

Clearinghouse Rule 09-087

PROPOSED ORDER OF THE DEPARTMENT OF REVENUE CREATING RULES

The Wisconsin Department of Revenue proposes an order to: **create** Tax 2.85 and 11.90; **relating to** penalties for failure to produce records.

Analysis by the Department of Revenue

Statutes interpreted: ss. 71.80(9m) and 77.61(19), Stats.

Statutory authority: ss. 71.80(9m)(c) and 77.61(19)(c), Stats.

Explanation of agency authority: Sections 71.80(9m)(c) and 77.61(19)(c), Stats., provide that the Department shall promulgate rules to administer the penalties for failure to produce records.

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

Plain language analysis: This proposed rule does the following:

- Reflects changes in Wisconsin's tax laws due to the adoption of penalties for failure to produce records.
- Provides guidance to Department employees and taxpayers so that the penalties can be administered in a fair and consistent manner. This includes providing a standard response time, a standard for noncompliance, and penalty waiver provisions.

Summary of, and comparison with, existing or proposed federal regulation:

There is no existing or proposed federal regulation that is intended to address the activities to be regulated by the rule.

Comparison with rules in adjacent states:

The department is not aware of a similar rule in an adjacent state.

Summary of factual data and analytical methodologies: 2009 Wisconsin Act 28 adopted statutory changes creating penalties for failure to produce records. Within these provisions are requirements that the Department promulgate rules to administer these penalties. The department has created this rule to reflect these changes in Wisconsin's tax laws and comply with statutory requirements.

Analysis and supporting documents used to determine effect on small business: As explained above, this emergency rule is created to reflect changes in Wisconsin's tax laws and comply with statutory requirements. As the rule itself does not impose any significant financial or other compliance burden, the department has determined that it does not have a significant effect on small business.

Anticipated costs incurred by private sector: This proposed rule does not have a significant fiscal effect on the private sector.

Effect on small business: This proposed rule does not have a significant effect on small business.

Agency contact person: Please contact Dale Kleven at (608) 266-8253 or dale.kleven@revenue.wi.gov, if you have any questions regarding this proposed rule.

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

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Madison, WI 53708-8933

SECTION 1. Tax 2.85 is created to read:

Tax 2.85 Penalty for failure to produce records under s. 71.80(9m), Stats.

(1) GENERAL. A person who fails to produce records or documents, as provided under ss. 71.74(2) and 73.03(9), Stats., that were requested by the department may be subject to the following penalties:

(a) The disallowance of deductions, credits, exemptions or income inclusion to which the requested records relate.

(b) In addition to any other penalties that the department may impose, a penalty for each violation under s. 71.80(9m), Stats., that is equal to the greater of \$500 or 25% of the amount of the additional tax on any adjustment made by the department that results from the person's failure to produce the records.

(2) DEFINITIONS. In this section:

(a) "Disallowance," "inclusion," or "adjustment" include action taken by the department when a proposed assessment or refund or notice of assessment or refund is issued to a taxpayer.

(b) "Records" or "documents" include both paper and electronic formats. Examples include, but are not limited to, bills, receipts, invoices, contracts, letters, memos, accounting statements or schedules, general ledgers, journal entries, and board of director's minutes.

(c) "Records requested were not provided" means that all records requested were not provided to the department within the time specified by the department.

(d) "Written request for records" includes requests made by letter, e-mail, fax or any other written form.

(3) PROCEDURES. The penalties in this section may be imposed if the records requested were not provided and the department provided the following notifications regarding the records requested:

(a) A first written request for records where the department allowed the person a minimum of 15 days for the records to be provided.

(b) A second written request for records where the department allowed the person a minimum of 30 days for the records to be provided. This second written request for records shall include a statement explaining that if the requested records are not provided by the date specified, the penalties provided by s. 71.80(9m), Stats., may be imposed.

