

rebuilding entrances, exits, and interiors, all to the customer's specification. New electrical, plumbing, heating, and ventilating systems are installed.

The value of a railroad car is as low as \$10,000 before XYZ begins work and after 6 to 9 months of work, the car may be worth \$350,000 to \$600,000, depending upon the work involved.

The properties where the work on freight car wheels and railroad cars is done are currently zoned "M-1 Industrial." XYZ reports all equipment as manufacturing equipment used in the transformation of materials and components. XYZ considers itself exempt from personal property taxes.

The rebuilding of railroad cars is listed as a manufacturing activity under Section 3743 of the *Standard Industrial Classification Manual*, 1987 Edition.

- a. Does the remanufacture, to original specifications, of railroad freight car wheels constitute manufacturing for Wisconsin sales and use tax purposes?
- b. Does the refurbishing or remaking of railroad cars constitute manufacturing for Wisconsin sales and use tax purposes?

Answer:

- a. Yes. The remanufacture of railroad freight car wheels, as performed by XYZ, constitutes manufacturing under sec. 77.54(6m), Wis. Stats. (1987-88). The situation is similar to that in the case of *Argyle Industries, Inc. vs. Wisconsin Department of Revenue*, (Docket No. I-8393, July 25, 1983). The Commission concluded in that case that Argyle's "remanufacturing" of automobile parts from new and used component parts constituted manufacturing.
- b. Yes. The refurbishing or remaking of passenger railroad cars, to the degree and scale engaged in by XYZ, constitutes manufacturing under sec. 77.54(6m), Wis. Stats. (1987-88).

Note: The scope of this Tax Release only encompasses whether particular operations constitute manufacturing. The question of exclusive use of machinery and equipment in the manufacturing operations for purposes of sales and use tax exemptions is not addressed.



PRIVATE LETTER RULINGS

"Private letter rulings" are written statements issued to a taxpayer by the department that interpret Wisconsin tax laws to the taxpayer's specific set of facts. Any taxpayer may rely upon the ruling to the same extent as the requestor, provided the facts are the same as those set forth in the ruling.

The number assigned to each ruling is interpreted as follows: The first two digits are the year issued, the next two digits are the week issued, and the last three digits are the number in the series of rulings issued that year. "Issued" means when the ruling is available to be published (80 days after being mailed to the requester). The date following the 7-digit number is the date the ruling was mailed to the requester.

Certain information contained in the ruling that could identify the taxpayer requesting the ruling has been deleted. Wisconsin Publication 111, "How to Get a Private Letter Ruling From the Department of Revenue," contains additional information about private letter rulings.

W 8927002, April 19, 1989

Type Tax: Sales/Use

Issue: Manufacturing Machinery and Equipment; Property Consumed in the Manufacturing Process

Statutes: Sections 77.54(2) and (6)(a), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the classification of the production of microfiche as manufacturing for purposes of the sales tax exemption for machinery and equipment, s. 77.54(6)(a), and property consumed in manufacturing, sec. 77.54(2), Wis. Stats.

Facts: A operates a micrographics service business. The company receives computer tapes and cassettes in various electronic data formats from clients. This machine readable information is reprogrammed to satisfy client output format requirements. Microfiche copies of the data are produced, without conversion of the data through a paper report state.

In this process, A consumes supplies in the production of microfiche for clients including computer tapes, photographic sensitive film, processing chemicals, and paper packaging materials.

You have indicated that A has purchased equipment from DatagraphiX, Inc. of San Diego, California, and is financing the purchase through B a division of A. The cost of the equipment was \$164,000 and the monthly financing lease payments are \$5,326. Use tax was not paid on the acquisition from DatagraphiX nor on the lease payments, as A believes this equipment is being used exclusively in a manufacturing process.

A also purchases supplies which are consumed exclusively in the production of microfiche. A sells the reformatted information by transfer of the completed microfiche product.

You describe the process as involving the conversion of machine readable electronic data into a human readable format and you further describe the process as set forth below.

