

Report From Agency

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), 77.61(19)(c), and 227.24, 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:

Illinois statute 35 ILCS 120/7 provides that, for sales and use tax purposes:

“...the Department is authorized to notify the taxpayer in writing to produce such evidence, and the taxpayer shall have 60 days subject to the right in the Department to extend this period either on request for good cause shown or on its own motion from the date when such notice is sent to the taxpayer by certified or registered mail (or delivered to the taxpayer if the notice is served personally) in which to obtain and produce such evidence for the Department's inspection, failing which the matter shall be closed, and the transaction shall be conclusively presumed to be taxable hereunder.”

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 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 rule does not have a significant fiscal effect on the private sector.

Effect on small business: This 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 emergency rule.

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 any of the following penalties under s. 71.80(9m), Stats.:

(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 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" means that an item is disallowed, included or adjusted through action taken by the department when a proposed assessment or refund or notice of assessment or refund is issued to a taxpayer.

(b) "Records" include both paper and electronic formats. Examples include bills, receipts, invoices, contracts, letters, memos, accounting statements or schedules, general ledgers, journal entries, and board of director's minutes. "Records" do not include items protected by attorney-client privilege, if the taxpayer provides a brief description or summary of the contents of each record, the date each record was prepared, the person or persons who prepared each record, the person to whom each record was directed, or for whom each record was prepared, the purpose in preparing each record, and how each element of the privilege is met as to each record.

(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.

(e) "Provided" means the records are provided by electronic means or in paper format to the address specified by the department in its written request for records. If the address specified by the department is the person's location, the records are considered provided on the date the person notifies the department they are available for review at that location.

(3) PROCEDURES. The penalties in this section may be imposed if the records requested were not provided and the department provided the notifications below regarding the records requested. The number of days established by the department for the person to respond to the record requests should be reasonable based on the facts of each situation.

(a) A first written request for records where the department allowed the person a minimum of 30 days from the date of request for the records to be provided.

(b) After the time period to respond to the first written request has expired as provided in par. (a), a second written request for records where the department allowed the person a minimum of 30 days from the date of request 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 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.

2) The department issues a first written request for records to Corporation B on December 21, 2009, 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 that were not provided relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from the requested records that were not provided.

(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 any of 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 facts and circumstances 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), shall result in a reduction of the penalties provided in sub. (1)(a) and sub. (1)(b) if the department determines that these records support a reduction in the disallowance or inclusion previously made by the department.

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, which represents the penalty provided in s. 71.80(9m)(a), Stats. Additional tax of \$100,000 and the penalty as provided in s. 71.80(9m)(b), Stats., 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, without any further detail, 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. In addition, the records provided do not support a reduction of the interest expense disallowed in the proposed audit report. Therefore, the interest expense adjustment is not modified so the proposed additional tax of \$100,000 and the original proposed penalty as provided in s. 71.80(9m)(b), Stats., of \$25,000 remain.

2) Since Mr. Smith does not provide the records requested regarding his business, which primarily receives payments in cash, 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, which represents the penalty provided in s. 71.80(9m)(a), Stats. Additional tax of \$60,000, a negligence penalty of \$15,000 and the penalty as provided in s. 71.80(9m)(b), Stats., 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 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 as provided in s. 71.80(9m)(b), Stats., is reduced from \$15,000 to \$3,000.

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 as provided in s. 71.80(9m)(b), Stats., 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 any of the following penalties under s. 77.61(19), Stats.:

(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 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" means that an item is disallowed, included or adjusted through action taken by the department when a proposed assessment or refund or notice of assessment or refund is issued to a taxpayer.

(b) "Records" include both paper and electronic formats. Examples include bills, receipts, invoices, contracts, letters, memos, accounting statements or schedules, general ledgers, journal entries, and board of director's minutes. "Records" do not include items protected by attorney-client privilege, if the taxpayer provides a brief description or summary of the contents of each record, the date each record was prepared, the person or persons who prepared each record, the person to whom each record was directed, or for whom each record was prepared, the purpose in preparing each record, and how each element of the privilege is met as to each record.

(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.

(e) "Provided" means the records are provided by electronic means or in paper format to the address specified by the department in its written request for records. If the address specified by the department is the person's location, the records are considered provided on the date the person notifies the department they are available for review at that location.

(3) PROCEDURES. The penalties in this section may be imposed if the records requested were not provided and the department provided the notifications below regarding the records requested. The number of days established by the department for the person to respond to the record requests should be reasonable based on the facts of each situation.

(a) A first written request for records where the department allowed the person a minimum of 30 days from the date of request for the records to be provided.

(b) After the time period to respond to the first written request has expired as provided in par. (a), a second written request for records where the department allowed the person a minimum of 30 days from the date of request 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 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.

2) The department issues a first written request for records to Corporation B on December 21, 2009, 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 that were not provided relate and impose a penalty equal to the greater of \$500 or 25% of the additional tax on the adjustments made resulting from the requested records that were not provided.

(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 any of 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 facts and circumstances 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), shall result in a reduction of the penalties provided in sub. (1)(a) and sub. (1)(b) if the department determines that these records support a reduction in the disallowance or inclusion previously made by the department.

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, which represents the penalty provided in s. 77.61(19)(a), Stats. Additional tax of \$100,000 and the penalty as provided in s. 77.61(19)(b), Stats., 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, without any further detail, 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. In addition, the records provided do not support a reduction of the exempt sales deductions disallowed in the proposed audit report. Therefore, the deductions for exempt sales adjustment is not modified so the proposed additional tax of \$100,000 and the original proposed penalty as provided in s. 77.61(19)(b), Stats., of \$25,000 remain.

2) Since Mr. Smith does not provide the records requested regarding his business, which primarily receives payments in cash, 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, which represents the penalty provided in s. 77.61(19)(a), Stats. Additional tax of \$60,000, a negligence penalty of \$15,000 and the penalty as provided in s. 77.61(19)(b), Stats., 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 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 as provided in s. 77.61(19)(b), Stats., is reduced from \$15,000 to \$3,000.

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 as provided in s. 77.61(19)(b), Stats., 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

E:Rules/285 1190 Proposed Order (v3)