

## 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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## INCOME AND FRANCHISE TAXES

### 1. Credit for Minimum Tax Paid to Other States

Facts and Questions: Section 71.09(8)(c), Wis. Stats., provides for a credit against Wisconsin net income taxes for income taxes paid to other states.

If the taxpayer pays a minimum tax to another state based on tax preference items enumerated in section 57(a)(2) (accelerated depreciation on real property), (3) (accelerated depreciation on leased personal property), (6) (circulation and research and experimental expenditures), (8) (depletion), (11) (intangible drilling costs) and (12) (accelerated cost recovery deduction) of the internal revenue code, may the payment of a minimum tax on any of these items be claimed as a credit against Wisconsin income taxes under s. 71.09(8)(c)?

Answer: No, a minimum tax based on those tax preference items stated above does not meet the requirements of s. 71.09(8)(c). The conditions for claiming the credit include (1) the tax paid to the other state is a net income tax upon income taxable by such state and (2) the income taxed by the other state is also considered income for Wisconsin tax purposes. The tax preference items mentioned above do not meet these two conditions.

### 2. Crime Victim Compensation Awards

Facts and Question: For the tax year 1977 and thereafter, victims of crime (and/or their dependents), who suffer fi-

nanacial hardship may qualify for compensation under the Crime Victim Compensation program. The program is administered by the Crime Victim Compensation Bureau of the Wisconsin Department of Justice and is governed by Chapter 949 of the Wisconsin Statutes. If a Wisconsin resident suffers injury or death in a situation which occurred outside the state, the resident may qualify for compensation provided the state in which the act occurred does not have a compensation of victims of crime law which covers the injury or death. Nonresident victims receive compensation only if the crime occurs in Wisconsin.

Compensation includes reimbursements for loss of wages, medical, dental and surgical expenses, and funeral and burial expenses. All compensation is subject to certain limits, ranging from \$200 to \$10,000.

Example: A Wisconsin resident was granted \$1,157 in 1983 by the Crime Victim Compensation Bureau. The reimbursement covered the following expenses and loss of wages which resulted from attempting to prevent a crime in 1983:

\$ 747	medical expenses
225	dental expenses
<u>185</u>	loss of wages
\$1,157	Total reimbursement

What is the Wisconsin tax treatment of payments received from the Crime Victim Compensation program?

Answer:

Wisconsin Treatment: Section 71.01(3)(g), Wis. Stats., provides that awards received under the Crime Victim Compensation program are exempt from Wisconsin income taxation. However, any medical expenses which are compensated for by such an award are not deductible on the Wisconsin return.

### 3. Deductibility of Gift of Stock to the Community Development Finance Authority

Facts and Question: The Wisconsin Community Development Finance Authority is a newly authorized nonprofit public corporation which was created by the Wisconsin legislature in 1982 (Chapter 371, Laws of 1981) to develop or redevelop blighted or impoverished areas in Wisconsin. The Authority is required by law to establish a for-profit venture capital fund (called the Community Development Finance Company) and to purchase a majority of the stock of the Finance Company. Individuals and corporations who make a contribution to the Finance Authority and in the same year purchase stock in the Finance Company, at a price equal to their contribution to the Finance Authority, are allowed to claim a credit against their Wisconsin income/franchise taxes due. The allowable credit is 75% of the purchase price of the stock in the Finance Company (s. 71.09)(12m), Wis. Stats.). In addition, a deduction is allowed for contributions made to the Finance Authority. The deduction is an itemized deduction for individuals (s. 71.02(2)(f), Wis. Stats.) and a deduction from gross income for corporations (s. 71.04(5m), Wis. Stats.). The amount of the deduction must be reduced by any tax credit claimed under s. 71.09(12m), Wis. Stats.

If an individual or corporation then makes a gift of the stock of the Community Development Finance Company to the Wisconsin Community Development Finance Au-

thority, is this a deductible contribution under the provisions of s. 71.02(2)(f) and 71.04(5m), Wis. Stats.?

**Answer:** Yes, the gift of the Finance Company stock would be a deductible contribution under s. 71.02(2)(f) and 71.04(5m), Wis. Stats. The amount of the deduction is the fair market value of the stock at the time of the contribution. The fair market value may differ from the original purchase price of the stock.