Examples: 1) The department issues a first written request for records to John Jones on May 5, 2010, allowing him until May 20, 2010 to provide the records requested. Mr. Jones does not provide the requested records to the department by May 20, 2010. The department issues a second written request for records to him on June 1, 2010, allowing him until July 1, 2010, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 71.80(9m), Stats. Mr. Jones does not provide the requested records by July 1, 2010. Therefore, the department may disallow the deductions, credits, or exemptions or include in Wisconsin income the additional income to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Mr. Jones not providing the records requested.

2) The department issues a first written request for records to Corporation A on September 1, 2009, allowing Corporation A until October 6, 2009, to provide the records requested. Corporation A does not provide the requested records to the department by October 6, 2009. The department issues a second written request for records to Corporation A on October 21, 2009, allowing Corporation A until November 30, 2009, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 71.80(9m), Stats. Corporation A does not provide the requested records by November 30, 2009. Therefore, the department may disallow the deductions, credits, or exemptions or include in Wisconsin income the additional income to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Corporation A not providing the records requested.

3) The department issues a first written request for records to Corporation B on January 5, 2010, allowing Corporation B until January 20, 2010, to provide the records requested. Corporation B does not provide the requested records to the department by January 20, 2010. The department issues a second written request for records to Corporation B on February 8, 2010, allowing Corporation B until March 10, 2010, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 71.80(9m), Stats. Corporation B provides records to the department by March 10, 2010, but the department determines that the taxpayer did not provide some of the records requested by March 10, 2010. Therefore, since the taxpayer did not provide all of the records requested by March 10, 2010, the department may disallow the deductions, credits, or exemptions or include in Wisconsin income the additional income to which the requested records relate and

impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Corporation B not providing the records requested.

(4) WAIVER OF PENALTIES. (a) The penalties in this section may be waived if the person whose records were requested can show that, under all the facts and circumstances, its response to the written request for records or its failure to respond to the written request for records was reasonable or justified by factors beyond the person's control. In determining whether the penalties will be waived, the department may consider the following factors:

1. Death of the taxpayer, tax preparer, accountant or other responsible party.
2. Onset of debilitating illness or injury of the taxpayer, tax preparer, accountant or other responsible party.
3. Natural disaster such as tornado, flood or fire.
4. Records that were destroyed due to events beyond control of the taxpayer or other responsible party and not due to neglect.
5. Any other unusual circumstance that the department believes pertinent.

(b) Providing requested records after the time period required for providing the records has expired, as provided in sub. (3), may result in a reduction of the penalty provided in sub. (1)(a) if the department determines that these records support a reduction in the disallowance or inclusion previously made by the department, but would not result in a reduction of the penalty provided in sub. (1)(b) unless the person can show that under all the facts and circumstances providing the requested records at that time was reasonable or justified by factors beyond the person's control.

Examples: 1) Since Corporation C does not provide the records requested by the date specified in a second written request for records to support interest expense deducted, the department issues a proposed audit report to Corporation C disallowing all the interest expense previously deducted. Additional tax of \$100,000 and penalty of \$25,000 results in the proposed audit report from disallowing this interest expense. Corporation C provides the records requested 26 days after the department issues the proposed audit report but before the notice of assessment is issued and explains that they were too busy with other aspects of their business to respond to the two written requests for records by the dates specified. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond the person's control. However, the records provided support half of the interest expense deduction previously claimed. Therefore, the interest expense adjustment is modified to reduce the proposed additional tax from \$100,000 to \$50,000, but the original proposed penalty of \$25,000 for failure to provide records remains.

2) Since Mr. Smith does not provide the records requested regarding his cash business to support the reported gross receipts by the date specified in a second written request for records, the department issues a notice of assessment to Mr. Smith including an estimated amount into income for unreported receipts. Additional tax of \$60,000, a negligence penalty of \$15,000 and a penalty for failure to produce records of \$15,000 results in the assessment from including these estimated receipts. Mr. Smith appeals the assessment, provides the records that were requested during the audit, and explains that he forgot to provide the records that were previously requested. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond

the person's control. However, the records provided show that unreported receipts were only 20% of the amount previously included by the department as estimated unreported receipts. Therefore, the unreported receipts adjustment and negligence penalty are modified to reduce the additional tax from \$60,000 to \$12,000 and the negligence penalty from \$15,000 to \$3,000, but the original penalty for failure to produce records of \$15,000 remains.

