TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answer 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

1. Addition Modification For Moving Expenses Incurred to Move From Wisconsin

Facts and Question: The starting point for computing Wisconsin taxable income for individuals is federal adjusted gross income as determined under the Internal Revenue Code as of a specific date. Individuals may be required to make certain modifications to federal adjusted gross income to arrive at Wisconsin adjusted gross income. One of the addition modifications is for "moving expenses incurred to move from this state" (s. 71.05 (1) (a) 7, Wis. Stats.). This addition modification is required if such moving expenses were deducted in computing federal adjusted gross income on a Wisconsin income tax return.

If a taxpayer is domiciled in Wisconsin while living in Wisconsin and is still a Wisconsin domiciliary after moving to another state, is the taxpayer required to make an addition modification under s. 71.05 (1) (a) 7, Wis. Stats. (assuming such moving expenses were deducted in computing federal adjusted gross income on his or her Wisconsin return)?

Answer: No. This addition modification for moving expenses is not required when the taxpayer retains his or her Wisconsin domicile after moving to another state and continues to be subject to Wisconsin's taxing jurisdiction. However, this addition modification would apply when the taxpayer becomes domiciled in another state (a nonresident for Wisconsin tax purposes) on the day he or she moved to another state and is no longer subject to Wisconsin's taxing jurisdiction.

2. Change of Accounting Period - Short Period Returns

A. Federal

The Internal Revenue Service has adopted temporary regulations and procedures for individual taxpayers to change from a fiscal year to a calendar year to take full advantage of the tax rate reductions in the Economic Recovery Tax Act (ERTA) of 1981. Part A of this Tax Release explains the federal treatment and Part B describes the Wisconsin treatment and procedures.

The general federal rules for changing an accounting period are found in section 442 of the Internal Revenue Code and section 1.442-1 of the Income Tax Regulations, and provide that in order to change an annual accounting period for federal income tax purposes, the taxpayer must obtain the approval of the Commissioner. To obtain approval, the taxpayer must file an application on federal Form 1128, Application for Change in Accounting Period, on or before the 15th day of the second calendar month following the close of the short period. In general, approval will be granted where the taxpayer has established a substantial business purpose for making the change.

Section 5c.442-1 of the Temporary Regulations and Rev. Proc. 82-25 have been adopted federally to provide a procedure for fiscal year taxpayers to change their accounting period to a calendar year basis to obtain the full benefits of the federal tax rate reductions.

The federal rules in section 5c.442-1 apply to federal returns if:

(1) The taxpayer requesting the change in accounting period is an individual;

(2) The purpose of the change in accounting period is to benefit as of the first day of the calendar year from changes in the individual income tax rates;

(3) The change is from a fiscal year to a calendar year;

(4) For a principal partner in a partnership formed after April 1, 1954 whose principal partners all change to a calendar year, the partnership changes to a calendar year;

(5) In the case of a shareholder in an electing small business corporation whose shareholders all change to a calendar year, the small business corporation changes to a calender year; and

(6) The short period involved in the change ends on December 31, 1981 or December 31, 1982.

The following special federal rules also apply to federal returns in the case of a request for change in accounting period under section 5c.442-1 of the Temporary Regulations:

(1) The substantial business purpose requirement will not be applied.

(2) Approval of the change in accounting period will be granted regardless of the number of years that have elapsed since the previous change of accounting period.

(3) A net operating loss will be treated according to the rules set forth in Rev. Proc. 82-25.

(4) No subsequent change in accounting period will be approved if the short period involved in the subsequent change would end fewer than five calendar years after the last day of the short period involved in the change of accounting period under the temporary regulations.

The procedures to be followed by an individual taxpayer requesting a change of accounting period from the Internal Revenue Service under the temporary regulations are:

(1) The taxpayer must file a current Form 1128, Application for Change in Accounting Period, with the federal income tax return for the short period ending December 31, 1981 or December 31, 1982.

(2) For the short period ending December 31, 1981, the Form 1128 and federal tax return must be filed no later than June 15, 1982.

(3) For the short period ending December 31, 1982, the Form 1128 and federal income tax return must be filed no later than April 15, 1983.

(4) Reference to the revenue procedure must be made by typing or legibly printing at the top of page 1 of the federal income tax return and Form 1128: "FILED UNDER REV. PROC. 82-25."

(5) If an individual taxpayer with a fiscal year ending after December 31, 1981, files a federal income tax return prior to June 15, 1982 and wishes to use the change in accounting period provisions, the previously filed federal income tax return may be amended. The federal income tax return for the short period ending December 31, 1981 and the Form 1128 must be filed no later than June 15, 1982.

(6) The taxpayer must disclose on the Form 1128 any partnership formed after April 1, 1954 in which the taxpayer is a principal partner or any electing small business corporation in which the taxpayer is a shareholder.

(7) All other requirements of Rev. Proc. 82-25 must also be complied with.

B. Wisconsin

Section 71.02 (2) (k), Wis. Stats., provides that a person other than a corporation (e.g., an individual) is required to adopt the same taxable year for Wisconsin income tax purposes as was used for federal income tax purposes. Where an individual files a federal income tax return for a fractional part of the year, s. 71.10 (16) (a), Wis. Stats., requires the individual to file a Wisconsin income tax return for such fractional year.

