

Applicability of Wisconsin Income Tax to Out-of-State Lenders

As noted in an earlier [Real Estate Opinion Update](#), a recent revision to the Wisconsin Statutes has made it impossible for our firm to opine that making a loan, taking a mortgage on property in Wisconsin and enforcing rights under that mortgage would not be likely to create the type of "nexus" required to subject the lender to Wisconsin income tax. Recently, members of our firm's real estate and tax teams have been asked to explore these issues further in order to determine whether particular out-of-state lenders would be subject to Wisconsin income tax simply as a result of making a single loan secured by Wisconsin property. This update describes the general analysis that would be followed in making such a determination.

Overview of Applicability of Wisconsin Income Tax

In general, any entity or individual will be subject to Wisconsin income tax if it has sufficient presence or contacts in Wisconsin to establish nexus with Wisconsin. Generally, the level of contacts required to establish nexus is based on the facts and circumstances of all of that lender's activities in the state or in any manner connected with the state. The determination is further affected by whether the lender is a corporation, another form of legal entity or an individual.

Applicability of Wisconsin Income Tax to Corporations Serving as a Lender

If the lender is a corporation, Wisconsin Statutes provide that making a loan secured by Wisconsin property is sufficient to create nexus in Wisconsin and to subject that lender to Wisconsin income tax. Wisconsin Statutes § 71.23 provides that any corporation that is doing business in Wisconsin will be subject to Wisconsin income tax. The phrase "doing business in Wisconsin" includes "holding loans secured by real or tangible personal property located in this state; owning, directly or indirectly, a general or limited partnership interest in a partnership that does business in this state, regardless of the percentage of ownership; and owning, directly or indirectly, an interest in a limited liability company that does business in this state, regardless of the percentage of ownership, if the limited liability company is treated as a partnership for federal income tax purposes."

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Wis. Stat. § 71.22(1r) (effective 2009); cf Wis. Admin. Code § Tax 2.82.

Although the statute is clear that a lender that is a corporation is subject to Wisconsin income tax solely by reason of making a loan secured by Wisconsin property, it is important to note that every state's power to tax is limited by constitutional protections under the Due Process, Equal Protection and Commerce Clauses of the United States Constitution. Those constitutional protections have been the subject of much litigation across the country with the more recent cases finding nexus as a result of minimal contacts with a state. Thus, under some circumstances, a lender that is a corporation may take the position that it is not subject to Wisconsin income tax based on the limitations on a state's power to tax under the United States Constitution. Whether a lender would be successful in its position and override the Wisconsin Statutes in a given case would depend on the facts and circumstances specific to that lender. A complete discussion of those constitutional limitations is beyond the scope of this e-alert.

Applicability of Wisconsin Income Tax to Partnerships and LLCs Serving as a Lender

The Wisconsin Statutes are less clear as to whether a lender that is a partnership, LLC or other flow-through entity will have sufficient nexus to be subject to Wisconsin income tax if its sole contact with Wisconsin is as a lender for a loan secured by Wisconsin property. The Wisconsin Statutes provide that, so far as applicable and unless specifically provided otherwise, partnerships, LLC's, fiduciaries of trusts and tax-option (Subchapter S) corporations are subject to the provisions, requirements and liabilities in the Wisconsin income tax statutes. See Wis. Stat. § 71.19 (partnerships and LLCs), § 71.12 (fiduciaries of trusts) and § 71.32 (tax-option corporations). In addition, as stated above, the definition of "doing business in Wisconsin" includes owning a partnership interest in a partnership or an interest in an LLC. Wis. Stat. § 71.22(1r). Thus, a lender in a loan secured by Wisconsin property that is a partnership, LLC or other flow-through entity is likely to be treated as having nexus in Wisconsin in the same way as a corporation would be if it were serving as a lender in a loan secured by Wisconsin property.

Applicability of Wisconsin Income Tax to Natural



Persons Serving as a Lender

Lenders who are natural persons are also subject to Wisconsin income tax on income earned in Wisconsin or "derived from property located or business transacted within the state." Wis. Stat. § 71.02(1). Income earned in Wisconsin includes a partner's distribution share of partnership income and an LLC member's distributive share of LLC income.

The language in Wisconsin Statutes § 71.02(1) imposing tax on natural persons uses the phrase income "derived from property located or business transacted within the state," which is different from the defined term in Wisconsin Statutes § 71.22(1r) for corporations, which is "doing business in this state." Because of the use of different terms, it is less clear whether a lender who is a natural person will be subject to Wisconsin tax if the only contact the person has with the state is as a lender holding a loan secured by real or tangible personal property located in Wisconsin. An individual is likely to be subject to Wisconsin income tax if he/she is a partner of a partnership or a member of an LLC that is a lender. Wisconsin law is less clear as to natural persons who are lenders in their individual capacity and the prior common law interpretations for nexus may apply. In those cases, a determination of whether a lender who is an individual is subject to Wisconsin income tax will be based on the facts and circumstances of their overall contacts with Wisconsin.

Conclusion

In summary, the determination of whether a particular lender has nexus in Wisconsin is based on facts and circumstances specific to that lender. If you have particular questions about the possible applicability of Wisconsin income tax within the context of a particular loan, please contact your Reinhart attorney, [Margaret Derus](#), [John Murphy](#), [Kristina Somers](#) or any member of the Reinhart Real Estate Opinion Team.

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