

STATE OF WISCONSIN
TAX APPEALS COMMISSION

MACKINNEY SYSTEMS, INC.,

DOCKET NO. 20-W-222

Petitioner,

v.

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

RULING & ORDER

ELIZABETH KESSLER, CHAIR:

This case comes before the Commission for decision on competing Motions for Summary Judgment. The Petitioner, MacKinney Systems, Inc., with headquarters located in Springfield, Missouri, appears by Stephen MacKinney, Board Chairman and CEO. The Respondent, the Wisconsin Department of Revenue (“the Department”), is represented by Attorney Mark Zimmer and Chief Counsel Dana Erlandsen. Both parties have filed with the Commission briefs and documents in support of their respective positions. For the reasons stated below, we find for the Respondent.

FACTS

Jurisdictional Facts

1. On January 7, 2020, Respondent issued a pass-through withholding assessment against Petitioner, covering tax years 2015-2018 ("Audit Period"). (Joint Stipulation of Facts ("Stip."), Ex. 2).
2. On January 28, 2020, Petitioner timely appealed the Notice of Assessment by filing a Petition for Redetermination. (Stip., Ex. 3).
3. On September 15, 2020, Respondent timely denied the Petition for Redetermination in a Notice of Action. (Stip., Ex. 4).
4. On November 16, 2020, Petitioner filed a timely Petition for Review with the Commission. (Commission file).

Material Facts

5. MacKinney Systems, Inc. ("MacKinney") is a corporation formed under the laws of the State of Missouri, with its headquarters located in Springfield, Missouri. (Stip. ¶ 1).
6. MacKinney is a Subchapter S corporation for federal tax purposes and is a pass-through entity for tax purposes. (Stip. ¶ 2).
7. All of the shareholders of MacKinney are nonresidents of Wisconsin. (Stip. ¶ 3).
8. All of the employees of MacKinney are residents of Missouri. (Stip. ¶ 4).

9. MacKinney is in the business of licensing computer software for use on mainframe computers to business end users located throughout the United States, including Wisconsin. (Stip. ¶ 6).

10. MacKinney software is prewritten computer software and is not customized for its customers. (Stip. ¶ 9).

11. MacKinney software was delivered to customers via electronic download over the internet. (Stip. ¶ 10).

12. MacKinney software is generally licensed on an annual basis, but some of its software licenses are multi-year, and others are permanent licenses. (Stip. ¶ 8).

13. MacKinney software licenses include maintenance, with 24/7 technical support, new releases, enhancements, and fixes to the software at no additional cost to the customer. (Stip. ¶ 11).

14. All support and maintenance of MacKinney software is conducted from the MacKinney offices in Missouri. (Stip. ¶ 12).

15. During each year of the Audit Period, Petitioner had customers who licensed MacKinney software for use in Wisconsin. (Stip. ¶ 14).

16. During the Audit Period, MacKinney received total payments from customers as follows for MacKinney software used in Wisconsin (Stip. ¶ 15):

2015: \$129,393
2016: \$119,310
2017: \$123,509
2018: \$105,785

17. MacKinney did not file pass-through withholding tax returns with the State of Wisconsin for any year during the Audit Period. (Stip. ¶ 19).

18. MacKinney did not file income tax returns with the State of Wisconsin for any year during the Audit Period. (Stip. ¶ 18).

19. MacKinney did not pay any pass-through withholding taxes to the State of Wisconsin for any year during the Audit Period. (Stip. ¶ 20).

20. MacKinney files annual income tax returns with the State of Missouri. (Stip. ¶ 17).

21. The Department revised the assessments against Petitioner during the Audit Period. As of March 15, 2021, the assessments and statutory interest for each year in the Audit Period were:

2015: Tax \$1,745, Interest \$1,047;
2016: Tax \$1,538, Interest \$738;
2017: Tax \$1,581, Interest \$569;
2018: Tax \$1,543, Interest \$370;
Total: Tax \$6,407, Interest \$2,724.

(Stip., ¶ 25).

APPLICABLE LAW

Summary Judgment

A motion for summary judgment will be granted if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. Wis. Stat. § 802.08(2). In this case, both parties filed Motions for Summary Judgment along with a Joint Stipulation of Facts.

Summary judgment is thus appropriate. *Healthcare Services Group, Inc. v. Wisconsin Dept. of Revenue*, Wis. Tax Rptr. (CCH) ¶ 402-086 (WTAC 2016).

