

Partnership A is not subject to the temporary recycling surcharge because its net farm profit for purposes of the surcharge of \$900 (\$1,500 - \$600) is less than \$1,000.

D. Partnerships Engaged in Farming and Another Trade or Business

Example: Partnership A is engaged in farming, but also has trade or business income from selling cleaning supplies. Partnership A reports the following amounts on its 1992 federal Form 1065:

| | | |
|--------------------------------------|----|-----|
| Gross receipts or sales (line 1a) | \$ | 500 |
| Net farm profit (line 5) * | | 900 |

* Gross receipts from farming are \$2,000.

Partnership A is not subject to a temporary recycling surcharge for 1992 based on the net business income from its cleaning supplies business because it does not have at least \$1,000 of gross receipts from that business. Partnership A is not subject to the surcharge on its farming operation since its net farm profit is less than \$1,000. (Note: Assuming the same facts for 1991, Partnership A would have been subject to the surcharge.)

Question 3: How do partnerships compute the temporary recycling surcharge?

Answer 3: Partnerships compute the temporary recycling surcharge as described in the sections that follow.

A. Partnerships Engaged in Business Other Than Farming

The temporary recycling surcharge is the greater of

- \$25, or

- the amount computed by multiplying the partnership's net business income, as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800.

The following examples illustrate the computation of the temporary recycling surcharge for partnerships that are not engaged in farming.

Example 1: Partnership A, which is doing business only in Wisconsin, reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

| | | |
|---|----|---------|
| Ordinary income from trade or business activities (line 1) | \$ | 200,000 |
| Net loss from rental real estate activities (line 2) | | (5,000) |
| Interest income (line 4a) | | 10,000 |
| Net short-term capital gain (line 4d) | | 3,000 |
| Net long-term capital gain (line 4e) | | 2,000 |
| Guaranteed payments to partners (line 5) | | 15,000 |
| Net gain under section 1231 (line 6) | | 1,000 |
| Charitable contributions (line 8) | | 5,000 |
| Section 179 expense deduction (line 9) | | 6,000 |
| Deductions related to portfolio income (line 10) | | 1,000 |
| Interest expense on investment debts (line 12a) | | 2,000 |
| State and municipal bond interest (line 16) | | 1,000 |

Partnership A's net business income is \$200,000, which is its ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Therefore, Partnership A is subject to a temporary recycling surcharge of \$869 (\$200,000 x .004345).

Example 2: Assume the same facts as in Example 1, except that Partnership A reports a \$20,000 ordinary loss from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A has a net business loss of \$20,000.

Partnership A is subject to a temporary recycling surcharge of \$25. Although Partnership A has a net business loss, the minimum surcharge of \$25 applies.

Example 3: Assume the same facts as in Example 1, except that Partnership A reports \$3,000,000 of ordinary income from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A's net business income is \$3,000,000.

Partnership A is subject to a temporary recycling surcharge of \$9,800. Although Partnership A computes a surcharge of \$13,035 (\$3,000,000 x .004345), the maximum surcharge of \$9,800 applies.

Example 4: Partnership B, which is doing business only in Wisconsin, reports the following amounts on its 1992 federal Form 1065:

| | | |
|--|----|------------------|
| Ordinary income from other partnerships (line 4) | \$ | 100,000 |
| Total deductions (line 21) | | (20,000) |
| Ordinary income from trade or business activities (line 22) | | <u>\$ 80,000</u> |

Partnership B reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

| | | |
|---|----|--------|
| Ordinary income from trade or business activities (line 1) | \$ | 80,000 |
| Interest income (line 4a) | | 10,000 |
| Other portfolio income (line 4f) | | 5,000 |

Deductions relating to portfolio income (line 10) 1,000

Partnership B's net business income is \$80,000, which is the ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership B's net business income includes its distributive share of trade or business income from another partnership, even though that partnership is also subject to the surcharge on the income. Therefore, Partnership B is subject to a temporary recycling surcharge of \$348 (\$80,000 x .004345).

Example 5: Partnership C, which is doing business only in Wisconsin, derives income from the rental of tangible personal property and reports \$15,000 of net income from other rental activities on its 1992 Wisconsin Form 3, Schedule 3K, line 3, column d.

Partnership C's net business income is \$15,000, which is its ordinary income from the rental of tangible personal property reported on Wisconsin Form 3, Schedule 3K, line 3, column d. Therefore, Partnership A is subject to a temporary recycling surcharge of \$65 (\$15,000 x .004345).

