

The "Tax Audit"

Two types of audits are conducted by the Department of Revenue, "office audits" and "field audits." Office audits were discussed in *Wisconsin Tax Bulletin 79* (October 1992). This article focuses on field audits.

Field audits are conducted by auditors located in offices throughout the state and in Chicago, New York, Minneapolis, and Los Angeles. A field audit is a detailed examination of a taxpayer's records to determine if the correct income, sales, deductions, and credits were reported on the tax returns. In some instances the auditor will obtain information from other sources such as banks, vendors, and creditors, to verify items on the returns.

A field audit typically begins when you are notified by letter that your tax returns have been selected for examination. The letter also informs you of the time and date of your first meeting with the auditor, and the initial records you should have available. At this meeting the auditor will want to discuss the nature of your business or employment, the accounting or record system used, and other related matters. The auditor may also want to tour your facility and meet with you again at various times during the audit to ask questions about certain transactions.

If possible, the field audit will be conducted at your place of business or, if you have chosen to have your accountant, attorney, or other person represent you, at that person's office. The auditor will try to select the place that is most appropriate under the circumstances and most convenient for you.

Upon completing the field audit, a conference is usually held with you and/or your authorized representative to review any proposed adjustments.

If you agree with the proposed audit report in full, the auditor will ask you to sign a "Notice of Proposed Audit Report" form, indicating this. If you do not fully agree with the report, you may be asked to meet with the auditor and the auditor's supervisor at a later date to further discuss your objections. Any necessary changes will be made to the report, and you will then be asked to sign the Notice of Proposed Audit Report, indicating whether you agree fully or partially, or you disagree totally.

The department will then officially notify you by mail of the results of the field audit. If there are changes in the tax, you will receive an assessment or refund notice and a copy of the audit report, explaining the adjustments, the amount of tax, interest, and penalty (if any), and your appeal rights. If there is no tax due or no refund, a letter will be sent to you explaining that there is no change in your tax liability.

For the fiscal year ending June 30, 1992, the department completed 1,803 field audits, resulting in 1,450 assessments for \$74,400,000, 125 refunds for \$4,900,000, and 228 audits with no change in tax. This compares with 1,522 field audits for the previous year ending June 30, 1991, which resulted in 1,289 assessments for \$55,000,000, 85 refunds for \$3,900,000, and 148 audits with no change in tax. The 1,803 field audits for fiscal 1991-92 included 1,409 corporations, 322 individuals, and 72 partnerships or exempt organizations. □

Administrative Rules in Process

Listed below are proposed new administrative rules and changes to existing rules that are currently in the rule adoption process. The rules are shown at their stage in the process as

of July 1, 1993, or at the stage in which action occurred during the period from April 2, 1993, to July 1, 1993.

Each affected rule lists the rule number and name, and whether it is amended (A), repealed (R), repealed and recreated (R&R), or a new rule (NR).

Rules at or Reviewed by Legislative Council Rules Clearinghouse

3.095 Income tax status of interest and dividends from municipal, state and federal obligations received by individuals and fiduciaries-R&R

Rules Sent to Revisor of Statutes for Publication of Notice or Hearing Date

- 2.07 Earned income tax credit-NR
- 2.13 Moving expenses-R
- 2.14 Aggregate personal exemptions-R
- 2.15 Methods of accounting for corporations-R
- 2.16 Change in method of accounting for corporations-R
- 2.165 Change in taxable year-R
- 2.19 Installment methods of accounting for corporations-R
- 2.20 Accounting for acceptance corporations, dealers in commercial paper, mortgage discount companies and small loan companies-R
- 2.21 Accounting for incorporated contractors-R
- 2.22 Accounting for incorporated dealers in securities-R
- 2.24 Accounting for incorporated retail merchants-R
- 2.25 Corporation accounting generally-R
- 2.26 "Last in, first out" method of computing inventory for corporations-R

