

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. Taxation of Partnership Income For Wisconsin Income Tax Purposes

Facts and Question: A partnership is an association of two or more persons to carry on as co-owners a business for profit. In a general partnership, all partners have equal rights in the management of the partnership business and may act on behalf of the partnership, and each partner can be held individually liable for obligations of the partnership. In a limited partnership, the activities of certain partners are limited, and the liabilities of these partners are limited to a stated amount. Wisconsin law requires one of the partners of a limited partnership to be a general partner with unlimited liability.

Under Internal Revenue Code Section 706(a), a partner must report his or her distributive share of partnership items or guaranteed payments in the partner's taxable year in which the partnership year ends.

How is partnership income taxed to residents and nonresidents of Wisconsin? (A Tax Release on how partnership income is taxed to part-year residents will be issued in a future Wisconsin Tax Bulletin.)

Answer:

A. Residents of Wisconsin

All partnership income of Wisconsin residents is taxable regardless of the situs of the partnership or the nature of the income from the partnership, such as business in-

come, service income or professional income, unless otherwise exempt (such as U. S. government bond interest). This applies both to general partners and to limited partners. Section 71.07(1), Wis. Stats., provides that all income or loss of resident individuals follows the residence of the individual.

B. Nonresidents of Wisconsin

(1) General Partners

That portion of the partnership income attributable to a business located in Wisconsin, services performed in Wisconsin, or rental property located in Wisconsin is taxable to nonresidents of Wisconsin. The income to be reported is based on the activities of the partnership and is not dependent upon whether or not the individual partner conducts business or performs services in Wisconsin. Section 71.07(1), Wis. Stats., provides that income or loss of nonresident individuals follows the situs of the business from which derived. Income from personal services of nonresidents, including income from professions, follows the situs of the services.

Example 1. Two nonresident individuals are the general partners of a partnership whose entire income is attributable to a business located in Wisconsin. Both nonresidents are taxed on their entire share of the partnership income for Wisconsin income tax purposes.

Example 2. A nonresident is one of two equal general partners of a partnership whose income is attributable one-half to a business located in Wisconsin and one-half to a business located in Illinois. The Wisconsin resident partner operates the business located in Wisconsin. The nonresident partner operates the business located in Illinois. The Wisconsin resident is taxed on one-half of the total partnership income for Wisconsin income tax purposes. The nonresident is taxed on his or her one-half of the one-half of the partnership income attributable to the business located in Wisconsin.

Example 3. A nonresident is a general partner, with a one-third interest in partnership profits, of a Certified Public Accounting Firm whose income is attributable one-fourth to professional services performed in Wisconsin and three-fourths to professional services performed in other states. The nonresident partner does not personally perform any services in Wisconsin. The nonresident partner is taxed on his or her one-third of the one-fourth of the partnership income attributable to professional services performed in Wisconsin by the partnership.

(2) Limited Partners

A nonresident limited partner in a partnership engaged in business in Wisconsin is not taxed on any income distributable to the partner from the partnership, provided that the partner is precluded from taking any part in the management of the business or affairs of the partnership and is not authorized to act for or bind the partnership in any way. If the partner is limited in this manner, the distribution of income represents income which follows the residence of the individual. Section 71.07(1), Wis. Stats., provides that income or loss of nonresident individuals from intangible personal property follows the residence of the

individual. In the case *Sweitzer v. Revenue*, 65 Wis. 2d 235, 1974, the Wisconsin Supreme Court ruled that a limited partnership interest is analogous to the interest held by a corporate shareholder, resulting in intangible income which follows the residence of the recipient. Thus, a nonresident of Wisconsin is generally not taxed on income from a limited partnership.

However, even if an individual is defined as a "limited partner", if that individual may take part in any of the management of the business or affairs of the limited partnership, or is authorized to act for or bind the partnership in any way, the individual is treated the same as a nonresident general partner. The individual is taxed on his or her proportionate share of the partnership's Wisconsin income.

Example. A nonresident is a limited partner of a real estate partnership located in Wisconsin. Although the nonresident's liability is limited in the partnership agreement, the nonresident is authorized to participate in the buying and selling of real estate for the partnership. This individual is treated the same as a nonresident general partner and is taxed on his or her proportionate share of the partnership's Wisconsin income.

