

The Circuit Court concluded that the transactions between the taxpayer and his drivers are not taxable, because it is the transactions between the drivers and their customers which are the final and ultimate employment of the cabs which withdraws them from the marketplace of goods and services

and are thus the retail sale subject to sales tax. Because it concluded that the transactions on which sales tax were imposed by the department's assessment are not taxable, the Court did not address whether the department is estopped from collecting the tax.

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

□

## TAX RELEASES

*"Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. In situations where the facts vary from those given herein, the answers may not apply. 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. Effect of a Farmland Preservation Credit on Property Taxes Allowable for the School Property Tax Credit (p. 13)
2. Interest Received From Resolution Funding Corporation Bonds (p. 14)

### Homestead Credit

1. Gross Rent Includes Separate Charges (p. 14)
2. Rent/Property Tax Reduction for AFDC Recipients (p. 15)

### Corporation Franchise or Income Taxes

1. Section 338(h)(10), IRC, Election (p. 15)
2. Wisconsin Tax Treatment of Qualified REIT Subsidiaries (p. 17)
3. Wisconsin Treatment of United Kingdom Advance Corporation Tax (ACT) Refunds (p. 18)

### Sales/Use Taxes

1. Compression Hosiery (p. 18)
2. Gross Receipts for Purposes of Wisconsin Sales and Use Tax - Federal Luxury Tax (p. 19)
3. Photographic Services Furnished in Taxable County (p. 19)

## INDIVIDUAL INCOME TAXES

1. Effect of a Farmland Preservation Credit on Property Taxes Allowable for the School Property Tax Credit

STATUTES: Section 71.07(9), Wis. Stats. (1989-90)

BACKGROUND: The Wisconsin farmland preservation credit is a

refundable credit to owners of qualified Wisconsin farmland. The credit is based on property taxes accrued on qualified farmland (including improvements). Based on a letter ruling received from the Internal Revenue Service dated February 25, 1980, the amount of farmland preservation credit is a recovery of the property tax upon which the credit is based.

Section 71.07(9), Wis. Stats. (1989-90), provides for the Wisconsin school property tax credit. The Wisconsin school property tax credit is equal to a percentage of the property taxes paid on the taxpayer's principal residence during the tax year.

QUESTION: The property taxes used to compute a farmland preservation credit may include the property taxes on the taxpayer's principal residence located on the farm. In these cases, does the receipt of the farmland preservation credit affect the amount of property taxes which can be used to compute the Wisconsin school property tax credit?

ANSWER: Yes, but only when receipt of the farmland preservation credit and payment of the property taxes used to compute that credit occur during the same tax year. When payment of the tax and recovery of a portion of the tax (through the farmland preservation credit) occur during the same year, the portion of the farmland preservation credit allocable to taxes on the principal residence will reduce the amount of taxes which can be used to compute the Wisconsin school property tax credit.

(Note: This means that the property taxes which may be used to compute a Wisconsin school property tax credit are the same as those which may be deducted as an itemized deduction for federal tax purposes on federal Schedule A.)

### Example 1:

#### Facts and Question:

1. A calendar year taxpayer paid 1989 property taxes accrued of \$6,000 during 1990.
2. Of the \$6,000 of property taxes, \$4,800 (80%) are determined to be farm property taxes and \$1,200 (20%) are determined to be taxes on the taxpayer's principal residence.
3. During 1990, the taxpayer received a 1989 farmland preservation credit of \$2,000 which was based on the 1989 property taxes accrued of \$6,000.

What amount of 1989 property taxes on the principal residence can be used to compute the 1990 Wisconsin school property tax credit?

**Answer:** The amount of 1989 property taxes on the principal residence which can be used in computing the 1990 Wisconsin school property tax credit is \$800 (\$6,000 of property taxes paid in 1990 less \$2,000 of farmland preservation credit received in 1990 times 20% principal residence portion).

#### Example 2:

##### *Facts and Question:*

1. A calendar year taxpayer paid 1989 property taxes accrued of \$6,000 during 1989 of which \$4,800 (80%) are determined to be farm property taxes and \$1,200 (20%) are determined to be taxes on the taxpayer's principal residence.
2. During 1990, the taxpayer received a 1989 farmland preservation credit of \$2,000 which was based on the 1989 property taxes accrued of \$6,000.
3. The taxpayer paid 1990 property taxes accrued of \$6,500 in 1990 of which \$1,365 (21%) relate to the taxpayer's principal residence.

