

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those given herein, the answers may not apply. Unless otherwise indicated, Tax Releases apply for all periods open to adjustment. All references to section numbers are to the Wisconsin Statutes unless otherwise noted.)

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INDIVIDUAL INCOME TAXES

1. Amount of Estimated Tax Payments—Part-Year Residents

Statutes: Section 71.09(13), Wis. Stats. (1987-88)

Background: Estimated tax payments are generally required whenever the amount of estimated net tax for the year will exceed the amount of tax withheld from wages, pensions, etc., by \$200 or more.

The amount of estimated tax must generally be paid in four equal installments. Section 71.09(13)(a), Wis. Stats. (1987-88), requires

that the amount of each installment payment shall be 25% of the lower of the following amounts:

- (A) Ninety percent of the tax shown on the Wisconsin return for the taxable year or, if no return is filed, 90% of the tax for the taxable year.
- (B) The tax shown on the Wisconsin return for the preceding year.

A taxpayer cannot base the amount of each installment payment on the tax shown on the Wisconsin return for the preceding year if the preceding taxable year was less than 12 months. Sec. 71.09(13)(b), Wis. Stats. (1987-88).

Facts and Question: A person is a part-year resident of Wisconsin (i.e., domiciled in Wisconsin for only a part of the tax year) for 1989. He or she files a 1989 Wisconsin Form 1NPR (return for nonresidents and part-year residents) which shows a net tax of \$400. For 1990, this person expects to have a Wisconsin net tax of \$2,000, and no portion of his or her income is subject to withholding. Is this person required to make Wisconsin estimated tax payments of \$1,800 (90% of the 1990 tax) or \$400 (tax shown on the Wisconsin return for the preceding year)?

Answer: A person who was a part-year resident of Wisconsin for the preceding year and filed a Wisconsin income tax return for such year qualifies to base current year estimated tax payments on the tax shown on the Wisconsin return for the preceding year. A part-year resident's return covers the entire 12-month taxable year, even though he or she is not domiciled in Wisconsin during all 12 months of that taxable year. Thus, the person described above is required to make Wisconsin estimated tax payments for 1990 of \$400 (\$100 for each of the four installments).

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2. Election of Internal Revenue Code Section 911, Foreign Earned Income and/or Housing Costs

Statutes: Section 71.01(6), Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to taxable years 1986 and thereafter.

Background: Section 911 of the Internal Revenue Code (IRC) provides that a qualified individual may make an election to exclude from gross income, foreign earned income not to exceed a specified amount and/or housing costs over a base amount.

The election applies to the taxable year for which it is made *and to all subsequent taxable years* unless revoked. (Section 911(e)(1), IRC, emphasis added.)

Facts and Question: Taxpayer B is a Wisconsin resident prior to 1988. Taxpayer B works for a multinational corporation with

operations in Wisconsin. On January 1, 1988, the taxpayer is transferred to his employer's location in Canada. It is expected that the taxpayer will work for 3 years in Canada and then be transferred to a location in the United States. The taxpayer determines that he has terminated residency in Wisconsin effective January 1, 1988.

The taxpayer files a Wisconsin income tax return for 1988, as a nonresident, reporting only income received from rental property located in Wisconsin. The taxpayer sells his rental property in January 1989 and reports the capital gain income on his 1989 Wisconsin income tax return filed as a nonresident. The taxpayer does not file a 1990 Wisconsin income tax return.

The taxpayer files a federal income tax return for the 1988, 1989, and 1990 taxable years. On the federal income tax returns filed with the IRS, the taxpayer makes an election under sec. 911, IRC, to exclude foreign earned income and housing costs from his gross income.

During 1991, the Wisconsin Department of Revenue determines that the taxpayer never terminated his Wisconsin residency. As a result, for the taxable years 1988, 1989, and 1990, the department requires the taxpayer to report income from all sources as Wisconsin income.

Is the taxpayer eligible to claim the exclusion provided by sec. 911, IRC, for taxable years 1988, 1989, and 1990 for Wisconsin income tax purposes?

