

Revenue Impact of Adopting a Depreciation "Opt-Out" Provision

Prepared by Henry A. Jasper, CPA, MST

Methodology:

- 1 These calculations start with the corporate income tax statistics as reported by the WI Legislative Fiscal Bureau, in the study titled "Corporate Income/Franchise Tax" ("Report") dated January, 2015. See Attachment A for relevant excerpts.
- 2 We have computed an overall fiscal effect for the conversion to federal basis, and used the same assumptions as the DOR regarding the number of businesses that would opt-out, as well as grossing up the result to take into account the effects on S corporations, partnerships and individuals.
- 3 Table 2 on page 21 of the Report notes that out of 42,097 corporate returns filed for 2011, only 14,186 reported a net tax liability. Because of improvements in the economy we will assume that for 2014 20,000 returns would show a liability.
- 4 The estimated basis adjustment per company is based on the input of the WI Taxation Committee of the WICPA. The most capital intensive businesses are the ones most likely to be reporting losses from operations. This includes manufacturing, agricultural, mining, construction and transportation industries. Therefore, the industries that are most profitable - financial services, business services, wholesale and retail trades, entertainment, educational, health care, etc. - are likely to have much smaller federal-WI basis adjustments. Therefore, we believe that a reasonable range for the basis adjustment for the profitable WI corporations is between \$50,000 and \$100,000 per company.
- 5 Starting in 2013, manufacturing and agricultural businesses are allowed a credit against their WI taxes. This in effect reduces the revenue impact on the basis adjustment, because as expenses go up, the MA credit goes down. See calculation below of the effective tax rate for manufacturing and agricultural activities. See Attachment B - excerpt from the U.S. Bureau of Economic Analysis. According to the BEA manufacturing and agriculture account for 22% of WI's GDP, therefore we assumed that 22% of the overall adjustment would be related to these activities.

Revenue Impact of Adopting a Depreciation "Opt-Out" Provision, cont.

Computation:

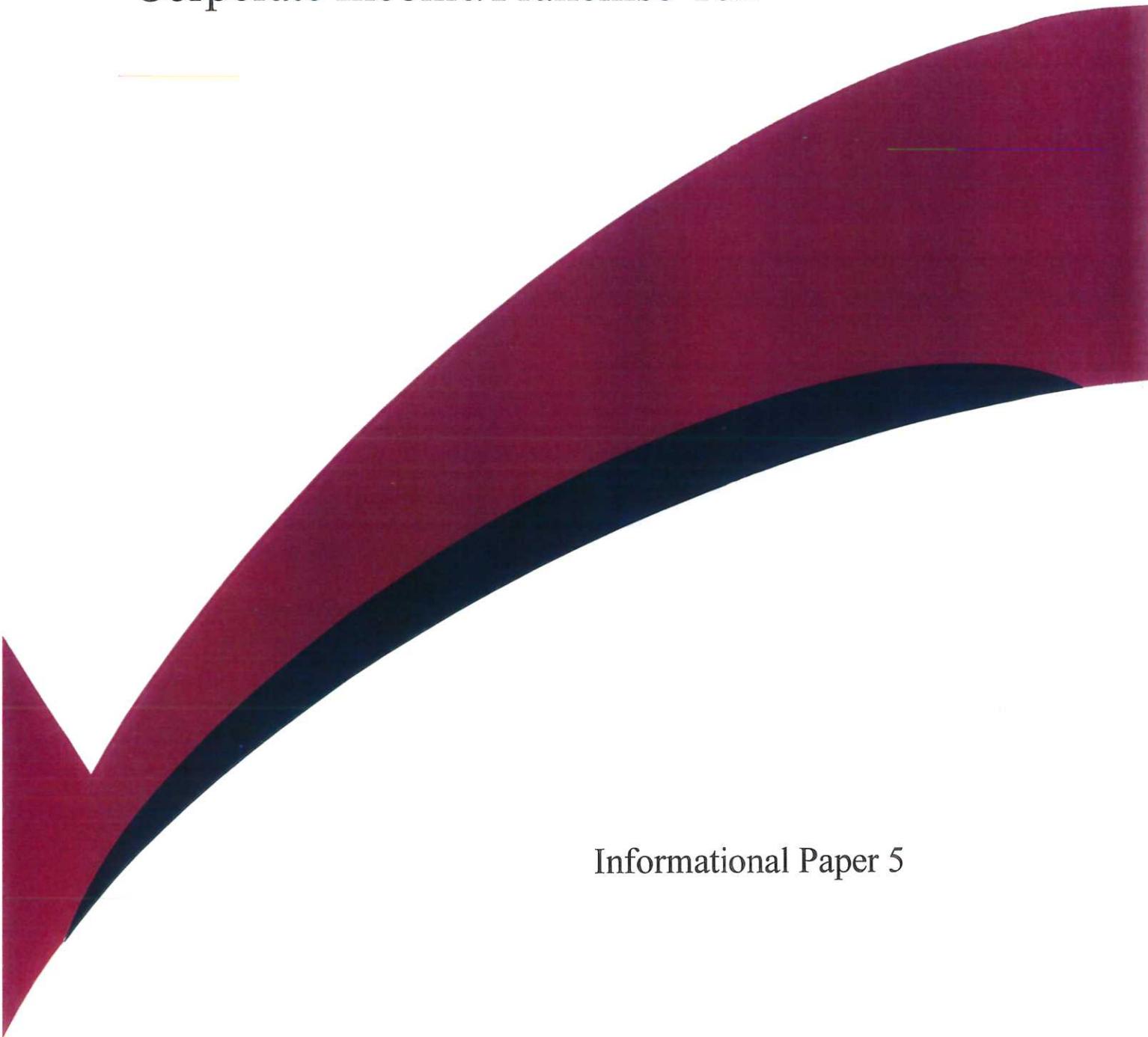
| | | | | |
|---|-------------------------|-----------------|--------|--------------------------|
| Corporate returns showing net tax liability | 20,000 | | Note 3 | |
| Estimated basis adj per company | \$ 75,000 | | Note 4 | |
| Total estimated basis adjustment | <u>\$ 1,500,000,000</u> | | | |
| Estimated % of companies that would "opt-out" per DOR | <u>1%</u> | | | |
| | | | | |
| Estimated total basis adjustment | <u>\$ 15,000,000</u> | | | |
| | | <u>Tax Rate</u> | | <u>Revenue Impact</u> |
| Basis adjustment related to non-mfg and non-ag | 78% \$ 11,700,000 | 7.90% | | \$ 924,000 |
| Basis adjustment related to mfg and ag -Note 5 | 22% \$ 3,300,000 | 0.51% | | <u>\$ 17,000</u> |
| | | | | |
| Estimated revenue impact for corporations | | 70% | | \$ 941,000 |
| Non-corporate taxpayers (rounded) - per DOR is 30% of total | | 30% | | <u>\$ 403,000</u> |
| | | | | |
| Total impact of entire basis adjustment for entities that "opt-out" | | | | \$ 1,344,000 |
| The fiscal impact is spread over 5 years beginning with 2014 | | | | 20% |
| Annual impact (rounded) | | | | <u>\$ 269,000</u> |
| Impact for the 2015-2017 budget | | X | | <u>2</u> |
| | | | | |
| Overall revenue impact for the biennium | | | | <u>\$ 538,000</u> |