CORPORATION FRANCHISE/INCOME TAXES

1. Deductibility of Annual License Fee Imposed on Light, Heat and Power Companies

Facts: Section 76.28 of the Wisconsin Statutes (created by 1983 Wisconsin Act 27) imposes an annual license fee on light, heat and power companies. The Department of Revenue must assess this fee on or before May 1, 1985 and every May 1 thereafter. The fee is measured by the company's gross revenue of the preceding year. Payment of the May 1 assessment constitutes a license to carry on business for the 12-month period beginning on the preceding January 1.

On or before May 10, 1985, each light, heat and power company must pay a license fee for 1985 (s. 76.28(3)(a), Wis. Stats.). Beginning with the 1985 calendar year, a portion of the license fees must be paid on an estimated basis. Payment of 45% of the total estimated liability of the May 1, 1986 assessment is due May 10, 1985 (s. 76.28(3)(b), Wis. Stats.). Thereafter, payment of 45% of the estimated assessment for the succeeding calendar year is due on or before May 10 of the current year.

These estimated payments are considered a deposit. No liability for the license fee exists unless the company operates in the calendar year following the year in which the estimated payment is made. For example, if the company terminates operations on December 31, 1985, the estimated payment made May 10, 1985 is refundable. However, if the company terminates operations on January 1, 1986, a license fee based upon the total revenues for 1985 is due in 1986.

Question 1: Are the license fees deductible on a Wisconsin franchise/income tax return?

Answer 1: Yes, the license fees are deductible. Section 71.04(3), Wis. Stats., provides that the license fee imposed under s. 76.28, Wis. Stats., is deductible from gross income as "taxes".

Question 2: When is the license fee for 1985, which is due and paid by May 10, 1985, deductible?

Answer 2: The amount due and paid for 1985 is deductible on a 1985 Wisconsin franchise/income tax return.

Question 3: When is the estimated payment for 1986, which is due May 10, 1985, deductible?

Answer 3: Since there is no liability for the 1986 license fee unless the company operates in 1986, the estimated payment made in 1985 is *not* deductible on a 1985 Wisconsin franchise/income tax return. This applies to both cash basis and accrual basis taxpayers. The actual fee assessed and paid in 1986 (including the estimated payment made in 1985) is deductible on a 1986 Wisconsin franchise/income tax return.

SALES/USE TAXES

1. Sales of Photocopies by Lawyers

Facts and Questions: The gross receipts from providing legal services are not subject to the sales and use tax. However, a law firm may charge for legal services and then separately charge its clients for photocopies along with other itemized charges.

The *Frisch, Dudek and Slattery v. Wisconsin Department of Revenue* decision of the Wisconsin Tax Appeals Commission, dated May 25, 1984, describes how the attorney involved in the legal matter exercised a judgment as to whether or not to bill clients for photocopies. If a copy was made for the benefit of the client, the client was billed for it; if a copy was made for the benefit of the attorney or office, the client was not billed for it. In its decision the Commission held that the law firm's charges for photocopies are sales of tangible personal property under s. 77.51(4)(h), Wisconsin Statutes, which were subject to the sales tax.

Effective September 1, 1983, 1983 Wis. Act 27 amended and created various sections in the sales tax law relating to tangible personal property purchased and provided by service providers in conjunction with selling, performing or furnishing services. Under the new law, if property is transferred by lawyers to their clients "incidental" to providing legal service, the lawyer is not the seller or reseller of such property and must pay a tax on its cost of the property.

Do the policies that apply to sales of photocopies under the prior law as reflected in the *Frisch, Dudek and Slattery* decision continue to apply under the incidental test now found in sales tax law, as incidental is defined in s. 77.51(29), Wisconsin Statutes, on and after September 1, 1983?

Answer: The *Frisch, Dudek and Slattery* decision no longer sets policy under the incidental test, effective September 1, 1983. The Department's position is that photocopies provided to a lawyer's client incidental to legal services provided, whether or not separately charged, are not taxable. A photocopy is incidental to the legal service when the copy is transferred in conjunction with providing the service and the number of copies transferred do not exceed the usual number normally transferred to clients in providing the legal service. Charges for other photocopies not incidental to providing a legal service are taxable.

