

Enacted Wisconsin legislation affects pass-through entities and codifies sales tax nexus provisions

Overview

On December 14, 2018, Governor Walker signed Senate Bill 883¹, which became 2017 Wisconsin Act 368 ("Act 368").² This tax alert highlights some of the more notable Wisconsin tax law changes (which have various effective dates as specified in the discussion that follows) that were contained in Act 368, including:

- Effective for taxable years beginning on or after January 1, 2018 for S Corporations and effective for taxable years beginning on or after January 1, 2019 for partnerships, and limited liability companies taxed as partnerships under the Internal Revenue Code, an optional election to be taxed at the entity level for Wisconsin income tax.
- Codification of a sales/transaction-based nexus standard for sales and use tax purposes.

Pass-Through Entity Election

Under current law, tax-option corporations (S corporations), partnerships, and limited liability companies (LLCs), collectively referred to as pass-through entities (PTEs), are not subject to state income tax at the entity level. Instead, PTEs pass income, losses, or deductions of the business through to the individual income tax returns of their respective shareholders, partners, or members who then pay the appropriate taxes under the individual state income tax rates.

Effective for taxable years beginning on or after January 1, 2018 for S Corporations and effective for taxable years beginning on or after January 1, 2019 for partnerships, and limited liability companies taxed as partnerships under the Internal Revenue Code, Act 368 permits PTEs to elect to be taxed at the entity level for Wisconsin income taxes.³ If a PTE elects to be taxed at the entity level, through consent of the majority share ownership or majority partnership, the entity is taxed at the rate of 7.9 percent of net income reportable to Wisconsin.⁴ This election is separate from the election under current law allowing S Corporations to be taxed as a C Corporation for Wisconsin income taxes.⁵

By making the election to be taxed at the entity level for Wisconsin income taxes, the following rules apply:⁶

1. The net income of the PTE is computed under Wis. Stat. §71.21(1) through (5) and the situs of income shall be determined if the election was not made.
2. The PTE is not allowed to claim a net business loss (net operating loss) deduction.
3. The PTE is not allowed to claim credits, other than the credit for taxes paid to other states.
4. A shareholder, partner or member's adjusted basis of the interest in the S corporation, partnership or LLC is determined as if the election was not made.
5. The provisions of Wis. Stat. §71.09 and Wis. Stat. §71.84 relating to estimated payments and underpayment interest shall apply to the PTE for tax years beginning on or after January 1, 2019.

As a result of the election, the shareholder, partner or member of the PTE will exclude their proportionate share of all items of income, gain, loss, or deduction of the PTE when computing their share of Wisconsin adjusted gross income. The PTE

¹ A copy of the senate bill is accessible [here](#).

² 2017-18 Wisconsin Statutes, 2017 General Session (Act 368). A copy of the adopted law is accessible [here](#).

³ Act 368, Section 21(1).

⁴ Act 368, Section 7 creating §71.21(6)(a) Wis. Stat.; Act 368, Section 11 creating §71.365(4m)(a) Wis. Stat.

⁵ §71.365(4)(a) Wis. Stats.

⁶ Act 368, Section 7 creating §71.21(6)(d) Wis. Stat.; Act 368, Section 11, creating §71.365(4m)(d) Wis. Stat.

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shall pay tax on items that would otherwise be taxed at the shareholder, partner or member level absent the election.⁷ Note that if the PTE fails to pay the amount owed to the Department with respect to income as a result of the election, the Department may collect the amount directly from the shareholders, partners or members based on their proportionate share of such income.⁸

This election may be revoked through consent of the majority share ownership or majority partnership, on or before the due date (including extension) of the PTE's Wisconsin tax return for that taxable year.⁹

The Department is authorized to issue regulations on this election which, if issued, are anticipated to provide guidance as to the actions necessary for a PTE to elect to be taxed at the entity level for Wisconsin income taxes.¹⁰

Credit for taxes paid

Subject to certain limitations, a PTE that elects to be taxed at the entity level may claim a credit against the amount of income tax due for the amount of net income tax paid by the entity to another state and the net income tax paid on behalf of shareholders, partners, and members who are Wisconsin residents on another state's composite return. The credit for taxes paid may not be allowed unless the income taxed by other states is also considered income for Wisconsin tax purposes and would otherwise be reported by the shareholders, partners, or members to Wisconsin absent the election. The amount of the credit may not exceed an amount determined by multiplying the income subject to tax in the other state that is also subject to tax in Wisconsin by 7.9 percent.¹¹

Partners, members, and shareholders of a partnership, limited liability, or S Corporation who are Wisconsin residents may not claim a credit for taxes paid by the PTE if the PTE has made an election to be taxed at the entity level.¹²

Additional Tax-Option Corporations (S-Corporation) considerations

Under current law, items adjusting an S corporation shareholder basis who elected to be taxed as a C Corporation for Wisconsin income tax purposes are disregarded under s. 71.365(4)(a) Wis. Stats.¹³ Under Act 368, this provision does not apply.¹⁴

Sales and use tax

Act 368 codifies the Wisconsin Department of Revenue's Emergency Rule 1819, which became effective on October 1, 2018. Act 368, effective December 16, 2018, adds to the statutory definition of "retailer engaged in business in this state" to include retailers who, during the previous year or current year, have either annual gross sales into the state that exceed \$100,000, or annual number of separate sales transactions into the state that is 200 or more.¹⁵

Under Act 368, if an out-of-state retailer meets or exceeds the above criteria in the previous year, the retailer shall register with the Department and collect the taxes administered under s. 77.52 or 77.53 Wis. Stats. on sales sourced to the state under s. 77.522 Wis. Stats. for the entire current year.¹⁶ Conversely, if an out-of-state retailer's annual gross sales or transactions do not meet or are less than the above criteria in the previous year, the retailer is not required to register with the Department and collect the taxes administered under s. 77.52 or 77.53 Wis. Stats. on sales sourced to the state under s. 77.522 Wis. Stats. until the retailer's sales or transactions meet the above criteria for the current year, at which time the retailer shall register with the Department and collect the tax for the remainder of the current year.¹⁷

⁷ Act 368, Section 7 creating §71.21(6)(b) Wis. Stat.; Act 368, Section 11, creating §71.365(4m)(b) Wis. Stat.; Act 368, Section 3, creating §71.05(10)dm Wis. Stat.

⁸ Act 368, Section 7, creating §71.21(6)(d)6. Wis. Stat.; Act 368, Section 11, creating §71.365(4m)(d)5. Wis. Stat.

⁹ Act 368, Section 7 creating §71.21(6)(c) Wis. Stat.; Act 368, Section 11, creating §71.365(4m)(c) Wis. Stat.

¹⁰ Act 368, Section 7, creating §71.21(6)(e) Wis. Stat.; Act 368, Section 11, creating §71.365(4m)(e). Wis. Stat.

¹¹ Act 368, section 6, amending §71.07(7)(c) Wis. Stat.

¹² Act 368, section 4, creating §71.07(7)(b)2. Wis. Stat.

¹³ §71.05(6)(a)(14) Wis. Stats.

¹⁴ Act 368, section 2, amending §71.05(6)(a)14. Wis. Stat.

¹⁵ Act 368, Section 16, creating §77.51(13gm)(a) Wis. Stats.

¹⁶ Act 368, Section 16, creating §77.51(13gm)(b) Wis. Stats.

¹⁷ Act 368, Section 16, creating §77.51(13gm)(c) Wis. Stats.

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Act 368 also modifies the Wisconsin Department of Revenue's responsibilities to determine the amount of additional revenue reported to the Department during the period beginning October 1, 2018 and ending September 30, 2019.¹⁸ Once the Department completes its determination, the Department shall determine how much the individual income tax rates may be reduced for the taxable year ending on December 31, 2019 to offset the amount of additional sale tax revenue.¹⁹

Contacts:

If you have questions regarding Act 368 or other Wisconsin tax matters, please contact any of the following Deloitte professionals:

Jeannette Thorel

Tax Managing Director

Deloitte Tax LLP, Milwaukee
+1 414 977 2618

jthorel@deloitte.com

Renise Cohen

Tax Managing Director

Deloitte Tax LLP, Milwaukee
+1 414 977 2521

recohen@deloitte.com

Scott Bender

Tax Principal

Deloitte Tax LLP, Milwaukee
+1 414 347 6104

sbender@deloitte.com

Linda Joers

Tax Managing Director

Deloitte Tax LLP, Milwaukee
+1 414 977 2553

ljoers@deloitte.com

Michael Gordon

Tax Senior Manager

Deloitte Tax LLP, Milwaukee
+1 414 977 2666

michagordon@deloitte.com

The authors of this alert would like to acknowledge the contributions of Joe Meeusen and Jeremy Blodgett. Joe and Jeremy are both Tax Managers in the Multistate Tax practice of Deloitte Tax LLP.

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¹⁸ Act 368, Section 13, amending §73.03(71)(a) Wis. Stats.

¹⁹ Act 368, Section 13, amending §73.03(71)(b) Wis. Stats.