WITHHOLDING

William A. Mitchell vs. Secretary of Revenue, Mark E. Musolf, and Chief, Central Compliance Section, W. H. Wescott; and Automation Engineering Company, Inc., AA Electric Division, 1220 Highway 143, Cedarburg, WI 53012, General Manager, Neil Stein. (Dane County Circuit Court). On March 6, 1981, the taxpayer completed and filed with his employer, Automation Engineering Company, Inc., a Wisconsin Withholding Exemption Certificate (Form WT-4) certifying that he was "exempt" from Wisconsin withholding tax. On March 12, 1981, Automation Engineering Company, Inc. mailed a copy of the taxpayer's Wisconsin withholding exemption certificate to the Department of Revenue as required by s. 71.20 (8) (f), Wis. Stats.

The department reviewed the taxpayer's withholding exemption certificate and on March 18, 1981 notified Automation Engineering Company, Inc. and the taxpayer that it had been determined that the certificate was incorrect, and instructed Automation Engineering Company, Inc. to start to withhold tax from the taxpayer's wages on the basis of five exemptions. As a result of this action by the department, the taxpayer filed a claim for declaratory judgment and injunctive relief with the Dane County Circuit Court.

The taxpayer has asked the Court to grant a preliminary injunction, enjoining and restraining the department from collecting withholding tax from his wages. He has also asked that the Court grant a permanent injunction, enjoining and restraining the department from collecting withholding tax from his wages as long as he has on file with his employer a current Wisconsin Withholding Exemption Certificate, Form WT-4, wherein he has certified that he is exempt from withholding tax.

On June 5, 1981 the Circuit Court of Dane County dismissed the taxpayer's request for a declaratory judgment.

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answers may not apply to all questions of a similar nature. In situations where the facts vary from those given herein, it is recommended that advice be sought from the Department. 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.)

INCOME TAXES

I. Interest Paid by Financial Institutions

Facts & Question: A resident individual has several small savings accounts with a single financial institution located in Wisconsin. The interest income received from each of these accounts is less than $100 for the calendar year; however, in the aggregate the interest income received from all of the accounts is in excess of $100. Is the financial institution required to file an information return (Wisconsin Form 9b or federal Form 1099-INT) with the Department of Revenue regarding interest paid to this individual? If so, must a separate information return be filed for each account?

Answer: Under s. 71.10 (15), Wis. Stats., the financial institution is required to report to the department interest paid to a Wisconsin resident whenever the total paid during a calendar year to the person is $100 or more. It does not matter whether the interest is paid on a single account or multiple accounts.

The financial institution must either file (a) one information return showing the total interest paid on all accounts, or (b) separate information returns for each account.

II. Installment Sale Qualifies for Capital Gain Treatment in 1982

Facts & Question: In 1981 a Wisconsin resident sells a cottage at a gain. The sale is a deferred payment sale which qualifies for installment reporting. Payments will be received equally in the years 1981, 1982, 1983, 1984 and 1985. Will the amounts of gain which are reportable in 1982 and subsequent years qualify for the long-term capital gain exclusion provided by Wisconsin law (s. 71.05 (1) (a) 2, as amended by Chapter 20, Laws of 1981) for those years, even though the sale took place in 1981?

Answer: Yes. The gain reportable in each of the years 1982, 1983, 1984 and 1985 will qualify for the long-term capital gain exclusion available under Wisconsin law for such years.

CORPORATION INCOME/FRANCHISE TAX

I. Cost Depletion Recognized in Property Factor for Apportionment Purposes

Facts & Question: Corporations which are operating owners or owners of an economic interest in properties such as mines, oil and gas wells, other natural deposits and timber, are allowed by federal and Wisconsin income tax laws to account for the consumption or exhaustion of such asset interest by a reasonable charge against revenues produced. This is recognized by a charge to depletion expense of which there are two methods: (1) Cost depletion, and (2) Percentage depletion. Cost depletion is generally calculated on the unit-of-production basis, while percentage depletion is based upon a certain percentage of gross income from the property during the tax year. Wisconsin Administrative Code sections Tax 3.35 through 3.38 provide rules regarding the depletion allowance for Wisconsin purposes.

A corporation which operates both within and outside Wisconsin and whose business in Wisconsin is an integral part of a unitary business is required to report its income to Wisconsin under the apportionment method which uses three factors: property, payroll and sales. Property is valued at original cost. In regard to oil companies, exploration and development costs of corporations involved in extracting products from depletable assets are often capitalized and subsequently depleted.

For the purposes of the property factor, shall original costs of depletable property, including capitalized exploration and development costs, be reduced by depletion deducted?

Answer: Yes, the original cost of the depletable asset, including capitalized exploration and development expenses, shall be reduced by cost depletion in determining the property factor of the apportionment formula.

Wisconsin Administrative Code section Tax 2.39 (3) (b) provides as follows: "As a general rule 'original cost' is deemed to be the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc."

