

purchased and was the consumer of tangible personal property used by it in real property construction activities, and use tax applies to the sale of the materials used by it.

The taxpayer has not appealed this decision.

GIFT TAX

Gilson Medical Electronics, Inc. and Warren E. Gilson vs. Wisconsin Department of Revenue (Court of Appeals, District IV, October 11, 1983). Gilson Medical Electronics, Inc. and Warren Gilson appealed a Circuit Court judgment affirming a gift tax assessment against the corporation by the Wisconsin Tax Appeals Commission (see WTB #30). The Commission determined that Warren Gilson's conveyance of real property and improvements to the corporation was a gift taxable to the

corporation. The Gilsons contend that the tax should be imposed against the corporate shareholders when, as here, a closely held corporation is involved.

In Wisconsin, a gift to a corporation is taxable to the corporation. Section 72.75(1)(a), Wis. Stats., provides that "[a] tax is imposed upon any transfer to any person . . . when: [t]he transfer is by gift from a donor who . . . was a resident of this state." Section 72.01(10), Wis. Stats., defines "person" as including "all partnerships, associations, corporations and municipalities." All corporations include closely held corporations. Because the Wisconsin gift tax statute is not patterned after the federal gift tax statute, 26 U.S.C. § 2501 (a)(1) (1976), there is no need to make Wisconsin law consistent with federal law. 26 C.F.R. § 25.2511-1(h)(1) (1983) pro-

vides that a gift to a corporation is a gift to the corporation's shareholders. There is, however, a critical difference between the federal gift tax and the Wisconsin gift tax. The federal tax is imposed on the donor, based on the total amount of taxable gifts made by that donor, while the state tax is imposed upon the donee. The Gilsons would gain a substantial Wisconsin gift tax advantage if they were permitted to split there one large transfer to the corporation into several small transfers to the shareholders.

The Court of Appeals affirmed the judgement of the Circuit Court because Wisconsin law unambiguously requires that the gift be taxed to the corporation.

The taxpayers have not appealed this decision.

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.)

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INDIVIDUAL INCOME TAXES

1. Income Tax Filing Requirements — Marital Status

Facts: Under s. 71.10(2)(a)5, Wis. Stats., Wisconsin individual income tax filing requirements are determined based on age, gross income, marital status and residency. The following chart illustrates 1983 filing requirements for full-year residents:

Marital Status	Age as of December 31, 1983	Gross Income (or total gross income of husband & wife)
Single	Under 65	\$3,200 or more
	65 or older	\$4,200 or more
Married	Both under 65	\$5,200 or more
	One spouse 65 or older	\$6,200 or more
	Both spouses 65 or older	\$7,200 or more

Part-year and nonresidents with 1983 Wisconsin gross income of \$2,000 or more must file, regardless of age or marital status.

Dependents with unearned income, such as interest or dividends, must file if their unearned income for 1983 is \$1,000 or more.

During the taxable year a taxpayer's marital status may change from married to single, or single to married. For purposes of income tax filing requirements, a taxpayer's marital status is determined as of the last day of the taxable year (unless the taxpayer's spouse died during the year, in which case the determination is made at the time of death).

A taxpayer is considered married for purposes of 1983 income tax filing requirements in the following situations:

1. If on December 31, 1983 the taxpayer is:

- a) Married and living together as husband and wife.
- b) Married and living apart from spouse but not legally separated under a decree of divorce or separate maintenance.
- c) Separated under an interlocutory (not final) decree of divorce.
- d) Not married but spouse died during 1983.

A taxpayer is considered single for 1983 in the following situations:

- 1. Taxpayer not married during the entire year 1983.
- 2. Taxpayer legally separated under a decree of divorce or separate maintenance as of December 31, 1983.
- 3. Taxpayer's divorce finalized during 1983 and taxpayer did not remarry in 1983.

Question: What is the marital status of each of the following taxpayers for the year 1983?

