bank B because the original loan obligation is over \$5,000,000.

3) A commercial loan of \$5,000,000 is issued by Bank A. Bank B purchases a loan participation of \$3,000,000 in the commercial loan from Bank A. The income derived from the commercial loan may qualify for the exemption for Bank A and Bank B because the original loan obligation was for \$5,000,000 or less.

(d) *Loan syndication.* If one or more financial institutions enter a loan syndication where both financial institutions will be originating the loans, the total loan amount provided to the borrower is used to determine the original loan obligation, not each financial institution's portion of the syndicated loan. If the original loan obligation is \$5,000,000 or less, each financial institution may qualify for the exemption in proportion to the financial institution's interest in the syndicated loan.

Example: Four financial institutions pool their resources to fund a loan syndication to a borrower for a total original loan obligation of \$20,000,000. Although each financial institution funds \$5,000,000 of the loan, income derived from the \$20,000,000 loan does not qualify for the exemption.

(e) *Aggregation.* For purposes of claiming the income exemption:

1. A financial institution may not create separate commercial loan agreements for \$5,000,000 or less for a borrower that seeks a commercial loan over \$5,000,000, including refinancing a single loan into separate loans.

2. A financial institution may have multiple qualifying commercial loans of \$5,000,000 or less with the same borrower if the loans are obtained for a different use and qualifying purpose.

3. A commercial loan over \$5,000,000 does not qualify, regardless of whether a portion of the loan is used for purposes outside this state.

Example: A commercial loan is issued for \$15,000,000 and 33% or \$4,950,000 of the proceeds are used for a business purpose in Wisconsin and 67% outside Wisconsin. The income derived from the commercial loan does not qualify for the exemption because the original loan obligation is over \$5,000,000.

(6) RECORD KEEPING.

(a) Financial institutions shall keep electronic records in easily accessible and usable form to substantiate the exemption from income for each loan, including electronic data that can be queried and analyzed for each of the following data elements:

(1.) Borrower's legal name

(2.) Borrower's state of residence

(3.) Loan ID number

(4.) Name of originating underwriter of the loan if someone other than the financial institution

(5.) Loan origination date

(6.) Original loan obligation amount, including costs and fees rolled into the loan obligation

(7.) Detailed description of the purpose of the loan, including whether there is more than one purpose, and where the loan proceeds will be used.

(b) Financial institutions shall keep records to substantiate whether the borrower is a person who is a resident of this state, such as tax returns and trust agreements.

(c) The records described in pars. (a) and (b) shall be kept for as long as any period of limitation for assessment for the taxable year in which the exemption is claimed has not expired under ss. 71.76 and 71.77, Stats. If the taxable year results in a net loss, the records described in pars. (a) and (b) shall be kept for as long as the period of limitation for assessment for the taxable year in which the loss carryforward is used, as described in ss. 71.05 (8) (b) 1. and 71.26 (4) (a), Stats., has not expired.

SECTION 2. EFFECTIVE DATE. This rule takes effect on the first day of the month following publication in the Wisconsin Administrative Register as provided in s. 227.22(2) (intro), Stats.

END RULE TEXT