Examples of photocopies provided "incidental" to providing the legal service:

- a) A lawyer drafts a will and provides the principal and each of the beneficiaries a copy of the will.
- b) A lawyer provides tax preparation services and provides a client with copies of returns to be filed and a copy of each return for the client.
- c) A lawyer in litigating a case charges the client by the page for a photocopy of the brief provided to the client.

Examples of taxable sales of photocopies because they are not "incidental" to the legal service:

- a) Copies of a transcript relating to a case, which upon request are provided to other law firms not involved in that litigation.
- b) A client requests copies of prior years' tax returns prepared by the lawyer.
- c) Any sale of photocopies not provided in conjunction with providing legal services.

2. Optional Call Detail Charges by Telephone Companies

Facts and Question: A person who is in the business of providing long distance telephone service, for an additional fee, will provide a customer with computer produced monthly reports showing how its telephones are being used. The report can define the customer's telephone facility usage, call detail charges and provide various other accounting details. The customer has the option to choose from a variety of types of reports depending on the type of call detail it desires. Are these charges by a telephone company for call detail information subject to the sales tax?

Answer: Yes. This computer provided service is a taxable telephone service under s. 77.52(2)(a)4, Wis. Stats., which imposes the tax on "the sale of telephone services of whatever nature..."

HOMESTEAD AND FARMLAND PRESERVATION CREDITS

1. Depreciation Add-Back for (S) Corporation Shareholders

Question: Must a shareholder of a tax-option (S) corporation add-back depreciation expense of the tax-option (S) corporation in determining household income for the homestead or farmland preservation credit?

Under s. 71.09(11)(a)6.a and s. 71.09(7)(a)1, Wis. Stats., "income" for homestead or farmland household income means the sum of adjusted gross income, plus various other items of income that are not includable in adjusted gross income, plus depreciation expense that was deducted in determining adjusted gross income. For farmland claimants, "income" does not include the first \$25,000 of depreciation in respect to the farm, but does include any nonfarm business losses.

Beginning with the 1979 taxable year the net income of a tax-option (S) corporation may be deducted from the cor-

poration's tax return if the income is reported by the shareholders of the corporation. When the income is reported by the shareholders, it retains its character as business income and is treated as ordinary income or loss on the shareholders' Wisconsin tax returns. Tax-option (S) corporation income or loss flows through to shareholders as a whole rather than as individual items of income and expense. Therefore, depreciation expense of a tax-option (S) corporation does not retain its character as depreciation when it flows through to the individual shareholders.

Answer: No, for purposes of determining household income for homestead or farmland preservation credit, a shareholder of a tax-option (S) corporation does not have to add back the depreciation expense of the tax-option (S) corporation. For a farmland credit claimant, the tax-option (S) corporation's depreciation is not used in determining the \$25,000 of allowable exclusion, nor must depreciation of the tax-option (S) corporation in excess of \$25,000 be added back for household income.

2. Farmland Credit — Two Township Proration

Background: Under s. 71.09(11)(b)3, Wis. Stats., farmland preservation credit claimants may be eligible for either 100% or 70% of the credit, depending on which of the following apply to the farmland on which the claim is based:

- a) the qualified farmland is located in a county which has a certified agricultural preservation plan,
- b) the qualified farmland is in an area zoned for exclusive agricultural use,
- c) the qualified farmland is subject to a transition area agreement, or
- d) the qualified farmland is subject to a farmland preservation area agreement.

The instructions to the farmland preservation credit form, Schedule FC, explain in detail how the above factors qualify the claimant for either 100% or 70% of the farmland preservation credit.

In some instances a claimant can have qualified farmland that is located in different townships (or other geographic areas) so that part of the farmland is eligible for the 100% credit, and part of the farmland is eligible for the 70% credit.

Question: How is the farmland preservation credit computed when part of the claimant's farmland is eligible for 100% of the credit, and part is eligible for 70% of the credit?

