

**WISCONSIN DEPARTMENT OF REVENUE  
DIVISION OF INCOME, SALES, AND EXCISE TAX**

**NOTICE OF PROPOSED GUIDANCE DOCUMENTS**

Pursuant to sec. 227.112, Wis. Stats., the Wisconsin Department of Revenue, Division of Income, Sales, and Excise Taxes hereby seeks comment on the proposed guidance document listed in the table below.

**SUBMITTING PUBLIC COMMENTS**

Public comments on proposed or adopted guidance documents may be submitted online at: <https://www.revenue.wi.gov/Pages/contactUs/proposed-Guidance.aspx>.

**DEADLINE FOR SUBMISSION**

The period for public comment for proposed guidance documents ends 21 days after publication in the Administrative Register, unless the Governor approves a shorter commenting period.

<b>Document Number</b>	<b>Document Title</b>
<b>100092</b>	Addback of Related Entity Expenses - Common Questions

State of Wisconsin  
Department of Revenue

## Addback of Related Entity Expenses

**This is a proposed guidance document. The document has been submitted to the Legislative Reference Bureau for publication in the Administrative Register for public comment as provided by sec. 227.112(1), Wis. Stats.**

1. What types of expenses do I have to "add back" in computing my Wisconsin income?
2. Who is a "related entity"?
3. What are "interest expenses"?
4. What are "rental expenses"?
5. What are "intangible expenses"?
6. What are "management fees"?
7. Does the addback requirement apply to interest I included in my Wisconsin itemized deduction credit?
8. How do I become eligible for a deduction for the amount added back?
9. What documentation must I submit to show that a related entity interest or rental expense is deductible?
10. If I have related entity interest or rental expenses that aren't eligible for a deduction and I had similar transactions in years before the addback was required, will the deductions be allowed for those prior years?
11. If I have related entity interest or rental expenses that aren't eligible for a deduction, does the related entity still have to report the corresponding interest or rental income in Wisconsin income?
12. How do pass-through entities report the Wisconsin addition and subtraction modifications associated with the addback requirement?
13. How do members of pass-through entities report the Wisconsin addition and subtraction modifications associated with the addback requirement?

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1. **What types of expenses do I have to "add back" in computing my Wisconsin income?**

You must "add back" any interest expenses, rental expenses, intangible expenses and management fees that are directly or indirectly paid, accrued, or incurred to, or in connection with one or more transactions with, a related entity, if you deducted them on your federal return.

These amounts must be reported as Wisconsin addition modifications. If certain conditions are met, you may then report a subtraction modification for the amount deductible against your Wisconsin income.

## 2. Who is a "related entity"?

For purposes of the addback requirement, a "related entity" is a related person under section 267 or 1563 of the Internal Revenue Code (IRC). In general, these sections provide that the following relationships are "related persons":

- Members of a family; namely, brothers and sisters, half-brothers and half-sisters, spouse, ancestors, and lineal descendants.
- An individual and a corporation (whether a C corporation or an S corporation), if more than 50% of the outstanding stock is owned (directly or indirectly) by or for the individual.
- Two corporations which are members of the same controlled group as defined in section 1563(a), IRC, except that 50% is substituted for 80% wherever it appears in sec. 1563(a).
- A grantor and fiduciary of any trust.
- A fiduciary of a trust and a fiduciary of another trust, if the same person is the grantor of both trusts.
- A fiduciary of a trust and a beneficiary of such trust.
- A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts.
- A fiduciary of a trust and a corporation more than 50% of the value of which is owned (directly or indirectly) by or for the trust or the grantor of the trust.
- A person and an exempt organization under sec. 501, IRC which is controlled directly or indirectly by the person or (if the person is an individual) the person's family.
- A corporation and a partnership if the same persons own more than 50% of the outstanding value of the corporation's stock and more than 50% of the capital interest or profits interest in the partnership.
- An S corporation and another S corporation if the same persons own more than 50% in value of the outstanding stock of each corporation.
- An S corporation and a C corporation if the same persons own more than 50% in value of the outstanding stock of each corporation.
- An executor of an estate and a beneficiary of such estate.

Additionally, the following relationships involving partnerships and limited liability companies (LLCs) are "related persons":

- A partnership and a partner who holds a direct or indirect capital or profits interest in that partnership of more than 50%.
- An LLC and a member who holds a direct or indirect interest in that LLC of more than 50%.
- Two partnerships or LLCs if a single partner or member owns, directly or indirectly, more than 50% of both entities.