Manufacturing and Agricultural Credit (MA credit) effect:

Increasing deductions for WI businesses will reduce the amount of the MA credit claimed:

| | |
|---|--------------|
| Tax rate before MA credit applied | 7.90% |
| Less MA credit | |
| Phase in of credit: 2014= 3.75%; 2015= 5.526%; 2016 and later | |
| =7.5% Weighted % for 2014-2018 = 6.4% | <u>6.40%</u> |
| | |
| Net tax rate for manufacturing and agricultural businesses | <u>0.51%</u> |

Corporate Income/Franchise Tax



Informational Paper 5

Wisconsin Legislative Fiscal Bureau
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Attachment A-1

Corporate Income/Franchise Tax

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Summary Data

The following tables provide summary data concerning the Wisconsin corporate income/franchise tax.

Corporate income/franchise tax collections, state general fund tax collections, and corporate tax collections as a percent of total general fund collections for fiscal years 2003-04 through 2013-14 are shown in Table 1. The table indicates that corporate tax collections vary significantly from year to year. For example, annual growth rates ranged from -24.9% in 2008-09, to 32.6% in 2009-10. The large decrease in 2008-09 shows the effect of the recent recession on collections. The increases from 2009-10 through 2013-14 reflect improved corporate profits and the implementation of combined reporting. Corporate tax collections as a share of total general fund tax revenues have fluctuated from 5.2% in 2008-09 to 7.1% in 2006-07.

Table 2 presents tax year 2011 summary statistics for the total number of returns filed, the number of returns that had a net tax liability, the income apportioned to Wisconsin before and after the use of loss carryforwards from previous

Table 2: Wisconsin Aggregate Statistics on State Corporate Tax Returns (Tax Year 2011)

| | |
|---|------------------|
| Count -- All Returns | 42,097 |
| Count -- Returns with Net Tax Liability | 14,186 |
| WI Net Income Before Carryforwards | \$12,261,496,627 |
| Loss Carryforwards Used | 2,347,455,736 |
| WI Net Income | 9,914,040,891 |
| WI Gross Tax Liability | 782,841,679 |
| Non-Refundable Credits Used | 40,315,037 |
| WI Net Tax | 742,526,642 |
| Economic Development Surcharge | 12,222,189 |
| Refundable Tax Credits | 25,718,903 |

Source: Department of Revenue Aggregate Statistics.

years, gross tax liability, the amount of non-refundable credits used, and Wisconsin net tax liability for C corporations. Also included are the amount of economic development surcharge paid by, and the amount of refundable tax credits paid to, corporate filers. The surcharge is a separate tax collected on a corporate tax return and is not included in calculating Wisconsin net tax. Refundable credits are not included in the calculation of Wisconsin net tax because the credits can be paid to taxpayers with no tax liability and are considered expenditures rather than a reduction in tax revenue.

The distribution of corporate income tax liability by Wisconsin net income class for C cor-

Table 1: Wisconsin Corporate Tax Collections 2003-04 to 2013-14 (\$ in Millions)

| Fiscal Year | Corporate Tax Collections | Percent Change | Total General Fund Collections | Percent Change | Corporate Tax As Percent of General Fund Collections |
|-------------|---------------------------|----------------|--------------------------------|----------------|--|
| 2003-04 | \$650.5 | 23.6% | \$10,739.3 | 5.3% | 6.1% |
| 2004-05 | 764.1 | 17.5 | 11,396.7 | 6.1 | 6.7 |
| 2005-06 | 780.3 | 2.1 | 12,030.1 | 5.6 | 6.5 |
| 2006-07 | 890.1 | 14.1 | 12,618.0 | 4.9 | 7.1 |
| 2007-08 | 837.8 | -5.9 | 13,042.9 | 3.4 | 6.4 |
| 2008-09 | 629.5 | -24.9 | 12,113.2 | -7.1 | 5.2 |
| 2009-10 | 834.5 | 32.6 | 12,131.7 | 0.2 | 6.9 |
| 2010-11 | 852.9 | 2.2 | 12,911.6 | 6.4 | 6.6 |
| 2011-12 | 906.6 | 6.3 | 13,514.6 | 4.7 | 6.7 |
| 2012-13 | 925.4 | 2.1 | 14,085.6 | 4.2 | 6.6 |
| 2013-14 | 967.2 | 4.5 | 13,948.1 | -1.0 | 6.9 |

porations from 2011 tax year returns is illustrated in Table 3. Combined reports are shown as single returns. The table shows that although 42,097 corporations filed returns, only 14,186 had net tax liability. Corporations can have no tax liabilities because deductible expenses and loss carryforwards entirely offset income. In other cases, tax credits entirely offset tax liability. Table 3 also shows that a large proportion of the corporate income tax was from a relatively small number of returns. About 88.7% of total corporate tax liability was generated by 2.69% of the corporations and combined groups that filed tax returns.