The procedure for changing the accounting period is explained in Wisconsin Administrative Code section Tax 2.165. A change in accounting period is effected by attaching a copy of federal Form 1128 and the federal approval (in cases where the individual is required to obtain approval from the Internal Revenue Service) to the Wisconsin return.

The computation of Wisconsin taxable income and the Wisconsin tax due on a short period return is provided in s. 71.10 (16) (b), Wis. Stats. and section Tax 2.165 of the Wisconsin Administrative Code.

NOTE: Section 71.05 (3) (d) 3 of the Wisconsin Statutes provides that the standard deduction or low-income allowance cannot be claimed on a short period return. Itemized deductions must be used to compute Wisconsin taxable income.

3. Taxability of Gain on Installment Sale of Residence

Facts And Question: In August, 1978 a residence located in Wisconsin which is jointly owned by husband and wife is sold at a gain of $30,000. The home is sold on a 5-year land contract and the taxpayers receive equal payments (20% of the selling price) in each of the years 1978, 1979, 1980, 1981 and 1982. The sale qualifies and is reported as an installment sale for Wisconsin purposes.

Husband and wife are both age 55 before the date of sale. They qualify for the "age 55 exclusion" provisions under Section 121 of the Internal Revenue Code enacted in 1978. They elect the one-time exclusion of gain from the sale of a principal residence under Section 121 and, therefore, no gain is reported for federal tax purposes.

Wisconsin did not adopt the $100,000 exclusion on the gain on the sale of a principal residence for qualified individuals age 55 and over until 1979 when the reference to the Internal Revenue Code was updated to December 31, 1978. Must the "gain" portion of installment payments received in the years 1978 through 1982 be reported as taxable income or do they qualify for the "age 55 exclusion" for Wisconsin purposes?

Answer: The gain on the installment payments received in 1978 are taxable for Wisconsin because the Wisconsin provision permitting the one-time exclusion of gain was not adopted until 1979. The gains on installment payments received in 1979 and subsequent years could, at the election of the taxpayer, be excluded from Wisconsin taxable income because the gains are realized and reportable in years when Wisconsin adopted the provisions of Section 121 of the Internal Revenue Code (as of December 31, 1978) which provides that such gains may be excluded from gross income for sales occurring after July 26, 1978.

CORPORATION FRANCHISE/INCOME TAX

1. Election to Expense Section 179 Property

Section 202 of the Federal Economic Recovery Tax Act of 1981 amended Section 179 of the Internal Revenue Code to permit taxpayers (other than trusts, estates and certain noncorporate lessors) the election to expense certain property, called Section 179 property, rather than depreciate it. Qualifying taxpayers may elect for federal purposes to expense amounts ranging from a maximum of $5,000 in 1982 and 1983 to $10,000 in 1986 and thereafter.

Question: How does this code Section 179 expense provision apply for Wisconsin individual income tax purposes and corporate franchise/income tax purposes for the 1982 taxable year?

Answer: The election to claim an expense under Section 179 of the Internal Revenue Code is available to individual taxpayers and to regulated investment companies and real estate investment trusts, because Wisconsin law provides that such taxpayers shall compute their income (with some exceptions) for the taxable year 1982 under the Internal Revenue Code in effect on December 31, 1981. Since the amendment to code Section 179 in ERTA of 1981 was enacted in 1981, this election is available to such taxpayers for Wisconsin purposes.

However, a corporation (other than a real estate investment trust or regulated investment company) may not elect to claim the expense under Section 179 of the Internal Revenue Code for Wisconsin purposes. Although s. 71.04 (15), Wis. Stats., permits corporations to claim depreciation or amortization under the Internal Revenue Code in effect for the current year, the deduction under code Section 179 is an *expense*; not depreciation or amortization. There is no provision in Wisconsin law authorizing the expense under Section 179 of the Internal Revenue Code.

For corporations which elect to claim the expense under Section 179 of the Internal Revenue Code for federal purposes, the depreciation may differ on their Wisconsin and federal returns. For example, a corporation purchased Section 179 property costing $6,000 which was placed in service in 1982. It elected for federal purposes to claim the $5,000 expense under Section 179, therefore only $1,000 was deductible under ACRS (Accelerated Cost Recovery System) for the 3 year property. Under ACRS, the recovery percentage for 1982 (1st year) is 25%, therefore the ACRS deduction for 1982 is $250 ($1,000 X 25%). For Wisconsin purposes the full $6,000 is the basis for ACRS. The deduction under ACRS on the Wisconsin return for 1982 would be $1,500 (25% of $6,000).

NOTE: If the taxpayer disposes of the asset in the above example, the net basis of the asset for computing gain or loss on the corporation's federal return may be different than the basis for computing gain or loss on the Wisconsin return.

