

RECENT DEVELOPMENTS IN STATE & LOCAL TAX

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Douglas A. Pessefall is a shareholder in Reinhart's Tax, Litigation and Corporate Law practices. Doug represents and advises taxpayers in connection with state and local tax (SALT) planning; state, local and federal tax controversy; tax-exempt organizations; and general business matters. He provides legal representation to clients on the nature or extent of their tax reporting obligations, tax compliance or tax liabilities arising from exemptions, audits, assessments, voluntary disclosures or claims for refund, which include sales and use tax, property tax, ad valorem tax, gross receipts tax, franchise tax and income tax. Doug is a frequent speaker and publisher on tax matters. Doug is an associate member of the WICPA and has served as chairperson of the State Bar of Wisconsin Taxation Section Board of Directors and as chairperson of the Milwaukee Bar Association Tax Section. Doug received his B.A. degree from the University of Dayton and his J.D. degree, cum laude, from The John Marshall Law School in Chicago. He is listed in The Best Lawyers in America in Litigation & Controversy - Tax and Tax Law, and as a "Leading Lawyer" by M, Milwaukee's Lifestyle Magazine.

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Property Tax

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General Observations

- 1,850 taxation districts
- \$10.6 billion gross levy in 2015
- Highest total tax rate was 47.19
 - Village of Brokaw in Marathon Co. (243)
- Lowest total tax rate was 8.04
 - Town of Manitowish Rivers in Vilas Co. (583)
- Average total tax rate was 21.54

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Assessment

- Assessed at full value as of January 1
- All property presumed taxable
 - Not intangible property
 - Not business income (unless inextricably intertwined with property)
- Assessment presumed correct—burden on taxpayer

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Assessment Methodology

- Recent arm's-length sale of subject property if conforming to arm's-length sales of reasonably comparable property
- Recent arm's-length sales of reasonably comparable property

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Methodology (cont.)

- All other factors affecting value
 - Income (market versus contract rents, other income, vacancy/collection loss, operating expenses, reserves, capitalization rate)
 - Cost (replacement versus reproduction)
- Undeveloped land (50%), agricultural forest land (50%) and agricultural land (use value)

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Methodology (cont.)

- Sources of information
 - Real Estate Transfer Return
 - Assessor's property file
 - Property tour
 - Appraisals
 - Income and expense
 - Cost estimates

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Appearances

- Board of Review appearances
 - Board may allow property owner or property owner's representative to appear, under oath, before the board by telephone or to submit written statements, under oath, to the board
 - Section 70.47(8) of the Wisconsin Statutes first applies to assessments as of 1/1/2015

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Waivers

- Board of Review Hearing Waiver
 - Upon request or in its own discretion
 - Upon waiver, taxpayer may proceed with certiorari review or commence action on excessive assessment within 60 days
 - Section 70.47(8m) of the Wisconsin Statutes first applies to assessments as of 1/1/2015

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Local Assessment Process

- Information/Statement of Personal Property
- Notice of Assessment
- Open book
- Notice of Intent to File Objection
- Objection
- Board of Review hearing
- Judicial appeal

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Manufacturing Assessment

- Request for classification by March 1
- Real and personal property returns
- Notice of Assessment
- Objection to State Board of Assessors
- Petition for Review to Wisconsin Tax Appeals Commission
- Judicial appeal

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Assessment Challenges

- Recent sale of subject property
- Comparable sales
- Depreciation
 - Physical
 - Functional obsolescence
 - Economic obsolescence

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Challenges (cont.)

- Inability to finance
- Long-term leases in place
- Vacancy rates up
- Rental income is flat or down
- Tenant improvements required
- Captures business value
- Captures goodwill or intangible value

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Refund Interest

- *Lands' End, Inc. v. City of Dodgeville*, 2016 WI 64, 370 Wis. 2d 500, 881 N.W.2d 702 (holding taxpayer did not have vested right in statutory interest rate or other interest rates payable under prior law because taxpayer did not acquire legally enforceable right to recover interest until judgment and because judgment was not equal to or greater than settlement offer)

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Valuation

- *JFM1, LLC v. City of Sheboygan*, 2016 WL 4198136 (Wis. Ct. App. Aug. 10, 2016) (holding circuit court did not err when it failed to consider 2015 sale of mall property when valuing property for 2010-2013 since 2015 sale involved different configuration and would have required speculation)

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Valuation (cont.)