For relationships that involve ownership of stock, assets, or net profits, the constructive ownership rules of section 318(a), of the IRC apply.

A "related entity" also includes certain real estate investment trusts (REITs) if they are not "qualified REITs." For more on qualified REITs, see [\*Wisconsin Tax Bulletin #158\*](#), page 17, Questions A2 and A3.

### 3. **What are "interest expenses"?**

For purposes of the addback requirement, "interest expenses" means interest that would otherwise be deductible under section 163 of the Internal Revenue Code and otherwise deductible in the computation of Wisconsin income.

Expenses that are deductible as "interest expenses" under section 163, IRC may include:

- All interest paid or accrued within the taxable year on indebtedness.
- Original issue discount.
- Nonseparately stated interest included in carrying charges for installment purchases.
- Redeemable ground rents, excluding amounts paid in redemption.
- Premiums paid or accrued for mortgage insurance.

The interest expense must be deductible as an expense within the taxable year under section 163 of the Internal Revenue Code to be subject to the addback requirement. Interest that is capitalized under section 263A of the Internal Revenue Code is not an "interest expense" for this purpose.

### 4. **What are "rental expenses"?**

For purposes of the addback requirement, "rental expenses" means expenses for the use of (or the right to use) real property or tangible personal property in connection with real property, regardless of how computed and regardless of how reported for financial accounting purposes.

Services furnished or rendered in connection with rented property are also considered "rental expenses" if the services are furnished by a related entity in connection with property rented from a related entity. Such services would constitute "rental expenses" regardless of whether the same related entity furnished the services as rented the property.

If a lease from a related entity is treated as a capital lease for financial accounting purposes, the amounts expensed over the term of the lease are considered "rental expenses" subject to the addback requirement. The method used to compute the expense and the manner in which it is reported for financial accounting purposes have no effect on whether the expense is a "rental expense" for purposes of the addback requirement.

### 5. **What are "intangible expenses"?**

"Intangible expenses" include the following, to the extent that the amounts would otherwise be deductible in computing Wisconsin income:

- Expenses, losses, and costs for, related to, or directly or indirectly in connection with the acquisition, use, maintenance, management, ownership, sale, exchange, or any other disposition of intangible property.
- Losses related to, or incurred in connection directly or indirectly with, factoring transactions or discounting transactions.
- Royalty, patent, technical, and copyright fees.
- Licensing fees.
- Other similar expenses, losses, and costs.

"Intangible property" includes stocks, bonds, financial instruments, patents, patent applications, trade names, trademarks, service marks, copyrights, mask works, trade secrets, and similar types of intangible assets.

**6. What are "management fees"?**

"Management fees" include expenses and costs, not including interest expenses, pertaining to accounts receivable, accounts payable, employee benefit plans, insurance, legal matters, payroll, data processing, purchasing, taxation, financial matters, securities, accounting, or reporting and compliance matters or similar activities, to the extent that the amounts would otherwise be deductible in the computation of Wisconsin income.

**7. Does the addback requirement apply to interest I included in my Wisconsin itemized deduction credit?**

No. For taxpayers who are individuals, the addback requirement applies only to related entity interest or rental expenses that would be included in federal adjusted gross income (before itemized deductions) as modified for Wisconsin purposes. For example, related entity interest or rental expenses from a sole proprietorship (Schedule C) would be subject to the addback requirement.

**8. How do I become eligible for a deduction for the amount added back?**

You must disclose the expense on Wisconsin Schedule RT, except that you do not have to file Schedule RT if your total expenses paid, accrued or incurred to all related entities is \$100,000 or less. See the Schedule RT Instructions for details.

Whether or not you are required to file Schedule RT, the expense must meet one of three conditions described in Part II of Schedule RT. In general, these conditions tend to indicate that the transaction was not entered into solely for tax avoidance purposes. The Schedule RT Instructions provide a complete explanation of these conditions and important exceptions.

For additional guidance on determining the deductibility of related entity expenses, see the set of questions and answers in Wisconsin Tax Bulletin #158, titled "Conditions Necessary to Deduct Expenses Added Back," beginning on page 18.

**9. What documentation must I submit to show that a related entity expense is deductible?**

You are not required to submit specific documentation with your return (other than a properly completed Schedule RT where required) to substantiate a related entity interest or rental expense. However, you must maintain adequate documentation to substantiate your deductions. Specific evidence that adequately supports that a deduction is allowable will vary based on the facts and circumstances.

