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May 8, 2017

Wisconsin Legislature
Assembly Committee on Ways and Means

Via E-mail

Re: COST's Support for Assembly Bill 259

Dear Chair Macco, Vice-Chair Katsma, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing in support of Assembly Bill 259, which would continue the work of the Wisconsin State Legislature in improving the fairness of the State's tax administration. COST is a nonprofit trade association consisting of approximately 600 multistate corporations engaged in interstate and international business. COST's objective is to preserve and promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Important Taxpayer Fairness Reform Enacted in 2016

COST recognizes the achievements of the Wisconsin State Legislature last year in addressing a taxpayer fairness issue identified in COST's State Tax Administration "Scorecard." As enacted, 2016 S.B. 503 requires the Department of Revenue to issue a summons, and for the taxpayer to fail to comply with the summons in good faith, before the Department may impose penalties for failure to produce records and documents during an audit. Before this change, the Department's regulations allowed for penalties to be imposed even when the taxpayer timely responded to the Department's records request if the Department deemed the response insufficient. This change was an important recognition that the taxpayer is at a disadvantage when required to clear a higher hurdle than the Department or is penalized at the Department's discretion.

Leveling the Playing Field on "Economic Substance"

Assembly Bill 259 would likewise address a fairness issue by moving toward a level playing field for taxpayers required to defend the economic substance of legitimate business transactions. This issue was included in last year's reform legislation, but was not enacted. Existing law creates a presumption that any intercompany transaction – essentially any business conducted within the corporate group – lacks economic substance, and the taxpayer bears the burden of proving otherwise by clear and convincing evidence. This blanket presumption has no regard for legitimate

transactions and places businesses at a significant disadvantage in defending normal business arrangements.

While Assembly Bill 259 leaves the presumption in place, it changes the burden of proof to a “preponderance of the evidence” standard. In practice, the taxpayer would still be required to provide evidence establishing economic substance for those intercompany transactions challenged by the Department’s auditor – a common audit situation. However, by changing the burden from clear and convincing evidence, the taxpayer would be placed on a more equal footing when the Department requires it to show that its intercompany transactions possess economic substance.

The Department’s Fiscal Estimate acknowledges that the revenue impact of this change is unknown, but presumes without support that the change would result in a loss. On the contrary, providing a more even-handed evidentiary standard could streamline audits and appeals, result in more settlements and accelerate resulting payments to the State. Further, the Department believes that the change “will increase the Department’s administrative expenses,” although fewer disputes could result in less, not more, administrative cost to the State. Puzzlingly, the Department states that the “preponderance of the evidence” standard is “less clear” than a “clear and convincing evidence” standard. The fact that “clear” is in the current statutory language does not make the application of the statute any clearer. Arguably, a greater weight of the evidence, or preponderance, test is clearer than determining what constitutes a level of clear and convincing evidence.

Taxpayer Reliance on DOR Audits

Taxpayers should be able to rely on the results on Department audits. Current law provides such protections, but allows exceptions where the taxpayer did not “give the department employee adequate and accurate information” or if the issue was settled in the prior audit determination. The adequacy and accuracy of information provided by the taxpayer should be determined during the audit – that is the function of audit procedures and the duty of the Department. Of course, intentionally misleading or fraudulent conduct by taxpayers should not be excused, and in fact is punishable under Wisconsin law. Likewise, the Department is free to assess tax based on available information if the taxpayer fails to provide adequate information, and as noted above, the Department can issue summons and impose penalties on uncooperative taxpayers. Moreover, the Department may issue an estimated assessment if a taxpayer fails to provide information needed for the Department to audit the taxpayer.

COST believes the Department’s representation in its Fiscal Estimate that this change would enable taxpayers to “conceal or misrepresent” relevant tax information is entirely outside the scope of the proposed change, and this concern is addressed in current law. In fact, with this amendment the statute will largely codify case law on reasonable reliance that has existed for decades. Contrary to the fiscal note, this change should not impact taxpayer compliance with the Department’s audit activities; rather, it should shield taxpayers from the Department questioning prior audit conclusions, including whether the Department had enough information and whether the Department conducted the audit effectively to determine the accuracy of that information. Likewise, settlements reflect agreements between taxpayers and the Department on which taxpayers should be able to rely. Rather than reduce taxpayer compliance, establishing settled expectations enhances taxpayer compliance and streamlines audits.

Thank you for the opportunity to provide this Committee with COST's rationale supporting Assembly Bill 259. I welcome any questions or requests for information I can provide the Committee to aid in its consideration of this measure.

Respectfully,

A handwritten signature in black ink, appearing to read 'F. Hogroian', with a large, sweeping flourish extending to the right.

Ferdinand Hogroian

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director