

- 11.19 Printed material exemptions-A
- 11.26 Other taxes in taxable gross receipts and sales price-A
- 11.32 "Gross receipts" and "sales price"-A
- 11.40 Exemption of machines and processing equipment-A
- 11.41 Exemption of property consumed or destroyed in manufacturing-A
- 11.51 Grocers' guidelist-A
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- 14.01 Administrative provisions - R&R
- 14.02 Qualification for credit - R&R
- 14.03 Household income - R&R
- 14.04 Property taxes accrued - R&R
- 14.05 Rent constituting property taxes accrued - R&R

B. Rules Approved by Legislative Standing Committee But Not Yet Effective

- 11.12 Farming, agriculture, horticulture and floriculture - A

C. Rules Adopted in 1988

- 3.095 Interest income from federal obligations-R&R (effective 5/1/88)
- 11.10 Occasional sales-A (effective 1/1/88)

REPORT ON LITIGATION

This portion of the WTB summarizes recent significant Tax Appeals Commission and Wisconsin court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher court.

The last paragraph of each WTAC decision in which the department's determination has been reversed will indicate one of the following: (1) "the department appealed," (2) "the department has not appealed but has filed a notice of nonacquiescence" or (3) "the department has not appealed" (in this case the department has acquiesced to the Commission's decision).

The following decisions are included:

Individual Income Taxes

Capital Preservation Fund, Inc., et al. (p. 8)

Interest income—mutual funds

Allen M. Taylor (p. 9)

Foreign taxes

Homestead Credit

David A. Jensen (p. 9)

Filing deadline

Corporation Franchise or Income Taxes

Hammermill Paper Company (p. 9)

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Bank Equipment Lease, Inc. (p. 10)

Leases and rentals

International Business Machines Corporation (p. 11)

Computer and data processing—programs

INDIVIDUAL INCOME TAXES

Interest income—mutual funds. *Capital Preservation Fund, Inc., Trust for Short Term U.S. Government Securities, Lee V. Hribar, Urquhart L. Meeter, Barbara C. Meeter, and James E. Bartelt vs. Wisconsin Department of Revenue* (Court of Appeals, District IV, July 21, 1988). The Wisconsin Department of Revenue appeals from a summary judgment declaring that dividend distributions from the Capital Preservation Fund (the Fund) and the Trust for Short Term U.S. Government Securities (the Trust) are not subject to the Wisconsin income tax. The issue is whether 31 U.S.C., §3124(a), which declares "obligations of the United States Government are exempt from [State] taxation," precludes Wisconsin from taxing the distributions insofar as this results from (a) investments in direct obligations of the federal government, and (b) transactions under repurchase agreements involving federal securities.

The Fund and the Trust are mutual or "money market" funds. They are diversified investment companies which invest in various types of interest-bearing securities and sell their shares to individual and institutional investors in Wisconsin and elsewhere. They distribute substantially all of the income earned from these investments to their shareholders.

The Fund invests solely in direct obligations of the federal government — U.S. Treasury bills, notes, and zero coupon securities. The Trust also invests exclusively in treasury obligations and those of other federal agencies, such as the Federal Home Loan Banks. The Trust also enters into "repurchase agreements" through which it purchases government obligations from a third party — normally a bank — pursuant to a contract in which the bank agrees to repurchase the obligations from the Trust on a specified date (usually within a day or so of the initial sale to the Trust) and at a set price and rate of interest.

The department argues that *Rockford Life Ins. Co. v. Ill. Dept. of Rev.*, 96 L. Ed.2d 152 (1987), and a recent decision of the Court, *Savings League v. Revenue Dept.*, 141 Wis. 2d 918, 416 N.W. 2d 650 (Ct. App. 1987), compel a different result. Here, however, the issue is not whether a particular security is a federal "obligation." There is no question that neither the Fund nor the Trust deals in anything but direct obligations of the federal government. The issue is the scope of the exemption; and once a security is found to be an "obligation of the United States Government" in the statutory sense, the exemption provided by sec. 3124(a) is, in the words of the United States Supreme Court, to be "broad[ly]" and "sweeping[ly]" construed.