Example 6: Partnership D is at least 51% owned and controlled by American Indians who are enrolled members of the same tribe. It is engaged in business both on and off the tribal reservation of its partners. For 1992, Partnership D earns \$30,000 of net income, of which \$12,000 is attributable to business activities in Wisconsin off the reservation. Partnership D must file a Wisconsin partnership return since it is doing business in Wisconsin off the reservation.

Partnership D is subject to a temporary recycling surcharge of \$52 (\$12,000 x .004345).

B. Partnerships Engaged Solely in Farming

For partnerships engaged solely in farming and having at least \$1,000 of net farm profit for federal income tax purposes, the temporary recycling surcharge is \$25.

Example 1: Partnership A is engaged in dairy farming. Partnership A reports the following amounts on its 1992 federal Form 1065:

| | |
|----------------------------------|------------|
| Net farm profit (line 5) | \$ 100,000 |
| Net gain from Form 4797 (line 6) | 30,000 |

Partnership A reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

| | |
|--|------------|
| Ordinary income from trade or business activities (line 1) | \$ 130,000 |
| Interest income (line 4a) | 1,000 |

Partnership A is subject to a temporary recycling surcharge of \$25. A \$25 temporary recycling surcharge applies to partnerships engaged solely in farming and having net farm profit of \$1,000 or more.

Example 2: Assume the same facts as in Example 1, except that Partnership A operates two separate farms.

Partnership A is subject to a temporary recycling surcharge of \$25, regardless of the number of farms it operates, assuming its combined net farm profit is at least \$1,000.

C. Partnerships Engaged in Farming and Another Trade or Business

1. Taxable years beginning on or after January 1, 1992

For taxable years beginning on or after January 1, 1992, the temporary recycling surcharge for a partnership that is engaged in farming and another trade or business is the sum of the following amounts:

- the greater of \$25 or the amount computed by multiplying the partnership's net business income (other than from farming), as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus
- \$25, if the net farm profit is at least \$1,000.

The following examples illustrate the computation of the temporary recycling surcharge for partnerships that are engaged in both farming and other trade or business activities in taxable years beginning on or after January 1, 1992.

Example 1: Partnership A is engaged in farming and in the business of selling farm supplies. Partnership A reports the following amounts on its 1992 federal Form 1065:

| | |
|---|-------------------|
| Gross receipts or sales (line 1a) | \$ 200,000 |
| Cost of goods sold (line 2) | <u>(70,000)</u> |
| Gross profit (line 3) | \$ 130,000 |
| Net farm profit (line 5) | 90,000 |
| Net gain from Form 4797 (line 6) * | <u>5,000</u> |
| Total income (line 8) | \$ 225,000 |
| Total deductions (line 21) | <u>(125,000)</u> |
| Ordinary income from trade or business activities (line 22) | <u>\$ 100,000</u> |

* The gain is from the sale of nonfarm business assets.

Partnership A reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

| | |
|--|------------|
| Ordinary income from trade or business activities (line 1) | \$ 100,000 |
| Interest income (line 4a) | 5,000 |
| Net long-term capital gain (line 4e) | 4,000 |
| Charitable contributions (line 8) | 3,000 |
| Other deductions (line 11) | 1,000 |
| Interest expense on investment debts (line 12a) | 1,000 |

Partnership A's net business income is \$10,000, which is its ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d, minus its net farm profit from federal Form 1065, line 5. Partnership A is subject to a temporary recycling surcharge of \$69, computed as follows:

| | |
|---|--------------|
| Surcharge for all nonfarm trade or business activities (\$10,000 x .004345) | \$ 44 |
| Surcharge for farming | 25 |
| Total temporary recycling surcharge | <u>\$ 69</u> |

Example 2: Partnership B is engaged in farming and in the business of trucking. Partnership B reports the following amounts on its 1992 federal Form 1065:

| | |
|---|---------------|
| Gross receipts or sales (line 1a) | \$ 1,200 |
| Cost of goods sold (line 2) | (0) |
| Gross profit (line 3) | \$ 1,200 |
| Net farm profit (line 5) | 500 |
| Net gain from Form 4797 (line 6) * | 5,000 |
| Total income (line 8) | \$ 6,700 |
| Total deductions (line 21) | (5,900) |
| Ordinary income from trade or business activities (line 22) | <u>\$ 800</u> |

* The gain is from the sale of farm assets.