Most authorities recognize "depletion" as an expense deduction representing the diminution of the quantity remaining of a natural resource through the removal of such resource from its natural reservoir until it is finally exhausted. Depletable assets are often referred to as "exhaustable" or "wasting" assets. Kohler (A Dictionary for Accountants) defines wasting assets as "An asset that diminishes in value by reason of and commensurately with the extraction or removal of a natural product such as ores, oil, and timber, which it contains." The Internal Revenue Code regards depletion as a deduction from gross income that represents loss of value of such assets as mines, oil and gas wells, other natural deposits, and timber brought about by a reduction in the quantity of these assets as a result of extraction operations. Depletion differs from depreciation in that the former implies removal of a natural resources, i.e., a physical shrinkage or lessening of an estimated available quantity, while the latter implies a reduction in the service capacity of an asset through use, obsolescence, or inadequacy.

Since depletion accounts for the gradual exhaustion of the asset, such exhaustion is considered equivalent to a "partial disposition" as indicated in Administrative Code section Tax 2.39 (3) (b). Assets for which depletion has been recorded are no longer considered to be whole, or entire. Therefore, only the cost of the remaining portion may be used in the property factor for apportionment purposes.

II. Taxability of Federal Income Tax Refund to a Surviving Corporation in a Nontaxable Reorganization

Facts & Question: Two corporations (A and B) merged in a tax-free reorganization under sections 71.354 and 71.368 (1) (a) 1, Wis. Stats. The merged corporation "A" had recorded on its books a receivable for a refund claim of federal income taxes previously paid. The right to this refund was transferred to the surviving corporation "B" upon the merger. (1) When the refund is subsequently received by the survivor "B", is it taxable to "B"? (2) If the refund received by the survivor "B" in (1) exceeds the amount recorded on the books of the merged corporation "A", is the excess taxable to "B"? (3) Should the refund be allocated to the assets acquired in the merger to reduce the basis of those assets? (4) Should a portion of the refund be allocated to inventory and taxed currently? (5) If a receivable is not recorded on the books of the merged corporation "A" prior to merger, is the refund taxable to the survivor corporation "B" upon receipt?

Answer: (1) No, since the claim for refund had been recorded as a receivable on the books of the merged coporation "A", any consideration which passed to "A" upon the merger is attributable in part to the refund claim. The survivor "B", therefore, has a basis in the claim equal to the amount of the claim. Upon receipt of payment it merely represents liquidation of the receivable and as such is not taxable. (2) Yes, if an account receivable for the refund claim was recorded on the books of the merged corportation "A", but a greater amount was subsequently paid to the survivor corporation "B", the excess is taxable to "B" under s. 71.03 (1) (k), Wis. Stats. (3) and (4) No, there is no provision in Wisconsin law to allocate the refund to the assets acquired in the merger. The basis of assets acquired is not reduced by the refund received, nor is any amount allocated to inventory and taxed currently. (5) Yes, if a receivable for the federal income tax refund was not considered in the merger as evidenced by being recorded on the books of the merged corporation "A" prior to the merger, such refund subsequently received by the surviving corporation "B" is taxable to "B" as other income under s. 71.03 (1) (k), Wis. Stats.

III. Nexus Not Created by Delivery of Goods With a Freight Charge

Facts & Question: A corporation, incorporated outside of Wisconsin, which operates as a wholesale distributor, distributes products with its own trucks to retailers located in Wisconsin. The company owns no real or tangible personal property permanently located in Wisconsin. The company's only Wisconsin activities are the solicitation of sales and the daily delivery of goods from outside Wisconsin by company drivers in company trucks. The company does, however, add a freight charge to customer bills. Does delivery, for which a freight charge is made, represent a separate and distinct activity beyond the protection of Public Law 86-272? Is the corporation required to file Wisconsin franchise/income tax returns?

Answer: No, the corporation is not required to file Wisconsin franchise/income tax returns. Public Law 86-272 protects companies involved in interstate commerce from taxation in a state where the only business activities are the mere solicitation of orders 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 (15 USC § 381).

The distributor in this case is not in the transportation business, and does not provide shipping services that are separate from its operation as a wholesale distributor. The freight charge is added to the cost of goods sold to compensate the company for the expense of delivery.

In view of the above, the distributor is protected by federal law from the imposition of a Wisconsin franchise tax. The charge for delivery does not imply a separate service beyond the protected activity.

SALES/USE TAXES

I. Manufacturing - Chemically Treating Wood

Facts & Question: A person is engaged in the process of chemically treating wood to produce "flame proof fire retardant" wood. Lumber is placed in a tank having a partial vacuum and chemicals are released in the tank and the chemicals penetrate the wood. In some cases it is also necessary to kiln dry the treated lumber. The person treats his or her own lumber and also provides this service

to other retailers of lumber. Is this person a manufacturer for sales tax purposes under s. 77.51 (27), Wis. Stats.?

Answer: Yes, this person is considered a manufacturer under s. 71.51 (27), Wis. Stats., and is able to claim the exemptions provided in ss. 77.54 (6) (a) and 77.54 (2).

