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Corporate Income/Franchise Tax

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This paper provides general information regarding the Wisconsin corporate income / franchise tax. Included in the paper are a general rationale for the tax, a description of the method by which the tax is applied to corporations, and summary and comparative data about the tax.

Theoretical Rationale for the Corporate Income Tax

One theoretical rationale given for the corporate income tax is based on the view that a corporation is a legal entity with an existence of its own. A corporation can be a significant factor in economic and social decision-making, operated by professional management subject to little control by the average shareholder. Proponents of the corporate income tax believe that, as a separate entity with substantial earnings and economic power, the corporation is properly subject to a separate tax. In addition, proponents believe that, since a corporation can be viewed as a separate income earning entity, it is appropriate to tax a corporation's profits, especially when a substantial amount of the corporation's income is from the sale of goods and services to the state's residents.

Critics of the corporate income tax believe it depresses the overall level of business investment in the U.S. They argue that although corporations operate as distinct, decision-making units, corporations should not be subject to a distinct tax because, ultimately, corporate taxes are borne by natural persons. Since corporate profits are part of the income of shareholders, some view the corporate income tax as a tax on the income of shareholders. Under this view, the corporation has no independent taxpaying ability but should be seen as a "conduit" through which earnings pass on the way to the shareholders. Those who hold this view criticize the corporate income tax because corporate profits that are distributed are taxed twice--first at the corporate level under the corporate income tax and then under the individual income tax when they are distributed as dividends to shareholders. However, many economists believe that the corporate income tax is borne not only by stockholders but by consumers and employees as well. Regardless of the specific incidence, critics of the corporate income tax argue that it is not a tax on corporate income but rather a tax on the income of people, including shareholders, consumers, and employees.

Another rationale for the corporate income tax is that corporations receive benefits from their form of organization. These benefits include perpetual life, limited liability of shareholders, liquidity of ownership through marketability of shares, growth through retention of earnings, and possibilities of intercorporate affiliations. In addition, corporations derive benefits from certain governmental services which may reduce corporate costs, expand markets, and facilitate financial transactions. Proponents of the corporate income tax believe that it is reasonable that corporations pay for such benefits through the tax. However, critics argue that the general level of the corporate income tax paid is too high for the benefits received. Moreover, individual corporations receive similar benefits from their status but pay different amounts of taxes. To the extent the tax is for services provided by government, a general business tax or value-added tax would more closely relate to the cost of services that are provided.

A practical justification for the corporate income tax is that it safeguards the individual income tax. If the corporate income tax were abolished, retained earnings would no longer be taxed and individuals could simply leave their wealth within corporations where it would be sheltered from taxes until it was withdrawn. There have been proposals to "integrate" the individual and corporate income taxes to make the income tax more efficient and equitable. However, these proposals have not been adopted on either the federal or state level and would involve substantial administrative problems if enacted.

A final rationale for the corporate income tax is that it is a major source of revenue for the federal and state governments. Critics contend that the corporate tax is used because it is politically easier to increase taxes on corporations than to increase taxes on individuals.

Current Wisconsin Corporate Income/Franchise Tax Law

Wisconsin has both a corporate income tax and a corporate franchise tax. The corporate franchise tax is imposed upon corporations for the privilege of doing business or exercising their franchise in the state in a corporate capacity. The corporate franchise tax is also imposed on corporations that buy or sell lottery prizes if the winning tickets were purchased in the state. The corporate income tax is imposed upon corporations which are not subject to the franchise tax and own property in the state; that derive income from sources within the state or from activities that are attributable to the state; or if their business within the state consists exclusively of foreign commerce, interstate commerce, or both. As a result, companies having any intrastate business are subject to the franchise tax while those having only interstate business here are subject to the income tax. The basic difference between the corporate franchise and income taxes is that income from obligations of the U.S. government and its instrumentalities is subject to the franchise tax, but not the income tax. Typically, the corporate franchise tax is imposed on corporations subject to taxation in Wisconsin. Since both taxes are similar, they are jointly referred to as the corporate income tax in this paper.

In general, all corporations over which Wisconsin has taxing jurisdiction are subject to the corporate income tax. However, there are certain types of corporations that are specifically exempt. These include municipal corporations, nonprofit corporations or associations, except those subject to the unrelated business income tax, cooperatives, most credit unions, most insurance companies (Wisconsin nonlife, nonmortgage guarantee companies and the nonlife insurance business of Wisconsin life insurance companies are not exempt), and banks under liquidation.

The income of nonprofit cooperative sickness care associations, nonprofit service insurance corporations, and religious, educational, benevolent, and other nonprofit corporations that is derived from health maintenance organizations (HMOs) and limited service health organizations is subject to the state corporate income tax. In addition, small corporations which elect to be treated as tax-option corporations (Subchapter S corporations) generally have corporate net income attributed to their shareholders who are taxed under the individual income tax. Similarly, business enterprises such as sole proprietorships, partnerships, and limited liability companies (LLCs) that are treated as partnerships for federal income tax purposes are not subject to the state corporate income tax but, rather, the net income of the business is taxed under the individual income tax.

Jurisdictional Nexus

There are two circumstances which give Wisconsin taxing jurisdiction over corporations. First, corporations which are created and authorized to act in a corporate capacity (incorporated) under Wisconsin law or foreign corporations which are licensed to transact business in the state are subject

to the Wisconsin corporate income tax. Such firms are subject to the corporate income tax whether or not they conduct business or own property in the state. However, even though a corporation is subject to the corporate income tax, it may not have a tax liability.

Second, corporations which are organized under the laws of other states or foreign nations are generally subject to the Wisconsin corporate income tax if they exercise a franchise, conduct business, or own property within the state. The statutes specify that doing business in the state includes issuing credit, debit, or travel and entertainment cards to customers in Wisconsin; owning, directly or indirectly, a general or limited partnership that does business in Wisconsin, regardless of the percentage of ownership; and owning, directly or indirectly, an interest, in a limited liability company that does business in Wisconsin and is treated as a partnership for federal income tax purposes, regardless of the percentage of ownership.

The Department of Revenue (DOR) has promulgated administrative rules which describe, for non-Wisconsin firms, what type of business activities are needed to make such firms subject to the state's corporate income tax. Under the administrative rules, a non-Wisconsin (foreign) corporation is considered to have "nexus" with Wisconsin and be subject to taxation if it has one or more of the following "activities" in the state:

1. Maintenance of any business location in Wisconsin, including any kind of office.

2. Ownership of real estate in Wisconsin.

3. Ownership of a stock of goods in a public warehouse or on consignment in Wisconsin.

4. Ownership of a stock of goods in the hands of a distributor or other nonemployee representative in Wisconsin, if used to fill orders for the owner's account.

5. Usual or frequent activity in Wisconsin by employees or representatives soliciting orders with authority to accept them.

6. Usual or frequent activity in Wisconsin by employees or representatives engaged in purchasing activity or in the performance of services, including construction, installation, assembly, or repair of equipment.

7. Operation of mobile stores in Wisconsin, such as trucks with driver-salespersons, regardless of frequency.

8. Miscellaneous other activities by employees or representatives in Wisconsin such as credit investigations, collection of delinquent accounts, conducting training classes or seminars for customer personnel in the operation, repair, and maintenance of the taxpayer's products.

9. Leasing of tangible property and licensing of intangible rights for use in Wisconsin.

10. The sale of other than tangible personal property such as real estate, services, and intangibles in Wisconsin.

11. The performance of construction contracts and personal services contracts in Wisconsin.

An out-of-state (foreign) corporation is not considered to have "nexus" with Wisconsin and is not subject to the corporate income tax if:

1. The corporation stores tangible personal property, such as inventory or a stock of goods, in or on property in the state that is not owned by the corporation, and the tangible personal property is delivered to another corporation in the state for manufacturing, fabricating, processing, or printing in the state.

2. The corporation stores, in or on property not owned by the corporation, finished goods that have been fabricated, processed, manufactured, or printed in the state and the entire amount of such goods is shipped or delivered out-of-state by

another corporation in the state.

3. The corporation is an out-of-state publisher that has finished publications printed and stored in this state, in or on property not owned by the publisher, whether or not the finished publications are subsequently sold or delivered in this state or shipped outside of it.

In addition, current law provides that an out-of-state corporation does not have nexus with Wisconsin and is not subject to the state corporate income tax if each of the following conditions are met

1. The out-of-state corporation stores tangible personal property in the state on property not owned by the corporation;

2. The tangible personal property is stored for 90 days or less;

3. The tangible personal property is stored on another person's property in the state and is transferred to the person for manufacturing, processing, fabricating, or printing on the parcel of property in or on which it is stored; and

4. The assessed value of the parcel of property in or on which the tangible personal property is stored and manufactured was between $10 million and $11 million on January 1, 1999.

Federal Restrictions on State Taxation of Corporations

Federal restrictions on state taxing powers are contained in the U.S. Constitution. The states have the power to levy taxes in accordance with their own laws, subject to the restrictions imposed principally by the due process clause of the 14th Amendment and the commerce clause. Under the due process clause, a minimal connection must exist between a corporation's activities and the taxing state and the income attributed to the state for tax purposes must be rationally related to income-generating activities within the taxing state. Under the commerce clause, a state is prohibited from adopting a taxation scheme which discriminates against, or places undue burden on, interstate commerce.

In 1959 the U.S. Congress enacted Public Law 86-272, which provides that a state may not impose its income tax upon a corporation that is organized under the laws of other states and that sells tangible personal property, if the corporation's only activities in the state are:

1. Solicitation, by employees, of orders for tangible personal property which are sent out-of-state for approval or rejection. (The orders must be filled from a delivery point outside the state.)

2. Solicitation of sales by nonemployee independent contractors conducted through their own offices or businesses located in the state.

Public Law 86-272 does not apply to corporations which are organized (incorporated) under the laws of the taxing state or a foreign nation. The law also does not apply to corporations which sell services, real property, or intangible personal property in more than one state.

Procedure for Determining Net Corporate Tax Liability

The first step in computing corporate taxes is to determine gross (or total) income. With certain adjustments, Wisconsin uses the federal definition of income as the base for state corporate tax computation purposes. Once gross income is determined, the corporation then subtracts deductions from the total amount. Deductions are also generally based on federal definitions and include: compensation paid to corporate officers; wages, bonuses, and other remuneration; the cost of repairs and maintenance; bad debts and other losses; rent paid on property used to produce net income; certain taxes; interest paid; depreciation and amortization; advertising; contributions to pensions, profit sharing,

and employee benefit plans; charitable contributions; a domestic production activities deduction; certain dividend income; and certain other expenses. (Certain federal tax provisions have not been adopted for state corporate income tax purposes. In addition, specific state provisions limit the deductibility of rent and interest payments to related entities, if certain conditions are not met. The specific provisions are described in later sections).

When allowable deductions are subtracted from total income, the net income of the corporation has been determined. If the corporation is a multijurisdictional firm, the next step is to subtract total nonapportionable income from net income. Nonapportionable income is income that is allocable directly to a particular state and includes income or loss derived from the sale of nonbusiness real or tangible personal property or from rentals and royalties from nonbusiness real or tangible personal property.

By subtracting total nonapportionable income from net income, the corporation has determined its apportionable income. If the firm is a multijurisdictional firm, it applies its Wisconsin apportionment ratio to apportionable income to arrive at income apportioned to Wisconsin. A single sales factor apportionment formula is generally used to apportion income to Wisconsin. (The income of certain types of corporations such as public utilities, is apportioned using different apportionment formulas). A multijurisdictional firm next adds nonapportionable income that is allocated to Wisconsin. If the firm is a 100% Wisconsin corporation, no apportionment ratio is applied, since 100% of its income is taxable to Wisconsin. Both multijurisdictional and 100% Wisconsin corporations then subtract any business losses carried forward. (Wisconsin law allows business losses to be carried forward for a period of fifteen years.) The result is Wisconsin net taxable income.

The tax rate of 7.9% is applied to Wisconsin net taxable income to determine gross tax. Finally, to arrive at net tax liability, allowable credits are subtracted. For tax year 2008, Corporate income tax credits are provided for qualified capital and noncapital research expenses, early stage seed investments in certain businesses, contributions to the Wisconsin Housing and Economic Development Authority (WHEDA), expenses to rehabilitate historical structures, expenses to modernize or expand dairy and livestock farm operations and dairy manufacturing facilities, manufacturing investments, film production services and capital investments, purchase of ethanol and biodesel fuel pumps, internal equipment used in a broadband market, assessments paid by insurance companies to the Wisconsin Insurance Security Fund and the Health Insurance Risk Sharing Plan (HIRSP), and for certain activities in development, enterprise development, development opportunity, agricultural development, enterprise, airport development, and technology zones. In addition, eligible corporations can claim the farmland preservation and farmland tax relief credits.

Figure I provides an illustration of how, in general, the net tax liability of a multijurisdictional corporation is computed.

Components Used to Determine Corporate Income Tax Liability

In general, state definitions of income and deductions are referenced to federal law. For corporate income tax purposes, state provisions are referenced to the federal Internal Revenue Code (IRC) in effect on December 31, 2006, with certain exceptions. However, state law has not been referenced to a number of federal provisions enacted since 2000.

FIGURE I

Computation of Wisconsin Net Tax Liability for a Multijurisdictional Corporation

1. Determine Total Income

   a. Gross Sales - Cost of Goods Sold = Gross Profit
   b. Gross Profit + Other Income or Loss (Dividends, Interest, etc.) = Total Income

2. Determine Apportionable Income

   a. Total Income - Deductions (Wages, Depreciation, Interest Paid, etc.) = Net Income
   b. Net Income - Total Nonapportionable Income = Total Apportionable Income

3. Determine Wisconsin Net Income

   a. Wisconsin Apportionment Ratio = [Sales by WI Destination ÷ Total Sales]
   b. Total Apportionable Income x Wisconsin Apportionment Ratio = Income Apportioned to Wisconsin
   c. Apportioned Income + Income Allocated to Wisconsin - Wisconsin Net Business Loss = Wisconsin Net Income

4. Determine Wisconsin Net Tax

   a. Wisconsin Net Income x 7.9% = Gross Tax
   b. Gross Tax - Tax Credits (Development Zones, Noncapital and Capital Research Expenditures, etc.) = Wisconsin Net Tax

In addition, federal law changes enacted after December 31, 2006, do not apply for Wisconsin purposes unless they are adopted by the Wisconsin Legislature. However, the Wisconsin corporate income tax is generally calculated using federal provisions to determine income and deductions, and then apportioning the net income of a multistate corporation, applying the tax rate, and allowing for any credits. Under current Wisconsin corporate income tax law, each separate corporation, including a member of an affiliated group of corporations, is taxed as a separate entity. Each individual corporation reports its own income, its own deductions, and its own net tax due.

Total Income

Gross business income is income that is generated by a taxpayer in the active conduct of a trade or business. For tax purposes, each corporation first calculates federal total income which includes gross profit, dividends, interest, rents, royalties, capital gains or losses, and other income.

Gross business income equals the net amount realized from sales (gross receipts less sales returns and allowances) minus the cost of goods sold, plus incidental and other types of business income. Incidental and other miscellaneous types of business income include items such as income from scrap sales, bartering transactions, recovered bad debts, and interest on notes and accounts receivable.

Cost of goods sold is an adjustment made to inventoried items to arrive at gross profit. The adjustment measures the cost of producing inventory or the cost of producing or acquiring property or merchandise for sale or resale. In general, the cost of goods sold is determined by adding related purchases and costs to the value of inventory at the beginning of the year and subtracting the value of inventory at the year's end.

An inventory should include all goods, finished or otherwise, that are either held for sale or intended to be converted to finished goods for sale. The dollar value of inventory is determined by an inventory method that consists of two elements: (a) identification of the goods included in inventory; and (b) assignment of cost or other value to the goods identified as belonging to inventory. Inventory valuation involves using one method, such as first-in first-out, for identifying items in an ending inventory and then using another method, such as cost or market, to assign an overall value to the inventory. The method of taking, recording, and valuing inventory must clearly reflect the taxpayer's income. The value of inventory determined at the end of the year carries over as the value of the beginning inventory for the following year unless there has been a change in the method of taking inventory or other special situations or adjustments.

The most common, acceptable methods for identifying units included in closing inventory consist of the following methods: (a) actual cost or specific identification; (b) byproduct and allocated costs; (c) first-in first-out [FIFO]; (d) last-in first-out [LIFO]; (e) perpetual inventories; (f) process costs; and (g) specific methods applicable to securities dealers and farmers and livestock raisers.

Specific identification of the items in inventory is usually considered the most accurate and acceptable method of determining the business' ending inventory. The LIFO method is also an acceptable method. Under this method, the last goods that have been acquired or produced are treated as the first to be sold. Whenever specific identification is not possible and the LIFO method has not been elected, the taxpayer may use the FIFO method of identifying inventory. Under this method, items in ending inventory are considered to be those that were most recently purchased or produced.

Generally, if property included in inventory consists of property produced by the taxpayer or property acquired for resale, federal uniform capitalization rules must be used to value the

inventory. The uniform capitalization rules require that taxpayers allocate specified direct and indirect costs to inventories. However, taxpayers whose average annual gross receipts for the preceding three tax years do not exceed $10 million are not required to apply uniform capitalization rules to personal property acquired for resale. Such taxpayers use federal rules to value inventory at cost. For these taxpayers, the cost of goods purchased during the year is ordinarily their invoice price less trade or other discounts plus freight, delivery, and other necessary costs of acquiring possession. Also, specific methods of valuation are authorized for certain securities and commodities dealers, farming businesses, and foreign taxpayers.

Under federal uniform capitalization provisions, producers and sellers are required to capitalize all direct costs and certain indirect costs properly allocable to property that is produced, or to property that is acquired for resale. This means that certain expenses that are incurred during the year must be included in the basis of the property that is produced or acquired in inventory costs rather than be claimed as a current deduction. The expenses are recovered through depreciation, amortization, or calculation of cost of goods sold as the property is used, sold, or disposed of in some manner.

Resellers are required to capitalize the direct acquisition costs of property acquired for resale. Cost means the invoice price minus trade and other discounts.

Producers are required to capitalize direct material costs and direct labor costs. Direct material costs include the cost of those materials that become an integral part of the asset plus the cost of materials that are used in the ordinary course of the production of the asset. Direct labor costs include the cost of labor that can be identified or associated with particular units or groups of units of specific property produced. This includes all types of compensation (basic, overtime, sick, vacation) plus payroll taxes and payments to an unemployment benefit plan.

Indirect costs that directly benefit or are incurred by reason of a production or resale activity must be capitalized. Costs that benefit production or resale activities and other operations must be reasonably allocated to each related production or resale activity. Capitalized indirect costs include: officer's compensation; pension and other related expenses; employee benefit expenses; purchasing costs; handling costs; storage costs; rent; taxes; insurance; utilities; repairs and maintenance; and other similar expenses.

Businesses do not have to determine cost of goods sold if the sale of merchandise is not an income-producing factor for their business. In these instances, gross profits are the same as net receipts. Most businesses and professions that sell services rather than products can figure profits in this manner.

Total income also includes income other than that generated from the sales of goods and services. The amount of a distribution representing a dividend is included in total income, subject to dividends received deductions for corporate recipients. A dividend is defined as any distribution made by a corporation out of its earnings or profits to its shareholders, whether in money or in property. Generally, all interest received or credited to the taxpayer is includable in gross income. (For federal income tax purposes, interest on U.S. obligations is defined as income but interest on state and local obligations is excluded. However, interest on state and local obligations is taxable under the Wisconsin franchise tax. Also, with limited exceptions, state and local interest is taxable under the state corporate income tax.) Profit from the sale or exchange of business property and other capital assets is taxable income. Such profits are taxable if they are treated either as ordinary income or capital gains. Rent received from property is income. Royalties are also included in income. Finally, other types of business income such as recoveries of bad debt adjustments due to a change

in accounting, refunds of taxes deducted in prior years, and recapture of certain previously-claimed deductions are included in gross income.

Deductions

Deductions are subtractions made from gross income in arriving at net or taxable income. In part, deductions are based on the proposition that certain components of income are not available for the taxpayer's own free use. For example, taxes are viewed as involuntary reductions in the amount of available income. In addition, deductions can affect taxpayer behavior and are sometimes used as incentives to encourage certain types of activities. Accelerated methods of depreciation are designed, in part, to encourage capital investment. Since the corporate income tax is a tax on business, many of the deductions allowed are, in general, related to the expenses incurred in operating a business. In order to be deductible as a business expense, an expense must be an ordinary and necessary expense of the taxpayer's trade or business paid or incurred during the taxable year in which it is deducted and connected with the trade or business conducted by the taxpayer. The general categories of deductions under the corporate income tax are the following (state modifications to these general categories are described in a succeeding section):

1. Compensation of Officers. Salaries, wages, and other forms of remuneration to officers of the business are deductible expenses. However, a publicly-held corporation cannot deduct compensation (remuneration) in excess of $1 million per tax year that is paid or accrued to certain executives. A publicly-held corporation is any corporation that issues a class of securities required to be registered under the federal Securities Exchange Act of 1934. Generally, this includes a corporation with its securities listed on a national securities exchange, or which has $5 million or more of assets and 500 or more shareholders. The deduction limitation applies to: (a) compensation to the chief executive officer (CEO); (b) compensation to the principle executive officer; and (c) any other employee having total compensation required to be reported to shareholders under SEC rules because the employee is among the three highest compensated officers in the tax year. Compensation subject to the limitation includes cash and noncash benefits paid for services except for certain specified types of remuneration. The $1 million limit on deductible compensation is reduced by the amount of excess golden parachute payments that are not deductible under the provisions of the IRC.

2. Salaries and Wages. A deduction is provided for a reasonable salary allowance or other compensation for services actually rendered by employees. The form of compensation (fixed salary, percentage of gross or net income, commissions, bonuses, contributions to pensions or profit sharing plans) or method of payment is not controlling as to deductibility. To be deductible, the compensation must be: (a) an ordinary and necessary expense; (b) reasonable in amount; (c) based on actual services rendered; and (d) actually paid or incurred. Amounts that are deducted from an employee's salary for payroll taxes (FICA) are treated as part of the employee's wages.

3. Repairs. A deduction is allowed for the cost of incidental repairs and maintenance, such as labor and supplies, that do not add materially to the value of property or appreciably prolong its life but rather keep the property in ordinarily efficient operating condition.

4. Taxes. A tax is defined as an exaction by a government, imposed by some rule of apportionment, according to which the persons or property taxed share a public burden. To qualify for the deduction, the expense must be a tax imposed by a government that is paid into the government treasury for public purposes. Charges for specific services or special purposes (user fees) are often not considered taxes and are not deductible as such. However, these charges might be deductible under another provision--for example, as business expenses.

Under federal law, a deduction is allowed for

the following types of taxes generally for the year in which they are incurred or paid: (a) one-half of the federal self-employment tax; (b) state, local, and foreign real property taxes; (c) state and local personal property taxes; (d) state, local, and foreign income, war profits, and excess profits taxes; and (e) the generation-skipping transfer tax imposed on income distributions. In addition, any state, local, and foreign taxes paid or accrued in carrying on a trade or business or in connection with the production of income (such as sales taxes on production inputs) are deductible. (Sales and fuel taxes are deductible as part of the cost of services, property, or fuel purchased.)

