



WISCONSIN MANUFACTURERS & COMMERCE

~~Ben Willis~~
Ben Willis

Testimony in Support of Senate Bill 203

Senate Committee on Revenue, Financial Institutions, and Rural Issues

February 7, 2018

Thank you Chair Marklein and members of the Senate Committee on Revenue, Financial Institutions, and Rural Issues for hearing my testimony in support of Senate Bill 203 (SB 203) as amended by Senate Amendment One. This legislation will make compliance with Wisconsin's tax code fairer for taxpayers.

Wisconsin Manufacturers & Commerce (WMC) is the state chamber of commerce and largest general business association in Wisconsin. We were founded over 100 years ago, and are proud to represent approximately 3,800 member companies of all sizes, and from every sector of our economy. Our mission is to make Wisconsin the most competitive state in the nation in which to do business.

SB 203 will help make Wisconsin more competitive by creating a more even playing field between taxpayers and the Department of Revenue. The bill as amended contains two provisions:

- First, SB 203 would change the law to treat taxpayers fairly under the legal threshold for challenging whether a transaction has economic substance. The current "clear and convincing" standard is simply too high for taxpayers to successfully challenge an allegation that a transaction did not have economic substance. The bill would change this standard from "clear and convincing" to "clear and satisfactory."
- Second, SB 203 would extend taxpayer protections for material reviewed during a prior tax audit. This bill would delete ambiguous language for when a taxpayer cannot rely on a prior audit to protect them from tax liability for the period that past audit was conducted under. The ambiguous language would be replaced with clear exemptions for when a taxpayer is no longer protected by a prior audit.

Adopting the provisions of this legislation will help make compliance with Wisconsin's tax code easier for taxpayers. Thank you again Chair Marklein and committee members for hearing my testimony. WMC urges support for the passage of Senate Bill 203.

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Founded in 1911, WMC is Wisconsin's chamber of commerce and largest business trade association.



HOWARD MARKLEIN

STATE SENATOR • 17TH SENATE DISTRICT

December 12, 2017

**Senate Committee on Revenue, Financial Institutions & Rural Issues
Testimony on Senate Bill (SB) 203**

Good morning!

Thank you committee members for hearing Senate Bill 203 (SB 203), which proposes changes to Wisconsin's tax code to improve compliance and provide fairness during the collection and audit processes.

I would like to thank Rep. Katsma for working on this proposal, and the subsequent amendment. The bill as introduced has four main provisions: Federalizing the Built-in Gains recognition, Economic Substance, Withdrawal from the Multistate Tax Commission, and Reliance on past audits.

If the amendment is adopted, the Built-in Gains and Multistate Tax Commission sections of the bill will be removed. Economic Substance and Reliance on past audits will remain, but are amended.

When the Department of Revenue (DOR) conducts audits, in certain situations they will examine whether a business engaged in a transaction for business purposes or merely to evade tax liability. The current evidentiary standard for the taxpayer is "clear and convincing" evidence (the highest standard of proof.) Under the amendment the evidentiary standard is changed to "clear and satisfactory."

Reliance on past audits provides certainty for taxpayers. If DOR conducts an audit and finds no tax liability for the reviewed transactions, the taxpayer should be able to rely on that determination. In most audit situations, the audit is resolved via a written agreement between DOR and the taxpayer. Under the amendment, DOR in subsequent audits would not be able to revisit a topic that had been previously settled, unless the taxpayers provided "false or incomplete" information during that review.

Thank you again for allowing me the opportunity to testify in support of this bill, and I welcome any questions.



TERRY KATSMAS

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P.O. Box 8952
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Date: February 7th, 2018
To: Senate Committee on Revenue, Financial Institutions and Rural Issues
From: Representative Terry Katsma
Re: Senate Bill 203: Taxpayer Fairness Act

Dear Chairman Marklein and committee members,

Thank you for convening a hearing on Senate Bill (SB) 203, a bill that aims to keep making Wisconsin a better place to do business. This bill originally comprised four main elements; Senate Amendment 1 is the result of subsequent negotiation among stakeholders and significantly pares down the original bill.