Table 3 does not directly translate into taxes paid by size of corporation since, for example, a very large corporation which suffered a loss could have no taxable income in the year of the loss, or in succeeding years, if the loss was carried forward. Also, due to combined reporting,

many of the returns reflected the tax liabilities of combined groups of corporations. Note that a few returns shown in the zero income group have a net tax liability. This is because a small number of combined groups have zero income for the combined return, but have members with a net tax liability on nonapportionable income that is greater than the member's share of the group's current year net business loss.

Because Tables 2 and 3 primarily show the total tax liability for corporations from tax year 2011, it differs from the total corporate collections shown for fiscal year 2011-12 in Table 1. The tables do not include corporate income/franchise taxes paid by S corporations. Tax year amounts do not include additional collections due to audit adjustments and delinquent collections. Finally, fiscal year collections include declaration payments for a more recent year than the tax year collections shown in Tables 2 and 3.

Table 3: Corporate Tax Liability by Net Income Class (Tax Year 2011)

| Wisconsin Net Income | Number of Returns | % of Returns | Total Income | % of Total Income | Number of Taxpayers | Total Liability | % of Total Liability |
|-------------------------|-------------------|--------------|-----------------|-------------------|---------------------|-----------------|----------------------|
| Zero or Less | 27,478 | 65.27% | \$0 | 0.00% | 6 | \$132,220 | 0.02% |
| Zero to \$10,000 | 5,500 | 13.07 | 16,580,440 | 0.17 | 5,348 | 1,298,024 | 0.17 |
| 10,001 to 25,000 | 2,062 | 4.90 | 33,919,274 | 0.34 | 2,019 | 2,621,150 | 0.35 |
| 25,001 to 50,000 | 1,689 | 4.01 | 61,230,257 | 0.62 | 1,644 | 4,690,479 | 0.63 |
| 50,001 to 100,000 | 1,497 | 3.56 | 106,794,429 | 1.08 | 1,449 | 8,103,420 | 1.09 |
| 100,001 to 250,000 | 1,422 | 3.38 | 226,571,442 | 2.29 | 1,352 | 16,731,844 | 2.25 |
| 250,001 to 500,000 | 747 | 1.77 | 267,402,130 | 2.70 | 719 | 19,950,543 | 2.69 |
| 500,001 to 1,000,000 | 571 | 1.36 | 405,832,105 | 4.09 | 547 | 30,258,620 | 4.08 |
| 1,000,001 to 5,000,000 | 770 | 1.83 | 1,662,804,452 | 16.77 | 752 | 124,464,916 | 16.76 |
| 5,000,001 to 10,000,000 | 164 | 0.39 | 1,168,584,683 | 11.79 | 159 | 84,844,212 | 11.43 |
| Over 10,000,000 | 197 | 0.47 | 5,964,321,679 | 60.16 | 191 | 449,431,214 | 60.53 |
| Totals | 42,097 | 100.00% | \$9,914,040,891 | 100.00% | 14,186 | \$742,526,642 | 100.00% |

Source: Department of Revenue Aggregate Statistics.

Bureau of Economic Analysis

Gross domestic product (GDP) by state (millions of current dollars)

Levels

| Fips | Area | IndCode | Industry | 2013 |
|-------|-----------|-----------|---|----------------|
| 55000 | Wisconsin | <u>1</u> | All industry total | 282,486 |
| 55000 | Wisconsin | <u>2</u> | Private industries | 250,558 |
| 55000 | Wisconsin | <u>3</u> | <u>Agriculture, forestry, fishing, and hunting</u> | <u>7,652</u> |
| 55000 | Wisconsin | <u>4</u> | Farms | (NA) |
| 55000 | Wisconsin | <u>5</u> | Forestry, fishing, and related activities | (NA) |
| 55000 | Wisconsin | <u>6</u> | Mining | 1,058 |
| 55000 | Wisconsin | <u>7</u> | Oil and gas extraction | (NA) |
| 55000 | Wisconsin | <u>8</u> | Mining, except oil and gas <i>22%</i> | <i>61,029</i> |
| 55000 | Wisconsin | <u>9</u> | Support activities for mining | <i>282,436</i> |
| 55000 | Wisconsin | <u>10</u> | Utilities | 5,293 |
| 55000 | Wisconsin | <u>11</u> | Construction | 9,531 |
| 55000 | Wisconsin | <u>12</u> | <u>Manufacturing</u> | <u>53,377</u> |
| 55000 | Wisconsin | <u>13</u> | Durable goods manufacturing | 31,188 |
| 55000 | Wisconsin | <u>14</u> | Wood products manufacturing | (NA) |
| 55000 | Wisconsin | <u>15</u> | Nonmetallic mineral products manufacturing | (NA) |
| 55000 | Wisconsin | <u>16</u> | Primary metals manufacturing | (NA) |
| 55000 | Wisconsin | <u>17</u> | Fabricated metal products | (NA) |
| 55000 | Wisconsin | <u>18</u> | Machinery manufacturing | (NA) |
| 55000 | Wisconsin | <u>19</u> | Computer and electronic products manufacturing | (NA) |
| 55000 | Wisconsin | <u>20</u> | Electrical equipment, appliance, and components manufacturing | (NA) |
| 55000 | Wisconsin | <u>21</u> | Motor vehicles, bodies and trailers, and parts manufacturing | (NA) |
| 55000 | Wisconsin | <u>22</u> | Other transportation equipment manufacturing | (NA) |
| 55000 | Wisconsin | <u>23</u> | Furniture and related products manufacturing | (NA) |
| 55000 | Wisconsin | <u>24</u> | Miscellaneous manufacturing | (NA) |
| 55000 | Wisconsin | <u>25</u> | Nondurable goods manufacturing | 22,189 |
| 55000 | Wisconsin | <u>26</u> | Food and beverage and tobacco products manufacturing | (NA) |
| 55000 | Wisconsin | <u>27</u> | Textile mills and textile product mills | (NA) |
| 55000 | Wisconsin | <u>28</u> | Apparel and leather and allied products manufacturing | (NA) |
| 55000 | Wisconsin | <u>29</u> | Paper products manufacturing | (NA) |
| 55000 | Wisconsin | <u>30</u> | Printing and related support activities | (NA) |
| 55000 | Wisconsin | <u>31</u> | Petroleum and coal products manufacturing | (NA) |
| 55000 | Wisconsin | <u>32</u> | Chemical products manufacturing | (NA) |
| 55000 | Wisconsin | <u>33</u> | Plastics and rubber products manufacturing | (NA) |
| 55000 | Wisconsin | <u>34</u> | Wholesale trade | 17,054 |
| 55000 | Wisconsin | <u>35</u> | Retail trade | 15,837 |

