gross income (on Wisconsin Form 1, line 4) the $1,800 of capital gain income which was included in his federal adjusted gross income but is not taxable by Wisconsin. Sec. 71.05(6)(b)9, Wis. Stats. (1987-88).

Taxpayer X does not need to recompute his allowable passive activity losses because the capital gain deduction is a modification to federal adjusted gross income when computing Wisconsin adjusted gross income rather than an exception to the federal Internal Revenue Code when computing federal adjusted gross income for Wisconsin purposes. Neither this nor any other Wisconsin modification requires Taxpayer X to recompute his allowable passive activity losses by excluding the 60% capital gain deduction and to report the difference as an addition modification.

Facts and Question 4: Taxpayer W, a full-year Wisconsin resident, is a shareholder in JKL Corporation, a federal S corporation. Taxpayer W determines that she must treat her interest in JKL Corporation as a passive activity. For 1989, Taxpayer W's pro rata share of JKL Corporation's ordinary income is $1,000. JKL Corporation did not make any distributions to its shareholders in 1989.

For federal purposes, Taxpayer W enters all of her passive activity income and losses, including her ordinary income of $1,000 from JKL Corporation, on federal Form 8582. She determines that $10,600 of her passive activity losses is allowable in computing her 1989 federal adjusted gross income.

For Wisconsin purposes, JKL Corporation elected, pursuant to sec. 71.365(4)(a), Wis. Stats. (1987-88), not to be a tax-option corporation. Therefore, Taxpayer W must subtract from her federal adjusted gross income the $1,000 of income that she reported which was passed through from JKL Corporation. Sec. 71.05(10)(d), Wis. Stats. (1987-88).

Since the undistributed ordinary income from JKL Corporation is not taxable to Taxpayer W for Wisconsin purposes, must Taxpayer W recompute her allowable passive activity losses for Wisconsin purposes?

Answer 4: No. Taxpayer W is not required to recompute her allowable passive activity losses. She must subtract from her federal adjusted gross income (on Wisconsin Form 1, line 4) the $1,000 of JKL Corporation's income which was included in her federal adjusted gross income but is not taxable by Wisconsin. Sec. 71.05(10)(d), Wis. Stats. (1987-88).

Taxpayer W does not need to recompute her allowable passive activity losses because the exclusion of the S corporation income is a modification to federal adjusted gross income when computing Wisconsin adjusted gross income rather than an exception to the federal Internal Revenue Code when computing federal adjusted gross income for Wisconsin purposes. Neither this nor any other Wisconsin modification requires Taxpayer W to recompute her allowable passive activity losses by excluding the S corporation income and to report the difference as an addition modification.

Facts and Question 5: Assume that the facts are the same as in Question 4 above except that JKL Corporation incurred an ordinary loss for 1989, and Taxpayer W's pro rata share of that loss is $5,000.

For federal purposes, Taxpayer W enters all of her passive activity income and losses, including her ordinary loss of $5,000 from JKL Corporation, on federal Form 8582. She determines that $10,600 of her passive activity losses, including $1,770 of her loss from JKL Corporation, is allowable in computing her 1989 federal adjusted gross income.

For Wisconsin purposes, Taxpayer W may not deduct the $5,000 ordinary loss from JKL Corporation because the corporation elected not to be treated as a tax-option corporation. Sec. 71.05(10)(d), Wis. Stats. (1987-88).

Since the ordinary loss from JKL Corporation is not deductible by Taxpayer W on her Wisconsin income tax return, may Taxpayer W recompute her allowable passive activity losses for Wisconsin purposes?

Answer 5: No. Taxpayer W may not recompute her allowable passive activity losses. She must add to her federal adjusted gross income (on Wisconsin Form 1, line 2) the $1,770 of ordinary loss from JKL Corporation actually included in her 1989 federal adjusted gross income.

When figuring her Wisconsin adjusted gross income in future years, Taxpayer W must add back to her federal adjusted gross income the portion of her 1989 ordinary loss from JKL Corporation allowed that year in the computation of her federal adjusted gross income.

Neither this nor any other Wisconsin modification permits Taxpayer W to recompute her allowable passive activity losses for 1989 by excluding the S corporation loss and to make a modification for the difference.