The first element is federalizing the built-in gains tax. Some for-profit corporations choose, when they are created, to be taxed separately from their owners under Subchapter C of Chapter 1 of the Internal Revenue Code (and are therefore known as “C corporations”). Other corporations instead choose to be “S corporations,” dividing any gains or losses among its shareholders, who are then responsible for paying the income taxes as part of their individual tax returns. A C corporation can choose to convert itself to an S corporation, but the new S corporation must keep paying tax for a period of time (which is commonly called a “built-in gains tax”) as if it were still a regular C corporation. A 2015 federal law permanently reduced this period of time from 10 years to 5 years. SB 203 adopts into state law the new 5-year federal recognition period and provides for state law to adjust automatically to match any future changes in federal law.
February 2018 update: Senate Amendment 1 deletes this provision from the bill entirely.

The second part of the bill helps level the playing field between government and taxpayer in audit situations. In some tax audits of businesses, the Department of Revenue (DOR) examines whether a business engaged in certain transactions for genuine business purposes—with “economic substance” behind the transaction—or merely to evade tax liability. If DOR alleges that a transaction lacked economic substance, the burden is presently on the taxpayer to provide “clear and convincing” evidence (the law’s highest possible standard of proof) that economic substance did in fact exist. In reality, this is an impossibly high legal threshold for a business to meet; a business has practically no hope of successfully contesting such an allegation. Under this bill, a taxpayer bears the burden of establishing economic substance by a “preponderance of the evidence” rather than “clear and convincing” evidence, thus giving taxpayers a fairer chance in dispute situations than they have today.

February 2018 update: Senate Amendment 1 reduces the current “clear and convincing” burden of proof to “clear and satisfactory,” a compromise position agreeable to stakeholders and the Department of Revenue. This compromise will result in zero fiscal impact to the state relative to current law.



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Third, SB 203 would withdraw our state from the Multistate Tax Commission (MTC). Presently, the Department of Revenue contracts annually with the MTC to conduct business audits. Many businesses believe that MTC auditors do a poorer job than DOR auditors (who are more familiar with Wisconsin law). Involving third-party contractors in the audit process can compromise the confidentiality of tax information that is more appropriately kept private between taxpayer and government. And contracting for audit services can create an incentive for contractors to “find something” worth selling to DOR even where tax liability does not reasonably exist. This bill withdraws Wisconsin from participation in the MTC.

February 2018 update: Senate Amendment 1 deletes this provision from the bill entirely.

Finally, this bill creates greater certainty for taxpayers after disputes are settled. If DOR reviews a taxpayer’s transactions and finds no tax liability, the taxpayer should be able to rely upon that determination unless the law is changed or DOR publishes new guidance that would alter the determination. This is particularly true when, as in most audit situations, an audit is resolved via a written agreement between DOR and the taxpayer. SB 203 eliminates a possibility for auditors to overreach in new audits by unfairly revisiting issues settled in previous audits or by unreasonably expecting taxpayers to provide more information than DOR actually requests.

February 2018 update: Senate Amendment 1 modifies the bill’s original provisions. The compromise increases taxpayers’ ability to rely upon the Department of Revenue’s past determinations while preserving the Department’s ability to enforce the law. This compromise will result in zero fiscal impact to the state relative to current law.

Thank you for your time and consideration of SB 203.