The department argues that in such transactions the interest paid to the Trust is not interest on the transferred and retransferred government securities, but rather is the equivalent of interest on the Trust's "loan" to the bank.

The Court of Appeals concluded that the state may not tax any of the investment distributions, but that distributions based on income from the Trust's repurchase agreements are taxable. Because both the Fund and the Trust invest solely in direct obligations of the federal government, distribution to their shareholders (or trustees) of the income from those investments may not be subjected to state income taxes. However, the same result does not obtain with respect to distributions representing interest income to the Trust arising out of its repurchase agreements.

The department and the taxpayer have not appealed this decision.

□

Foreign taxes. *Allen M. Taylor vs. Wisconsin Department of Revenue* (Court of Appeals, District I, May 18, 1988). Allen M. Taylor paid foreign income taxes of \$11,015 and \$17,982 during 1979 and 1980, respectively, in connection with his

activities as an insurance underwriting member of Lloyd's of London. Taylor deducted these foreign taxes on his Wisconsin income tax returns for those years. In 1982, the Wisconsin Department of Revenue disallowed these deductions. The Wisconsin Tax Appeals Commission upheld the department's decision, holding that sec. 71.02(2)(f), Stats., excluded Taylor's deductions.

The Circuit Court affirmed the finding and conclusion of the Commission. The Circuit Court held that IRC section 164(a)(3) authorized the deduction of foreign income taxes but that sec. 71.02(2)(f), Stats., specifically excluded such a deduction. The Circuit Court further concluded that Taylor's foreign income tax liability was a remote expense connected with the conduct of his trade or business and, hence, was not deductible as a business expense under IRC section 162.

The Court of Appeals concluded the memorandum decision of the trial court properly analyzed and applied sec. 71.02(2)(f), Stats., and the applicable federal code and treasury regulations to the facts of this case and, therefore, adopted the trial court's decision as its own.

The taxpayer has appealed this decision to the Wisconsin Supreme Court.

□

HOMESTEAD CREDIT

Filing deadline. *David A. Jensen vs. Wisconsin Department of Revenue* (Circuit Court of Dane County, February 19, 1987). Before the Court is a Ch. 227, Stats., proceeding for judicial review of an administrative decision of the Wisconsin Tax Appeals Commission, dated July 29, 1986. That decision affirmed an assessment made by the Wisconsin Department of Revenue against the claimant.

The claimant filed Wisconsin income tax returns for 1980-1983 on February 27, 1985. In so doing, he attempted to use

homestead credits for those years to offset taxes owed. The Department of Revenue refused to allow the homestead credits because they were not filed before December 31 of the year following the year(s) for which the claim was made.

The claimant contends that Wisconsin income tax law subsumes homestead credit regulation. Therefore, where the department permits the filing of homestead credit on income tax returns, so too should it permit the late filing of the homestead credits that would have been attached to any late returns.

The Circuit Court found that the homestead credit provision neither comprises part of the Wisconsin income tax, nor fails under the uniformity clause of the Wisconsin Constitution. The Department of Revenue correctly disallowed the claim for homestead credit offset against income taxes for the years 1980-1983; therefore, the decision of the Wisconsin Tax Appeals Commission was affirmed.

The claimant has not appealed this decision.

□

CORPORATION FRANCHISE OR INCOME TAXES

Equitable recoupment. *Hammermill Paper Company vs. Wisconsin Department of Revenue* (Circuit Court of Dane County, April 5, 1988). The Hammermill Paper Company seeks review of a Wisconsin Tax Appeals Commission dismissal of its claim for a refund of manufacturer's sales tax credit for the years 1973 through 1975.