The film, the main component in the process, in its unprocessed form along with the chemicals are not an end product or in a usable form. The information received from the customer in the form of magnetic images on magnetic tape is reformatted and electronically transferred into a human readable form on the film. The film, at this point, has been permanently altered but is still light sensitive and retains no images placed on the film. Through the chemical processing, the image becomes unalterable and permanent on the film. Through cutting and shaping, the film becomes the usable end product, microfiche. The tangible property that entered the process is permanently altered.

Computer generated data is provided by customers on magnetic tape or cartridge for microfiche processing. The tapes or cartridges are loaded on the computer output microfilm system for processing. The system reads the data from the tape or cartridge, generates the data on a CRT tube inside the system, and flashes an image of the data on to film. The film is then processed and dried. Additional copies of the microfiche can be produced on a microfiche duplicator.

A has two complete systems for producing microfiche. Equipment includes two DatagraphiX auto-com recorders, two Datamaster duplicators, two cartridge tape units, and one tape drive.

Other equipment in the facility includes an Allen 16MM microfilm processor, an Extek 16MM Diazo duplicator, 2 micro-design microfilm viewers, and other related film handling devices such as rewinds, splicers, etc.

The production area is approximately 1,050 sq. ft. and is operated and staffed by 4 full-time employees and one part-time employee.

Ruling: The production of microfiche from customers' computer tapes, in the scope and to the extent engaged in by A, constitutes manufacturing for sales and use tax purposes. Thus, the machines and specific processing equipment used by A exclusively and directly in the production of microfiche are exempt from sales and use tax under sec. 77.54(6)(a), Wis. Stats.

Exempt equipment includes the two DatagraphiX auto-com recorders, the two Datamaster duplicators, the two cartridge tape units, the tape drive, the Allen 16MM microfilm processor, the Extek 16MM Diazo duplicator, the 2 micro-design microfilm viewers, and the other related film handling devices such as rewinds, splicers.

Tangible personal property consumed or destroyed in the production of the microfiche or that becomes an ingredient or component part of the microfiche is exempt from sales tax under sec. 77.54(2), Wis. Stats. Examples of exempt property consumed or destroyed in the manufacturing process include the auto-pos film and chemistry used to produce the finished microfiche and the diazo film and ammonia to produce duplicates.

Analysis: Section 77.54(6)(a), Wis. Stats., provides an exemption for "machines and specific processing equipment and repair parts

or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property."

The term "manufacturing" as used in sec. 77.54(6)(a), Wis. Stats., is defined in sec. 77.54(6m), Wis. Stats., to mean "the production by machinery of a new article with a different form, use, and name from existing materials by a process properly regarded as manufacturing."

The concept that the microfilming (e.g., producing of microfiche) of customer's records constitutes manufacturing was affirmed in *Valley Microforms, Inc. vs. DOR*, Wisconsin Tax Appeals Commission decision dated May 30, 1984. Based on the information provided, A is engaged in the business of producing microfiche and duplicates of microfiche to a sufficient extent as to be regarded as engaged in manufacturing.

Manufacturing machinery must be used exclusively and directly in the manufacturing process to qualify for the exemption. "Exclusively" as defined in sec. Tax 11.40(1)(a), Wis. Adm. Code, and as used in sec. 77.54(6)(a), Wis. Stats., means that the machines and specific processing equipment are used solely by a manufacturer in manufacturing tangible personal property to the exclusion of all other uses, except that the sales and use tax exemption will not be invalidated by an infrequent and sporadic use other than in manufacturing tangible personal property.



W 8927003, April 19, 1989

Type Tax: Sales/Use

Issue: Manufacturing Equipment - Book Binding

Statutes: Section 77.54(6)(a) and (6m), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the sales and use tax status of certain binding equipment.

1. A, a nonprofit organization, is the sole shareholder of B.
2. B (taxpayer) has two lines of business operations. The primary business operation is the provision of bindery services to printers servicing the public and private sectors. For example, taxpayer has accepted bindery contracts for various national magazine publications.
3. An important although secondary business operation of taxpayer is its mailing service support business. This operation assists Wisconsin printers by wrapping, addressing, and mailing supplemental magazines and brochures to subscribers. An agreement with the United States Postal Service enables the taxpayer to perform on-site stamping and ship-

ment of the wrapped and finished materials from the business location.