Fiscal Estimate - 2017 Session

Original
 Updated
 Corrected
 Supplemental

LRB Number **17a0586/1** Introduction Number **AA1-AB259**

Description
 the length of the recognition period for built-in gains tax; the evidentiary standard for proving a transaction has economic substance; participation by the Department of Revenue in the Multistate Tax Commission Audit Program; and reliance by a taxpayer on past audits by the Department of Revenue

Fiscal Effect

State:

- No State Fiscal Effect
- Indeterminate
 - Increase Existing Appropriations
 - Decrease Existing Appropriations
 - Create New Appropriations
- Increase Existing Revenues
- Decrease Existing Revenues
- Increase Costs - May be possible to absorb within agency's budget
 - Yes No
- Decrease Costs

Local:

- No Local Government Costs
- Indeterminate
- 1. Increase Costs 3. Increase Revenue
 - Permissive Mandatory
- 2. Decrease Costs 4. Decrease Revenue
 - Permissive Mandatory
- 5. Types of Local Government Units Affected
 - Towns Village Cities
 - Counties Others
 - School Districts WTCS Districts

Fund Sources Affected **Affected Ch. 20 Appropriations**

GPR
 FED
 PRO
 PRS
 SEG
 SEGS

Agency/Prepared By	Authorized Signature	Date
DOR/ Michael Oakleaf (608) 261-5173	Jamie Adams (608) 266-6785	1/31/2018

Fiscal Estimate Narratives

DOR 1/31/2018

LRB Number 17a0586/1	Introduction Number AA1-AB259	Estimate Type Supplemental
Description the length of the recognition period for built-in gains tax; the evidentiary standard for proving a transaction has economic substance; participation by the Department of Revenue in the Multistate Tax Commission Audit Program; and reliance by a taxpayer on past audits by the Department of Revenue		

Assumptions Used in Arriving at Fiscal Estimate

As described below, if the amendment is adopted the bill would have no net fiscal effect.

Built-in Gains

Under the bill as introduced, the recognition period for built-in gains for an S-corporation that converted from a C-corporation would be the same for Wisconsin purposes as for federal purposes, and all future changes to the federal recognition period would automatically be adopted for Wisconsin purposes. The amendment deletes the provisions in the bill that relate to the recognition period for built-in gains.

If the amendment is adopted it would result in an increase in income and franchise tax revenue of an estimated \$950,000 in FY18, \$800,000 in FY19, and \$600,000 in FY20 relative to the bill. Relative to current law, if the amendment is adopted there would be no change to the built-in gains recognition period and therefore no fiscal effect.

Evidentiary Standards

The bill would reduce the evidentiary standard for taxpayers related to intercompany transactions between members of a controlled group from "clear and convincing evidence" to a "preponderance of the evidence." The amendment changes the standard to "clear and satisfactory."

If the amendment is adopted, the Department would be able to administer the provision such that there would be no fiscal effect.

MTC Audit Authority

Under the bill as introduced, the current-law authority for the Department to enter into a contract to participate in the Multi-State Tax Commission (MTC) audit program would be repealed. The amendment deletes the repeal, which would leave the current law authority in place.

If the amendment is adopted it would result in an increase in income and franchise tax revenue of an estimated \$1.25 million annually relative to the bill. Relative to current law, if the amendment is adopted there would be no change to the Department's authority to participate in the MTC audit program and therefore there would be no fiscal effect.

Reliance on Past Audits

The bill would remove the current law exceptions allowing DOR to revisit assessments for cases in which the taxpayer did not give DOR adequate and accurate information regarding the tax issue in the prior audit determination or if the tax issue was settled in the prior audit determination by a written agreement between DOR and the taxpayer, preventing DOR from reexamining audits in cases in which taxpayers conceal or misrepresent relevant tax information. The amendment keeps the deletion in the original bill but also creates new exceptions for cases where 1) the taxpayer provides incomplete or false information; 2) the tax issue is settled by a written agreement between the Department and the taxpayer before the effective date of the provision; or 3) the tax issue was settled in a prior audit after the effective date of the provision and the parties acknowledge that the Department did not adopt the taxpayer's position.

If the amendment is adopted, the Department can administer the provision such that there would be no fiscal effect.