**Example:** Assume a corporation makes a \$1,000 contribution to the Finance Authority and also purchases stock in the Finance Company for \$1,000. The corporation would receive a \$750 tax credit for the purchase of the stock (75% of the purchase price of the stock). The corporation would also receive a contribution deduction for \$250 under s. 71.04(5m) (\$1,000 contribution to the Finance Authority minus \$750 tax credit). If the corporation then donates the Finance Company stock to the Finance Authority, the corporation would receive an additional \$1,000 contribution deduction, assuming the fair market value of the stock equalled the purchase price. Thus, the corporation would receive a total tax credit of \$750 under s. 71.09(12m) and a total deduction of \$1,250 under s. 71.04(5m) for contributions to the Finance Authority.

#### 4. Taxability Of Foreign Interstate Common Carriers

**Facts and Questions:** Corporation X, a federally licensed interstate common carrier, was incorporated outside of Wisconsin. No office is maintained in Wisconsin. The only property, real or personal, owned or used in Wisconsin are vehicles performing the described activities below. No other activity is performed in Wisconsin. What is the taxability of Corporation X for each of the following situations:

1. Corporation X frequently drives into Wisconsin with a load of goods from out-of-state, delivers them at one in-state location, and immediately leaves Wisconsin. There is no "backhaul", i.e., there are no goods loaded onto Corporation X's truck in Wisconsin for delivery outside of or to another point within Wisconsin.
2. Corporation X frequently drives into Wisconsin from out-of-state, picks up goods at one location, and immediately leaves Wisconsin. The goods picked up are for delivery outside of Wisconsin. There is no other pick up or delivery in Wisconsin.
3. Corporation X frequently drives into Wisconsin with a load of goods from out-of-state, delivers them at a location within Wisconsin, travels to another nearby location in Wisconsin, where goods are picked up for delivery outside of Wisconsin and immediately leaves Wisconsin. There are no other deliveries or pickups within Wisconsin.
4. Corporation X frequently drives through Wisconsin either carrying a load of goods for delivery in another state or traveling to another state to pick up goods for delivery outside of Wisconsin. There are no pick-ups or deliveries made in Wisconsin by Corporation X.

**Answer:** Each of the four transactions described above would subject Corporation X to Wisconsin taxation. Any foreign corporation owning or renting property in Wisconsin or transacting business in this state is required to file a Wisconsin franchise or income tax return if its business operations exceed the minimum standards established by Public Law 86-272. Since this law does not provide immunity from state franchise or income tax to a foreign corpo-

ration deriving income from transportation services performed by corporate employees in Wisconsin. Corporation X would be required to file Wisconsin corporation tax returns.

Corporation X, in accordance with Wisconsin Administrative Code section Tax 2.47, would apportion its income to Wisconsin based on the arithmetical average of the following two ratios:

1. The ratio of the gross receipts from carriage of property first acquired for carriage in Wisconsin to the total gross receipts from carriage of property everywhere, and
2. The ratio of ton miles of carriage in Wisconsin to ton miles of carriage everywhere.

When originating revenue data is not available, originating tonnage data may be substituted, and when ton mileage data is not available, revenue mileage data may be substituted.

#### 5. Wisconsin Corporate Tax Treatment Of Franchise Companies

##### Background:

Franchise companies (fast food restaurants, hotels, temporary help companies, etc.) derive their income from one or both of two sources: (1) from the sale of initial franchises and related assets or services ("the initial franchise fee") and (2) from continuing fees based on the operations of franchises ("franchise royalties"). In return for this income the franchisor (the party who grants business rights under the franchise) normally provides the franchisee (the party who operates the franchised business) with various services. Initially the franchisor may assist in site selection and in evaluation of potential income. During building stages the franchisor may supervise construction activity and assist in the acquisition of signs, fixtures and equipment. The franchisor may then provide a wide range of services to assist the franchisee in its operations including bookkeeping and advisory services, employee and management control, quality control and advertising and promotion.

**Question 1:** Are initial franchise fees and franchise royalties considered business income to the franchisor for Wisconsin tax purposes?

**Answer:** Yes. Initial franchise fees and franchise royalties constitute business income to the franchisor pursuant to s. 71.07(1m) and (2), Wis. Stats. (Union Prescription Centers, Inc. vs. Wisconsin Department of Revenue (WTAC 9/8/80)).

**Question 2:** Are initial franchise fees and franchise royalties paid by franchisees to franchisors deductible for Wisconsin tax purposes?

