

**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.

Document Number	Document Title
100184	Pass-Through Entity-Level Tax - Tax-Option (S) Corporation Determining Income and Computing Tax - Common Questions

State of Wisconsin
Department of Revenue

Pass-Through Entity-Level Tax: Tax-Option (S) Corporation Determining Income and Computing Tax

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.

Effective for taxable years beginning on or after January 1, 2018

1. How does an electing tax-option (S) corporation determine the situs of income?
2. What is the entity-level tax rate?
3. Are long-term capital gains taxed at a different rate?
4. Can an electing tax-option (S) corporation claim the 30-percent or 60-percent long-term capital gain deduction under sec. 71.36(1m)(a), Wis. Stats.?
5. Can an electing tax-option (S) corporation claim the capital gain exclusion for the sale of an investment in a qualified Wisconsin business?
6. Can an electing tax-option (S) corporation register to be a qualified Wisconsin business?
7. Can an electing tax-option (S) corporation claim a deduction for charitable contributions?
8. Is an electing tax-option (S) corporation subject to passive activity loss limitations?
9. How does an electing tax-option (S) corporation determine the characterization of passive income or loss?

10. Is an electing tax-option (S) corporation subject to the \$500 Wisconsin capital loss limitation or the \$3,000 federal capital loss limitation?
11. Is an electing tax-option (S) corporation subject to federal section 179 expense limitations?
12. Can an electing tax-option (S) corporation claim the federal special depreciation allowance, bonus depreciation, under sec. 168(k), Internal Revenue Code (IRC)?
13. Can an electing tax-option (S) corporation carry forward suspended capital and passive activity losses?
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18. How is the manufacturing and agriculture (M&A) credit included in Wisconsin income if a tax-option (S) corporation makes an election to pay tax at the entity level in the year the M&A credit is computed and does not make the election to pay tax at the entity level in the following year?
19. How does an electing tax-option (S) corporation compute the credit for taxes paid to another state?
20. Can an electing tax-option (S) corporation claim a credit for taxes paid to another state if the taxes paid to the other state are paid by a shareholder on an individual income tax return?
21. Is withholding tax paid by an electing tax-option (S) corporation in another state (e.g., Illinois) on behalf of its members considered a "composite return" for purposes of the Wisconsin entity-level credit for taxes paid to another state?
22. Can a tax-option (S) corporation making the election to pay tax at the entity level exclude income at the entity level if the income is attributable to a tax-exempt shareholder (e.g., employee stock ownership plan)?
23. For Wisconsin purposes, how will the tax-option (S) corporation entity-level tax election affect the deductible amount of a shareholder's interest expense related to a debt-financed acquisition of stock of the electing tax-option (S) corporation?
24. Where does an electing tax-option (S) corporation report taxable federal, state, and municipal government interest that would have been reported on line 1 of Form 5S if the entity-level tax election was not made?
25. Can an electing tax-option (S) corporation claim a deduction for health insurance premiums paid on behalf of a greater than 2-percent shareholder?

26. If a shareholder of an electing tax-option (S) corporation had a suspended loss from a prior year due to basis limitations, can the electing tax-option (S) corporation use the shareholder's suspended loss to reduce its Wisconsin taxable income in the current year?

1. How does an electing tax-option (S) corporation determine the situs of income?

The situs of income for an electing tax-option (S) corporation is determined as if the election under sec. 71.365(4m)(a), Wis. Stats., was not made. Therefore, an electing tax-option (S) corporation must determine income attributable to Wisconsin for each shareholder pursuant to secs. 71.04 and 71.362, Wis. Stats., and use that method for determining the situs of income to the corporation.

