



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 "W" is for "Wisconsin," the first two digits are the year the ruling becomes available for publication (80 days after the ruling is issued to the taxpayer), the next two digits are the week of the year, and the last three

digits are the number in the series of rulings issued that year. The date following the 7-digit number is the date the ruling was mailed to the requestor.

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 Wisconsin Department of Revenue," contains additional information about private letter rulings.

The following private letter rulings are included:

Individual Income Taxes

Capital gains — modification (1987 and thereafter) — IRC sec. 1256 contracts
W9251013, September 24, 1992 (p. 30)

Sales and Use Taxes

Computer software — programs (canned vs. custom)
Computer software — related charges
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✳ W9251013, September 24, 1992

Type Tax: Individual Income

Issue: Capital gains — modification (1987 and thereafter) — IRC sec. 1256 contracts

Statutes: Sections 71.05(6)(b)9, Wis. Stats. (1989-90), and 71.01(6)(g), Wis. Stats., as created by 1991 Wisconsin Act 269

This letter is in response to your request for a private letter ruling in regard to the Wisconsin tax treatment of Internal Revenue Code sec. 1256 contracts.

Facts

IRC sec. 1256 requires all regulated futures contracts, foreign currency contracts, nonequity options, and dealer equity options to be treated as sold for their fair market value on the last day of the taxable year, and any gain or loss shall be taken into account for the taxable year. Furthermore, IRC sec. 1256 requires that any gain or loss on the sale or deemed sale of such contract shall be treated as short-term capital gain or loss to the extent of 40 percent of such gain or loss and long-term capital gain or loss to the extent of 60 percent of such gain or loss, regardless of the holding period.

Request

You request a ruling for taxable year 1992 and future taxable years to clarify the Wisconsin treatment of regulated futures contracts, foreign currency contracts, nonequity options, and dealer equity options as described in IRC sec. 1256. Specifically, you request the department to confirm that the long-term capital gain portion of IRC sec. 1256 contracts are subject to the Wisconsin capital gain exclusion under sec. 71.05(6)(b)9, Wis. Stats. (1989-90).

Ruling

Wisconsin follows the federal treatment of IRC sec. 1256 contracts prescribed under the Code provisions as amended to December 31, 1991. Amendments to the IRC enacted after December 31, 1991, however, will apply for Wisconsin purposes only if the Wisconsin Legislature specifically adopts them. In addition, any amount

of an IRC sec. 1256 contract which is treated as long-term capital gain for federal tax purposes under the IRC provisions that Wisconsin adopts for the particular taxable year qualifies for the Wisconsin capital gain exclusion under sec. 71.05(6)(b)9, Wis. Stats. (1989-90).

Analysis

IRC sec. 1256 requires regulated futures contracts, foreign currency contracts, nonequity options, and dealer equity options to be marked-to-market at year end.

This mark-to-market rule treats each IRC sec. 1256 contract as if it was sold for fair market value on the last business day of the taxable year. Any gain or loss on the contract is included in income for the taxable year, together with the gain or loss on other contracts which were held during the year but closed out before the last business day. In the year these contracts are settled, the taxpayer must adjust the gain or loss actually realized on these contracts to reflect any gain or loss taken into account with respect to the contracts in a prior year. This rule also treats any capital gain or loss on an IRC sec. 1256 contract as if 40% of the gain or loss is short-term capital gain or loss and 60% is long-term capital gain or loss.

Wisconsin generally follows the IRC. Section 71.01(6)(g), Wis. Stats., as created by 1991 Wisconsin Act 269, provides that, for taxable years beginning on or after January 1, 1992, Wisconsin follows the IRC in effect on December 31, 1991. (Note: There are some exceptions to Wisconsin's conformity to the IRC as of December 31, 1991, but these exceptions have no effect on IRC sec. 1256 contracts.) Therefore, the provisions of IRC sec. 1256 apply for Wisconsin tax purposes in the same manner as for federal tax purposes.

The department expressed this position in a tax release titled "Wisconsin Tax Treatment of Section 1256 Contracts" which was published in the April 1987 *Wisconsin Tax Bulletin*.