**Answer:** For Wisconsin tax purposes, treatment of the initial franchise fee paid by the franchisee depends on the terms of the actual franchise agreement. The cost of a franchise which is limited in duration and where renewal is uncertain is amortizable over the useful life of the franchise by the franchisee (s. 71.04(2)(a) and s. 71.04(15), Wis. Stats.). Amounts paid for franchises of unlimited duration, or for perpetual franchises, are not amortizable or depreciable for Wisconsin tax purposes.

Examples: (a) An agreement is entered into to construct motels under a franchise name. The franchise terms are limited to a 10 year life with no renewal clauses. Because the franchise is limited in duration, the cost of the franchise is amortizable by the franchisee over its 10 year life.

(b) A fast food restaurant franchise agreement provides for a 5 year term after which it may be automatically extended in 5 year intervals for a maximum of 20 additional years. Since the franchise is not perpetual, its cost is amortizable over the extended 25 year franchise period. If it is decided not to extend the franchise at some time during this period, the remaining amortizable cost would be written off in the last year of the franchise agreement.

(c) A franchise contract to operate an automobile dealership provides for an indefinite succession of automatic renewals. There is no set limited term provided for. Such an agreement is for an indefinite and unlimited period and is not amortizable by the franchisee.

Franchise royalties paid by franchisees are ordinary business expenses deductible under s. 71.04(2), Wis. Stats. These operating expenses should be deducted in the period in which they are incurred.

Question 3: How are initial franchise fees and franchise royalties received treated for Wisconsin tax purposes by corporate franchisors (a) doing 100 percent of their business in Wisconsin, (b) headquartered in Wisconsin and engaged in business both within and outside Wisconsin, and (c) headquartered outside Wisconsin and engaged in business in Wisconsin and other states?

Answer: (a) Initial franchise fees and franchise royalties are includable in full in Wisconsin income by franchisors transacting all their business in Wisconsin.

(b) For franchisors headquartered in Wisconsin and engaged in business both within and outside Wisconsin and reporting income under the apportionment method, initial franchise fees and royalties received from franchisees located in Wisconsin are includable in full in apportionable business income and in the numerator of the sales factor (s. 71.07(2)(c), Wis. Stats. and s. Tax 2.39(5) (f)2, Wis. Adm. Code).

Initial franchise fees and franchise royalties received from franchisees located outside Wisconsin are also fully includable in apportionable business income. However, the amount includable in the sales factor numerator is based on a cost of performance allocation as provided in s. Tax 2.39(5)(f)5.b.(iii). The denominator of the sales factor would include initial franchise fees and franchise royalties received from all franchisees wherever located.

Example: Corporation B is a multistate franchisor headquartered in Wisconsin. The corporation maintains a staff of employees in Wisconsin who service franchisees either from their home office or through direct contact at individual franchise locations both within and outside Wisconsin. For the 1981 tax year the corporation determined that 10 percent of the total compensation of these employees, along with other direct franchise servicing costs, was incurred in Wisconsin servicing Wisconsin franchisees. The remaining 90 percent was incurred servicing non-Wisconsin franchisees of which two-thirds was incurred in Wisconsin and one-third outside Wisconsin. During the year, the corporation received \$1,000,000 of initial franchise

fees and franchise royalties from Wisconsin franchisees and \$6,000,000 from non-Wisconsin franchisees, all of which were located in states having jurisdiction to tax the franchisor.

For Wisconsin tax purposes, total initial franchise fees and franchise royalties of \$7,000,000 are includable in apportionable business income. The entire \$1,000,000 of initial franchise fees and franchise royalties received from Wisconsin franchisees is includable in the numerator of the sales factor. The numerator would also include \$4,000,000 of franchise fees and royalties received from its non-Wisconsin franchisees (two-thirds of the \$6,000,000.) The sales factor denominator would include the entire \$7,000,000 franchise fees and royalties.

(c) For corporate franchisors headquartered outside Wisconsin and filing Wisconsin income/franchise tax returns under the apportionment method, initial franchise fees and franchise royalties are fully includable in apportionable business income (s. 71.07(1m), Wis. Stats.). The numerator of the sales factor would include franchise fees and royalties received from franchisees located in Wisconsin based on a cost of performance allocation (Tax 2.39(5)(f)5.b.(iii)). The sales factor denominator would include total company franchise fees and royalties.

Example: Corporation C, headquartered outside Wisconsin, is a multi-state franchisor. It has no offices or staff located in Wisconsin. During its 1981 tax year the corporation received \$500,000 of initial franchise fees and franchise royalties from Wisconsin franchisees and \$3,000,000 from non-Wisconsin franchisees. Twenty percent of compensation and direct costs attributable to producing income from Wisconsin franchisees was incurred in Wisconsin.

For Wisconsin franchise tax purposes, the entire \$3,500,000 franchise fees and royalties are includable in apportionable business income. Of the \$500,000 received from Wisconsin franchisees 20 percent, or \$100,000, would be includable in the sales factor numerator. None of the \$3,000,000 earned from non-Wisconsin franchisees is includable in the numerator because none of the compensation and other direct costs attributable to earning these fees was incurred within Wisconsin. The denominator would include the total \$3,500,000.

Note: While the cost of performance factor computed in Examples B and C above is the same for both franchise fees and franchise royalties, the franchisor may compute two different cost of performance factors for franchise fees and for franchise royalties based on different amounts of time and costs incurred in earning these types of income.

Question 4: Do the Wisconsin Statutes contain any special provisions regarding the property or payroll factors of franchise companies reporting income under the apportionment method?

Answer: No. The property and payroll factors of franchisors and franchisees reporting income under the apportionment method are computed in accordance with ss. 71.07(2)(a) and (b) of the Wisconsin Statutes.

## **6. Wisconsin Relocation Payments - Income and Franchise Tax Treatment**

Facts: Sections 32.185-32.27, Wis. Stats., provide that a property owner, tenant, farm operation, business or non-

profit organization displaced by any public project is to be compensated at specified rates for the property acquired and other losses suffered.

**Example:** A displaced tenant-occupant business receives a relocation payment of \$24,000 as provided under ss. 32.185-32.27, Wis. Stats. The lump sum payment is made at the time of displacement although intended to cover increased rent for a period of 4 years following displacement. The business, which had paid \$2,500 rent per month before displacement, incurred a monthly rental increase of \$500 after renting a comparable building for \$3,000 per month (\$500 increase per month  $\times$  48 months = \$24,000).

**Question 1:** Is the lump sum payment covering increased rental costs over a 4 year period taxable?

**Answer 1:** No, the \$24,000 lump sum payment is not taxable. Section 32.19 (4)(c), Wis. Stats., states: "Relocation payments not taxable. No payments received under this section shall be considered as income for the purposes of ch. 71 . . . ."

**Question 2:** For the replacement rental property, how much of the monthly \$3,000 cost is deductible as a business expense?

**Answer 2:** Of the \$3,000 rental cost, \$2,500 may be deducted as a business expense. Since \$500 per month has been reimbursed, that portion of the rental expense may not be claimed as a deduction.

## SALES/USE TAXES

### 1. Governmental Unit's Gross Receipts from Damage Repair and Weed Cutting

**Facts and Questions:** Operators of motor vehicles damage or destroy lawns, trees and shrubs in the boulevard strip and in the area between the sidewalk and the city street. The City's Forestry Department repairs the damage, and then based on Police Accident Reports, bills the party who caused the damage. If the person doesn't pay, the city sues under common law for damages caused to another's property.

The city also has a weed control ordinance which provides that the landowner must cut the weeds. When it isn't done properly, the city does the weed cutting and bills the property owner for the work. Are a city's gross receipts from repairing damages to lawns, trees or shrubs taxable? Also, are a city's charges for weed cutting or weed removal taxable?

**Answers:** The department's position is set forth in par. (3)(c) of rule Tax 11.05, titled "Governmental units", which provides that a governmental unit's gross receipts for "claims assessed against persons for damaging government property" are not taxable. This would apply to the city's billings to persons who caused lawn, tree and shrub damage in the boulevard or between the sidewalk and street.

The sales tax imposed on landscaping and lawn maintenance services under s. 77.52(2)(a)20, Wis. Stats., effective May 1, 1982, results in certain weed cutting services being taxable. Thus, when a city provides weed cutting services in lawn or garden areas, including residential, business,

commercial, industrial or other developed areas, the city has taxable receipts from such services.