Example:

Facts

- o Shareholders A and B each own 50 percent of Tax-Option (S) Corporation
- o Shareholder A was a Wisconsin resident for the entire year in 2018
- o Shareholder B was a nonresident of Wisconsin for the entire year in 2018
- o In 2018, 25 percent of Tax-Option (S) Corporation's income is earned in Wisconsin and 75 percent is earned in other states
- o Tax-Option (S) Corporation has \$100,000 of net ordinary business income for 2018
- o Tax-Option (S) Corporation makes an election under sec. 71.365(4m)(a), Wis. Stats., to pay tax at the entity level for 2018

Computation of income attributable to Wisconsin

	Shareholder A (resident)	Shareholder B (nonresident)
Portion of business income from the tax-option (S) corporation	\$50,000	\$50,000
Wisconsin apportionment % (situs of income)	100%	25%
Shareholder's Wisconsin income from the tax-option (S) corporation	\$50,000	\$12,500

The electing tax-option (S) corporation's Wisconsin income is \$62,500 (\$50,000 + \$12,500).

2. What is the entity-level tax rate?

The net income reportable to Wisconsin is taxed at 7.9% as provided in sec. 71.365(4m)(a), Wis. Stats., and is computed on Schedule 5S-ET, *Entity-Level Tax Computation*.

3. Are long-term capital gains taxed at a different rate?

No, there is no separate tax rate for long-term capital gains.

4. Can an electing tax-option (S) corporation claim the 30-percent or 60-percent long-term capital gain deduction under sec. 71.36(1m)(a), Wis. Stats.?

No, an electing tax-option (S) corporation may not claim the Wisconsin 30-percent or 60-percent long-term capital gain deduction.

Section 71.36(1m)(a), Wis. Stats., was written with the intent that shareholders include the tax-option items in their Wisconsin adjusted gross income. However, when a tax-option (S) corporation makes an election under sec. 71.365(4m)(a), Wis. Stats., the statutes specifically provide that it is the intent of the election that shareholders may not include the items of income, gain, loss, or deduction of the tax-option (S) corporation in their Wisconsin adjusted gross income, and the net income is computed under sec. 71.34(1k), Wis. Stats. This section provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. The IRC does not provide for a 30-percent or 60-percent long-term capital gain deduction for S corporations.

5. Can an electing tax-option (S) corporation claim the capital gain exclusion for the sale of an investment in a qualified Wisconsin business?

No, pursuant to sec. 71.365(4m)(d)1., Wis. Stats., net income of an electing tax-option (S) corporation is computed under sec. 71.34(1k), Wis. Stats., which provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. The IRC does not provide an exclusion for the sale of an investment in a qualified Wisconsin business. Additionally, pursuant to sec. 71.05(25)(a)1., Wis. Stats., only an individual may claim a capital gain exclusion from the sale of investment in a qualified Wisconsin business.

6. Can an electing tax-option (S) corporation register to be a qualified Wisconsin business?

Yes, an electing tax-option (S) corporation may register to be a qualified Wisconsin business if they otherwise qualify. See common questions on the department's [website](#).

7. Can an electing tax-option (S) corporation claim a deduction for charitable contributions?

No, an electing tax-option (S) corporation may not deduct charitable contributions and may not pass through charitable contributions to its shareholders.

Pursuant to sec. 71.365(4m)(d)1., Wis. Stats., net income of an electing tax-option (S) corporation is computed under sec. 71.34(1k), Wis. Stats., which provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. Pursuant to sec. 1363(b)(2), IRC, taxable income of a tax-option (S) corporation is computed in the same manner as an individual as provided under the IRC, except that the deductions referred to in sec. 703(a)(2), IRC, shall not be allowed to the corporation. Section 703(a)(2)(C), IRC, provides that the deduction for charitable contributions provided in sec. 170, IRC, are not allowed.

Pursuant to sec. 71.34(1k)(b), Wis. Stats., charitable contributions are included in a tax-option (S) corporation's net income, and therefore may not pass through to the shareholders.

8. Is an electing tax-option (S) corporation subject to passive activity loss limitations?

Yes, an electing tax-option (S) corporation is subject to passive activity loss limitations as provided in sec. 469, IRC.

