

sistent with section Tax 11.39(2) (b) and 11.40(2)(c) and (3)(d), Wis. Adm. Code, since both the Commission and the Circuit Court have concluded that Thiry Daems' milk tank is *not* used as a means of storage as contemplated by the Legislature. Therefore, the decision and order of the Wisconsin Tax Appeals Commission were affirmed.

The department has not appealed this decision.

**Wisconsin Department of Revenue vs. Vita Plus Corporation** (Circuit Court of Dane County, March 13, 1986). This was an action to review a decision of the Wisconsin Tax Appeals Commission which reversed the department's action disallowing a tax exemption under s. 77.54(6)(a), Wis. Stats., claimed by Vita Plus Corporation (Vita Plus) and reversed the department's action denying a reduction to Vita Plus' franchise tax under s. 71.043(2), Wis. Stats., on property

used in connection with the blending and secondary cleaning operations which are performed in the production of Vita Plus' finished product.

It was the department's position that the blending and secondary cleaning operations do not constitute "manufacturing" within the intent and meaning of s. 77.51 (27), Wis. Stats. The department contended that the manufacturing process terminates at the time the grain is placed into the conditioning bins, and therefore the property at issue does not qualify for the sales and use tax or franchise tax exemptions. Specifically, the department argued that because the Commission failed to make a legal distinction between "storage" and "manufacturing": (1) the Commission's conclusions of law are based on an erroneous view of the law and (2) Findings of Fact Nos. 14-28 are not supported by the record.

The basic issue for the Circuit Court to resolve is whether the blending and secondary cleaning operations constitute "manufacturing" under s. 77.51 (27), Wis. Stats.

First, the Court found that the Commission's conclusions of law were not based upon an erroneous view of the law. The Court found that the Commission did not fail to make a legal distinction between "storage" and "manufacturing." Accordingly, the Commission's Findings of Fact Nos. 14-28 are supported by substantial evidence in the record. For these reasons, it was the view of the Circuit Court that the Commission's decision and order dated August 16, 1985 be affirmed in all respects.

The department has 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.)*

### Individual Income Taxes

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## INDIVIDUAL INCOME TAXES

1. Taxability of Railroad Unemployment Insurance Benefits

**Statutes:** section 71.05(1)(b)4, 1983 Wis. Stats.

**Facts and Question:** For federal income tax purposes, Section 85 of the Internal Revenue Code provides that all or a portion of unemployment benefits which are received from the U.S. Railroad Retirement Board - Bureau of Unemployment and Sickness Insurance are subject to federal income tax. Can Wisconsin impose an income tax on amounts of railroad unemployment insurance benefits which are taxable for federal income tax purposes?

**Answer:** No, railroad unemployment insurance and sickness benefits are exempt from Wisconsin income tax. Section 352(e) of the United States Code bars state and local taxation of railroad unemployment insurance benefits. On a 1985 Form 1, railroad unemployment insurance and sickness benefits included in federal adjusted gross income are subtracted from federal income on line 34.

## 2. Taxing Supplemental Unemployment Benefits to Nonresidents

Statutes: section 71.07(1), 1983 Wis. Stats.

Facts and Question: Section 71.07(1), 1983 Wis. Stats., provides that "Income from personal services of nonresident individuals, including income from professions, shall follow the situs of the services. All other income or loss of nonresident individuals and nonresident estates and trusts, including income or loss derived from land contracts, mortgages, stocks, bonds and securities or from the sale of similar tangible personal property, shall follow the residence of such persons . . ."

A taxpayer who is a Wisconsin resident and works in Wisconsin becomes unemployed and then changes his or her residence to another state. Under a company plan, the taxpayer will receive supplemental unemployment benefits. Are any of the supplemental unemployment benefits which are received during the period of nonresidency taxable to Wisconsin?

Answer: No. Supplemental unemployment benefits paid by a Wisconsin employer under a company plan to a nonresident are "other income" under s. 71.07(1), 1983 Wis. Stats., not subject to the Wisconsin individual income tax.

## 3. Wisconsin Tax Treatment of Distributions Received Upon the Termination of a Disqualified Employee Savings Trust

Statutes: section 71.02(2)(e), 1983 Wis. Stats.

Facts and Question: ABC Corporation established an employee savings plan, which it believed qualified as a tax-exempt trust. If an employee chose to participate in the savings plan, ABC Corporation contributed a portion of the employee's wages to the trust. On his or her individual income tax return, each participating employee was required to report as income (a) ABC Corporation's contribution to the trust on the employee's behalf, and (b) the employee's share of earnings from the trust for the taxable year.