Facts and Question 6: Taxpayer V, a nonresident of Wisconsin, reports the following income on his 1989 federal income tax return:

Wages earned in Illinois	$58,000
Interest income	8,000
Passive activity losses allowed*	(6,600)
Gain on sale of Wisconsin real estate	20,000
Federal adjusted gross income	$79,400

*Taxpayer V's passive activity losses from federal Form 8582 consist of the following:

	Total	Allowed
MNO Properties (Illinois)	$5,000	$3,667
PQR Associates (Wisconsin)	3,000	2,200
STU Partnership (Illinois)	1,000	733
Totals	$9,000	$6,600

Taxpayer V is a general partner in PQR Associates and a limited partner in MNO Properties and STU Partnership. PQR Associates conducts a business solely in Wisconsin while the other two partnerships operate only in Illinois.

What is Taxpayer V's Wisconsin adjusted gross income for 1989?

Answer 6: Taxpayer V's 1989 Wisconsin adjusted gross income is $5,800 which is computed as follows:

Gain on sale of Wisconsin real estate	$20,000	
Less: Capital gain deduction (60%)	(12,000)	$8,000
Wisconsin passive activity loss allowed		(2,200)
Wisconsin adjusted gross income		$5,800

Nonresidents of Wisconsin are subject to Wisconsin income tax on income derived from property located or business transacted in Wisconsin and from the performance of personal services in Wisconsin. Sec. 71.02, Wis. Stats. (1987-88). Therefore, Taxpayer V's gain on the sale of Wisconsin real estate is taxable by Wisconsin.

In addition, since Taxpayer V was a general partner in PQR Associates and the partnership conducted business only in Wisconsin, Taxpayer V may deduct his distributive share of PQR Associates' loss for Wisconsin purposes. However, his allowable loss for 1989 is limited to the $2,200 that was allowed for federal purposes. The Wisconsin Statutes do not permit Taxpayer V to recompute his allowable passive activity losses by excluding the income and losses that are not taxable by Wisconsin and to make a modification for the difference.

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INDIVIDUAL AND FIDUCIARY INCOME TAXES

1. Wisconsin Filing Requirements for Qualified Subchapter S Trusts

Statutes: Sections 71.13(1) and 71.17(5), Wis. Stats. (1987-88).

Background: Under sec. 1361 of the Internal Revenue Code (IRC), a Qualified Subchapter S Trust (QSST) may be a shareholder of an S corporation if the current income beneficiary or his or her legal representative elects to have the trust qualify as a QSST. A QSST is a trust whose terms require that

(1) during the life of the current income beneficiary there can be only one income beneficiary,

(2) corpus distributions during the current income beneficiary's life can be made only to him or her,

(3) the current income beneficiary's income interest must terminate on the earliest of his or her death or the termination of the trust, and

(4) if the trust terminates during the current income beneficiary's life, the trust's assets must all be distributed to the current income beneficiary.

In addition, all of the trust's income must be distributed or required to be distributed currently to only one individual who is a citizen or resident of the United States. Moreover, the current income beneficiary must make a separate election for each S corporation in which the trust owns stock. The beneficiary is treated as the deemed owner under IRC sec. 678 of that portion of the trust that consists of the stock in the S corporation.

Facts: The stock of a corporation which has elected tax-option (S) corporation status for federal and Wisconsin purposes is held, in part, by ten different trusts. The trusts qualify as QSSTs for federal S election purposes, and the beneficiaries of the trusts have made federal QSST elections.

Question 1: Must the beneficiaries make a separate QSST election for Wisconsin purposes?

Answer 1: No. The beneficiaries are not required to make a separate Wisconsin election.

Question 2: May the beneficiaries, rather than the QSSTs, be listed as the shareholders on the tax-option (S) corporation's Wisconsin Schedules 5K-1, Wisconsin Tax-Option (S) Corporation Shareholder's Schedule of Income, Deductions, etc.?

Answer 2: No. The trusts, not the beneficiaries, are considered to be the shareholders for purposes of the Wisconsin Schedules 5K-1. Thus, the QSSTs must be listed as the shareholders on the Schedules 5K-1.

Question 3: Who must file Wisconsin income tax returns to report their shares of the tax-option (S) corporation income?

Answer 3: The QSSTs must file Wisconsin fiduciary income tax returns to report their shares of the tax-option (S) corporation income. Such trusts which receive income from Wisconsin sources, except trusts exempt from federal income tax pursuant to subtitle A, chapter 1, subchapter F of the Internal Revenue Code, must file a Wisconsin fiduciary income tax return, Form 2. The QSSTs must file Forms 2 to report their shares of the tax-option (S) corporation income regardless of whether all of the trust income is distributed. In addition, the beneficiaries of the QSSTs must file individual income tax returns to report their shares of the trust income.

Question 4: If the beneficiaries of the QSSTs are nonresidents of Wisconsin, may they file Wisconsin Form 1CNS, the combined individual and fiduciary income tax return for nonresident tax-option (S) corporation shareholders, in lieu of the QSSTs and individuals filing separate Wisconsin fiduciary and individual income tax returns?

