Testimony before the Steering Committee for Symposia Series on State Income Tax

Richard J. Kollauf, JD, CPA

Director, Vogel Consulting Group, S.C.

Member, WICPA Wisconsin Taxation Committee

October 18, 2012

Good morning Chairperson Vos and members of the Steering Committee for the Symposia Series on State Income Tax. Thank you for the opportunity to testify this morning regarding recommendations for potential changes to the Wisconsin income tax code that you might include in your Committee report.

My name is Rick Kollauf and am licensed in Wisconsin as both an attorney and CPA. As a Client Services Director at Vogel Consulting, in Brookfield, Wisconsin, I serve many individual and business clients' tax, accounting, finance, investment, and succession needs. Previously, I served as a CFO and General Counsel to a long-established Milwaukee business and its family. I began my career as a CPA with a "Big-8" CPA firm. I am a member of the Wisconsin Institute of CPAs and sit on the Wisconsin Taxation Committee, and American Institute of CPAs. I am also a member of the Wisconsin State Bar and a director of the Wisconsin State Bar Taxation Section Board, and a member of the American Bar Association.

My colleague, Hank Jasper, has provided the foundation for my testimony, which will be anecdotal in nature and support the propositions laid out by Hank.

1. **Follow model tax law guidelines**
    a. Client Example: Moving Away From The Uniform Division Of Income Tax Purposes Act (UDITPA) Provisions

    One of my clients recently reviewed the Wisconsin treatment of taxation on services and intangibles. UDITPA was adopted in 1957 by the National Conference of Commissioners on Uniform Sate Laws and used a three factor formula for apportionment (sales, payroll, and assets). Subsequently, as states more closely aligned the formula for their economic development purposes the sales factor became double weighted. The alignment shifted more of the tax burden on out-of-state companies that used the state as a market rather than as a location for production and jobs. As to service businesses or those that derive their income from intangibles, receipts were sourced to the primary place where cost of performance was incurred (i.e. the state where the property or employees are based). Wisconsin has since further modified this UDITPA approach by changing is sourcing regime to more of a market-based approach for services and intangibles income (i.e. based on where the services are received or performed, or where the intangible property is used). The "unintended" consequence in trying to shift the state tax burden to more out-of-state companies in this

regard has been to dissuade companies from even doing business in Wisconsin or taking the focus of their market to businesses not located in Wisconsin. The reason – Wisconsin's individual tax rates (i.e. tax imposed for the purposes of pass-through entities and its corporate tax rates are among the highest in the nation). So, what was an attempt to shift tax burden, indirectly is preventing additional business from being transacted in Wisconsin. Consequently, Wisconsin's approach, while taken up in a few other states, is genuinely different from the majority of state where UDITPA was adopted. There are other Wisconsin differences from UDITPA (i.e. the inapplicability of the sales "throwback" rule to foreign destination sales). Not following model tax laws makes WI stand out in ways that can hinder production and jobs growth.

2. **Conform to federal tax law to the fullest extent possible**
   a. Client Example: Depreciation Variation

      Many if not most of my clients have to keep book depreciation for GAAP purposes, tax depreciation for federal and AMT purposes and state tax depreciation for Wisconsin and WI AMT purposes and if applicable ACE depreciation. Moreover, as four to six sets of depreciation books are required to be kept, four to six versions of gain/loss reporting is required on assets disposed of that are not fully depreciated. In addition, if the activities for which depreciation is being reported differently between federal and Wisconsin are passive activities, further passive loss accounting is required to calculate and allocate these differences across all the taxpayer's passive activities with losses. This is an unreasonable compliance burden and one that has actually swayed the decision making process to repair rather than buy new equipment, thus preventing jobs growth of the potential equipment vendors.

   b. Client Example: "Usury-like" Interest Rates

      At a time when "real-life" interest rates are at an all time low, Wisconsin is charging 18% per year on delinquent taxes (in addition to other penalty charges), <u>even though</u> some delinquencies may be by honest mistake (the rate is 12% if a taxpayer volunteers to pay additional tax on a discovered deficiency). The federal government uses a "real-life" indexed approach and one Wisconsin should consider.