4. B has recently acquired financing for the purpose of acquisition of certain equipment to be used exclusively in its bindery manufacturing process. These machines include paper cutters, stitchers, folding machines, drills, and a saddle stitcher. Taxpayer uses these machines by taking printed materials and then cutting, folding, binding, and wrapping them so that they may be provided to the end user. Set forth below is a description of the equipment in question ("Bindery Equipment"):

Saddle Stitching Machine: This machine is used in taxpayer's basic binding line to assemble printed paper, trim it, and bind it into a final finished product. The finished product would typically be a catalog or a weekly magazine publication. A picture of and operational data concerning the saddle stitcher was attached to your request as Exhibit A.

Folding Machine: This machine is used in conjunction with the saddle stitcher to fold flat press sheets into multiple pages which can be assembled into a final printed product. A picture of and operational data concerning the folding machine was attached to your request as Exhibit B.

Paper Cutter: This machine is used to cut paper so that it can be folded and stitched into the final printed product. A picture of and operational data concerning the folding machine was attached to your request as Exhibit C.

Collator: This machine gathers flat press sheets together into a form that can then be fed into the folding machine, paper cutter, and saddle stitcher for production of the final printed product.

Upright Stitcher: This machine is a smaller version of the saddle stitcher that is used to stitch (bind) small quantity jobs and is used to correct stitching flaws which occur in larger runs on the saddle stitcher.

Electro Spiro Punch: This machine is used to punch holes in paper so that it can then be bound in a spiral metal wire process by the electric spiro binder.

Electro Spiro Binder: This machine is used to thread spiral metal wire through assembled paper sheets to produce items such as technical manuals and spiro binder notebooks.

Five Head Drill: This machine is used to drill holes through paper so that it can be assembled in the binding process.

Ruling Request: You state that the operative transaction giving rise to this ruling request is the purchase of the Bindery Equipment by the taxpayer. The business purpose for the acquisition of this equipment is to permit the taxpayer to perform the necessary operations of its bindery business.

Based on the foregoing, you request that a ruling be issued providing that the Bindery Equipment is manufacturing equipment within the meaning of sec. 77.54(6)(a), Wis. Stats., and is therefore, exempt from the sales and use tax.

Ruling: The process of book binding, to the extent engaged in by B constitutes manufacturing under sec. 77.54(6m), Wis. Stats. The machines and processing equipment (Bindery Equipment) used by B exclusively and directly in the binding process qualifies for exemption under sec. 77.54(6)(a), Wis. Stats.

Providing a mailing service does not constitute manufacturing. Any bindery equipment also used in providing the mailing service (except for infrequent and sporadic use) would violate the exclusive use requirement of sec. 77.54(6)(a), Wis. Stats., and thus, void the exemption.

Analysis: Section 77.54(6)(a), Wis. Stats., provides an exemption for "machines and specific processing equipment and repair parts or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property."

The term "manufacturing" as used in sec. 77.54(6)(a), Wis. Stats., is defined in sec. 77.54(6m), Wis. Stats., to mean "the production by machinery of a new article with a different form, use, and name from existing materials by a process properly regarded as manufacturing."

The Bindery Equipment is used to produce books and magazines in a bound and finished form from source materials that are essentially loose printed papers. The Bindery Equipment takes the loose printed paper, cuts it to size, drills holes in it for stitching, folds it, and then stitches it together with a covering material to produce a finished product in a different shape or form than the source materials. This description falls within the definition of manufacturing found in sec. 77.54(6m), Wis. Stats., because the Bindery Equipment is used to produce a new article with a form, use, and name that is different than the source materials.

Manufacturing machinery must be used exclusively and directly in the manufacturing process. Since mailing services are not considered manufacturing, the machines and equipment used in the mailing service do not qualify for the exemption. In addition, any Bindery Equipment also used in the providing of mailing services would not qualify for the exemption in sec. 77.54(6)(a), Wis. Stats., because it is not used exclusively in the manufacturing (binding) process.