- 1. Taxpayer's spouse died on January 5, 1983. Taxpayer did not remarry in 1983.
- 2. Taxpayer separated from spouse during 1983. (Taxpayer not separated under decree of divorce or separate maintenance.) Taxpayer's divorce is finalized in 1984.
- 3. Taxpayer separated from spouse under decree of divorce as of December 31, 1983.
- 4. Taxpayer separated from spouse under separate maintenance as of December 31, 1983.
- 5. Taxpayer granted a divorce on December 15, 1983 under the no-fault divorce law.

Answer: The first two taxpayers are considered married for purposes of 1983 filing requirements; the taxpayers described in numbers 3, 4 and 5 are considered single. An individual separated under a decree of divorce or separate maintenance is considered single. Also, under the no-fault divorce law, divorces are final immediately upon being granted by the court.

2. Prorating Deductions and Personal Exemption Credits - Fraction of Wisconsin Adjusted Gross Income to Federal Adjusted Gross Income Includes Zero or a Negative Amount

Background: Part-year residents and nonresidents are required to prorate their itemized deductions, standard deduction and personal exemption credits on their Wisconsin income tax return. Single persons who are part-year residents or nonresidents must prorate their itemized deductions and standard deduction by a fraction, the numerator of which is the person's Wisconsin adjusted gross income and the denominator is federal adjusted gross income. This fraction is then multiplied by the total itemized deductions or standard deduction claimed by the single person.

For married persons who are both part-year residents or nonresidents, the numerator is the combined Wisconsin adjusted gross income of both husband and wife and the denominator is the combined federal adjusted gross income of both husband and wife. The fraction is then multiplied by the total itemized deductions or standard deduction claimed by husband and wife.

The proration of personal exemption credits for *nonresidents* is based on the same fraction (as mentioned in the preceding paragraphs) for single persons and married persons. Part-year residents must prorate personal ex-

emption credits on the basis of the number of months they were a resident of Wisconsin during the taxable year.

The purpose of this tax release is to explain how itemized deductions, the standard deduction and personal exemption credits should be prorated when the numerator (Wisconsin adjusted gross income) or denominator (federal adjusted gross income) of the fraction includes zero or a negative amount.

Law Relating to Proration: Section 71.02(2)(f), Wis. Stats. - Itemized Deductions - "'Itemized deductions' means deductions from federal adjusted gross income allowable under the internal revenue code in determining federal taxable income, other than the federal standard deduction, low-income allowance and deductions for personal exemptions; but with respect to nonresident natural persons deriving income from property located, business transacted or personal or professional services performed in this state, including natural persons changing their domicile into or from this state in the calendar year 1972 or corresponding fiscal year or thereafter, 'itemized deductions' are limited to such fraction of the amount so determined as Wisconsin adjusted gross income is of federal adjusted gross income, except for married persons 'itemized deductions' are limited to such fraction of the amount so determined as combined Wisconsin adjusted gross income is of combined or joint federal adjusted gross income. In addition, for taxable year 1979 and thereafter, 'itemized deductions' excludes deductions for taxes allowable under section 164 of the internal revenue code. In addition, 'itemized deductions' includes contributions to the community development finance authority under s. 233.03, minus any credit received under s. 71.09(12m)."

Section 71.02(2)(gq)7, Wis. Stats. - Standard Deduction - "With respect to nonresident natural persons deriving income from property located, business transacted or personal or professional services performed in this state, including natural persons changing their domicile into or from this state, for the taxable year 1977 and thereafter, the low-income allowance authorized under this paragraph is limited, and for the taxable year 1979 and thereafter, the Wisconsin standard deduction is limited by such fraction of that amount as Wisconsin adjusted gross income is of federal adjusted gross income for unmarried persons, and as combined Wisconsin adjusted gross income is of combined or joint federal adjusted gross income for married persons."

Section 71.09(6p)(d), Wis. Stats. - Personal Exemption Credits - "Beginning with the calendar year 1975 and corresponding fiscal years and thereafter, the deduction for personal exemptions provided for in this subsection shall be limited as follows:

- 2. With respect to nonresident persons, personal exemptions shall be limited to such fraction of the amount so determined as Wisconsin adjusted gross income is of federal adjusted gross income, except that for married persons personal exemptions shall be limited to such fraction of the amount so determined as combined Wisconsin adjusted gross income is of combined federal adjusted gross income, but the total deduction for all personal exemptions shall not be less than \$5."