Taxes which are not deductible under federal law include: (a) federal income taxes; (b) foreign income taxes if the foreign tax credit is claimed; (c) taxes not imposed on the corporation; and (d) taxes, including state or local sales taxes, that are paid or incurred with an acquisition or disposition of property. (These taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.)

Under the Wisconsin corporate income and franchise tax, the following taxes, which are deductible under the federal corporate income tax, are not deductible: (a) state and local income and franchise taxes that are value-added taxes, single business taxes, or taxes on or measured by net income, gross income, gross receipts, or capital stock; (b) the federal environmental and windfall profits taxes; and (c) the state recycling surcharge. (Wisconsin gross receipts and ad valorem utility taxes and license fees, and net proceeds taxes on metallic mineral mining taxes are deductible for state corporate income and franchise tax purposes.) Foreign taxes are deductible only if the income on which the foreign taxes are based is taxable under the state corporate income and franchise tax.

5. Interest. A deduction is allowed for interest on indebtedness incurred in the operation of a trade or business. Interest is defined as compensation for the use or forbearance of money. Only interest on actual indebtedness is deductible. There must be both a legal and an economic obligation for the debt.

In most cases, the time when interest is deducted is determined by the taxpayer's method of accounting. Generally, the interest is deductible when it accrues or is paid in accordance with the interest provisions of the loan. However, in certain cases, interest must be accounted for using specific rules. For example, this occurs when the loan agreement (debt instrument) provides an inadequate stated rate of interest or when the debt instrument is issued for an amount that is less than the redemption price at maturity (original issue discount--OID). Interest on debt must be capitalized if the debt is incurred or continued to finance the construction, building, installation, manufacture, development, or improvement of real or tangible personal property that is produced by the taxpayer and that has: (a) a long useful life; (b) an estimated production period exceeding two years; or (c) an estimated production period exceeding one year and a cost exceeding $1 million. Certain other carrying charges relating to futures contract straddles and other property are also capitalized rather than deducted. Interest expense on debts incurred to purchase or carry tax-exempt securities is not deductible. Finally, certain limitations apply to interest deductions when a corporation is a policyholder or beneficiary of a life insurance, endowment, or annuity contract.

Under provisions of 2007 Wisconsin Act 226, deductions claimed for interest and rent payments to related entities must be added back to income under the state corporate income tax, if certain conditions are not met. These provisions are described in a subsequent section.

6. Charitable Contributions. Ordinarily, a corporation can claim a limited deduction for charitable contributions made in cash or property to or, for the benefit of, a qualified organization. However, payments made to a charitable organization that are determined to be business expenses are deducible without regard to the

percentage limits imposed on charitable contributions. To be a business expense, the payments must bear a direct relationship to the taxpayer's business and be made with a reasonable expectation of a financial return commensurable with the amount of the donation. If the payments made by the business are in fact charitable contributions (made with a charitable intent) they may not be deducted as business expenses. Instead, they are subject to percentage limitations. The total amount of the deduction claimed may not be more than 10% of taxable income. Charitable contributions in excess of the 10% limitation may not be deducted for the tax year, but may be carried over and used to offset income for the next five years, subject to the 10% limit. Special rules govern contributions of certain property to charitable organizations.

7. Depreciation. The deduction for depreciation allows taxpayers to recover, over a period of years, the cost of capital assets used in a trade or business or for the production of income. The deduction is an allowance for the wear and tear, deterioration, or obsolescence of the property. Depreciable property may be either tangible or intangible, and either real or personal property. Land is not depreciable. To be depreciable, the property must have a determinable life of more than one year, and it must decline in value through use or the passage of time. Only property used in a trade or business or held for the production of income is eligible for a depreciation deduction. Depreciation may not be claimed on assets used in connection with a not-for-profit activity. No deduction is allowed for property used for personal purposes.

For tangible assets, depreciation applies to only that part of the property that is subject to wear and tear, to decay or decline from natural causes, or to exhaustion and obsolescence. The property must also be of a relatively permanent nature with a determinable useful life of over one year.

Intangible assets may be depreciated or amortized if it is known from experience or other factors that the assets will be of use in the business or in the production of income for only a limited period of time and if that time period can be estimated with reasonable accuracy. Certain patents, copyrights, and franchise agreements are examples of depreciable intangibles. Intangible assets cannot be depreciated under an accelerated method but, rather, must be depreciated using a reasonable method, usually the straight-line method. However, under provisions enacted in the federal Revenue Reconciliation Act of 1993, the cost of many intangibles can be amortized over 15 years.

In order to claim depreciation on any property, the taxpayer must have a capital interest in it. Generally, the owner of the depreciable property may claim the deduction. However, the right to deduct depreciation is not predicated solely upon ownership of the legal title, but also upon investment in the property.

The amount to be recovered by depreciation is the cost or other appropriate basis of the property. The life over which the depreciable basis of property is recovered depends upon the type of asset that is depreciated and the system of depreciation that is used.

The Modified Accelerated Cost Recovery System (MACRS) rules of depreciation apply to most tangible property placed in service after 1986. Generally, the Accelerated Cost Recovery System (ACRS) of depreciation applies to property placed in service after 1980 and before 1987.

Property, other than MACRS and ACRS property, must be depreciated using general depreciation rules. Under the general rules, the basis to be recovered through depreciation must be charged off over the life of the property using recognized methods of depreciation. MACRS and ACRS property is recovered using statutory percentages that are annually applied to the depreciable basis of the property over a specified recovery period.

Under the general depreciation rules, three particular methods of depreciation are generally authorized:

a *The straight-line method.* The straight-line method involves writing off the cost or other applicable basis of the property in equal annual amounts over the established life of the property.

b *The declining-balance method.* Under declining-balance methods, depreciation is greatest in the first year and smaller in each succeeding year. Each year, the depreciable basis of the property is reduced by a certain amount and the associated rate of depreciation is applied to the resulting balance in each of the remaining years of the property's life. For example, under the 200% or double declining-balance method, assets are depreciated at twice the straight-line rate. Generally, the taxpayer is allowed to switch to the straight-line method when it becomes advantageous.

(c) *Sum-of-the-years-digits method.* To use this method, the taxpayer must first compute the sum of each of the digits comprising the asset's life. For example, for an asset with a depreciable life of four years, the numbers 4, 3, 2, and 1 are summed to a total of 10. In the first year, 4/10ths of the depreciable basis is written off. In succeeding years, 3/10ths, 2/10ths, and 1/10th of the depreciable basis respectively is written off until the entire basis of the asset, minus salvage value, is recovered.

An asset cannot be depreciated below salvage value under a method of depreciation other than ACRS or MACRS. Once this amount has been reached, no more depreciation may be claimed.

Since its inclusion in the federal tax code in 1913, the depreciation deduction has been periodically revised both by Congress and the Internal Revenue Service (IRS). As a result of these changes, until recent years, taxpayers often used one or more of the different systems to depreciate assets for federal tax purposes: (a) the general depreciation system based on salvage value; (b) the Class Life Asset Depreciation Range (ADR) system; (c) the Accelerated Cost Recovery System; and (d) the Modified Accelerated Cost Recovery System. The first two systems generally apply to property placed in service before 1981. As noted, ACRS primarily applies to assets placed in service after 1980 and before 1987. MACRS applies to property placed in service since January 1, 1987.

More recently, the federal Job Creation and Worker Assistance Act of 2002, which was enacted in March, 2002, included provisions that provided taxpayers with an additional first-year depreciation deduction equal to 30% of the adjusted basis of certain property that was acquired after September 10, 2001. The federal Jobs and Growth Tax Relief Reconciliation Act of 2003, enacted in May, 2003, increased the bonus depreciation rate to 50% for property that was acquired after May 5, 2003. The 30% rate generally applied to property acquired after September 10, 2001, and before May 6, 2003, and placed in service before January 1, 2005. The 50% rate generally applied to property acquired after May 5, 2003, and placed in service before January 1, 2005. A taxpayer could elect to continue to claim the 30% rate for property acquired after May 5, 2003, or not claim the allowance for eligible property.

The additional first year depreciation allowance (bonus depreciation) could be claimed for: (a) new MACRS property for which the recovery period is 20 years or less (includes most property, except real property); (b) MACRS water utility property; (c) certain depreciable computer software; and (d) qualified leasehold improvement property. Property that must be depreciated under the MACRS alternative depreciation system (ADS) did not qualify. The special depreciation allowance is generally equal to 30% or 50% of the adjusted basis of the property. The adjusted basis of property is generally its cost or other basis multiplied by the percentage of business/investment use, reduced by the amount of any IRC code Section 179 expense allowance, and adjusted for other code or regulation provisions. After reducing the adjusted basis of the property by the bonus depreciation amount

and other required adjustments, the remaining depreciable basis of the property is used to figure the regular MACRS deductions over the life of the property.

The federal Economic Stimulus Act of 2008 provides an additional first-year depreciation deduction equal to 50% of the adjusted basis of qualified property. The property must be purchased or acquired pursuant to a binding written contract after December 31, 2007, and before January 1, 2009, and placed in service during the same time period. The basis of the property and the depreciation allowances in the year the property is placed in service and in later years are adjusted to reflect the additional first year depreciation reduction. The same operative rules, such as the definitions of qualifying property, that applied to expired bonus depreciation provisions from 2002 and 2003, also apply under the Stimulus Act.

Generally, changes in federal tax law concerning depreciation were effective for Wisconsin corporate income taxpayers. However, following enactment of the ACRS system by the federal government in 1981, the Legislature adopted a series of state limitations on federal depreciation provisions that applied for state corporate income tax purposes. These limits were repealed as a part of the federalization provisions included in 1997 Wisconsin Act 27. As a result of Act 27, state tax provisions related to amortization and depreciation were again automatically referenced to the federal IRC. This provision applied to the state corporate income tax until the bonus depreciation provisions were enacted as part of the federal Job Creation and Worker Assistance Act of 2002. The Legislature then included provisions in 2001 Wisconsin Act 109 that referenced state amortization and depreciation provisions specifically to the federal IRC in effect on December 31, 2000. Consequently, the federal bonus depreciation provisions that were enacted by Congress in 2002, 2003, and 2008 were not adopted for state corporate income and franchise tax purposes, and the Legislature must take action to reference state amortization and depreciation provisions to federal provisions that take effect after December 31, 2000.

However, 2005 Wisconsin Act 362 created an exception to the required legislative update for certain depreciable property used in farming. For property acquired and placed in service in tax years beginning on or after January 1, 2006, a corporation that is "actively engaged in farming," as defined in the federal code, may compute amortization and depreciation on property used in farming under any changes enacted after December 31, 2005 to the federal IRC 30% and 50% bonus depreciation laws. To apply for state income tax purposes the changes must be amendments to the specific laws and not be new laws that modify the IRC. The federal laws referenced in the statutes include: (a) the Job Creation and Workers Assistant Act of 2002 (PL 107-147); or (b) the Jobs Growth Tax Relief Reconciliation Act of 2003 (PL 108-27).

Because state depreciation provisions are fully referenced to the Internal Revenue Code in effect on December 31, 2000, tangible depreciable property currently placed in service is generally subject to MACRS. MACRS consists of two systems that determine how a taxpayer depreciates property. The most commonly used system is called the General Depreciation System (GDS). There is also an Alternative Depreciation System (ADS), which must be used for certain types of property, such as property used predominately outside the U.S. In addition, taxpayers can elect to use ADS. The main difference between the two systems is that ADS usually provides for a longer period of depreciation and uses only the straight-line method. Although most property placed in service after 1986 is depreciated under MACRS, some types of property are excluded from MACRS treatment, including certain public utility property, intangible assets, and motion picture films, video tapes, and sound recordings.

Under MACRS, the cost of property is recovered by using accelerated methods of cost recovery and statutory recovery periods and conventions. The deduction is computed by first determining the MACRS basis of the property.

Each item of eligible property is then assigned to a specific class and each class establishes a recovery period over which the cost of the property is recouped using the applicable depreciation method and convention. Depreciation tables may be used by multiplying the basis of the assets by the applicable percentage for the applicable year of the recovery period. Alternatively, the deduction can be calculated using the appropriate method, recovery period, and convention. Deductions can be claimed for used property, and the cost recovery methods and periods are the same as those used to depreciate new property.

Specifically, the cost of eligible property is recovered over a 3-, 5-, 7-, 10-, 15-, 20-, 27.5-, 31.5, 39-, or 50-year period depending upon the type of property involved. Depreciation methods are prescribed for each MACRS class. Generally, personal property is assigned to the three-year class, the five-year class, the seven-year class, or the 10-year class. Real property is assigned to the remaining classes based on the type of property involved. Property included in the three-year, five-year, seven-year, and ten-year classes is depreciated using the double declining balance method, switching to the straight-line method at a time which maximizes the depreciation allowance. (Agricultural property used in farming and placed in service after 1988 must be depreciated using the 150% declining balance method.) Property included in the 15-year and 20-year classes is depreciated using the 150% declining balance method, again switching to the straight-line method at a time which maximizes the depreciation allowance. Fifteen-year property includes certain land improvements, municipal waste treatment plants, and certain types of telecommunications plant and equipment. Twenty-year property includes certain multipurpose farm buildings. Residential rental property is depreciated over 27.5 years, while nonresidential real property not included in other classes is depreciated over 31.5 years (39 years when placed in service after 1993) using the straight-line method. Certain railroad property is depreciated using the straight-line method over 50 years.

8. Amortization. Amortization provisions allow a taxpayer to annually deduct a portion of certain capital expenses that are not ordinarily deductible. Generally, these expenses are not otherwise deductible because: (a) they relate to assets that are not depreciable because the assets have unlimited or indefinite life; or (b) they pertain to organizational or investigative expenses that were incurred before the taxpayer went into business. The deduction for amortization is similar to the straight-line method of depreciation in that a taxpayer is allowed to recover the capital costs through an annual deduction over a fixed period of time. Generally, the capital expenses which are amortized are deducted in equal monthly amounts over the amortization period. The amortization period depends upon the type of asset that is acquired. Expenses which may be amortized include: certain computer software; the cost of pollution control facilities; certain bond premiums; research and experimental expenditures; the cost of acquiring a lease; qualified forestation and reforestation costs; business start-up expenditures; and certain organizational expenditures.

In addition, the capitalized costs of "amortizable section 197 intangibles" can be amortized over 15 years. Generally, section 197 intangibles are eligible for the amortization deduction if acquired after August, 1993, and held in connection with a trade or business or in an activity engaged in for the production of income. The following assets are section 197 intangibles: goodwill; going concern value; workforce in place; business information base; patents, copyrights, formulas, and similar items; customer-based intangibles; supplier-based intangibles; licenses, permits, and other government granted rights; covenants not to compete; and franchises, trademarks, and trade names.

9. Election to Expense Depreciable Assets. Under Section 179 of the IRC, a taxpayer may elect to treat all or a portion of the cost of qualifying property, up to a limit, as an expense rather than as a capital expenditure. Such an expense or cost is deductible in the year in which the property is placed in service. The amount claimed as a

deduction is referred to as a Section 179 expense allowance. Qualifying property is generally:

a. Tangible personal property.

b. Other tangible property (except buildings and their structural components) used as: (1) an integral part of manufacturing, production, or extraction, or of furnishing transportation, communications, electricity, gas, water, or sewage disposal services; (2) a research facility used in connection with any of these activities; or (3) a facility used in connection with such activities for the bulk storage of tangible commodities.

c. Single purpose agricultural property (livestock or horticultural structures).

d. Storage facilities (except buildings and their structural components) used in connection with distributing petroleum or any primary product of petroleum.

e. Off-the-shelf computer software (this type of property is not eligible for Section 179 treatment under Wisconsin law).

Under federal law, the Section 179 deduction is the cost of qualifying property up to a maximum limit, and the deductible amount is reduced by the amount by which the total cost of the Section 179 property placed in service in a year exceeds a specified phase-out amount. Current federal Section 179 provisions were enacted in the Economic Stimulus Act of 2008. Under federal law, for property placed in service in 2008, the maximum amount a taxpayer may expense is $250,000. For property placed in service in tax years 2009 and 2010, the maximum amount that may be expensed is $125,000, and is annually adjusted for inflation. Beginning with property placed in service in 2011, the expense limit is $25,000, and will not be adjusted for inflation.

The dollar limitation on the amount of deduction is reduced on a dollar-for-dollar basis for the cost of qualifying property placed in service during the tax year over an investment limit. For tax year 2008, the investment limit is $800,000. The investment limit for property placed in service in 2009 and 2010 is $500,000, and is annually adjusted for inflation. Beginning with property placed in service in 2011, the investment limit is $200,000, and will not be adjusted for inflation. Federal law also places limits on the amounts that can be deducted for certain types of investments such as automobiles. In addition, the American Jobs Creation Act of 2004 limited to $25,000 the amount that could be expensed for vehicles weighing between 6,000 and 14,000 pounds ("SUV exclusion").

Federal section 179 provisions enacted since 2003 have not have adopted for state income and franchise tax purposes for non-farm property. Rather, state taxpayers are generally subject to Section 179 IRC provisions that were in effect for tax years through 2002. As a result, under current Wisconsin law, a taxpayer may elect to deduct up to $25,000 of the cost of qualifying property (except for property used in farming) in the year it is placed in service rather than taking depreciation deductions over a specified recovery period. In general, qualifying property is depreciable tangible personal property that is purchased for the active conduct of a trade or business. The maximum deductible amount of $25,000 is reduced (but not below zero) by the amount by which the qualifying property placed in service during the taxable year exceeds $200,000. In addition, the amount eligible to be expended for a taxable year may not exceed the taxable income of the taxpayer that is derived from the active conduct of a trade or a business for that year. Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding years and deducted, subject to the total investment and taxable income limits. The $25,000 expense limits also apply to vehicles weighing between 6,000 and 14,000 pounds.

Current state law is referenced to the Section 179 provisions included in the federal Tax Increase Prevention and Reconciliation Act of 2005, for property that is used in farming that is acquired

and placed in service in tax years beginning on or after January 1, 2008, and used by a person who is actively engaged in farming. Under the Act, the maximum amount that could be expensed was $100,000, and the investment limit was $400,000. Both the maximum expense deduction and investment limit were indexed for inflation. Consequently, for state income and franchise tax purposes, for the 2008 state tax year, the maximum amount that can be expensed is $115,000, and the investment limit is $460,000, for eligible property used in farming.

The terms "farming" and "actively engaged in farming" are referenced to federal law. "Farming" means the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. Trees, other than trees bearing fruit or nuts, are not treated as an agricultural or horticultural commodity.

"Actively engaged in farming" means that the individual or entity independently makes a significant contribution to a farming operation of: (a) capital, equipment, or land, or a combination of capital, equipment, or land; and (b) active personal labor or active personal management, or a combination of active personal labor and active personal management. In determining if the individual or entity is actively contributing a significant amount of active personal labor or active personal management, the following factors must be considered: (a) the types of crops and livestock produced by the farming operation; (b) the normal and customary farming practices of the area; and (c) the total amount of management and labor necessary for such a farming operation in the area. In order to be actively engaged in farming, the individual or entity must have: (a) a share of the profits or losses from the farming operation; and (b) contributions to the farming operation that are at risk.

10. Bad Debts. Only bonafide debts qualify for the deduction. A bonafide debt is debt that arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money. A debt is considered bad when it is worthless. A debt is worthless when the creditor who has made a reasonable effort to collect the debt no longer has a chance to be repaid. Bad debts are characterized as business or nonbusiness debts, with each type of debt having its own rules for deductibility.

A bad debt is deductible as a business bad debt if the creation of the debt was proximately related to the taxpayer's trade or business. In addition, the dominant motive for the creation of the debt must be to benefit the taxpayer's trade or business. The bad debts of a corporation are considered business bad debts. To deduct a bad debt, the taxpayer must have previously included the amount in income, or loaned out cash. Generally, business bad debts are deducted using the specific charge-off method of computing the deduction. Under this method, the debt is deducted as it becomes wholly or partially worthless. The amount deductible for a bad debt loss is the taxpayer's basis in the bad debt. Normally, the taxpayer's basis in the bad debt is the amount of loan outstanding at the time it becomes worthless. However, there are variations related to accounts receivable, foreclosures, repossessions of collateral, secondary liability on home mortgages, and a creditor's anticipated income from the loan. Certain taxpayers may use the nonaccrual-experience method of accounting where the taxpayer does not accrue income expected to be uncollectible. In addition, small banks and thrift institutions can use the reserve method of deducting bad debts.

Nonbusiness debt is a debt other than: (a) a debt created or acquired in connection with the taxpayer's trade or business; or (b) a loss from the worthlessness of a debt that is incurred in the taxpayer's trade or business. Transactions not entered into for profit are treated as nonbusiness debts. If a nonbusiness debt becomes worthless, it is deductible only as a short-term capital loss, and only in the year the debt becomes totally worthless.

11. Rent. Rent expenses are deductible as business expenses if they are incurred as a condition to the continued use or possession of property used in a trade or business, and the taxpayer has not taken or is not taking title or has no equity in the property. The amount of rent claimed can be a fixed sum, or can be based upon a percentage of profits, a percentage of gross sales or a combination of these. A deduction is allowed where the amount of rent is fixed in an arm's-length transaction without a tax-avoidance motive. In general, rental expenses are deductible in the year they are accrued or paid. However, in certain cases, such as where advance payments are made by a cash-basis taxpayer, special rules for determining the deduction apply. (Royalties are deductible as business expenses under rules that are similar to those governing the deductibility of rent paid for business or income-producing purposes.) As noted, under provisions of 2007 Wisconsin Act 226, interest and rent payments to related entities must be added back to income under the state income tax, if certain conditions are not met. These provisions are described in a subsequent section.

12. Depletion. A deduction for depletion is allowed in determining the income derived from the sale of natural resources; it returns to the owner or operator (extractor) the capital investment on a pro rata basis over the productive life of such resources. Depletion is the exhaustion of natural resources by the process of mining, quarrying, drilling, and felling. The depletion deduction, in effect, represents the reduction in the content of the reserves from which the resource is taken. The taxpayer must have an economic interest (capital investment) in the mineral deposit or timber in order to claim the deduction.

Methods for computing depletion are cost depletion or percentage depletion. Although a taxpayer must generally use the depletion method that produces the greatest deduction each year, the allowance for percentage depletion has historically been preferred over cost depletion, since percentage depletion may be claimed even though the total deductions exceed the cost basis of the resource. However, unless the taxpayer is an independent producer or royalty owner, percentage depletion generally cannot be used for oil and gas wells.

Under the Wisconsin corporate income tax, taxpayers are not allowed to claim the depletion deduction using the percentage depletion method. Therefore, for state tax purposes, depletion is only deductible using the cost method of computing the deduction.