"Exclusively" as defined in sec. Tax 11.40(1)(a), Wis. Adm. Code, and as used in sec. 77.54(6)(a), Wis. Stats., means that the machines and specific processing equipment are used solely by a manufacturer in manufacturing tangible personal property to the exclusion of all other uses, except that the sales and use tax exemption will not be invalidated by an infrequent and sporadic use other than in manufacturing tangible personal property.



W 8927004, April 19, 1989

Type Tax: Individual Income

Issue: Proration of Itemized Deduction Credit - Part-Year Resident

Statutes: Section 71.07(5), Wis. Stats. (1987-88)

This is in reply to your ruling request concerning the proration of the Wisconsin itemized deduction credit.

Facts: You were part-year residents of Wisconsin for taxable year 1988 and have submitted Wisconsin Form 1NPR and Schedule 1 (Wisconsin Itemized Deduction Credit). The Wisconsin itemized deduction credit is discounted (prorated) on Form 1NPR by a ratio of Wisconsin income to federal income. Two of the items used to compute the Wisconsin itemized deduction credit ("interest paid on your principal residence" and "moving expenses") pertain to only your Wisconsin income. The mortgage interest was paid for a home located in Wisconsin and reimbursement for moving expenses is included in Wisconsin income.

Request: You specifically request that the portion of the Wisconsin itemized deduction credit which is attributable to mortgage interest and moving expenses not be prorated and the tax liability be calculated accordingly.

Ruling: Wisconsin law provides that part-year residents must prorate the Wisconsin itemized deduction credit based on the ratio of Wisconsin adjusted gross income to federal adjusted gross income. There is no provision in Wisconsin law to allow part-year residents to prorate certain portions of the Wisconsin itemized deduction credit and not prorate other portions.

Analysis: Section 71.07(5), Wis. Stats. (1987-88), provides for the computation of the Wisconsin itemized deduction credit. Paragraph (d) provides that "With respect to persons who change their domicile into or from this state during the taxable year and nonresident persons, the credit under this subsection shall be limited to the fraction of the amount so determined that Wisconsin adjusted gross income is of federal adjusted gross income."

Accordingly, as a part-year resident of Wisconsin for 1988, you must prorate the total amount of your Wisconsin itemized deduction credit, including the portion attributable to moving expenses and interest paid for a home located in Wisconsin. The statute is clear and the department has no alternative to permit any other method than that authorized by the statute.

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W 8930005, May 8, 1989

Type Tax: Corporation Franchise or Income

Issue: Net Business Loss Carryforward - Merger

Statutes: Section 71.26(3), Wis. Stats. (1987-88)

This letter responds to your request for a private letter ruling regarding the proposed statutory merger transaction and the effect on the Wisconsin net business loss carryforwards of the merged corporations.

Facts: In your letter you state that Parent, a Wisconsin corporation, is a publicly-held corporation with several wholly-owned subsidiaries. The taxpayer is contemplating the entering of a merger agreement between 3 of the wholly-owned subsidiaries. You state that such mergers will be effected pursuant to Internal Revenue Code section 368(a)(1)(A). The proposed merger transactions would be as follows:

(Sub B) into (Sub A)

and

(Sub C) into (Sub A)

Sub B, a Wisconsin corporation, holds the office building for the headquarters of Parent, in Wisconsin. Sub A, a Wisconsin corporation, and Sub C, a Kentucky corporation, are engaged in manufacturing. Sub A operates the assembly facilities in Wisconsin and Sub C operates the assembly facility in Kentucky.

The corporations are all on the accrual basis of accounting and are included in the consolidated federal income tax return of Parent. Sub B and Sub C both have net operating loss carryforwards for 1987, and estimated losses for the year 1988. You state that the losses of Sub B are attributable fully to Wisconsin and the Sub C losses are attributable fully to Kentucky. Sub A currently files in Wisconsin and Kentucky and has been profitable in recent years.

