

ABC Corporation would compute its 1985 sales factor based on the *U.S. Steel* and *IBM* decisions as follows:

	<u>Wisconsin/ Numerator</u>	<u>Total/ Denominator</u>
Sales:		
Into Wisconsin.....	\$5,000,000	\$ 5,000,000
Into nexus states		10,000,000
Into nonnexus states (50% throwback)	2,000,000	4,000,000
To U.S. Government	1,000,000	1,000,000
Interest Income:		
From trade accounts receivable	10,000	10,000
From investments (unitary)	100,000	100,000
Dividend Income:		
\$200,000 deductible per 71.04(4)(a) (100% deductible)	-0-	-0-
\$100,000 deductible per 71.04(4)(b) (100% deductible*)	-0-	-0-
Other.....	50,000	50,000
Proceeds from Capital Gains:		
Sales of stock.....	500,000	500,000
Sale of business assets.....	200,000	200,000
Royalties from Patents (Unitary)	50,000	50,000
Gross Rents:		
Real property (business).....	50,000	50,000
Personal property (business)	20,000	40,000
Real property (nonbusiness)	-0-	-0-
Total	<u>\$8,980,000</u>	<u>\$21,000,000</u>
Sales Factor Percentage to Wisconsin		<u>42.7619%</u>

*50% deductible for taxable years 1980 through 1983 and 75% deductible for taxable year 1984.

If ABC exercised its option to compute its 1985 sales factor under the provisions of 1985 Wisconsin Act 120, its computation would be as follows:

	<u>Wisconsin/ Numerator</u>	<u>Total/ Denominator</u>
Sales:		
Into Wisconsin.....	\$5,000,000	\$ 5,000,000
Into nexus states		10,000,000
Into nonnexus states (50% throwback)	2,000,000	4,000,000
To U.S. Government	1,000,000	1,000,000
Interest Income:		
From trade accounts receivable	10,000	10,000
From investments (unitary)	-0-	-0-
Dividend Income:		
\$200,000 deductible per 71.04(4)(a) (100% deductible)	-0-	-0-
\$100,000 deductible per 71.04(4)(b) (100% deductible*)	-0-	-0-
Other.....	-0-	-0-
Proceeds from Capital Gains:		
Sales of stock.....	-0-	-0-
Sale of business assets.....	-0-	-0-
Royalties from Patents (Unitary)	50,000	50,000
Gross Rents:		
Real property (business).....	50,000	50,000
Personal property (business)	20,000	40,000
Real property (nonbusiness)	-0-	-0-
Total	<u>\$8,130,000</u>	<u>\$20,150,000</u>
Sales Factor Percentage to Wisconsin		<u>40.3474%</u>

*50% deductible for taxable years 1980 through 1983 and 75% deductible for taxable year 1984.

2. Deductibility of Motor Carriers' Operating Authorities

Statutes: section 71.04(8), 1983 Wis. Stats.

Note: This Tax Release, which was published in *Wisconsin Tax Bulletin* #32 dated April 1983, has been withdrawn. In *Star Line Trucking Corporation vs. Wisconsin Department of Revenue*, Docket No. I-10609, September 23, 1985, the Wisconsin Tax Appeals Commission concluded that 1980 was the proper tax year in which the taxpayer may write off the value of its motor carrier interstate operating rights. See the summary of the *Star Line Trucking Corporation* decision in the "Report on Litigation" in this bulletin.

3. Bad Debts - Savings and Loan Associations

Statutes: sections 71.04(7) and (9)(b), 1983 Wis. Stats.

Facts and Question: The Wisconsin Tax Appeals Commission decision in *Liberty Savings and Loan Association vs. Department of Revenue* (Docket No. I-6426, December 22, 1982) concluded that a savings and loan association is allowed under s. 71.04(9)(b), as it applied to the years 1972 through 1976, a bad debt deduction for two-thirds of the amount actually transferred to its Federal Insurance Reserve (FIR) account if that amount is reasonable and within the federal and state requirements.