Pursuant to sec. 71.365(4m)(d)1., Wis. Stats., net income of an electing tax-option (S) corporation is computed under sec. 71.34(1k), Wis. Stats. Section 71.34(1k), Wis. Stats. provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. Pursuant to sec. 1363(b), IRC, taxable income of a tax-option (S) corporation is computed in the same manner as an individual under the IRC.

9. How does an electing tax-option (S) corporation determine the characterization of passive income or loss?

The electing tax-option (S) corporation must determine the characterization of passive income or loss as if the election under sec. 71.365(4m)(a), Wis. Stats., was not made. Therefore, an electing tax-option (S) corporation must determine how each shareholder would characterize the income or loss as if the election was not made. Passive losses may not be passed through to the shareholders; however, suspended losses may be carried forward by the electing tax-option (S) corporation to be used to offset income in a subsequent year in which the election is made.

The electing tax-option (S) corporation must complete a pro forma federal Form 8582, Passive Activity Loss Limitations, for Wisconsin in order to determine the allowable passive activity losses it may claim.

Pursuant to sec. 71.365(4m)(d)1., Wis. Stats., net income of an electing tax-option (S) corporation is computed under sec. 71.34(1k), Wis. Stats. Section 71.34(1k), Wis. Stats. provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. Pursuant to sec. 1363(b), IRC, taxable income of a tax-option (S) corporation is computed in the same manner as an individual under the IRC. Pursuant to sec. 71.365(4m)(b), Wis. Stats., it is the intent that an electing tax-option (S) corporation must pay tax on items that would otherwise be taxed if the election was not made.

10. Is an electing tax-option (S) corporation subject to the \$500 Wisconsin capital loss limitation or the \$3,000 federal capital loss limitation?

An electing tax-option (S) corporation is subject to the \$3,000 federal capital loss limitation, not the \$500 Wisconsin capital loss limitation. Capital losses may not be passed through to the shareholders; however, suspended losses may be carried forward by the electing tax-option (S) corporation to be used to offset income in a subsequent year in which the election is made, to the extent allowed under the Internal Revenue Code in effect under Wisconsin law.

Pursuant to sec. 71.365(4m)(d)1., Wis. Stats., net income of an electing tax-option (S) corporation is computed under sec. 71.34(1k), Wis. Stats. Section 71.34(1k), Wis. Stats. provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. Pursuant to sec. 1363(b), IRC, taxable income of a tax-option (S) corporation is computed in the same manner as an individual under the IRC.

11. Is an electing tax-option (S) corporation subject to federal section 179 expense limitations?

Yes, an electing tax-option (S) corporation is subject to federal section 179 expense limitations, as provided in [sec. 71.34\(1k\)](#), Wis. Stats. The limit is applied at the entity level.

12. Can an electing tax-option (S) corporation claim the federal special depreciation allowance, bonus depreciation, under sec. 168(k), Internal Revenue Code (IRC)?

No, an electing tax-option (S) corporation may not claim the federal special depreciation allowance provided in [sec. 168\(k\)](#), IRC.

Pursuant to [sec. 71.365\(4m\)\(d\)1.](#), Wis. Stats., net income of an electing tax-option (S) corporation is computed under [sec. 71.34\(1k\)](#), Wis. Stats. [Section 71.34\(1k\)](#), Wis. Stats., provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under secs. [71.34\(1g\)](#) and [71.98](#), Wis. Stats. These sections exclude the federal special depreciation allowance provided in sec. 168(k), IRC.

13. Can an electing tax-option (S) corporation carry forward suspended capital and passive activity losses?

Yes, an electing tax-option (S) corporation may carry forward suspended capital and passive activity losses. When an election is made, such losses may not pass through to shareholders; they are suspended until such time that the tax-option (S) corporation may use them to offset income in a subsequent year in which the election is made.

14. Can an electing tax-option (S) corporation carry back or carry forward net business losses?

No, pursuant to [sec. 71.365\(4m\)\(d\)3.](#), Wis. Stats., an electing tax-option (S) corporation may not claim net operating or business losses under secs. [71.05\(8\)](#) and [71.26\(4\)](#), Wis. Stats.