| Fips | Area | IndCode | Industry | 2013 |
|-------|-----------|-----------|---|-------|
| 55000 | Wisconsin | <u>36</u> | Transportation and warehousing | 7,920 |
| 55000 | Wisconsin | <u>37</u> | Air transportation | (NA) |
| 55000 | Wisconsin | <u>38</u> | Rail transportation | (NA) |
| 55000 | Wisconsin | <u>39</u> | Water transportation | (NA) |
| 55000 | Wisconsin | <u>40</u> | Truck transportation | (NA) |
| 55000 | Wisconsin | <u>41</u> | Transit and ground passenger transportation | (NA) |
| 55000 | Wisconsin | <u>42</u> | Pipeline transportation | (NA) |

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| | | | | |
|-------|-----------|--------------------|--|--------|
| 55000 | Wisconsin | 43 | Other transportation and support activities | (NA) |
| 55000 | Wisconsin | 44 | Warehousing and storage | (NA) |
| 55000 | Wisconsin | 45 | Information | 8,813 |
| 55000 | Wisconsin | 46 | Publishing industries, except Internet (includes software) | (NA) |
| 55000 | Wisconsin | 47 | Motion picture and sound recording industries | (NA) |
| 55000 | Wisconsin | 48 | Broadcasting and telecommunications | (NA) |
| 55000 | Wisconsin | 49 | Data processing, internet publishing, and other information services | (NA) |
| 55000 | Wisconsin | 50 | Finance, insurance, real estate, rental, and leasing | 55,636 |
| 55000 | Wisconsin | 51 | Finance and insurance | 20,267 |
| 55000 | Wisconsin | 52 | Federal Reserve banks, credit intermediation, and related services | (NA) |
| 55000 | Wisconsin | 53 | Securities, commodity contracts, and investments | (NA) |
| 55000 | Wisconsin | 54 | Insurance carriers and related activities | (NA) |
| 55000 | Wisconsin | 55 | Funds, trusts, and other financial vehicles | (NA) |
| 55000 | Wisconsin | 56 | Real estate and rental and leasing | 35,369 |
| 55000 | Wisconsin | 57 | Real estate | (NA) |
| 55000 | Wisconsin | 58 | Rental and leasing services and lessors of intangible assets | (NA) |
| 55000 | Wisconsin | 59 | Professional and business services | 26,200 |
| 55000 | Wisconsin | 60 | Professional, scientific, and technical services | 11,883 |
| 55000 | Wisconsin | 61 | Legal services | (NA) |
| 55000 | Wisconsin | 62 | Computer systems design and related services | (NA) |
| 55000 | Wisconsin | 63 | Miscellaneous professional, scientific, and technical services | (NA) |
| 55000 | Wisconsin | 64 | Management of companies and enterprises | 7,381 |
| 55000 | Wisconsin | 65 | Administrative and waste management services | 6,936 |
| 55000 | Wisconsin | 66 | Administrative and support services | (NA) |
| 55000 | Wisconsin | 67 | Waste management and remediation services | (NA) |
| 55000 | Wisconsin | 68 | Educational services, health care, and social assistance | 27,550 |
| 55000 | Wisconsin | 69 | Educational services | 2,850 |
| 55000 | Wisconsin | 70 | Health care and social assistance | 24,700 |

| Fips | Area | IndCode | Industry | 2013 |
|-------|-----------|--------------------|--|---------|
| 55000 | Wisconsin | 71 | Ambulatory health care services | (NA) |
| 55000 | Wisconsin | 72 | Hospitals and nursing and residential care facilities | (NA) |
| 55000 | Wisconsin | 73 | Social assistance | (NA) |
| 55000 | Wisconsin | 74 | Arts, entertainment, recreation, accommodation, and food services | 8,487 |
| 55000 | Wisconsin | 75 | Arts, entertainment, and recreation | 2,092 |
| 55000 | Wisconsin | 76 | Performing arts, spectator sports, museums, and related activities | (NA) |
| 55000 | Wisconsin | 77 | Amusements, gambling, and recreation industries | (NA) |
| 55000 | Wisconsin | 78 | Accommodation and food services | 6,395 |
| 55000 | Wisconsin | 79 | Accommodation | (NA) |
| 55000 | Wisconsin | 80 | Food services and drinking places | (NA) |
| 55000 | Wisconsin | 81 | Other services, except government | 6,148 |
| 55000 | Wisconsin | 82 | Government | 31,928 |
| 55000 | Wisconsin | 83 | Federal civilian | (NA) |
| 55000 | Wisconsin | 84 | Federal military | (NA) |
| 55000 | Wisconsin | 85 | State and local | (NA) |
| 55000 | Wisconsin | 86 | Addenda: | |
| 55000 | Wisconsin | 86 | Natural resources and mining | 8,710 |
| 55000 | Wisconsin | 87 | Trade | 32,891 |
| 55000 | Wisconsin | 88 | Transportation and utilities | 13,213 |
| 55000 | Wisconsin | 89 | Private goods-producing industries | 71,618 |
| 55000 | Wisconsin | 90 | Private services-providing industries | 178,940 |

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Testimony before the Senate Committee on Revenue, Financial Institutions, and Rural Affairs

Henry A. Jasper, CPA, MST

February 11, 2015

Good afternoon Chairman Marklein and members of the Senate Committee on Revenue, Financial Institutions, and Rural Affairs. Thank you for this opportunity to share testimony on behalf of the Wisconsin Institute of CPAs relating to the depreciation provisions in Senate Bill 24.

My name is Hank Jasper; I am a resident of Fort Atkinson, Wisconsin and am licensed in Wisconsin as a CPA. I have been a partner in a small local CPA firm in Fort Atkinson for the last 16 years and I specialize in taxation. Our firm works with small businesses, their owners and other individuals to provide a full range of accounting and tax services. I also provide consulting services to other CPA firms, retired CPAs and to Kwik Trip, Inc. regarding various tax matters, and litigation support in divorce cases.

I am a native of the Upper Peninsula of Michigan and practiced in Michigan for several years before moving to Wisconsin in 1984.

I have a Master Degree in Taxation, and previously was a manager in the Madison office of McGladrey & Pullen, the 5th largest CPA firm in the U.S., specializing in state and local taxes. I am a member of both the American Institute of CPAs and the Wisconsin Institute of CPAs, and a member of the WICPA Wisconsin Taxation Committee of the WICPA for 31 years.

OLD LAW

In the fall of 2012 I provided testimony before the Steering Committee for Symposia on State Income Tax to present recommendations for changes to Wisconsin's tax laws. One of the items discussed at that time was a proposal to simplify Wisconsin's taxes by allowing Wisconsin companies to follow federal depreciation rules to avoid the need to keep separate records for Wisconsin.

Under the old rules, businesses were required to maintain at least five different sets of depreciation records:

Financial

Fed Reg Tax

Fed AMT

WI Reg Tax

WI Min Tax

This causes a tremendous amount of compliance time and costs for taxpayers to comply with 5 different sets of rules. The federal depreciation rules are very complex. The CCH "U.S. Master Depreciation Guide" is 1,249 pages. The software manual for one of the more popular depreciation software systems is the Sage Fixed Assets program; its user's guide is 579 pages.

Example of the Complexities. A prior client of mine was in the water softening business. They rented out over 2,000 water softeners. To be able to compute the numbers required for financial, federal tax and Wisconsin tax purposes, 5 sets of depreciation records had to be maintained, resulting in almost 10,000 separate entries in the depreciation system.

This company added about 200 softeners each year and also sold about the same number each year. Each of these additions had to be added to the depreciation software program, and the disposals had to be recorded as well. Because each asset can have 5 different rates of depreciation, when an asset was sold, 5 separate computations of gain or loss must be made. Thus in a typical year, there were 1,000 entries in the tax software for additions and a 1,000 entries for the disposals. Because our firm maintained their depreciation books, this added significantly to the accounting fees each year.

See sample depreciation books, and Attachment A which includes some of the details for a single asset and total company totals.

GOVERNOR'S 2013-2015 BUDGET BILL

To simplify record keeping for businesses, the Governor's 2013-2015 Budget bill (Acts 19 and 20) included several changes to the depreciation rules. It provided the following:

1. Eliminated the need to keep a separate set of books for Wisconsin regular tax and Wisconsin AMT purposes – on old assets.
2. All purchases after December 31, 2013 could use Section 179 expensing in accordance with federal depreciation rules, and would automatically adopt any future federal changes.
3. The temporary difference between federal book value and state book value for the pre-January 1, 2014 purchases would be converted into a separate asset and amortized/depreciated over a 5 year life. The differences for all assets in the taxing unit would be consolidated into one "asset" for purposes of transitioning to the usage of the federal tax schedules.
4. However, Wisconsin does not automatically concur with federal tax law changes that have any impact on depreciation rates and expensing options effective for all depreciation changes after 1/1/2014.

WHERE WE ARE AT NOW IF THE LAW IS NOT CHANGED

- A. **Assets acquired in tax years beginning before Jan. 1, 2014 must be converted to their federal basis as of end of that tax year. For a calendar year taxpayer, that date is Dec. 31, 2013.**
- B. **The adjustment is computed in the following manner:**
 1. Starting with the first taxable year beginning after December 31, 2013, and for each of the next 4 taxable years, a person must either add or subtract 20 percent of the difference

between the combined federal adjusted basis and the combined Wisconsin adjusted basis of all depreciated or amortized assets as of the last day of the taxable year beginning in 2013 that are being depreciated or amortized for both federal and Wisconsin purposes.

2. If the combined federal adjusted basis of the assets is less than the Wisconsin adjusted basis, the person must subtract 20 percent of the difference for the taxable year beginning in 2014 and for each of the next 4 taxable years.
3. If the combined federal adjusted basis of the assets is more than the Wisconsin adjusted basis, the person must add 20 percent of the difference for the taxable year beginning in 2014 and for each of the next 4 taxable years.
4. Adjusted basis is the original cost of the asset less depreciation claimed including regular and bonus depreciation, and Section 179 expensing.

5. Example for a calendar-year taxpayer:

WI adjusted basis of depreciable assets on 12/31/2013 = \$200,000
Federal adjusted basis of depreciable assets on 12/31/2013 = \$100,000
Difference in basis = \$100,000
Amount that must be subtracted from income for 2014 and each of the next 4 years is \$20,000.

6. The amortization over 5 years is mandatory.

7. In many cases, this basis adjustment will extend the time over which a taxpayer would benefit from the depreciation of its assets for WI income tax purposes.

Example:

ABC Corp. purchases a computer system for \$500,000 in 2012, and claims 50% bonus depreciation on its federal income tax return, and the balance is depreciated over 6 years. For WI, bonus depreciation was not allowed, so the full cost is depreciated over 6 years. Also assume it is the only asset ABC owns.

Depreciation allowed under prior law:

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|-----------------------|---------|---------|---------|---------|---------|---------|
| Fed Deduction | 300,000 | 80,000 | 48,000 | 29,000 | 29,000 | 14,000 |
| Fed Accum Depr | 300,000 | 380,000 | 428,000 | 457,000 | 486,000 | 500,000 |
| WI Deduction | 100,000 | 160,000 | 96,000 | 58,000 | 58,000 | 28,000 |
| WI Accum Depr | 100,000 | 260,000 | 356,000 | 414,000 | 472,000 | 500,000 |

The adjusted basis for WI at 12/31/2013 = \$240,000 (\$500,000-\$260,000)
The adjusted basis for federal at 12/31/2013=\$120,000 (\$500,000-\$380,000)
Basis difference at 12/31/2013 = \$120,000 @ 20%/yr = \$24,000

Annual basis adjustment subtraction from WI income for 2014-2018 is \$24,000.