The department sent Hammermill a notice of amount due relating to the uncontested portions of a 1981 assessment, plus interest. Hammermill objected to the department's determination. The taxpayer filed a claim for refund and objection to notice of amount due with the department. Hammermill objected to a calculational error in the department's notice of

amount due and claimed a refund, for the first time, of a manufacturer's sales tax credit not originally sought in returns filed for 1973 through 1975.

In response to the taxpayer's request, the department amended the notice of amount due, but rejected Hammermill's claim for a manufacturer's sales tax credit refund. Hammermill petitioned the Commission for review after the department rejected a request for redetermination. The taxpayer argued that it was entitled to a refund of the sales tax credit to offset its tax liability under the doctrine of equitable recoupment. On October 30, 1987, the Commission granted the department's motion to dismiss on grounds that it lacked "subject matter jurisdiction" to hear and decide claims based upon the doctrine of equitable recoupment because such claims were not timely and properly raised during the original redetermination of tax liability.

The Circuit Court concluded that the Commission's decision and order must be affirmed on two grounds. First, the present case does not fall within the doctrine of equitable recoupment. Second, the taxpayer's failure to raise its claim for a refund in a timely manner resulted in waiver of the claim.

The taxpayer has not appealed this decision.

Appeals—timely. *Northern States Power Company v. Wisconsin Department of Revenue* (Court of Appeals, District III, May 10, 1988). Northern States Power Company (NSP) petitioned the Circuit Court to review a Wisconsin Tax Appeals Commission decision. NSP claims to have mailed, by certified mail, a copy of the petition for review to the Department of Revenue. The department, however, did not receive the copy. The Circuit Court dismissed the petition due to lack of jurisdiction for failure of timely service on the department.

NSP appeals the dismissal order, contending that (1) timely service was accomplished, (2) because the Commission's determination was not final, it was not appealable, and (3) the Circuit Court had jurisdiction in any event to resolve the constitutionality of the statute in question.

The Court of Appeals concluded that the right to judicial review of administrative agency orders is dependent upon strict compliance with sec. 227.16, Stats. Failure to comply with this section deprives the Circuit Court of subject matter jurisdiction. Because the Court was without jurisdiction, adjudication of the tax laws' constitutionality would have been inappropriate.

The taxpayer appealed this decision to the Wisconsin Supreme Court. The Supreme Court denied the taxpayer's petition for review.

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SALES/USE TAXES

Leases and rentals. *Bank Equipment Lease, Inc. vs. Department of Revenue* (Court of Appeals, District IV, March 10, 1988). Bank Equipment Lease, Inc. appeals from a judgment affirming a Tax Appeals Commission decision which upheld a sales tax assessment against the taxpayer. The issues are:

- A. Whether the taxpayer's transactions were leases and, therefore, subject to the sales tax.
- B. Whether the taxpayer was properly found to be a "retailer."
- C. Whether the taxpayer should be relieved of liability for worthless accounts.
- D. Whether the finding that it held title to the leased equipment is erroneous.
- E. Whether the financial institutions, rather than the taxpayer, are liable for the

tax since the leases were completely assigned.

F. Whether the statute of limitations as to 1976, 1977, and 1978 has run.

G. Whether the assessment is invalid because it was based on projections of payments that were not made.

H. Whether the Department of Revenue should be estopped from assessing the tax.

The taxpayer, a Wisconsin corporation, was assessed a sales tax of \$67,379.04 on May 28, 1982, for 1976 through 1981. The taxpayer challenged the assessment, contending it had not made transactions subject to the sales tax. The Commission found that the taxpayer had applied for a Wisconsin seller's permit in 1977, representing that its business purpose was retail and that it would engage in equipment leasing. The permit was issued August 16, 1977. The taxpayer bought equipment requested by companies, then leased the equipment to the companies for amounts exceeding the value of the equipment. It obtained loans from various financial institutions to purchase the equipment. Upon obtaining a signed lease from the company, it assigned the rental receipts to the lending institution, which applied the rent against the taxpayer's loan. It also assigned its rights, title, and interest in and to the property described in the lease and all of its rights and remedies, but agreed to perform the obligations of a lessor under the lease.