3) Assume the same facts as example 2, except that Mr. Smith explains that he did not previously provide the requested records because his accountant had possession of them and was in the hospital when the records were requested during the audit. In this situation the failure to provide the records requested is reasonable or justified by factors beyond the person's control. Therefore, the unreported receipts adjustment is modified to reduce the additional tax from \$60,000 to \$12,000, the negligence penalty is reduced from \$15,000 to \$3,000 and the original penalty for failure to produce records of \$15,000 is waived.

SECTION 2. Tax 11.90 is created to read:

Tax 11.90 Penalty for failure to produce records under s. 77.61(19), Stats.

(1) GENERAL. A person who fails to produce records or documents, as provided under ss. 73.03(9) and 77.59(2), Stats., that were requested by the department may be subject to the following penalties:

(a) The disallowance of deductions, credits, exemptions or inclusions of additional taxable sales or additional taxable purchases to which the requested records relate.

(b) In addition to any other penalties that the department may impose, a penalty for each violation under s. 77.61(19), Stats., that is equal to the greater of \$500 or 25% of the amount of the additional tax on any adjustment made by the department that results from the person's failure to produce the records.

(2) DEFINITIONS. In this section:

(a) "Disallowance," "inclusion," or "adjustment" include action taken by the department when a proposed assessment or refund or notice of assessment or refund is issued to a taxpayer.

(b) "Records" or "documents" include both paper and electronic formats. Examples include, but are not limited to, bills, receipts, invoices, contracts, letters, memos, accounting statements or schedules, general ledgers, journal entries, and board of director's minutes.

(c) "Records requested were not provided" means that all records requested were not provided to the department within the time specified by the department.

(d) "Written request for records" includes requests made by letter, e-mail, fax or any other written form.

(3) PROCEDURES. The penalties in this section may be imposed if the records requested were not provided and the department provided the following notifications regarding the records requested:

(a) A first written request for records where the department allowed the person a minimum of 15 days for the records to be provided.

(b) A second written request for records where the department allowed the person a minimum of 30 days for the records to be provided. This second written request for records shall include a statement explaining that if the requested records are not provided by the date specified, the penalties provided by s. 77.61(19), Stats., may be imposed.

Examples: 1) The department issues a first written request for records to John Jones on May 5, 2010, allowing him until May 20, 2010, to provide the records requested. Mr. Jones does not provide the requested records to the department by May 20, 2010. The department issues a second written request for records to him on June 1, 2010, allowing him until July 1, 2010, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 77.61(19), Stats. Mr. Jones does not provide the requested records by July 1, 2010. Therefore, the department may disallow the deductions, credits, or exemptions or include the additional taxable sales or additional taxable purchases to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Mr. Jones not providing the records requested.

2) The department issues a first written request for records to Corporation A on September 1, 2009, allowing Corporation A until October 6, 2009, to provide the records requested. Corporation A does not provide the requested records to the department by October 6, 2009. The department issues a second written request for records to Corporation A on October 21, 2009, allowing Corporation A until November 30, 2009, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 77.61(19), Stats. Corporation A does not provide the requested records by November 30, 2009. Therefore, the department may disallow the deductions, credits, or exemptions or include the additional taxable sales or additional taxable purchases to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Corporation A not providing the records requested.

3) The department issues a first written request for records to Corporation B on January 5, 2010, allowing Corporation B until January 20, 2010, to provide the records requested. Corporation B does not provide the requested records to the department by January 20, 2010. The department issues a second written request for records to Corporation B on February 8, 2010, allowing Corporation B until March 10, 2010, to provide the records requested. Included in this second written request for records is a notification regarding the penalties provided by s. 77.61(19), Stats. Corporation B provides records to the department by March 10, 2010, but the department determines that the taxpayer did not provide some of the records requested by March 10, 2010. Therefore, since the taxpayer did not provide all of the records requested by March 10, 2010, the department may disallow the deductions, credits, or exemptions or include the additional taxable sales or additional taxable purchases to which the requested records relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from Corporation B not providing the records requested.