How to Determine Proration: The proration of itemized deductions and the standard deduction for part-year residents and nonresidents and the proration of personal ex-

emption credits for nonresidents shall be determined as follows:

1. If both the numerator (Wisconsin adjusted gross income) and denominator (federal adjusted gross income) are both positive amounts, the resulting fraction shall be a positive percentage; however, such percentage may not exceed 100% (see example 1 below).
2. If the numerator (Wisconsin adjusted gross income) is a positive amount and the denominator (federal adjusted gross income) is zero or a negative amount, the resulting fraction shall be 100% (see example 2 below).
3. If the numerator (Wisconsin adjusted gross income) is zero or a negative amount and the denominator (federal adjusted gross income) is either a positive, zero or a negative amount, the resulting fraction shall be zero percent.

The above three situations also apply to married persons who are both nonresidents or part-year residents, except that the numerator would be based on the combined Wisconsin adjusted gross income of both spouses and the denominator would be based on the combined federal adjusted gross income of both spouses.

The five examples that follow illustrate how the proration is determined for married persons. If a single person had identical numerators and denominators as the married persons in these examples, the answers for a single person would be the same as for the married persons.

Examples:

Situation 1: Combined Wisconsin adjusted gross income and federal adjusted gross income are positive amounts.

Facts: Husband and wife are Wisconsin residents for one-half of 1983.

Husband's Wisconsin adjusted gross income (loss)	(\$ 3,000)
Wife's Wisconsin adjusted gross income	10,000
Combined Wisconsin adjusted gross income	<u>\$ 7,000</u>

Combined federal adjusted gross income	\$ 6,000
Itemized deductions before proration	\$ 4,000

Solution: The proration percentage is determined by using the fraction of combined Wisconsin adjusted gross income to combined federal adjusted gross income, limited to 100% (7,000 divided by 6,000 = 117%, therefore 100% is used). One-hundred percent of the itemized deductions of \$4,000 are allowed for Wisconsin.

If the husband and wife were nonresidents of Wisconsin, with the same facts as stated above, 100% of the personal exemption credits would be allowed.

Situation 2: Combined Wisconsin adjusted gross income is positive, federal adjusted gross income is negative.

Facts: Husband and wife are both nonresidents of Wisconsin for 1983.

Husband's Wisconsin adjusted gross income (loss)	(\$ 3,000)
Wife's Wisconsin adjusted gross income	10,000
Combined Wisconsin adjusted gross income	<u>\$ 7,000</u>

Combined federal adjusted gross income	(\$ 1,000)
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Itemized deductions before proration	\$ 4,000
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Solution: Since combined Wisconsin adjusted gross income is positive and combined federal adjusted gross income is negative, the proration percentage is 100%. One-hundred percent of the itemized deductions of \$4,000 and personal exemption credits are allowed.

Situation 3: Combined Wisconsin adjusted gross income and federal adjusted gross income are zero.

Facts: Husband and wife are both nonresidents of Wisconsin for 1983.

Husband's Wisconsin adjusted gross income (loss)	(\$ 8,000)
Wife's Wisconsin adjusted gross income	8,000
Combined Wisconsin adjusted gross income	<u>\$ 0</u>

Combined federal adjusted gross income	\$ 0
Standard deductions before proration	\$ 4,000

Solution: Since combined Wisconsin adjusted gross income is zero, the proration percentage is 0%. No standard deduction is allowed. The \$5 minimum personal exemption credit is allowed.

Situation 4: Combined Wisconsin adjusted gross income is negative, federal adjusted gross income is positive.

Facts: Husband and wife are Wisconsin residents for one-half of 1983.