- *Thermo Electron v. Wisconsin Department of Revenue* (WTAC 4/12/2016) (holding Department's use of a "building residual" method to separately value land and improvements owned by a medical products office campus was inconsistent with WPAM and generally accepted appraisal practices; land comps were invalid because several were zoned for different purposes)

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Search and Seizure

- *Milewski v. Town of Dover, et al.*, 370 Wis. 2d 262, 881 N.W.2d 359 (Ct. App. 2016) (unpublished) (holding town's request to inspect property interior for assessment purposes did not force taxpayers to submit to a search, did not involve an unreasonable search and did not violate taxpayer's Fourth Amendment rights)

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Highest and Best Use

- *Domtar A.W., LLC v. Wisconsin Department of Revenue*, 369 Wis. 2d 74, 879 N.W.2d 809 (Ct. App. 2016) (holding property's highest and best use was an operational pulp and paper mill even when pulp and paper mill had closed)

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Presumption of Correctness

- *Sears Holding Corporations v. City of Eau Claire*, 366 Wis. 2d 808, 874 N.W.2d 346 (Ct. App. 2015) (unpublished) (holding arm's-length sales used by the City were reasonably comparable even when sales failed to include sales of mall anchor department stores)

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Presumption of Correctness (cont.)

- *Slocum v. Star Prairie Township*, 2016 WL 4512624 (Wis. Ct. App. 8/30/2016) (holding taxpayer failed to present significant contrary evidence to rebut presumption of correctness when taxpayer failed to present recent appraisals of subject property)

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Nonprofit Hospital Exemption

- *SSM Health Care of Wisconsin, Inc. v. City of Fitchburg*, 2015 WI App 82, 365 Wis. 2d 349, 871 N.W.2d 693 (2015) (holding nonprofit hospital corporation was entitled to refund of tax paid with respect to personal property located in off-campus renal center and sleep center)

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Nexus Standards

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Sales Tax Nexus

- Based on *Quill v. North Dakota*, 504 U.S. 298 (1992)
- Requires physical presence
- "Physical presence" generally found when taxpayer has office, employees, representatives, agents, independent contractors, property, affiliates, construction activities in a state

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Income Tax Nexus

- Based on *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E.2d 13 (S.C. 1993)
- Requires economic presence
- "Economic presence" found when taxpayer advertises or otherwise exploits a market in and derives income from a state
- Different than sales tax—may have nexus for sales tax and not income tax

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Income Tax Nexus (cont.)

- P.L. 86-272 allows taxpayers to engage in certain protected activities without creating nexus for income tax (distinguishable)
 - For example, solicitation of order when approval occurs outside state and goods shipped into state by common carrier
- Licensing intellectual property, intangibles may create economic presence

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Factor Presence Nexus

- Sales in excess of certain threshold
- Payroll in excess of certain threshold
- Property in excess of certain threshold

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Recent Developments

- *Direct Marketing Association v. Brohl* (U.S. 2015)
 - Colorado required out-of-state sellers of more than \$10,000 to notify Colorado buyers of use tax liability
 - Supreme Court remanded on procedural grounds (Tax Injunction Act)
 - Justice Kennedy called for reexamination of *Quill's* physical presence standard

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Nexus-Creating Activities

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Real Property

- Office
- Distribution place
- Sales/sample room or place
- Store
- Warehouse or storage place

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Personal Property

- Inventory
- Machinery and equipment
- Furniture and office equipment
- Company cars
- Samples

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Employees/Agents

- Visit state
- Deliver or install property
- Service, repair or perform warranty work
- Engage in construction activities
- Perform customer assistance
- Operate in-state kiosk
- Distribute through third-parties
- Meet with suppliers

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Sales-Related

- Promote sales
- Negotiate prices
- Check credit
- Accept deposits
- Handle credit disputes, customer complaints
- Check customer inventories
- Maintain free samples

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Nonsales Related

- Collect delinquent accounts
- Repossess property
- Set up product displays
- Supervise or inspect installation
- Conduct training courses
- Pick up defective products
- Provide design functions

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Nonsales Related (cont.)