The remaining question is whether the 60% of the IRC sec. 1256 contract which is treated as a long-term capital gain (regardless of the holding period) is subject to the Wisconsin capital gain exclusion.

IRC sec. 1256(a)(3)(B) provides that any gain or loss with respect to a section 1256 contract shall be treated as "long-term capital gain or loss, to the extent of 60 percent of such gain or loss" IRC sec. 1222(3) defines long-term capital gain as "gain from the sale or exchange of a capital asset held for more than 1 year"

Section 71.05(6)(b)9, Wis. Stats. (1989-90), provides a subtraction from federal adjusted gross income as follows: "On assets held more than one year . . . , 60% of the capital gain as computed under the internal revenue code"

The IRC deems 60% of any sec. 1256 contract's gain to be long-term capital gain. By definition, "long-term capital gain" is gain from the sale or exchange of a capital asset held more than 1 year. Because Wisconsin follows IRC section 1256, such gain qualifies as gain from an asset held more than one year for purposes of the capital gain exclusion provided under sec. 71.05(6)(b)9, Wis. Stats. (1989-90). □

✳ **W9251014**, September 25, 1992

Type Tax: Sales and Use

Issue: Computer software — programs (canned vs. custom); Computer software — related charges

Statutes: Section 77.51(20), Wis. Stats. (1989-90), as amended by 1991 Wisconsin Act 269

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications of the sale of computer software and related items.

Facts

ABC Corporation, a company based outside Wisconsin, sells computer hardware and software. ABC Corporation's software package is designed specifically for a particular industry.

The software package consists of separate modules including job status, estimating, accounts payable, accounts receivable, general ledger, and payroll.

A customer may start with a portion of the package (a minimum of 4 modules) and add to the package as business needs change (a present maximum of 15 modules). A customer will typically purchase 4 to 10 modules.

Depending on hardware and the number of modules purchased, the software package sells for \$15,000 to \$100,000.

Prior to a sale, ABC Corporation's sales people spend several sessions (approximately 12 to 20 hours) with a prospective client to determine their precise accounting and job costing needs.

After the sale, an account consultant will work with the client to further determine the client's needs and to tailor the system to meet the client's needs. This consultation lasts one to five days.

Parameters and tables are set which allow for changes in the functionality of the program, without actually modifying the program. For example, a parameter might indicate whether a client is on the cost or accrual basis of accounting. This type of modification is needed for each system sold, as the software will not function properly without it. A system that would only require these changes could be delivered in several weeks.

For the majority of the systems sold, modifications to the actual programs are needed. These changes are in addition to changes made to parameters and tables. For example, a change to the program might be made to provide additional screens or reports. Modifications to the programs can take months to complete.

An installation manager supervises the installation and testing of the system. This normally takes from 2 to 5 days.

ABC Corporation's support staff provides on-site training on the application software. This training normally lasts one day for each module purchased.

Documentation includes a manual with detailed instructions for each module purchased and a manual containing an overview of the system.

Maintenance and support are a required part of the system. The client must maintain a modem to allow ABC Corporation to diagnose and cure problems. An ABC Corporation technician, while at ABC Corporation's home office, can make changes to a customer's program, test it, and have it ready for the customer, all through the use of a modem.

Updates and enhancements typically come out once a year.

ABC Corporation does not provide the client with a copy of the source code (programs), although the client may purchase the code separately if needed.

The principal reason for the client wanting the source code would be for backup protection.

Ruling Request

You ask whether Wisconsin sales or use tax applies to:

1. The sale of ABC Corporation's software and related maintenance, training, and updates, and
2. The sale of ABC Corporation's source code, as a transaction separate from the sale of the software system.

Ruling

The software sold by ABC Corporation is the sale of custom programs and is not subject to Wisconsin sales or use tax. Other charges relating to the sale of custom software are also not taxable, except training materials provided for a specific charge. The separate sale of the source code is not taxable.

Analysis

Effective May 1, 1992, sec. 77.51(20), Wis. Stats. (1989-90), was amended by 1991 Wisconsin Act 269, to clarify that tangible personal property includes computer programs, except custom computer programs.