For years 1981 and thereafter, federally chartered savings and loans are no longer required by the Federal Home Loan Bank to make an allocation to a loss reserve. The statutory reserve is a net worth requirement determined by audit of an organization's undistributed earnings, bad debt reserve, capital stock (if a stock company) and other surplus reserves. A state chartered savings and loan insured by the FSLIC must still maintain the FIR account and make appropriate transfers to that account.

What is the allowable bad debt deduction under s. 71.04(7) or 71.04(9)(b), 1983 Wis. Stats., for Wisconsin corporation franchise or income tax purposes for a year in which no transfer was made to the book FIR account by a savings and loan association?

Answer: Since no transfers were actually made to the book FIR account, no deduction is allowable under s. 71.04(9)(b), 1983 Wis. Stats. However, in lieu thereof actual bad debts sustained during the year are allowed as a deduction under s. 71.04(7), 1983 Wis. Stats.

4. Nexus and Certain Exempt Activities for Foreign Corporations

Statutes: sections 71.01(1), (2) and (2m), 1983 Wis. Stats.

Wis. Adm. Code: section Tax 2.82, September 1983 Register

Note: This Tax Release applies only with respect to taxable years 1983 and thereafter.

Background: 1983 Wisconsin Act 89 amended sections 71.01(1) and (2), Wisconsin Statutes, and created section 71.01(2m), effective for the 1983 taxable year and thereafter, as follows:

"(2m) ACTIVITIES THAT DO NOT CREATE NEXUS. A foreign corporation may do business, exercise its franchise and own property in this state to the limited extent referred to in the following activities, in addition to those activities permitted under P.L. 86-272, without

subjecting itself to the imposition of the income or franchise tax under subs. (1) and (2):

(a) The storage for any length of time in this state in or on property owned by a person other than the foreign corporation of its tangible personal property and the delivery of its tangible personal property to another person in this state when such storage and delivery is for fabricating, processing, manufacturing or printing by that other person in this state.

(b) The storage for any length of time in this state in or on property owned by a person other than the foreign corporation, and the shipment or delivery outside this state by another person in this state, of the entire amount of the foreign corporation's tangible personal property fabricated, processed, manufactured or printed in this state.

(c) If the foreign corporation is a publisher, the purchase from a printer of a printing service or of tangible personal property printed in this state for the publisher and the storage of the printed material for any length of time in this state in or on property owned by a person other than the publisher, whether or not the tangible personal property is subsequently resold or delivered in this state or shipped or delivered outside this state."

Facts and Question - Example 1: Company A is a U.S. corporation incorporated and domiciled in Ohio and doing business in all fifty states. A is a manufacturer and seller of pulp, paper and related products.

Company B is a U.S. corporation, incorporated in Delaware, domiciled in Ohio and doing business in Wisconsin. B, a wholly-owned subsidiary of A, is a seller of market pulp that is manufactured by various producers.

Company C, a foreign corporation, is incorporated and domiciled in Canada. C, a 50 percent-owned affiliate of A, is a manufacturer of pulp, paper and lumber.

C ships raw pulp from Canada, via common carrier, into Wisconsin for storage in a public warehouse. Such pulp remains in storage until sale. B, acting as C's representative, solicits customers for the purchase of the stored pulp and receives a commission for sales thereof. Upon consummation of the sale, the pulp is shipped, via common carrier, to a customer's facility.

The raw pulp is sold by B to companies located both within and without Wisconsin. Approximately 30 percent of the shipments of the warehoused pulp are to companies located within Wisconsin. The remaining shipments are to companies located without Wisconsin. A portion of the out-of-state shipments are made to facilities owned by A. All such purchasers use the pulp to manufacture and fabricate paper and related products.

The sequence of events that result in a sale is as follows:

- (1) C ships pulp to a public warehouse in Wisconsin.
- (2) B sells such pulp as C's independent agent.
- (3) The pulp is then shipped to customers located within and without Wisconsin.
- (4) The pulp is used by these companies for further activities as described in s. 71.01(2m).