- Hire and recruit employees
- Attend seminars and meetings
- Employ telecommuters
- Receive services of volunteers
- Distribute promotional materials
- Solicit in-person or by telephone
- Pick up raw materials

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Third Party

- Distribute promotional materials
- Demonstrate products
- Refer via Internet click-through
- Advertise or post info on in-state website
- Optimize search engines

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Distribution/Delivery

- Deliver goods using own trucks (as opposed to common or contract carrier)
- Pick up defective goods
- Pick up raw materials
- Hold title to electricity or natural gas

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Trade Shows

- Attend trade show, conference or seminar
- Make sales
- Hold seminars
- Appear in court

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Financial Activities

- Issue credit cards
- Hold general or limited partnership interest
- Hold liability company interest
- Lease or repair equipment

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Affiliates

- Sell property
- Accept returns
- Operate retail store
- Sell gift cards
- Participate in loyalty points program

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Internet Activities

- Provide Software as a Service (SaaS)
- Own in-state Internet server
- Lease third-party server
- Paid web hosting provider with server
- Link to in-state third party (affiliate linking arrangement)

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Digital Property

- Sell music or video downloads
- Provide canned software for downloads
- Sell access to webinar

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Other

- Hold certificate of authority
- Maintain bank account
- Maintain P.O. Box
- Maintain in-state telephone number
- Maintain in-state telephone books
- Maintain an 800 phone number

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Tax Exposure Analysis

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Tax Exposure Analysis

- Interviews with personnel
 - Not just accounting and finance
 - Engineering
 - Training
 - Warranty
 - Credit and collection

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Tax Exposure Analysis (cont.)

- Dollar amount of sales by state
- History of sales and projected sales
- Changes in state laws
- Customer or vendor audits
- New or expanded business activity
- Contracts with state
- Website and advertising

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Tax Exposure Analysis (cont.)

- Website advertising
- Local and county taxes
- Disregarded entities
- Intangible property
- Bundled transactions
- Location of sale (sourcing)

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Tax Exposure Analysis (cont.)

- Customer contracts
 - Allocation of tax, interest and penalties
 - Billing and invoices
 - Indemnification
 - Attorneys' fees

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Tax Exposure Analysis (cont.)

- Purchase documentation
 - Credit card purchases
 - Capital assets
- Sale documentation
 - Local sales tax rates
 - Resale and exemption certificates requested, verified and maintained

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Tax Exposure Analysis (cont.)

- After audit compliance
- Acquired business
- Other taxes
 - Income and franchise
 - Property
 - Certificate of authority
 - Surcharges

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Voluntary Disclosure

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General Observations

- Encourages taxpayers to come into compliance by filing and paying back taxes
- Available in most states (formal or informal)
- Usually available for income/franchise, and sales/use taxes
- Eligibility generally requires no prior contact by tax authority

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Benefits

- May be pursued anonymously
- May limit need for returns
- Limited look-back period
- Waiver of civil and criminal penalties
- Possible reduction of interest

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Sales and Use Tax

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Transportation Subsidiary

- Section 77.54(5)(b) of the Wisconsin Statutes provides an exemption from tax for motor trucks, truck tractors, road tractors, buses, trailers and semitrailers, and accessories, attachments, parts, supplies and materials therefor, sold to common or contract carriers who use such motor trucks, truck tractors, road tractors, buses, trailers and semitrailers exclusively as common or contract carriers

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Transportation Subsidiary (cont.)

- To qualify for exemption, contract carrier must use vehicle exclusively for hauling goods of others for hire
- Title to property being transported should not pass to the contract carrier
- A licensed carrier ("LC") number is required if one hauls goods for hire

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Occasional Sales Exemption

- Wis. Stat. § 77.54(7m)
- 2015 Wis. Act 364, first applying to 2017 sales
- Provides that neighborhood association, church, civic group, garden club, social club or similar nonprofit organization is not required to remit sales tax when organization is not engaged in trade or business

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Occasional Sales Exemption (cont.)