**10. If I have related entity expenses that aren't eligible for a deduction and I had similar transactions in years before the addback was required, will the deductions be allowed for those prior years?**

The department may disallow those same expenses for prior years under its express statutory authority in secs. 71.10(1), 71.30(2), and 71.80(1)(b), Wis. Stats.

**11. If I have related entity expenses that aren't eligible for a deduction, does the related entity still have to report the corresponding interest or rental income in Wisconsin income?**

If you cannot deduct an interest or rental expense paid to a related entity, or intangible expenses or management fees because they don't meet the conditions described in Part II of Schedule RT, the related entity may subtract the corresponding income from his, her, or its Wisconsin income if the following requirements are met:

- You must complete Part I of Schedule RT-1, Statement of Disallowed Related Entity Expenses, and provide it to the related entity,
- The related entity must complete Part II of that same Schedule RT-1 and include the schedule with his, her, or its return to substantiate the subtraction modification. (The related entity may file an amended return to claim this subtraction.), and
- The related entity must maintain supporting documentation to permit the department to verify the amount claimed on Schedule RT-1.

**12. How do pass-through entities report the Wisconsin addition and subtraction modifications associated with the addback requirement?**

Below is a summary of where pass-through entities would report these modifications.

***Tax-option (S) Corporations***

*Form 5S, Schedule 5K*

- Column c of lines 1 through 12d, according to the type of pass-through item to which the expense relates (if the entire amount of expense is deductible, the addition and subtraction modifications would cancel out and result in \$0 net adjustment), and
- Column d of lines 18a through 18b.

*Form 5S, Schedule 5K-1*

- Same places as on Schedule 5K, but only use the shareholder's allocated share of the amounts reported on Schedule 5K (before applying any apportionment percentage).

***Partnerships and Limited Liability Companies Treated as Partnerships***

*Form 3, Schedule 3K*

- Column c of lines 1 through 13d, according to the type of pass-through item to which the expense relates (if the entire amount of expense is deductible, the addition and subtraction modifications would cancel out and result in \$0 net adjustment), and
- Column d of lines 21a through 21b.

*Form 3, Schedule 3K-1*

- Same places as on Schedule 3K, but only use the partner's or member's allocated share of the amounts reported on Schedule 3K (before applying any apportionment percentage).

***Estates and Trusts***

*Form 2*

- Lines 5 and 11 of Schedule A.

*Form 2, Schedule 2K-1 (for each beneficiary's share)*

- Column c of lines 1 through 11e, according to the type of pass-through item to which the expense relates (if the entire amount of expense is deductible, the addition and subtraction modifications would cancel out and result in \$0 net adjustment), and
- Column d of lines 14a through 14b.

**13. How do members of pass-through entities report the Wisconsin addition and subtraction modifications associated with the addback requirement?**

**Resident individuals** report the addition modifications on Form 1, line 4, and the subtraction modifications for the allowable deductions on Form 1, line 11. If the modifications come from a tax-option (S) corporation, use code 51 for both the line 4 amount and the line 11 amount. If the modifications come from a partnership, LLC treated as a partnership, estate, or trust, use code 52 for both the line 4 amount and the line 11 amount.

**Nonresident individuals** include the addition and subtraction modifications in the Wisconsin amount they report on Form 1NPR, line 15. These individuals must also submit Schedule M, which provides lines to identify each of the addition and subtraction modifications.

**Corporations:** Corporations filing Form 4, report the addition modifications on Schedule 4V, line 3, and the subtraction modifications for the allowable deductions on Schedule 4W, line 2. Corporations filing Form 6, report the modifications on Part II, lines 2c and 4b.

**Pass-through entities** report these modifications as described in Question 12 above.

## Applicable Laws and Rules

This document provides statements or interpretations of the following laws and regulations in effect as of December 13, 2019: Sections 71.01, 71.05, 71.10, 71.22, 71.30, 71.34, 71.42 and 71.80, Wis. Stats., and sec. Tax 3.01, Wis. Adm. Code.

Laws enacted and in effect after December 13, 2019, new administrative rules, and court decisions may change the interpretations in this document. Guidance issued prior to December 13, 2019, that is contrary to the information in this document is superseded by this document, pursuant to sec. 73.16(2)(a), Wis. Stats.

### FOR QUESTIONS OR COMMENTS CONTACT:

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