Is Company C's activity in Wisconsin protected by s. 71.01(2m), 1983 Wis. Stats., and thus exempt from Wisconsin's franchise/income tax law?

Answer: No. The ownership of the property must remain in the foreign corporation throughout its presence in Wisconsin to exempt the foreign corporation from filing. Section 71.01(2m), 1983 Wis. Stats., does not provide exemption to a foreign corporation when sales orders are filled from a stock of goods located in Wisconsin owned by that corporation unless the out-of-state owner is a publisher and the goods are materials printed in this state. Company C must file Wisconsin franchise/income tax returns.

Facts and Question - Example 2: Corporation P, a publisher incorporated and domiciled in New Jersey, stores printing supplies (paper, ink, etc.) at Wisconsin locations. It also stores printed materials (books, magazines, etc.) in or on Wisconsin property owned by a Wisconsin corporation which has printed these materials in Wisconsin for the publisher. These printed materials are subsequently sold to customers located both within and without Wisconsin.

Is Corporation P's activity in Wisconsin protected by s. 71.01(2m), 1983 Wis. Stats., and thus exempt from Wisconsin's franchise/income tax law?

Answer: Yes. But any other activity exceeding the limits of P.L. 86-272, such as maintaining its employees at the printer's Wisconsin business location for quality control purposes, will subject Corporation P to Wisconsin's franchise/income tax law.

Facts and Question - Example 3: Corporation X, a New York based manufacturing company, has raw materials stored in a public warehouse in Wisconsin. Corporation X has the raw materials shipped by common carrier to Corporation W, a Wisconsin subcontractor, to process these raw materials before shipping them to Corporation X for the purpose of being combined with other materials into Corporation X's finished product.

Is Corporation X's activity in Wisconsin protected by s. 71.01(2m), 1983 Wis. Stats., and thus exempt from Wisconsin's franchise/income tax law for 1983 and all subsequent years?

Answer: Yes. The storage of raw materials in Wisconsin in a public warehouse for delivery to a Wisconsin subcontractor for processing, storage and shipment out of Wisconsin are protected activities.

5. Wisconsin Tax Treatment of Deferred Income by Corporations

Statutes: section 71.11(8)(a), 1983 Wis. Stats.

Wis. Adm. Code: section Tax 2.16, September 1983 Register

Facts and Question: Section 71.11(8)(a), 1983 Wis. Stats., provides that the income and profits of a corporation for the income year shall be computed in accordance with the method of accounting regularly employed in keeping its books, but if no method has been employed or if the method does not clearly reflect income, the computation shall be made in a manner that does, in the opinion of the Department, clearly reflect the income.

It has been well established by court decisions that under the accrual basis of accounting, income is accruable when all events have taken place to give the taxpayer a

right to receive the income. This is known as the "claim of right" doctrine. Similarly expenses or deductions are accruable when all events have taken place to fix the taxpayer's liability for payment and the amount of the liability can be determined. There is another principle established by court decisions to the effect that a taxpayer who receives cash for property or services and has unrestricted use of the funds so received, is taxable on such income in the year in which it is received. Under this principle, if an advance payment is received in one year for services or property to be delivered in the following year, the advanced payment is taxable in the year in which received. This principle is contrary, however, to good accounting theory which requires that income and the costs and expenses of producing such income must be reported in the same accounting period.

What is the Wisconsin tax treatment of various types of income deferred for book purposes in accordance with Generally Accepted Accounting Principles?

Answer:

A. Prepayments for Delivery of Merchandise at a Later Date

Advance billings or refundable deposits made in one accounting period for specific merchandise to be delivered in a subsequent accounting period may be deferred and reported as income in the year in which delivery of the merchandise is made to the customer. Income from the sale of merchandise on credit or the installment basis must be reported in full in the year in which the merchandise is delivered to the customer. Billings for tangible personal property delivered under a long-term supply contract are reportable as income in the year billed and may not be deferred until the contract has been completed. Prepaid subscription income may be reported ratably over the number of months covered by the subscription or may be reported in the year received, at the election of the taxpayer.