To figure cost depletion, the taxpayer must determine the following: (a) the property's basis for depletion; (b) the total recoverable units, such as tons or barrels in the property's natural deposit; and (c) the number of the units sold during the tax year. That part of the basis in the property that is allocable to the depletable reserves is then divided by the number of total recoverable units. The quotient is the cost depletion per unit. This amount multiplied by the number of extracted units sold during the year determines the cost depletion deduction for the year. Each year the basis of the property is reduced by the amount of depletion deducted for that year. The remaining basis is used in computing cost depreciation for the following year.

13. Retirement Plans. Employer contributions to employee retirement plans can be deducted as a current business expense if certain plan-related conditions are met. Retirement plans are savings plans through which employers can set aside money for their employees' retirement.

The most common types of retirement plans include qualified plans, simplified employee pensions (SEP), 401(k) plans, savings incentive match plans for employees (SIMPLE), individual retirement arrangements (IRAs), and nonqualified plans. (Employers with 100 employees or less may qualify for a federal tax credit for some of the costs of establishing new retirement plans. This credit is not provided under the state corporate income tax.)

Qualified Plans. The term qualified plan en-

compasses a wide variety of retirement plans that employers may establish for the benefit of their employees. A plan is qualified if it meets specific requirements concerning its formation, operation, and funding. Although all qualified plans must meet certain minimum standards, each type of plan may be required to satisfy its own unique set of requirements before the IRS recognizes it as qualified. Qualified plans provide the following tax benefits:

a. A tax-free accumulation of earnings and gains on a plan's invested funds;

b. A deduction for allowable employer contributions made under the plan;

c. An exemption from current taxation for employees on the value of employer contributions.

d. Favorable tax treatment of fund distributions; and

e. Taxation of distributions can be further deferred if employees roll the distribution over into another type of qualified plan.

There are two basic types of qualified retirement plans that can be sponsored by an employer:

a. *Defined Contribution Plans.* Defined contribution plans provide for a separate account for each participant, and benefits are based solely on amounts contributed to or allocated to and accumulated in each account.

b. *Defined Benefit Plans.* Defined benefit plans include any plans that are not defined contribution plans. The goal of the defined benefit plan is to provide a definitely determinable amount of benefits to an employee. Contributions to the plan are based on actuarial assumptions.

As noted, employers may claim a business deduction for contributions to qualified plans. Limits are placed on the amounts that may be contributed and deducted by an employer. The rules differ for defined benefit plans and defined contribution plans. Generally, employer contributions under a qualified plan are deductible if they qualify as ordinary and necessary business expenses, are reasonable in amount, and meet the specific limitations. Deductions cannot be claimed in excess of the total contributions permitted under the IRC.

The two principal variations of defined benefit plans are the pension plan and the annuity plan. A pension plan provides for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. The determination of the benefits to be paid and the contributions that must be made in order to pay the benefits cannot be dependent on the employer's profits.

Under federal law that governs qualified benefit plans, an annuity plan is a pension plan that is not funded through the use of a trust or a custodial account but through the employer's direct purchase of annuity contracts from an insurance company.

The federal Pension Protection Act of 2006 increased the limits on total deductible contributions to defined benefit plans. For tax years beginning in 2006 and 2007, the maximum deductible amount of contributions to a single-employer defined benefit plan is not less than the excess (if any) of: (a) 150% of the plan's current liability over, (b) the value of plan assets. For taxable years beginning after 2007, the maximum deductible amount of contributions to a single-employer defined benefit plan is equal to the greater of: (a) the excess (if any) of the sum of the plan's funding target, the plan's target normal cost, and a cushion amount for a plan year, over the value of plan assets; and (b) the minimum required contribution for the year. For multi-employer defined benefit plans, the maximum deductible amount of contributions for years after 2005 is not less than the excess of 140% of the plan's current liability over the value of the plan assets. Additional special rules apply where an employer

maintains both a defined benefit plan and a defined contribution plan for the same group of employees.

In addition, federal law places limits on the benefits that defined benefit plans may provide. The maximum dollar limit on employer-derived annual benefits for an employee under a defined benefit plan is the lesser of: (a) an inflation-adjusted dollar amount ($185,000 for 2008); or (b) 100% of the employee's average compensation for the highest three consecutive years during which the employee received the most compensation from the employer (not to exceed $230,000 for 2008) and was an active participant in the plan. In some cases, such as certain collectively bargained plans, these limits may be waived. For plan years beginning after 2001, the maximum deduction for contributions can equal the plan's unfunded current liability.

Defined benefit plans are subject to minimum funding requirements. For plan years beginning after December 31, 2007, the minimum required contribution to a single-employer defined benefit pension plan for a plan year generally depends on a comparison of the value of the plan's assets with the plan's funding target and target normal cost. Specifically, the minimum required contribution for a plan year, based on the value of plan assets compared to the funding target is as follows:

a. If the value of plan assets (reduced by any prefunding balance and funding standard carry-over balance) is less than the funding target, the minimum required contribution is the sum of: (1) target normal cost; (2) any shortfall amortization charge; and (3) any waiver amortization charge.

b. If the value of the plan assets (reduced by any prefunding balance and funding standard carryover balance) equals or exceeds the funding target, the minimum required contribution is the normal target cost reduced (but not below zero) by the excess of: (1) the value of plan assets (reduced by any prefunding balance and funding standard carryover balance); or (2) the funding target.

A plan's "funding target" is the present value of all benefits accrued or earned as of the beginning of the plan year. A plan's "target normal cost" for a plan year is the present value of benefits expected to accrue or be earned during the plan year. A "shortfall amortization charge" is generally the sum of the amounts required to amortize any shortfall amortization bases for the plan year and the six preceding plan years. A "shortfall amortization base" is generally required to be established for a plan year, if the plan has a funding shortfall for a plan year. In general, a plan has a funding shortfall if the plan's funding target for the year exceeds the value of the plan's assets (reduced by any prefunding balance and funding carryover balance). A "waiver amortization charge" is the amount required to amortize a waived funding deficiency. The charge is an increase to the minimum required contribution to offset a funding deficiency resulting from a prior year waiver in required contributions authorized by the Secretary of the Treasury.

Some of the major variations of defined contribution plans include profit-sharing, money purchase, stock bonus, and target benefit plans:

a. *Profit-Sharing Plan*. A profit-sharing plan is established and maintained by the employer to provide for employees and their beneficiaries to share in the profits of the business. The plan must provide a definite, predetermined formula for allocating contributions among the participants and for distributing accumulated funds.

b. *Money Purchase Plan*. A money purchase plan is designed to provide employees or their beneficiaries with benefits that will be paid upon retirement or for a period of years after retirement. Contributions to a money purchase plan are based on a predetermined formula, and not on business profits.

c. *Stock Bonus Plan*. A stock bonus plan provides benefits similar to those of a profit-sharing plan; however, benefits under the plan are payable in the form of the company's stock.

d. *Target Benefit Plan*. A target benefit plan is a defined contribution plan under which the amount of employer contributions that are allocated to each participating employee is determined under a formula that does not allow employer discretion, but is based on the amount necessary to provide a target benefit that is specified by the plan for each participant.

Generally, the annual amount that can be added to the account of a participant in a defined contribution plan is restricted to the lesser of: (a) $46,000 (for 2008), subject to cost-of-living increases; or (b) 100% of the employee's compensation up to a maximum of $230,000 (for 2008), subject to cost-of-living increases. These limits apply to the aggregate of employer contributions, employee contributions, and forfeitures. The maximum deduction for contributions to a defined contribution plan is 25% of the compensation paid or accrued during the year to all employees participating in the plan.

Elective Deferrals -- 401(k) Plans. A 401(k) plan is a form of qualified retirement plan, also called a cash or deferred arrangement (CODA), that is a special arrangement under which a participant can choose to have the employer contribute part of the employee's before-tax compensation to the plan rather than receive the compensation in cash. The contribution is called an elective deferral because participants choose to set aside the compensation and defer the tax on it until it is distributed to them. A 401(k) plan must satisfy the requirements imposed on other types of qualified plans. In addition, requirements related to employee elections, distributions, and vesting must be met. A 401(k) plan may be maintained as part of a profit-sharing or stock bonus plan and be a money purchase plan established before the date of the federal Employee Retirement Income Security Act (ERISA) (1974).

An annual limit is placed on the aggregate amount of money deferred to a plan by an employee. For 2008 and 2009, the maximum amount that can be deferred is $15,500 and $16,500 respectively. The amount is subject to an inflation adjustment. In addition, employees age 50 or over may make catch-up contributions to their 401(k) plans. The maximum catch-up contribution is $5,000 in 2008 and $5,500 in 2009. After 2009, the maximum amount is subject to an inflation adjustment. Employers are not required to include catch-up provisions in their 401(k) plans.

As with other types of qualified retirement plans, employers can claim a current deduction for their allowable contributions to 401(k) retirement plans. Employers can: (a) contribute a percentage of each employee's compensation to the employee account (nonelective contribution); (b) match the employee contribution; or (c) do both. The deduction is subject to the limit imposed for contributions to qualified defined contribution plans, which is 25% of the annual compensation paid or accrued to employees participating in the plan.

Savings Incentive Match Plan for Employees. A savings incentive match plan for employees (SIMPLE) is a written arrangement that provides employers and employees with a simplified way to make contributions to provide retirement income. SIMPLE plans are designed to encourage small employers to establish retirement plans for their employees. Simple plans may take the form of a traditional IRA with higher contribution limits, or a type of 401(k) plan. The incentives for an employer to establish a SIMPLE plan are exclusion from the requirements applicable to qualified plans and from the requirements of ERISA, and lower administrative costs. Rather, a SIMPLE plan substitutes a few rules for all the requirements generally applicable to retirement plans under ERISA and the IRC.

An employer can establish a SIMPLE plan only if it has no other retirement plan, and had 100 or fewer employees who received $5,000 or more in compensation in the preceding year. A SIMPLE account must include an arrangement under which each eligible employee may elect to have the employer make payments either: (a) directly to the

employee in cash; or (b) as a contribution on behalf of the employee to the SIMPLE account (salary reduction arrangement). Contributions are generally a percentage of compensation, but can be a specific dollar amount subject to annual limits, subject to an annual inflation adjustment. Employee contributions to SIMPLE plans are limited to $10,500 for 2008, and $11,500 for 2009. A SIMPLE plan can permit participants who are age 50 or older to make catch-up contributions. The maximum catch-up contribution is $2,500 for 2008 and 2009.

Generally, the employer is required to match the elective contribution of an employee, and may elect to match up to 3% of the employee's compensation. An employer can meet the matching requirement if it chooses to make nonelective contributions of 2% of compensation for each eligible employee. For SIMPLE IRA's, an employer, upon notification of the employees, can elect to contribute a smaller percentage for all employees but not less than 1%, of compensation. The compensation taken into account in determining salary reduction contributions, matching contributions, and nonelective contributions cannot exceed $230,000 in 2008, for SIMPLE IRA's and 401(k) plans.

The employer may claim a deduction for its contributions to a SIMPLE, including elective contributions made under a salary reduction arrangement. Matching contributions, and nonelective contributions made in lieu of matching ones are also deductible.

Simplified Employee Pensions. A simplified employee pension (SEP) is an arrangement where an employer may make contributions to the IRA of eligible employees (including a self-employed person). The IRA may be established by the employee or the employer, but is controlled by the employee. However, a SEP is funded solely by employer contributions and the employer makes contributions to the financial institution where the SEP-IRA is maintained.

Under a SEP, an employer can make deductible contributions to a traditional retirement arrangement (called a SEP-IRA) established for each eligible employee. Each year the employer must contribute to the IRA of each employee who: (a) is age 21 or older; (b) has performed services for the employer during at least three of the immediately preceding five calendar years; and (c) has received at least $500 ($550 in 2009) in compensation for the year. Annually, an employer may contribute to and deduct for each participating employee's SEP the lesser of the amount of contributions made to participating employees or 25% of compensation paid to participants, up to $46,000 in 2008 ($49,000 in 2009) per participant. The maximum amount of compensation that may be taken into account for purposes of this computation is $230,000 in 2008. Employees may make independent contributions and claim a deduction subject to the limitations imposed by the rules that apply to traditional IRAs.

Nonqualified Retirement Plans. A nonqualified retirement plan is a retirement plan or other type of deferred compensation plan that does not meet the requirements imposed on qualified plans by the Internal Revenue Code. By establishing a nonqualified plan, an employer loses many tax advantages associated with qualified plans. However, the employer gains some advantages by offering a plan that need not follow the requirements associated with qualified plans. Chief among these advantages is the fact that participation in the nonqualified plan can be offered to a few, select employees. As a general rule, nonqualified plans are offered as a means of attracting and retaining the services of key employees. Frequently, the nonqualified plan serves as an adjunct to a qualified plan.

Establishment of a nonqualified deferred compensation arrangement consists of two main steps: (a) entering into a contractual arrangement between the employer and employee; and (b) the employer adopting a nonqualified plan.

The usual practice is for the employer and employee to formalize the fact that the employee is covered by a nonqualified plan by entering into a

written contractual arrangement. The contract provides such plan details as whether the plan will be funded or unfunded, when distributions may be made, what the employee's rights to plan assets are, and the employer's and employee's obligations under the plan. While some nonqualified plans are based upon nothing more than a handshake, a written arrangement is preferred because it protects the interests of both employer and employee.

Many types of nonqualified plans may assist the employer in the development of a comprehensive, or alternate compensation package. Among the nonqualified plans that an employer may offer are:

a. *Excess Benefit Plan*. These plans provide the employee with benefits that are in excess of those allowed under qualified arrangements.

b. *Deferred Bonus Plan*. This type of plan usually provides for a bonus for a particular year to be paid out over a number of annual installments. Payments may also be deferred until after retirement, when presumably the individual will be in a lower tax bracket.

c. *Vested Trusts*. Vested trusts are a type of unfunded deferred compensation trust in which the employee has no right to funds until the occurrence of a specified event (for example, termination, retirement, takeover). It is the occurrence of this event that "vests" the employee.

d. *Rabbi Trusts*. Under this arrangement, the employer contributes to a irrevocable trust for the benefit of the covered employee. If properly structured, the employee will not be currently taxed on the contributions. For example, fund assets must be subject to the claims of the employer's creditors.

A nonqualified plan may either be funded or unfunded. If the plan is funded, the employer makes current contributions to the plan. If the plan is unfunded, the arrangement between employer and employee involves only the unsecured promise of the employer to pay an amount at some future time.

Contributions made to nonqualified retirement plans are deductible under different rules than qualified retirement plans. In general, to be deductible, contributions to nonqualified plans must be ordinary and necessary expenses of a business or other activity engaged in for the production of income. However, the method of claiming the deduction depends upon whether the nonqualified plan is funded or unfunded.

Generally, a funded nonqualified plan is one under which the deferred compensation is irrevocably contributed by the employer to a separate fund. When a plan is funded, the employer is allowed to claim a deduction for a contribution to the plan in the year in which an employee's interest in the plan is includible in gross income. The amount of the deduction that may be claimed by the employer is the amount of the original contribution. Any investment gain occurring between the time of contribution to the plan and the vesting in the employee accrues to the employee. The employer is not entitled to a deduction for investment gain vesting in or distributed to the employee.

Ordinarily, an employer's contribution to a nonqualified deferred compensation plan is includible in the employee's gross income and, therefore, is deductible by the employer when the employee's interest in the plan becomes substantially vested. A contribution is substantially vested when it is free from a substantial risk of forfeiture, or is transferable to any transferee without substantial risk of forfeiture.

The deduction is allowed when the employee's interest is vested, which may occur before actual distribution. Deduction before distribution is not allowable under a multiple-participant plan, however, unless the plan maintains a separate account for each participant. Similar rules apply when a nonqualified plan is funded by annuity contracts. In cases where the interests of the

covered employees in a nonqualified plan change from nonvested to vested during the life of the plan, the deductibility of employer contributions also reflect such changes.

Under an unfunded nonqualified plan, the covered employees often have only an unsecured promise of the employer to pay them the deferred compensation. The employer may simply keep track of the benefit in a bookkeeping account or may voluntarily choose to invest in annuities, securities, or insurance arrangements to fulfill the promise to pay the employee. Even if the deferred compensation is in fact set aside and invested, the plan is still treated as unfunded if the employees have no legal right to, or interest in, the resulting fund.

If a plan is not funded, the employer is allowed a deduction only when the deferred compensation is actually paid or made available to the employee. This is so whether the employer uses a cash or an accrual method of accounting. The full amount of the deferred compensation is deductible, subject to the requirement of reasonableness.

In some unfunded plans, the employer may credit employees with "interest" on deferred compensation. Such interest is not deductible until includible in the employee's income.

14. Employee Benefit Programs. In general, a deduction is allowed for contributions to employee benefit plans not claimed as a deduction elsewhere on the tax return and that are ordinary and necessary business expenses and are not an incidental part of a pension, profit-sharing, or similar type of retirement plan. Amounts paid by an employer to improve well-being and morale of employees that directly benefit the business in inducing low turnover in labor, absence, or services, increase loyalty and similar outcomes are deductible as ordinary and necessary business expenses. Examples of employee benefit programs include accident and health plans, educational assistance plans, prepaid legal service plans, cafeteria plans, dependent care assistance plans, and premiums on various types of insurance policies covering employees.

a. *Accident and Health Plans.* Contributions to accident and health plans to provide health or disability benefits (through insurance or otherwise) for employees are deductible as business expenses. Payments for such things as medical care, permanent injury, or compensation for loss of wages in reasonable amounts are deductible, to the extent not compensated for by insurance.

b. *Educational Assistance Plans.* Contributions to educational assistance plans which provide payments to employees for qualified educational expenses can be deducted. An educational assistance program is a separate written plan that provides educational assistance only to employees. To qualify, the program must meet the following tests: (1) provides benefits to employees who qualify under rules established by the employer that do not favor highly-compensated employees; (2) provides no more than 5% of benefits annually to shareholders or owners; (3) does not allow employees to receive cash or other benefits that must be included in gross income instead of educational assistance; and (4) provides reasonable notice of the program to employees. Generally, an educational assistance plan can cover tuition, fees, and the cost of books, supplies, and tools.

c. *Prepaid Legal Service Plans.* Employer contributions to a qualified group legal services plan are deductible as business expenses.

d. *Payments on Insurance Contracts.* Group hospitalization, medical insurance, worker's compensation insurance, unemployment insurance/compensation contribution payments, and life insurance premiums paid by an employer to purchase and maintain policies covering employees and their families are deductible by the employer.

e. *Dependent Care Assistance.* Employer contributions to plans which provide employees with child and dependent care are deductible business expenses.

f. *Cafeteria Plans.* Employer contributions under a written cafeteria plan are deductible business expenses. A cafeteria plan is a written benefit plan that allows the employee to select particular benefits. Qualified benefits can include accident and health benefits, adoption assistance, dependent care assistance, and group term life insurance. A plan that provides for deferred compensation generally is not a cafeteria plan.

g. *Employee Stock Options.* A stock option is an agreement on the part of the corporation to sell a given number of shares of its stock at a given price (the option price) to an employee within a specified period of time. The decision to exercise the option and buy the shares is left entirely to the employee in most cases. Two primary types of employee stock option plans are incentive stock options and employee stock purchase plans. An incentive stock option is usually designed to give key employees an opportunity to acquire stock at a bargain price without incurring a tax liability until the shares are sold. An employee stock purchase plan is similar to an incentive stock option in that employees are given an option to buy the employer's shares at a price that may be below market when the option is exercised. Employee stock purchase plans are different than incentive stock options in that the plan may not discriminate among employees and are therefore aimed primarily at rank and file employees.

A third type of employer stock purchase plan is an employee stock ownership plan (ESOP). An ESOP is a qualified stock bonus plan or a qualified stock bonus and money purchase plan that is designed to invest primarily in qualifying employer securities and may borrow the funds to purchase the securities.

In general, a transfer of stock through an employee stock option plan is not a taxable event. No income is received by the employee when the employee exercises the option and receives the stock. The employee will not be taxed until the stock acquired under the option is sold or exchanged. Also, when stock is transferred pursuant to an option, the employer corporation may not take a business deduction with respect to the transfer, and no amount other than the price paid under the option may be considered as received by the corporation for the stock transferred. Generally, employers cannot claim a deduction for qualified stock options.

15. Advertising. Advertising expenses that are reasonable in amount and related to the business activities in which the taxpayer is engaged are deductible. Advertising costs that generate future benefits beyond the current year may be treated as a capital expense and must be capitalized. The taxpayer is free to choose the advertising that best serves the taxpayer's purpose; however, the burden of proving the deductibility of advertising expenses is on the taxpayer.

16. Domestic Production Activities. In 2000, Congress enacted an income tax exclusion for extraterritorial income (ETI) and repealed foreign sales corporation (FSC) exclusion provisions. This was a response to a World Trade Organization (WTO) ruling that FSC provisions were an illegal export subsidy. Wisconsin did not adopt federal ETI provisions. However, in 2002, the WTO ruled that ETI violated WTO rules and authorized the European Union to impose sanctions on the U.S. In October, 2004, the American Jobs Creation Act was enacted. The bill repealed the ETI provisions (through a scheduled phase-out) and provided a deduction for income attributable to domestic production activities.

Effective for tax years beginning after December 31, 2004, a deduction against gross income is provided for a portion of the income attributable to domestic production activities. The deduction is phased-in from 2005 through 2010, and is equal to the lesser of a specified percentage of the business' qualified production activities income or its taxable income. However, the amount of the deduction for any tax year is limited to 50% of the W-2 wages that are properly allocable to domestic production gross receipts. For 2005 and 2006, the deduction equaled 3% of the lesser of: (a) qualified production

activities income; or (b) taxable income for the tax year. For 2007 through 2009, the percentage increases to 6%. When the deduction is fully phased-in in 2010, it will equal 9% of the lesser of: (a) qualified production activities income; or (b) taxable income.

"Qualified production activities income" is determined by reducing domestic production gross receipts by the cost of goods sold and other deductions, expenses, or losses directly allocable to such receipts and a ratable amount of indirect expenses. "Domestic production gross receipts" are the gross receipts of the business that are derived from:

a. The lease, rental, license, sale, exchange, or other disposition of: (1) qualifying production property (generally, tangible personal property, computer software, and sound recordings) manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part in the United States; (2) any qualified film produced by the business in the U.S.; and (3) electricity, natural gas, or potable water produced by the taxpayer in the U.S.

b. Construction performed in the U.S..

c. Engineering or architectural services performed in the U.S. for construction projects located in the U.S.

17. Other Deductions. Ordinary and necessary business expenses related to the operation of a trade or business and not deducted elsewhere can be deducted under a general miscellaneous category. Deductible business expenses include: 50% of business meal and entertainment expenses; certain limited lobbying expenditures; the cost of materials and supplies used in business operations; membership payments to business associations; and the cost of professional books, subscriptions, and dues to professional societies.