Request: You have requested that the following rulings be issued:

1. The proposed statutory mergers under the laws of the states of Wisconsin and Kentucky will qualify as an "A" reorganization under Internal Revenue Code section 368(a)(1)(A); and the 3 corporations qualify as "a party to a reorganization" under Internal Revenue Code section 368(b).
2. No gain or loss will be recognized pursuant to Internal Revenue Code section 361(a) to Parent or any other affiliated corporation as a result of the proposed statutory merger.
3. The assets and liabilities of Sub B and Sub C to be transferred to Sub A will retain the same tax basis as that of Sub B and Sub C in accordance with the provisions of Internal Revenue Code section 362(b).

4. Pursuant to Internal Revenue Code section 358(a), the basis of the stock received by Parent will equal the existing basis in Sub B and Sub C immediately prior to the merger transaction and the holding period of such stock will continue pursuant to Internal Revenue Code section 1223(1).
5. The Wisconsin net business loss carryforwards of the merged corporations will be available to the survivor corporation irrespective of continuance of the same trade or business.
6. The losses will not be subject to limitations under Internal Revenue Code section 382 and thus will be 100% available to the survivor corporation in the year of the merger.
5. The Wisconsin net business loss carryforwards of Sub B will be available to the survivor corporation as provided by Internal Revenue Code sections 381 and 382. For transactions occurring during the 1987 taxable year and thereafter, it is no longer necessary that the laws of the state under which the reorganization is accomplished provide for the continued existence of the dissolved corporation in the survivor. Since the losses of Sub C are attributable fully to Kentucky, they will not be available to the survivor corporation.
6. If the limitations under Internal Revenue Code section 382 do not apply for federal income tax purposes because the merger does not constitute an ownership change as defined in Internal Revenue Code section 382(g), the Wisconsin net business loss carryforwards of Sub B for 1980 and thereafter will be 100% available to the survivor corporation. Since the losses of Sub C are attributable fully to Kentucky, they will not be available to the survivor corporation.

Ruling:

1. If the proposed statutory mergers under the laws of the states of Wisconsin and Kentucky qualify as an "A" reorganization under Internal Revenue Code section 368(a)(1)(A) and the 3 corporations qualify as "a party to a reorganization" under Internal Revenue Code section 368(b) for federal income tax purposes, Internal Revenue Code section 368(a)(1)(A) and (b) will also apply for Wisconsin franchise and income tax purposes.
2. If no gain or loss is recognized pursuant to Internal Revenue Code section 361(a) to Parent or any other affiliated corporation for federal income tax purposes as a result of the proposed merger, Internal Revenue Code section 361(a) will also apply for Wisconsin franchise and income tax purposes.
3. If the assets and liabilities of Sub B and Sub C to be transferred to Sub A retain the same tax basis as that of Sub B and Sub C in accordance with the provisions of Internal Revenue Code section 362(b) for federal income tax purposes, Internal Revenue Code section 362(b) will also apply to their Wisconsin tax basis.
4. If, pursuant to Internal Revenue Code section 358(a), the basis of the stock received by Parent will equal the existing basis in Sub B and Sub C immediately prior to the merger transaction and the holding period of such stock will continue pursuant to Internal Revenue Code section 1223(1) for federal income tax purposes, Internal Revenue Code sections 358(a) and 1223(1) will also apply for Wisconsin franchise and income tax purposes.

Analysis: Beginning with the 1987 taxable year, the Wisconsin net income of a corporation is determined under the Internal Revenue Code, with certain modifications. The modifications to the Internal Revenue Code in section 71.26(3), Wis. Stats. (1987-88), do not include any modifications to Internal Revenue Code sections 358, 361, 362, 368, or 1223. Internal Revenue Code sections 381, 382, and 383 are modified so that they apply to Wisconsin net business loss carryforwards and Wisconsin credits instead of to federal net operating losses and federal credits. Internal Revenue Code section 381 first applies to mergers occurring in taxable year 1987. When such application is warranted, the successor corporation may utilize the predecessor corporation's unused Wisconsin net business loss carryforwards from 1980 and thereafter.

Since the Department of Revenue will not issue private letter rulings involving interpretations of the Internal Revenue Code, we will not rule that Internal Revenue Code sections 358(a), 361(a), 362(b), 368(a)(1)(A) and (b), and 1223(1) do apply, nor will we rule that Internal Revenue Code section 382 does not apply to this transaction.

