SALT Alert! 2018-17: Wisconsin: Elective Pass-through Entity Tax Scheme Enacted

Senate Bill 883, which was signed into law in Wisconsin on December 14, 2018, allows entities treated as partnerships for federal income tax purposes, plus S Corporations (generally referred to as “tax-option corporations” by Wisconsin) to elect to pay tax at the entity level. Specifically, if consent is obtained from the persons who hold more than 50 percent of the capital and profits of a partnership or shares of an S Corporation, then the partnership or S Corporation may elect to be taxed at the entity level at a rate of 7.9 percent of net income reportable to Wisconsin. Notably, this rate is higher than the top marginal individual income tax rate of 7.65 percent. The election must be made annually on or before the due date, or the extended due date if applicable, of the entity’s return. If the owners decide to revoke an election, that must also occur on or before the due date, or the extended due date if applicable, of the entity’s return.

The general effect of making the election is that the income is taxed at the entity level and is not taxed again at the individual level, as the individual owners will be allowed a subtraction from Wisconsin adjusted gross income for the owner’s share of income or gain from the partnership or S Corporation. Also, a particular owner who receives a loss or deduction allocation from the partnership or S Corporation would need to add back these amounts.

If the election is made, the following apply:

1. The net income of the partnership is computed under the existing rules that apply to the computation of the net income of a partnership under Wis. Stat. §71.21(1) through (5). The situs of income shall be determined as if the election had not been made.
2. The partnership will continue to not claim a net operating loss under Wis. Stat. §71.05 (8).
3. Tax credits may not be claimed by the partnership, other than the new provision for the partnership or S Corporation to get a credit for taxes paid to other states.
4. The adjusted basis of a partner's interest in the partnership is determined as if the election had not been made.
5. The provisions of Wisconsin law relating to estimated payments and underpayment interest apply to the partnership.
6. If the partnership fails to pay the Department the amount it owes with respect to its income as a result of the election, the Department may collect the amount due from the partners in proportion to their share of such income.

The election is available for taxable years beginning on January 1, 2019 and Senate Bill 883 expressly notes that the Department of Revenue may promulgate regulations to implement the new law. Provisions similar to those discussed above also apply to S Corporations. For S Corporations only, the election is available for taxable years beginning on January 1, 2018. An electing partnership or S Corporation is exempt from nonresident owner withholding, as otherwise required under Wis. Stat. § 71.775.

Wis. Stat. §71.07, which addresses the “other state tax credit,” has been revised to adopt a new provision stating that if a partnership or S Corporation makes the election, the electing entity may take a credit for taxes paid to other states. The amount of this credit equals the net income or franchise tax paid by the entity to another state on that same income, plus the net income tax on that same income that was paid by the entity to another state for a composite return on behalf of the entity’s owners who are residents of Wisconsin.

This credit will not be allowed unless the income taxed by the other state is also considered income for Wisconsin tax purposes and is attributable to amounts that would have been reported to Wisconsin by owners of the partnership or S Corporation if the election had not been made. Other than for income taxed by states that border Wisconsin, the entity’s credit for taxes paid may not exceed an amount equal to 7.9 percent multiplied by the income subject to tax in another state that is also subject to tax in Wisconsin.

Please contact Brad Wilhelmson with questions.