Related Entity Transactions

2007 Wisconsin Act 226 enacted provisions that require Wisconsin taxpayers to add back to income certain interest and rent payments to related entities. Specifically, rental expenses and interest expenses deducted or excluded under the IRC have to be added back if they are directly or indirectly paid, accrued, or incurred to, or in connection directly or indirectly with one or more direct or indirect transactions with, one or more related entities.

"Rental expenses" are defined as the gross amounts paid which would otherwise be deductible under the IRC and in the computation of Wisconsin taxable income for the use of, or the right to use, real property and tangible personal property in connection with real property, including services furnished or rendered in connection with such property, regardless of how the expenses are reported for financial accounting purposes and regardless of how the expenses are computed.

"Interest expenses" means interest which otherwise would be deductible under the IRC and deductible in the computation of Wisconsin taxable income.

"Related entity" is defined as any person related to a taxpayer as provided under specified sections of the Internal Revenue Code during all or a portion of the taxpayer's taxable year, and any real estate investment trust (REIT), under the IRC, except a qualified REIT, of which more than 50% of any class of the beneficial interests or shares of the real estate investment trust are owned directly, indirectly, or constructively by such taxpayer or any person related to the taxpayer during all or a portion of the taxpayer's tax year. Constructive ownership rules under specified sections of the IRC apply in determining the ownership of stock, assets, or net profits of any person.

"Qualified real estate investment trust" means a REIT, except a real estate investment trust the shares or beneficial interest of which are not regularly traded on an established securities market and more than 50% of the voting power or

value of any class of the beneficial interests or shares of which are owned or controlled, directly, indirectly, or constructively, by a single entity that is treated as an association taxable as a corporation under the IRC. The following entities are not considered an association taxable as a corporation:

1. An entity that is exempt from Wisconsin taxation under state law and exempt from federal income tax under the IRC.

2. A qualified REIT.

3. A qualified REIT subsidiary under the IRC which is a subsidiary of a qualified REIT.

4. A corporation, trust, association, or partnership organized outside the laws of the United States which satisfies all of the following criteria:

a. At least 75% of the entity's total asset value at the close of its taxable year consists of real estate assets as defined in the IRC, cash and cash equivalents, and U.S. Government securities;

b. The entity is not subject to tax on amounts distributed to its beneficial owners, or is exempt from entity-level taxation;

c. The entity distributes at least 85% of its taxable income, as computed in the jurisdiction in which it is organized, to the holders of its shares or certificates of beneficial interest on an annual basis;

d. Not more than 10% of the voting power or value in such entity is held directly, indirectly, or constructively by a single entity or individual, or the shares or beneficial interests of such entity are regularly traded on an established securities market; and

e. The entity is organized in a country which has a treaty with the United States.

A deduction is allowed for rental and interest expenses if any of the following conditions apply:

1. The related entity to which the taxpayer paid, accrued, or incurred the rental or interest expenses during the tax year directly or indirectly paid, accrued, or incurred such amounts in the same tax year to a person who is not a related entity, or the related entity to which the taxpayer paid, accrued, or incurred such expenses is a bank holding company or a direct or indirect subsidiary of a bank holding company as defined under specified sections of the U.S. Code, excluding any entity organized under the laws of another jurisdiction that primarily holds and manages investments of a bank, subsidiary, or affiliate. If a portion of such an expense is paid, accrued, or incurred in the same taxable year to a person who is not a related entity, then that portion is allowed as a deduction to the taxpayer. For purposes of this paragraph, "interest" excludes interest that is paid in connection with any debt that is incurred to acquire the taxpayer’s assets or stock under the IRC.

2. The related entity was subject to tax on, or measured by, its net income or receipts in this state, or any state, U.S. possession, or foreign country; the related entity's tax base in such state, U.S. possession, or foreign country included the income received from the taxpayer for the rental or interest expenses; the aggregate effective tax rate applied to such income or receipts was at least 80% of the taxpayer's aggregate effective tax rate; and the related entity is not an REIT under the IRC, other than a qualified REIT. "Any state, U.S. possession, or foreign country" does not include any state, U.S. possession, or foreign country under the laws of which the taxpayer files with the related entity, or the related entity files with another entity, a combined income tax report or return, a consolidated income tax report or return, or any other report or return that is due because of the imposition of a tax that is measured on or by income or receipts, if the report or return results in eliminating the tax effects of transactions directly or indirectly between either the taxpayer and the related entity, or between the related entity and another entity.

3. The taxpayer establishes that the transaction satisfies any other conditions the Department of Revenue (DOR) considers relevant, based on the facts and circumstances, to determine that the primary motivation of the transaction was one or more business purposes other than the avoidance or reduction of state income or franchise taxes; that the transaction changed in a meaningful way, apart from tax effects, the economic position of the taxpayer; and that the interest or rental expenses were paid, accrued, or incurred using terms that reflect an arm's length relationship.

Deductions under these provisions are not allowed unless the amounts paid, accrued, or incurred for the type of transactions are disclosed on a separate form prescribed by DOR in the manner prescribed by the Department.

If a deduction for rental or interest expenses is denied to a taxpayer because the expenses were paid to a related entity and the conditions to deduct the expenses were not satisfied, then such amounts are not included in the income of the related entity for state tax purposes. This provision is intended to prevent double-taxation.

"Aggregate effective tax rate" is defined as the sum of the effective tax rates imposed by a state, U.S. possession, foreign country, or any combination thereof on the person or entity.

"Effective tax rate" means the maximum tax rate imposed by the state, U.S. possession, or foreign country multiplied by the apportionment percentage, if any, applicable to the person or entity under the laws of that jurisdiction.

Other State Adjustments to Federal Provisions

Although state income and deductions are primarily referenced to federal law, there are a number of modifications that must be made to reflect differences in the state treatment of certain items, in addition to the related entity provisions. These state modifications made to federal definitions include the following:

1. Income received by an original policy holder or original certificate holder from the sale of a life insurance policy or certificate, or the sale of the death benefit under a life insurance policy or certificate under a viatical settlement contract is excluded from gross income. A viatical settlement contract is a written agreement providing for the payment to the policyholder of a life insurance policy, or to the holder of a group life insurance certificate, insuring the life of a person who has a catastrophic or life-threatening illness or condition, in an amount that is less than the expected death benefit under the policy or certificate, for assigning, selling, devising, or otherwise transferring the ownership of or the death benefit under the policy or certificate to the person paying the viatical settlement.

2. The federal gross-up of dividends to reflect taxes claimed in computing the foreign tax credit is excluded in computing income.

3. Corporations subject to the state corporate franchise tax must add to income all interest income not included in federal taxable income under the federal corporate income tax. Also, corporations subject to the state corporate income tax must add to income all interest income not included in federal taxable income except for interest income which by federal or state law is exempt from taxation. For corporations subject to franchise taxes, interest income from all state and local government bonds is included in the computation of Wisconsin net income. For corporations subject to the income tax, all interest income from state and local government bonds, except that which is exempt by federal law from state taxation, and interest from certain state and local obligations, is included in the computation of Wisconsin net income. In addition, all interest income received by a bank or other corporation actively engaged in the business of lending money with respect to a securities acquisition loan, is includable in Wisconsin net income.

4. In certain specified circumstances where there is a nonrecognition of income from the dis-

charge of indebtedness, the basis of assets or tax attributes (such as net operating losses, credits, and the depreciable and nondepreciable bases of assets) must be reduced in exchange for the income exclusion. In these cases, state net operating loss and credit provisions apply and the state basis of depreciable property or state tax attributes must be reduced. The reduction rate for credit carryforwards is 7.9%.

5. The federal deduction for wages, salaries, commissions, and bonuses can be claimed only if the name, address, and amount paid to each resident of Wisconsin to whom compensation of $600 or more has been paid during the taxable year is reported to the Department of Revenue, or if the Department is satisfied that failure to report has resulted in no revenue loss to the state. Rent payments may be deducted only if the amount paid along with the names and addresses of the parties to whom the rent is paid is reported. Also, payments for salaries, wages, bonuses, interest, and other expenses paid to an entertainer or entertainment corporation may be deducted only if certain withholding and cash deposit or bond requirements are met.

6. The federal deduction for taxes paid is modified so that: (a) foreign taxes are not deductible unless the income on which the taxes are based is taxable; (b) Wisconsin utility gross receipts and ad valorem taxes and license fees are deductible; and (c) the state net proceeds tax on mining of metallic minerals is deductible. Also, state taxes and the taxes of the District of Columbia that are value-added taxes, single business taxes, or taxes on, or measured by, all or a portion of net income, gross income, gross receipts, or capital stock are not deductible. The federal windfall profits and the environmental tax are not deductible.

7. The rules for federally taxable bonds also apply to bonds that are taxable under the state corporate income and franchise tax and the rules for federally tax-exempt bonds apply to bonds that are exempt from Wisconsin taxation. Therefore, if a bond is taxable for Wisconsin purposes, a taxpayer may deduct the amortizable bond premium for Wisconsin. If the bonds are not taxable for Wisconsin purposes, the amortizable bond premium is not deductible. Also, federal provisions are modified for Wisconsin law to require the basis of certain tax-exempt state and local bonds to be reduced by the amount of amortizable bond premium disallowed as a deduction so that it only applies to bonds that are tax-exempt for Wisconsin.

8. State net operating loss provisions are substituted for federal law. Specifically, corporations may carry forward and offset against Wisconsin net business income, any Wisconsin net business loss sustained for up to 15 years after the year in which the loss is incurred. However, unlike federal law, net operating losses cannot be carried back to offset income in prior tax years.

9. Instead of federal dividends received provisions, corporations may deduct all dividends received from a corporation with respect to its common stock if the corporation receiving the dividends owns, directly or indirectly, for its entire taxable year, at least 70% of the total combined voting stock of the payor corporation. The federal dividends paid deduction for certain preferred stock of public utilities is excluded from state law.

10. Federal provisions governing the treatment of expenses and interest relating to tax-exempt income are replaced by the state rule that amounts otherwise deductible that are directly or indirectly related to income that is wholly exempt from state tax are not deductible. Furthermore, amounts that are directly or indirectly related to losses from the sale of assets, gains from which would have been exempt under state law, if the assets were sold or otherwise disposed of at a gain, are also not deductible. "Wholly exempt income" includes amounts received from affiliated or subsidiary corporations as interest, dividends, or capital gains that, because of the degree of common ownership, control, or management between the payor and payee, are not subject to the state corporate income tax. "Wholly exempt income" also includes interest on obligations of the U.S. govern-

ment for corporations subject to the state corporate income tax rather than the state franchise tax. "Wholly exempt income" does not include income that is excludable, not recognized, exempt, or deductible under specific corporate income tax provisions. Any expenses or amounts otherwise deductible that are indirectly related to both wholly exempt income or loss, and to other income or loss, are reasonably proportionately allocated to each type of income or loss.

11. Federal provisions governing treatment of losses, expenses, and interest in transactions between related taxpayers are modified so that, in circumstances where it is applicable, gains on the sale of transferred property may be reduced only if the corresponding loss was incurred while the corporation was subject to the Wisconsin corporate income tax.

12. Federal provisions which require the reduction in the amount deductible for certain expenses related to exempt income of certain financial institutions do not apply to deductions that are allocable to income that is taxable under the state corporate income or franchise tax.

13. Federal laws relating to the treatment of net operating loss carryforwards and excess credits in certain corporate acquisitions, and limitations on the use of net operating loss carryforwards, certain credits, and capital losses in corporate acquisitions are modified so that Wisconsin net operating loss and credit provisions are substituted for federal items.

14. The federal deduction for qualified payments to nuclear power plant decommissioning reserve funds is allowed only if the fund is subject to the Wisconsin corporate income tax.

15. State provisions concerning the treatment of nonprofit institutions (including veterans service organizations), political organizations, cooperatives, associations, and other tax-exempt organizations replace federal provisions except that state law includes federal definitions of the taxable unrelated business income of such organizations.

16. State law does not follow federal law regarding percentage depletion for certain natural resources. Corporations must use cost depletion in determining the depletion deduction under the state corporate income and franchise tax.

17. State law does not follow federal treatment of domestic international sales corporations (DISCs). In general, DISCs have no special status for state tax purposes. If the DISC has nexus in Wisconsin for tax purposes and if it is not a "paper corporation" without substance, it is taxed like any other corporation. However, if the DISC is a "paper corporation" having no employees and no actual involvement or activity in connection with the sales that give rise to its income, the income is allocated to the corporation that actually earned the income, which is usually the parent corporation. The DISC's income is included in that corporation's income for state corporate franchise tax purposes. Generally, a DISC that meets only minimum qualifying requirements and does not carry on any substantial business activity is treated as a paper corporation.

It should be noted that, the federal system of taxing DISCs was generally replaced after 1984 with a system of taxing foreign sales corporations. Although DISCs were not abolished by the Federal Tax Reform Act of 1984, their tax benefits were limited, and an interest charge for tax-deferred amounts was imposed on DISC shareholders. An interest charge DISC is a domestic corporation with income that is predominantly derived from export sales and rentals. Generally, all of the income of a DISC attributable to $10 million or less of qualified exports may be deferred. However, an interest charge is imposed on the shareholders of the DISC based on the amount of tax that would have been due if the deferred income had been distributed.

18. State law does not follow federal law governing controlled foreign corporations. As a result, Subpart F income is not includable in the computation of Wisconsin net income. Subpart F income is undistributed income from controlled foreign cor-

porations which is required to be included in the federal net income of the U.S. shareholders of such corporations. Any actual income received from a controlled foreign corporation, such as dividends or interest, is included in the computation of Wisconsin net income, provided the income is not wholly exempt income.

19. Federal treatment of involuntary conversions as nontaxable exchanges is modified so that the federal provisions do not apply to involuntary conversions of property in this state that produce nonbusiness income when the property is replaced with similar property outside the state. In addition, federal provisions do not apply to involuntary conversions of property in the state that produce business income when the property is replaced with property outside the state if, at the time of replacement, the taxpayer is not subject to the Wisconsin corporate income tax.

20. Federal rules governing the filing of consolidated income tax returns and related provisions are not included in state law.

21. Federal provisions concerning amortization and depreciation authorized under the IRC in effect December 31, 2000, are included in state law. A corporation is required to compute amortization and depreciation under the federal IRC provisions which were in effect on December 31, 2000. In addition, specific state provisions which governed depreciation of property placed in service before January 1, 1987, under state law continue to apply for certain property. Future federal modifications to bonus depreciation provisions included the Federal Job Creation and Worker Assistance Act of 2007 (PL 107-147), and the Jobs Growth Tax Relief Reconciliation Act of 2003 (PL 108-27) that applied to farming would automatically apply for state income and franchise taxes.

Although state corporate tax provisions are referenced to federal law, with limited exceptions, changes to federal law take effect for state corporate income tax purposes only after action by the Legislature. Each year the Legislature must review the previous year's federal law changes to determine which items to federalize and which items to exclude from Wisconsin tax law. In general, state corporate income and franchise tax provisions are referenced to the IRC as amended to December 31, 2006. However, as is noted above, 2001 Wisconsin Act 109 included a provision that eliminated the automatic referencing of state depreciation and amortization provisions to the IRC. Instead, most state depreciation and amortization provisions are referred to the Code in effect on December 31, 2000. The Legislature must take action to update these references in future years.

In addition, the Legislature has not adopted certain corporate income tax provisions included in federal laws that were enacted between 2000 and 2006.

Allocation and Assignment of Income

For state tax purposes, specified rules and laws are used to allocate or assign income of a particular corporate taxpayer.

100% Wisconsin Corporations

A corporation which conducts all of its business and owns property only in Wisconsin has all of its income subject to taxation in Wisconsin. Usually, such firms are incorporated in Wisconsin. These types of firms are often referred to as 100% Wisconsin firms and they compute their taxes very much like a Wisconsin resident does under the individual income tax.

Multijurisdictional Corporations

A corporation which conducts its business operations and owns property both within and outside of the state is subject to a different corporate income tax treatment than is a 100% Wisconsin firm. When the states tax the income of corporations generated by activities carried on across state lines, they are required under the strictures of the

due process and commerce clauses of the U.S. Constitution to tax only income that is fairly attributable to activities carried on within the state. In order to meet this constitutional obligation, Wisconsin generally employs one of three methods of assigning income to the state--separate accounting, formula apportionment, or specific allocation.

1. *Separate Accounting.* Under separate accounting, a geographic or functional area of a single, multistate corporation is treated separately from the rest of the business activities of the corporation. Net income is computed as if the activities of the corporation were confined to that geographic or functional area. Separate accounting implies that both the income and expenses of each specific function or activity of a multijurisdictional corporation can be accounted for individually and independently. For example, if a corporation manufactures automobile parts in Wisconsin and owns a motel in another state, using separate accounting, its Wisconsin tax liability would be based solely on its income and expenses generated by manufacturing automobile parts in Wisconsin. Any business transactions which occur between the in-state business and out-of-state businesses are required to be valued at "arm's length."

Under Wisconsin law, a multijurisdictional corporation may use separate accounting when the corporation's business activities in the state are not an integral part of a unitary business. Generally, a unitary business is one that operates as a unit; its business cannot be segregated into independently operating branches. Its operations are integrated, and each branch is dependent upon or contributory to the operating of the business as a whole. The Department of Revenue may permit separate accounting in any case in which it is satisfied that the use of the method will properly reflect the income that is taxable by the state. Currently, few multijurisdictional corporations in the state use separate accounting to determine their net tax liability.

2. *Formula Apportionment.* Under the formula apportionment method of assigning corporate income, a formula is employed for dividing the income of a multistate corporation among the states in which its business is conducted. States have developed apportionment formulas as a rough means of attributing a reasonable share of the income tax base of a multistate unitary business to the taxing state.

A principal reason for using formula apportionment is that many corporations cannot explicitly attribute the income generated by multistate activities or businesses to a particular state. It is frequently difficult to separately identify the income that is earned in and the expenses that are associated with a particular activity or a particular state. An example would be a corporation which produces and sells tractors with manufacturing divisions in State A, State B, and Wisconsin, assembly divisions in Wisconsin and State C, retail outlets in all fifty states, and headquarters, administration, and research operations located in State D. In this case, it would be quite difficult to determine through separate accounting the portion of total corporate income and expenses that is generated by each operation in each state. For example, what amounts of total administrative and other corporate business expenses and income are generated solely by the manufacturing operations in State A? Formula apportionment provides a standard method for allocating the corporation's net income among the state taxing jurisdictions.

Another reason for using formula apportionment is that it eliminates the need to establish "transfer prices" for transactions within the corporation. Under separate accounting, transactions between the in-state and out-of-state operations of a corporation must be valued at market price or "arms length" for tax purposes. However, when the transaction occurs entirely within a corporation and a market value is never actually established, it can make the determination of income more complicated. In the example above, separate accounting would require the Wisconsin manufacturing operation to determine the market sales price of an unassembled tractor sold to the assembly plant in State C.

Transfer pricing also raises the issue of income shifting. Concerns have been expressed that, to some extent, it is possible for a corporation to determine the amount of income reported to each state through transfer pricing arrangements. For example, it would be possible for the corporation described above to shift income from Wisconsin to State A or B (perhaps to take advantage of a lower tax rate) by increasing the price an out of state manufacturing division charges its Wisconsin assembly division. Because the firm would subtract the cost of purchased production goods in computing Wisconsin taxable income, the increased cost of unassembled tractors would reduce Wisconsin net income. Conversely, net income of the out-of-state division would increase. Since there is no freely-established market price for an unassembled tractor, it would be very possible to shift income through transfer pricing arrangements in such a case. Formula apportionment reduces the possibility of such income shifting through transfer pricing arrangements because it is not necessary to separately account for the amount of income earned and the amount of expenses applicable to operations in each state. Instead, the corporate income that is subject to taxation in a particular state is determined through the apportionment formula rather than by attempting to separately account for income and expenses.

Under Wisconsin law, formula apportionment is used if a corporation's Wisconsin activities are an integral part of a unitary business which operates both within and outside of the state. In these cases, the corporation adds its total gross income from its in-state and out-of-state unitary activities, subtracts its deductions, and multiplies the amount of net income by its apportionment ratio as determined by the Wisconsin apportionment formula. The apportionment ratio is used to approximate how much of a corporation's total net income is generated by activities in Wisconsin.

The apportionment ratio is the end result of the application of the Wisconsin apportionment formula to a particular corporation. Historically, for most corporations, the apportionment ratio or fraction was based on three factors: property, payroll, and sales. Specifically, the apportionment ratio was determined by adding three fractions--the corporation's property value in Wisconsin divided by its total property value, the corporation's payroll in Wisconsin divided by its total payroll, and the corporation's sales in Wisconsin divided by its total sales -- double weighting the sales factor, and dividing the aggregate sum by four.

Under provisions included in 2003 Wisconsin Act 37, enacted in July, 2003, use of a single sales factor apportionment formula for most multistate corporations was phased-in over three years, from 2006 to 2008. As a result, most corporations, insurance companies, nonresident individuals, estates, and trusts apportion income to Wisconsin using a single sales factor apportionment formula.

Figure II provides an illustration of the Wisconsin apportionment formula.

FIGURE II

Wisconsin Apportionment Formula
Beginning Tax Year 2008

$$\text{Apportionment Percentage} = \left[\frac{\text{Sales by WI Destination}}{\text{Total Sales}} \right]$$

The sales factor is the ratio of the total sales of the taxpayer in the state to total sales everywhere. Sales are generally all gross receipts from the course of the taxpayer's regular trade or business operations which produce apportionable business income. For the sales factor, sales of tangible personal property are generally considered to be in Wisconsin if the property is delivered or shipped to a purchaser within Wisconsin or if the property is shipped from Wisconsin and the taxpayer is not subject to the taxing jurisdiction of the state of destination. The latter type of sales are "throwbacks" and 50% of such sales are included in

the apportionment formula. In addition, sales of tangible personal property from an office in the state, but shipped from an out-of-state supplier to an out-of-state customer are considered throwback sales, if the taxpayer is not subject to the taxing jurisdiction of the states in which the supplier or customer are located. Sales to the federal government are only considered to be in Wisconsin if they are shipped from a location within the state and are delivered to the federal government at a location within the state or if they are "throwback" sales. Fifty percent of federal throwback sales are included in the apportionment formula.

Sales other than the sales of tangible personal property are usually considered to be in Wisconsin if the income-producing activity is performed wholly in Wisconsin. However, gross receipts from the use of computer software are treated as in the state if the purchaser or licensee uses the computer software at a location in the state. In addition, gross receipts from services are attributed to Wisconsin if the purchaser of the service received the benefit of the service in the state. Generally, sales of intangible assets are excluded from the sales factor. Sales which produce nonapportionable income are also excluded from the sales factor.

The sales factor for financial institutions is the ratio of receipts in-state to total receipts. Receipts include: gross receipts from the lease of real property or tangible personal property; gross interest and other fees from loans secured by real property or by tangible personal property; gross interest and other fees from loans not secured by real or tangible personal property; net gains from the sale of loans; gross receipts from credit card issuer's reimbursement frees; gross receipts from merchant discount; loan servicing fees; gross receipts from traveler checks, cashiers checks, certified checks and money orders; gross receipts from automated teller machines; gross receipts from electronic funds transfer; gross receipts from safety deposit boxes; gross receipts from maintaining accounts; gross receipts from electronic funds transfer; gross receipts from cash management services; gross receipts from internet and trade services; gross receipts from data processing services, document imaging services, and microfilming services; gross receipts from research services; gross receipts from trust services; gross receipts from investment banking services; gross receipts from security brokerage services; gross receipts from other services; gross receipts from gross royalties; gross receipts from intangibles; and gross receipts from services provided to regulated investment companies and other sales.