2.51	Rent received by corporations from Wisconsin real estate-R	3.14	Losses from bad debts by corporations-R	Rules Adopted But Not Yet Effective	
2.53	Stock dividends and stock rights received by corporations-R	3.17	Corporation losses, miscellaneous-R	11.15	Containers and other packaging and shipping materials-A
2.56	Insurance proceeds received by corporations-R	3.35	Depletion, basis for allowance to corporations-R	Rules Adopted and in Effect (including effective dates)	
2.57	Annuity payments received by corporations-R	3.36	Depletion of timber by corporations-R	2.02	Reciprocity-A (5/1/93)
2.60	Dividends on stock sold "short" by corporations-R	3.37	Depletion of mineral deposits by corporations-R	2.31	Taxation of personal service income of nonresident professional athletes-R (7/1/93)
2.63	Dividends accrued on stock-R	3.38	Depletion allowance to incorporated mines and mills producing or finishing ores of lead, zinc, copper or other metals except iron-R	2.955	Credit for taxes paid to other states-A (5/1/93)
2.65	Interest received by corporations-R	3.43	Amortization of trademark or trade name expenditures — corporations-R	11.03	Elementary and secondary schools and related organizations-A (5/1/93)
2.70	Gain or loss on capital assets of corporations; basis of determining-R	3.45	Bond premium, discount and expense — corporations-R	11.05	Governmental units-A (5/1/93)
2.72	Exchanges of property by corporations generally-R	3.48	Deductions for research or experimental expenditures — corporations-R	11.08	Medical appliances, prosthetic devices and aids-A (6/1/93)
2.721	Exchanges of property held for productive use or investment by corporations-R	3.52	Automobile expenses — corporations-R	11.12	Farming, agriculture, horticulture and floriculture-A (5/1/93)
2.73	Involuntary conversion by corporations-R	3.54	Miscellaneous expenses — corporations-R	11.17	Hospitals, clinics and medical professions-A (6/1/93)
2.75	Recoveries by corporations-R	3.81	Occupational taxes paid by corporations-R	11.18	Dentists and their suppliers-A (6/1/93)
2.76	Refunds of taxes to corporations-R	3.82	Evasion of tax through affiliated interests-R	11.33	Occasional sales-A (5/1/93)
2.80	Improvements on leased real estate, income to corporate lessor-R	5.01	Filing reports-R	11.38	Fabricating and processing-R&R (7/1/93)
2.81	Damages received by corporations-R	11.04	Constructing buildings for exempt entities-A	11.45	Sales by pharmacies and drug stores-A (6/1/93)
2.83	Requirements for written elections as to recognition of gain in certain corporation liquidations-R	11.27	Warranties-R&R	11.49	Service stations and fuel oil dealers-A (5/1/93)
2.86	Income to corporations from cancellation of government contracts-R	11.67	Service enterprises-A	11.57	Public utilities-A (5/1/93)
3.01	Rents paid by corporations-R	11.675	Janitorial services-NR	11.70	Advertising agencies-R&R (5/1/93)
3.05	Profit-sharing distributions by corporations-R	11.68	Construction contractors-A	11.71	Computer industry-A (5/1/93)
3.07	Bonuses and retroactive wage adjustments paid by corporations-R	11.82	Mailing lists and mailing services-A	11.83	Motor vehicles-A (5/1/93)
3.08	Retirement and profit-sharing payments by corporations-R	17.01	Administrative provisions-R	11.84	Aircraft-A (5/1/93)
3.09	Exempt compensation of military personnel-R	17.02	Eligibility-R	11.85	Boats, vessels and barges-A (5/1/93)
3.12	Losses on account of wash sales by corporations-R	17.03	Application and review-R	11.88	Mobile homes-A (5/1/93)
		17.04	Repayment of loan-R	11.95	Retailer's discount-A (5/1/93)
		Rules Sent to Legislative Committees		14.03	Household income and income-A (7/1/93) □
		11.66	Telecommunication and CATV services-R&R		

Recently Adopted Rules Summarized

Listed below is a summary of recently adopted changes to administrative rules. In addition to the summary, substantive changes to the rules are reproduced. In the amendments, material lined through (~~lined through~~) represents deleted text, and underscored (underscored) material represents new text.