During 1985, the Internal Revenue Service determined that the employee savings plan did not qualify as a tax-exempt trust. The employees were given two options: (a) to withdraw all of their funds, or (b) to roll over these funds into a new savings plan which qualifies as a tax-exempt trust. Regardless of which option they chose, the employees must treat the distribution as an accumulation distribution from a trust for federal tax purposes. Section 667 of the Internal Revenue Code provides for a tax on an accumulation distribution made by a trust. The employees compute the tax on federal Form 4970—Tax on Accumulation Distribution of Trusts—and add this tax to the federal income tax computed on federal taxable income shown on their federal Form 1040.

Are the employees subject to an additional Wisconsin income tax on the trust distribution?

Answer: No. Wisconsin law does not provide for an additional tax on accumulation distributions similar to the

tax provided for in Section 667 of the Internal Revenue Code. Such distributions are not part of federal taxable income and thus are not included in Wisconsin taxable income.

## 4. Exception to the Penalty for Underpayment of Estimated Tax Based on a Return for the Preceding Taxable Year

Statutes: section 71.21(1), (4), (11), (14) and (16), 1983 Wis. Stats.

Facts and Question: Section 71.21(1), 1983 Wis. Stats., provides that every individual deriving income subject to taxation shall make a declaration of estimated income tax if the total tax on income of the year can reasonably be expected to exceed withholding on wages paid in the year by \$100 or more. The amount of the estimated income tax shall be the total estimated tax, including surtaxes, if any, reduced by the amount the individual determines will be withheld from wages (s. 71.21(4), 1983 Wis. Stats.).

Section 71.21(11), 1983 Wis. Stats., provides for an addition to the tax in the case of any underpayment of estimated tax. However, s. 71.21(14) and (16), 1983 Wis. Stats., provide four exceptions to this underpayment penalty.

For purposes of the first exception, the underpayment penalty will not be imposed if the total amount of all payments of estimated tax made on or before the last day prescribed for such payments (April 15, June 15, etc.) equals or exceeds the amount which would have been required to be paid on or before such date if the total estimated tax were an amount equal to the tax shown on the return of the preceding taxable year (s. 71.21(14)(a), 1983 Wis. Stats.).

On April 15, 1985, a single taxpayer files a 1984 Wisconsin income tax return which indicates a net tax of \$2,000. On September 15, 1985, the taxpayer amends the tax return which results in a reduction of the net tax to \$1,600 for 1984. For tax year 1985, the taxpayer makes estimated tax payments of \$400 on April 15, \$400 on June 15, \$400 on September 15 and \$400 on January 15, 1986. The payments equal the tax shown on the preceding year's amended return. Does the taxpayer meet the requirements of the first exception for purposes of avoiding the penalty for underpayment of estimated tax?

Answer: Yes, the taxpayer does meet the requirements of the first exception and no penalty will be imposed for any underpayment of estimated tax. The amended return qualifies as the return "for the preceding taxable year." As long as the estimated tax payments are timely made, no penalty will be imposed if the payments equal or exceed the net tax shown on the amended return. To claim this exception, the taxpayer should complete Schedule U and attach it to his/her Wisconsin income tax return.

## 5. Interest Allowable in Computing the Wisconsin Itemized Deduction Credit

Statutes: section 71.09(6r), 1985 Wis. Stats.

**Note:** This Tax Release applies only with respect to taxable years 1986 and thereafter. Any reference to federal Schedule A and/or itemized deductions allowable for federal income tax purposes is based on federal law and forms as they existed on December 31, 1985.

If there are any changes to federal Schedule A and/or laws pertaining to itemized deductions allowable subsequent to December 31, 1985, references to federal Schedule A and itemized deductions allowable will still be as of December 31, 1985 in computing the Wisconsin itemized deduction credit unless s. 71.09(6r), 1985 Wis. Stats., is also changed.

**Background:** Persons filing a 1986 Wisconsin income tax return may claim a 5% credit against, but not to exceed the amount of, net income taxes due. The credit is based on certain expenses that were formerly deductible as itemized deductions and adoption expenses. If the total of these items exceeds the amount of Wisconsin standard deduction allowable to an individual, 5% of such excess is allowed as a credit. One of the items used in calculating the Wisconsin itemized deduction credit is interest expense per Internal Revenue Code (IRC) Section 163. The following types of interest may be used:

(a) Interest which would be deductible on federal Schedule A (itemized deductions) *and* is paid on a loan to purchase or refinance a residence in Wisconsin or paid on a land contract in respect to a residence in Wisconsin.