B. Advance Payments on Long-Term Construction Projects

Advance payments or progress payments under a general construction contract may, at the election of the taxpayer, be reported on the percentage of completion basis where costs can be matched against progress payments, or may be deferred and reported in the year in which the contract is completed.

C. Advance Payments for Future Services

Income from advanced ticket sales to a fixed schedule of events may be reported in the year received or prorated and included in the income in the year in which the events take place.

Advanced payments for personal services to be performed in a subsequent income year, for the right of occupancy or the exercise of any other right during a subsequent taxable year, are includible in income in the year received if the taxpayer has unrestricted use of the funds. This type of income may not be deferred even though there may be direct or indirect costs relating to the earning of such income in a subsequent tax year. See *Villa Maria, Inc. and Allen Hall Corp. vs. Wisconsin Department of Revenue*, Wisconsin Tax Appeals Commission, Docket Nos. I-2395 and I-2396, June 16, 1969 and *Commonwealth Land Title Insurance Co. vs. Wisconsin Department of Revenue*, Wis-

consin Circuit Court, Milwaukee County, No. 405-664, January 25, 1974.

Example: ABC Corporation sells and services office business machines. In this respect, it sells maintenance contracts for a fixed period of time. For book purposes this income is deferred and allocated to income over the period of the contract. However, for Wisconsin corporate franchise/income tax purposes the ABC Corporation must report this income when received since it has the unrestricted use of the funds. The difference in accounting for this income for book and tax purposes is summarized as follows:

Item	Per Books		Per Tax	
	1984	1985	1984	1985
Cash Received on Contracts	\$ 100,000	\$ 150,000	\$100,000	\$150,000
Deferred to Period Earned	(15,000)	(25,000)	-0-	-0-
Income from Deferred	-0-	15,000	-0-	-0-
Income Reported	<u>\$ 85,000</u>	<u>\$ 140,000</u>	<u>\$100,000</u>	<u>\$150,000</u>

The above methods of accounting for prepayments are considered to clearly reflect income for Wisconsin taxpayers under s. 71.11(8)(a), 1983 Wis. Stats. Therefore, a change in such methods of accounting for Wisconsin tax purposes may not be made without first obtaining Department approval under Wis. Adm. Code section Tax 2.16.

6. Doctrine of Recoupment in Pending Cases Where Taxpayer Has Paid an Admitted Portion of Tax

Statutes: section 71.12(1)(b), 1983 Wis. Stats.

Background: The case *American Motors Corporation v. Department of Revenue*, 64 Wis. 2d 227, 219 N.W. 2d 300 (1974), stands for the proposition that either the state or the taxpayer can counter with a "stale" claim (i.e., a claim barred by the statute of limitations) to the extent of an additional assessment or refund, so long as the same year or income tax period is involved.

Section 71.12(1)(b), Wis. Stats., provides in part, "A person may also pay any portion of an assessment which is admitted to be correct and the payment shall be considered an admission of the validity of that portion of the assessment and may not be recovered in an appeal or any other action or proceeding."

Question: In light of the above cited section of the law, can the Department issue a refund or permit an offset from an admitted payment?

Answer: No, once an additional assessment is admitted and paid after a petition for redetermination has been filed regarding the additional assessment, the admitted additional assessment cannot be subsequently recovered.

The following examples clarify how *American Motors* and s. 71.12(1)(b), Wis. Stats., would apply in various situations:

Example 1

Facts: The Department issues an additional assessment based on two points.

The taxpayer contests only the first point and admits and pays the remainder of the additional assessment.

The taxpayer later decides that he wants to contest the second point.

Outcome: Regardless of whether the taxpayer wins or loses on the first point, he cannot seek recoupment or contest the second point. Per s. 71.12(1)(b), Wis. Stats., the second point was admitted and paid and, therefore, not recoverable in an appeal or any other action or proceeding.