2. Foreign Tax Deduction Related to Deductible Dividends

Facts and Questions: Section 71.04 (4) (b), Wis. Stats., reads: "Every corporation, joint stock company or association shall be allowed to make from its gross income the following deductions: Fifty percent of the amount of cash dividends received during the year from a corporation with respect to its common stock if the corporation receiving the dividends owned directly or indirectly during the entire income year at least 80% of the total combined voting stock of the payor corporation." (Effective for taxable year 1980 and thereafter.)

Many corporations operating in foreign countries are required by the laws of the foreign country to withhold and pay a tax from the amount of any dividends paid to domestic shareholders.

Example: A subsidiary corporation doing business in a foreign country pays a gross dividend of $6,000,000 to its domestic parent corporation, less $700,000 of foreign income tax withheld and paid, for a net cash dividend of $5,300,000. The parent corporation owns 100% of the total combined voting stock of the subsidiary.

Question #1: Does the wording of s. 71.04 (4) (b), Wis. Stats., which refers to "cash dividends received" mean dividends less any directly related foreign income taxes withheld, for the purposes of determining the deductible portion of the dividend received? In the above example, is the deductible dividend 50% of $6,000,000 (i.e. $3,000,000), or 50% of the actual amount received of $5,300,000 (i.e. $2,650,000)?

Question #2: In the above example, what is the amount of deductible tax under s. 71.04 (3), Wis. Stats.? Is it (a) the total foreign income tax withheld and paid of $700,000, or (b) 50% of the applicable foreign tax withheld and paid, i.e. $350,000, or (c) zero?

Answer to Question #1: The words "cash dividend received" do not mean cash dividends received less directly related foreign income taxes. Fifty percent of the gross dividend constructively received is deductible under s. 71.04 (4) (b), Wis. Stats. In the example, gross dividends of $6,000,000 must be reported, of which 50% or $3,000,000 is the deductible portion under s. 71.04 (4) (b), Wis. Stats. The remaining $3,000,000 is includible in taxable income.

Answer to Question #2: The entire amount of income tax withheld and paid (including a tax paid to a foreign country, measured by net income, gross income, gross receipts or capital stock) is deductible under s. 71.04 (3), Wis. Stats., regardless of whether the income on which the tax is imposed is taxed for Wisconsin franchise/income tax purposes. In the example, the deductible tax under s. 71.04 (3), Wis. Stats. is $700,000.

SALES/USE TAXES

1. Plastic and Styrofoam Cups Purchased by a Tavern

Facts and Questions: A tavern uses 9 oz. and 10 oz. clear plastic cups and 32 oz. styrofoam containers to transfer beer to customers. The tavern's supplier asks if the purchase of these containers by the tavern is subject to the 5% sales tax.

Answer: The sale of these containers to a tavern is exempt under s. 77.54 (6) (b), Wis. Stats., which provides an exemption for containers used to transfer merchandise to customers.

2. Restaurants' Purchases of Disposable Items

Facts and Question: The January 29, 1982 Wisconsin Tax Appeals Commission decision in Rause Enterprises, et. al. held that a fast food restaurant operator can purchase disposable plastic eating utensils, napkins, straws and disposable place mats without tax for resale. This decision is final as the Department of Revenue did not appeal the decision. On the basis of this decision, which items may be purchased from suppliers by restaurants without tax and how does a restaurant claim an exemption from the 5% tax?

Answer: A restaurant may issue a resale certificate to its supplier (s) for purchases of paper and plastic disposable items which are transferred to customers in conjunction with providing meals, food, food products and beverages to its customers.

3. Do Tree Nursery Operators Qualify for Farming Exemption?

Facts and Question: A nursery operator purchased shrubs, trees and evergreens which are either planted in a nursery growing area or are placed in inventory for sale. The shrubs, trees and evergreens placed in the growing area are sometimes used for budding and grafting, and ultimately will be sold.

Section 77.54 (3), Wis. Stats., provides an exemption for tractors and machines, including accessories, attachments, fuel and parts therefor, used directly in farming. Section 77.54 (3m), Wis. Stats., provides an exemption for seeds, plants, feeds, fertilizers and certain other items which are used exclusively in farming. Both of these sections specify that farming includes "horticulture".

Is the operation of a growing area by the nursery operator considered "horticulture" for purposes of s. 77.54 (3) and (3m), Wis. Stats?

Answer: The operation of a growing area where trees, shrubs, and evergreens are raised for sale is considered "horticulture" for purposes of s. 77.54 (3) and (3m), Wis. Stats., and under subsection (2) (b) of rule Tax 11.12 titled "Farming, agriculture, horticulture and floriculture". Therefore, a person engaged in horticulture is entitled to purchase the various items listed under s.

77.54 (3) and (3m), Wis. Stats., if the items are used as provided in these statutes.

CORRECTION NOTICE: Wisconsin Tax Bulletin #29, pages 18 and 19, contained a tax release on converting initial farmland preservation agreements to long-term agreements. The tax release referred to Wisconsin statute section 71.09 (11) (a) 3.cm as the section which allows claimants to apply for conversion to long-term agreements. Section 71.09 (11) (b) 3.cm (rather than s. 71.09 (11) (a) 3.cm) is the correct statutory reference.