II. Boarding Animals

Facts & Question: A kennel trains dogs which the kennel also boards for 6 to 8 weeks until such time as the dogs are properly trained. The customer is billed a monthly training fee of $150 to $200, depending on the type of dog, which fee includes the cost of boarding the dog. The normal boarding fee is $3.75 per day. Is any part of the $150 - $200 training fee taxable as a charge for boarding the dog under s. 77.52 (2) (a) 10, Wis. Stats.?

Answer: Yes, the portion of the monthly training fee equal to the normal boarding fee for the dogs ($3.75 per day) is a taxable service even though it is not separately itemized on the customer's bill.

III. Municipal Waste Treatment Facility Exemption Under s. 77.54 (26)

Facts & Question: A Solid Waste Recycling Authority is constructing a building and will have a private operator own and operate the equipment in the authority's building. The equipment consists of a conveyor and baler. The refuse is compacted into bales to make it easier to haul to a landfill site. There is no sorting of the refuse, merely baling. The operator is paid so much a ton for the refuse that goes through the baler and at the end of ten years the baler belongs to the County. Is the purchase of the conveyor and baler by the private operator exempt under s. 77.54 (26), Wis. Stats.?

Answer: No. Without addressing the question of whether a conveyor and baler constitute waste treatment equipment, the exemption for municipal waste treatment facilities does not apply to a private operator's purchases of equipment it will own and operate in providing a service for the recycling authority.

IV. Realty vs. Personal Property — Central Air Conditioning Unit

Facts & Question: The central air conditioning unit for a residence consists of an outdoor unit (containing the condensor, motor, fan and condensing coil), and evaporator and blower coils which are placed in the furnace, and connecting refrigerant lines. Is the replacement of the entire outdoor unit considered a taxable repair of personal property or a real property construction activity?

Answer: The replacement of the entire outdoor unit constitutes a real property construction activity, and the contractor must pay the tax on the cost of the materials used in this construction activity.

V. Auto Manufacturer's Promotional CASH Rebate Program

Facts & Question: An auto manufacturer's rebate program involved the manufacturer making a $500 or $700 cash bonus payment (depending on the price of the car purchased) to the retail purchaser of the car. Dealers were required to share in funding this cash bonus, and their cost was $200 or $300 per car, again depending on the price of the car. The manufacturer forwarded the customer's check to the dealer for presentation to the customer. However, at the option of the customer and the dealer, the check could be assigned to the dealer and become part of the customer's down payment. Is the dealer's portion ($200 or $300 per car) a cash discount or price adjustment under s. 77.51 (11) (b) 1 or 2, Wis. Stats., which would reduce the gross receipts of the dealer which are subject to the tax?

Answer: No. The dealer's portion of the cash bonus paid the customer is not a reduction of its taxable gross receipts. Instead it is a portion of the promotional cost of selling motor vehicles which is passed along to the dealer. The customer may use the cash bonus (including the dealer's portion) for any purpose, including application toward the purchase price of the car. When applied toward the purchase price of the car, the bonus is the same as any other money received by the dealer and this part of the dealer's gross receipts is subject to tax.

VI. Is a Boat a Motor Vehicle Under the Exemption in s. 77.53 (18), Wis. Stats., for New Residents?

Facts & Question: Household goods for personal use, including motor vehicles, purchased outside this state by a nondomiciliary of this state 90 days or more before bringing the property into this state, in connection with a change of domicile to this state, are exempt from the use tax. Does this exemption apply to boats?

Answer: No. Household goods for personal use, including motor vehicles, under s. 77.53 (18), Wis. Stats., do not include boats.

VII. Farmer's Livestock Feeders

Facts & Question: A feeder used to move feed to farm animals consists of a powered conveying unit (feeder) located in a platform, trough or bunk that supports the moving parts of the feeder. The platform, trough or bunk is usually constructed at the farm from ordinary building materials, such as concrete; but it may also be prefabricated in a factory and sold to the farmer. What is the scope of the farmer's exemption for such purchases in subsections (4) (a) 3 and 4 of rule Tax 11.12, titled "Farming, agriculture, horticulture and floriculture"?

Answer: Subsection (4) (a) 3 of rule Tax 11.12 provides that farmers may purchase machines such as powered feeders without tax, but not ordinary building materials used to construct platforms or troughs. Subsection (4) (a) 4 provides that farmers also may purchase without tax machines such as automated livestock feeder bunks (but not ordinary building materials), even though the machine becomes a part of realty after installation.

Fixed platforms, troughs or bunks which are not machines do not qualify for the farm machine exemption. However, an automated feeder bunk sold as one unit by a retailer to a farmer qualifies for the farm machine exemption.

VIII. Farmer's Purchase of Trail Bike

Facts & Question: A farmer purchased a 3-wheel trail bike, an all-terrain vehicle, which cannot be licensed for highway use. The farmer uses it exclusively to check on calves being born in remote pastures. This is done several times a day because the calves must be attended to shortly after they are born. Is this farmer's purchase exempt under s. 77.54 (3), Wis. Stats.?

Answer: Yes, is exempt under s. 77.54 (3), Wis. Stats.