Answer 4: No. Neither such QSSTs nor their beneficiaries may file a Wisconsin Form 1CNS. This form may be used only by nonresident individuals who directly own tax-option (S) corporation stock and by nonresident trusts which do not distribute any of their income in the current year.

CORPORATION FRANCHISE OR INCOME TAXES

1. Dividends Received Deduction - Requirement to Own Stock During Entire Taxable Year

Statutes: Sections 71.22(10) and 71.26(3)(j), Wis. Stats., as amended by 1989 Wisconsin Act 31.

Facts: Corporation A does business in Wisconsin and files a Wisconsin franchise tax return on a fiscal January 31 year end basis. From February 1, 1980 to June 30, 1989 Corporation A owned 100% of the voting stock of Corporation C. On June 30, 1989 the corporations underwent a reorganization. Corporation A formed a new subsidiary, Corporation B. Corporation A owns 100% of the voting stock of Corporation B. Corporation B in turn owns 100% of Corporation C. All of the corporations have a January 31 year end. On November 30, 1989, Corporation C distributed a $20,000 property dividend to Corporation B.

Question: Is the $20,000 property dividend received by Corporation B from Corporation C deductible by Corporation B in arriving at its Wisconsin net income for the year ended January 31, 1990?

Answer: Section 71.26(3)(j), Wis. Stats., as amended by 1989 Wisconsin Act 31, provides in part that a corporation may deduct from income dividends received from a corporation with respect to its common stock if the corporation receiving the dividends owns, directly or indirectly, during the entire taxable year at least 80% of the total combined voting stock of the payor corporation.

Section 71.22(10), Wis. Stats., as amended by 1989 Wisconsin Act 31, provides in part that the taxable year means the taxable period upon the basis of which the taxable income of the taxpayer is computed for federal income tax purposes.

Therefore, since the period from June 30, 1989 through January 31, 1990 is the taxable period upon which the taxable income of Corporation B will be computed for federal tax purposes and since Corporation B owned at least 80% of the voting stock of Corporation C during that entire period, the $20,000 property distribution from Corporation C to Corporation B is deductible by Corporation B in arriving at its Wisconsin net income for the year ended January 31, 1990.

2. Due Dates and Estimated Tax Payment Requirements for Short-Period Corporate Returns

Statutes: Sections 71.22(10) and 71.24(1) and (9)(a), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31.

Note: This tax release applies with respect to taxable years beginning on or after August 1, 1988.

Background: Corporation franchise and income tax returns for less than a full taxable year must be filed on or before the due date applicable for federal income tax purposes under the Internal Revenue Code (IRC). Sec. 71.24(1), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31. The taxable year is the taxable period for which the taxpayer's taxable income is computed for federal purposes. Sec. 71.22(10), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31. Corporation franchise and income taxes not paid by the 15th day of the 3rd month following the close of the taxable year are deemed delinquent. Sec. 71.24(9)(a), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31.

Wisconsin corporate net income is computed under the Internal Revenue Code, with certain modifications. One of the modifications excludes IRC secs. 1501 to 1505, 1551, 1552, 1563, and 1564, relating to consolidated returns, for the purpose of computing corporate income. Secs. 71.22(4) and 71.26(3)(x), Wis. Stats. (1987-88). These modifications, however, do not eliminate the consolidated return provisions of the Internal Revenue Code for the purpose of establishing filing dates.

Situation 1 — Facts: Corporation P owns 100% of the stock of Corporation S. The corporations file consolidated federal returns on a calendar-year basis. On March 31, 1989, P sells all of the stock of S to third parties, thus severing the affiliated group. Neither P nor S changes its taxable year as a result of severing the relationship.

For federal purposes, P and S file a consolidated return for the period from January 1 through March 31, 1989. The consolidated return includes the income of P for the entire 1989 calendar year and the income of S for the period from January 1 through March 31, 1989. S files a separate federal return for the period from April 1 through December 31, 1989, or is included in the consolidated return of a new affiliated group, if appropriate.

Since Wisconsin does not permit the filing of consolidated returns, P and S must file separate Wisconsin franchise or income tax returns to report their respective incomes.

Question 1: What are the filing requirements of P and S for Wisconsin franchise or income tax purposes?

Answer 1: P must file one Wisconsin franchise or income tax return for the entire 1989 calendar year, the same as for federal purposes. P's Wisconsin return is due March 15, 1990, plus any extensions.

Since S must file two short-period federal returns, S must also file two short-period Wisconsin franchise or income tax returns. The first return covers the period from January 1 through March 31, 1989, and the second, the period from April 1 through December 31, 1989. S's Wisconsin returns are due no later than its federal income tax returns. Thus, both Wisconsin returns are due no later than March 15, 1990, plus any extensions. However, the tax due on the first short-period return is payable by June 15, 1989, and the tax due on the second short-period return is payable by March 15, 1990.

Question 2: What were the estimated tax filing requirements for P and S for 1989? (Assume that the annualized installment method was not used.)

Answer 2: P was required to make four estimated tax installment payments. The payments, each for 25 percent of the estimated tax liability, were due March 15, June 15, September 15, and December 15, 1989.

S was required to make the following estimated tax installment payments:

(A) For the first short taxable year, one installment payment for 100% of the estimated tax liability was due March 15, 1989.

(B) For the second short taxable year, three installment payments were due. The first payment, for 50% of the estimated tax liability, was due June 15, 1989. The second and third payments, each for 25% of the estimated tax liability, were due September 15 and December 15, 1989.

Situation 2 — Facts: Corporation X buys 100 percent of the stock of Corporation Y on August 29, 1989. Both corporations compute their taxable incomes on a calendar-year basis. For federal purposes, X and Y file a consolidated income tax return for the period from August 30 through December 31, 1989. The consolidated return includes X's income for the entire 1989 calendar year and Y's income for the period from August 30 through December 31, 1989. Y files a separate federal return for the period from January 1 through August 29, 1989.

Question 3: What are the filing requirements of X and Y for Wisconsin franchise or income tax purposes?

Answer 3: X must file one Wisconsin franchise or income tax return for the entire 1989 calendar year, the same as for federal purposes. X's Wisconsin return is due March 15, 1990, plus any extensions.

Y must file two short-period Wisconsin franchise or income tax returns for 1989. The first return covers the period from January 1 through August 29, 1989, and the second, the period from August 30 through December 31, 1989. Both of these returns are due no later than March 15, 1990, the federal due date. However, the tax due on the first short-period return is payable by November 15, 1989, and the tax due on the second short-period return is payable by March 15, 1990.

Question 4: What were the estimated tax filing requirements for X and Y for 1989? (Assume that the annualized installment method was not used.)

Answer 4: X was required to make four estimated tax installment payments. The payments, each for 25 percent of the estimated tax liability, were due March 15, June 15, September 15, and December 15, 1989.

Y was required to make the following estimated tax installment payments:

(A) For the first short taxable year, three estimated tax installment payments were due. The first and second payments, each for 25 percent of the estimated tax liability, were due March 15 and June 15, 1989. The third payment, for 50 percent of the estimated tax liability, was due August 15, 1989.

(B) For the second short taxable year, two estimated tax installment payments were due. The first payment, for 75 percent of the estimated tax liability, was due November 15, 1989. The second payment, for 25 percent of the estimated tax liability, was due December 15, 1989.

Situation 3 — Facts: ABC Corporation, a calendar-year filer, merges into XYZ Corporation on October 6, 1989. The reorganization qualifies as an "A" reorganization under IRC sec. 368(a)(1).

Question 5: When is ABC Corporation's final Wisconsin franchise or income tax return due?

Answer 5: ABC Corporation's final return is due January 15, 1990. However, if ABC Corporation files a consolidated federal income tax return with XYZ Corporation, ABC Corporation's Wisconsin return is due no later than the federal consolidated return. The tax due on ABC Corporation's final return is payable by January 15, 1990.

Question 6: How many estimated tax installment payments was ABC Corporation required to make for 1989, and when were those payments due?

Answer 6: ABC Corporation was required to make four estimated tax installments due March 15, June 15, September 15, and October 15, 1989. Each payment should have been for 25 percent of ABC Corporation's estimated tax liability, unless the annualized installment method was used.

Question 7: If the merger of ABC Corporation into XYZ Corporation had occurred on July 6 rather than October 6, how many estimated tax payments would ABC Corporation have been required to make, and when would those payments have been due?

Answer 7: If the merger had occurred on July 6, 1989, ABC Corporation would have been required to make three estimated tax payments. The first and second payments, each for 25 percent of the estimated tax liability, would have been due March 15 and June 15, 1989. The third payment, for 50 percent of the estimated tax liability, would have been due July 15, 1989. (Note that the percentages would change if the annualized installment method were used.)

Situation 4 — Facts: Corporation P and its subsidiaries S1 and S2 file consolidated federal income tax returns on a calendar-year basis. Since Wisconsin law does not permit consolidated filing, the income and expense items are separated for Wisconsin franchise and income tax purposes. P made 1989 estimated tax payments of $10,000 each on March 15, June 15, September 15, and December 15, 1989, even though P did not operate in Wisconsin at all during 1989 and filed withdrawal papers with the Wisconsin Secretary of State's office in April 1989. Neither S1 nor S2 made any estimated tax payments for the taxable year that began in 1989.

Question 8: May either S1 or S2 claim the unused $40,000 of P's estimated tax payments for 1989 in order to avoid underpayment interest and delinquent interest on their 1989 Wisconsin franchise or income tax returns?

Answer 8: No. Each corporation is a separate entity for Wisconsin franchise or income tax purposes. Therefore, neither S1 nor S2 may claim P's estimated tax payments. *WTMJ, Inc. and Newspapers, Inc. v. Wisconsin Department of Revenue*, Wisconsin Tax Appeals Commission, Docket Nos. I-6306, I-6307 (October 23, 1980).

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3. Recognition of Adjustments Necessary as a Result of a Change in Method of Accounting

Statutes: Sections 71.26(2)and (3) and 71.30(1)(b), Wis. Stats. (1987-88).

Note: This tax release applies with respect to the 1987 taxable year and thereafter.

Background: Section 71.26(2), Wis. Stats. (1987-88), provides that Wisconsin net income is computed under the Internal Revenue Code (IRC) as defined for Wisconsin with certain modifications. The modifications are provided in sec. 71.26(3), Wis. Stats. (1987-1988). Since IRC secs. 381 and 481 are not excluded for Wisconsin, they generally apply for Wisconsin in computing Wisconsin net income.

IRC sec. 481 provides that when a change in method of accounting occurs, there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. In certain situations the required adjustments to income are allowed or required to be spread over several taxable years.

IRC sec. 381 provides that in certain corporate reorganizations the tax attributes of a liquidated corporation are allowed or required to be carried over and reported by the surviving corporation. The adjustments required as a result of a change in method of accounting that are being spread over several years may be tax attributes that are to be reported by a surviving corporation in its computation of federal net income in certain corporate reorganizations.

Section 71.30(1)(b), Wis. Stats. (1987-88), provides that if a corporation changes its method of accounting while subject to franchise or income taxation by Wisconsin, it shall make the adjustments required under the IRC, except that in the last year that a corporation is subject to taxation by Wisconsin it shall take into account all remaining adjustments required as a result of the change in method of accounting.

Facts and Question: Corporation B, a calendar year Wisconsin bank, became a large bank (that is, it had assets of more than $500 million) during 1990. As a result, it is no longer allowed to claim a deduction for bad debts on the reserve method. Accordingly, it must change its method of accounting for bad debts and is required to include in income its bad debt reserve balance of $100,000 on December 31, 1989. IRC sec. 585 requires that ten percent of the adjustment required by IRC sec. 481 be reported in 1990, 20 percent in 1991, 30 percent in 1992, and 40 percent in 1993. Therefore, $10,000 will be included in the computation of federal net income for 1990. This would be included in the computation of Wisconsin net income as well.

If on December 31, 1991, Corporation B is merged into its parent, Corporation P, how is the remaining $90,000 of the adjustment to be accounted for?

Answer: Generally, for federal purposes, Corporation B will report $20,000 in 1991 and Corporation P will report $30,000 in 1992, and $40,000 in 1993 in the computation of net income.

Since sec. 71.30(1)(b), Wis. Stats. (1987-88), requires that in the last year that a corporation is subject to taxation by Wisconsin it shall take into account all remaining adjustments required as a result of a change in method of accounting, the entire $90,000 is required to be reported in the computation of Corporation B's Wisconsin net income on the 1991 Wisconsin return, the final Wisconsin return to be filed by Corporation B.

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4. Return Requirements Under an "F" Reorganization

Statutes: Section 71.22(10), Wis. Stats. (1987-88), as amended by 1989 Wisconsin Act 31.

Note: This tax release applies with respect to the 1987 taxable year and thereafter.

Facts and Question: A corporation incorporated in Wisconsin (Wis. Corp.) reports its income to Wisconsin on the basis of a fiscal year ending July 31. In 1989, for business reasons, the corporation desires to reincorporate in Delaware. To accomplish this, Wis. Corp. organizes and owns 100 percent of the stock of a subsidiary corporation incorporated in Delaware (Del. Corp.). In December 1989, Wis. Corp. merges into Del. Corp. The operations of Wis. Corp. become those of Del. Corp. and continue in all respects in the same manner as before