What amount of 1990 property taxes on the principal residence can be used to compute the 1990 Wisconsin school property tax credit?

**Answer:** The amount of 1990 property taxes on the principal residence which can be used in computing the 1990 Wisconsin school property tax credit is \$1,365. The 1990 property taxes paid in 1990 do not have to be reduced by the 1989 farmland preservation credit received in 1990. The 1989 farmland preservation credit is a recovery of 1989 property taxes accrued and has no effect on the amount of 1990 property taxes accrued and paid in 1990 which can be used to compute the Wisconsin school property tax credit.

#### Example 3:

##### *Facts and Question:*

1. A calendar year taxpayer paid one-half (\$3,000) of 1989 property taxes accrued of \$6,000 in 1989 and the remaining one-half in 1990.
2. Of the \$6,000 of property taxes, \$4,800 (80%) are determined to be farm property taxes, and \$1,200 (20%) are determined to be taxes on the taxpayer's principal residence.
3. During 1990, the taxpayer received a 1989 farmland preservation credit of \$2,000 which was based on the 1989 property taxes accrued of \$6,000.

What amount of 1989 property taxes on the principal residence can be used to compute the 1990 Wisconsin school property tax credit?

**Answer:** The amount of 1989 property taxes on the principal residence which can be used in computing the 1990 Wisconsin school property tax credit is \$200 (\$3,000 of 1989 property taxes paid in 1990 less \$2,000 of 1989 farmland preservation credit received in 1990 times 20% principal residence portion).

□

## 2. Interest Received From Resolution Funding Corporation Bonds

**STATUTES:** Section 71.05(6)(b)1, Wis. Stats. (1989-90)

**BACKGROUND:** Section 71.05(6)(b)1, Wis. Stats. (1989-90), provides that the amount of interest income which is by federal law exempt from taxation by Wisconsin may be subtracted from federal adjusted gross income in computing Wisconsin taxable income.

**FACTS AND QUESTION:** A Wisconsin resident receives interest income from bonds issued by the Resolution Funding Corporation. Is the interest income received from this security exempt from Wisconsin income tax?

**ANSWER:** Yes, interest income which an individual receives from bonds issued by the Resolution Funding Corporation is exempt from Wisconsin income tax. Federal law (12 USC sec. 1441b(f)(7)) prohibits states from taxing interest income from these bonds (except surtaxes, estate, inheritance, and gift taxes). Therefore, if interest income from bonds issued by the Resolution Funding Corporation is included in federal adjusted gross income, such interest may be subtracted from federal adjusted gross income in computing Wisconsin taxable income.

□

## HOMESTEAD CREDIT

### 1. Gross Rent Includes Separate Charges

**STATUTES:** Section 71.52(2), Wis. Stats. (1989-90)

**WIS. ADM. CODE:** Section Tax 14.05(2)(a), February 1990 Register

**BACKGROUND:** Under sec. 71.52(2), Wis. Stats. (1989-90) and sec. Tax 14.05(2)(a), Wis. Adm. Code, February 1990 Register, "gross rent" means rental paid at arm's length, solely for the right of occupancy of a homestead. However, "gross rent" does not include charges for food, medical services, or other personal services provided by the landlord.

**FACTS AND QUESTION:** A homestead credit claimant pays \$350 to his landlord for each month of 1990. This includes \$300 for rental of his apartment, \$30 for the use of a garage, and \$20 for the use of a

stove, refrigerator, and window air conditioner. The garage and appliances are "optional" items which the claimant would not be required to use in order to rent the apartment.

May the "optional" payments for the garage and appliances be included as rent in determining the claimant's allowable homestead credit for 1990?

**ANSWER:** Yes. Amounts paid by a claimant to a landlord in addition to basic rental for items normally associated with the occupancy of a homestead are considered to be a part of the total rent for purposes of determining the claimant's allowable homestead credit. Examples of additional amounts which are considered rent include payments to a landlord for a garage or other parking space, appliances, furniture, or utilities. (Caution: Allowable rent for homestead credit purposes does not include amounts paid to a landlord for food, medical services, or other personal services, as these items are expressly excluded from the definition of "gross rent" by statute.)