(b) Interest which would be deductible on federal Schedule A *and* is paid to purchase or refinance a residence in or near Washington, D.C. or paid on a land contract in respect to such a residence by members of the United States Congress.

(c) For the tax years 1986 to 1988 only, interest which would be deductible on federal Schedule A *and* is paid by an employee on a loan to purchase stock in an employee-owned business where the employee receives at least 50% of that employee's wage and salary income.

(d) Interest which would be deductible on federal Schedule A *and* is paid on agricultural real property, not including residences, that has been sold on a land contract from which interest income is reported. For the balance of this Tax Release, this interest will be identified as "agricultural property interest."

(e) Interest, up to \$1,200 for single persons and married persons filing jointly and up to \$600 for each married person if filing separately, which would be deductible on federal Schedule A and not mentioned above in "a" through "d." For the balance of this Tax Release, this type of interest will be identified as "other interest."

**Question 1a-1i:** Based on each of the facts below, does the interest paid qualify as interest paid to purchase or refinance a residence? (Assume all properties are located in Wisconsin.)

**Fact 1a:** A taxpayer borrows \$5,000 from her parents to make a downpayment on her home. She makes annual interest payments on a personal note.

**Answer 1a:** Yes, the source of the loan is irrelevant. The statute requires only that funds be used for the purchase of a residence.

**Fact 1b:** A single taxpayer, who is building his own home, pays interest to the various suppliers of building materials.

**Answer 1b:** No, while the ultimate use of the goods may be to build a residence, the loans obtained are not being used to purchase or refinance a residence. However, the interest paid to retailers is includable in the \$1,200 of "other interest" allowed to the taxpayer.

**Fact 1c:** A taxpayer takes out a second mortgage on her home to add a family room.

**Answer 1c:** Yes, a second mortgage is a means of refinancing a residence.

**Fact 1d:** A single taxpayer takes out a personal loan from a credit union to make home improvements.

**Answer 1d:** No, the loan obtained is neither for a purchase of a residence nor a refinance of a residence. However, the interest paid to the credit union is includable in the \$1,200 of "other interest" allowed to the taxpayer.

**Fact 1e:** A taxpayer acquires and resides in a new residence but has not been able to sell his former residence. He pays mortgage interest on the current residence and former residence.

**Answer 1e:** Yes, the taxpayer may include the amounts of interest paid on both mortgages because both mortgages are to purchase a residence.

**Fact 1f:** A taxpayer sold her former home on a land contract; she continues to pay interest on the mortgage held by her bank.

**Answer 1f:** Yes, the mortgage was obtained to purchase the home. Even though she has now transferred equitable ownership in the residence to the land contract vendee, she remains obligated to pay principal and interest on the mortgage.

**Fact 1g:** A taxpayer co-signed a mortgage so his son could purchase a home. The taxpayer, not the son, makes the mortgage payment.

**Answer 1g:** Yes, the taxpayer is paying mortgage interest to purchase a residence. The taxpayer must be joint and severally liable for the mortgage note. If he were merely secondarily liable or a guarantor on the note, he would not be considered to be paying interest to purchase or refinance a residence.

**Fact 1h:** A taxpayer takes a first mortgage on her home to consolidate the existing mortgage, a car loan, and personal loans at a lower interest rate.

**Answer 1h:** Yes, the mortgage was used to refinance the taxpayer's residence.

**Fact 1j:** A taxpayer takes out a home improvement loan secured by a second mortgage on her home, but uses the funds to buy a new car.

**Answer 1j:** Yes, the taxpayer has refinanced her residence for making a noninvestment purchase.

**Question 2:** Do points, paid by a taxpayer when obtaining a mortgage, qualify as interest paid to purchase or refinance a residence?

**Answer 2:** Yes, if the points paid are deductible as compensation for the use of the money. However, if the points must be allocated over the life of the loan for federal income tax purposes, they must also be allocated over the life of the loan for purposes of calculating the Wisconsin itemized deduction credit. If the points are not allowable as an itemized deduction for federal purposes, they may not be used in calculating the Wisconsin itemized deduction credit.

**Question 3:** Does the term "residence" include such property as a lake cottage or hunting shack?

**Answer 3:** Yes, a taxpayer may include interest, in the calculation of the Wisconsin itemized deduction credit, to purchase or refinance more than one residence. However, the second residence must be for personal use. If the property is used for more than personal use (e.g., the property is rented for a portion of the year), only the portion attributable to personal use may be used for the credit.