Husband's Wisconsin adjusted gross income (loss)	(\$10,000)
Wife's Wisconsin adjusted gross income	5,000
Combined Wisconsin adjusted gross income	<u>(\$ 5,000)</u>

Combined federal adjusted gross income	\$ 8,000
Itemized deductions before proration	\$ 5,000

Solution: Since combined Wisconsin adjusted gross income is a negative amount, the proration percentage is 0%. No itemized deductions are allowed.

If husband and wife were nonresidents of Wisconsin, with the same facts as stated above, the \$5 minimum personal exemption credit would be allowed.

Situation 5: Combined Wisconsin adjusted gross income and federal adjusted gross income are negative amounts.

Facts: Husband and wife are Wisconsin residents for one-half of 1983.

Husband's Wisconsin adjusted gross income (loss)	(\$10,000)
Wife's Wisconsin adjusted gross income	5,000
Combined Wisconsin adjusted gross income	<u>(\$ 5,000)</u>

Combined federal adjusted gross income	\$ 6,000
Itemized deductions before proration	\$ 5,000

Solution: Since combined Wisconsin adjusted gross income is a negative amount, the proration percentage is 0%. No itemized deductions are allowed.

If the husband and wife were nonresidents of Wisconsin, with the same facts as stated above, the \$5 minimum personal exemption credit would be allowed.

3. Sale of Reinvested Public Utility Stock Dividends

Effective for stock distributions after 1981 in tax years ending after 1981, a qualified public utility can establish a plan under which shareholders who choose to receive a dividend of qualified common stock (instead of cash or property) can elect to exclude from federal income up to \$750 a year (\$1,500 on a joint federal return) of the stock dividends (Section 305(e), IRC). Under s. 71.05(1)(a)12, Wis. Stats., any amount excluded under section 305(e) of the internal revenue code (relating to dividends reinvested in stock of public utilities) must be added back as a modification on the Wisconsin return. The difference in tax treatment between federal and Wisconsin raises questions concerning the subsequent sale of such stock.

Facts:

Prior Federal Treatment: A stock dividend is taxable if the distribution is, at the election of any of the shareholders, payable either in stock or in property (Section 305(b)(1), IRC). Taxable stock dividend distributions are treated as distributions of property to which section 301 applies. For individual shareholders, the basis of the taxable stock dividends received is their fair market value at the time of the distribution (Section 301(d)(1), IRC).

New Federal Treatment: Code Section 305(e) as added by Act 321 of the Economic Recovery Tax Act of 1981 provides special tax treatment for taxable stock dividends issued by qualified public utilities. The special rule for public utility stock dividends distributed after 1981 and before 1986 in taxable years ending after 1981 allows shareholders to elect to exclude from income up to \$750 per year (\$1,500 on a joint return) of the stock dividends received if they choose a dividend of qualified common stock instead of cash or property. The shareholder elects the exclusion, with respect to any share, on his or her return for the tax year in which the dividend would otherwise have been included in income.

If the shareholder elects to exclude the dividend, the federal basis of the stock then becomes zero. Therefore the full amount of the sales proceeds would be taxable. If the stock is held for over one year, capital gain treatment applies to the sale of the stock. If the stock is sold within one year, the gain becomes ordinary income instead of short-term capital gain.

Wisconsin Treatment (Beginning with 1982 taxable year):

If a shareholder elects the exclusion available under section 305(e) of the internal revenue code, an add modification is required for the amount excluded on the federal return (s. 71.05(1)(a)12, Wis. Stats.).

Questions:

1. If a shareholder elects the exclusion available under section 305(e), what is the basis of the stock for Wisconsin purposes?
2. The \$100 dividend exclusion may be used to offset the amount of reinvested public utility stock dividends reported as an add modification, if the entire \$100 dividend exclusion was not used in determining the amount of dividend income reported on line 8 of a 1982 Wisconsin Form 1. Will this \$100 dividend exclusion affect basis?