**NOTE:** The definition of "gross rent" as discussed in this Tax Release applies only with respect to 1988 and subsequent years' homestead credit claims. For a 1987 homestead credit claim, the value of medical services and other personal services was not excluded from the definition of gross rent. For a 1986 or prior year's homestead credit claim, the definition of gross rent excluded the rental value of services, appliances, utilities, furniture, and other furnishings provided by the landlord. Thus, the \$20 payment for appliances in the "Facts and Question" above could not be included in a claimant's rent for 1986 and prior years.



## 2. Rent/Property Tax Reduction for AFDC Recipients

**STATUTES:** Section 71.54(2)(a), Wis. Stats. (1989-90)

**BACKGROUND:** Section 71.54(2)(a), Wis. Stats. (1989-90), provides that a one-twelfth reduction of property taxes and/or rent constituting property taxes must be made by a homestead credit claimant for each month the claimant receives either \$400 or more of general relief payments or any amount of Aid to Families with Dependent Children (AFDC). Under sec. 71.54(2)(a)2, Wis. Stats. (1989-90), however, the one-twelfth reduction is not necessary if the AFDC benefits the claimant receives are either 1) foster care payments or 2) assistance received as a relative other than a parent with whom a dependent child is living, which does not include any aid to meet the needs of the claimant or the claimant's spouse or children.

**QUESTION 1:** Does the one-twelfth reduction of property taxes or rent constituting property taxes apply to a claimant who receives AFDC payments solely on behalf of his or her dependent grandchild living with the claimant?

**ANSWER 1:** No. Since the claimant is a relative other than a parent with whom a dependent child is living, and since the assistance is solely for the needs of the dependent and not for the needs of the claimant or the claimant's spouse or children, the one-twelfth reduction does not apply to the claimant.

**EXAMPLE 1:** A claimant receives AFDC payments of \$400 per month for the care of her dependent grandchild, who lives with her. The AFDC grant provides that the payments are solely for the care of the grandchild. The one-twelfth reduction does not apply.

**QUESTION 2:** Does the one-twelfth reduction apply to a claimant who receives AFDC payments for use both to pay for a dependent grandchild's care while living with the claimant, and to help pay the rent and other household expenses?

**ANSWER 2:** Yes. Even though the claimant is a relative other than a parent with whom a dependent child is living, the claimant receives the aid to meet the needs of both the dependent child and the claimant or the claimant's spouse or children. The one-twelfth reduction thus applies to the claimant.

**EXAMPLE 2:** A claimant receives AFDC payments of \$400 per month. The grant specifies that the payments may be used to help pay the rent and other household bills, as well as for the care of her grandchild living with her. The one-twelfth reduction does apply, since the assistance includes aid to meet the needs of the claimant or the claimant's spouse or children.

**QUESTION 3:** Does the one-twelfth reduction apply if a claimant who is a relative of a dependent other than its parent becomes the dependent's legal guardian?

**ANSWER 3:** No. A dependent's legal guardian is not considered to be the dependent's parent, and the claimant is thus a relative other than a parent. The one-twelfth reduction does not apply to the claimant.

**QUESTION 4:** Does the one-twelfth reduction apply if a claimant is a dependent child's relative other than its parent, but the claimant subsequently adopts the child?

**ANSWER 4:** Yes. The adoptive parent is considered to be the dependent's parent, and thus the exception under sec. 71.54(2)(a)2, Wis. Stats. (1989-90), does not apply. The one-twelfth reduction is required.



## CORPORATION FRANCHISE OR INCOME TAXES

### 1. Section 338(h)(10), IRC, Election

**STATUTES:** Sections 71.26(2) and (3) and 71.30(1)(a), Wis. Stats. (1989-90)

**BACKGROUND:** Under section 338(h)(10) of the Internal Revenue Code (IRC), a corporation which makes a qualified stock purchase of another corporation (the "target") can elect to treat the stock purchase as an asset purchase. Under such an election, the target corporation is treated as if it sold all of its assets in a single transaction at the close of the acquisition date. The target corporation must report any resulting gain or loss on this deemed sale. The selling corporation does not recognize the gain or loss on the sale of the stock of the target corporation. In addition, the target corporation is treated as a new corporation that purchased the assets on the day after the acquisition date and is allowed to adjust the basis of its assets to fair market value at that date.