The receipts factor for interstate broker-dealers, investment advisors, investment companies, and underwriters includes: gross brokerage commissions; gross margin interest; gross account maintenance fees; gross receipts from trading assets; investment company receipts; gross receipts from underwriting services; and other gross receipts.

Interstate air carriers, motor carriers, railroads, pipeline companies, and telecommunications companies are required to use different apportionment formulas to determine Wisconsin net taxable income. The specific apportionment factors used by these types of firms are shown in Table 1. Telecommunications companies are required to use the arithmetic average of the ratios of the regular three-factor (payroll, property, and sales) formula to apportion income to the state. Thus, telecommunications companies apportion income using the average of the ratios of payroll, property, and sales in-state to total payroll, property, and sales.

3. *Specific Allocation.* Specific allocation traces income to the state of its supposed source and includes the income in that state's tax base. Generally, this method of assigning income is applied to income from property with the source of the income generally following the location of the property. Many states, for example, specifically allocate the income from real and tangible personal property, such as rents from real estate, and oil and mineral royalties, to the state where the underlying property is located. Income from intangible property, such as dividends and interest, is often allocated to the taxpayer's commercial or legal domicile or to the state in which the intangible

Table 1: Apportionment Factors Used by Certain Types of Multijurisdictional Corporations

Type of Corporation	Apportionment Factors
Interstate Air Carrier	1. Ratio of aircraft arrivals and departures in state to total aircraft arrivals and departures.
	2. Ratio of revenue tons handled at airports in state to total revenue tons handled.
	3. Ratio of originating revenue in state to total originating revenue.
Interstate Motor Carrier	1. Ratio of gross receipts from carriage of persons or property, or both, first acquired for carriage in Wisconsin to total gross receipts from carriage of persons or property, or both, everywhere.
	2. Ratio of ton miles of carriage in Wisconsin to total ton miles of carriage.
Interstate Railroads and Sleeping Car Companies	1. Ratio of gross receipts from carriage of property, or persons, or both, first acquired for carriage in Wisconsin to total gross receipts from carriage of property, or persons, or both, everywhere.
	2. Ratio of revenue ton miles of carriage in Wisconsin to revenue ton miles of carriage everywhere.
Interstate Pipeline Company	1. Ratio of net cost of real and tangible property owned and used in Wisconsin to produce apportionable income to total net cost of such property used everywhere.
	2. Ratio of traffic units (e.g. barrel miles, cubic foot miles, or other appropriate measure of product movement) in Wisconsin to the total of such units everywhere.
	3. Ratio of compensation paid to employees located in the state to total compensation paid to all employees.
Interstate Telecommunications Company	1. Ratio of sales in Wisconsin to total sales everywhere.
	2. Ratio of property in Wisconsin to total property everywhere. (The property factor is generally the average value of real and tangible personal property owned and purchased by the tax payer.)
	3. Ratio of payroll in Wisconsin to total payroll everywhere. (The payroll factor is generally the total amount of compensation paid.)

property is utilized.

Wisconsin law distinguishes nonapportionable income from apportionable income. In determining a corporation's tax liability, total corporate nonapportionable income or loss is removed from the total income of a unitary multistate corporation and the remaining income or loss is apportioned to the state. Nonapportionable income allocated to Wisconsin is then added to apportioned business income to determine Wisconsin net income.

Nonapportionable income is allocable directly to the state in which the nonbusiness property that

produced the income, gain, or loss is located. For state income and franchise tax purposes, nonapportionable income includes income, gain, or loss from: (a) the sale of nonbusiness real property or nonbusiness tangible personal property; (b) rental of nonbusiness real property or nonbusiness tangible personal property; and (c) royalties from nonbusiness real property or nonbusiness tangible personal property. Income from lottery prizes is nonapportionable income allocable to Wisconsin if the tickets were originally purchased in Wisconsin. In addition, income or gain or loss from intangible property that is earned by a personal holding company is nonapportionable income and is allocated to the state in which the business is incorporated.

The state statutes provide that income or loss from intangibles (interest, dividends, royalties from patents, and similar types of income) is generally apportionable business income which follows the situs of the business. However, interest, dividends, and capital gains may be exempt from state tax when the recipient and payor are not a unitary business, and the recipient and payor are not related as a parent company and subsidiary or affiliates, and the investment activity from which the income is received is not an integral part of a unitary business, or the transaction does not serve an operational function. Conversely, if the corporation has commercial or legal domicile in Wisconsin, this intangible income is treated as business income for tax purposes.

Insurance Companies

Although most insurance companies that conduct business in the state are generally exempt from the state corporate income and franchise tax and, instead, pay the state insurance premiums tax, certain types of insurance companies are subject to the corporate franchise tax. Specifically, the state corporate franchise tax is imposed on most domestic nonlife insurance companies and on the nonlife insurance business of domestic life insurance companies. Insurers generally exempt from the state franchise tax include:

1. Foreign insurance companies (companies not organized under Wisconsin laws);

2. Domestic life insurance companies engaged exclusively in life insurance business. If a life insurance company engages in a business other than life insurance, the net income from the nonlife insurance business is subject to the state franchise tax. These companies pay the state premiums tax on their life insurance business;

3. Domestic insurers transacting mortgage guaranty insurance business as defined under the state administrative code;

4. Town mutual insurers organized under or subject to state law;

5. Insurers exempt from federal income taxation under the IRC; and

6. Certain corporations that are bona fide cooperatives operating without pecuniary profit to any shareholder or member, or operated on a cooperative plan pursuant to which they determine and distribute their proceeds in compliance with state law. However, cooperative sickness care associations, service insurance corporations, and nonprofit organizations that derive income from an HMO or limited service health organization (LSHO) are subject to tax on that income.

Under federal law and under state law, insurance companies (other than life insurance companies) are generally exempt from the corporate income tax if their gross receipts for the tax year are $600,000, or less, and the premiums received exceed 50% of gross receipts. (For mutual insurance companies gross receipts cannot exceed $150,000 and premiums must exceed 35% of gross receipts.) If net premiums do not exceed $1.2 million, a company may elect to only have its taxable investment income taxed. (Life insurance companies are subject to the state insurance premiums tax, but not the state corporate franchise tax.)

Insurers that derive income from the sale or

purchase and subsequent sale or redemption of lottery prizes, if the winning ticket was purchased in Wisconsin, must pay state franchise tax on this income.

Similar to the tax treatment of other corporations, the income and deductions of insurance companies are generally determined by reference to federal law. The basis for determining net Wisconsin taxable income is federal taxable income. However, insurance companies are required to make the following adjustments to federal taxable income:

1. Business or capital loss carryforwards or carrybacks deducted in determining federal taxable income are added to income.

2. Federal depreciation or amortization that exceeds the amount of depreciation or amortization allowed under Wisconsin law is added to income.

3. For assets that are disposed of, the excess of federal basis over the basis allowed under Wisconsin law is added to income.

4. Interest income received or accrued and not included in federal taxable income is added to income.

5. Dividend income received and used as a deduction in determining federal taxable income is added to income.

6. State taxes that are value-added taxes, single business taxes, or taxes on, or measured by, gross income, gross receipts, or capital stock deducted in determining federal taxable income are added to income. Gross receipts taxes assessed in lieu of property taxes are deductible.

7. Other items not included in federal taxable income, but taxable under state law, such as the federal deductions for unpaid losses or state credits claimed, or the federal environmental tax, are added to income.

8. Dividends received that are deductible under state law are subtracted from income.

9. Depreciation or amortization allowed under state law and in excess of such amounts permitted under federal law is subtracted from income.

10. The basis of assets allowed under state law that is in excess of the basis allowed under federal law for assets disposed of is subtracted from income.

11. Other items included in federal income that are not included in state taxable income are subtracted from income.

Depending upon the type of insurance company involved, the adjusted federal taxable income amount might require further modifications before arriving at Wisconsin net taxable income. Domestic insurance companies not engaged in the sale of life insurance that have collected premiums written on property and risks located only in Wisconsin are not required to further modify this measure of income. For these insurance corporations, adjusted federal taxable income is Wisconsin net income (before any offset for business loss carryforwards).

However, domestic insurance corporations that are not engaged in the sale of life insurance but that have collected premiums written on property and risks located both in and outside of Wisconsin must allocate a portion of total adjusted federal income to the state based on a premiums factor, which is similar to the sales factor used by other types of corporations. The premiums factor is the ratio of direct premiums and assumed premiums written for reinsurance with respect to property and risks resident, located, or performed in the state, divided by the total of such premiums everywhere. The apportionment ratio (premiums factor) is applied to adjusted federal income to arrive at Wisconsin net income before any offset for business loss carryforwards.

"Direct premiums" is defined as direct premiums reported for the tax year on the annual

statement required to be filed with the Commissioner of Insurance. "Assumed premiums" is defined as assumed reinsurance premiums from domestic insurance companies also reported for the tax year on the annual statement.

Domestic insurance companies that are engaged in the sale of both life insurance and other types of insurance must first determine the nonlife insurance portion of total adjusted federal income. As a first step in calculating Wisconsin net income, these companies are required to multiply total adjusted federal income by the ratio of the company's net gain from its nonlife insurance operations to total net gain from operations (with specific exceptions). If this amount is from premiums written on property and risks located only in Wisconsin, then the amount represents Wisconsin net income (before business loss carryforward offsets). However, if the calculated nonlife insurance income is from premiums written on property and risks located both in and outside of the state, then Wisconsin net income is determined using the allocation method described above.

Under state law, the amount of tax that an insurance company pays under the state franchise tax cannot exceed 2% of gross Wisconsin premiums. (The 2% gross premiums limitation does not apply to income from lottery prizes.)

Net Operating Losses

Although similar to federal law, Wisconsin has specific state provisions governing the determination and use of net operating losses for state corporate income tax purposes. Under state law, a net operating loss is generally defined as the excess of business expenses allowed as deductions in computing net income over the amount of income attributable to the operation of a trade or business in the state. Nonapportionable losses having situs in Wisconsin are included in Wisconsin net business loss; nonapportionable income having situs in the state is included in net business income.

Net operating losses are determined in a manner similar to the way taxable income is determined. The taxpayer starts with gross income and subtracts business expenses allowable as deductions. If expenses are greater than income, a net operating loss is generated. Wisconsin law allows net operating losses to be carried forward for 15 years to offset income. Federal law permits net operating losses to be carried back for two years but state law does not provide for carrybacks of net operating losses. Under state tax provisions, net operating losses, if any, are used to offset state taxable income before the state tax rate is applied to net income.

State Corporate Income Tax Rate

The state corporate income tax rate is 7.9% and is applied to all income subject to the state corporate income tax. The resulting amount is the corporation's gross tax liability. Currently, the federal corporate income tax uses a graduated rate and bracket structure that ranges from 15% to 35% with higher 38% and 39% marginal tax rates that apply over certain ranges of taxable income.

Recycling Surcharge

The state recycling surcharge was first imposed on businesses for tax years ending after April 1, 1991, and it remained in effect until April, 1999. The recycling surcharge was eliminated for all businesses beginning with tax years ending after April, 1999. Therefore, businesses were generally not subject to the recycling surcharge for tax year 1999. A permanent recycling surcharge was recreated in 1999 Wisconsin Act 9, effective with tax year 2000. The recycling surcharge is 3% of gross tax liability for corporations (including insurance companies and LLCs taxed as corporations) or 0.2% of net business income for sole proprietorships, LLCs taxable as partnerships, and S corporations. There is a minimum payment of $25 and a maximum payment of $9,800. Farms and other businesses with less than $4 million in gross receipts are excluded from paying the surcharge. Noncorporate farms (sole proprietorships, partner-

ships, LLCs taxable as partnerships) that are subject to the recycling surcharge pay the $25 minimum amount. Farms organized as regular C and S corporations that are subject to the surcharge, determine surcharge liabilities in the same manner as other C and S corporations.

The Department of Revenue is authorized to administer the recycling surcharge under provisions governing administration of the individual and corporate income and franchise taxes, including provisions relating to audits and assessments, claims for refund, statutes of limitations, IRS adjustments, confidentiality, appeals, collections, and set-offs for debts owed other state agencies.

Total recycling surcharge collections were $23.5 million in 2006-07, and $25.1 million in 2007-08.

Corporate Income Tax Credits

A tax credit is an amount that is subtracted from the gross income tax liability of the taxpayer in a given year. A tax credit differs from a deduction in that the credit is subtracted from the tax itself, resulting in a dollar-for-dollar reduction in the gross tax liability; a deduction is subtracted from income, resulting in a reduction in the amount of income subject to tax. Rather than adopting federal tax credits for state purposes, Wisconsin provides its own corporate income tax credits for certain business expenditures.

The following sections describe the credits provided under the state corporate income tax. The descriptions include tax credits that have been enacted for future tax years and are not effective on January 1, 2008.

1. Manufacturing Investment Tax Credit. For tax years beginning before January 1, 2006, a credit against corporate income taxes due could be claimed for the amount of sales and use tax paid for fuel and electricity consumed in manufacturing in Wisconsin (manufacturer's sales tax credit). The credit could not be claimed for heating, light, or other uses of energy. The manufacturer allocated manufacturing use as a portion of total energy use for purposes of computing the credit. If the credit exceeded tax liability for the year, it was not refundable but any unused portion could be carried forward for 20 years to offset any future tax liability. The carryover period for the manufacturers' sales tax credit was increased from 15 to 20 years under provisions included in 2003 Wisconsin Act 267.

The rationale for allowing an income and franchise tax credit for sales tax paid for fuel and electricity was to provide comparable sales tax treatment for fuel and electricity that is given other inputs into the manufacturing process. For example, sales of machines and specific processing equipment, repair parts, and replacements used to manufacture tangible personal property are exempt from the state sales tax. The tax credit was established for sales taxes on fuel and electricity because it was believed that it would be administratively easier for the business to determine the amount of fuel and electricity that was devoted to the manufacturing process than to require utility companies to account for such taxes in the business' utility bill. In addition, the credit lowered the cost of production for certain key state industries and improved the competitive position of those industries.

Historically, the amount of manufacturer's sales tax credits claimed, including both unused credits carried forward from prior years and new credits claimed in a year, exceeded the actual amount of credits used in a given year by a substantial amount. For example, Department of Revenue corporate aggregate statistics for the 2004-05 processing year (mostly 2004 tax year returns) showed that a total of $27.2 million (9.7%) of the total of $281 million of credits claimed was used to offset corporate income tax liability. This pattern reflected a concern, raised by industry groups, about the effectiveness of the manufacturing sales tax credit in providing the same tax benefits as a sales tax exemption for fuel and electricity used in manufacturing. The inability to use the credit to offset tax liability meant claimants were not

benefiting from the credit in the same way they would from an actual sales tax exemption.

The manufacturer's sales tax credit was replaced with a sales tax exemption and manufacturing investment credit by 2003 Wisconsin Act 99, which was enacted in December, 2003. The following provisions related to the manufacturer's sales tax credit were enacted:

a. The individual and corporate income and franchise tax credit for fuel and electricity used in manufacturing was repealed effective for tax years that begin after December 31, 2005.

b. A sales tax exemption for the gross receipts from the sale of fuel and electricity consumed in manufacturing tangible personal property in Wisconsin was provided beginning on January 1, 2006.

c. Taxpayers having $25,000 or less of unused manufacturer's sales tax credits as of January 1, 2006, could use up to 50% of the amount of unused credits to offset tax liability in tax years beginning in 2006 and 2007 (50% for tax year 2006; 50% for tax year 2007).

d. Taxpayers having more than $25,000 of unused manufacturers' sales tax credits as of January 1, 2006, could not use the credits to offset tax liability during 2006 and 2007. However, these taxpayers could deduct, in each of the tax years beginning after December 31, 2005, and before January 1, 2008, 50% of the total amount of unused manufacturers' sales tax credits that the taxpayer had added back to income when the credit was first claimed. For manufacturers' sales tax credits passed through from a partnership, LLC, or S corporation, a deduction was allowed for 50% of the amount that the entity added back to its income and that was included in the partner's, member's or shareholder's Wisconsin net income at the time that the credit was first claimed.

e. Taxpayers having more than $25,000 of unused manufacturers' sales tax credits can claim a manufacturing investment credit for tax years beginning after December 31, 2007. The credit is equal to the taxpayer's unused manufacturers' sales tax credits and the credit must be amortized over 15 years, starting with tax years beginning after December 31, 2007. The amortized amount may be offset against the taxpayer's income or franchise tax, and unused amounts may be carried forward up to 15 years to offset future tax liabilities. To qualify for the credit a business must be certified by the Department of Commerce and must attach a copy of the certification to the tax return. To be certified, a business must meet one of the following conditions: (1) the business has retained 100% of the business' full-time jobs in Wisconsin from December 23, 2003, through either December 31, 2006, or December 31, 2007; (2) the business' average annual investment in Wisconsin from January 1, 2003, through either December 31, 2006, or December 31, 2007, is equal to no less than 2% of the total book value of the business' depreciable assets in facilities that are based in Wisconsin; or (3) the business' average annual investment in Wisconsin from January 1, 2003, through either December 31, 2006 or December 31, 2007, is no less than $5 million.

Partnerships, LLCs, and S corporations may not claim the manufacturing investment credit but eligibility for, and the amount of, the credit are based on the amount of the entity's unused credits. The entity must compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to each of them. Partners, members of LLCs, and shareholders of S corporations may claim the credit in proportion to their ownership interest.

Applicants for tax credits were required to file an application with Commerce by September 30, 2008. Commerce may revoke any certification if supporting information included in applications is found to be inaccurate or significantly misleading.

"Annual investment" is defined as the purchase price of depreciable, tangible, personal property, and the amount expended to acquire, construct,

rehabilitate, remodel or repair real property, for all of the taxpayer's facilities that are based in Wisconsin, in each calendar year. "Book value" means an asset's cost minus the accumulated depreciation since the asset was acquired. "Full-time job" means a regular nonseasonal full-time position in which an individual, as a condition of employment, is required to work at least 35 hours in a week.

2. Research Credit. The state research credit is equal to 5% of the increase in a corporation's qualified research expenditures in Wisconsin over the base amount. The "base amount" is calculated by multiplying the taxpayer's average annual gross receipts for the preceding four years by a fixed-base percentage. However, the base amount does not include sales treated as throwback sales in the corporate apportionment formula. The "fixed-base" percentage is the percentage that the taxpayer's total aggregate qualified research expenditures for a specified period is of the taxpayer's total aggregate gross receipts for those years. The fixed-base percentage cannot exceed 16%. In addition, the base amount cannot be less than 50% of research expenses in the year for which the credit is claimed. Consequently, the state research credit is 5% of the lesser of: (a) the excess of current year research expenses over the base amount; or (b) 50% of current year research expenses.

Under the provisions of 2005 Wisconsin Act 452, increased research credits were provided for qualified research for certain activities. Specifically, a 10% tax credit can be claimed for qualified research expenses (less the base amount) for the following activities:

a. Designing internal combustion engines for vehicles, including expenses related to designing vehicles that are powered by such engines, and improving production processes for such engines and vehicles.

b. Designing and manufacturing energy efficient lighting systems, building automation and control systems, or automotive batteries for use in hybrid-electric vehicles that reduce the demand for natural gas or electricity or improve the efficiency of its use.

"Internal combustion engine" includes substitute products such as fuel cell, electric and hybrid drives. "Vehicle" means any vehicle or frame, including parts, accessories, and component technologies, in which an engine is mounted for use in mobile or stationary applications. "Vehicle" includes any truck, tractor, motorcycle, snowmobile, all-terrain vehicle, boat, personal watercraft, generator, construction equipment, lawn and garden maintenance equipment, automobile, van, sports utility vehicle, motor home, bus, or aircraft.

"Frame" includes:

a. Every part of a motorcycle, except tires.

b. In the case of a truck, the control system and the fuel and drive train, excluding any comfort features located in the cab, or the tires.

c. In the case of a generator, the control modules, fuel train, fuel scrubbing process, fuel mixers, generator, heat exchangers, exhaust train, and similar components.

Start-up companies must use a minimum fixed-base percentage of 3%. As a result, start-up companies must spend 3% of their gross receipts on research in order to qualify for the credit. For years six to ten, the percentages are an increasing portion of the percentage which qualified research expenses bear to gross receipts for certain prior years. A "start-up company" is defined as a firm that, during the five-year period used to compute the fixed-base percentage, has fewer than three taxable years in which the taxpayer had both gross receipts and qualified research expenses.

The credit applies only to research expenditures paid or incurred in connection with the trade or business of the taxpayer that are research and development costs in an experimental or laboratory sense. In general, qualifying expenses are non-

capital, and thus, do not include spending for buildings and equipment. Qualified research expenses are the sum of: (a) in-house expenditures for research, wages and supplies used in research, plus certain amounts paid for research use of laboratories, equipment, computers, or other personal property; and (b) 65% of the amount paid by the taxpayer for qualified research conducted on behalf of the taxpayer. Examples of eligible costs include: (a) the costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention, or similar property; and (b) the cost of improving this type of property. Qualified research is research which is undertaken for the purpose of discovering information which is technological in nature and the application of which is intended to be useful in the development of a new or improved business component of the taxpayer. In addition, substantially all of the activities of the research must be elements of a process of experimentation relating to a new or improved function, performance, reliability, or quality.

Corporations may elect to determine the research credit under the federal alternative research credit rules. Under these rules, the research credit is the difference between certain percentages of average gross receipts and actual research expenses.

In all cases, only the expenses for eligible research activities conducted in Wisconsin qualify for the credit. If the credit amount exceeds the corporation's tax liability, it is not refundable, but unused amounts can be carried forward 15 years to offset future tax liabilities.

For the 2005 tax processing year, a total of $93.9 million in research credits was claimed while approximately $14.5 million was used to offset tax liabilities for that year. The unused credit amounts could be carried forward to offset future tax liabilities. In that year, about 312 corporations claimed the research expenses credit.

3. Research Facilities Credit. The research facilities credit is equal to 5% of the annual expenditures for constructing or equipping new facilities or expanding existing facilities in Wisconsin to conduct qualified research activities. Qualified research activities are defined as those eligible for the research expense credit. Eligible capital expenditures include only amounts paid or incurred for tangible depreciable property but do not include expenditures for replacement property. This credit also is not refundable but unused amounts can be carried forward to offset corporate income tax liability for up to 15 years.

2005 Act 452 also created increased research facilities tax credits for facilities used for the activities for which the increased research expenses tax credits were established. A research facilities tax credit can be claimed for 10% of the amount paid to equip and construct new facilities or expand existing facilities used in Wisconsin for qualified research for: (a) designing internal combustion engines; or (b) designing and manufacturing energy efficient lighting systems, building automation and control systems, or certain automotive batteries.