### 2. Providing Package Sound Services for Live Music Performances

**Facts and Question:** A professional sound company provides a "package" of sound services and equipment for live music performances. This package includes the rental of sound equipment, transporting the equipment, setting it up and checking it out, providing a technician and crew during the live performance, dismantling and supervising its loading into trucks, and transporting it from the site. For providing these services and equipment, the company charges a flat rate, which varies according to the amount of equipment and crew provided, distance traveled and number of performances.

Are the gross receipts from providing this sound package, including equipment and technicians, subject to sales tax? May the company accept a properly completed "Resale Certificate" in good faith when selling this sound package to a promoter who is charging sales tax on the receipts from providing a recreational event?

**Answers:** The sound company's gross receipts for providing this sound package, including equipment and technicians, is subject to the sales tax. Rentals of equipment are taxable under s. 77.52(1), Wis. Stats., and the services provided in connection with the rentals are taxable under s. 77.51(11)(c)2, Wis. Stats. A Resale Certificate can not be taken in good faith by this company from the promoter, because the promoter is not rerenting the equipment pursuant to s. 77.51(24), Wis. Stats.

### 3. Telephone Circuits Used For Data Transmission

**Facts and Question:** A Wisconsin service bureau provides automatic data processing service to its Wisconsin customers by use of a telephone company's circuits. It provides customers with remote access to its computers, which is commonly referred to as "time-sharing services". The gross receipts from providing time-sharing services to customers are not subject to the sales tax. Are the service bureau's purchases of telephone services from a telephone company subject to sales tax?

**Answer:** Section 77.52(2)(a)4, Wis. Stats., imposes a sales tax on the sale of telephone services of whatever nature, including in addition to services connected with voice communication, any services connected with the transmission of sound, vision, information and data. Therefore, the sales tax applies to the service bureau's purchase of telephone services used in providing time-sharing data processing services to its customers.

## WITHHOLDING TAXES

### 1. Employer Contributions to Section 401(k) Plans Not Subject to Wisconsin Withholding

**Facts and Question:** Section 401(k) of the December 31, 1982 Internal Revenue Code (IRC) provides that a profit sharing plan of an employer will meet the requirements of section 401(a) of the IRC and be treated as a "qualified" plan, even though employees may elect to have the employer make the profit sharing payments directly to them in cash rather than as a contribution to a trust under the

plan. In the absence of the section 401(k) provision, employees participating in a plan offering the immediate cash payment option would be regarded as having constructively received employer payments, even when the employer payment was made to the trust. As a result of the 401(k) provision, an employee electing to have his or her employer pay profit sharing amounts into the trust will not be required to include such amounts in his or her federal taxable income until the amount is withdrawn from the plan.

Under the federal withholding tax law (section 3401(a)(12) of the IRC) payments which employers make on behalf of employees to section 401(a) trusts are exempt from withholding. A trust meeting the requirements of section 401(k) fulfills the requirements of section 401(a) and employer payments to the 401(k) trust are not subject to withholding.

Section 401(k) of the December 31, 1982 IRC applies in the same manner for both Wisconsin and federal purposes for the 1983 tax year and thereafter.

Are payments which an employer makes on behalf of an employee to a profit sharing plan, which meets the requirements of section 401(k) of the December 31, 1982 IRC, subject to withholding of Wisconsin income taxes?

Answer: Such employer payments are not subject to withholding of Wisconsin income tax.

## **2. Withholding for Contributions to Tax-Deferred Annuities**

Facts and Question: Under section 403(b) of the Internal Revenue Code, when certain types of employers purchase a retirement annuity contract for their employees, the employees may exclude from federal adjusted gross income the amount of the employer's contribution, subject to an annual limitation. Since employees are not currently taxed on the amount of money used to purchase these tax-deferred annuities, the amount of federal tax withheld is computed on employees' gross earnings exclusive of the contributions made by their employers. How is the amount of Wisconsin tax withheld computed when contributions are made for employees' tax-deferred annuities?

Answer: Amounts contributed by employers to purchase tax-deferred annuities for employees are not taxable to the employee for both federal and Wisconsin purposes at the time the annuities are purchased. The withholding for Wisconsin purposes, therefore, is computed on the same gross income on which the federal withholding is based. The amount of Wisconsin income tax to be withheld is computed on the employees' gross earnings exclusive of amounts used to purchase tax-deferred annuities under the provisions of section 403(b) of the Internal Revenue Code.