- Must meet all three tests to qualify:
 1. Does not hold and is not required to hold seller's permit
 2. Does not make taxable sales on more than 75 days and of more than \$50,000 (increased from 20 and \$25,000)
 3. No entertainment for which more than \$10,000 is paid at event for which admission is charged (increased from \$500)

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Jukebox Exemption

- Provides exemption for sale, storage, use or other consumption of music
- Sold in tangible form
- To person in business of providing taxable service through a jukebox
- If music is used exclusively for jukebox

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Jukebox Exemption (cont.)

- Music sold in tangible form is a separate sale from jukebox through which music played if the sales price of the music is separately stated from the sales price of the jukebox on the invoice or bill of sale
- Effective 6/1/2016
- Wis. Stat. § 77.54(63); 2016 Wis. Act 251

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Sales of Admissions

- Wis. Stat. § 77.52(2)(a)2.
- Imposes tax on:
 - Admissions to amusement, athletic, entertainment or recreational events
 - Privilege of access to clubs or having access to or use of amusement, athletic, entertainment or recreational devices or facilities
 - Other recreational rights such as membership rights, vacation services and club memberships

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Traps for the Unwary

- Admissions
- Entry fees for runs, walks and races
- Golf outings, dances, card playing
- Parking
- Silent auctions
- Club memberships
- Fundraising dinners

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Printers Exemption

- Clarifies the exemption for a person primarily engaged in printing applies to sales made to those printers, as well as the storage, use or other consumption by those printers, of certain tangible personal property
- Effective 3/3/2016
- Wis. Stat. § 77.54(61); 2015 Wis. Act 216

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Statute of Limitations

- Begins to run from due date of income or franchise tax return that corresponds to year in which transaction occurred
- Previously began to run from due date of income or franchise tax return that corresponded to year in which tax paid

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Statute of Limitations (cont.)

- Provides claim for refund based on and filed within two years of audit may only include items adjusted in the audit determination
- Provides assessments may be made within four years after dissolution of a corporation
- Effective for claims filed on or after 3/3/2016
- 2015 Wis. Act 216

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Building Materials Exemption

- Provides exemption for sale of tangible personal property that becomes a component of a facility owned by a county, municipality, school district or nonprofit organization
- Applies to tangible personal property purchased by a contractor who transfers property to eligible entities

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Building Materials Exemption (cont.)

- Defines "facility" as any building, shelter, parking lot, parking garage, athletic field, athletic park, storm sewer, water supply system, or sewerage and waste water treatment facility, but not highway, street, or road
- Effective 1/1/2016
- Wis. Stat. § 77.54(9m); 2015 Wis. Act 126

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Out-of-State Disaster Relief Responders Exemption

- Out-of-state business, employer or employee
- Who performs qualified disaster relief work
- In Wisconsin
- During state of emergency declared by Governor
- And who was not, immediately prior to disaster relief period, performing services that required filing Wisconsin returns

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Out-of-State Disaster Relief Responders Exemption (cont.)

- Exempt from:
 - State income, franchise or withholding tax
 - State or local licenses, certificates, registrations, permits or other credentials
 - Use tax on tangible personal property and services purchased outside state and brought into state for disaster relief work

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Out-of-State Disaster Relief Responders Exemption (cont.)

- To claim exemption, must notify Department within 90 days after the last day of a disaster period in prescribed manner
- Generally effective 11/13/2015
- 2015 Wis. Act 84

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Online Reservations

- *Orbitz, LLC v. Wisconsin Department of Revenue*, 2016 WI App 22, 367 Wis. 2d 593, 877 N.W.2d 372 (2016) (holding online travel company was not liable for tax on the amount of payments it retained as compensation for reserving rooms because it served as intermediary between travelers and hotels, did not furnish lodging and did not provide taxable service)

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Online Reservations (cont.)

- Department contended
 - Provision of online services allowing traveling to arrange for lodging was equivalent to the "furnishing of rooms or lodging . . . by hotelkeepers, motel operators and other persons furnishing accommodations" within meaning of Section 77.52(2)(a)1.

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Online Reservations (cont.)