Aggregate data for processing year 2005 indicate that the total amount of research facilities credits claimed for that year was about $12.5 million. Of that total, approximately $3.6 million was used to offset tax liabilities and the remaining unused credit amounts were available to be carried forward to future tax years. A total of 60 corporations claimed the research facilities credit.

4. Farmland Preservation Tax Credit. Corporate owners of eligible farmland can receive a refundable tax credit under the farmland preservation program. To be eligible, the claimant must own at least 35 acres of state farmland and that land must have produced: (a) at least $6,000 in gross farm profits during the year for which the credit is claimed; or (b) at least $18,000 during the year for which the credit is claimed and the preceding two years. The credit amount is determined by formula and based on the property taxes levied on the eligible farmland and the household income of the farm owner. Income is

broadly defined and includes such items as nonfarm business losses and farm depreciation expenses in excess of $25,000. For corporate claimants, income includes the household income of each shareholder of record. In addition, the amount of credit depends on the land use provisions, such as agricultural zoning ordinances and preservation agreements, that cover the land. The maximum potential credit which can be received for a given tax year is $4,200.

5. Farmland Tax Relief Credit. Eligible corporations can claim a refundable farmland tax relief credit equal to a percentage of the amount of property taxes levied on agricultural land (excluding improvements), up to a maximum credit claim of $1,500. The Department of Revenue annually determines the reimbursement rate that will distribute the estimated total expenditures under the farmland tax relief credit for that year. Annual expenditures for the credit under the individual and corporate income and franchise taxes equal $15 million plus an amount equal to the amount estimated to be expended as farmland tax relief credits in the previous year minus the actual expenditure of farmland tax relief credits in the previous year. To be eligible, the claimant must meet the same acreage and production requirements as those used for the farmland preservation tax credit. The sum of the farmland preservation and farmland tax relief credits cannot exceed 95% of the total property taxes accrued on the farm.

For tax year 2008, DOR established the credit reimbursement rate at 19% of the first $10,000 in property taxes. However, the maximum credit is limited to $1,500.

6. Community Development Finance Credit. A corporation that contributes an amount to the Wisconsin Housing and Economic Development Authority and, in the same year, purchases common stock or partnership interests of the Community Development Finance Company in an amount no greater than the contribution may claim a tax credit. The credit is equal to 75% of the purchase price of the stock or partnership interests. However, the credit cannot exceed 75% of the contribution to the Community Development Finance Authority. The credit is not refundable but can be carried forward 15 years to offset corporate income tax liability.

7. Dairy and Livestock Farm Investment Credit. The dairy investment tax credit was created by 2003 Wisconsin Act 135. 2005 Wisconsin Act 25 renamed the credit and expanded it to include amounts paid for non-dairy livestock farm modernization or expansion.

Under current law, a tax credit may be claimed, for tax years that begin after December 31, 2003, and before January 1, 2010, equal to 10% of the amount paid by the claimant during the tax year for dairy farm modernization or expansion related to the operation of the claimant's dairy farm.

Dairy farm modernization or expansion is defined as the construction, improvement, or acquisition of buildings or facilities, or the acquisition of equipment for dairy animal housing, confinement, animal feeding, milk production, or waste management, including the following, if used exclusively related to dairy animals and if acquired and placed in service in the state during tax years that begin after December 31, 2003, and before January 1, 2010: (a) freestall barns; (b) fences; (c) watering facilities; (d) feed storage and handling equipment; (e) milking parlors; (f) robotic equipment; (g) scales; (h) milk storage and cooling facilities; (i) bulk tanks; (j) manure pumping and storage facilities; (k) digesters; and (l) equipment used to produce energy. Dairy animals include heifers raised as replacement dairy animals. Dairy farm includes a facility used to raise heifers as replacement to dairy animals.

For tax years that begin after December 31, 2005, and before January 1, 2012, a tax credit can be claimed equal to 10% of the amount paid by the claimant during the tax year for livestock farm modernization or expansion related to the operation of the claimant's livestock farm.

"Livestock modernization and expansion" is defined as the construction, improvement, or acquisition of buildings or facilities, or the acquisition of equipment, for livestock housing, confinement, feeding, or waste management, including the following, if used exclusively related to livestock and if acquired and placed in service in the state during tax years that begin after December 31, 2005, and before January 1, 2012: (a) birthing structures; (b) rearing structures; (c) feedlot structures; (d) feed storage and handling equipment; (e) fences; (f) watering facilities; (g) scales; (h) manure pumping and storage facilities; (i) digesters; (j) equipment used to produce energy; (k) fish hatchery buildings; (l) fish processing buildings; and (m) fish rearing ponds. "Livestock" means cattle, not including dairy animals (eligible under the dairy credit); swine; poultry, including farm-raised pheasants, but not including other farm-raised game birds or ratites; fish that are raised in aquaculture facilities; sheep; and goats.

For both credits "used exclusively" means used to the exclusion of all other uses except for use not exceeding 5% of total use.

The aggregate amount of dairy and livestock modernization tax credits that may be claimed by a taxpayer is $50,000. The credits cannot be claimed for any amounts also claimed as business expense deductions. Unused credit amounts can be carried forward up to 15 years to offset future tax liabilities.

Partnerships, LLCs, and S corporations cannot claim a tax credit, but eligibility for, and the amount of credit is based on each entity's payment of eligible expenses. A partnership, LLC, or tax-option corporation is required to compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to each of them. Partners, members of LLCs, and shareholders of tax-option corporations claim the credit in proportion to their ownership interest. If two or more persons own and operate a dairy or livestock farm, each person can claim the dairy or livestock tax credit in proportion to his or her ownership interest, subject to the $50,000 maximum limit on aggregate tax credit claims.

For tax processing year 2005, $4.1 million in dairy farm investment tax credits were claimed, while about $711,000 was used to offset tax liability. There were 383 claimants.

8. Dairy Manufacturing Facility Credit. 2007 Wisconsin Act 20 created a refundable dairy manufacturing facility investment tax credit under the state individual income and corporate income taxes equal to 10% of the amount paid in a tax year by a claimant for modernization or expansion related to the claimant's dairy manufacturing operation. The tax credit can be claimed for tax years beginning after December 31, 2006, and before January 1, 2015. The maximum aggregate amount of tax credits that a claimant can claim is $200,000, and a credit cannot be claimed for expenses that were deducted as trade or business expenses. If the allowable credit claim exceeds the taxes otherwise due on the claimant's income, the amount of credit claim that is not used is certified by DOR to the Department of Administration for payment by check, share draft, or other draft.

The total amount of tax credits that can be claimed is limited to $600,000 for fiscal year 2007-08, and to $700,000 for subsequent fiscal years.

Partnerships, LLCs, and tax-option corporations cannot claim the tax credit, but eligibility for, and the amount of the credit is based on the entity's payment of eligible expenses, subject to the $200,000 limit on the maximum aggregate amount of tax credits that a single entity can claim. A partnership, LLC, or tax-option corporation is required to compute the amount of the credit that each of its partners, members, or shareholders can claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations can claim the credit in proportion to their ownership interest.

If two or more persons own or operate a dairy manufacturing operation, each person can claim

the dairy manufacturing facility investment tax credit in proportion to his or her ownership interest, subject to the aggregate total credit limit of $200,000.

The Department of Commerce is required to certify claimants and allocate credits, subject to the statewide limit on the total amount that can be claimed ($600,000 in 2007-08, $700,000 thereafter). An operator of a dairy manufacturing operation or an owner of a building or facility in which the operation occurs, who intends to claim a dairy manufacturing facility credit must apply to Commerce for certification and allocation of the credit. Each application must be made on a Department-prescribed form and must include a Department of Revenue schedule DM (The dairy manufacturing facility investment credit form) listing the applicant's eligible expenses for the project. Commerce will certify eligible claimants and allocate credits in a manner that most likely promotes economic development. In determining the allocation of tax credits Commerce is required to consider the following factors:

a. The jobs created by the project.

b. The salaries, wages, and other employee benefits of the jobs created by the project.

c. The impact of the project on the dairy industry in Wisconsin.

d. The extent to which the area served by the project is economically distressed.

e. The amount of new, eligible capital investment in the project.

f. The impact of the project on business in Wisconsin.

g. Any previous assistance from Commerce.

Commerce may prorate some or all of credit allocations in order to broaden the potential for promoting economic development.

Commerce is required to notify each applicant of the outcome of the application, and the Department of Revenue of every taxpayer that is certified for tax credits. Dairy manufacturing tax credit claims must include: (a) a copy of the certification for tax credits; (b) the employer's tax identification number; and (c) the North American Industry Classification System code (NAICS) for the certified applicant.

"Dairy manufacturing modernization or expansion" is defined as constructing, improving, or acquiring buildings or facilities, or acquiring equipment, for dairy manufacturing, including the following, if used exclusively for dairy manufacturing, and if acquired and placed in service in Wisconsin during tax years that begin after December 31, 2006, and before January 1, 2015:

a. Building construction, including storage and warehouse facilities.

b. Building additions.

c. Upgrades to utilities, including water, electric, heat, and waste facilities.

d. Milk intake and storage equipment.

e. Processing and manufacturing equipment, including pipes, motors, pumps, valves, pasteurizers, homogenizers, vats, evaporators, dryers, concentrators, and churns.

f. Packaging and handling equipment, including sealing, bagging, boxing, labeling, conveying, and product movement equipment.

g. Warehouse equipment, including storage racks.

h. Waste treatment and waste management equipment, including tanks, blowers, separators, dryers, digesters, and equipment that uses waste to produce energy, fuel, or industrial products.

i. Computer software and hardware used for managing the claimant's dairy manufacturing operation, including software and hardware related to logistics, inventory management, and production plant controls.

"Dairy manufacturing" means processing milk into dairy products or processing dairy products for sale commercially. "Used exclusively" means used to the exclusion of all other uses, except for use not exceeding 5% of total use.

"Dairy product" means a value-added, saleable product resulting from processing milk or another dairy product, and includes: beverage milk products; soft milk products such as yogurt, ice cream, and cottage cheese; cheese; butter; non-fat dried milk; whole milk powder; dried whey; whey protein concentrate or isolates; casein; and dairy waste that can be used to produce energy, fuel, and industrial products. "Milk" means the lacteal secretion of cows, sheep, or goats.

"Eligible capital investment" includes all expenses incurred in the acquisition, construction, or improvement of buildings or facilities, and the purchase price of depreciable personal property or equipment.

9. Early Stage Seed Investment Credit. The early stage seed investment credit is equal to 25% of the claimant's investment to a fund manager that the fund manager invests in a business certified by the Department of Commerce. Up to $2.0 million in aggregate investment in a certified business over the life of the investment qualifies for a tax credit. However, the maximum aggregate investment in a single certified business is limited to $4.0 million. Investment in the fund and the initial qualifying investment in the certified business must be made after the fund manager is certified by Commerce. To be eligible for the tax credit an investment must be kept with a certified fund manager for at least three years. Unused tax credits can be carried forward up to 15 years to offset future tax liabilities. The aggregate amount of early stage seed investment tax credits that may be claimed for investments paid to certified fund managers is $6.0 million per tax year, and $52.5 million for all tax years combined. DOR, in consultation with Commerce can carry forward unclaimed tax credit amounts for given year to a future year for allocation.

To be eligible for the credit, an investment must be made with a fund manager who is certified by Commerce. In determining whether to certify an investment fund manager, Commerce is required to consider the manager's experience in managing venture capital funds, the past performance of investment funds managed by the fund manager, the expected level of investment in the fund to be managed, and any other relevant factors. In addition, the Department can only certify investment fund managers who commit to consider placing investments in certified businesses.

Commerce certifies investment funds that are legally organized specifically to invest in early stage companies. The funds must be certified, prior to investing in certified businesses, to be eligible for tax credits. A certified fund may invest in any business. However, tax credits can only be claimed for investments in certified businesses. A fund's tax credits are based on the proportion of the fund's investors that pay Wisconsin income taxes (For example, if 50% of a fund's investors pay Wisconsin income taxes, the fund receives tax credits based on 50% of its investments in certified businesses. The credits pass through to investors who pay Wisconsin income taxes.)

A business may be certified as a qualified new business venture (QNBR) by Commerce only if it meets all of the following conditions:

a. It has its headquarters in Wisconsin.

b. At least 51% of its employees are employed in the state.

c. It is engaged in, or has committed to engage in, manufacturing, agriculture, or processing or assembling products and conducting research and development, or developing a new product or

business process.

d. The business is not engaged in real estate development; insurance; banking; lending; lobbying; political consulting; professional services provided by attorneys, accountants, business consultants, physicians, or health care consultants; wholesale or retail trade; leisure; hospitality; transportation; or construction.

e. It has fewer than 100 employees.

f. The business has not been operating in Wisconsin for more than seven consecutive years.

g. It has not received more than $1.0 million in investments that would qualify for angel investment tax credits. (The angel investment tax credit was also created by Act 255, and may be claimed under the individual income tax.)

h. It has not received aggregate private equity investments of more than $10.0 million.

Partnerships, LLCs, and S corporations may not claim the credit, but the eligibility for and the amount of the credit are based on each entity's eligible investments. The partnership, LLC, or S corporation must compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to each of them. Partners, members of LLCs, and shareholders of S corporations claim the credit in proportion to their ownership interest, or as specially allocated in their organizational documents.

To be eligible for tax credits, a fund's investments in certified businesses must be verified by Commerce. The verification form issued by Commerce must be submitted with the investor's Wisconsin income tax form.

"Investment" means the investment of cash in a qualified new business venture (certified business) in exchange for any of the following: (a) common stock; (b) partnership or membership interest; (c) preferred stock; (d) an equivalent ownership interest in the qualified new business venture acceptable to commerce.

10. Supplement to Federal Historic Rehabilitation Credit. A corporation may claim a credit against taxes due for up to 5% of qualified rehabilitation expenditures for certified historic structures. A certified historic structure is defined as a building that is listed in the National Register of Historic Places or that is determined to be historic and will be listed in the National Register. The building must be used for the production of income, such as commercial, industrial, or residential rental purposes. "Qualified rehabilitation expenditures" are amounts incurred that must be capitalized and added to the basis of the building rather than being deducted. Qualified expenditures don't include any amount being depreciated under an accelerated method, the cost of acquiring the building itself, or any expense for enlargement of an existing building. Expenses capitalized or properly chargeable to a capital account are those that are properly includable in calculating the basis of real property, such as architectural, engineering, and site survey fees, and construction period interest and taxes that are treated by the taxpayer as chargeable to a capital account. Also included are legal and development fees, insurance premiums, and construction costs.

Qualified rehabilitation expenditures are eligible for the credit only if incurred in connection with substantial rehabilitation of property located in the state, if the physical work of construction or destruction in preparation for construction begins after December 31, 1988, and the rehabilitated property is placed in service after June 30, 1989. The test of substantial rehabilitation generally is met if the qualified expenditures during a two-year period (60 months for phased rehabilitation) exceed the greater of $5,000 or the adjusted basis of the building. However, qualified rehabilitation expenditures that are eligible for the credit are not limited to those used for the purposes of meeting the substantial rehabilitation test. Unused credit amounts can be carried forward up to 15 years to

offset future tax liabilities.

11. Wisconsin Insurance Security Fund Assessments Credit. The Wisconsin Insurance Security Fund is a nonprofit legal entity (Association) created by the Wisconsin Legislature to protect Wisconsin resident policyholders in the event of an insolvency of a member insurance company. To provide this protection, the Association continues insurance policy coverage while paying the claims and other policy benefits under life, annuity, accident, and health insurance policies. All insurance companies (with certain exceptions) licensed to write life and health insurance, or annuities in the state are required to be a member of the Association.

If a member company becomes insolvent, and the company's assets and reserves are inadequate, money to continue coverage and pay claims is obtained through assessments of the other member insurance companies writing the same line or lines of insurance as the insolvent company. If the premium rates are fixed on the line of business so that it is not possible for an insurer to recoup its assessments by increasing those premium rates, the insurer may claim a credit against any state tax liability, including the state corporate income and franchise tax, for the assessment.

12. Internet Equipment Credit. Provisions of 2005 Wisconsin Act 479 created a sales tax exemption and related corporate and individual income and franchise tax credit for certain internet equipment used in the broadband market to provide internet availability in areas of the state where there is no service provider. The Department of Commerce is required to certify businesses as eligible for the sales tax exemption and for related income and franchise tax credits, and to determine the maximum amount of tax credits and exemptions that a business can claim. Commerce can only allocate tax credits and exemptions to a business if the allocation of credits and exemptions is likely to increase the availability of broadband internet service in areas of the state that are not served, or are served by one broadband internet service provider.

A sales tax exemption is provided for the gross receipts from the sale of and the storage, use, or other consumption of internet equipment used in the broadband market. To receive the exemption, the purchaser must certify to Commerce, in a manner prescribed by the Department, that the business will, by June, 2009, make an investment that is reasonably calculated to increase broadband internet availability in the state. Every business that receives the exemption is required, within 60 days after the end of the year in which the investment is made, to file a report describing the investment.

A business may claim a tax credit against state individual income and corporate income and franchise tax liability the amount of the sales tax exemption for each of two tax years. The credit can be claimed in the first tax year following the tax year in which the business claimed the exemption. The amount of tax credits allocated to each business for each year the business can claim the tax credits must equal the amount of sales tax exemptions allocated to that business. The credit is not refundable, but unused credit amounts may be carried forward up to 15 years to offset future tax liabilities. The total amount of internet equipment sales tax exemptions and internet equipment income and franchise tax credits that can be allocated to all eligible businesses cannot exceed $7.5 million.

Partnerships, LLCs, and tax-option corporations may not claim the credit, but eligibility for, and computation of the credit are determined at the entity level. A partnership, LLC, or tax-option corporation must compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations can claim the credit in proportion to their ownership interests.

"Internet equipment used in the broadband market" is defined as equipment that is capable of

transmitting data packets or internet signals at speeds of at least 200 kilobits per second.

The internet equipment sales tax exemption was effective on July 1, 2007. Consequently, the individual and corporate income and franchise tax credit could first be claimed in tax years beginning on or after August 1, 2007. All of the $7.5 million has been allocated to nine certified businesses.

13. Film Production Credits. Provisions of 2005 Wisconsin Act 483 created both a film production services tax credit and a film production investment tax credit under the state individual and corporate income and franchise taxes.

Film Production Services Tax Credit. An eligible taxpayer can claim as a credit against the individual and corporate income and franchise taxes any of the following:

a. An amount equal to 25% of the salary or wages paid by the claimant to the claimant's employees, up to a maximum credit of $25,000 per employee, for services rendered in the state to produce an accredited production and paid to employees who were residents of the state at the time they were paid. The salary or wages have to be paid for services rendered after December 31, 2007, and directly incurred to produce the accredited production. The tax credit cannot be claimed for the salaries or wages of the two highest paid employees. Unused tax credit amounts can be carried forward up to 15 years to offset future tax liabilities.

b. An amount equal to 25% of production expenses paid by the claimant to produce an accredited production. If the amount of tax credit exceeds the taxpayer's income or franchise tax liability, the amount of credit not used to offset the tax due is certified by the Department of Revenue and refunded to the claimant by check, share draft, or other draft.

c. An amount equal to the sales and use taxes paid by the claimant on the purchase of tangible personal property and taxable services that are used directly in producing an accredited production in the state, including all stages of production, from the final script stage to the distribution of the finished production. Unused tax credit amounts can be carried forward up to 15 years to offset future tax liabilities.

In order to claim a tax credit, the claimant is required to file an application with the Department of Commerce, at the time and in a manner prescribed by the Department, and Commerce is required to approve the application and accredit the production for the purpose of claiming the tax credit. If Commerce accredits a production it must determine the amount of production expenditures that are eligible for the tax credit.

Partnerships, LLCs, and S corporations cannot claim the tax credit, but eligibility for and the amount of the credit is based on the entity's payment of allowable wages and salaries. A partnership, LLC, or tax-option corporation is required to compute the amount of the tax credit each of its partners, members, or shareholders can claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations can claim the credit in proportion to their ownership interest.

"Accredited production" is defined as a film, video, electronic game, broadcast advertisement, or television production, as approved by the Department of Commerce, for which aggregate salary and wages included in the cost of production for the period ending 12 months after the month in which the principal filming or taping of the production begins exceeds $100,000 for a production that is 30 minutes or longer, or $50,000 for a production that is less than 30 minutes. "Accredited production" does not include any of the following, regardless of production costs:

a. News, current events, or public programming, or a program that includes weather or market reports.

b. A talk show.

c. A production with respect to a questionnaire or contest.

d. A sports event or sports activity.

e. A gala presentation or awards show.

f. A finished production that solicits funds.

g. A production for which the production company is required under federal law to maintain records with respect to performers in programs with sexually explicit content.

h. A production produced primarily for industrial, corporate, or institutional purposes.

"Production expenditures" means any expenditures that were incurred in the state and directly used to produce an accredited production, including expenditures for set construction and operation, wardrobes, make-up, clothing accessories, photography, sound recording, sound synchronization, sound mixing, lighting, editing, film processing, film transferring, special effects, visual effects, renting or leasing facilities or equipment, renting or leasing motor vehicles, food, lodging, and any other similar expenditure as determined by Commerce. "Production expenditures" also include expenditures for: (a) music that is performed, composed, or recorded by a musician who is a resident of the state, or published or distributed by an entity that has its headquarters in the state; (b) air travel that is purchased from a travel agency or company that has its headquarters in the state; and (c) insurance that is purchased from an insurance agency or company that has its headquarters in the state. "Production expenditures" do not include expenditures for the marketing and distribution of an accredited production.

An eligible claimant is a film production company that operates an accredited production in the state. The company must own the copyright in the accredited production, or have contracted directly with the copyright owner, or a person acting on the owner's behalf, and the company must have a viable plan as determined by Commerce for the commercial distribution of the finished production.

Film Production Company Investment Tax Credit. An eligible claimant can claim as a credit against individual and corporate income and franchise taxes, for the first three tax years that the claimant does business in the state as a film production company, an amount that equals 15% of the following that the claimant paid in the tax year to establish a film production company in Wisconsin:

a. The purchase price of depreciable, tangible personal property. The claimant must purchase the tangible personal property after December 31, 2007, and at least 50% of the property's use must be in the claimant's business as a film production company. Unused tax credit amounts can be carried forward up to 15 years to offset future tax liabilities.

b. The amount expended to construct, rehabilitate, remodel, or repair real property. A claimant can claim the credit if the claimant began the physical work of construction, rehabilitation, remodeling, or repair, or any demolition or destruction in preparation for the physical work, after December 31, 2007, and if the completed project is placed in service after December 31, 2007. A claimant can also claim the credit for an amount expended to acquire real property, if the property is not previously owned property, and if the claimant acquires the property after December 31, 2007, and the completed project is placed in service after December 31, 2007. Unused tax credit amounts can be carried forward up to 15 years to offset future tax liabilities.