The target corporation must file two short-period returns for federal purposes. The first return is for the period that begins on the first day of the taxable year and ends on the date of acquisition of the stock. This return, which is included in the consolidated federal return of the selling corporation, includes the gain or loss on the deemed sale of the assets. The second return is for the period that begins on the day after the acquisition date and ends on the last day of the taxable year of the target. The stepped-up (or stepped-down) basis of the assets is recognized on this return, which is included in the consolidated federal return of the purchasing corporation.

**EXAMPLE:** On March 31, 1989, Corporation P purchases 100% of the stock of Corporation T from Corporation S for \$100,000. All three corporations are calendar-year tax filers. Corporation S had a basis of \$50,000 in the stock of Corporation T. Corporation T had a basis of \$70,000 in its assets. If a section 338(h)(10) election is made, Corporation S will not report the \$50,000 gain on the sale of Corporation T's stock.

In addition, Corporation T must file two returns. The first return is for January 1, 1989, through March 31, 1989. On this return, which is filed with the consolidated federal return of Corporation S, Corporation T reports the \$30,000 gain on the deemed sale of its assets. Corporation T's second return is for April 1, 1989, through December 31, 1989. On this return, which is filed with the consolidated federal return of Corporation P, Corporation T adjusts the basis of its assets to \$100,000.

**QUESTION 1:** Does IRC sec. 338(h)(10) apply for Wisconsin purposes?

**ANSWER 1:** Yes. Wisconsin net income for corporation franchise and income tax purposes is determined under the Internal Revenue Code with certain modifications. Since there is no modification under the state statutes for IRC sec. 338, this provision is the same for both state and federal purposes.

However, a corporation may make a section 338 election for federal purposes but not for Wisconsin, and vice versa. Although sec. 71.30(1)(a), Wis. Stats. (1989-90), requires a corporation to use the same method of accounting for both state and federal purposes, a section 338 election is not considered to be a method of accounting. Therefore, the same election does not have to be made for federal and state purposes.

**QUESTION 2:** How is a section 338(h)(10) election made for Wisconsin purposes?

**ANSWER 2:** If the same election is being made for federal and state purposes, a separate election is not required for Wisconsin. However, the corporations involved must file a complete copy of their federal returns and all attachments with their Wisconsin returns. Therefore, the target corporation must attach a copy of the federal Form 8023 and any additional data and materials required to be filed with that form to the final Wisconsin return of the old target and to the first return of the new target. The selling corporation must also attach a copy of the federal Form 8023 to its Wisconsin return.

To make a different election for state purposes than that made for federal purposes, the target corporation and the selling corporation must attach a statement to the Wisconsin returns being filed. If making a section 338(h)(10) election for Wisconsin purposes but not federally, the statement must include the information required by federal Form 8023. The election must be made within the time prescribed by federal law. Generally, this is the 15th day of the 9th month beginning after the month in which the acquisition date occurred. Once made, the election is irrevocable.

**QUESTION 3:** How is the result of a section 338(h)(10) election reflected on the Wisconsin corporation franchise or income tax returns of the corporations involved in such a transaction?

**ANSWER 3:** Since Wisconsin is a separate entity state (that is, combined or consolidated returns are not allowed), each corporation must file a Wisconsin return if it has a Wisconsin filing requirement. Assuming all three corporations in the above example have a Wisconsin filing requirement, the returns required for Wisconsin are as follows:

**Corporation P:** A return for the 1989 calendar year is required. The net income (loss) on this return is unaffected by the section 338(h)(10) election.

**Corporation T:** Two short-period returns, covering the same periods as the federal returns, are required. The gain on the deemed sale of its assets is reported on the first return and the stepped-up basis in the assets is recognized on the second return. Corporation T will pay any tax due on the deemed sale. Both returns are due on the corresponding federal due date(s), including applicable extensions.

**Corporation S:** A return for the 1989 calendar year is required. The gain on the sale of the stock of Corporation T is excluded from the computation of Wisconsin net income.

**QUESTION 4:** If a section 338(h)(10) election is made for federal purposes but not for Wisconsin, how is this difference reflected on the Wisconsin franchise or income tax returns?

**ANSWER 4:** Both the target corporation and the selling corporation must attach statements to their Wisconsin franchise or income tax returns, explaining that the transaction is being treated as a stock