15. Can an electing tax-option (S) corporation pass through net business losses to its shareholders?

No, shareholders of an electing tax-option (S) corporation may not include in their Wisconsin adjusted gross income their proportionate share of all items of income, gain, loss, or deduction of the tax-option (S) corporation, pursuant to [sec. 71.365\(4m\)\(b\)](#), Wis. Stats.

16. Can an electing tax-option (S) corporation claim credits to offset taxable income at the entity level?

Pursuant to [sec. 71.365\(4m\)\(d\)2.](#), Wis. Stats., an electing tax-option (S) corporation may only claim a credit for other state taxes paid under [sec. 71.07\(7\)\(b\)3.](#), Wis. Stats.

17. Can an electing tax-option (S) corporation pass through credits to its shareholders?

Yes, an electing tax-option (S) corporation may pass through credits to its shareholders, except for the credit for taxes paid to other states by the tax-option (S) corporation as provided in [sec. 71.07\(7\)\(b\)2.](#), Wis. Stats.

18. How is the manufacturing and agriculture (M&A) credit included in Wisconsin income if a tax-option (S) corporation makes an election to pay tax at the entity level in the year the M&A credit is computed and does not make the election to pay tax at the entity level in the following year?

The M&A credit must be added to the tax-option (S) corporation's income for the year following the year in which the credit was computed as provided in [sec. 71.26\(2\)\(a\)11.](#), Wis. Stats., regardless of whether the tax-option (S) corporation makes the election to pay tax at the entity level.

19. How does an electing tax-option (S) corporation compute the credit for taxes paid to another state?

An electing tax-option (S) corporation must use Schedule ET-OS to compute the allowable credit for taxes paid to another state. See Schedule ET-OS instructions for additional information.

20. Can an electing tax-option (S) corporation claim a credit for taxes paid to another state if the taxes paid to the other state are paid by a shareholder on an individual income tax return?

No, in order for an electing tax-option (S) corporation to receive credit for taxes paid to another state, the tax-option (S) corporation must pay the taxes owed to the other state on a corporate income or franchise tax return, or pay tax to the other state on a composite return filed on behalf of its shareholders as provided in sec. 71.07(7)(b)3., Wis. Stats.

21. Is withholding tax paid by an electing tax-option (S) corporation in another state (e.g., Illinois) on behalf of its members considered a "composite return" for purposes of the Wisconsin entity-level credit for taxes paid to another state?

A tax-option (S) corporation may claim a credit for withholding taxes paid to another state on behalf of a Wisconsin resident shareholder as provided in sec. 71.07(7)(b)3., Wis. Stats., if all of the following apply:

- o The law in the other state provides that the Wisconsin resident is not required to file an individual income tax return because the individual's net income tax liability is considered paid in full as a result of the withholding tax paid by the entity on the Wisconsin shareholder's income attributable to the other state.
- o The Wisconsin resident does not file an individual income tax return in the other state. **Caution** Although the individual is not required to file an Illinois income tax return, the individual may file such return with Illinois.
- o The income taxed by the other state is attributable to amounts that would be reportable to Wisconsin if the entity-level tax election was not made.
- o The tax-option (S) corporation pays the liability shown on the other state's withholding tax return. Amounts paid to the other state are considered paid to that other state only in the year in which the withholding tax return for that state was required to be filed.
- o The tax-option (S) corporation attaches a copy of the other state's withholding tax return to its Wisconsin Form 5S.
- o The credit is claimed within four years of the unextended due date of the entity's return.

For example, Illinois law provides that a nonresident of Illinois who has had Illinois income tax withheld by a tax-option (S) corporation is not required to file an Illinois individual income tax return if the nonresident's income tax liability is paid in full after taking into account the withholding.