The Commission concluded that receipts from the leases were subject to the sales tax under sec. 77.52(1), Stats., that the statute of limitations had not run on 1976 through 1978 sales tax liability due to taxpayer's failure to file annual information returns as required by sec. 77.58(2)(a), Stats., and that the department was not estopped from collecting the tax. The Circuit Court affirmed.

The taxpayer argues that the evidence shows it did not lease personal property but instead acted as a "loan broker" and argues that since no payments were made

to it, it cannot be a retailer under sec. 77.51 (13)(k), Stats., which defines "retailer" to include "any person deriving rentals from a lease of tangible personal property situated in the state." The taxpayer also contends that since its customers went bankrupt and the accounts were determined to be worthless, it should be relieved from liability for the sales tax under sec. 77.51 (4)(b)4, Stats. This section relieves a retailer from liability for accounts found to be worthless and charged off for income tax purposes.

The taxpayer contends that the department erroneously computed the assessment based on the full price of the lease if all the payments were made, despite its witness's admission that most of the companies went bankrupt, and challenges the finding that it held title to tangible personal property, claiming the testimony was uncontradicted that at no time did it own any equipment.

The taxpayer contends that the statute of limitations has run as to 1976 through 1978 pursuant to sec. 77.54(3), Stats. The taxpayer also contends that if these were taxable transactions, the financial institutions should have collected the sales tax since the leases were assigned to them and they received the payments. It relies on *Tullgren v. School Dist.*, 16 Wis. 2d 135, 142, 113 N.W. 2d 540, 544 (1962), which held that a particular assignment of a contract was absolute.

The taxpayer argues that the department should be estopped from assessing any sales tax since it previously accepted the taxpayer's returns showing no sales tax was due.

The Court concluded that:

A. The assessment was based on 23 transactions involving the taxpayer and various companies and financial institutions. All are evidenced by assignments of leases between the taxpayer and a company to a financial institution, by leases between the taxpayer and the company, or both. In addition, the taxpayer's application for a seller's permit states it is in the business of equipment leasing. This is

sufficient evidence to support the finding that the transactions were leases.

B. The taxpayer derived the proceeds, but used them to pay off its loans. That the proceeds were received by the lending institutions directly, rather than initially by the taxpayer, does not alter the fact that they were derived by the taxpayer from the leases. The finding that taxpayer was a retailer is supported by substantial evidence.

C. There was no finding that the accounts were worthless. There was no evidence that these accounts were charged off for income tax purposes. Section 77.51(4)(b)4, Stats., does not absolve the taxpayer of liability.

D. The department properly computed the assessment. Under sec. 77.51(4)(a), Stats., "gross receipts" means "the total amount of the . . . lease price . . . from sales at retail of tangible personal property, . . . valued in money, whether received in money or otherwise . . ." Under this section, the lease price, rather than the actual payments made, is the basis for the assessment of sales tax liability.

E. All of the transactions are evidenced by documents which refer to the transactions as leases of equipment. The taxpayer presented no evidence that it did not hold title to the property which was the subject of the leases. The finding is supported by substantial evidence.

F. The Commission correctly concluded that the statute of limitations had not run for the years 1976 through 1978 since the annual returns have not yet been filed. The monthly returns filed by the taxpayer are not the annual information returns referred to in the statute.

G. The assignments in this case reserved to the taxpayer all of its obligations under the leases. The assignments were not absolute.

H. Equitable estoppel may be applied against the Department of Revenue where the elements are clearly present. Those elements are action or inaction by one

party which reasonably induces reliance by the other party to the latter party's detriment. The taxpayer does not contend, and did not offer evidence, that it reasonably relied on the department's prior inaction to its detriment.

The taxpayer has not appealed this decision.

□

Computer and data processing—programs. *Wisconsin Department of Revenue v. International Business Machines Corporation* (Court of Appeals, District IV, June 23, 1988). The Wisconsin Department of Revenue appeals an order affirming a decision of the Wisconsin Tax Appeals Commission. The department sought to collect sales taxes from IBM on revenues from the license of made-to-order computer programs to Wisconsin customers. The Commission and the trial court held that IBM's transactions were tax exempt.

At issue here is whether the computer programs IBM made to order for its Wisconsin customers were tangible personal property for tax purposes. The department argues that the transfer involved tangible property because IBM delivered the programs on magnetic tapes, similar to music tapes. IBM contends that the transfers were nontaxable because their essential purpose was to provide the customer with intangible programmed information.

The Court concluded that the transactions at issue here were not taxable under sec. 77.52(1), Stats. In *Janesville Data Center v. Dept. of Revenue*, 84 Wis. 2d 346, 267 N.W.2d 658 (1978), the Supreme Court held that although the sales of computer programs may include the transfers of tangible property, such as tapes, they are not taxable under sec. 77.52, Stats., if the "essence of the transaction" was the transfer of intangible property such as coded or processed data. There is no dispute that the essence of these transactions was the data on the tapes IBM delivered to its

customers, and not the tapes themselves. *Data Center* therefore controls the decision.

The department has appealed this decision to the Supreme Court.



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.)

The following Tax Releases are included:

Individual Income Taxes

1. Reclassifying Income Received Under Wisconsin's Marital Property Law (p. 12)
2. Reporting Gain on the Sale of a Home Under Wisconsin's Marital Property Law (p. 13)

Individual and Corporation Franchise or Income Taxes

1. Deductibility of Federal Minimum Tax (p. 14)

Corporation Franchise or Income Tax

1. Bad Debt Deduction Transition Adjustments Required for Certain Financial Institutions (p. 15)
2. Deductible Dividends Received from Subsidiaries (p. 16)
3. Deduction for Bad Debts by Corporations Other Than Certain Financial Organizations (p. 16)
4. Sales Included in Sales Factor in Same Year That Income Is Recognized (p. 17)
5. When a Sale Is in Wisconsin for Computing the Sales Factor of the Apportionment Formula (p. 18)

Sales/Use Taxes

1. Are Certain Charges Related to the Construction of a Golf Course Taxable Landscaping Services? (p. 19)

2. Laboratory Testing in a Creamery (p. 19)
3. Parking Is Provided for Monies Intended to Cover Costs (p. 20)
4. Refuse Derived Fuel Plant Is a Recycling Facility (p. 20)
5. Retailers' Receipts for Handling Manufacturers' Coupons (p. 20)
6. Sales to Government and Other Exempt Organizations' Employees (p. 21)
7. Wax Purchased by Car Wash Operators (p. 22)

INDIVIDUAL INCOME TAXES

1. Reclassifying Income Received Under Wisconsin's Marital Property Law

Statutes: Sections 71.02(2)(me) and 71.11(2m) and (2r), Stats. (1985-86), as amended by 1987 Wisconsin Act 393

Note: This Tax Release applies with respect to taxable year 1986 and thereafter.

Background: Generally, under Wisconsin's marital property law, income of spouses received up until the date of divorce is marital property and one-half is reportable by each spouse. However, certain income may be classified as individual property by a marital property agreement, unilateral statement, or court decree. Income classified as individual property is reportable by the owner.

Facts: A husband and wife, who have been separated since January 1987, are divorced on May 31, 1988. The husband earned wages of \$15,000 from January 1 to May 30, 1988, and \$25,000 thereafter. The wife earned wages of \$2,000 from January 1 to May 30, 1988, and \$8,000 thereafter. Incorporated into their divorce decree is a property settlement agreement which provides that the wages earned up until the date of divorce are individual income and must be reported by the wage earner on his or her tax return.