3. **Apply laws consistently without regard to the entity type**
   a. Client Example: Angel Investment Tax Credit

      A successful company in operating as an S corporation wanted to help other fledgling businesses but was unable to take advantage of the Angel Investment Tax Credit so certain investments were not made, thus hindering job creation in Wisconsin. However, other pass-through entities such as partnerships and LLCs are allowed to take advantage of the credit and pass it through to their member owners for use on their individual returns.

4. **Reduce taxes to encourage economic growth**
    a. Client Example: Wisconsin Continues To Be Near The Top Of The Country In Tax Rates

    Many businesses are operating in a pass-through entity structure, meaning their tax is based on the individual tax rates of their owners. In Wisconsin, this burden is further exacerbated by the state's high tax rates. Even corporations that operate in Wisconsin face higher tax rates than in most other states. I have witnessed, first hand, annual business plans deleting growth options because the owner's understanding of their current tax expense creates a lack of a desire to grow. I often hear: "We can only eat so much steak, why should we further build this business if so much more is to go out in taxes." This is a direct jobs loss scenario.

5. **Simplify tax deductions and credits to reduce compliance costs**
    a. Client Example: Extraordinary Number Of Addition And Subtraction Modifications And Tax Credit Offerings To Track

    The current number of addition and subtraction modifications to Wisconsin income, and number of available credits requires an inordinate amount of taxpayer compliance time in keeping up with the differences, accounting for the differences, reporting the differences, and defending the differences reported during review or audit. On the flip side, the Department has an equally large time commitment requirement and burden, thereby increasing costs while not necessarily increasing tax revenue on a statewide basis. Perhaps some movement to a "flat" tax should be reviewed making the state budgeting process and compliance process easier and the whole system more equitable. In addition, the double taxation of an entity simply because it is a subchapter C corporation is archaic with all the types of and movements to pass-through entity forms of doing business.
        i. Client specific example: My clients' decision making process of investing in start-up businesses is actually swayed by the Angel/VC credits offered in Wisconsin though the many and varied types of these credits are not so determinative. Often credits are used because they are just available, not necessarily entering into a decision making process on the frontend. The R&D credit used to be a frontend impacting credit but with the burden on compliance and the interpretations of what qualifies; many clients who actually qualify for the credit don't even account for or claim the credit (especially small to medium sized businesses).

6. **Review current administrative tax rules to revise or eliminate those that impose an unreasonable burden on taxpayers**
    a. Client Example: Current Administrative Rules Not Always Updated

    The current combined reporting forms are not columnar and not intuitively reviewable with separate entity forms.

As a final side note – I understand this committee is charged with income tax code revision. Income taxes are assessed individually and to corporations. Remember that much business activity is conducted through the operations of pass-through entities; however, regular corporations still comprise a signification tax revenue source. I also understand this committee may not be prepared to enter into the arena of corporate taxation for fear of whatever... That being said, the taxation of the citizens of Wisconsin (individual or otherwise) needs to be tackled as a whole as one piece fits with the other and both pieces present economic growth opportunities that fuel the state revenue stream. The disproportionate excess individual tax to corporate tax filings inherently dictates that some leveling-out of the taxation policies amongst individual and corporate taxation be reviewed.

I would be pleased to answer any questions at this time, later in this meeting, or as they arise. My contact information appears below:

Richard J. Kollauf, JD, CPA | Director of Business & Taxation
Vogel Consulting | 3415 Gateway Road | Brookfield WI 53045
262.790.4884 direct | 262.790.4960 general | 262.408.0618 mobile | 262.790.4990 fax
rickk@vogelcg.com | www.vogelcg.com