22. Can a tax-option (S) corporation making the election to pay tax at the entity level exclude income at the entity level if the income is attributable to a tax-exempt shareholder (e.g., employee stock ownership plan)?

No, pursuant to sec. 71.365(4m)(d)1., Wis. Stats., net income of an electing tax-option (S) corporation is computed under sec. 71.34(1k), Wis. Stats., which provides that net income or loss of a tax-option (S) corporation means net income or loss computed under the Internal Revenue Code (IRC), as defined under sec. 71.34(1g), Wis. Stats. Pursuant to sec. 1363(b), IRC, taxable income of a tax-option (S) corporation is computed in the same manner as an individual as provided under the IRC.

23. For Wisconsin purposes, how will the tax-option (S) corporation entity-level tax election affect the deductible amount of a shareholder's interest expense related to a debt-financed acquisition of stock of the electing tax-option (S)

corporation?

The interest paid by the shareholder is an expense incurred by the shareholder; it is not an expense of the tax-option (S) corporation. The deductibility of the interest expense on the shareholder's Wisconsin income tax return is determined under the Internal Revenue Code (IRC) in effect for Wisconsin. The shareholder may deduct the interest expense to the extent allowable under Internal Revenue Service Treas. Reg. sec. 1.163-8T and secs. 163(d) and 469, IRC, in effect for Wisconsin, regardless of whether the tax-option (S) corporation makes an election under sec. 71.365(4m)(a), Wis. Stats., to pay tax at the entity level.

24. Where does an electing tax-option (S) corporation report taxable federal, state, and municipal government interest that would have been reported on line 1 of Form 5S if the entity-level tax election was not made?

Taxable federal, state, and municipal government interest is reported on line 1 of Form 5S regardless of whether the tax-option (S) corporation makes an election under sec. 71.365(4m)(a), Wis. Stats., to pay tax at the entity level. The interest is not included as part of the entity level tax computation on Schedule 5S-ET.

25. Can an electing tax-option (S) corporation claim a deduction for health insurance premiums paid on behalf of a greater than 2-percent shareholder?

An electing tax-option (S) corporation is allowed to deduct health insurance premiums paid on behalf of a greater than 2-percent shareholder as wage expense reportable on the shareholder's Form W-2. The electing tax-option (S) corporation may not also claim the self-employed health insurance deduction allowed on the shareholder's tax return. **Note** The shareholder may still claim their self-employed health insurance deduction as if the election to pay tax at the entity level was not made.

26. If a shareholder of an electing tax-option (S) corporation had a suspended loss from a prior year due to basis limitations, can the electing tax-option (S) corporation use the shareholder's suspended loss to reduce its Wisconsin taxable income in the current year?

No, an electing tax-option (S) corporation may not use a shareholder's suspended loss from prior years when computing Wisconsin taxable income. Suspended loss due to a basis limitation occurs when a shareholder is disallowed business loss passed-through from a tax-option (S) corporation because the shareholder does not have enough tax basis in the entity.

Note: Pursuant to sec. 71.365(1)(b), Wis. Stats., a shareholder's adjusted basis of the shareholder's stock in an electing tax-option (S) corporation is determined as if the election was not made. Therefore, a shareholder with prior year suspended losses due to basis limitations may be able to deduct a portion of the suspended losses in a year the shareholder's basis in the stock of the tax-option (S) corporation increases, regardless if the tax-option (S) corporation makes the entity-level tax election.

Applicable Laws and Rules

This document provides statements or interpretations of the following laws and regulations in effect as of February 10, 2020: Sections 71.03, 71.04, 71.05, 71.07, 71.26, 71.34, 71.36, 71.362 and 71.365, Wis. Stats., sec. Tax 2.08, Wis. Adm. Code, 26 U.S. Code §§ 162, 163, 170, 469, 703, 1211 and 1363, and 26 CFR § 163-8T.

Laws enacted and in effect after February 10, 2020, new administrative rules, and court decisions may change the interpretations in this document. Guidance issued prior to February 10, 2020, 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:

MS 5-77

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