(4) WAIVER OF PENALTIES. (a) The penalties in this section may be waived if the person whose records were requested can show that, under all the facts and circumstances, its response to the written request for records or its failure to respond to the written request for records was reasonable or justified by factors beyond the person's control. In determining whether the penalties will be waived, the department may consider the following factors:

1. Death of the taxpayer, tax preparer, accountant or other responsible party.
2. Onset of debilitating illness or injury of the taxpayer, tax preparer, accountant or other responsible party.
3. Natural disaster such as tornado, flood or fire.
4. Records that were destroyed due to events beyond control of the taxpayer or other responsible party and not due to neglect.
5. Any other unusual circumstance that the department believes pertinent.

(b) Providing requested records after the time period required for providing the records has expired, as provided in sub. (3), may result in a reduction of the penalty provided in sub. (1)(a) if the department determines that these records support a reduction in the disallowance or inclusion previously made by the department, but would not result in a reduction of the penalty provided in sub. (1)(b) unless the person can show that under all the facts and circumstances providing the requested records at that time was reasonable or justified by factors beyond the person's control.

Examples: 1) Since Corporation C does not provide the records requested by the date specified in a second written request for records to support deductions for exempt sales, the department issues a proposed audit report to Corporation C disallowing all the deductions for exempt sales previously claimed. Additional tax of \$100,000 and penalty of \$25,000 results in the proposed audit report from disallowing the deductions for exempt sales. Corporation C provides the records requested 26 days after the department issues the proposed audit report but before the notice of assessment is issued and explains that they were too busy with other aspects of their business to respond to the two written requests for records by the dates specified. In this situation, the failure to provide the records requested is not reasonable or justified by factors beyond the person's control. However, the records provided support half of the deductions for exempt sales previously claimed. Therefore, the deductions for exempt sales adjustment is modified to reduce the proposed additional tax from \$100,000 to \$50,000, but the original proposed penalty of \$25,000 for failure to provide records remains.

2) Since Mr. Smith does not provide the records requested regarding his cash business to support the reported gross receipts by the date specified in a second written request for records, the department issues a notice of assessment to Mr. Smith including an estimated amount into taxable sales for unreported receipts. Additional tax of \$60,000, a negligence penalty of \$15,000 and a penalty for failure to produce records of \$15,000 results in the assessment from including these estimated receipts. Mr. Smith appeals the assessment, provides the records that were requested during the audit, and explains that he forgot to provide the records that were previously requested. In this situation, the failure to provide the records requested is not reasonable or justified by

factors beyond the person's control. However, the records provided show that unreported receipts were only 20% of the amount previously included by the department as estimated unreported receipts. Therefore, the unreported receipts adjustment and negligence penalty are modified to reduce the additional tax from \$60,000 to \$12,000 and the negligence penalty from \$15,000 to \$3,000, but the original penalty for failure to produce records of \$15,000 remains.

3) Assume the same facts as example 2, except that Mr. Smith explains that he did not previously provide the requested records because his accountant had possession of them and was in the hospital when the records were requested during the audit. In this situation the failure to provide the records requested is reasonable or justified by factors beyond the person's control. Therefore, the unreported receipts adjustment is modified to reduce the additional tax from \$60,000 to \$12,000, the negligence penalty is reduced from \$15,000 to \$3,000 and the original penalty for failure to produce records of \$15,000 is waived.

The rules contained in this order shall take effect on the first day of the month following publication in the Wisconsin administrative register as provided in s. 227.22(2)(intro.), Stats.

Initial Regulatory Flexibility Analysis

This proposed rule order does not have a significant economic impact on a substantial number of small businesses.

DEPARTMENT OF REVENUE

Dated: _____

By: _____

Roger M. Ervin
Secretary of Revenue