Example: Taxpayer A received \$400 of dividends for which he reported \$300 (\$400 less \$100 exclusion) on line 8 of his 1983 Form 1. On line 29c of Form 1 he reported reinvested public utility stock dividends of \$500 which he had excluded from federal income. Taxpayer B had no dividends other than \$500 of reinvested public utility stock dividends which he had excluded from federal income. Taxpayer B reported zero on line 8 and \$400 on line 29c (\$500 less \$100 exclusion) of his 1983 Form 1. Is the basis of Taxpayer A's stock different from that of Taxpayer B?

Answers:

1. The basis of the stock for Wisconsin purposes is its fair market value at the time of distribution. Since this creates a difference in basis between federal and Wisconsin, an adjustment should be made on Wisconsin Schedule T in the year of sale per s. 71.05(4)(a), Wis. Stats.
2. The \$100 dividend exclusion does not affect Wisconsin basis. The Wisconsin basis of Taxpayer A's stock is the same as that of Taxpayer B. (Section 116, IRC, which provides for the partial exclusion of dividends received by individuals, does not require a change in the basis of the stock for the dividend exclusion.)

4. Wisconsin Basis of Investment Credit Property

Facts and Question: For property placed in service after December 31, 1982, a taxpayer electing to claim investment tax credit for federal tax purposes must either (1) claim the full 10% credit and reduce the depreciable basis of the property by one-half of such credit, or (2) in the case of regular investment tax credit property, claim a reduced investment credit and depreciate the full cost of the property (IRC Sections 48(q)(1) and (4)(B)(ii)(I)).

Example: During 1983 a taxpayer buys and places in service a new \$25,000 piece of equipment in the five-year ACRS recovery class which qualifies for the regular 10% investment tax credit. For federal tax purposes the taxpayer may either (1) claim the regular 10% investment credit of \$2,500 and have a depreciable basis of \$23,750 (\$25,000 minus one-half of \$2,500), or (2) claim the reduced 8% investment credit of \$2,000 and have a depreciable basis of \$25,000.

If the taxpayer claims the regular investment credit and reduces the depreciable basis of the property accordingly for federal income tax purposes, must this reduced basis also be used for computing depreciation for Wisconsin income tax purposes?

Answer: No. Due to the elections available for claiming investment tax credit, there is more than one allowable method of computing depreciation under the Internal Revenue Code. Therefore, a taxpayer who claims the higher investment tax credit for federal tax purposes (and makes a reduction in the basis of the depreciable property) is not required to use the reduced basis for computing depreciation for Wisconsin income tax purposes. The taxpayer's deduction for depreciation or ACRS may be computed on the full cost of the property rather than on the reduced basis.

In the above example, the depreciation deductions would be computed as follows (assuming the taxpayer elected to depreciate based on the full cost of the property for Wisconsin rather than the reduced basis):

	Federal Return	Wisconsin Return	Difference
ACRS deductions:			
1983 (15%)	\$ 3,562.50	\$ 3,750.00	\$ 187.50
1984 (22%)	5,225.00	5,500.00	275.00
1985 (21%)	4,987.50	5,250.00	262.50
1986 (21%)	4,987.50	5,250.00	262.50
1987 (21%)	4,987.50	5,250.00	262.50
Totals	\$23,750.00	\$25,000.00	\$1,250.00

The taxpayer in this instance would be required to maintain separate depreciation records for Wisconsin income tax purposes. The difference in depreciation allowable may be reflected on the Wisconsin income tax return in one of two ways.

