

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 and Franchise Taxes

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INCOME AND FRANCHISE TAXES

1. Farmland Preservation Credit - Depreciation Addback for Rented Property

Background: A person (lessor) who owns and rents out farmland may qualify for the farmland preservation credit if the tenant farms the property and the farmland meets the gross farm profits and other qualifications. The lessor may rent farm buildings, a farm house and farm equipment along with the farmland. Depreciation on the rented farm buildings, farm house and farm equipment will be deducted from the lessor's total rent to compute the farm rental profit or loss. Farm rental profit or loss is reported in one of two ways. If the rent charged is based on crops or livestock produced by the tenant, the income and expenses are reported on federal Form 4835, "Farm Rental Income and Expenses", and the net farm rental profit or loss is carried to federal Schedule E, "Supplemental Income Schedule". If the rent is a flat charge the net profit or loss is computed directly on federal Schedule E.

Section 71.09(11)(a)6, Wis. Stats., allows farmland preservation claimants to deduct "the first \$25,000 of depreciation expenses in respect to the farm" (emphasis added) when computing an individual's or a corporation's farmland household income.

Question: When a person (lessor) rents out a farm that qualifies for farmland preservation credit, is the depreciation on the rented farm buildings, farm house and farm equipment considered depreciation "in respect to the farm" for purposes of computing household income for the farmland preservation credit?

Answer: Yes. The first \$25,000 of depreciation for farm equipment and for improvements located on the farmland, including farm buildings and a farm house, is considered depreciation "in respect to the farm" and allowed as a deduction in computing household income.

2. Insurance Companies - Amortization of Premiums Paid on Purchase of Municipal Bonds

Facts & Questions: Section 71.01(4)(a)4, Wis. Stats. provides that an insurance company must add back to its federal taxable income an amount equal to interest received or accrued during the taxable year to the extent such interest income was used as a deduction in determining the company's federal taxable income (e.g., interest income on municipal bonds).

Wisconsin treats premiums on bonds as part of the purchase price which is recoverable at the time the bonds are redeemed or sold. Such premiums are to be amortized over the life of the bonds for federal tax purposes. An example of the Wisconsin and federal treatment is as follows:

Face Value of 10 Year Municipal Bond \$10,000
 Purchase Price (1/83) \$10,500
 Selling Price (7/84) \$10,400
 Interest Rate 8%

	Wisconsin	Federal
1983 Gross Interest Income	\$ 800	\$ 800
Amortization of Premium		(50)
Net Interest	\$ 800	\$ 750
Schedule M-1 Modification	---	(750)
Net Income Per Return	<u>\$ 800</u>	\$ 0
1984 Gross Interest Income	\$ 400	\$ 400
Amortization of Premium		(25)
Net Interest	\$ 400	\$ 375
Schedule M-1 Modification	---	(370)
Net Income Per Return	<u>\$ 400</u>	\$ 0
Loss on Sale of Bond	\$(100)	\$(25)
Schedule M-1 Modification	---	25
Taxable Gain (Loss)	<u>\$(100)</u>	<u>\$ 0</u>

The decision of the Wisconsin Tax Appeals Commission in American Family Mutual Insurance Co. vs. Department (2/1/84) held that the addback of interest income provided for in s. 71.04(4)(a)4 is to be net of the amortization of premium as provided for in Section 822 of the Internal Revenue Code. (As in the example above, the required modification from federal net income is \$750 for 1983 and \$375 for 1984 to arrive at Wisconsin net income.)

In light of the American Family Mutual Insurance Co. case, will the Department permit amortization of premiums paid on purchase of municipal bonds for all insurance companies or will this decision apply only to mutual insurance companies?

Answer: Section 822 of the Internal Revenue Code provides in part that mutual insurance company taxable income means the gross investment income minus the deductions provided in s. 822(c). This section is unique to mutual insurance companies and does not apply to life insurance companies nor stock companies. Therefore, the American Family Mutual Insurance Co. decision will affect premiums amortized only by mutual insurance companies.

Life insurance companies and stock companies must continue to add to federal taxable income the gross interest income received on municipal bonds. Premiums will continue to be considered as a cost of the bond and recoverable only at the time of sale or redemption.

3. Nonresident Air Carrier Employees' Wages May Be Exempt from Tax

Facts and Question: In the Federal Aviation Safety and Noise Abatement Act of 1979 (P.L. 96-193) Sec. 1112, states that "(a) No part of the compensation paid by an air carrier to an employee who performs his regularly assigned duties as such an employee on an aircraft in more than one State, shall be subject to the income tax laws of any State or subdivision thereof other than the State or subdivision thereof of such employee's residence and the State or subdivision thereof in which such employee earns more than 50 per centum of the compensation paid by the carrier to such employee."

"(b) For the purposes of subsection (a), an employee shall be deemed to have earned 50 per centum of his compensation in any State or subdivision in which his scheduled flight time in such State or subdivision is more than 50 per centum of his total scheduled flight time in the calendar year while so employed."

Under what conditions would an air carrier employee's wages be subject to Wisconsin income tax?

Answer: An air carrier employee would be subject to Wisconsin income tax on the wages earned from an air carrier if:

1. The employee is a Wisconsin resident, or
2. While a nonresident of Wisconsin, more than 50% of the employee's total air carrier wages during the taxable year are earned in Wisconsin.

SALES/USE TAXES

1. Interstate Telephone Services Provided by a Telegraph Company

Facts and Question: Effective May 1, 1982, Chapter 317, Laws of 1981, amended s. 77.52(2)(a)3, Stats., to impose the sales tax on interstate telegraph services by eliminating the word "intrastate" in the imposition language. At the same time a phrase was added to s. 77.52(2)(a)4, the telephone service imposition language, which provides that interstate telephone service is taxable if "that interstate service originates from and is charged to a telephone located in this state".

Most or all of the services provided by a telegraph company are also defined as telephone services in s. 77.52(2)(a)4, Stats., because telephone services now include many types of services other than voice communication.

Are interstate telephone services provided by a telegraph company subject to the sales tax, if these interstate services originate in Wisconsin but are not charged to a telephone located in this state?

Answer: Because telephone services provided by telegraph companies are also included within the definition of telephone services in s. 77.52(2)(a)4, Stats., these interstate services are not taxable unless they originate from and are charged to a telephone located in Wisconsin. This requirement (originating from and charged to a telephone in Wisconsin) also applies to receipts from transmitting in-

terstate messages by wire or satellite which are received in a written or picture form, such as facsimile transmission service, which is another type of taxable telephone service.

The term "telegraph services" in s. 77.52(2)(a)3 refers to "telegraph services" in the traditional sense of that term. Whenever a telegraph company is providing "telephone services" by selling services connected with the transmission of sound, information, data and material, these services are taxable under s. 77.52(2)(a)4. Accordingly, only interstate telephone services originating from and charged to a telephone located in Wisconsin are subject to sales tax. The taxability of a sale depends upon the nature of the transaction and not on the identity of the person rendering the service. To the extent a telegraph company is conducting a telephone service it would be taxed as any other person selling the same service.

2. Well Drillers' Receipts

Facts and Question: Transaction 1 - A well driller enters into a well drilling contract with Person A for \$10,000. The contract includes drilling a well and installing well casing, pipe, fittings and a pump.

Transaction 2 - A well driller replaces a pump for \$500 for Person B.

Transaction 3 - A well driller performs repair service and maintenance work on the water pump in the well for \$100 for Person C.

What is the sales tax status of the well driller's receipts from each of these 3 transactions?

Answer: Transaction 1 - According to s. 77.51(4)(i) and (18), 1983 Wis. Stats., contractors are the consumers of tangible personal property used by them in real property construction activities and the sales/use tax applies on the sale of tangible personal property to them. The well driller is engaged in a real property construction activity when performing this well drilling contract for Person A. The well driller is therefore required to pay sales/use tax on his or her purchases of pumps, well casing, pipes and fittings used to perform the contract. The sale of these items by the supplier to the well driller is considered a retail sale.

There is no sales tax on the \$10,000 paid by Person A to the well driller since there was no retail sale of taxable property or services to Person A.

Transaction 2 - The replacement of a pump in an existing system is a real property construction activity. The well driller should pay sales/use tax on his purchase of the pump because the seller of the pump is considered making a retail sale to the well driller. The \$500 payment by Person B to the well driller is not subject to the sales/use tax because that transaction is not a retail sale of taxable property or services.

Transaction 3 - The \$100 received by the well driller from Person C for the repair, service and maintenance of a water pump is a taxable service under s. 77.52(2)(a)10, 1983 Wis. Stats. Therefore, the \$100 is subject to the sales/use tax as the well driller is making a retail sale of taxable services to Person C in this transaction.