**Question 4:** What is the proper treatment of interest paid in connection with a seller-financed sale of investment property which consists of retail space and residential apartments. During the period the property was owned by the seller, it was treated as rental property. After the sale, is a portion of the interest which is paid by the seller considered to be interest paid on a "residence" and the remaining portion considered "other interest" subject to the \$1,200 ceiling?

**Answer 4:** No, investment property is not considered a residence for purposes of Section 71.09(6r), 1985 Wis. Stats., even though all or a portion of the investment property may be devoted to residential use. The entire amount of interest paid in connection with a seller-financed sale of investment property is "other interest," subject to the \$1,200 limitation. [Exception: If the taxpayer occupied a portion of the investment property as his/her residence, interest attributable to the taxpayer's residence is fully includable in calculation of the credit under s. 71.09(6r), Stats.]

**Question 5:** A taxpayer refinances his home by taking out a new mortgage loan. The entire loan proceeds are used to purchase stock. For federal tax purposes this interest is considered "investment interest" and is only allowable as an itemized deduction up to the investment interest limits imposed by the IRC.

(a) Does this interest qualify as interest paid to refinance a residence, and does the "investment interest" limitation of section 163 of the IRC also apply for purposes of calculating the Wisconsin itemized deduction credit?

(b) If any amount of "investment interest" is not allowable as an itemized deduction for federal purposes in the year paid but is allowable as a carryover to a subsequent tax year, will that amount also be available for purposes of calculating the Wisconsin itemized deduction credit in the carryover year?

**Answer 5a:** Yes, the taxpayer has refinanced his residence. The amount of interest which qualifies for the Wisconsin itemized deduction credit will be limited to the amount which is deductible as investment interest under Section 163(d) of the Internal Revenue Code.

**Answer 5b:** Yes, interest carried over as excess investment interest is interest allowed as an itemized deduction. It is recognized for calculating the Wisconsin itemized deduction credit in the same year that it may be deducted for federal purposes.

**Question 6:** Does a mobile home qualify as a "residence" for purposes of the Wisconsin itemized deduction credit if it is used as a principal or recreational residence either permanently on the taxpayer's land or on land that is rented?

**Answer 6:** Yes, a mobile home does qualify as a residence for purposes of the Wisconsin itemized deduction credit, whether used as a principal residence or for recreational purposes and whether located on the owner's land or someone else's. The mobile home need not be attached to a foundation.

**Question 7:** Does a travel trailer designed to be pulled behind a vehicle when traveling or a similar recreational vehicle that is not pulled behind a vehicle but rather is one unit with its own driving compartment qualify as a residence for purposes of the Wisconsin itemized deduction credit?

**Answer 7:** No, a travel trailer or similar recreational vehicle is personal property and, thus, does not meet the requirement of being a residence.

**Question 8:** A taxpayer sells his farm, including the residence he and his family have resided in, on a land contract. The taxpayer has a balance remaining on the loan he obtained when he originally purchased the farm. He includes interest from the land contract in his Wisconsin taxable income. Can the interest which the taxpayer pays on the loan be used in computing the Wisconsin itemized deduction credit?

**Answer 8:** Yes. The portion of the interest payments relating to the residence may be used for the Wisconsin itemized deduction credit as interest paid to purchase or refinance a residence. The portion of the interest payments on the land and farm buildings qualifies as "agricultural property interest."

**Question 9:** Assume the same facts as in question 8 except that the taxpayer and his family never resided in the home on the farm but rented it out. Does the interest paid on the residence portion qualify as "agricultural property interest" for purposes of computing the Wisconsin itemized deduction credit?

**Answer 9:** No. The residence would have had to be lived in by the taxpayer. However, the interest paid on the residence portion is "other interest" and may be used, subject to the

\$1,200 limitation, in computing the Wisconsin itemized deduction credit.

**Question 10:** Assume the same facts as question 8. In addition assume that when the taxpayer purchased the farm, a portion of the loan proceeds was used to purchase farm machinery (e.g., tractors, milking equipment). Does the portion of interest paid for farm machinery qualify as "agricultural property interest" for purposes of computing the Wisconsin itemized deduction credit?

**Answer 10:** No. Only interest paid on a loan to purchase agricultural real property is treated as "agricultural property interest." However, the interest allocable to the farm machinery is "other interest" and may be used, subject to the \$1,200 limitation, in computing the Wisconsin itemized deduction credit.