Depreciation allowed under new law starting in 2014:

| | PRIOR ACCUM | 2014 | 2015 | 2016 | 2017 | 2018 |
|--|----------------|-----------------|----------------|----------------|---------------|---------------|
| Fed & WI | 380,000 | 48,000 | 29,000 | 29,000 | 14,000 | 0 |
| WI Adjust | | <u>24,000</u> | <u>24,000</u> | <u>24,000</u> | <u>24,000</u> | <u>24,000</u> |
| Total WI Deduction | | <u>72,000</u> | <u>53,000</u> | <u>53,000</u> | <u>38,000</u> | <u>24,000</u> |
| WI Prior Law | | <u>96,000</u> | <u>58,000</u> | <u>58,000</u> | <u>28,000</u> | <u>0</u> |
| (Reduction) Addition to WI Depreciation | | <u>(24,000)</u> | <u>(5,000)</u> | <u>(5,000)</u> | <u>10,000</u> | <u>24,000</u> |

In this case ABC Corp. had its allowable deductions for WI reduced by \$24,000 in 2014, and \$5,000 in 2015 and 2016. Thus, ABC Corp. is disadvantaged by the new law for WI income tax purposes for 3 years, and it takes an extra year to receive the full benefit for the depreciation on the computer system.

C. The *quid pro quo* for adopting the federal rules and amortizing the basis adjustment over 5 years was that there would be no need to keep separate depreciation books for WI, because all federal depreciation changes would be automatically followed by WI, including bonus depreciation provisions. However, that was not how the law was written, as it does not automatically pick up any changes in the law enacted after Jan. 1, 2014.

1. The federal Tax Increase Prevention Act of 2014 was signed by the President on December 19, 2014. This Act retroactively extended for 1 year a number of federal tax provisions that had expired for 2014. The extensions of these provisions generally do not apply for Wisconsin for 2014 including these provisions relating to depreciation:
 - a. 50% special (bonus) depreciation to certain property placed in service in 2014.
 - b. 15-year recovery period for leasehold improvement property and restaurant property.
 - c. 50% depreciation deduction for cellulosic fuel ethanol plant property.
2. For Section 179 expensing, however, WI will follow all federal rules regardless of when adopted. That is a very beneficial provision which solves the depreciation issues for most small businesses but doesn't affect larger ones. We appreciate your efforts in enacting this provision.

D. Not adopting federal changes for 2014 creates a tremendous compliance burden for businesses.

1. This is a nightmare for businesses; they can't use their old WI regular tax and AMT depreciation books; two new depreciation books need to be created for WI. That is because all old assets have to be same as federal, but 2014 assets are prohibited from

using federal rules. This is extremely unfair to businesses and the law needs to be changed to fix this problem.

Illustration:

Under prior law, businesses had to keep a minimum of 5 depreciation books:



What we should have ended up with is this:



However, as the law stands now we have this:



New WI books require copying of all pre-2014 assets into them from the federal depreciation books, then adding 2014 purchases:



2. Creating new depreciation books is not as simple as copying the federal books into new books and then adding the 2014 additions. Most depreciation software programs have a limit on how many books it can handle – usually 3 to 6. And in many programs you can't copy books.
3. For large companies it is extremely difficult to make these changes as it would require hundreds of hours of customizing their legacy programs, or combinations of legacy programs and other programs/modules which may or may not be integrated. Add in multiple companies and locations and this is huge compliance burden.
4. The only other option is for taxpayers to reenter all assets in the new WI regular tax, and WI minimum tax books, but that is not a feasible option for any company with more than a handful of assets.
5. The same will apply for the WI minimum tax depreciation records.

E. Not adopting federal changes for 2014 also tarnishes WI's image that it is trying to cultivate that it is a great state to do business in.

1. Companies are very concerned with a state's tax laws, but they are equally concerned about the potential for laws to be changed after they move their business to WI, or start a business here. So political stability is an important factor that businesses take into consideration when looking to move to WI or expand here.
2. Federalizing all depreciation rules is a very positive sign that the state is taking steps to reduce compliance costs for businesses. However, if immediately after federalizing the depreciation rules for pre-2014 assets, WI decides to not follow federal rules for 2014 assets, the only take-away for a business is that WI is not serious about reforming its tax laws.
3. I know that this is not the message that legislators intended to send, and the law changes they enacted seemed innocuous on their face. Nevertheless when it comes to actually applying the law, the end result of not adopting federal changes is a significant compliance burden for businesses already in the state, and a negative factor for businesses looking to move here.

THE WICPA SUPPORTS THE ADOPTION OF SENATE BILL 24:

Do nothing regarding adopting the 2014 federal rules, but provide that taxpayers may but are not required to change to the federal basis for assets purchased before 2014, and would use the depreciation rules in effect on January 1, 2013.

1. The purpose behind the law change to adopt the federal rules was to avoid the need to keep separate depreciation books for WI tax purposes. Not adopting the 2014 federal depreciation changes defeats that purpose.
2. Therefore, if the federal changes are not adopted, allow taxpayers the option of not converting pre-2014 assets to be the same as federal. That way they can continue with their old Wisconsin depreciation records and not have to create two new ones.
3. We believe the fiscal impact of Senate Bill 24 will be minimal. See separate estimate of the impact.

WICPA'S ALTERNATIVE RECOMMENDATION FOR LAW CHANGES:

Adopt all federal depreciation changes to always be the same as federal including the 2014 federal changes, but provide that 80% of the bonus depreciation claimed will be an addback in the year bonus depreciation is claimed with a subtraction modification of 25% per year of the addback amount for the following four years.

1. **Adopting all federal depreciation provisions concurrently will avoid the need to keep separate depreciation books for WI, however, it will add complexity with the additional computations for the addback and amortization periods.**

2. The addback would be a company level adjustment; it is not tracked on an asset by asset basis.
3. The addback would be amortized over 4 years, and would be a subtract modification on WI returns.
4. The amortization of the addback would follow essentially the same rules that apply to the amortization of the adjustment required as a result of adopting the federal basis of assets purchased before 2014.
5. The amortization period should be four years, which is the same adjustment period that is used for the basis adjustment.
6. Based on our estimates, it appears that these changes to adopt federal depreciation rules in full, but with an 80% addback provision, will be essentially revenue neutral. See spreadsheet attached.

7. Example of Addback and Amortization Provisions:

Assume ABC Corp. purchases a computer system for \$500,000 in 2014, and claims 50% bonus depreciation on its federal and WI income tax returns, and the balance is depreciated over 6 years.

Wisconsin Deductions Allowed With Addback & Amortization

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Total |
|----------------------------|----------------|----------------|---------------|---------------|---------------|---------------|----------------|
| Fed & WI deprec | 50,000 | 80,000 | 48,000 | 29,000 | 29,000 | 14,000 | 250,000 |
| Fed & WI bonus | <u>250,000</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>250,000</u> |
| Total Deprec. | <u>300,000</u> | <u>80,000</u> | <u>48,000</u> | <u>29,000</u> | <u>29,000</u> | <u>14,000</u> | <u>500,000</u> |
| WI 2014 Adjust | (200,000) | | | | | | (200,000) |
| WI Amortization | <u>0</u> | <u>50,000</u> | <u>50,000</u> | <u>50,000</u> | <u>50,000</u> | <u>0</u> | <u>200,000</u> |
| Net WI Dedtn | <u>100,000</u> | <u>130,000</u> | <u>98,000</u> | <u>79,000</u> | <u>79,000</u> | <u>14,000</u> | <u>500,000</u> |

My contact information appears below:

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Main - SAMPLE COMPANY

System Number: 7414.000

Status: Active

General Information

| | |
|-------------------|------------|
| Co asset no | |
| Location | |
| Department | |
| Class | S |
| Purchase order no | |
| Vendor/Mfg | 0 |
| User Numeric 1 | \$0.00 |
| Replacement Value | 32M AQS |
| Model # | |
| SER # | |
| User Field 5 | |
| User Field 7 | |
| User Field 9 | |
| Warranty date | MM/DD/YYYY |

| | |
|---------------------|------------|
| Desc | AW02396 |
| Asset G/L acct no | |
| Accum G/L acct no | |
| Expense G/L acct no | |
| Insurance category | |
| Mfg serial no | |
| Mkt Value | No |
| RV Override? | |
| Serial # | |
| User Field 4 | |
| User Field 6 | |
| User Field 8 | |
| Disposal metho | |
| Acquisition date | 11/07/2008 |

> Items in bold are required fields

Entity:

Book Information

Acquisition Date: 11/07/2008

Acquired by: Purchase

| Property Type | Tax | Internal | State | AMT | WI AMT |
|----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Placed-in-Service Date | P | 11/07/2008 | P | 11/07/2008 | P |
| Acquisition Value | \$435.59 | \$435.59 | \$435.59 | \$435.59 | \$435.59 |
| Depreciation Method | MF200 | MF200 | MF200 | MF150 | MF150 |
| Estimated Life | 07 yrs 00 mos |
| ADS Life | 00 yrs 00 mos | N/A | N/A | 00 yrs 00 mos | N/A |
| Business Use % | 100.00 | 100.00 | 100.00 | 0.00 | 100.00 |
| 179 Deduction | \$435.59 | \$0.00 | \$0.00 | \$435.59 | \$0.00 |
| 168 Allowance % BONUS | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Salvage Value | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Investment Tax Credit | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Beginning Date | MM/YYYY | MM/YYYY | MM/YYYY | MM/YYYY | MM/YYYY |
| Beginning YTD | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Beginning Accum | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Depreciation Calculations | | | | | |
| Current Through Date | 12/2010 | 12/2010 | 12/2010 | 12/2010 | 12/2010 |
| 168 Allowance Amount | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Current YTD | \$0.00 | \$76.20 | \$76.20 | \$0.00 | \$65.48 |
| Current Accum | \$0.00 | \$245.11 | \$245.11 | \$0.00 | \$195.49 |
| Net Book Value | \$0.00 | \$190.48 | \$190.48 | \$0.00 | \$240.10 |
| Period Close Date | MM/YYYY | MM/YYYY | MM/YYYY | MM/YYYY | MM/YYYY |
| Period Close YTD | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |
| Period Close Accum | \$0.00 | \$0.00 | \$0.00 | \$0.00 | \$0.00 |

A-1

~~Abendroth Water Conditioning, Inc.~~

Depreciation - Softeners & Coolers ←

December 31, 2007

| <u>COST</u> | <i>Financial Reporting</i> BOOKS | FED TAX | STATE | FED AMT | STATE AMT |
|----------------------------------|-------------------------------------|-------------------|-------------------|-------------------|-------------------|
| Total - Beginning of Year | 594,505.33 | 594,505.33 | 594,505.33 | 594,505.33 | 594,505.33 |
| Additions | 111,701.53 | 111,701.53 | 111,701.53 | 111,701.53 | 111,701.53 |
| Disposals | (49,708.66) | (49,708.66) | (49,708.66) | (49,708.66) | (49,708.66) |
| Total - End of Year | <u>656,498.20</u> | <u>656,498.20</u> | <u>656,498.20</u> | <u>656,498.20</u> | <u>656,498.20</u> |
| <u>ACCUMULATED DEPN</u> | | | | | |
| Total - Beginning of Year | | | | | |
| -Regular | 429,721.34 | 311,644.75 | 379,269.56 | 306,706.16 | 353,585.18 |
| -IRC 179/30%-50% Allowance | - | 227,859.03 | 74,298.29 | 227,859.13 | 74,298.29 |
| <u>Current Year Depreciation</u> | | | | | |
| -Regular | 62,454.99 | 19,938.65 | 53,500.73 | 20,695.36 | 51,891.10 |
| -IRC 179 | - | 79,111.31 | 17,700.00 | 79,111.31 | 17,700.00 |
| -IRC 30%-50% Allowance | - | - | - | - | - |
| <u>Disposals</u> | | | | | |
| -Regular | (19,105.78) | (14,231.90) | (16,279.94) | (13,873.38) | (15,384.05) |
| -IRC 179/30%-50% Allowance | - | (9,128.32) | (5,169.84) | (9,128.32) | (5,169.84) |
| Adjustments | | | | | |
| Total - End of Year | <u>473,070.55</u> | <u>615,193.52</u> | <u>503,318.80</u> | <u>611,370.26</u> | <u>476,920.68</u> |
| Recap: | | | | | |
| Regular | 473,070.55 | 317,351.50 | 416,490.35 | 313,528.14 | 390,092.23 |
| IRC 179/30% Allowance | - | 297,842.02 | 86,828.45 | 297,842.12 | 86,828.45 |
| Total - End of Year | <u>473,070.55</u> | <u>615,193.52</u> | <u>503,318.80</u> | <u>611,370.26</u> | <u>476,920.68</u> |

~~Abendrom Water Conditioning, Inc.~~
Depreciation - Property, Equipment and Softeners
December 31, 2007

← *Combined with other assets*

| <u>COST</u> | <i>Financial Reporting</i> <u>BOOKS</u> | <u>FED TAX</u> | <u>WIS TAX</u> | <u>FED AMT</u> | <u>STATE AMT</u> |
|-----------------------------|--|---------------------|---------------------|---------------------|---------------------|
| Total - Beginning of Year | 1,027,232.69 | 1,027,232.69 | 1,027,232.69 | 1,027,232.69 | 1,027,232.69 |
| Additions | 121,114.75 | 121,114.75 | 121,114.75 | 121,114.75 | 121,114.75 |
| Disposals | (52,555.44) | (52,555.44) | (52,555.44) | (52,555.44) | (52,555.44) |
| | | | | | |
| Total - End of Year | <u>1,095,792.00</u> | <u>1,095,792.00</u> | <u>1,095,792.00</u> | <u>1,095,792.00</u> | <u>1,095,792.00</u> |
| <u>ACCUMULATED DEPN</u> | | | | | |
| Total - Beginning of Year | | | | | |
| -Regular | 752,758.62 | 592,439.32 | 694,175.03 | 584,657.14 | 658,600.03 |
| -IRC 179/30% Allowance | - | 294,731.41 | 81,836.10 | 294,731.51 | 81,836.10 |
| Current Year Depreciation | - | | | | |
| -Regular | 93,979.23 | 43,335.67 | 84,414.92 | 44,209.05 | 84,047.70 |
| -IRC 179 | - | 86,411.31 | 25,000.00 | 86,411.31 | 25,000.00 |
| -30% Allowance | - | - | - | - | - |
| Disposals | - | | | | |
| -Regular | (21,952.56) | (17,078.68) | (19,126.72) | (16,720.16) | (18,230.83) |
| -IRC 179/30% Allowance | - | (9,128.32) | (5,169.84) | (9,128.32) | (5,169.84) |
| Adjustments | - | | | | |
| Total - End of Year | <u>824,785.29</u> | <u>990,710.71</u> | <u>861,129.49</u> | <u>984,160.53</u> | <u>826,083.16</u> |
| Recap: | | | | | |
| Regular | 824,785.29 | 618,696.31 | 759,463.23 | 612,146.03 | 724,416.90 |
| IRC 179/30% Allowance | - | 372,014.40 | 101,666.26 | 372,014.50 | 101,666.26 |
| Total - End of Year | <u>824,785.29</u> | <u>990,710.71</u> | <u>861,129.49</u> | <u>984,160.53</u> | <u>826,083.16</u> |

Annual Projection Report

Projection for 10 Fiscal Years Beginning 01/01/2008 ~~2008~~ 2014

| Mo Year | Fed Tax YTD Depreciation | Books Internal YTD Depreciation | WI State YTD Depreciation | AMT YTD Depreciation | WI AMT YTD Depreciation |
|--------------------|-----------------------------|---------------------------------------|------------------------------|-------------------------|----------------------------|
| Class = S | | | | | |
| Dec 2008 | \$ 14,698.28 | \$ 56,424.46 | \$ 47,779.26 | \$ 14,085.51 | \$ 47,107.99 |
| Dec 2009 | 10,042.88 | 40,387.99 | 34,212.75 | 10,230.41 | 38,266.81 |
| Dec 2010 | 6,730.66 | 30,266.48 | 25,503.82 | 7,717.05 | 31,506.17 |
| Dec 2011 | 4,470.01 | 23,588.19 | 19,457.52 | 5,812.47 | 26,704.89 |
| Dec 2012 | 2,969.31 | 17,641.12 | 14,126.00 | 4,075.02 | 19,387.28 |
| Dec 2013 | 1,612.11 | 10,688.29 | 8,448.62 | 2,212.75 | 11,596.21 |
| Dec 2014 | 444.80 | 3,974.79 | 3,184.95 | 610.58 | 4,371.72 |
| Dec 2015 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2016 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2017 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Class = S | \$ 40,968.05 | \$ 182,971.32 | \$ 152,712.92 | \$ 44,743.79 | \$ 178,941.07 |
| Class = WC | | | | | |
| Dec 2008 | \$ 244.75 | \$ 312.86 | \$ 312.86 | \$ 292.27 | \$ 429.42 |
| Dec 2009 | 66.10 | 112.24 | 112.24 | 66.10 | 154.01 |
| Dec 2010 | 15.60 | 31.20 | 31.20 | 15.60 | 42.84 |
| Dec 2011 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2012 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2013 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2014 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2015 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2016 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Dec 2017 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Class = WC | \$ 326.45 | \$ 456.30 | \$ 456.30 | \$ 373.97 | \$ 626.27 |
| Grand Total | \$ 41,294.50 | \$ 183,427.62 | \$ 153,169.22 | \$ 45,117.76 | \$ 179,567.34 |

Report Assumptions

Report Name: Annual Projection
Source Report: <Standard Report>

Calculation Assumptions:
Include Sec 168(k) Allowance & Sec 179: No

Group/Sorting Criteria:
Group = Active Assets
Include Assets that meet the following conditions:
Activity is currently A,D,F,J,K,L,M,N
Sorted by: Class (with subtotals), FYE Month & Year

→ 41,294.50 → 45,117.76

\$ 111,874.72

\$ 134,449.58

20% 22,375.00

26,889.92

per year subtract
mod. starting in
2014

per year subtract
mod. for WI Minimum Tax
starting in 2014