In a decision of *Wisconsin Department of Revenue v. International Business Machines Corporation*, that

made-to-order computer programs were not subject to Wisconsin sales tax.

Section Tax 11.71(1)(e), Wis. Adm. Code, provides that "The determination of whether a program is a custom program shall be based upon all the facts and circumstances, including the following:

1. The extent to which the vendor or independent consultant engages in significant presale consultation and analysis of the user's requirements and system.
2. Whether the program is loaded into the customer's computer by the vendor and the extent to which the installed program must be tested against the program's specifications.
3. The extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation.
4. The extent to which the enhancement and maintenance support by the vendor is needed for continued usefulness.
5. There is a rebuttable presumption that any program with a cost of \$10,000 or less is not a custom program.
6. Custom programs do not include basic operational programs.
7. If an existing program is selected for modification, there must be a significant modification of that program by the vendor so that it may be used in the customer's specific hardware and software environment."

ABC Corporation meets the criteria set forth in sec. Tax 11.71(1)(e), Wis. Adm. Code, because:

1. Significant presale consultation (12 to 20 hours) is conducted to determine the needs of a client.
2. ABC Corporation installs and tests the program against the customer's requirements.
3. One to two days of training is required for each module purchased.
4. For most systems, the cost far exceeds \$10,000.
5. All of the software sold is built-to-order as the systems are tailored for each business and computer environment. In addition, for the majority of the systems sold significant modifications are made to the programs.

Section Tax 11.71(2)(c), Wis. Adm. Code, provides that training services are not taxable, although any training materials provided for a specific charge are taxable.

Section Tax 11.71(3)(c), Wis. Adm. Code, provides that technical support, error correction services, and maintenance and enhancement to custom programs are not taxable.

Section Tax 11.67, Wis. Adm. Code, provides that when a transaction involves the transfer of tangible personal property along with the performance of a service, the true objective of the purchaser must be determined. The sale of source code, even though a separate sale from the sale of the software, is incidental to the transfer of nontaxable custom programs.

The amendment of sec. 77.51(20), Wis. Stats. (1989-90), by 1991 Wisconsin Act 269, has no impact on the

taxability of the software sold by ABC Corporation. Accordingly, this ruling is effective to transactions entered into prior to May 1, 1992, and on or after May 1, 1992. □

✳ **W9253016**, October 8, 1992

Type Tax: Sales and Use

Issue: Computer software — programs (canned vs. custom); Computer software — related charges

Statutes: Section 77.51(20), Wis. Stats. (1989-90), as amended by 1991 Wisconsin Act 269

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications of the sale of a computer software system and related charges.

Facts

XYZ Corporation, a Wisconsin-based company, develops and sells computer software applications to manufacturers and distributors, and to customers in the food and dairy industry.

XYZ Corporation sold software applications to Company W, which is based in Wisconsin and has several locations outside of Wisconsin.

Prior to the installation of the software, XYZ Corporation employees spent 90 hours on a system study to determine the needs of Company W.

The contract provides that installation, training, and modifications are billed at the normal hourly rate of \$60.

As a part of the contract, specific requirements of the system are spelled out. These requirements are

met by making modifications to the base program. Initially, in excess of 50 modifications were identified.

Modifications include adding fields, changing fields, producing additional reports required by Company W, changing the appearance of certain reports and screens, adding files, and allowing certain operations to function on specific processing units at specific times.

Telephone support is available at \$60 per hour, with a 1/2 hour minimum. Telephone charges, travel time, and expenses are billed as the actual charges are incurred.

The base software sold included financial applications totalling \$39,000 for the Wisconsin location and \$60,500 for out-of-state locations.

From March 1990, through May 1992, XYZ Corporation invoiced Company W for the following: modifications to the base software; training; installation at the Wisconsin location; installation at out-of-state locations; customer support and further system study and meetings; UPS charges to out-of-state locations; travel expenses; and telephone expenses (use of the communications line to remote locations).

All transactions have had sales tax included.

Ruling Request

You ask whether sales tax applies to any or all of the items billed by XYZ Corporation to Company W.

Ruling

The software sold by XYZ Corporation to Company W is the sale of custom programs and is not subject to sales tax. Charges related to the sale of custom software are not