In order to claim a film production company investment tax credit, the Department of Commerce must certify, in writing, that the credits claimed were for expenses related to establishing a film production company in the state. The claimant

has to submit a copy of the certification with the return.

Partnerships, LLCs, and S corporations cannot claim the tax credit, but eligibility for and the amount of the credit are based on the entity's allowable investments as described above. A partnership, LLC, or tax-option corporation is required to compute the amount of the tax credit each of its partners, members or shareholders can claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations claim the credit in proportion to their ownership interest.

"Film production company" is defined as an entity that creates films, videos, electronic games, broadcast advertisement, or television productions, not including the productions specifically excluded under the definition of "accredited production" used for the film production services tax credit (described above). "Physical work" does not include preliminary activities such as planning, designing, securing financing, researching, developing specifications, or stabilizing property to prevent deterioration. "Previously owned property" means real property that the claimant or a related person owned during the two years prior to doing business in the state as a film production company, and for which the claimant could not deduct a loss from the sale of the property to, or an exchange of the property with, the related person as defined under the federal IRC.

14. Health Insurance Risk-Sharing Plan (HIRSP) Assessments. Provisions included in 2005 Wisconsin Act 74 created a tax credit for health insurance risk-sharing plan assessments under the state individual and corporate income and franchise taxes and the state insurance premiums tax. HIRSP offers health insurance coverage to individuals with adverse medical histories and others who cannot obtain affordable health care coverage from the private sector. There are three sources of funding used to support HIRSP: (a) premiums paid by participants; (b) assessments on health insurance companies doing business in Wisconsin; and (c) a pro rata reduction in the billed charges of health care providers.

A tax credit is provided equal to a percentage of the amount of HIRSP assessments paid by an insurer in the calendar year in which the claimant's tax year begins. DOR, in consultation with the Office of the Commissioner of Insurance (OCI), is required to determine the credit percentage for each tax year so that the amount of income, franchise, and premiums tax credits awarded to all insurers is as close as practicable to $5 million in each state fiscal year. The percentage is equal to $5 million (the annual total credit amount limit) divided by the aggregate HIRSP annual assessment. Unused tax credits can be carried forward up to 15 years to offset future income and franchise tax liabilities.

The tax credit could first be computed for tax years beginning on or after December 31, 2005. However, the amount of tax credits that a claimant was awarded for tax years beginning after December 31, 2005, and before January 1, 2008, can first be claimed against income and franchise taxes imposed for tax years beginning on or after December 31, 2007.

Partnerships, tax-option corporations and limited liability companies cannot claim the tax credit, but eligibility for, and the amount of credit that could be claimed is based on the assessment paid by the entity. A partnership, LLC, or tax-option corporation must compute the amount of tax credit that each of its partners, members, or shareholders can claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations can claim the tax credit in proportion to their ownership interest.

15. Electronic Medical Records Credit. 2007 Wisconsin Act 20 created an electronic medical records tax credit under the individual and corporate income and taxes. The tax credit equals 50% of the amount paid by a health care provider in a tax year for information technology hardware

or software that is used to maintain medical records in an electronic form. Tax credits not entirely used to offset income and franchise taxes can be carried forward up to 15 years to offset future tax liabilities. The maximum total amount of electronic medical records tax credits that can be claimed in a tax year is $10 million, and is allocated to claimants by the Department of Commerce.

Commerce is required to implement a program to certify health care providers as eligible to claim the electronic medical records tax credit. After certifying health care providers as eligible, Commerce is required to allocate tax credits to individual claimants, subject to the annual total credit limit of $10 million. Commerce must inform DOR of every health care provider that is certified and of the amount of tax credits allocated to each provider. Commerce must also, in consultation with DOR, promulgate rules to administer the certification and tax credit allocation process.

Partnerships, LLCs, and tax-option corporations cannot claim the tax credit, but eligibility for and the amount of the credit is based on the entity's payment of allowable information technology costs. A partnership, LLC, or tax-option corporation is required to compute the amount of the tax credit each of its partners, members, or shareholders can claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations can claim the credit in proportion to their ownership interest.

"Health care provider" means a licensed nurse, chiropractor, dentist, physician, podiatrist, perfusionist, physical therapist, occupational therapist, occupational therapy assistant, physician assistant, respiratory care practitioner, dietician, athletic trainer, optometrist, pharmacist, acupuncturist, psychologist, social worker, marriage and family therapist, professional counselor, speech-language pathologist, audiologist, speech and language pathologist, massage therapist, bodyworker, a partnership of providers, a corporation or LLC of providers that offer health care services, an operational cooperative sickness care plan that directly provides services through salaried employees at its own facility, a hospice, a rural medical center, an inpatient health care facility, and a community-based residential facility.

The electronic medical records tax credit can first be claimed for tax years beginning after December 31, 2009.

16. Ethanol and Biodiesel Fuel Pump Credit. 2007 Act 20 created an ethanol and biodiesel fuel pump tax credit under the state individual and corporate income taxes, equal to 25% of the amount paid in a tax year to install or retrofit pumps located in Wisconsin that dispense motor fuel consisting of at least 85% ethanol, or at least 20% biodiesel fuel. The tax credit can be claimed for tax years beginning after December 31, 2007, and before January 1, 2018. The maximum tax credit for a tax year cannot exceed $5,000 for each service station that claims a credit for an installed or retrofitted pump. Unused credit amounts may be carried forward up to 15 years to offset future tax liabilities.

Partnerships, LLCs, and tax-option corporations cannot claim the credit, but eligibility for, and the amount of the tax credit is based on eligible expenditures for installation and retrofitting. A partnership, LLC, or tax-option corporation is required to compute the amount of credit each of its partners, members, or shareholders can claim and to provide that information to them. Partners, members, and shareholders claim the credit in proportion to their ownership interests.

"Motor vehicle fuel" means gasoline or diesel fuel. "Biodiesel fuel" means a fuel that is comprised of monoalkyl esters of long chain fatty acids derived from vegetable oils or animal fats.

17. Community Rehabilitation Program Credit. 2007 Act 20 created, under the state individual and corporate income taxes, for tax years beginning on or after July 1, 2009 a community rehabilitation program tax credit that equals 5% of the amount the claimant pays in a tax year to a community

rehabilitation program to perform work for the claimant's business, pursuant to a contract. The maximum tax credit that can be claimed is $25,000 for each community rehabilitation program that the claimant enters into a contract with, and unused credit amounts can be carried forward up to 15 years to offset future tax liabilities. In order to claim a credit, the claimant is required to submit with the claimant's return, a form prescribed by the Department of Revenue, that verifies that the claimant has entered into a contract with a community rehabilitation program, and that the program has received payment from the claimant for work provided by the program.

Partnerships, LLCs, and tax-option corporations cannot claim the tax credit but eligibility for, and the amount of, the tax credit is based on entity payments for community rehabilitation programs. Partnerships, LLCs, or tax-option corporations must compute the amount credit that each of its partners, members, or shareholders may claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations may claim the credit in proportion of their ownership interest.

"Community rehabilitation program" is defined as a nonprofit entity, county, municipality, or federal agency that directly provides, or facilitates the provision of, vocational rehabilitation services to individuals who have disabilities to maximize the employment opportunities, including career advancement, of such individuals. "Vocational rehabilitation services" is defined to include education, training, employment, counseling, therapy, placement, and case management. "Work" is defined to include production, packaging, assembly, food service, custodial service, clerical service, and other commercial activities that improve employment opportunities for individuals who have disabilities.

18. Biodiesel Fuel Production Credit. 2007 Act 20 established, for tax years beginning on or after January 1, 2009, and before January 1, 2013, under the state individual and corporate income taxes, a tax credit equal to 10 cents per gallon for biodiesel fuel produced by biodiesel fuel producers located in Wisconsin that produce at least 2.5 million gallons of biodiesel fuel per year. The maximum credit that can be claimed is $1 million.

Partnerships, LLCs, and tax-option corporations cannot claim the tax credit but eligibility for, and the amount of, the tax credit is based on their biodiesel fuel production. Partnerships, LLCs, or tax-option corporations must compute the amount of credit that each of its partners, members, or shareholders may claim and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations may claim the credit in proportion to their ownership interest.

Economic Activity Zone Tax Credits.

Wisconsin has numerous programs that provide tax credits to businesses for various types of economic activity in designated areas of the state. These programs include: (a) development zones; (b) enterprise development zones; (c) development opportunity zones; (d) technology zones; (e) agricultural development zones; (f) airport development zones; and (g) enterprise zones. The Department of Commerce is generally authorized to designate or approve, and to administer the various zone programs. Commerce also verifies or certifies expenditures and/or claimants as eligible to claim tax credits. Each of these zone programs provides certain tax credits to eligible businesses operating in the zones.

Development Zones. Development zones are designated areas in municipalities and counties, or American Indian reservations that meet certain economic distress criteria, such high employment, and low incomes. The program includes 22 zones, including zones that encompass 17 entire counties and two American Indian reservations. A total of $38.155 million in tax credits can be claimed under the program, and $34.2 million has been allocated to businesses in the zones. Eligible businesses in the zones can claim the development zones jobs and environmental remediation tax credit.

Enterprise Development Zones. Enterprise development zones provide tax credits to new or expanding business projects that will affect areas that meet economic distress criteria. The program has authorized 98 zones, including 10 zones for environmental remediation projects, to be designated in municipalities and counties. A total of $201.4 million in tax credits has been allocated to businesses in the zones. Businesses in the zones can claim the development zones jobs and environmental remediation tax credit.

Development Opportunity Zones. Development opportunity zones are designated areas in certain municipalities that are the location of a business project. One development opportunity zone has been designated in Beloit through August 31, 2010. A total of $6.7 million in tax credits have been authorized for businesses in the zone. Businesses in the zone can claim the development zones jobs and environmental remediation tax credit, and development zones capital investment tax credit. Other zones in Beloit, Eau Claire, Kenosha, Milwaukee, and West Allis have lapsed.

Technology Zones. Technology zones are relatively large areas of the state designated to provide tax credits to high-tech or technology-based businesses. A total of eight technology zones have been designated encompassing 54 counties. The maximum amount of tax credits that can be claimed in each zone is $5 million. However, under provisions enacted by 2007, Wisconsin Act 183, up to $6.0 million in unallocated airport development zone tax credits can be allocated to technology zones for which the $5.0 million tax credit limit is insufficient. A total of $24.6 million in tax credits have been allocated to businesses in the zones. Eligible businesses can claim technology zones tax credits for jobs created, capital investments, and property taxes paid.

Agricultural Development Zone. The agricultural development zone includes rural, low-population counties and provides tax credits to agricultural businesses. Eighteen counties (not designated as technology zones) have been designated as an agricultural development zone. The maximum amount of tax credits that can be claimed in the zone is $5 million. However, up to $6.0 million in unallocated airport development zones tax credits can be allocated to the agricultural development zone, if the $5.0 million tax credit allocation is insufficient. A total of $3.8 million in tax credits have been allocated to businesses in the zone. Agricultural businesses in the zone can claim development zones capital investment tax credits and the jobs and environmental remediation tax credit.

Airport Development Zones. Airport development zones were created by 2005 Wisconsin Act 487, and may be designated in areas that include airports that have certain primary and secondary runway lengths. Businesses that locate or expand operations, increase employees, or increase investment in the zone are eligible for tax credits. The maximum amount of tax credits that can be claimed in a zone is $3 million and the maximum total amount of tax credits that can be claimed through the program is $9 million. As noted, up to $6.0 million in unallocated airport development zone tax credits can be allocated to technology zones or the agricultural development zone. Businesses in airport development zones can claim the development zones capital investment tax credit and the consolidated jobs and environmental remediation tax credit.

Enterprise Zones. Enterprise zones were created by 2005 Wisconsin Act 361, and may be designated in areas that demonstrate economic need as measured by such factors as household income, average wages, and housing values. An enterprise zone may not exceed 50 acres, and a total of 10 zones can be designated. Businesses that locate or expand operations in the zone can claim the enterprise zone jobs tax credit.

Prior to 1997 Act 27, businesses in development zones, development opportunity zones, and enterprise development zones were eligible for any of seven development zone tax credits including:

the jobs credit; investment credit; location credit; sales tax credit; research credit; day care credit; and environmental remediation credit. The jobs and sales tax credits were refundable. In general, those tax credits can no longer be claimed. The current tax credits that are available to businesses that operate in economic activity zones are outlined below.

1. Development Zones Credit. Currently, a development zone tax credit can be claimed by businesses in development, enterprise development, development opportunity, airport development, and the agricultural development zone. Businesses in technology zones are statutorily authorized to claim the development zones tax credit, but only if certified by the Department of Commerce.

The development zones tax credit is based on amounts spent on environmental remediation and the number of full-time jobs created or retained.

a. *Environmental Remediation Component.* A credit against income taxes due can be claimed for 50% of the amount expended for environmental remediation in a zone. "Environmental remediation" is defined as: (a) removal or containment of environmental pollution; (b) restoration of soil or groundwater that is affected by environmental pollution in a brownfield; or (c) investigation, unless the investigation determines that remediation is required and remediation is not undertaken. The removal, containment, or restoration work, other than planning and investigating, must begin after the site where the work is being done is designated a zone and after the claimant is certified for tax benefits. "Environmental pollution" means the contaminating or rendering unclean or impure the air, land, or waters of the state, or making the same injurious to public health, harmful for commercial or recreational use, or deleterious to fish, bird, animal, or plant life. "Brownfield" is defined as an industrial or commercial facility the expansion or redevelopment of which is complicated by environmental contamination.

b. Full-Time Jobs Component. A credit against income taxes can be claimed for up to the following amounts for job creation or retention: (a) up to $8,000 for each full-time job created in a zone and filled by a member of a targeted group; (b) up to $8,000 for each full-time job retained in an enterprise development zone (excluding jobs for which the former jobs tax credit was claimed) if Commerce determines that the person made a significant capital investment to retain the full-time job; (c) up to $6,000 for each full-time job created or retained (excluding jobs for which the former jobs tax credit was claimed) filled by a Wisconsin resident who is not a member of a targeted group. Amounts claimed for Wisconsin Works (W-2) program participants must be reduced by W-2 wage subsidies that the employer receives for those jobs. At least one-third of jobs tax credits claimed must be based on jobs created and filled by targeted group members. In addition, except for businesses that only claim tax credits for environmental remediation, 25% of all tax credits must be based on creating or retaining full-time jobs.

"Full-time job" is defined as a regular, nonseasonal, full-time position in which an individual, as a condition of employment, is required to work at least 2,080 hours per year, including leave and paid holidays. The individual must receive pay equal to at least 150% of the federal minimum wage and also receive benefits that are not required by federal or state law. However, Commerce requires that starting pay for the new positions must be at least $9.75 per hour. A full-time job does not include initial training before an employment position begins.

"Member of a targeted group" is defined as a Wisconsin resident who resides in an area designated by the federal government as an economic revitalization area or is a member of one of the following groups:

a. *Dislocated Workers.* A dislocated worker includes an individual who: (1) has been terminated or laid-off, or has received a termination or layoff notice, or is eligible for or has exhausted his or her entitlement to unemployment compensation,

or has been employed long enough to show attachment to the workforce, but is not eligible for unemployment compensation due to insufficient earnings or having performed services for an employer that were not covered under state unemployment compensation law, and is unlikely to return to his or her previous industry occupation; (2) is employed at a facility where the employer has made a general announcement that the facility will close within 180 days; (3) was self-employed (including farmers) and is unemployed as a result of general economic conditions in the community in which he or she resides, or because of natural disasters; or (4) is a displaced homemaker who has been dependent on the income of another family member and is no longer supported by the income, or is unemployed or underemployed and experiencing difficulty in updating or obtaining employment.

b. *Economically Disadvantaged Youths.* An individual who is between 18 and 23 years of age on the hiring date, and is a member of an economically disadvantaged family (family income level no greater than 70% of the U.S. Bureau of Labor Statistics lower living standard).

c. *Economically Disadvantaged Ex-Convicts.* An individual who: (1) was convicted of a felony under any federal or state law; and (2) is a member of an economically disadvantaged family; and (3) is hired within five years of being convicted or released from prison.

d. *Vocational Rehabilitation Referrals.* An individual who: (1) has a physical or mental disability that results in a substantial barrier to employment; and (2) is referred to the employer upon completing or while receiving rehabilitative services under an individualized written rehabilitation plan under a state plan for vocational rehabilitation, or a program of vocational rehabilitation for veterans.

e. *Economically Disadvantaged Veterans.* An individual who: (1) served on active duty in the U.S. Armed Forces for more than 180 days or who was discharged or released from active duty because of a service-connected disability; (2) was not on active duty for more than a 90-day period, or any day in the 60-day period that ends on the date the employee is hired; and (3) is a member of an economically disadvantaged family.

f. *General Assistance Recipients.* An individual who received assistance under a general assistance program for any month ending within the 60-day period that ends on the date the individual is hired.

g. *Supplemental Security Income (SSI) Recipients.* An individual who received SSI benefits for any month ending within the 60-day period that ends on the date the individual is hired.

h. *Qualified Summer Youth Employees.* An individual who: (1) works for the employer between May 1 and September 15; (2) is at least 16 or 17 years of age when hired, or on May 1 if the individual is hired before that date; (3) has not previously worked for the employer; and (4) is a member of an economically disadvantaged family. An employer can claim the credit for a summer youth employee only once. If the employee continues working during the school year on a permanent basis, the employee may be recertified as a member of another target group.

i. *W-2 Participants.* An individual who: (1) is employed in an unsubsidized job but meets eligibility requirements; (2) is employed in a state-subsidized job under W-2; or (3) is eligible for W-2 child care assistance. Included in this group are participants in the Real Work, Real Pay (RWRP) pilot project.

j. *Food Stamp Recipients.* An individual who: (1) is a member of a family receiving food stamps for six months immediately prior to the hiring date; or (2) is a member of a family receiving food stamps for at least three months during the five months before the hiring date, and whose benefits were cancelled under federal law.

k. *Residents of a Federally Designated Economic*

Revitalization Area. An individual who is a resident of a federally designated revitalization area. In Wisconsin, the designated areas are the Northwoods Niijii Enterprise Community in Northern Wisconsin, and the Milwaukee federal renewal community.

The development zone tax credit can be used to offset the claimant's state income tax liability. Credits that are not entirely used to offset income or franchise taxes in the current year can be carried forward up to 15 years to offset future tax liabilities. Internal Revenue Code provisions govern the carry-forward of unused credits in cases where there is a change of ownership. If a certification of eligibility for tax benefits is revoked, credits cannot be claimed for the tax year in which the certification was revoked or for successive tax years, and unused credits cannot be carried forward to offset tax liabilities for the year in which certification was revoked and succeeding years. In addition, credits cannot be claimed for the year in which a person that was certified for tax benefits ceases business operations in a zone, and unused credit amounts cannot be carried forward from that year or from previous years.

Partnerships, LLCs, and tax option corporations may not claim the tax credit, but eligibility for, and the amount of credit is determined based on the economic activity of the entity. The partnership, LLC, tax-option corporation must compute the amount of credit that may be clamed by each partner, member, or shareholder and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations may claim the tax credit in proportion to their ownership interest.

2. *Technology Zones Credit.* A business that is located in a technology zone and that is certified by the Department of Commerce may be eligible to claim the technology zone tax credit. To be certified as eligible for the technology zone credit, the business must be new or expanding and be a high-technology business. High-technology business means either of the following:

a. A business engaged in the activities of the research, development, or manufacture of advanced products or materials for use in factory automation, biotechnology, chemicals, computer hardware, computer software, defense, energy, environmental, manufacturing equipment, medical, pharmaceuticals, photonics, subassemblies and components, test and measurement, telecommunications, and transportation.

b. A business identified as part of a target cluster that is a knowledge-based business or a business that utilizes advanced technology production processes, systems, or equipment. Knowledge-based businesses possess some, if not all, of the following attributes: highly skilled and educated workforce; high level of research and development activities; strong export orientation; high percentage of intangible assets; and products and materials with short life expectations and high gross margins. In addition, knowledge-based businesses are considered more likely to use and/or develop advanced technologies and to be innovative in their products, services, or processes.

Under current law, the technology zones tax credit equals the sum of the following: (a) the amount of real and personal property taxes paid during the tax year; (b) 10% of capital investments made, including the purchase price of depreciable, tangible personal property, and the amount expended to acquire, construct, rehabilitate, remodel, or repair real property in a technology zone; and (c) 15% of the amount spent for the first 12 months of wages for each job created in a technology zone. Credits may be used to offset the income or franchise tax liability of the claimant. Credits that are not entirely used to offset income or franchise taxes in the current year can be carried forward up to 15 years to offset future tax liabilities.

Generally the maximum amount of credits that can be claimed in a technology zone is $5.0 million. However, up to $6.0 million in unallocated airport development zone tax credits can be allocated to technology zones for which the $5.0 million maximum tax credit limit is insufficient.

Partnerships, LLCs, and tax option corporations may not claim the tax credit, but eligibility for, and the amount of credit is determined based on the economic activity of the entity. The partnership, LLC, tax-option corporation must compute the amount of credit that may be clamed by each partner, member, or shareholder and provide that information to them. Partners, members of LLCs, and shareholders of tax-option corporations may claim the tax credit in proportion to their ownership interest.

Claimants must include with the tax return a copy of the verification of the businesses certification and agreement with Commerce, and verification of expenses from Commerce.

3. *Development Zone Capital Investment Credit.* The development zone capital investment tax credit equals 3% of the following:

a. The purchase price of depreciable, tangible personal property. The property must have been purchased after the claimant was certified as eligible for tax benefits and the personal property has to have at least 50% of its use in the claimant's business location in the zone. If the property is mobile, the base of operations for at least 50% of its use must be in the zone.

b. The amount expended to acquire, construct, rehabilitate, remodel, or repair real property in the zone. Such expenses are eligible for the credit if the claimant began the physical work of construction, rehabilitation, remodeling or repair, or any demolition or destruction in preparation for the physical work, after the place where the property is located was designated a zone, or if the completed project is placed in service after the claimant is certified for tax benefits. A credit cannot be claimed for expenses for preliminary activities such as planning, designing, securing financing, research, developing specifications, or stabilizing the property to prevent deterioration.

A claimant can also claim a tax credit for amounts expended to acquire real property, if the property was not previously owned and the claimant acquired the property after the place where the property was located was designated a zone or if the completed project was placed in service after the clamant was certified as eligible for tax benefits.

In calculating the capital investment credit for purchases of real property, a claimant is required to reduce the amount expended to acquire the property by a percentage equal to the percentage of the area of the real property that is not used for the purposes for which the claimant is certified as eligible for tax benefits. Similarly, the amount expended for other purposes must be reduced by the amount expended on the part of the property not used for purposes for which the claimant is certified.