This issue includes information about changes to the rules listed in the "Rules Adopted and in Effect" section of the preceding article titled "Administrative Rules in Process."

Tax 2.02 Reciprocity. Tax 2.02(3)(a)(intro.) and 1, (4)(a)1 to 4, and (4)(b)(intro.) are amended; (4)(b)1 and 2 are repealed; (5)(a), (6)(b), (7), and (8) are amended; (9) is repealed; (10) to (13) are renumbered (9) to (12); and as renumbered, (10)(a) and (b), (11)(a), and (12) are amended. These changes reflect proper format, grammar, and punctuation; the renumbering of Tax 2.02(10); and the repeal of reciprocity between Wisconsin and Maryland.

Tax 2.31 Taxation of personal service income of nonresident professional athletes. Tax 2.31 is repealed, to reflect a Court decision that the rule conflicts with secs. 71.02 and 71.04(1)(a), Wis. Stats.

Tax 2.955 Credit for taxes paid to other states. Tax 2.955(3)(intro.), (3)(a), (4)(b)2 and 3, (4)(c), and (4)(d) are amended, to reflect proper format, and the repeal of reciprocity between Wisconsin and Maryland.

Tax 11.03 Elementary and secondary schools and related organizations. Tax 11.03(1)(a) is repealed and recreated, to reflect proper format and to define "school district"; (1)(b)

is amended, (2)(a)6 is created, and (3)(intro.) is amended, to reflect that sales of tangible personal property by a school district are exempt; and (3)(a) is amended, to reflect proper language. The text of Tax 11.03(1)(a) and (b), (2)(a)6, and (3)(intro.) is as follows:

11.03(1)(a) In this section:

1. "Elementary school" means a school providing any of the first 8 grades of a 12 grade system and kindergarten where applicable.

2. "Secondary school" means a school providing grades 9 through 12 of a 12 grade system and includes the junior and senior trade schools described in s. 119.30, Stats.

3. "School district" has the same meaning as provided for in s. 115.01(3), Stats.

(1)(b) Elementary and secondary schools include parochial and private schools not operated for profit which offer any academic levels comparable to those described in par. (a)1 and 2 and which are educational institutions having a regular curriculum offering courses for at least 6 months in the year. Elementary and secondary schools also include school districts for purposes of exemption under s. 77.54(4), Stats.

(2)(a)6. The transfer of tangible personal property to a contractor for performance of a real property construction activity in exchange for a reduction in the contract price, even though the contract provides that the contractor is to supply all materials.

(3) SALES BY SCHOOL-RELATED ORGANIZATIONS AND OTHERS. Sales by school-related organizations and others, not including school districts, the gross receipts from which are taxable, include:

Tax 11.05 Governmental units. Tax 11.05(3)(p) is amended, to reflect a law change relating to copies of

records and (4)(intro.) to (4)(e) are renumbered (4)(a) to (4)(f), to reflect proper format. The text of Tax 11.05(3)(p) is as follows:

11.05(3)(p) Charges for filing, entering, docketing, recording or furnishing certified or uncertified copies of records by a state registrar, register of deeds, health officer and clerk of court under ss. 59.42, 59.57 and 69.22, Stats., or by a filing officer under s. 409.407(2), Stats., and fees charged by a register in probate pursuant to s. 814.66, Stats. Also, charges by an "authority," as defined in s. 19.32(1), Stats., for copying a ~~public record or confidential record~~ under s. 19.35(1)(a), Stats., including charges for a search of records.