1. Since the amount of depreciation claimed will directly affect the computation of federal adjusted gross income (FAGI), it may also affect other amounts on the federal return which are based on federal adjusted gross income, including the taxable amount of unemployment compensation and itemized deductions for medical expenses, casualty losses, and contributions. (These items use FAGI in computing the taxable unemployment compensation or the amount of itemized deduction.) If the difference in depreciation (e.g., \$187.50 in 1983) will affect other items on the federal return, the taxpayer should submit with the Wisconsin return a federal return and accompanying schedules based on the depreciation allowable for Wisconsin tax purposes. The amounts on lines 6 through 26 and 39 of the 1983 Wisconsin Form 1 will be taken from the federal return using the depreciation allowable for Wisconsin, rather than from the federal return actually filed with the Internal Revenue Service.
2. If no other items on the federal return are affected by the difference in Wisconsin and federal depreciation, the taxpayer may report on lines 6 through 26 and 39 of the 1983 Wisconsin Form 1 the amounts as they appear on the federal return to be filed with the Internal Revenue Service. Then on line 36 of the 1983 Wisconsin Form 1, the taxpayer should write "adjustment to depreciation on investment credit property" and claim a subtraction modification for the difference between the depreciation claimed on the federal return and the amount allowable for Wisconsin. A schedule must be attached to the Wisconsin return showing how the subtraction modification was computed. In the above example, if \$3,562.50 of depreciation was deducted on the federal return and carried over to the Wisconsin return, the taxpayer could claim a subtraction modification of \$187.50 on line 36 of the 1983 Wisconsin return.

5. Wisconsin Treatment of Incentive Stock Options

Facts: Section 422A of the Internal Revenue Code, as added by Section 251 of Public Law 97-34 (the Economic Recovery Tax Act of 1981), provides for favorable federal tax treatment for incentive stock options granted to key employees on a selective and discriminatory basis. Under the provisions of s. 422A, IRC, there is no tax consequence when the incentive stock option is granted or exercised. The employee is taxed at capital gains rates when the stock is sold if the required holding period is met. Wisconsin does not recognize s. 251 of P.L. 97-34 for 1981 and thereafter (ss. 71.02(2)(b)7, 8 and 9, Wis. Stats.).

Example 1: Employee A receives an option which qualifies as an incentive stock option for federal income tax purposes. The option has no readily ascertainable fair market value at the date of grant. If the option is exercised, the shares acquired are not subject to a substantial risk of forfeiture and the shares are transferable.

Question 1: How is this incentive stock option treated for Wisconsin income tax purposes?

Answer 1: The option would be treated as a nonstatutory stock option, subject to the provisions of Section 83 of the Internal Revenue Code. Since the option has no readily ascertainable fair market value, and the shares acquired are not subject to a substantial risk of forfeiture and are transferable, income is realized by A on the date of exercise of the option. The amount of compensation (ordinary income) is the excess of the fair market value of the stock acquired at the date of exercise over the option price paid by employee A.

Employee A's employer is entitled to a deduction under s. 71.04(1), Wis. Stats., for the compensation element of the incentive stock option in the year A exercises the option. The amount deductible by the employer will be equal to the amount of income reportable by employee A.

Question 2: How is the employer to report this additional compensation on an informational return (Form W-2) for Wisconsin tax purposes?

Answer 2: A separate Form W-2 reporting only the additional compensation due to the exercise of the incentive stock option may be submitted in addition to the Wisconsin copy of the regular wage statement which was filed with the Internal Revenue Service. In the alternative, a revised Form W-2 reporting the total compensation for Wisconsin tax purposes may be submitted. In either case, the form should be transmitted with a Form WT-7, "Employer's Reconciliation of Taxable Wages".

Question 3: Is withholding required on the compensation element of the incentive stock option? If so, when must the tax be withheld?

Answer 3: The compensation element of the incentive stock option is "wages", and withholding is required at the time of exercise of the option (ss. 71.19(1) and 71.20(1), Wis. Stats., and s. Tax 2.90(4), Wis. Adm. Code). If the employee's salary is insufficient to pay the additional taxes due, the employee and employer must arrange to have enough money available so the employer can remit the proper amount of withholding tax.

Question 4: What is the basis of stock acquired by the exercise of an incentive stock option?

Answer 4: For Wisconsin purposes, the basis of the stock is the total of the exercise price of the option plus the amount of compensation included in the employee's Wisconsin income (i.e., the fair market value of the stock on the date the Wisconsin income is recognized). For federal purposes, the basis of the stock is the exercise price of the option. A modification for this basis difference should be made on the Wisconsin return for the year in which the stock is sold.

Example 2: An incentive stock option received by employee B has no readily ascertainable fair market value at the date of grant. The shares acquired by B are subject to a substantial risk of forfeiture and not transferable since em-