Partnership B reports the following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

| | |
|--|--------|
| Ordinary income from trade or business activities (line 1) | \$ 800 |
| Royalty income (line 4c) | 1,000 |
| Net short-term capital gain (line 4d) | 5,000 |
| Charitable contributions (line 8) | 500 |
| Other deductions (line 11) | 1,000 |

Partnership B has a net business loss of \$4,700, which is the ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d, minus the net farm profit. Partnership B is subject to a temporary recycling surcharge of \$50, computed as follows:

| | |
|-------------------------------------|--------------|
| Surcharge for trucking business | \$ 25 |
| Surcharge for farming | 25 |
| Total temporary recycling surcharge | <u>\$ 50</u> |

Partnership B is subject to the temporary recycling surcharge on its nonfarm trade or business activities because its \$1,200 of gross receipts from nonfarm trade or business activities are at least \$1,000.

In addition, Partnership B is subject to the \$25 temporary recycling surcharge on the farming operation because its \$5,500 net farm profit, which includes the ordinary gain from the sale of a farm asset, is at least \$1,000.

Example 3: Partnership C is engaged in both farming and mining. It has net business income of \$25,000 from its mining business and a net farm loss of \$20,000.

Partnership C is subject to a temporary recycling surcharge of \$109 (\$25,000 x .004345) on the net business income from its mining business.

It is not subject to a surcharge on its farming operation.

Note: Partnership C cannot reduce its net business income from nonfarm trade or business activities by the amount of its net farm loss.

2. Taxable years beginning before January 1, 1992

For taxable years beginning before January 1, 1992, the temporary recycling surcharge for a partnership that is engaged in farming and another trade or business is the sum of the following amounts:

- the greater of \$25 or the amount computed by multiplying the partnership's net business income (including income or loss from farming), as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus
- \$25, if the net farm profit is at least \$1,000.

The following examples illustrate the computation of the temporary recycling surcharge for partnerships that are engaged in both farming and other trade or business activities in taxable years beginning before January 1, 1992.

Example 1: Partnership A is engaged in farming and in the business of selling farm supplies. Partnership A reports the following amounts on its 1991 federal Form 1065:

| | |
|---|-------------------|
| Gross receipts or sales (line 1a) | \$ 200,000 |
| Cost of goods sold (line 2) | <u>(70,000)</u> |
| Gross profit (line 3) | \$ 130,000 |
| Net farm profit (line 5) | 90,000 |
| Net gain from Form 4797 (line 6) * | <u>5,000</u> |
| Total income (line 8) | \$ 225,000 |
| Total deductions (line 21) | <u>(125,000)</u> |
| Ordinary income from trade or business activities (line 22) | <u>\$ 100,000</u> |

* The gain is from the sale of nonfarm business assets.

Partnership A reports the following amounts on its 1991 Wisconsin Form 3, Schedule 3K, column d:

| | |
|--|------------|
| Ordinary income from trade or business activities (line 1) | \$ 100,000 |
| Interest income (line 4a) | 5,000 |
| Net long-term capital gain (line 4e) | 4,000 |
| Charitable contributions (line 8) | 3,000 |
| Other deductions (line 11) | 1,000 |
| Interest expense on investment debts (line 12a) | 1,000 |

Partnership A's net business income is \$100,000, which is its ordinary income from all trade or business activities, including farming, reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A is subject to a temporary recycling surcharge of \$460, computed as follows:

| | |
|---|---------------|
| Surcharge for all trade or business activities (\$100,000 x .004345) | \$ 435 |
| Surcharge for farming | <u>25</u> |
| Total temporary recycling surcharge | <u>\$ 460</u> |

Example 2: Partnership B is engaged in farming and in the business of trucking. Partnership B reports

the following amounts on its 1991 federal Form 1065:

| | |
|---|----------------|
| Gross receipts or sales (line 1a) | \$ 1,200 |
| Cost of goods sold (line 2) | <u>(0)</u> |
| Gross profit (line 3) | \$ 1,200 |
| Net farm profit (line 5) * | 500 |
| Net gain from Form 4797 (line 6) * | <u>5,000</u> |
| Total income (line 8) | \$ 6,700 |
| Total deductions (line 21) | <u>(5,900)</u> |
| Ordinary income from trade or business activities (line 22) | <u>\$ 800</u> |

* Gross receipts from farming are \$30,000; the gain is from the sale of farm assets.

Partnership B reports the following amounts on its 1991 Wisconsin Form 3, Schedule 3K, column d:

| | |
|--|--------|
| Ordinary income from trade or business activities (line 1) | \$ 800 |
| Royalty income (line 4c) | 1,000 |
| Net short-term capital gain (line 4d) | 5,000 |
| Charitable contributions (line 8) | 500 |
| Other deductions (line 11) | 1,000 |

Partnership B has net business income of \$800, which is the ordinary income from all trade or business activities, including farming, reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership B is subject to a temporary recycling surcharge of \$50, computed as follows:

| | |
|--|--------------|
| Surcharge for trucking business | \$ 25 |
| Surcharge for farming | <u>25</u> |
| Total temporary recycling surcharge | <u>\$ 50</u> |

Partnership B is subject to the temporary recycling surcharge on all trade or business activities because its \$31,200 of gross receipts from all

trade or business activities, including farming, are at least \$1,000.

In addition, Partnership B is subject to the \$25 temporary recycling surcharge on the farming operation because its \$5,500 net farm profit, which includes the ordinary gain from the sale of a farm asset, is at least \$1,000.

Example 3: Partnership C is engaged in both farming and mining. It has ordinary income of \$25,000 from its mining business and a net farm loss of \$20,000. Partnership C reports \$5,000 of ordinary income from trade or business activities on its 1991 Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership C has net business income of \$5,000, which is the ordinary income from all trade or business activities, including farming, reported on Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership C is subject to a temporary recycling surcharge of \$25 (the greater of \$25 or \$22 [\$5,000 x .004345]) on the net business income from its mining business.

D. Multistate Partnerships

If a partnership is engaged in business in and outside Wisconsin, the temporary recycling surcharge is computed as follows:

- If the partnership is not engaged in farming, the surcharge is the greater of \$25 or the amount computed by multiplying the partnership's net business income, as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800.
- If the partnership is engaged solely in farming and has at least \$1,000 of net farm profit for

federal income tax purposes, the surcharge is \$25.

- *For taxable years beginning on or after January 1, 1992*, if the partnership is engaged in farming and other trade or business activities, the surcharge is the sum of

- the greater of \$25 or the amount computed by multiplying the partnership's net business income (other than from farming), as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus
- \$25, if the net farm profit is at least \$1,000.

- *For taxable years beginning before January 1, 1992*, if the partnership is engaged in farming and other trade or business activities, the surcharge is the sum of

- the greater of \$25 or the amount computed by multiplying the partnership's net business income from all trade or business activities, including farming, as allocated or apportioned to Wisconsin, by 0.4345% (.004345), but not more than \$9,800, plus
- \$25, if the net farm profit is at least \$1,000.

Note: Neither the \$25 minimum surcharge nor the \$9,800 maximum surcharge are multiplied by the partnership's Wisconsin apportionment percentage.

Example 1: Partnership A is engaged in business in and outside Wisconsin. Partnership A is not engaged in farming. It reports the

following amounts on its 1992 Wisconsin Form 3, Schedule 3K, column d:

| | |
|--|-----------|
| Ordinary income from trade or business activities (line 1) | \$ 40,000 |
| Dividend income (line 4b) | 10,000 |
| Net long-term capital gain (line 4e) | 15,000 |
| Other deductions (line 11) | 5,000 |

Partnership A computes an apportionment percentage of 60% on 1992 Wisconsin Form 4B, line 28.

Partnership A's net business income is \$40,000, which is the ordinary income from trade or business activities reported on Wisconsin Form 3, Schedule 3K, line 1, column d. Partnership A is subject to a temporary recycling surcharge of \$104 $(\$40,000 \times 60\% \times .004345)$.

Example 2: Assume the same facts as in Example 1, except that Partnership A reports a \$100,000 ordinary loss from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership A is subject to the minimum temporary recycling surcharge of \$25 since it has a net business loss of \$100,000.

Note: The minimum temporary surcharge is not multiplied by Partnership A's apportionment percentage.

Example 3: Assume the same facts as in Example 1, except that Partnership A reports \$4,000,000 of ordinary income from trade or business activities on its 1992 Wisconsin Form 3, Schedule 3K, line 1, column d.

Partnership A is subject to a temporary recycling surcharge of \$9,800. Although Partnership A computes a surcharge of \$10,428 $(\$4,000,000 \times 60\% \times .004345)$, the maximum

temporary recycling surcharge of \$9,800 applies.

Note: The maximum temporary recycling surcharge of \$9,800 is not multiplied by Partnership A's apportionment percentage.

Example 4: Partnership B is engaged solely in farming in and outside Wisconsin. Partnership B reports \$50,000 of net farm profit on its 1992 federal Form 1065, line 5. Partnership B has no other income or loss. Partnership B computes an apportionment percentage of 30% on 1992 Wisconsin Form 4B, line 28.

Partnership B is subject to a temporary recycling surcharge of \$25, the surcharge applicable to a partnership engaged solely in farming.

Note: The \$25 temporary recycling surcharge for farming is not multiplied by the apportionment percentage. □

7 Temporary Recycling Surcharge — Individual Retirement Arrangements

Statutes: Sections 77.92(4), 77.93(2) and (5), and 77.94(1)(b), Wis. Stats. (1991-92)

Note: The temporary recycling surcharge applies to taxable years ending after April 1, 1991, and ending before April 1, 1999. This tax release supersedes the information relating to tax-exempt trusts in the 1991 instructions to Wisconsin Form 4T, Wisconsin Exempt Organization Business Franchise or Income Tax Return, and in the December 1991 edition of Publication 400, *Wisconsin's Temporary Surcharge*. The tax release applies retroactively to taxable years ending after April 1, 1991.

Background:

Federal Law: Individuals may establish personal savings plans, called individual retirement arrangements (IRAs), which offer tax advantages to set aside money for retirement. IRAs may be set up with various types of organizations, including banks and other financial institutions, mutual funds, and life insurance companies. IRAs can be individual retirement accounts or individual retirement annuities, or they can be part of either a simplified employe pension of an employer or an employer or employe association trust account. Funds in an IRA may be invested in a variety of ways, including stocks, government bonds, savings accounts, certificates of deposits, annuities, participations in common trust funds, partnerships, and real estate.

Generally, IRAs are exempt from federal income taxes other than the tax imposed under sec. 511 of the Internal Revenue Code (IRC) on unrelated business taxable income. IRC sec. 408(e)(1). Unrelated business taxable income is income from a trade or business regularly carried on by the IRA which is not substantially related to the exercise by the IRA of its tax-exempt purpose. It includes income from a trade or business carried on by a partnership of which the IRA is a member. IRC secs. 512(c) and 513(b).

Excluded from unrelated business taxable income are dividends, interest, annuities, royalties, certain rents, and gains or losses from the sale, exchange, or other disposition of property other than inventory or property held in the course of a trade or business. IRC sec. 512(b).

An IRA which has \$1,000 or more of gross income from an unrelated trade or business must file federal Form 990-T, Exempt Organization Business Income Tax Return.

Wisconsin Law: Trusts exempt from federal income tax are to the same extent exempt from Wisconsin income tax. Sec. 71.17(5), Wis. Stats. (1991-92). Trusts that have \$1,000 or more of gross income from an unrelated trade or business and must file federal Form 990-T are required to file Wisconsin Form 4T, Wisconsin Exempt Organization Business Franchise or Income Tax Return.

Wisconsin Temporary Recycling Surcharge Law: Trusts that must file a Wisconsin income tax return and that have a profit or loss, for federal income tax purposes, from a trade or business are subject to the temporary recycling surcharge. Sec. 77.93(2), Wis. Stats. (1991-92).

The temporary recycling surcharge for trusts, except those engaged only in farming, is equal to the greater of \$25 or 0.4345% of net business income, but not more than \$9,800. Sec. 77.94(1)(b), Wis. Stats. (1991-92).

Trusts engaged in farming are subject to a temporary recycling surcharge of \$25, if they have a net farm profit of at least \$1,000. Sec. 77.93(5) and 77.94(1)(c), Wis. Stats. (1991-92).

Facts and Question: Taxpayer X has an IRA which invests funds in real estate limited partnerships. The partnerships own property that is subject to a mortgage. Under IRC sec. 514, income from debt-financed property generally is treated as unrelated business income to tax-exempt entities. As a result, Taxpayer X's IRA is consid-

ered to have unrelated business income for federal income tax purposes.

For 1991, the IRA has more than \$1,000 of gross income from an unrelated trade or business. Therefore, the IRA must file federal Form 990-T and Wisconsin Form 4T and pay federal and Wisconsin tax on its unrelated business taxable income. All of the IRA's unrelated business income for 1991 was passed through from partnerships of which it is a member.

Is the IRA subject to the temporary recycling surcharge?

Answer: No. Since all of the IRA's unrelated business income for 1991 was passed through from partnerships, the IRA is not subject to the temporary recycling surcharge on that income, provided the partnerships paid any temporary recycling surcharge due on the income.

Section 77.93(2), Wis. Stats. (1991-92), provides that the temporary recycling surcharge is not imposed on the net business income of individuals for which the surcharge is imposed on a partnership of which an individual is a partner or a tax-option (S) corporation of which an individual is a shareholder. This same treatment applies to trusts, including tax-exempt trusts with unrelated business taxable income, whose business income is passed through from partnerships or tax-option (S) corporations. □