Tax 11.08 Medical appliances, prosthetic devices and aids. Tax 11.08(1)(intro.) is amended, to reflect the exemption for parts and accessories; (1)(d) is repealed, to reflect the exemption for adaptive equipment, and (1)(e) to (i) are renumbered (1)(d) to (h); and (2)(intro.), (3), (4), (5), (6), (8), and (9) are amended, to reflect proper format, and the exemption for parts and accessories. The text of Tax 11.08(1)(intro.), (2)(intro.), (3), (4), (5), (8), and (9) is as follows:

11.08(1) DEVICES FOR HANDICAPPED PERSONS. Section 77.54(22)(a), Stats., exempts gross receipts from the sale of "Artificial devices individually designed, constructed or altered solely for the use of a particular physically disabled person so as to become a brace, support, supplement, correction or substitute for the bodily structure including the extremities of the individual." This exemption includes parts and accessories and trusses, supports, shoes, and braces when specially fitted and altered to fit a particular person. "Altered" does

not include the adjusting of straps or seams but does include the bending of metal stays. The following items normally are not designed for use by a particular person, and if that is the case, do not qualify for the exemption:

(2) **PROSTHETIC DEVICES, APPLIANCES AND AIDS.** Section 77.54(22)(b), Stats., exempts gross receipts from the sale of "Artificial limbs, artificial eyes, hearing aids, and other equipment worn as a correction or substitute for any functioning portion of the body." This exemption includes parts and accessories. "Other equipment" includes colostomy, ileostomy and urinary appliances, artificial breast forms and heart pacemakers. This exemption does not apply to:

(3) **EYE GLASSES.** Section 77.54(22)(d), Stats., exempts gross receipts from the sale of "Eye glasses when especially designed or prescribed by an ophthalmologist, physician, oculist or optometrist for the personal use of the owner or purchaser." This exemption does not include tools and supplies, eyeglass cases, ~~eye shields,~~ and thermal and chemical care units for contact lenses, ~~chains, clips or other accessories~~ associated with eye glasses. Frames, parts and accessories for prescription glasses are exempt.

(4) **CRUTCHES AND WHEELCHAIRS.** Section 77.54(22)(e), Stats., exempts gross receipts from the sale of "Crutches and wheelchairs including motorized wheelchairs and scooters for the use of persons who are ill or disabled." This exemption includes parts and accessories and open and closed end walkers with or without casters and canes which provide walking support by making contact with the ground at more than one point.

(5) **ELASTIC HOSE AND STOCKINGS.** Section 77.54(22)(f), Stats., exempts gross receipts from

the sale of "~~antiembolism~~ Antiembolism elastic hose and stockings that are prescribed by a physician and sold to the ultimate consumer." This exemption includes parts and accessories.

(8) **ADAPTIVE EQUIPMENT FOR MOTOR VEHICLES.** Section 77.54(22)(g), Stats., exempts gross receipts from the sale of adaptive equipment, including parts and accessories, that makes it possible for handicapped persons to enter, operate or leave a vehicle, as defined in s. 27.01(7)(a)2, Stats., if that equipment is purchased by the handicapped person who will use it, a person acting directly on behalf of that handicapped person or a non-profit organization.

(9) **REPAIR PARTS, ACCESSORIES AND SERVICE.** Gross receipts from the sale of repair parts and service for exempt property are exempt. In addition, gross receipts from the sale of parts and accessories for items exempt under s. 77.54(22), Stats., are exempt.

Tax 11.12 Farming, agriculture, horticulture and floriculture. Tax 11.12(2)(d), (e), and (i), (3), (4)(a)(intro.), 3, 5.c, 6, and 7.c, (4)(b)(intro.), 4.a, 5, and 6.c are amended; (4)(a)4.(title), (4)(a)5.(title), (4)(b)3.(title), and (7)(title) are created; and (4)(b)9 is renumbered (4)(b)7; all to reflect proper format. Tax 11.12(4)(a)(intro.) and 3 are also amended and (5)(d) is repealed, to reflect the exemption for fuel sold for use in farming. The text of Tax 11.12(4)(a)3 and the titles to Tax 11.12(4)(a)4, (4)(a)5, (4)(b)3, and (7) are as follows:

11.12(4)(a)3. Accessories, attachments and parts. Included within the exemption are accessories, attachments; and parts and fuel for tractors and machines used directly in agriculture. "Accessories" and "attachments" include devices designed to

be mounted on a machine or to be pushed or pulled by a machine such as farm wagons and pipes attached to irrigation pumps. A machine "part" means a durable unit of definite, fixed dimensions and includes tractor cabs, oil filters and slow-moving-vehicle signs. Canvas covers and paint for exempt machines are exempt. "Parts" does not include fluids such as antifreeze or lubricants. These are "supplies" rather than "parts" and are not exempt. ~~The exemption for fuel for farm machines does not apply to purchases of electricity or fuel for machines which do not qualify for exemption under s. 77.54(3), Stats.~~

(4)(a)4. Machines.