- Commission and court concluded
 - Reservation not same as furnishing lodging
 - Online travel service not similar enough to activities of hotelkeepers and motel operators to fall under umbrella of "other persons furnishing accommodations"
 - Taxpayer was intermediary
 - Ambiguity resolved in favor of taxpayer

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Laundry Services

- *Healthcare Services Group, Inc. v. Wisconsin Department of Revenue (WTAC 7/27/2016)* (holding petitioner was providing taxable laundry services rather than nontaxable management services when it contracted with healthcare facilities to supply, staff and manage complete laundry departments onsite for clients)

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Return of Refunds

- *Smith-Bisonette, Inc. v. Wisconsin Department of Revenue (WTAC 11/17/2015)* (holding racetrack operator who erroneously remitted sales tax on back gate admissions paid by drivers to fund prize pool and later received a refund from the Department was liable for the tax and a 25% penalty after failing to return the tax to buyers)

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Mobile Point of Sale

- Department ruled restaurant customers' purchases of premium content (e.g., interactive games) on tablet devices used to view menu, order and pay bill at their tables was taxable admission
- PLR W1618001 (2/11/2016)

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Income and Franchise Tax

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Economic Substance

- Provides that a transaction has economic substance only if the transaction is treated as having economic substance as determined under Section 7701 (o) of the Internal Revenue Code
- Effective for taxable years beginning on or after 1/1/2016
- 2015 Wis. Act 218

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Economic Substance (cont.)

- Tax effect determined by using federal, state, local or foreign tax (not just federal)
- Effective for taxable years beginning on or after 1/1/2016
- 2015 Wis. Act 218

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Failure to Produce Records

- Provides penalties for failure to produce records may not be imposed until Department has issued a summons seeking records and documents, and taxpayer has failed to comply in good faith with summons
- First applies to audit commenced or summons issued on 3/3/2016
- Wis. Stat. § 71.80(9m); 2015 Wis. Act 218

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Lottery Prize

- *Great-West Life & Annuity Insurance Co. v. Wisconsin Department of Revenue*, 2016 WI App 18, 367 Wis. 2d 348, 876 N.W.2d 178 (2016) (denying trust's claim for refund of tax withheld by Department on state lottery prize assigned to and sold by trust created by delinquent taxpayer in violation of Section 565.30(6r)(c) of the Wisconsin Statutes

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Unclaimed Property

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MoneyGram Payments

- Money transfer company
- Are checks issued by MoneyGram "money orders" or "official checks" (e.g., third-party bank checks)?
- If money orders, then unclaimed payments escheat to state in which purchased
- If checks, then unclaimed payments escheat to state of incorporation—Delaware

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Moneygram Payments (cont.)

- Department filed claim in U.S. District Court alleging Delaware owes Wisconsin \$13 million
- Delaware seeking to invoke U.S. Supreme Court's exclusive and original jurisdiction over disputes among states, and named Wisconsin and Pennsylvania defendants
- In June 2016, 19 other states filed motions for leave to file with Supreme Court

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Withholding

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Mobile Workforce

- Wages generally subject to tax in employee's resident location AND in the nonresident employee's work location
- A state has incentive to enforce when state has a high number of nonresident employees and nonresident income tax rate is high (e.g., CA, MN, NY, OR)

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Lack of Compliance

- Withholding tax liability
- Penalties, interest and criminal charges
- Personal liability for officers or other responsible persons
- Loss of business license
- Loss of reputation (publicity)
- Employee audits and assessments

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Audit Flags

- Vehicles prominently display company logo and pass through jurisdiction
- Officers or highly paid employees perform highly publicized services in state (e.g., media reports, business acquisition, shareholder meeting)
- Sales and use tax reported to state without withholding tax

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Audit Flags (cont.)

- Unemployment insurance paid to state without withholding tax
- Wages reported to state but no local wages
- Expense reports show reimbursements for travel to other states
- Accounts payable records show travel, relocation or other out-of-state costs

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Audit Flags (cont.)

- Financial statements show reserves for contingent liabilities connected with underreported wages and related income tax
- Parent operates subsidiary in states other than parent's state
- Company owns or leases property in state

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Audit Flags (cont.)

- Employees own or lease residence, hold driver's license or registered to vote in state other than resident state
- Company has state or local contract
- Substantial use of independent contractors

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Compliance

- Quantify risks
- Track employee movement
- Educate workforce and provide resources to answer questions
- Develop system for apportioning and timing withholding wages for mobile employees

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Questions?



THANK YOU!

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