According to the language of s. 71.12(1)(b), Wis. Stats., the admission takes place at the time of payment, thus even in cases held in abeyance by the Department pending the outcome of another case, the taxpayer is barred from amending his petition for redetermination to contest the second point after the additional assessment on the second point is admitted and paid.

Because s. 71.12(1)(b), Wis. Stats., provides that the admission barring future recovery occurs at the time of payment, the doctrine of recoupment would be available to the taxpayer until the taxpayer pays the admitted portion of the assessment.

Example 2

Facts: The Department of Revenue issues an additional assessment based on two points.

The taxpayer contests the first point and admits and pays the remainder of the additional assessment.

The taxpayer later discovers a new basis for a claim for refund based on the same tax year or period. The claim for refund is now barred by the statute of limitations (i.e., it is a "stale" claim).

Outcome: If the taxpayer ultimately loses on the first issue and is required to pay the additional assessment, he is entitled to recoup the amount of the stale refund claim to the extent of the amount of contested additional assessment. The amount recoverable by the taxpayer cannot exceed the amount of the contested additional assessment.

If the taxpayer has not paid the admitted portion of the assessment, it would appear that the taxpayer can apply the doctrine of recoupment to the total additional assessment which has not been paid.

If the taxpayer ultimately wins on the first issue and is not required to pay the additional assessment, there is no assessment against which the taxpayer can assert his stale claim. Therefore, the stale claim is not recoverable.

Example 3

Facts: The Department of Revenue issues an additional assessment by office audit based on two points.

The taxpayer pays the total assessment and files for a refund on the first point before the expiration of the statute of limitations in s. 71.10(10)(e), Wis. Stats.

The refund is denied and taxpayer files a petition for redetermination, etc.

After the statute of limitations set forth in s. 71.10(10)(e), Wis. Stats., has expired, the taxpayer seeks a refund based on the second point.

Alternatively, the taxpayer seeks a second refund based on a totally new point arising out of the same tax year or

period after the statute of limitations set forth in s. 71.10(10)(bn), Wis. Stats., has expired.

Outcome: Regardless of whether the taxpayer wins or loses on the first refund claim, there is no assessment for the taxpayer to utilize for purposes of recouping his second stale refund claim. The taxpayer cannot increase the amount of his valid refund with stale refund claims. Therefore, the taxpayer's stale refund claims are barred.

Per American Motors, if the Department of Revenue has an additional assessment arising out of the same tax year or period which is closed to assessment by the statute of limitations, the Department of Revenue may recoup the additional assessment up to the amount of the refund if the taxpayer is successful. If the taxpayer does not ultimately prevail on its claim for refund, the Department of Revenue has nothing to offset its stale additional assessment against and, therefore cannot recover the stale assessment.

SALES/USE TAXES

1. Furnaces That May Be Used to Burn Bio-Mass Pellets or Lignite Fuel

Statutes: section 77.54(26m), 1983 Wis. Stats.

Facts and Question: A stoker-furnace has been specifically designed to produce heat by burning either lignite

coal or bio-mass pellets. The primary use of the furnace is to provide forced-air central heating for a variety of types residential or light commercial installations.

Bio-mass pellets are not solid waste, but they are a product which has been produced from solid waste. For example, fuel pellets may be produced from solid waste, such as paper or cardboard.

Is the purchase of a furnace-stoker, which has been specifically designed to burn bio-mass (fuel) pellets produced from solid waste, exempt from the sales/use tax as waste reduction or recycling machinery and equipment under s. 77.54(26m), Wis. Stats.?

Answer: No. The exemption in s. 77.54(26m) does not apply to a furnace specifically designed to burn bio-mass pellets or lignite fuel as its primary purpose is to produce heat. The furnace does not recover energy from solid waste, but rather from a product of solid waste or from coal. This is the case even though the bio-mass pellets which are burned may have been produced in a recycling process. Waste reduction and recycling includes the process of taking solid waste and producing a new marketable product from solid waste, but it does not go beyond producing the new marketable product.