Answer: The farmland claimant must first determine the portion of the real estate taxes levied for the taxable year on the farmland qualifying for 100% of the credit, and the taxes on the farmland qualifying for 70% of the credit. The farmland preservation credit is then computed by completing the following schedule:

Two Township Proration Schedule

	Col. a 100%	Col. b 70%
1. Enter the real estate taxes levied during the 1984 taxable year on the farmland on which this claim is based.	\$ _____	\$ _____
2. Col. a — Enter the smaller of the amount on line 1, Col. a or \$6,000.	_____	_____
3. Subtract the amount on line 2, Col. a from \$6,000 and enter here _____	_____	_____
4. Col. b — Enter the smaller of the amount on line 1, Col. b or the amount from line 3.	_____	_____
5. Enter your household income here _____	_____	_____
6. Using the amount on line 5, enter the appropriate figure from Table 1 of the 1984 farmland preservation credit instructions here _____	_____	_____
7. Col. b — Enter the smaller of the amount on line 4, Col. b or the amount on line 6.	_____	_____
8. Col. a — Subtract the amount on line 7, Col. b from the amount on line 6.	_____	_____
9. Col. a — Subtract the amount on line 8, Col. a from the amount on line 2, Col. a.	_____	_____
Col. b — Subtract the amount on line 7, Col. b from the amount on line 4, Col. b.	_____	_____
10. Add the amounts on line 9, Columns a and b and enter here _____	_____	_____
11. Using the amount on line 10, enter the appropriate figure from Table 2 of the 1984 farmland preservation instructions _____	_____	_____
12. Col. a — Using the amount on line 9, Col. a, enter the appropriate figure from Table 2 of the 1984 farmland preservation instructions.	_____	_____
13. Col. b — Subtract the amount on line 12, Col. a from the amount on line 11.	_____	_____
	100%	70%
14. Farmland preservation credit — Multiply the amounts on line 12, Col. a and line 13, Col. b by 100% or 70% as appropriate. Enter here and on lines 14a(1) and (2) of your 1984 Schedule FC. Attach this schedule to your 1984 Schedule FC.	\$ _____	\$ _____

Taxes qualifying for 100% of the credit — \$3,035
 Taxes qualifying for 70% of the credit — \$2,000

Farmer B also has household income of \$20,000.

Farmer B's 1984 farmland preservation credit is \$2,846, which he determines by completing the Two Township Proration Schedule as follows:

Two Township Proration Schedule

	Col. a 100%	Col. b 70%
1. Enter the real estate taxes levied during the 1984 taxable year on the farmland on which this claim is based.	\$3,035	\$2,000
2. Col. a — Enter the smaller of the amount on line 1, Col. a or \$6,000.	3,035	_____
3. Subtract the amount on line 2, Col. a from \$6,000 and enter here \$2,965.	_____	_____
4. Col. b — Enter the smaller of the amount on line 1, Col. b or the amount from line 3.	_____	2,000
5. Enter your household income here \$20,000.	_____	_____
6. Using the amount on line 5, enter the appropriate figure from Table 1 of the 1984 farmland preservation credit instructions here \$1,345.	_____	_____
7. Col. b — Enter the smaller of the amount on line 4, Col. b or the amount on line 6.	_____	1,345
8. Col. a — Subtract the amount on line 7, Col. b from the amount on line 6.	-0-	_____
9. Col. a — Subtract the amount on line 8, Col. a from the amount on line 2, Col. a.	_____	_____
Col. b — Subtract the amount on line 7, Col. b from the amount on line 4, Col. b.	3,035	655
10. Add the amounts on line 9, Columns a and b and enter here \$3,690.	_____	_____
11. Using the amount on line 10, enter the appropriate figure from Table 2 of the 1984 farmland preservation instructions \$2,985.	_____	_____
12. Col. a — Using the amount on line 9, Col. a, enter the appropriate figure from Table 2 of the 1984 farmland preservation instructions.	2,523	_____
13. Col. b — Subtract the amount on line 12, Col. a from the amount on line 11.	_____	462
	100%	70%
14. Farmland preservation credit — Multiply the amounts on line 12, Col. a and line 13, Col. b by 100% or 70% as appropriate. Enter here and on lines 14a(1) and (2) of your 1984 Schedule FC. Attach this schedule to your 1984 Schedule FC.	\$2,523	\$ 323

Note: Although the above schedule is specifically for 1984 claims, the same method may be used for other years.

Example: Farmer B has farmland located in two counties. Real estate taxes levied on the farmland for 1984 are as follows: