3.098 Railroad retirement supplemental annuities-A (8/1/89)
3.14 Losses from bad debts by corporations-A (8/1/89)
3.17 Corporation losses, miscellaneous-A (8/1/89)
3.35 Depletion, basis for allowance to corporations-A (8/1/89)
3.36 Depletion of timber by corporations-A (8/1/89)
3.43 Amortization of trademark or trade name expenditures-A (8/1/89)
3.44 Organization and financing expenses—corporations-A (8/1/89)
3.45 Bond premium, discount and expense—corporations-A (8/1/89)
3.48 Research or experimental expenditures-A (8/1/89)
3.52 Automobile expenses—corporations-R&R (8/1/89)
3.82 Evasion of tax through affiliated interests-A (8/1/89)
3.83 Domestic international sales corporations (DISCs)-A (8/1/89)
11.10 Occasional sales-A (5/1/89)

D. Emergency Rules

11.66 Communication and CATV services-A (effective 10/1/89)

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

Corporation Franchise or Income Taxes

Sales/Use Taxes

INDIVIDUAL INCOME TAXES

Nonresidents—personal service income. *John M. Dorsey vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, March 17, 1989). The only issue before this Commission is whether part of the $125,000 received by the taxpayer on July 10, 1984, at the time of the contract signing is taxable to the taxpayer, a nonresident of Wisconsin in 1984. In the event that there is a final determination that no portion of the $125,000 received by the taxpayer on July 10, 1984, is subject to Wisconsin income taxation, or that the amount subject to taxation is less than that assessed by the department, the itemized deductions allowed in the assessment notice will be subject to the adjustment for nonresident persons provided in sec. 71.02(2)(f), Wis. Stats.

John M. Dorsey, resided at all times during 1984 in the state of Connecticut.

On July 10, 1984, the taxpayer signed National Football League Player contracts with the Green Bay Packers for the 1984, 1985, and 1986 football seasons. Attached to and a part of the 1984 contract, was a rider providing for the additional payment of $125,000 in and for the year 1984. The taxpayer received the $125,000 at the time of signing the contract.

In filing his 1984 Wisconsin individual income tax return, the taxpayer claimed a Wisconsin subtraction from federal income of $150,000 for "Signing Bonus Green Bay Packers—Contract" and reported Wisconsin taxable income of zero.

Based on the taxpayer's 1984 W-2 form received from the Green Bay Packers, Inc., showing the taxpayer received total compensation of $152,457 from the Green Bay Packers, Inc., in 1984 and that $139,500 of such compensation was Wisconsin income, the department, on April 18, 1986, issued an assessment to the taxpayer taxing the income set forth of $139,500 less the taxpayer's IRA contribution of $2,000 and less prorated itemized deductions of $12,358, resulting in Wisconsin adjusted net taxable income of $125,142.

The $125,000 paid to the taxpayer was not a pure signing bonus requiring only his execution of the contract since in return for the bonus he was required not only to sign, but also perform a number of personal services. The taxpayer's bonus was an advance payment for the services which he agreed to render under the terms of the rider attached to his 1984 contract.

The Commission concluded that the bonus which the taxpayer received pursuant to the rider attached to his 1984 contract constituted income derived from the performance of personal services within the meaning and intent of secs. 71.01(1) and 71.07(1), Wis. Stats., and as such was properly taxable in Wisconsin to the extent that it represented compensation for those services which he rendered within Wisconsin.

The taxpayer has not appealed this decision.

❐

Foreign taxes paid. *Klaus Wacker vs. Wisconsin Department of Revenue* (Circuit Court of Milwaukee County, June 29, 1989). The issue is whether the taxpayer should be allowed to subtract from Wisconsin income his share of partnership trade taxes imposed by West Germany. A foreign tax credit had been allowed for federal tax purposes with respect to the trade taxes. See WTB 47 for a summary of the Commission's decision.

Understanding the weight to be given the determination of the Commission, the presumption that exists, and the burden placed upon Klaus Wacker, the Court found that the expenses incurred were business expenses of the subject partnership. This decision is dictated by the underlying reality that a different result produces unfair consequences to the taxpayer and an illogical application of the tax code. Because the intervening federal credit treats these expenses differently or dually does not alter their character as a business expense for purposes of the Wisconsin Revenue Code.

The department has appealed this decision to the Court of Appeals.

□

CORPORATION FRANCHISE OR INCOME TAXES

Manufacturer's sales tax credit—manufacturing defined. *Astra Plating, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, May 23, 1989). The issue is whether the taxpayer's automobile "bumper recycling" operation constitutes manufacturing. In fiscal years 1983 and 1984, the taxpayer claimed certain sales tax credits against its franchise tax liability. The department denied the credits on the grounds the taxpayer was not a manufacturer and, thus, did not qualify for the credits.

In general, the taxpayer's business could be described as a bumper recycling operation. The taxpayer takes scrap bumpers (worth $8-10 per ton) or, as they are known in the trade, "cores," reshapes them through a series of different operations, refinishes them, and sells them mainly to car dealers and independent body shops.

The taxpayer obtains the discarded cores from car dealers and auto body shops and stores them in its own storage area. When the taxpayer gets an order for a particular bumper, an employe removes the closest matching cores from the storage yard and brings them into the shop. For 90-95% of the orders, it's necessary to use two cores to produce the final product because part of one core is so badly damaged that it needs to be replaced. In such cases, both cores are measured to determine the location of cuts to be made. Both cores are then cut and the damaged parts either discarded or set aside. The remaining two pieces are welded.

After the welding is completed, the weld ridge is smoothed over with an electric grinder. Then the core is placed on a template, which matches manufacturer specifications, and is measured against the specifications. If necessary, the core is reshaped so as to match original equipment specifications. The taxpayer uses hydraulic presses to do the major reshaping. Some of the reshaping is done by means of manual hammering.

Next, the core is ground to remove scratches and other imperfections. As part of this process it is necessary to obtain a finish with a high luster; otherwise the untreated core would reflect internal imperfections because of the high mirror finish that the taxpayer ultimately puts on them. To remove the major imperfections, the taxpayer uses electric grinders applying a coarse grit abrasive. As an intermediate step, the taxpayer uses a semi-automatic polishing machine applying a finer grit abrasive to the core. Afterward, the core is put on a polishing lathe to obtain the proper pre-electroplating finish.

After the grinding and polishing are completed, the core undergoes the electroplating process—the final step resulting in the bright mirror finish. The electroplating adds new metal—between 1 and 2 mills of nickel. The bumper then is ready for sale at a price approximately 25-40% lower than what the original equipment manufacturer would charge.

Although 75-80% of the taxpayer's sales are to auto dealers and body shops, occasionally the taxpayer does work for individual consumers who are restoring their cars. With individual restoration work, the process is basically the same, except that sometimes the necessary core is not available. In such cases, the taxpayer actually splices a handmade piece of steel onto the core. Individual restoration work accounted for 1-2% of the taxpayer's sales. Another part of taxpayer's business is making customized bumpers for individual truck owners. This accounted for about 5-10% of the taxpayer's sales.

On the point of whether the taxpayer's process is popularly regarded as manufacturing, the taxpayer presented testimony to the effect that with the industry, the taxpayer's business is regarded as manufacturing. The taxpayer also testified that the U.S. Census Bureau classifies the taxpayer as a manufacturer, though the record is not clear on how the Census Bureau reached that determination. There was also testimony that the taxpayer is classified as an electroplater under the U.S. Government's standard industrial classification code 3471, a classification which falls under the general classification of manufacturing.

On the same point, the department presented contradictory expert testimony to the effect that the taxpayer's process is not popularly regarded as manufacturing. The expert based this conclusion on several points: the product being repaired to come back to original specifications; the product didn't have a different form, use, or name; and taxpayer's process was more like an automotive repair shop, a service industry, than manufacturing. He concluded the product is rebuilt, not manufactured. For the taxpayer's operation to qualify as manufacturing, the witness said, "The raw material would have to be in a much more amorphous form, be it plate steel or whatever." However, the witness did concede that in the 90-95% of the cases where welding is involved, the resulting constituted "two olds put together to make one new," and agreed "in a narrow sense" that the resulting article was new.

The Commission concluded that by the substantial weight of the evidence, the taxpayer's process is, in the legal sense, popularly regarded as manufacturing. The cores processed by the taxpayer have no significant intrinsic value to anyone other than the taxpayer. Consequently, the taxpayer's operations cannot be deemed to be repairs.

The department has petitioned the Commission for a rehearing. The petition for rehearing was granted.

❐

Business loss carryforward—mergers. *Appleton Papers, Inc. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, July 25, 1989). The only issues in this case are whether the taxpayer is entitled under sec. 71.043(3), Wis. Stats., to carry forward and apply against its 1982-84 Wisconsin corporate franchise tax liability, the excess 1981 manufacturer's sales and use tax credit generated in the business operations of one of its former wholly owned subsidiaries, subsequently merged into the taxpayer in 1982 along with 4 other corporations.

Appleton Papers, Inc. (new API) is a Delaware corporation and a successor in name to Germaine Monteil Cosmetiques Corporation (Germaine), a Delaware corporation. Pursuant to a statutory merger effective January 2, 1982, Germaine merged into itself under Delaware corporate law 5 of its wholly owned subsidiaries. Among the 5 subsidiaries merged with Germaine was Appleton Papers, Inc. (In this decision old API refers to Appleton Papers, Inc. as it existed prior to merger on January 2, 1982, in contradistinction to the taxpayer, new API.)

On its 1982-84 Wisconsin corporate franchise tax returns, the taxpayer claimed carryforwards of manufacturer's sales tax credits under sec. 71.043(3), Wis. Stats., generated in 1981 by old API's payment of Wisconsin sales and use taxes on fuel and electricity consumed in its Wisconsin paper manufacturing operation.

The department conceded that the 1981 manufacturer's sales tax credit was correctly computed by old API and that the 1982-84 credit carryforwards were timely claimed and properly computed by the taxpayer. The department disputed, however, the taxpayer's legal entitlement to the credit because of the 1982 merger.

After the merger in 1982, the taxpayer conducted the same Wisconsin paper manufacturing and sales operation as conducted by old API before the merger. The taxpayer also continued the pre-merger cosmetics business of Germaine. The taxpayer's franchise tax liability for 1982-84 was entirely derived from its Wisconsin paper manufacturing and sales operations. Cosmetics operations in Wisconsin, a minor venture at that, lost money in those years. There was a substantial continuity of key officers and employes between old API and the taxpayer. The merger in question was treated as a liquidation under sec. 332 of the Internal Revenue Code.

The Commission ruled that the excess 1981 manufacturer's sales and use tax credit on fuel and electricity consumed in manufacturing attributable to old API's paper manufacturing and sales operations in Wisconsin was available to the taxpayer under sec. 71.043(3), Wis. Stats., for years successive to 1981, including 1982-84, as an offset to its Wisconsin corporate franchise tax liability derived from the continued operation of said business, by reason of its status as successor by merger to old API.

The department has appealed this decision to the Circuit Court.

❐

Consolidated filing. *The Williams Companies, Inc., and Its Domestic Subsidiaries vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, June 14, 1989). The issue in this case is whether the Wisconsin Tax Appeals Commission should grant the Wisconsin Department of Revenue's motions to dismiss all or a part of taxpayer's two petitions for review, on the following grounds:

A. That taxpayer has filed claims for refund for the years 1984, 1985, and 1986 on the basis of combined or consolidated reporting of all of the income of The Williams Companies, Inc., and Its Domestic Subsidiaries (TWC, et al.) which is not permissible under Wisconsin law. Further, the taxpayer's application of the statutory apportionment formula in its claims for refund fails to include the income and factors of its unitary foreign subsidiaries and, in addition, causes the income of one of its subsidiaries, The Williams Pipeline Company (WPL), to be apportioned by an apportionment formula other than the special apportionment formula provided for under Wisconsin law for interstate pipeline companies.

B. That TWC, et al., may not claim a refund of taxes paid by one of its subsidiaries, WPL, for 1984, 1985, or 1986 since sec. 71.10(10)(gm), Wis. Stats., provides that "A refund payable on the basis of a separate return shall be issued to the person who filed the return," and WPL not TWC, et al., is the person who paid the tax and filed the return.

C. That the taxpayer's claim for refund for 1984 is barred under sec. 71.10(10)(d) and sec. 71.10(10)(e), Wis. Stats., by the field audit assessment against WPL which became final before the filing of the claim for refund.

During the years at issue, 1984, 1985, and 1986, The Williams Companies (TWC), the predecessor of The Williams Companies, Inc., was a Nevada corporation with its principal place of business in Tulsa, Oklahoma. TWC was the parent corporation of, and directly or indirectly owned, it's domestic subsidiaries.

For purposes of this motion, the department and the taxpayer agree that TWC and it's domestic subsidiaries constituted a unitary business engaged in the manufacture and sale of petroleum and agricultural products, real estate development, and various other business activities. WPL was a wholly owned subsidiary of TWC included within the TWC, et al., group, and was engaged in the interstate transportation of oil, gas, and other solutions by pipeline. Its principal place of business

was Tulsa, Oklahoma.

WPL filed separate Wisconsin franchise tax returns for the years 1984 to 1986 (all of the TWC subsidiaries that operated in, or were qualified to do business in Wisconsin, filed separate Wisconsin tax returns). On each return, WPL computed its income attributable to Wisconsin by using the special apportionment formula for interstate pipeline companies provided for in sec. Tax 2.48, Wis. Adm. Code.

The department assessed WPL for additional franchise taxes and interest for the years 1981 through 1984; none of the additional tax was based upon deconsolidating WPL's return or recomputing WPL's income on a combined reporting basis. The assessment was paid by WPL.

TWC, et al., filed a claim for refund of franchise taxes paid by WPL for the years 1984 and 1985. The claim for refund was in the form of an amended Wisconsin franchise tax return designating TWC, et al., as the taxpayer. TWC, et al., in its claim for refund computed the income of the group of corporations covered by the claim using the standard 3 factor apportionment formula provided for in sec. 71.07(2), Wis. Stats. The denominators of the factors were for the total company "consolidated." The Wisconsin return had attached The Williams Companies' consolidated federal return. The department denied the claim for refund for the reasons that Wisconsin does not permit the filing of consolidated returns and that the year 1984 had been closed to refunds by field audit assessment.

TWC, et al., subsequently filed a claim for refund for the year 1986 for franchise taxes paid by WPL for its taxable year 1986. The claim for refund was in the form of a Wisconsin franchise tax return designating TWC, et al., as the taxpayer. TWC, et al., in its claim for refund computed the income of the group of corporations covered by the claim using the standard 3 factor apportionment formula. The denominators of the factors were for the total company "consolidated." The Wisconsin return had attached The Williams Companies and Subsidiaries' consolidated federal return. The department denied the claim for refund for the year 1986 for the reason that Wisconsin does not permit the filing of consolidated returns.

The Commission found that in *Interstate Finance Corp. v. Dept. of Taxation*, 28 Wis. 2d 262 (1965), the Wisconsin Supreme Court clearly rejected the use of consolidated returns by a unitary business. Since *Interstate*, the Wisconsin legislature has not passed legislation allowing for the filing of consolidated returns by unitary businesses. In the absence of any such statutory changes, the Commission ruled that the taxpayer is not entitled to file claims for refund which are based upon consolidated returns prepared using combined reporting and, therefore, granted the Department's motion to dismiss taxpayer's petition for review.

The taxpayer has not appealed this decision.

❐

SALES/USE TAXES

When and where sale takes place. *Marathon Electric Manufacturing Corp. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 27, 1989). On March 17, 1988, the Wisconsin Tax Appeals Commission issued a decision and order that was subsequently appealed by both parties to the Dane County Circuit Court. See WTB 58 for a summary of the Commission's decision. On October 6, 1988, the case was remanded to the Commission for the specific purpose of making a finding of fact as to "whether the aircraft was located in Wisconsin in 1980."

After reviewing the entire record the Commission, in compliance with the Court's remand, made the following additional finding of fact:

The aircraft in question was delivered to the taxpayer in December of 1980 in Kansas, and first arrived in Wisconsin in January of 1981. It was not located in Wisconsin in 1980.

In all other respects, the Commission's original decision and order of March 17, 1988 was affirmed.

The department has not appealed this decision.

❐

Manufacturing defined and scope of. *Department of Revenue v. Pavelski Enterprises, Inc.* (Court of Appeals, District IV, April 20, 1989). The Wisconsin Department of Revenue appeals from a judgment affirming a Wisconsin Tax Appeals Commission decision that Pavelski Enterprises, Inc.'s Lor-Al Air-Flow Dry Sprayer machines are exempt from sales and use taxes under the manufacturing exemption, sec. 77.51(27), Wis. Stats.

Pavelski, a retail fertilizer and farm supply operation, purchased two Lor-Al Air-Flow Dry Sprayers in 1981 and 1983 for $84,159.37 and $90,650, respectively. Pavelski did not pay a sales or use tax at the time of purchase.

Pavelski analyzes a farmer's soil, then mixes ingredients to form agriculture grade fertilizer. The granular ingredients are physically mixed together in a machine with either an auger blender or a rotary drum blender. The liquid ingredients are sprayed on in a process called impregnation. The finished product would be given a specific analysis as a name.

After the fertilizer leaves the plant, it is conveyed to a delivery truck or unit. At this point, the mix segregates, with larger particles going to the outside and small particles staying in the center. The delivery truck takes the fertilizer to the farmer's field and places it in the Lor-Al machines, which have been transported there previously. At this point, further segregation occurs. The Lor-Al machine remixes the fertilizer with a horizontal and vertical auger configuration similar to the machine used at the plant. This returns the fertilizer to the analysis it had when it left the plant. No additional ingredients are added. It is then spread on the field through a pneumatic air process. A customer could pur-

chase fertilizer directly from the plant and apply it without using the Lor-Al machine.

Eldon Roesler, the executive secretary of the Wisconsin Feed, Seed and Farm Supply Association for 35 years, testified that the mixing which is done by the Lor-Al machine is regarded as manufacturing within his industry. Eldon Roesler testified that one must look at the Lor-Al mixing process as an extension of the manufacturing process since, if Pavelski recommends a certain blend of fertilizer, it has to produce that blend and distribute it correctly or it will be subjected to complaints and lawsuits by the farmer.

The Court concluded that the Commission's finding that the two steps are part of a continuous process is supported by this evidence. Although other evidence suggests that the second step is separate, it is not the Court's function to weigh the evidence. The department concedes that the mixing which occurs at the plant is manufacturing. Since the finding that the two steps are inseparable is supported by substantial evidence, the determination that the Lor-Al machines are entitled to the manufacturing exemption has a rational basis.

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

❐

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

Farmland Preservation Credit

Corporation Franchise or Income Taxes

Sales/Use Taxes

INDIVIDUAL INCOME TAXES

1. Limitations on Farm Losses

Statute: Section 71.05(6)(a)10, Wis. Stats. (1987-88)

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

Background: A new add modification, sec. 71.05(1)(a)26, Wis. Stats., was created by 1985 Wisconsin Act 29, effective for taxable year 1986. That section was renumbered 71.05(6)(a)10 by 1987 Wisconsin Act 312, effective January 1, 1989. The modification limits the amount of combined net losses from farming businesses, exclusive of net gains and net profits, which may be claimed on a Wisconsin individual income tax return when nonfarm income exceeds prescribed levels. The limitations are explained in a Tax Release, WTB #51, page 9.

Facts and Question: Taxpayer F is a farmer who owns an interest in three related farms and materially participates in their operation, for the purpose of making a profit. Two of the farms, A and B, are organized as tax-option (S) corporations, while the third farm, C, is a farm partnership. Taxpayer F is the sole shareholder of farm A. In 1987, farms B and C operated at a profit while farm A sustained a net loss. Taxpayer F received wages from farm A. If these wages are nonfarm income, the farm loss limitations will apply for 1987. Are the wages which F received from farm A in 1987 considered to be nonfarm income for purposes of applying the farm loss limitations in sec. 71.05(6)(a)10, Wis. Stats. (1987-88)?

Answer: No. The wages from farm A are considered farm income, rather than nonfarm income. F is operating the farm for a profit as the sole shareholder. Wages received by the owner of a farm for participating in its operation can be distinguished from wages received by a farm employe, which would be considered nonfarm income. Since F is the sole shareholder and operates farm A, F's wages from farm A are farm-related income.

❐