

General Fund Taxes and Shared Revenue

GENERAL FUND TAXES

1. ANGEL INVESTMENT AND EARLY STAGE SEED INVESTMENT TAX CREDITS

	Chg. to JFC
GPR-REV	\$7,800,000

Delete provisions, included in the bill, that would increase the maximum annual and total amount of angel investment and early stage seed investment tax credits. Compared to the bill, this would increase state income and franchise tax revenues by an estimated \$2,800,000 in 2007-08 and \$5,000,000 in 2008-09.

The angel investment tax credit can be claimed under the individual income tax and is equal to 12.5% of the claimant's bonafide angel investment made directly in a qualified new business venture in a tax year. The 12.5% tax credit can be claimed for two years, beginning with the tax year as certified by the Department of Commerce. Consequently, the total tax credit is 25% of the amount invested. Unused credit amounts can be carried forward up to 15 years to offset future tax liabilities. The maximum aggregate amount of angel investment tax credits that may be claimed for a tax year is \$3,000,000. The maximum total amount of tax credits that can be claimed for all tax years is \$30,000,000.

The early stage seed investment credit can be claimed under the individual income and corporate income and franchise taxes and is equal to 25% of the claimant's investment paid in the tax year to a fund manager that the fund manager invests in a business certified by Commerce (qualified new business venture). Unused credit amounts can be carried forward up to 15 years to offset future tax liabilities. The maximum aggregate amount of early stage seed investment tax credits that can be claimed for a tax year is \$3,500,000. The maximum total amount of tax credits that can be claimed for all tax years is \$35,000,000.

The bill would make the following modifications to the angel investment tax credit under the individual income tax and the early stage seed investment tax credit under the individual income and corporate income and franchise taxes:

a. Increase the total amount of angel investment tax credits that can be claimed for all tax years by \$17.5 million, from \$30 million to \$47.5 million. For tax years beginning after December 31, 2007, the aggregate amount of tax credits that could be claimed each year would be increased by \$2.5 million, from \$3 million to \$5.5 million. The maximum amount of investment that could be used as the basis for a tax credit would be increased from \$500,000 to \$2 million.

b. Increase the total amount of early stage seed investment tax credits that could be claimed for all tax years by \$17.5 million, from \$35 million to \$52.5 million. For tax years

beginning after December 31 2007, the aggregate amount of tax credits that could be claimed each year would be increased by \$2.5 million, from \$3.5 million to \$6 million.

**2. CORPORATE INCOME AND FRANCHISE TAX --
COMBINED REPORTING**

	Chg. to JFC
GPR-REV	\$130,500,000

Beginning with tax year 2008, require corporations that are subject to the state corporate income and franchise tax, and that are engaged in a unitary business, to file a combined report for state income and franchise taxes. The specific provisions for filing combined reports would include the following:

Definitions

"Person" would include corporations, unless the context required otherwise. "Person" could also include, as determined by the Department of Revenue (DOR), any individual, partnership, general partner of a partnership, limited liability company (LLC), registered limited liability partnership, foreign limited liability partnership, syndicate, estate, trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization.

"Combined group" would mean the group of all persons whose income and apportionment factors are required to be taken into account pursuant to filing a combined report in determining the taxpayer's share of the net business income or loss apportionable to this state.

"Combined report" would be defined as a tax return under state law on a form prescribed by the Department of Revenue (DOR) that specified the income of each taxpayer member of a commonly controlled group operating as a unitary business.

"Commonly controlled group" would be defined to mean any of the following:

(a) A parent corporation and any one or more corporations or chains of corporations that are connected to the parent corporation by direct or indirect ownership by the parent corporation, if the parent corporation owns stock representing more than 50% of the voting power of at least one of the connected corporations, or if the parent corporation or any of the connected corporations owns stock that cumulatively represents more than 50% of the voting power of each of the connected corporations.

(b) Any two or more corporations, if a common owner, regardless of whether or not the owner is a corporation, directly or indirectly, owns stock representing more than 50% of the voting power of the corporations or connected corporations.

(c) Any two or more corporations, if stock representing more than 50% of the voting power in each corporation are interests that cannot be separately transferred.

(d) Any two or more corporations, if stock representing more than 50% of the voting power in each corporation is directly owned by, or for the benefit of, family members. "Family

member" would mean an individual related by blood, marriage or adoption within the second degree of kinship as computed under state law, or the spouse of such an individual.

"Corporation" would mean any corporation as defined under state law, wherever located, which, if it were doing business in this state, would be subject to the state corporate income and franchise tax. The business conducted by a pass-through entity which is directly or indirectly held by a corporation would be considered the business of the corporation to the extent of the corporation's distributive share of the income of the pass-through entity. "Corporation" would not include a tax-option corporation.

"Internal Revenue Code (IRC)" would mean the IRC as defined under state law including any provision of a federal tax treaty that expressly applies to the U.S., but not including any other application of a federal tax treaty.

"Pass-through entity" would be defined as a general or limited partnership, organization of any kind treated as a partnership for tax purposes under state law, a real estate investment trust, regulated investment company, real estate mortgage investment conduit, financial asset securitization investment trust, trust, or estate.

"Tax haven" would mean a jurisdiction that, for any tax year, is identified by the Organization for Economic Co-operation and Development (OECD) as a tax haven or as having a harmful, preferential tax regime; or has no or nominal effective tax on the relevant income and all of the following apply:

(a) The jurisdiction has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime.

(b) The details of the legislative, legal, or administrative provisions of the jurisdiction's tax regime are not publicly available and apparent, or are not consistently applied among similarly situated taxpayers, or the information needed by tax authorities to determine a taxpayer's correct tax liability, such as accounting records and underlying documentation, is not adequately available.