Answer: Yes. Section 71.01(6), Wis. Stats. (1987-88), provides that the starting point for determining an individual's Wisconsin taxable income is his or her federal adjusted gross income. Any election which a taxpayer makes under the IRC in computing federal adjusted gross income on his or her federal income tax return also applies for Wisconsin purposes, unless the taxpayer specifically makes a separate (different) election for Wisconsin purposes. Thus, the election to use sec. 911, IRC provisions made by the taxpayer on the 1988 federal return also applies on the 1988 Wisconsin return and Wisconsin returns for subsequent years. Even though a Wisconsin income tax return was not filed for 1990, the taxpayer qualifies for the election for Wisconsin in 1990 under sec. 911(e)(1), IRC, which provides that the election applies to all tax years subsequent to the year the initial election is made, unless the election is revoked.

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3. Married Couple Credit for a Part-Year Resident Who Claims the Foreign Earned Income Exclusion

Statutes: Section 71.07(6), Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to taxable years 1986 and thereafter.

Background: Section 71.07(6), Wis. Stats. (1987-88), provides for the Wisconsin married couple credit. The credit is generally available to married persons where both spouses have earned income taxable to Wisconsin. The credit is not available to married persons who claim the foreign earned income exclusion (sec. 911, Internal Revenue Code) or the exclusion of income from sources within Guam, American Samoa, or the Northern Mariana Islands (sec. 931, Internal Revenue Code).

Facts and Question: A married couple abandons their Wisconsin domicile (and establishes a new domicile elsewhere) to live outside the United States. They file a Wisconsin Form 1NPR (income tax return for part-year residents and nonresidents) to report their Wisconsin income. Both spouses have earned income taxable to Wisconsin.

For federal tax purposes, the couple claims the foreign earned income exclusion against wages earned outside the United States. Their Wisconsin income is not reduced by the foreign earned income exclusion as none of their foreign earned income is taxable to Wisconsin.

Is the Wisconsin married couple credit available to persons who claim the foreign earned income exclusion for federal purposes but not for Wisconsin purposes?

Answer: Yes. Persons who claim the foreign earned income exclusion for federal purposes, but not for Wisconsin purposes, may qualify for the Wisconsin married couple credit. Because the above couple abandoned their Wisconsin domicile (and established a new domicile elsewhere), they did not reduce their Wisconsin income by the foreign earned income exclusion. Thus, they qualify to claim the married couple credit. However, if this couple had not abandoned their Wisconsin domicile and established a new domicile elsewhere, they would not qualify for the married couple credit because they would have reduced their Wisconsin income by the foreign earned income exclusion.

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4. Moving Expenses Used for the Wisconsin Itemized Deduction Credit

Statutes: Section 71.07(5)(a)4, Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to taxable years 1987 and thereafter.

Facts and Question: Section 71.07(5), Wis. Stats. (1987-88), provides for the computation of the Wisconsin itemized deduction credit.

The Wisconsin itemized deduction credit is based on amounts allowed as federal itemized deductions with certain exceptions.

One of the exceptions is for expenses to move from Wisconsin. Section 71.07(5)(a)4, Wis. Stats. (1987-88), prohibits "expenses to move from this state ..." from being used to compute the Wisconsin itemized deduction credit.

May expenses incurred in moving between two locations outside Wisconsin be used in computing the Wisconsin itemized deduction credit?

Answer: Yes. Expenses incurred in moving between two locations outside Wisconsin can be used in computing the Wisconsin itemized deduction credit. Section 71.07(5)(a)4, Wis. Stats. (1987-88), only requires those moving expenses incurred to move *from* Wisconsin to be removed from federal itemized deductions when computing the Wisconsin itemized deduction credit. It does not require the removal of expenses incurred in moving between two locations outside Wisconsin.

Example 1: The taxpayer is a nonresident of Wisconsin during 1990 (i.e., not domiciled in Wisconsin at any time during the year). The taxpayer files a 1990 Wisconsin Form 1NPR (income tax return for part-year residents and nonresidents) to report the gain on the sale of property located in Wisconsin. The taxpayer claims expenses on his or her federal Schedule A which were incurred for a move from Minnesota to California. The moving expenses can be used in computing the Wisconsin itemized deduction credit.

Example 2: The taxpayer is a resident of Wisconsin (i.e., domiciled in Wisconsin) from January 1 through August 31, 1990. On September 1, 1990, the taxpayer became a resident of Illinois. The taxpayer files a 1990 Wisconsin Form 1NPR to report income earned through August of 1990. The taxpayer claims expenses on his or her federal Schedule A which were incurred for the move from Wisconsin to Illinois. The moving expenses cannot be used in computing the Wisconsin itemized deduction credit.

Example 3: The taxpayer is a Wisconsin resident (i.e., domiciled in Wisconsin) and a member of the military services. The taxpayer is stationed in Virginia from January 1 through October 31, 1990, at which time the taxpayer is transferred from the military base in Virginia to another base in Tennessee. On November 1, 1990, the taxpayer takes the necessary steps to abandon his or her Wisconsin domicile and establish a new domicile in Tennessee. The taxpayer files a 1990 Wisconsin Form 1NPR reporting all income through October 31, 1990. The taxpayer claims expenses on his or her federal Schedule A which were incurred for the move from Virginia to Tennessee. The moving expenses can be used in computing the Wisconsin itemized deduction credit.

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5. Tax Treatment of Wisconsin Earned Income Credit

Statutes: Section 71.07(9e), Wis. Stats., as created by 1989 Wisconsin Act 31

Background: Section 71.07(9e), Wis. Stats., as created by 1989 Wisconsin Act 31, provides for the Wisconsin earned income credit. The Wisconsin earned income credit is a refundable credit which is equal to a percentage of the federal earned income credit. The Wisconsin earned income credit payments are based on need, as determined by federal income limitations, and family size.

Question: Is the amount of Wisconsin earned income credit subject to federal and Wisconsin income tax for the year in which the credit is received?

Answer: The Wisconsin earned income credit is not subject to either federal or Wisconsin income tax for the year in which the credit is received. The Wisconsin Department of Revenue has been informed by the federal Internal Revenue Service that payment of the Wisconsin earned income credit constitutes a disbursement from a general welfare fund in the interest of the general public and thus is not includable in federal gross income. Because the Wisconsin earned income credit is not included in federal gross income, it is not carried over to the Wisconsin return and used in determining Wisconsin taxable income. Thus the Wisconsin earned income credit is not taxable for either Wisconsin or federal purposes.

Note: Because the Wisconsin earned income credit is not includable in federal gross income, it will not be included on the Form 1099-G prepared by the department to report state tax refunds each year.

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6. Taxation of Social Security Benefits

Statutes: Section 71.05(1)(a), Wis. Stats. (1987-88), as amended by section 1817m of 1989 Wisconsin Act 31

Background: Effective for taxable years beginning on January 1, 1989, and thereafter, sec. 71.05(1)(a), Wis. Stats. (1987-88), as amended by sec. 1817m of 1989 Wisconsin Act 31, provides that certain payments received from the United States Government civilian employe and military personnel retirement systems are exempt from Wisconsin income tax. Only amounts which are paid on the account of a person who was a member of the retirement system as of December 31, 1963, or was retired from the system as of December 31, 1963, qualify for the exemption.

Facts and Question: An individual was a member of the social security system as of December 31, 1963, and retired during 1989. A portion of this individual's social security benefits is determined to be taxable under the provisions of the Internal Revenue Code and must be included in federal adjusted gross income.

Does the amount of taxable social security included in federal adjusted gross income qualify for the exemption provided in sec. 71.05(1)(a), Wis. Stats. (1987-88), as amended by sec. 1817m of 1989 Wisconsin Act 31?

Answer: No. Only payments from a U.S. Government civilian employe retirement system or a U.S. military personnel retirement system qualify for the exemption. Social security benefits do not come from either of these retirement systems.

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7. Wages Earned in Wisconsin by Nonresident Railroad Employes and Motor Carrier Transportation Employes May Be Exempt From Wisconsin Tax

Statutes: Section 71.05(6)(b)3, Wis. Stats. (1987-88)

Note: This Tax Release applies only with respect to wages paid on or after July 6, 1990.

Background: Effective July 6, 1990, Section 7 of the federal Amtrak Reauthorization and Improvement Act of 1990 (P.L. 101-322) provides that no part of the compensation paid to an employe of an interstate railroad subject to the jurisdiction of the Interstate Commerce Commission (ICC) shall be subject to the income tax laws of any state except the state of the employe's residence when the employe performs duties in more than one state.

The Act also provides that no part of the compensation paid by a motor carrier providing transportation subject to the jurisdiction of the ICC or by a motor private carrier to an employe who performs regularly assigned duties in two or more states shall be subject to the income tax laws of any state other than the state of the employe's residence.

Question: Under what conditions would wages earned in Wisconsin as (1) an employe of an interstate railroad subject to the jurisdiction of the ICC, (2) an employe of a motor carrier providing transportation subject to the jurisdiction of the ICC, or (3) an employe of a motor private carrier be subject to Wisconsin tax?

Answer: The above railroad employes and motor carrier employes would be subject to Wisconsin income tax on the wages earned in Wisconsin from the interstate railroad or motor carrier as follows:

- A. Employes who are legal residents of Wisconsin for the entire taxable year - all such wages are subject to Wisconsin income tax.
- B. Employes who are not legal residents of Wisconsin for any portion of the taxable year (i.e., nonresidents for the entire year) - such wages are subject to Wisconsin income tax only if all of the employe's railroad or motor carrier wages for the taxable year are earned in Wisconsin.
- C. Employes who are legal residents of Wisconsin for a portion of the taxable year (i.e., part-year residents of Wisconsin) —

(1) During the period in which the employe is a legal resident of Wisconsin, all such wages are subject to Wisconsin income tax.

(2) During the period in which the employe is a nonresident of Wisconsin, such wages are subject to Wisconsin income tax only if all of the employe's railroad or motor carrier wages during that portion of the year are earned in Wisconsin.

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8. Wisconsin Net Operating Loss When There Is No Federal Net Operating Loss

Statutes: Sections 71.01(3) and (14) and 71.05(8), Wis. Stats. (1987-88)

Background: Section 71.05(8)(a), Wis. Stats. (1987-88), provides that there shall be added to federal adjusted gross income in computing Wisconsin adjusted gross income the amount of any federal net operating loss carryover. Accordingly, there may be subtracted from federal adjusted gross income in computing Wisconsin adjusted gross income any Wisconsin net operating loss carryforward.

Section 71.01(14), Wis. Stats. (1987-88), defines Wisconsin net operating loss of persons other than corporations as the federal net operating loss adjusted for modifications in sec. 71.05(6) to (12), (19), (20), and (21), Wis. Stats. (1987-88), except that no deductions allowable on federal Schedule A are allowable for Wisconsin purposes. (Note: This section was amended by 1989 Wisconsin Act 31, effective for the computation of net operating losses for taxable year 1988 and thereafter, to provide that the modification for the capital gain exclusion can not be used in computing a Wisconsin net operating loss.)

Section 71.01(3), Wis. Stats. (1987-88), defines federal net operating loss as the net operating loss determined under the Internal Revenue Code. Internal Revenue Code for Wisconsin purposes is defined in sec. 71.01(6), Wis. Stats. (1987-88).

Question: Can a Wisconsin taxpayer have a Wisconsin net operating loss if the taxpayer has no federal net operating loss?

Answer: No. A taxpayer must have a federal net operating loss in order to have a Wisconsin net operating loss. Federal net operating loss is the starting point for computing Wisconsin net operating loss. Although the addition and subtraction modification provisions of Wisconsin law which are listed above (in the second paragraph of the "Background" information) operate to increase or decrease the amount of net operating loss available for Wisconsin purposes, they may not be used to create a Wisconsin net operating loss where no federal net operating loss is determined.

There are situations where a taxpayer may have a federal net operating loss for Wisconsin purposes even though a net operating loss is not determined on the federal income tax return the taxpayer files with the Internal Revenue Service. The following are descriptions of these situations:

- A. A federal net operating loss, although not computed on the federal income tax return filed with the Internal Revenue Service, may result for Wisconsin purposes because federal law changes enacted after the cutoff date provided in s. 71.01(6), Wis. Stats. (1987-88) for a particular tax year, do not apply for Wisconsin, or Wisconsin law specifically prohibits the use of certain provisions of the Internal Revenue Code for Wisconsin purposes (generally called "Schedule I adjustments").
- B. A federal net operating loss, although not computed on the federal income tax return filed with the Internal Revenue Service, may result for Wisconsin purposes if federal adjusted gross income is recalculated for Wisconsin purposes for the purpose of using an "elective" provision of the Internal Revenue Code in a different manner for Wisconsin than for federal purposes.
- C. A federal net operating loss, although not computed on the federal income tax return filed with the Internal Revenue Service, may result for Wisconsin purposes if the taxpayer is a part-year resident or nonresident of Wisconsin and a portion of federal adjusted gross income does not have situs in Wisconsin (i.e., Wisconsin does not have jurisdiction to tax such income).

Example 1: In 1988, Taxpayer B is a full-year Wisconsin resident. Taxpayer B computes his federal adjusted gross income as follows:

Interest income	\$ 5,000
Capital gain	10,000
Business income (loss)	<u>(11,000)</u>
Federal adjusted gross income	\$ 4,000

For Wisconsin purposes, Taxpayer B computes his Wisconsin adjusted gross income as follows:

Interest income	\$ 5,000
Capital gain (\$10,000 less 60% exclusion)	4,000
Business income (loss)	<u>(11,000)</u>
Wisconsin adjusted gross income	\$(2,000)

Taxpayer B does not have a Wisconsin net operating loss to carry forward to 1989 because he does not have a federal net operating loss and does not meet any of the exceptions given in the Answer above. To compute a Wisconsin net operating loss, Taxpayer B must have a federal net operating loss.

Example 2: In 1989, Taxpayer C is a full-year Wisconsin resident. Taxpayer C computes his federal adjusted gross income as follows:

Interest income	\$ 5,000
Business income (loss)	(10,000)
Rental income (loss)	<u>6,000</u>
Federal adjusted gross income	\$ 1,000

For Wisconsin purposes, Taxpayer C must recompute his federal adjusted gross income because Wisconsin law does not allow accelerated depreciation for his residential real property. (Note: In this example, it is assumed that the accelerated depreciation allowable for 1989 is less than straight line depreciation.)

Interest income	\$ 5,000
Business income (loss)	(10,000)
Rental income (loss)	<u>4,000</u>
Federal adjusted gross income per Wisconsin Schedule I	\$(1,000)

Taxpayer C computes his Wisconsin adjusted gross income as follows:

Interest income (\$5,000 less \$1,000 U.S. government interest)	\$ 4,000
Business income (loss)	(10,000)
Rental income (loss)	<u>4,000</u>
Wisconsin adjusted gross income	\$(2,000)

Taxpayer C falls under situation 1 given in the Answer above and, therefore, has a \$1,000 federal net operating loss as determined under the Internal Revenue Code in effect for Wisconsin purposes. He computes a \$2,000 Wisconsin net operating loss under sec. 71.01(14), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31.

Example 3: In 1989, Taxpayer D is a full-year Wisconsin resident. Taxpayer D computes her federal adjusted gross income as follows:

Interest income	\$ 5,000
Business income (loss)	(10,000)
Partnership income (loss)	<u>8,000</u>
Federal adjusted gross income	\$ 3,000

For federal purposes, Taxpayer D claims the federal jobs credit. For Wisconsin purposes, Taxpayer D elects to claim the wages used in computing the federal jobs credit as a deduction and recomputes her federal adjusted gross income as follows:

Interest income	\$ 5,000
Business income (loss)	(14,000)
Partnership income (loss)	<u>8,000</u>
Pro forma federal adjusted gross income	\$(1,000)

For Wisconsin purposes, Taxpayer D computes her Wisconsin adjusted gross income as follows:

Interest income (\$5,000 less \$2,000 U.S. government interest)	\$ 3,000
Business income (loss)	(14,000)
Partnership income (loss)	<u>8,000</u>
Wisconsin adjusted gross income	\$(3,000)

Taxpayer D falls under situation 2 given in the Answer above and, therefore, has a federal net operating loss of \$1,000 as determined under the Internal Revenue Code for Wisconsin. She computes a \$3,000 Wisconsin net operating loss under sec. 71.01(14), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31.

Example 4: Taxpayer E is a nonresident of Wisconsin. Taxpayer E computes his federal adjusted gross income as follows:

Wages (for services performed in Illinois)	\$ 50,000
Interest income	10,000
Partnership income (loss)	<u>(5,000)</u>
Federal adjusted gross income	\$ 55,000

The only income having a Wisconsin situs is the partnership income from a Wisconsin partnership of which Taxpayer E is a general partner. Therefore, Taxpayer E's Wisconsin adjusted gross income is \$(5,000). Taxpayer E falls under situation 3 given in the answer above. If Taxpayer E computes federal adjusted gross income based on those income and deduction items which have a Wisconsin situs, Taxpayer E has a federal net operating loss of \$5,000. Because Taxpayer E has a "federal net operating loss," he is entitled to a Wisconsin net operating loss as determined under sec. 71.01(14), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31.

CORPORATION FRANCHISE OR INCOME TAXES

1. Wisconsin Treatment of Foreign Sales Corporations and Domestic International Sales Corporations

Statutes: Sections 71.04(4) and 71.11(7r), Wis. Stats. (1985-86), and secs. 71.26(3)(j),(r) & (t) and 71.30(2) & (5), Wis. Stats. (1987-88)

Note: This Tax Release updates the Tax Release with the same title that was published in *Wisconsin Tax Bulletin* 42 (July 1985).

Background: Effective after December 31, 1984, the Tax Reform Act (TRA) of 1984 generally replaced the system of Domestic International Sales Corporations (DISCs) with a new system of Foreign Sales Corporations (FSCs). Under the FSC system, a portion of the foreign trade income of an FSC is exempt from federal tax at the corporate level, provided it is derived from the foreign presence and economic activity of the FSC. In contrast, under the DISC system there was no corporate income tax imposed on DISC income, and there was a partial deferral of taxes at the shareholder level. Although DISCs were not abolished by the TRA of 1984, their tax benefits are limited and an interest charge for tax deferred amounts is imposed on DISC shareholders.

To qualify as an FSC, section 922(a)(1) of the Internal Revenue Code (IRC) provides that a corporation meet six requirements designed to ensure that it has adequate foreign presence. If a corporation meets all six requirements, and makes an election that complies with the procedural requirements of sec. 927 (f)(1), IRC, it will be treated as an FSC by the Internal Revenue Service. The six requirements are:

- A. The FSC must be a foreign corporation created or organized under the laws of a qualified foreign country.
- B. The FSC must not have more than 25 shareholders.
- C. The FSC may not have any preferred stock.
- D. The FSC must maintain an office located outside the United States (or in any U.S. possession) at which there is a permanent set of tax records, including invoices.
- E. The board of directors of an FSC must always include at least one individual who is not a resident of the United States.
- F. An FSC cannot be a member of any controlled group of corporations of which a DISC is a member.

In lieu of forming FSCs, taxpayers are permitted, under TRA of 1984, to use their DISCs for annual export receipts up to \$10 million. DISCs that continue in existence or are formed after 1984 are known as "Interest-Charge" DISCs. As with other DISCs, their accumulated DISC income through 1984 is exempt from federal tax.

Most DISC income after December 31, 1984 may be deferred for federal tax purposes but the shareholders of DISCs will be required to pay an interest charge on the deferred tax, the rate of which will be determined annually by the United States Treasury based on Treasury Bill yields. The year-end of the FSC or Interest-Charge DISC must conform to the year-end of its shareholder. If there is more than one shareholder, the year-end must conform to the year-end of the majority shareholder, and if two or more shareholders or groups are tied for the highest percentage, the year-end must conform to the year-end of any one of such shareholders or groups.

The TRA of 1984 terminates the old DISC provisions as of December 31, 1984. A special transition rule treats distributions after January 1, 1985 as nontaxable amounts paid from previously taxed income of the DISC. Thus, the deferred tax liability is forgiven for federal income tax purposes.

The Sheboygan County Circuit Court decision in *Kohler Company, et al vs. Wisconsin Department of Revenue* (CCH 202-830) provided that the net income of a "paper corporation" must be allocated to the corporation that actually earned the income. It found that the DISCs were merely "paper corporations," having no employees and no actual involvement or activity in connection with the sales that gave rise to their income. It further found that the DISCs did not