Credits can be used to offset income tax liabilities of claimants. Credits that are not entirely used to offset income or franchise taxes in the current year can be carried forward up to 15 years to offset future tax liabilities. Claimants are required to include with their tax return: (a) Commerce verification that the claimant is eligible for tax credit; and (b) a statement from Commerce verifying the purchase price and eligibility of the investment. If a certification of eligibility for tax benefits is revoked, credits cannot be claimed for the tax year in which the certification is revoked or for successive tax years, and unused credits cannot be carried forward to offset tax liabilities in succeeding years. In addition, credits cannot be claimed for the year in which a business that is certified for tax benefits ceases businesses operations in a zone and unused credit amounts cannot be carried forward from that year or from previous years.

Partnerships, LLCs, and tax-option corporations may not claim the tax credit, but eligibility for, and the amount of, the credit is determined based on the investment of the entity. The partnership, LLC, or tax-option corporation must compute the amount of credit that may be claimed by each partner, member, or shareholder and provide that information to them. Partnerships, members, of

LLCs, and shareholders of tax-option corporations may claim the tax credit in proportion to their ownership interest.

DOR is authorized to deny any portion of a credit that was claimed if allowing the full credit would cause the total amount of credits to exceed the maximum credit limit.

Authority to Claim Tax Credits Based on the Economic Activity of Another. Development zone tax credits can be claimed based on the economic activity of another in the Beloit development opportunity zone. The Department of Commerce is authorized to certify as eligible for tax credits a business that is conducting economic activity in the zone that would not otherwise be entitled to claim the credits if certain criteria are met. (This provision is intended to address cases where a person develops a business location for lease to another business, and the lessee business created jobs but cannot claim the jobs component of the development zones tax credit.) In order for Commerce to certify a business as eligible for credits based on the economic activity of another business, the following must apply:

a. The economic activity must be instrumental in enabling another business to conduct economic activity in the development opportunity zone.

b. Commerce determines that the economic activity of the other business would not occur without involvement of the business to be certified.

c. The business to be certified for tax benefits will pass the tax benefits through to the other business conducting economic activity in the development opportunity zone.

d. The other business conducting economic activity in the zone does not itself claim tax benefits.

The business that intends to claim tax benefits based on the economic activity of another business is required to submit an application to Commerce with information required by Commerce and DOR. Commerce is required to verify information submitted for tax credits and to notify DOR of all businesses that are certified to claim the credits. Commerce is required to revoke entitlement to claim tax credits if the business does any of the following: (a) supplies false or misleading information to obtain tax benefits; (b) ceases operations in the development opportunity zone; or (c) does not pass the benefits through to the other business conducting economic activity in the zone.

4. *Enterprise Zones Jobs Credit*. The enterprise zones jobs tax credit was created by 2005 Wisconsin Act 361, and provides tax credits to eligible businesses operating in enterprise zones. The method of computing the refundable jobs tax credit was changed in 2007 Wisconsin Act 20. The credit is a refundable tax credit and is provided under the state individual and corporate income taxes to businesses that are certified by the Department of Commerce. The enterprise zones jobs tax credit is computed as follows:

a. Determine the lesser of: (1) the number of full-time employees that are employed in an enterprise zone whose annual wages are greater than $30,000 in the tax year minus the number of full-time employees that are employed in the enterprise zone in the base year whose annual wages are greater than $30,000 in the base year; or (2) the number of full-time employees in the state whose annual wages are greater than $30,000 in the tax year minus the number of full-time employees in the state whose annual wages are greater than $30,000 in the base year.

b. Determine the claimant's average zone payroll by dividing total wages for full-time employees in the zone whose annual wages are greater than $30,000 for the tax year by the number of those employees.

c. Subtract $30,000 from the average wage determined under " b."

d. Multiply the amount determined under "c" (average wage in excess of $30,000 a year) by the number determined under "a" (net number of new employees hired in the zone).

e. Multiply the amount determined under "d" by 7%.

"Zone payroll" means wages paid to full-time employees for services performed in the zone. "Wages" is defined under federal unemployment tax provisions to mean all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with specified exceptions, such as payments to certain trusts or annuity plans.

A supplemental tax credit can be claimed based on the claimant's qualified training expenses.

Training Component. The claimant may claim a credit equal to the amount paid in the tax year to upgrade or improve the job-related skills of any of the claimant's full-time employees, to train any of the claimant's full-time employees on the use of job-related new technologies, or to provide job-related training to any full-time employee whose employment with the claimant represents the employee's first full-time job.

As noted, the credit is refundable. Therefore, if the amount of credit exceeds the claimant's income or franchise tax liability, the state issues a check to the claimant for the difference.

No credit is allowed unless the claimant includes with the tax return a copy of the claimant's certification for tax benefits. Businesses may not claim enterprise zone tax credits to the extent the basis for the credit is the basis for another tax credit claimed by the business.

Commerce is authorized to certify for tax benefits any of the following:

a. A business that begins operations in an enterprise zone.

b. A business that relocates to an enterprise zone from outside the state if the business offers compensation and benefits to its employees working in the zone for the same type of work that are at least as favorable as those offered outside the zone.

c. A business that expands its operations in an enterprise zone and increases its personnel by at least 10% and enters into an agreement with Commerce to claim tax benefits only for years during which the business maintains the increased level of personnel. The business must offer compensation and benefits for the same type of work to its employers working in the enterprise zone that are at least as favorable as those offered to its employees working in Wisconsin but outside the zone.

d. A business that expands its operations in an enterprise zone and that makes a capital investment in property located in the enterprise zone if the following apply: (1) the value of capital investment is equal to at least 10% of the business' gross revenues in the state; (2) the business enters into an agreement with Commerce to claim tax benefits only for years during which the business maintains the capital investment; and (3) the business offers compensation and benefits for the same type of work to its employees in the zone that are at least as favorable as those offered to employees working in Wisconsin but outside the zone (determined by Commerce).

The Department of Commerce is required to determine the maximum amount of tax credits that a certified business may claim and notify DOR of the amount. Commerce is also required to verify information submitted to it that is related to the enterprise zone jobs tax credit. Claimants are required to include, with their tax returns, a copy of the certification for tax benefits and verification of expenses from Commerce .

Commerce must revoke a firm's certification if the business does any of the following:

a. Supplies false or misleading information to obtain tax benefits.

b. Leaves the enterprise zone to conduct substantially the same business outside the zone.

c. Ceases operations in the zone and does not renew operation of the business or a similar business in the zone within 12 months.

Commerce may require a business to repay any tax benefits the business claims for a year in which the business failed to maintain employment or capital investment levels required by the certification agreement.

Partnerships, LLCs, and tax-option corporations cannot claim the credit, but the eligibility for, and the amount of, the credit is based on their payment of the amounts eligible for the tax credit. A partnership, LLC, or tax-option corporation must compute the amount of credit that each of its partners, members, or shareholders can claim and provide that information to each of them. Partners, members of LLCs, and shareholders of tax-option corporations can claim the credit in proportion to their ownership interests.

Tax Shelter Disclosure Program

2007 Act 20 implemented a voluntary disclosure program that requires taxpayers and tax advisors to report certain types of transactions that may indicate the existence of tax shelters. Penalties are imposed for engaging in and failure to report on such activities. The specific provisions of the compliance initiative are described in the following sections. These provisions apply to business and individual taxpayers.

Disclosure of Reportable Transactions

Disclosure Requirement. Taxpayers are required to file with DOR a copy of the form prescribed by the Internal Revenue Service for disclosing a reportable transaction, for each tax year that the taxpayer participates in a reportable transaction. The filing requirement applies to any reportable transaction entered into on or after January 1, 2001, and for any reportable transaction entered into before January 1, 2001, that reduced the taxpayer's liability for tax years after that date, for any tax year for which the transaction remains undisclosed, and for which the statute of limitations on an assessment, including any extension, has not expired as of December 26, 2007. The form has to be filed no later than 60 days after the date for which the taxpayer is required to file the form for federal tax purposes, except that if the taxpayer filed a form with the IRS on or before October 27, 2007 (the effective date of Act 20), the taxpayer had to file a copy of the form with the Department by May 31, 2008. DOR can require that the disclosure form be filed separately from the taxpayer's state income and franchise tax return.

Penalty for Failure to Disclose. Any taxpayer who fails to file a required disclosure form is subject to a penalty equal to: (1) the lesser of $15,000 or 10% of the tax benefit obtained from a reportable transaction, if the taxpayer participates in such a transaction that is not a listed transaction; or (2) $30,000 if the taxpayer participates in a listed transaction. The penalties apply to: (1) any failure to disclose a listed transaction that was entered into on or after January 1, 2001, or entered into prior to January 1, 2001, that reduced the taxpayer's liability for tax years after that date, including transactions that were not listed transactions when entered into but became such before October 27, 2007; or (2) any other reportable transaction entered into on or after October 27, 2007, for any tax year for which the statute of limitations on assessment, including any extension, had not expired as of October 27, 2007. The Secretary of Revenue is authorized to waive or abate these penalties, or a portion of them, that are related to a reportable transaction that is not a listed transaction, if the waiver or abatement promotes compliance with these provisions and effective tax administration. The Secretary's decision is final.

Understatement Penalties. Taxpayers are also subject to penalties for reportable transaction understatements. In addition to any tax owed, the taxpayer is subject to a penalty of either 20% of the reportable transaction understatement, or 30% of the reportable transaction understatement in cases where the reportable transaction is not disclosed. A taxpayer has a reportable transaction understatement if the following calculation results in a positive number:

1. Multiply the taxpayer's highest applicable state individual income or corporate income and franchise tax rate by the amount of any increase in Wisconsin taxable income that results from the difference between the proper tax treatment of the reportable transaction and the taxpayer's treatment of the transaction on the taxpayer's return. This calculation also applies to any amended return the taxpayer filed before the date on which the Department first contacts the taxpayer regarding an examination of the tax year for which the amended return is filed. The amount of any increase in Wisconsin taxable income for a tax year includes any reduction in the amount of loss available for carry-forward to the subsequent year.

2. Add the amount determined under "1" to the amount of any decrease in the aggregate amount of Wisconsin income or franchise tax credits that results from the difference between the proper tax treatment of a reportable transaction and the taxpayer's treatment of the transaction as shown on the taxpayer's return.

The reportable transaction understatement penalties apply to any understatement from a reportable transaction, including a listed transaction, that was entered into on or after January 1, 2001, or entered into prior to January 1, 2001, that reduces the taxpayer's liability for tax years after that date, or for any tax year for which the statute of limitations on the assessment, including any extension, had not expired on October 27, 2007.

Additional penalties can be imposed for reportable transaction understatements. A taxpayer that files an amended return after the last day of May, 2008, and before the taxpayer is contacted by the IRS or DOR regarding a reportable transaction, is subject to a penalty equal to 50% of the interest assessed on tax due for any reportable transaction understatement for the tax period for which the IRS or DOR contacted the taxpayer. If the IRS or DOR contacts the taxpayer after the last day of May, 2008, regarding a reportable transaction, and before the taxpayer files an amended return with respect to the reportable transaction, the taxpayer is subject to a penalty equal to the interest assessed on taxes due for any reportable transaction understatement for the tax period for which the IRS or DOR contacts the taxpayer.

These penalties apply to any reportable transaction understatement that resulted from a reportable transaction, including a listed transaction, entered into on or after January 1, 2001, or entered into prior to January 1, 2001, that reduced the taxpayer's liability for tax years after that date, for any tax year for which the statute of limitations on assessment, including any extension, had not expired by October 27, 2007.

The Secretary of Revenue is authorized to waive or abate the understatement penalties, or any portion of the penalties, if the taxpayer demonstrates to the Department that the taxpayer had reasonable cause to act the way the taxpayer acted, and in good faith, in regard to the tax treatment for which a penalty is imposed, and all the facts relevant to such tax treatment are adequately included in the disclosure statement. If the taxpayer does not fully disclose such facts in the statement, the Secretary can waive the penalty if the taxpayer demonstrates to the Department that the tax treatment for which the penalty is imposed is more likely than not the proper treatment, and that substantial authority exists or existed for such tax treatment. The Secretary's decision is final.

Statute of Limitations. A statute of limitations is established for assessing taxes related to reportable transactions. In cases where a taxpayer fails to provide any information regarding a reportable trans-

action, but not including listed transactions, the time for assessing the state income or franchise tax with respect to that transaction expires on the date that is six years after the date on which the return for the tax year in which the reportable transaction occurred is filed. In cases where the taxpayer fails to provide any information regarding a listed transaction, the time for assessing the state income or franchise tax with respect to that transaction expires on the latest of the following dates:

1. The date that is six years after the date on which the return for the tax year in which the listed transaction occurred is filed.

2. The date that is 12 months after the date on which the taxpayer provides disclosure information regarding the listed transaction.

3. The date that is 12 months after the date on which the taxpayer's material advisor provides, at the Department's request, the required list of Wisconsin taxpayers served (described below).

4. The date that is four years after the date on which the Department discovers a listed transaction that was a listed transaction on the date the transaction occurs for which the taxpayer does not provide the required disclosure information, or for which the taxpayer's material advisor does not provide the required list of taxpayers served.

The limitation dates for reportable transactions and listed transactions can be extended by a written agreement between the taxpayer and DOR.

These provisions apply to any reportable transaction, including a listed transaction, entered into on or after January 1, 2001, or entered into prior to January 1, 2001, that reduced the taxpayer's liability for tax years beginning after that date.

Material Advisors. Material advisors to taxpayers are required to file disclosure statements. Each material advisor who is required to disclose a reportable transaction under the Internal Revenue Code is required to file a copy of the disclosure with DOR within 60 days after the date for which the material adviser is required to file the disclosure with the IRS. However, if the material advisor filed the disclosure with the IRS on or before October 27, 2007, the material advisor was required to file a copy of the disclosure statement with DOR by the last day of May, 2008.

Each material advisor is required to maintain a list that identifies each Wisconsin taxpayer for whom the material advisor provides services with respect to a reportable transaction, regardless of whether the taxpayer is required to file a disclosure form with DOR. A material advisor who is required to maintain such a list must provide the list to the Department, after receiving a written request to provide the list. The material advisor also has to retain the information contained in the list for seven years or for a period determined by the Department by rule. If two or more material advisors are required to maintain identical lists, DOR can authorize only one material advisor to maintain the list. The material advisor reporting provisions apply to reportable transactions, not including listed transactions, for which the material advisor provides services after October 27, 2007. The reporting provisions apply for listed transactions for which the material advisor provided services, and that were entered into, on or after January 1, 2001, or that were entered into before January 1, 2001, and that reduced the taxpayer's liability for tax years beginning after that date, regardless of when the transactions became listed transactions.

Material Advisor Penalties. Penalties are imposed on material advisors for failing to file or maintain required information, or filing false or incomplete information. Specifically, any person who fails to file a required disclosure form or files a disclosure containing false or incomplete information is subject to the following penalties: (1) $15,000 if the disclosure relates to a reportable transaction that is not a listed transaction; or (2) $100,000 if the disclosure relates to a listed transaction.

Any material advisor that fails to provide the required list of taxpayers to DOR no later than 20

business days after the date on which the person receives the request to provide the list, is required to pay a penalty to DOR that equals $10,000 per day for each day that the person does not provide the list, beginning with the day that is 21 business days after the date on which the person receives the Department's request.

The Secretary of Revenue is authorized to waive or abate the material advisor penalties, or any portion of such penalties, that are related to a reportable transaction that is not a listed transaction, if the waiver or abatement promotes compliance with the material advisor reporting provisions and effective tax administration. In cases where a penalty is imposed for failure to maintain or provide the list of taxpayers served, the Secretary can waive or abate the penalties if, on each day after the time for providing the list without incurring a penalty has expired, the person demonstrates that the failure to provide the list was due to a reasonable cause. The Secretary's decision is final.

Tax Shelter Promotion. A penalty is imposed on persons for promotion of tax shelters. Beginning on October 27, 2007, any person who organizes or assists in organizing a tax shelter, or directly or indirectly participates in the sale of any interest in a tax shelter, and who makes or provides, or causes another person to make or provide, in connection with the organization or sale of a tax shelter, a statement that the person knows, or has reason to know, is false or fraudulent as to any material matter regarding the allowability of any tax deduction or credit, the excludability of any income, the manipulation of any allocation or apportionment rule, or the securing of any other tax benefit resulting from holding an interest in the entity or participating in the plan or arrangement, is required to pay a penalty to DOR, for each such sale or act of organization. The amount of penalty equals 50% of the person's gross income derived from the sale or act of organization.

For the purpose of administering the tax shelter compliance provisions, beginning on October 27, 2007, a written communication to any person, director, officer, employee, agent, or representative of the person, or any other person holding a capital or profits interest in the person, regarding the promotion of the person's direct or indirect participation in any tax shelter will not be considered a confidential or privileged communication.

Injunction. DOR is authorized to commence an action in the circuit court of Dane County to enjoin a person from taking any action, or failing to take any action that is subject to the tax shelter compliance penalties or is in violation of the tax shelter compliance provisions or any related rules promulgated by DOR.

Definitions

"Listed transaction" means any reportable transaction that was the same as, or substantially similar to, a transaction, plan, or arrangement specifically identified by the U.S. Secretary of the Treasury as a listed transaction, for the purposes of section 6011 of the IRC (relating to tax shelter transactions), and that is specifically identified by the U.S. Secretary of the Treasury as a listed transaction on or after the date the transaction occurred.

"Material advisor" is defined as any person who provided any material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction and who, directly or indirectly, derived gross income from providing such aid, assistance, or advice in an amount that exceeded the following thresholds:

a. $50,000, in the case of a reportable transaction, not including a listed transaction from which the tax benefits are provided primarily to an individual.

b. $10,000, in the case of a listed transaction from which the tax benefits are provided primarily to an individual.

c. $250,000, in the case of a reportable transaction, not including a listed transaction, from

which the tax benefits are provided to an entity and not an individual.

d. $25,000 in the case of a listed transaction from which the tax benefits are provided primarily to an entity and not an individual.

"Reportable transaction" is defined as any transaction, plan, or arrangement, including a listed transaction, for which a taxpayer is required to submit information to DOR because the taxpayer is required to disclose the transaction, plan, or arrangement for federal income tax purposes for the tax year in which the transaction occurred, as provided under U.S. Department of Treasury regulations.

"Tax avoidance transaction" is defined as a transaction, plan, or arrangement devised for the principal purpose of avoiding federal or Wisconsin income or franchise tax and that is a reportable transaction as provided under U.S. Department of the Treasury regulations, as of October 27, 2007, and includes any transaction, as determined by DOR, that provides tax benefits for Wisconsin income and franchise tax purposes, even if there is no federal benefit.

"Tax shelter" means any entity, plan, or arrangement, if avoiding or evading federal income tax or Wisconsin income or franchise tax is a significant purpose of the entity, plan, or arrangement.

"Taxpayer" means a person who is subject to the state individual income or corporate income and franchise taxes, and who has a tax liability attributable to using a tax avoidance transaction for any tax year beginning before January 1, 2007.

Summary Data

The following tables provide summary data concerning the Wisconsin corporate income tax.

Corporate income and franchise tax collections, state general fund tax collections, and corporate tax collections as a percent of total general fund collections for fiscal year 1997-98 through fiscal year 2007-08 are shown in Table 2. The table indicates that corporate tax collections vary significantly from year to year, with annual growth rates ranging from -16.7% in 2000-01 to 23.6% in 2003-04. Corporate tax collections as a share of total general fund tax revenues ranged from 5.0% in 2001-02 to 7.1% in 2006-07.

The distribution of corporate income tax liability by Wisconsin net income class for C corporations for the 2005 tax processing year (primarily composed of tax year 2005 returns) is illustrated in Table 3.

The table shows that although 48,600 corporations filed returns, only 16,288 had net tax liability. Corporations can have no tax liabilities because deductible expenses and loss carryforwards entirely offset income. In other cases, tax credits entirely offset tax liability. Table 3 also shows that a large proportion of the corporate income tax was paid by a relatively small number of corporations. About 86% of total corporate tax liability was generated by slightly over 2% of the corporations that filed tax returns.

Aggregate data indicates that out-of-state corporations represented 33.6% of the total number of C corporation taxfilers, and paid about 43% of total corporate tax liabilities. Table 3 does not directly translate into taxes paid by size of corporation since, for example, a very large corporation which suffered a loss could have no taxable income in the year of the loss or in succeeding years if the loss was carried forward. Also, because the table primarily shows the distribution of total tax liability for C corporations for the 2005 processing year, it differs from the total corporate collections shown for fiscal year 2005-06 in Table 2. The table does not include corporate income and franchise taxes paid by S corporations. In addition, processing year amounts do not include additional collections due to audit adjustments and delinquent collections.

Table 2: Wisconsin Corporate Tax Collections 1997-98 to 2007-08 ($ in Millions)

Fiscal Year	Corporate Tax Collections*	Percent Change	Total General Fund Collections	Percent Change	Corporate Tax As Percent of General Fund Collections
1997-98	$627.0	-2.6%	$9,528.4	8.1%	6.6%
1998-99	635.2	1.3	9,948.4	4.4	6.4
1999-00	644.6	1.5	10,945.9	10.0	5.9
2000-01	537.2	-16.7	10,063.4	-8.1	5.3
2001-02	503.0	-6.4	10,020.2	-0.4	5.0
2002-03	526.5	4.7	10,199.7	1.8	5.2
2003-04	650.5	23.6	10,739.3	5.3	6.1
2004-05	764.1	17.5	11,396.7	6.1	6.7
2005-06	780.3	2.1	12,030.1	5.6	6.5
2006-07	890.1	14.1	12,618.0	4.9	7.1
2007-08	837.8	-5.9	13,042.9	3.4	6.4

*Excludes temporary recycling surcharge that is deposited in the segregated recycling fund.

Finally, fiscal year collections include declaration payments for a more recent year than the tax year collections included in the processing year amounts.

Aggregate data also indicates that 52,451 S corporations filed corporate income and franchise tax returns. Just over 338 of those S corporations reported a corporate income and franchise tax liability of about $1.3 million.

Table 3: Corporate Tax Liability by Net Income Class (2005 Processing Year)

Wisconsin Net Income	Number of Returns	% of Returns	Taxpayers	Liability	% of Total Liability
Zero or Less	31,710	65.25%	0	$0	0.00%
$0 to $10,000	6,256	12.87	6,030	1,471,363	0.24
$10,000 to $25,000	2,693	5.54	2,608	3,415,800	0.56
$25,000 to $50,000	2,264	4.66	2,192	6,212,262	1.02
$50,000 to $100,000	1,960	4.03	1,887	10,393,867	1.71
$100,000 to $250,000	1,504	3.09	1,444	17,366,070	2.87
$250,000 to $500,000	693	1.43	665	18,203,650	3.00
$500,000 to $1,000,000	532	1.09	517	27,817,051	4.59
$1,000,000 to $5,000,000	725	1.49	697	117,173,402	19.33
$5,000,000 to $10,000,000	118	0.24	111	57,243,971	9.44
$10,000,000 and over	145	0.30	137	346,802,860	57.22
Total	48,600	100.00%	16,288	$606,100,296	100.00%

Source: Department of Revenue, Corporation Aggregate Statistics.