## INCOME, FRANCHISE OR SALES/USE TAXES

### 1. Application of \$20 Late Filing Fee

**Statutes:** section 71.11(40), 1985 Wis. Stats.

**Facts and Question:** Section 71.11(40), as amended by 1985 Wisconsin Act 29, provides for a \$20 late filing fee if an income or franchise tax return is filed 60 or more days late.

The initial applicability language for this amendment reads as follows in 1985 Wisconsin Act 29: "Late returns. The treatment of section 71.11 (40) of the statutes by this act first applies to returns required to be filed on the effective date of this paragraph." (Note: 1985 Wisconsin Act 29 was published on July 19, 1985; therefore the "effective date of this paragraph" is July 20, 1985, the day after publication.)

To what returns does this \$20 late filing fee apply?

**Answer:** It applies only to income or franchise tax returns which have an original or extended due date on or after July 20, 1985 and which are filed 60 or more days late.

**Example:** A 1984 calendar year income tax return filed on October 15, 1985, would not be subject to the \$20 late filing fee because the original due date of April 15, 1985, was before July 20, 1985 (assuming no extension of time was granted). However, if the taxpayer received an extension until August 15, 1985, the \$20 late filing fee would apply to the 1984 return if it was filed 60 or more days after August 15, 1985.

### 2. Imposition of Penalties

**Statutes:** sections 71.11(6)(b), 71.11(46) and (47), 77.60(3), (4) and (5), 1985 Wis. Stats.

**Note:** The provisions of this Tax Release regarding the 100% penalty under s. 71.11(6)(b), 1985 Wis. Stats., apply to 1985 tax years and thereafter. For the 1969 through 1984 tax years the penalty was 50%. Prior law, applicable to 1968 tax years and prior, is found at s. 71.11(6)(a), 1985 Wis. Stats., and provides for assessments at twice the normal income or franchise tax rate.

### Background:

**25% Penalty -** Sections 71.11(47) and 77.60(3), 1985 Wis. Stats., provide for a penalty of 25% of the additional tax finally determined if an incomplete or inaccurate income, franchise, sales or use tax return is filed.

**5-25% Penalty -** Sections 71.11(46) and 77.60(4), 1985 Wis. Stats., provide that if an income, franchise, sales or use tax return is not filed by its due date, a graduated penalty of 5% to 25% may be imposed. The penalty is 5% of the amount of tax due and unpaid if the failure to file is one month or less, with an additional 5% for each additional month or part of a month during which the failure to file continues, not to exceed 25%.

The 25% and 5-25% penalties described above are commonly referred to as negligence penalties. The penalties apply unless it is shown that the failure to file or the incomplete or inaccurate filing is due to reasonable cause and not due to neglect. Neglect may be defined as failure to exhibit the ordinary business care and prudence that should be used. It is characterized chiefly by inadvertence, thoughtlessness, inattention, etc. It includes, but is not required to be, intentional conduct. The 5-25% income tax graduated penalty under s. 71.11(46), 1985 Wis. Stats., specifies willful neglect. Willful neglect requires intent, but in the absence of reasonable cause for the negligent conduct intent need not be shown for the penalty to apply.

**100% and 50% Penalties -** Sections 71.11(6)(b) and 77.60(5), 1985 Wis. Stats., provide for penalties of 100% for income and franchise tax returns, or 50% for sales and use tax returns, of the underpayment of tax for failing to file a return or for filing an incorrect return, with intent in either case to defeat or evade the tax assessment required by law. (For 1969 through 1984, the penalty was 50% for income and franchise tax returns.)

**Question 1:** Is the negligence penalty provided for under s. 71.11(47) or 77.60(3), Wis. Stats., imposed on the entire additional tax finally determined or can it be applied to specific amounts only?

**Answer:** The negligence penalty provided by s. 71.11(47) or s. 77.60(3), Wis. Stats., may be imposed on the entire additional tax finally determined or on specific parts thereof, depending on the facts and circumstances of the particular case.

**Example 1:** A medium-sized corporation is field audited for sales and use tax purposes. The taxpayer has a good system in place for charging and collecting sales tax. During the last two audit years it incorporated a system for self-assessing use tax as well and remitted about \$2,500 use tax to the Department. The audit results in a small amount of additional sales tax which is due primarily to clerical mix-ups. The first two years of the audit also result in about \$3,000 of use tax. For the last two audit years additional use tax of \$400 is assessed. The taxpayer's personnel responsible for sales and use tax compliance are knowledgeable about the Wisconsin sales and use tax laws. Pursuant to s. 77.60(3), Wis. Stats., a 25% negligence penalty will be imposed on the \$3,000 use