(c) The jurisdiction facilitates the establishment of foreign-owned entities without the need for a local substantive presence, or prohibits these entities from having any commercial impact on the local economy.

(d) The tax regime explicitly or implicitly excludes the jurisdiction's resident taxpayers from taking advantage of the tax regime's benefits, or prohibits enterprises that benefit from the regime from operating in the jurisdiction's domestic market.

(e) The jurisdiction has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial or other services sector relative to its overall economy.

"Taxpayer member" would mean a corporation that is subject to the state corporate income and franchise tax, that is a member of a combined group.

"Unitary business" would be defined as a single economic enterprise that consisted of separate parts of a single business entity, or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated by their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts. Two or more business entities would be considered a unitary business if the businesses had unity of ownership, operation and use, as indicated by a centralized management or a centralized executive force; centralized purchasing, advertising, or accounting; intercorporate sales or leases; intercorporate services; intercorporate debts; intercorporate use of proprietary materials; interlocking directorates; or interlocking corporate officers. Any business conducted by a pass-through entity that was owned directly or indirectly by a corporation would be considered conducted by the corporation, to the extent of the corporation's distributive share of the pass-through entity's income, regardless of the percentage of the corporation's ownership interest. A business conducted directly or indirectly by one corporation would be unitary with that portion of a business conducted by another corporation through its direct or indirect interest in a pass-through entity, if the corporations are sufficiently interdependent, integrated, and interrelated by their activities so as to provide a synergy of value among them and a significant flow of value to the separate parts, and the two corporations are members of the same commonly controlled group.

Corporations Required to Use Combined Reporting

A corporation engaged in a unitary business with any other corporation would be required to file a combined report which included the income, determined under combined reporting, and apportionment factor, determined under current law and combined reporting provisions, of the following members of the unitary business:

(a) Any member incorporated in the United States, including the District of Columbia and any territory or possession of the U.S., or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States.

(b) Any member, regardless of where the entity is incorporated or formed, if the average of the following ratios was 20% or more:

1. The value of the member's real and tangible personal property located in the United States, including the District of Columbia and any territory or possession of the U.S., not including property that is used to produce nonapportionable income, divided by the value of all the member's real property and tangible personal property, not including property that is used to produce nonapportionable income. Property that the member rents would be valued at the net annual rental amount for the property, multiplied by eight.

2. The amount of the member's payroll paid in the United States, including the District of Columbia and any territory or possession of the U.S., divided by the member's total payroll. "Payroll" would include compensation paid to employees, but would not include

payroll used to produce nonapportionable income. The payroll paid in the United States would be determined in the same manner as determined for payroll paid in Wisconsin under current law.

3. The member's sales in the United States, including the District of Columbia and any possession or territory of the U.S., divided by the member's total sales. Sales would include items identified in the current law definition of sales, but not items excluded under current law, and the situs of a sale would be determined in the same manner as for Wisconsin sales under current law, except that throw-back provisions would not apply.

(c) Any member that was a domestic international sales corporation as described in the IRC; a foreign sales corporation as described in the IRC; or any member which is an export trade corporation, as described in the IRC.

(d) Any member that was a "controlled foreign corporation," as defined in the IRC, to the extent of the income of that member that is defined in the Internal Revenue Code, including any lower-tier subsidiaries' distributions of such income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income; any item of income received by a controlled foreign corporation would be excluded if such income was subject to an effective tax rate imposed by a foreign country greater than 90% of the maximum rate of tax specified in the IRC.

(e) Any member that earned more than 20% of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined group, to the extent of that income and the apportionment factors related to that income.

(f) Any member that was doing business in a tax haven, if the member is engaged in an activity that was sufficient for that tax haven jurisdiction to impose a tax under federal law. If the member's business activity within a tax haven was entirely outside the scope of the laws and practices that cause the jurisdiction to be a tax haven, the member's business activity would not be considered to be conducted in a tax haven.

(g) Any member not described in (a) through (f) above to the extent its income was derived from, or attributable to, sources within the United States including the District of Columbia and any possession or territory of the U.S., as determined under the Internal Revenue Code, without regard to federal treaties, and by its apportionment factors related to that income.

DOR could require the combined report that was filed to include the income and associated apportionment factor of any persons that were not described under to combined reporting provisions, but that were members of a unitary business to reflect proper apportionment of income of the entire unitary business, including persons that are not, or would not be, subject to state income and franchise taxes if doing business in this state.

Components of Income Subject to Taxation

Each taxpayer member would be responsible for tax based on its taxable income or loss that would be apportioned or allocated to Wisconsin, and which would include:

(a) Its share of any business income apportionable to this state of each of the combined groups of which it is a member, determined under combined reporting provisions.

(b) Its share of any business income apportionable to this state of a distinct business activity conducted within and without the state wholly by the taxpayer member, determined under current law provisions.

(c) Its income from a business conducted wholly by the taxpayer member entirely within the state.

(d) Its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under combined reporting provisions.

(e) Its nonbusiness income or loss allocable to this state.

(f) Its income or loss allocated or apportioned in an earlier year, that was state source income during the income year, other than a net business loss carryforward.

(g) Its net business loss carryforward. If the taxable income computed under combined reporting provisions resulted in a loss for a taxpayer member of the combined group, that taxpayer member would have a net business loss, subject to the net business loss limitations and carryforward provisions under current law. The business loss would be applied as a deduction in a subsequent year only if that taxpayer member had net income sourced to this state, regardless of whether the taxpayer was a member of a combined group in the subsequent year.

Determining Business Income of the Combined Group

The business income of a combined group would be determined as follows:

(a) Compute the sum of the income of each member of the combined group determined under federal income tax laws as if the members were not consolidated for federal purposes, and modified for state purposes.

The income of each member of the combined group would be determined as follows:

(1) For any member incorporated in the United States, including the District of Columbia and any territory or possession of the U.S., or included in a consolidated federal corporate income tax return, the income to be included in the total income of the combined group would be the taxable income for the corporation as determined under current law.

(2) Except as provided under (3) below, and for any member not included under (1) above, the income to be included in the total income of the combined group would be determined as follows:

a. Each foreign branch or foreign corporation would prepare a profit and loss statement in the currency in which the books of account of the branch or corporation are regularly maintained.

b. The member would adjust the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements.

c. The member would adjust the profit and loss statement to conform it to the tax accounting standards required under state income and franchise tax provisions.

d. Each member would translate the profit and loss statement and the related apportionment factors into the currency in which the parent company maintains its books and records.

e. Each member would express income apportioned to this state in United States dollars.

(3) If DOR determined that the income determination reasonably approximated income as determined under current law, any member not included in determining the total income of the combined group could determine its income on the basis of the consolidated profit and loss statement that included the member and that was prepared for filing with the Securities and Exchange Commission by related corporations. If the member was not required to file with the Securities and Exchange Commission, DOR could allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If the above statements did not reasonably approximate income as determined under current law provisions, the Department could accept those statements with appropriate adjustments, as determined by DOR, to approximate that income.

(4) If a unitary business included income from a pass-through entity, the total income of the combined group would have to include the member of the combined group's direct and indirect distributive share of the pass-through entity's unitary business income.

(5) All dividends paid by one member to another would not be included in the recipients income, if the dividends were paid out of earnings and profits of the unitary business in the current tax year or an earlier tax year. This provision would not apply to dividends received from members of the unitary business which were not a part of the combined group.

(6) Except as provided by DOR, by rule, business income or loss from an intercompany transaction between members of the same combined group would be deferred in a manner similar to that provided under federal regulations. Upon the occurrence of any of the following events, deferred business income or loss resulting from an intercompany transaction

between members of a combined group, would be required to be included in the income of the seller, and be apportioned as business income earned immediately before the event:

a. The object of the deferred intercompany transaction was sold by the buyer to an entity that was not a member of the combined group.

b. The object of the deferred intercompany transaction was sold by the buyer to an entity that was a member of the combined group for use outside the unitary business in which the buyer and seller were engaged.

c. The object of the deferred intercompany transaction was converted by the buyer to a use outside the unitary business in which the buyer and seller were engaged.

d. The buyer and seller were no longer members of the same combined group, regardless of whether the members remain unitary.

(7) A charitable expense incurred by a member of a combined group would, to the extent allowable as a deduction under the IRC, be subtracted first from the business income of the combined group, subject to the income limitations of the IRC applied to the entire business income of the group, and any remaining amount would be treated as a nonbusiness expense allocable to the member that incurred the expense, subject to the income limitations of the IRC applied to the nonbusiness income of that specific member. Any charitable deduction described under this provision, but allowed as a carryover deduction in a subsequent year, would be considered to be originally incurred in the subsequent year by the same member, and the rules of this provision would apply in the subsequent year in determining the allowable deduction in that year.

(8) Gain or loss from the sale or exchange of capital assets, property subject to special rules for capital gains and losses under the IRC, and property subject to an involuntary conversion, would be removed from the total separate net income of each member of a combined group and would be apportioned and allocated as follows:

a. For short term capital gains or losses, long term capital gains or losses, gains or losses subject to IRC special rules, and involuntary conversions, the business gain and loss of all members would be combined within each class of net business gain or loss, and each such class separately apportioned to each member using the member's apportionment percentage determined under the provisions described below.

b. Each taxpayer member would net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this state, as provided under the Internal Revenue Code, without regard to any of the taxpayer member's gains or losses from the sale or exchange of capital assets, IRC special rules property, and involuntary conversions which are nonbusiness items allocated to another state.

c. Any resulting state source income or loss, if the loss is not subject to the IRC limitations on capital losses, of a taxpayer member produced by the application of the preceding subsections would then be applied to all other state source income or loss of that member.

d. Any resulting state source loss of a member that is subject to the IRC limitations would be carried forward or carried back by that member, and would be treated as a state source short-term capital loss incurred by that member for the year for which the carryforward or carryback applies.

(9) Any expense of one member of the unitary group which was directly or indirectly attributable to the nonbusiness or exempt income of another member of the unitary business would be allocated to that other member as a corresponding nonbusiness or exempt expense, as appropriate.

(b) From the total income of the combined group, determined under (a) above, subtract any nonbusiness income, and add any nonbusiness expense or loss, other than the business income, expense or loss of the combined group.

Taxpayer's Share of the Business Income of the Combined Group (Apportionment)

The taxpayer's share of the business income apportionable to this state of each combined group of which it was a member, would be the product of the business income of the combined group as determined under the combined reporting business income provisions above, and the taxpayer member's sales factor percentage, determined under state law provisions, modified in the following ways:

(a) Include in the numerator the taxpayer member's sales associated with the combined group's unitary business in this state.

(b) Include in the numerator the taxpayer member's sales associated with the combined group's unitary business in another state in which the taxpayer member is not engaged in business, regardless of whether another member of the combined group is engaged in business in the other state.

(c) Include in the denominator the sales of all members of the combined group, including the taxpayer, which sales are associated with the combined group's unitary business regardless of where the business is located.

(d) Include sales of a pass-through entity owned directly or indirectly by a corporation in proportion to a ratio the numerator of which is the amount of the corporation's distributive share of the pass-through entity's unitary income included in the income of the combined group in accordance with (4) above, and the denominator of which is the amount of the pass-through entity's total unitary income.

(e) Exclude sales between members of the combined group.

(f) If a member of a combined group was not subject to the state corporate income and franchise tax because it was not engaged in business in Wisconsin, the numerator of that member's sales factor is zero.

Credits and Post-Appportionment Deductions

No tax credit or post-apportionment deduction earned by one member of the combined group, but not completed, used by, or allowed to that member, could be used in whole or in part by another member of the combined group, or applied in whole or in part against the total income of the combined group.

Designated Agent

Each combined group would be required to appoint a sole designated agent. The designated agent would be the parent corporation of the combined group, if such parent corporation was a taxpayer member of the combined group and the income of the parent corporation was included in the combined report. If there was no such parent, the designated agent could be appointed by the taxpayer members. If there was no such parent and no taxpayer member was appointed, the designated agent would be the taxpayer member that had the most significant operations in this state on a recurring basis, as determined by the Department. The designated agent would change only when the designated agent was no longer subject to the state corporate income and franchise tax, in which case, the combined group would be required to notify DOR of such a change in a manner prescribed by the Department.

The designated agent would be responsible for acting on behalf of the taxpayer members of the combined group and would do all of the following:

- (a) File with the Department a combined report.
- (b) File any extensions.
- (c) File any amended combined reports and claims for refund or credit.
- (d) Send and receive all correspondence with the Department regarding the combined report.
- (e) Remit all taxes, including estimated taxes, to DOR. For purposes of computing interest on late payments, all payments remitted would be considered to be made on a proportionate basis by all taxpayer members of the combined group, unless otherwise specified by the designated agent.
- (f) Participate on behalf of the combined group members in any investigation or hearing requested by DOR regarding a combined report, produce all information requested by the Department regarding the combined report, and file any appeal related to a combined report. Any appeal filed by the designated agent would be considered as filed by all members of the combined group.

(g) Execute waivers, closing agreements, power of attorney, or other document regarding the combined report filed. Any waiver, agreement, or document executed by the designated agent would be considered as executed by all members of the combined group.

(h) Receive notices regarding the combined report. Any such notice the Department sent to the designated agent would be as considered sent to all taxpayer members of the combined group.

(i) Receive refunds regarding the combined report. Any such refund would be paid to, and in the name of, the designated agent and would discharge any liability of the state to any member of the combined group regarding the refund.

DOR could relieve the designated agent from any of the duties described, to the extent the duties relate to income, expense, or loss that is not includable in the business income of the combined group. Unless the Department provided for such relief by rule, a designated agent would be required to obtain written approval from the Department to be relieved of any such duties.

Tax Year of the Combined Group

The combined group's tax year would be the designated agent's tax year. If a member's tax year was different from the combined group's tax year, the designated agent could elect to determine the portion of that member's income to be included in the combined report either from a separate income statement from each member prepared from the books and records for the months included in the combined group's taxable year, or by including all of the income for the year that ends during the combined group's tax year.

If two or more members of a combined group filed a federal consolidated return, the combined group's taxable year would be the taxable year of the federal consolidated group.

Any election made under these provisions would remain in effect for subsequent years unless the designated agent submitted a request to change the election to DOR and DOR approved the change in writing.

Part-Year Members of a Combined Group

If a corporation became a member of a combined group or ceased to be a member of a combined group after the beginning of the tax year of the combined group, the corporation's income would be determined as provided under combined reporting provisions, for the portion of the year in which the corporation was a member of the combined group, and the income would be included in the combined report. The income for the remaining short period would be reported on a separate return or separate combined report.

Presumptions and Burden of Proof

A commonly controlled group would be presumed to be engaged in a unitary business and all of the income of the unitary business would be presumed to be apportionable business

income under these provisions. A corporation would have the burden of proving that it was not a member of a combined group that was subject to these provisions.

IRC sections related to consolidated returns would not apply for state purposes under the combined reporting provisions, except for U. S. Treasury regulations relating to deferred gain or loss from an intercompany transaction.

Effective Date

These provisions would first apply to taxable years beginning on or after January 1, 2008.

Fiscal Effect

The Department of Revenue estimates that this proposed method of combined reporting would increase corporate income and franchise tax revenues by \$40.5 million in 2007-08, and \$90 million in 2008-09 and thereafter.

In general, Wisconsin corporate income and franchise tax liability is computed using federal provisions to determine income and deductions, and then apportioning the net income of a multistate corporation, applying the tax rate, and allowing for any credits. A corporation that conducts all of its business and owns property only in Wisconsin has all of its income subject to taxation in Wisconsin. The taxable income of a corporation that is operating within and outside of Wisconsin through multiple divisions or branches is generally determined through formula apportionment. In certain cases, separate accounting is permitted, and certain types of income (nonapportionable income -- gain or loss from sales, rents, and royalties from nonbusiness real or tangible personal property) are specifically allocated to the state for tax purposes.

Under Wisconsin law, formula apportionment is used if a corporation's Wisconsin activities are an integral part of a unitary business which operates both within and outside of the state. Generally, a unitary business is one that operates as a unit; its business cannot be segregated into independently operating branches. Its operations are integrated, and each branch is dependent upon or contributory to the operating of the business as a whole. In these cases, the corporation adds its total gross income from its in-state and out-of-state unitary activities, subtracts its deductions, and multiplies the amount of net income by its apportionment ratio as determined by the Wisconsin apportionment formula. The apportionment ratio is used to approximate how much of a corporation's total net income is generated by activities in Wisconsin.

Under provisions included in 2003 Wisconsin Act 37, enacted in July, 2003, use of a single sales factor apportionment formula for most multistate corporations will be phased-in over three years, beginning in 2006. In general, the phase-in of the single sales factor apportionment formula will be accomplished as follows (insurance companies and financial institutions have special provisions): (a) for tax years beginning before January 1, 2006, income was apportioned using an apportionment formula with the sales factor representing 50% of the apportionment ratio, the property factor representing 25%, and the payroll factor representing 25%; (b) for tax

years beginning after December 31, 2005, and before January 1, 2007, the apportionment ratio was calculated with the sales factor representing 60% of the apportionment ratio, the property factor representing 20%, and the payroll factor representing 20%; (c) for tax years beginning after December 31, 2006, and before January 1, 2008, the apportionment ratio will be calculated with the sales factor representing 80% of the apportionment ratio, the property factor representing 10%, and the payroll factor representing 10%; and (d) for tax years beginning after December 31, 2007, a single sales factor apportionment formula will be used to apportion income to Wisconsin.

Wisconsin taxes each corporation separately. Consequently, taxable income is determined using only the gross income, business expenses, and apportionment factors that reflect the unitary operations of a single corporation that is conducting business, at least in part, in Wisconsin. The income, business expenses, and formula factors of affiliated corporations are not included, even if the business operations of the affiliated corporations would be considered part of a single unitary business. If the state has nexus with affiliated corporations engaged in a unitary business they are taxed separately. If the state does not have nexus with such corporations, they are not taxed by the state.

3. REGULATED INVESTMENT COMPANY AND REAL ESTATE INVESTMENT TRUST -- DIVIDENDS PAID DEDUCTION

	Chg. to JFC
GPR-REV	\$3,000,000

Modify the method of calculating net income for regulated investment companies (RICs) and real estate investment trusts (REITs) to specify that the dividend paid deduction otherwise allowed by federal law in computing the net income of an RIC or REIT that is subject to federal income tax would be required to be added back to income in computing the state income and franchise tax unless the RIC or REIT was a qualified RIC or qualified REIT, respectively.

"Qualified REIT" would be defined to mean an REIT, except an REIT: (a) of which more than 50% of the voting power or value of the beneficial interests or shares are owned or controlled, directly or indirectly, by a single entity that is subject to federal Internal Revenue Code provisions governing corporate distributions and adjustments (including distributions, liquidations, organizations and reorganizations, carryovers, and treatment of certain interests as stock or indebtedness); (b) that is not exempt from taxation under state law, and (c) that is not an REIT or a qualified real estate trust subsidiary as defined under the IRC.

"Qualified RIC" would be defined as an RIC, except an RIC: (a) of which more than 50% of the voting power or value of the beneficial interests or shares are owned or controlled, directly or indirectly, by a single entity that is subject to IRC provisions governing corporate distributions and adjustments; (b) that is not exempt from taxation under state law; and (c) that is not an RIC as would be defined under state provisions.

State definitions of REIT, RIC, and real estate mortgage investment conduit (REMIC) would be referenced to the IRC. Statutory provisions that are currently used to update

references to the IRC for REITs, RICs, and REMICs would be deleted. The Department of Revenue indicates that these updating provisions are not necessary because federal provisions related to REITs, RICs, and REMICs are included whenever state law is referenced to the IRC for corporations. Specific provisions defining income for REITs, RICS, and REMICs through references to the appropriate sections of the IRC would be adopted. These definitions would be automatically updated whenever state corporate income and franchise tax references were updated by the Legislature. Also, statutory provisions would specify the state treatment of differences between the depreciation or adjusted basis for federal and state income tax purposes.

These provisions would first apply to tax years beginning on or after July 1, 2007, and would increase income and franchise tax revenues by an estimated \$3.0 million in 2007-08.

Under another provision, corporations would be required to file a combined report for state corporate income and franchise taxes, for tax years beginning after December 21, 2007. Under the combined reporting provisions, corporations would no longer be able to reduce income through the specific practices these provisions would prevent. Additional revenue generated is reflected in the fiscal effect for combined reporting.

Regulated investment companies, commonly known as mutual funds, are corporations that act as investment agents for their shareholders. RICs typically invest in government and corporate securities and distribute dividend and interest income earned from the investments as dividends to their shareholders. A corporation must meet all of the following in order to be classified as an RIC:

- a. It must be a domestic corporation.
- b. It must be registered under federal law either as a management company or unit investment trust, or have an election under the law to be treated as a business development company, or it must be a common trust fund or similar fund that is neither an "investment company" under the law, nor a "common trust fund" maintained by a bank.
- c. It must derive at least 90% of its gross income for the current tax year from dividends, interest, payments with respect to securities loans, gains from the sale or other disposition of stock, securities, or foreign currencies, or other income (including gains from options, futures, or forward contracts) derived from the RIC's business of investing in stock or securities or currencies.
- d. At the close of each quarter, at least 50% of the value of its assets must be represented by cash, cash items, government securities, securities of other RICs and other issuers.
- e. It does not have more than 25% of the value of its total assets invested in the securities of any one issuer that are controlled by a single parent corporation and in a similar business.

f. It distributes at least 90% of its ordinary income and tax-exempt interest income to its shareholders.

g. It files an election to be treated as an RIC for tax purposes.

In addition, to qualify as an RIC, a corporation is required to distribute at least 90% of its ordinary and exempt interest income to its shareholders each tax year. If the thresholds are met, the corporation will only be taxed on the undistributed portion of its income. The ordinary income distribution threshold for an RIC is met by distributions out of its investment company taxable income. Any portion of this income that remains undistributed at the end of the tax year is subject to ordinary corporate income tax rates. Investment company taxable income is the taxable income of the RIC, calculated in the same manner as the taxable income of regular corporations, with certain modifications, including: (a) a dividends paid deduction may be claimed for any ordinary income distributions; (b) net capital gains are not included; (c) net operating losses may not be claimed; and (d) no deduction may be claimed for dividends received from other corporations.

There is no distribution threshold for the net capital gains of a RIC. Any distribution must be paid out from the net capital gain for that year. If any net capital gains remain undistributed, the RIC will be taxed at the corporate capital gains rate on the difference between all of the RICs net capital gains and the deduction for dividends paid (computed only with respect to capital gains dividends).

An REIT is an organization or corporation that is designed to act as an investment agent for its shareholders to enable small investors to pool resources together to make real estate investments that they might not otherwise be able to individually. A corporation, association, or trust must meet the following ownership and purpose requirements in order to qualify as an REIT:

a. Beneficial ownership in the organization must be held by at least 100 persons for at least 335 days during the 12-month tax year.

b. The beneficial ownership must be evidenced by transferable shares or certificates of beneficial interest.

c. The organization's management must be in the hands of one or more trustees or directors, with the trustees generally holding legal title to the organization's property and having exclusive authority over management.

d. The organization must possess all other necessary attributes that would, except for its treatment as a REIT, cause it to be taxed as a corporation.

e. Five or fewer individuals may not directly or indirectly own more than 50% of the value of the organization's stock during the last six months of the organization's tax year.

f. The organization cannot be a financial institution or an insurance company.

g. The organization must distribute at least 90% of its taxable income for the tax year to its shareholders.

h. The organization must elect to be treated as a REIT.

An REIT must also meet the following income and investment requirements:

a. At least 95% of the REIT's gross income must be from dividends, interest, rents from real property (including rents from interests in real property), net gains from the sale or other disposition of stock, securities, real property, and interests in mortgages on real property, abatements and refunds of taxes on real property (including foreclosure property involuntarily acquired), and gain from the sale of a real estate asset that is not a prohibited attraction.

b. At least 75% of the REIT's gross income must be derived from real property. Included within this 75% category are rents from real property, interest on obligations secured by mortgages on real property, net gain from the sale of real property and interests in mortgages on real property, dividends and other distributions from, and net gain on sale or other disposition of transferable shares in, other REITs, abatements and refunds of taxes on real property, and gain from the sale of a real estate asset that is not a prohibited transaction.

At the close of each quarter of the tax year, REITs must meet two tests regarding their assets: (a) 75% of the value of total assets must be represented by real estate assets, cash and cash items, or government securities; and (b) not more than 25% of the value of the REIT's assets may be represented by securities other than those described in the 75% test, and the entire amount of securities of any one issuer may not exceed 5% of the value of the total assets of the REIT or 10% of the voting securities of the issuer.

As noted, to qualify as a REIT, an organization is required to distribute to its shareholders at least 90% of its taxable income each tax year. If this threshold is met, the REIT is only taxed on the undistributed portion of its income at corporate income tax rates. To the extent the income is paid out as an ordinary dividend, the REIT may claim a dividends paid deduction for the amount of the dividend distribution. Under federal law, the REIT shareholder is not permitted to claim a dividends received deduction for the dividend, and the dividend distribution is taxed at the shareholder level. The REIT is a pass-through entity and the shareholder pays the tax on the REIT income when received as a dividend.

There is no distribution threshold for the net capital gains of a REIT. But any distribution of capital gains to shareholders must be paid out of the organization's net capital gains for that year. No deduction is provided for capital gains dividends distributions, and any undistributed capital gains are subject to taxation at the REIT level.

These modifications are designed to address two general types of business practices where REITs have been used to avoid state taxation. One type of practice generally involves large multi-state retailers that transfer ownership of the retailer's real property to a related REIT. The REIT charges the retailer rent for use of the property, which reduces the retailer's taxable income and state tax liability. Due to the ownership of property in the state, the REIT is subject

to state income taxes. However, the REIT typically distributes the rental payments as dividends to an affiliated or holding company that is located in a state that allows a dividends received deduction for REIT distributions, has no state corporate income tax, or that allows combined reporting. The REIT would not pay taxes on the rental income because it may claim a dividends paid deduction for the distributions of rental income to the affiliated or holding company. The affiliated or holding company also would not pay taxes on the distribution because it could: (a) claim a dividends received deduction for the rental payments distribution; (b) is located in a state, such as Delaware, that imposes no state income tax on this type of income; or (c) is located in a state that allows or requires combined reporting, which requires all intercompany transfers, such as dividend payments, to be eliminated in calculating taxable income.

A second similar practice generally involves multi-state banks. In this case, the bank transfers its mortgages or mortgage-backed securities to a related out-of-state REIT. As a result, the bank would shift its mortgage-related income to the REIT. If the REIT has no nexus with the bank's state, interest on the mortgages and related securities cannot be taxed by that state. In such cases the REIT may be located in a state which imposes no state income tax on the REIT, and the interest income is not taxed. If the REIT is subject to taxation by the bank's state or the state in which it operates, it can distribute the interest income as a dividend to an affiliated or holding company and claim a dividends paid deduction for that interest dividend. In turn, the affiliated or holding company would not pay taxes on the interest dividend for the reasons described in the preceding paragraph.

It should be noted that the inherent nature of an REIT is that it is a pass-through entity and generally not subject to taxation. When used as designed, an REIT is intended to result in income being taxed only once at the shareholder level. Moreover, most publicly-traded REITs are established for investment purposes, and not as vehicles for tax avoidance.

RICs are included because they operate very similar to REITs.

4. SALES TAX ON CERTAIN INTERCOMPANY TRANSFERS OF ASSETS

In response to a March, 2007, decision of the Wisconsin Supreme Court in *Wisconsin Department of Revenue v. River City Refuse Removal, Inc.* that concluded that certain intercompany transfers of assets between subsidiaries of the same parent company in which no money exchanged hands did not qualify as retail sales (and were, therefore, not subject to Wisconsin use tax), modify the sales and use tax to provide that the tax would apply in the case of such transfers.

Specify that a person who makes sales of tangible personal property or taxable services is a retailer regardless of the following: (a) whether the transaction is mercantile in nature (as is also the case under current law); (b) whether the seller sells smaller quantities of goods from an inventory; (c) whether the seller makes or intends to make a profit from the sale; (d) whether the seller or buyer reaps a bargained-for benefit; (e) the percentage of the seller's total sales that the sale represents; and (f) any other activities in which the seller is engaged. Provide that the same

changes would apply with respect to the definitions of "sale," "sale, lease, or rental," "retail sale," "sale at retail," and "seller."

In addition, provide that "consideration," as used in the definition of "purchase," would include transactions where a person's books and records showed the transaction created either an obligation to pay a certain amount or an increase in accounts payable (for the transferee), or a right to receive a certain amount of money or an increase in accounts receivable (for the transferor). Specify that "credits," as used in the definition of "gross receipts," would also include such transactions, as would the terms "sale," "sale, lease or rental," "retail sale," and "sale at retail."

Amend the sales and use tax statutes to provide that, unless specifically exempted: (a) all sales, leases, or rentals of tangible personal property at retail in Wisconsin are subject to the state sales tax; (b) the selling, performing, or furnishing of taxable services at retail in this state are subject to the state sales tax; and (c) the storage, use, or other consumption in this state of all tangible personal property, and the use or other consumption in this state of a taxable service, purchased from any retailer is subject to the state use tax. In addition, modify provisions related to the local food and beverage tax, local rental car tax, state rental vehicle fee, and the regional transit authority fee to include references to "a" and "c."

Provide that these provisions would take effect retroactively to January 1, 2006. The effective date would be consistent with provisions under 2005 Act 25 that specified that a "retailer" includes every seller who makes any sale, regardless of whether the sale is mercantile in nature.

2005 Act 25 provided an exemption for sales of taxable services and tangible personal property physically transferred to a purchaser as a necessary part of certain taxable services if the seller and the purchaser are members of the same affiliated group and are eligible to file a single consolidated return for federal tax purposes. Prior to the Supreme Court decision, DOR had considered other transfers of assets between two companies owned by the same parent to be taxable sales. However, based on the *River City* decision, businesses may be able to make certain purchases through out-of-state subsidiaries and avoid paying sales and use taxes. DOR has cited as examples software, computer equipment, and central office equipment, on which businesses currently pay an estimated \$66.0 million in state sales and use tax. DOR has estimated that businesses paid \$1.4 to \$1.7 billion in sales and use tax revenues on their purchases in 2005-06.

Based on information provided by the Department of Revenue, it is expected that the provisions would avert the loss of \$68.9 million in 2007-08 and \$71.6 million in 2008-09. In addition, by providing an effective date of January 1, 2006, the Department estimates that an additional potential loss of \$1.0 to \$3.0 million would be averted.

5. SALES TAX PAPER RETURN FILING FEE

Require the Department of Revenue to promulgate administrative rules for administering the sales and use tax paper return fee, and that such rules limit the fee to \$5 per return.

The bill includes a provision that would authorize DOR to impose a filing fee on sales tax returns that are filed on paper. The fee could first be imposed on returns that were filed for the calendar quarter ending on September 30, 2007. According to the administration, the filing fee would be \$5 on a paper return and would generate an estimated \$2.8 million in general purpose revenue annually.

6. SALES OF BEER, WINE, AND LIQUOR AT THE NATIONAL RAILROAD MUSEUM

Authorize a caterer with a license to sell beer and/or intoxicating liquor (including wine) at retail for on- and off-premises consumption to sell beer and/or intoxicating liquor at the National Railroad Museum in Green Bay for special events held at the Museum.

Provide that, for purposes of this provision, a "caterer" would mean any person holding a state restaurant permit who is in the business of preparing food and transporting it for consumption on premises where gatherings, meetings, or events are held, if the sale of food at each gathering, meeting, or event accounts for greater than 50% of the gross receipts of all the food and beverages served at the gathering, meeting, or event.

Provide that a Class "B" license for the retail sale of beer for on-premises or off-premises consumption would also authorize a caterer to provide beer, including the retail sale of beer, at the National Railroad Museum in Green Bay during special events held at the museum, notwithstanding the provisions under current law that specify the following: (a) each application for an alcoholic beverage license or permit must specify the premises where the alcoholic beverages will be sold or stored or both; (b) with certain exceptions, retailers and other alcoholic beverage licensees and permittees must have a separate permit or license covering each location or premises from which deliveries and sales of alcoholic beverages are made or at which alcoholic beverages are stored; and (c) with certain exceptions, owners, lessees, or persons in charge of a public place may not permit the consumption of alcoholic beverages on the premises of the public place unless the person has an appropriate retail license or permit.

In addition, provide that, notwithstanding current provisions that authorize municipal governing bodies to issue a Class "B" license for the sale of beer from a premise within the municipality to be consumed either on the premises where sold or off the premises, a caterer may provide beer at any location at the National Railroad Museum even though the National Railroad Museum is not part of the caterer's licensed premises and even if the Museum is not located within the municipality that issued the caterer's license. Specify that a caterer providing beer under these provisions would be subject to certain provisions related to premises operated under a Class "B" license as if the beer were provided on the caterer's Class "B" licensed premises.

Specify that these provisions would not authorize the National Railroad Museum to sell beer at retail or to procure or stock beer for purposes of retail sale. In addition, specify that all of the provisions described above with respect to sales of beer by a caterer at the National Railroad Museum in Green Bay would not apply if, at any time, the Museum held a Class "B" license.

Provide parallel provisions related to a "Class B" license to sell intoxicating liquor (which includes wine but does not include beer).

Specify that these provisions, which would not have a state fiscal effect, would take effect on the general effective date of the bill.

SHARED REVENUE AND TAX RELIEF

1. LEVY LIMIT ADJUSTMENT FOR CERTAIN COUNTY SPECIAL CHARGES

Chg. to JFC
GPR-Lapse - \$27,300

Exclude county special charges from the limitation on 2006 municipal property tax levies if the special charge is identified as being for the recovery of unlawful real estate taxes on a municipality's statement of taxes for 2006 that was filed with the Department of Revenue and the special charge resulted from a 2005 tax amount that was rescinded due to an error, as defined under current law provisions. This provision would change the levy limit law for 2006(07) to cause the property tax levies for 12 municipalities to comply with the limitation. As a result, the Department of Revenue would be precluded from imposing a levy limit penalty on these municipalities by withholding an estimated \$27,300 from their 2007 county and municipal aid payments. Because withheld amounts lapse to the state's general fund, the provision would decrease the GPR lapse by \$27,300 in 2007-08. Based on a preliminary list of levy limit penalties for 2007, this provision would eliminate the following penalties:

<u>Municipality</u>	<u>County</u>	<u>Amount</u>
T. Middleton	Dane	\$9,551
T. Eaton	Brown	6,314
V. Shorewood Hills	Dane	4,588
T. Solon Springs	Douglas	3,785
T. Georgetown	Polk	1,248
T. Mount Ida	Grant	680
T. Hazelhurst	Oneida	546
V. Eleva	Trempealeau	241
T. Farmington	La Crosse	164
T. Laketown	Polk	104
T. Stanton	St. Croix	51
T. Parkland	Douglas	13

2. PROPERTY TAX EXEMPTION FOR TREATMENT PLANT AND POLLUTION ABATEMENT EQUIPMENT

Modify the property tax exemption for treatment plant and pollution abatement equipment as follows. Expand the current law provision that requires waste treatment facilities to be used to treat industrial wastes or air contaminants to instead require facilities to be used exclusively and directly to remove, store, or cause a physical or chemical change in industrial waste or air contaminants. Define used exclusively to mean to the exclusion of all other uses except for other uses not exceeding 5% of total use or except to produce heat or steam for a manufacturing process, if the total fuel consists of either 95% or more industrial waste that would otherwise be considered superfluous, discarded, or fugitive material or 50% or more of wood chips, sawdust, or other wood residue from the paper and wood products manufacturing process, if the wood chips, sawdust, or other wood residue would otherwise be considered superfluous, discarded, or fugitive material. Repeal the current law provision that specifies that industrial waste includes wood chips, sawdust, or other wood residue from the paper and wood products manufacturing process that can be used as fuel and would otherwise be considered superfluous, discarded, or fugitive material.

Continue, but recodify, the current law provisions that exclude other wastes from the definition of industrial waste and that define industrial waste as waste resulting from any process of industry, trade, or business, or the development of any natural resource. In addition, specify that industrial waste has no monetary or market value, except as specified in the definition of "used exclusively," and that industrial waste would otherwise be considered as superfluous, discarded, or fugitive material. Recodify the current law definition of air contaminants. Amend cross-references to the property tax exemption for treatment plant and pollution abatement equipment in current law provisions regarding claims for the recovery of unlawful taxes, taxation of public utilities, general sales and use taxation (the definition in the property tax statute is used to determine eligibility for a sales tax exemption), and public utility aid.

With regard to property tax assessments and to claims for the recovery of illegal taxes, extend these provisions to first apply as of January 1, 2007, but specify that any changes related to general sales and use taxation take effect on the first day of the second month after publication of the act. In addition, specify that objections to assessments as of January 1, 2007, that are affected by these provisions may be filed no later than 60 days after the effective date of the act or the time allowed under current law, whichever is later. Specify that the changes related to general sales and use taxation would not apply to tangible personal property purchased in fulfillment of a contract to construct, repair, or improve a waste treatment facility, if the contract is entered into, or a formal bid is made, prior to the effective date of the act and the tangible personal property is affixed and made a structural part of the waste treatment facility.

3. DELETE PROPERTY TAX EXEMPTION FOR AUTOMATIC TELLER MACHINES

Modify the property tax exemption for computers to exclude automatic teller machines, effective with property assessed as of January 1, 2008. Automatic teller machines are currently considered computers and, therefore, are exempt from property taxation. By amending the exemption statute to specifically exclude automatic teller machines from the definition of computers, state aid payments for exempt computers would decrease. However, no fiscal effect is reported for this biennium because the provision would first affect payments in July, 2009. In the 2001-03 biennial budget bill, the Legislature included a similar provision, which was removed from the bill through partial veto. At that time, the value of automatic teller machines was estimated at \$45.5 million. Based on estimated tax rates for 2008(09), removing that value from the computer exemption would reduce state aid payments by an estimated \$900,000 in 2009-10.

4. DEFINITION OF AGRICULTURAL LAND

Modify the current law definition of agricultural land to exclude any land that is platted and zoned for residential, commercial, or industrial use, effective with property assessed as of January 1, 2008. Agricultural land is valued based on its use, while all other property is valued based on its highest and best use. To be classified as agricultural property, property must be devoted to an agricultural use, such as growing crops and producing livestock. This provision would cause land that is devoted to an agricultural use, but is also platted and zoned for a residential, commercial, or industrial use, to be included in a classification other than agricultural land and valued for property tax purposes according to its highest and best use. The amount of property meeting this definition is unknown, but the taxable value of that property would likely increase and cause taxes to be shifted between owners of taxable property. State collections from the state forestry tax would increase in proportion to any increase in taxable value, which would result in an unknown increase in revenue to the forestry account of the conservation fund.