*Federal Law*¹

15 U.S.C. § 381, also known as P.L. 86-272:

(a) Minimum standards. No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

- (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
- (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Wisconsin Statutes

Wis. Stat. § 71.22(1r): "Doing business in this state" includes, except as prohibited under P.L. 86-272, issuing credit, debit, or travel and entertainment cards to customers in this state; regularly selling products or services of any kind or nature to customers in this state that receive the product or service in this state; regularly soliciting business from potential customers in this state; regularly performing services outside this state for which the benefits are received in this state; regularly engaging in transactions with customers in this state that involve intangible property and result in receipts flowing to the taxpayer from within this state; holding loans secured by real or tangible personal property located in this state; owning, directly or indirectly, a general or limited

¹ The original version of this decision contained an erroneous header.

partnership interest in a partnership that does business in this state, regardless of the percentage of ownership; and owning, directly or indirectly, an interest in a limited liability company that does business in this state, regardless of the percentage of ownership, if the limited liability company is treated as a partnership for federal income tax purposes. A taxpayer doing business in this state for any part of the taxable year is considered to be doing business in this state for the entire taxable year.

Wis. Stat. § 71.775(4)(a), effective through December 31, 2015.²

(a) Each pass-through entity that is subject to the withholding under sub. (2) shall file an annual return that indicates the withholding amount paid to the state during the pass-through entity's taxable year. The entity shall file the return with the department no later than:

1. For tax-option corporations, the 15th day of the 3rd month following the close of the taxable year.
2. For partnerships, limited liability companies, estates, and trusts, the 15th day of the 4th month following the close of the taxable year.

Wis. Stat. § 71.775(4)(a), effective January 1, 2016, forward:

(4) Administration.

(a) Each pass-through entity that is subject to the withholding under sub. (2) shall file an annual return that indicates the withholding amount paid to the state during the pass-through entity's taxable year. The pass-through entity shall file the return with the department on or before the date on which the pass-through entity is required to file for federal income tax purposes, not including any extension, under the Internal Revenue Code.

Wis. Stat. § 71.775(4)(bn). If a pass-through entity subject to withholding tax under sub. (2) does not file the return under par. (a) on or before the extension date provided in par. (bn), the pass-through entity is liable for the penalty provided in s.

²Amended by 2017 Wis. Act 2, §§ 7-9, to renumber and amend the intro as (4)(a) and repealing subsections (4)(a)1. and (4)(a)2. The operative effect of the change in this Act was merely to make the filing deadlines conform to the equivalent federal filing deadlines and did not affect the tax liability. This change was retroactive to taxable years beginning on January 1, 2016, pursuant to 2017 Wis. Act 2, § 13(1).

71.83 (1), in addition to any unpaid tax, interest, and penalty otherwise assessable to a nonresident partner, member, shareholder, or beneficiary on income from the pass-through entity.

ANALYSIS

The fundamental question before the Commission is whether or not Petitioner, a Missouri Subchapter S corporation which licenses software to customers in Wisconsin and provides maintenance services for that software, is subject to the Wisconsin pass-through withholding tax. Partnerships and Subchapter S corporations are considered "pass-through entities" and are not generally subject to Wisconsin income or franchise taxes. However, "[f]or the privilege of doing business in this state or deriving income from property located in this state, a pass-through entity that has Wisconsin income for the taxable year that is allocable to a nonresident partner, member, shareholder, or beneficiary shall pay a withholding tax." Wis. Stat. § 71.775(2)(a). In addition, the pass-through entity must file an annual return pursuant to Wis. Stat. § 71.775(4)(a).

Petitioner argues, "Even though the Appeal is related to Withholding Tax, we are basing our appeal on the Franchise/Income tax." (Pet. Mtn. for Summary Judgment) Asserting that a withholding tax is based on an income tax, Petitioner then turns to federal law to claim that Wisconsin cannot charge income tax for sales on an out of state corporation that lacks a physical presence in the state. (*Id.*) There is no appeal of a franchise tax or an income tax that is ripe for appeal in this matter. The sole matter over which the Commission has jurisdiction, concerning this Petitioner, is the timely filed

Petition for Review of the Department's pass-through withholding assessment and subsequent Notice of Action.

Income/Franchise Tax

Much of Petitioner's argument is based on a 2015 document titled "Informational Paper 5" published by the Wisconsin Legislative Fiscal Bureau. In its introduction, Informational Paper 5 explains:

This paper provides general information regarding the Wisconsin corporate income/franchise tax. Included in the paper are a general rationale for the tax, a description of the method by which the tax is applied to corporations, and summary and comparative data about the tax.

This general information may be useful in obtaining an overview of such taxes in Wisconsin, but it is not the law. However, it does specifically note that corporations like MacKinney, S corporations, are not subject to corporate income/franchise taxes, because they "generally have corporate net income attributed to their shareholders who are taxed under the individual income tax." (Info. Paper 5, p. 2). MacKinney, as a business entity, is not subject to Wisconsin income/franchise tax. The question of whether or not Petitioner's shareholders will owe taxes or have the withheld tax revenue refunded is not yet ripe and is not the subject of this appeal. The fundamental issue in dispute here stems from misunderstanding of the difference between an income tax and a withholding tax.

Withholding Tax

The question of whether or not any shareholder in MacKinney Systems owes income tax to the State of Wisconsin is not on appeal. While Wisconsin's

withholding tax requirement presumes that at least some non-resident owners of businesses that earn income in Wisconsin will owe income to this state, it does not mean that any specific individual or business entity owes income tax. Residents and non-residents that earn income in Wisconsin must file income tax returns, and if more money has been withheld than is owed by a taxpayer, that taxpayer is entitled to a refund.

MacKinney Systems has stipulated that it is a pass-through entity for tax purposes. Under Wis. Stat. § 71.775(2)(a) "For the privilege of doing business in this state or deriving income from property located in this state, a pass-through entity that has Wisconsin income for the taxable year that is allocable to a nonresident partner, member, shareholder, or beneficiary shall pay a withholding tax."

Doing business in this state includes "regularly selling products or services of any kind or nature to customers in this state that receive the product or service in this state...." Wis. Stat. § 71.22(1r). Petitioner has stipulated to receiving payments, annually totaling more than \$100,000, for its software used in Wisconsin in each of the years at issue. The software licenses include both prewritten software and technical support, new releases, enhancements, and fixes to the software. Although the software and services are provided remotely, the Petitioner's customers in this state receive the product and any associated services in this state. This falls squarely under the definition of "doing business in this state."

CONCLUSIONS OF LAW

In applying Wisconsin law to the facts before us in this matter, we find that there is no dispute that the shareholders of the Petitioner are nonresidents of Wisconsin.

We find that Petitioner is a pass-through entity doing business in Wisconsin. Therefore, Petitioner is subject to withholding tax in the State of Wisconsin.

ORDER

Based on the foregoing, it is the order of this Commission that the Petitioner's Motion for Summary Judgment is denied, and Respondent's Motion for Summary Judgment is granted as we affirm the assessment.

Dated at Madison, Wisconsin, this 16th day of March, 2022.

WISCONSIN TAX APPEALS COMMISSION



Elizabeth Kessler, Chair



Lorna Hemp Boll, Commissioner



Jessica Roulette, Commissioner

ATTACHMENT: NOTICE OF APPEAL INFORMATION

WISCONSIN TAX APPEALS COMMISSION
5005 University Avenue - Suite 110
Madison, Wisconsin 53705

NOTICE OF APPEAL INFORMATION

NOTICE OF RIGHTS FOR REHEARING, OR JUDICIAL REVIEW, THE TIMES ALLOWED FOR EACH, AND THE IDENTIFICATION OF THE PARTY TO BE NAMED AS RESPONDENT

A taxpayer has two options after receiving a Commission final decision:

Option 1: PETITION FOR REHEARING BEFORE THE COMMISSION

The taxpayer has a right to petition for a rehearing of a final decision within 20 days of the service of this decision, as provided in Wis. Stat. § 227.49. The 20-day period commences the day after personal service on the taxpayer or on the date the Commission issued its original decision to the taxpayer. The petition for rehearing should be filed with the Tax Appeals Commission and served upon the other party (which usually is the Department of Revenue). The Petition for Rehearing can be served either in-person, by USPS, or by courier; however, the filing must arrive at the Commission within the 20-day timeframe of the order to be accepted. Alternately, the taxpayer can appeal this decision directly to circuit court through the filing of a petition for judicial review. It is not necessary to petition for a rehearing first.

AND/OR

Option 2: PETITION FOR JUDICIAL REVIEW

Wis. Stat. § 227.53 provides for judicial review of a final decision. Several points about starting a case:

1. The petition must be filed in the appropriate county circuit court and served upon the Tax Appeal Commission and the other party (which usually is the Department of Revenue) either in-person, by certified mail, or by courier, within 30 days of this decision if there has been no petition for rehearing or, within 30 days of service of the order that decides a timely petition for rehearing.
2. If a party files a late petition for rehearing, the 30-day period for judicial review starts on the date the Commission issued its original decision to the taxpayer.
3. The 30-day period starts the day after personal service, or the day we mail the decision.
4. The petition for judicial review should name the other party (which is usually the Department of Revenue) as the Respondent, but not the Commission, which is not a party.

For more information about the other requirements for commencing an appeal to the circuit court, you may wish to contact the clerk of the appropriate circuit court or, the Wisconsin Statutes. The website for the courts is <https://wicourts.gov>.

This notice is part of the decision and incorporated therein.