(4)(a)5. Real property improvements.

(4)(b)3. Feed.

(7) TAXABLE SALES.

Tax 11.17 Hospitals, clinics and medical professions. Tax 11.17(1)(a) is amended, to reflect proper format; (3) is amended, to reflect the exemption for parts and accessories; (4)(a)2 is amended, to reflect the taxability of meals sold off premises; (4)(b)4 is amended, to clarify its applicability to taxable services; (4)(b)5 is renumbered (4)(b)6, to reflect the creation of new subd. 5, and it is amended, to reflect proper format; and (4)(b)5 is created, to reflect the taxability of meals sold by hospitals off premises. In the list of exempt items in Tax 11.17(3), the phrase "including parts and accessories" is added to "Antiembolism . . .," "Artificial eyes and limbs," "Bone pins and plates," "Crutches . . .," "Hearing aids and parts," and "Pacemakers." The text of Tax 11.17(4)(a)2, (4)(b)4, and newly created (4)(b)5 is as follows:

11.17(4)(a)2. Hospitals' sales of meals, food, food products and beverages to patients, staff or visitors served on the hospitals' premises.

(4)(b)4. Sales of meals and other tangible personal property or taxable services by an organization affiliated with a hospital.

(4)(b)5. Sales of meals, food, food products and beverages by hospitals off the hospitals' premises, except when sold to the elderly or handicapped by persons providing "mobile meals on wheels."

Tax 11.18 Dentists and their suppliers. Tax 11.18(1) and (2)(a)3 are amended as follows, to include parts and accessories in the exemptions:

11.18(1) DENTISTS CHARGES. Charges by dentists for dental services are not subject to the sales tax. In addition, charges for items specifically designed for a patient which are installed in the patient's mouth, including artificial teeth, fillings, bridges, crowns, or inlays, and parts and accessories for those items, are not subject to the tax.

(2)(a)3. Crowns, bridges, bridge-work, dentures, inlays, fillings and other items fabricated by a dental laboratory, including parts and accessories for those items, which the dentist installs in the patient's mouth.

Tax 11.33 Occasional sales. Tax 11.33(2) and (4)(g) are amended, to reflect proper format and (4)(c) is amended, to reflect the exemption for transfers to in-laws. The text of Tax 11.33(4)(c) is as follows:

11.33(4)(c) The transfer of a motor vehicle, boat, snowmobile, mobile home not exceeding 45 feet in length, trailer, semitrailer, all-terrain vehicle or aircraft to a spouse, parent, stepparent, father-in-law, mother-in-law, child or step-child, son-in-law or daughter-in-law, of the transferor provided the property has been previously registered in Wisconsin in the name of the transferor, if required to be regis-

tered, and the transferor is not engaged in the business of selling this type of property.

Tax 11.38 Fabricating and processing. Tax 11.38 is repealed and recreated, to improve readability, to reflect proper format, and to address manufacturing exemptions for fabricators and processors. The text of Tax 11.38 is as follows; examples and a note appearing in the rule are not reproduced here:

Tax 11.38 Fabricating and processing. (ss. 77.51(14)(f) and (h), 77.52(2)(a)10 and 11, 77.54 and 77.55, Stats.) (1) SALES OF FABRICATING, PROCESSING AND PRINTING SERVICES. The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish directly or indirectly the materials used in the producing, fabricating, processing, printing or imprinting is subject to Wisconsin sales or use tax unless:

(a) The printing or imprinting is done on tangible personal property which will subsequently be shipped outside Wisconsin by the consumer for advertising purposes.

(b) An exemption under s. 77.54 or 77.55, Stats. applies.

(c) The producing, fabricating or processing is for resale.

(2) EXAMPLES OF FABRICATING AND PROCESSING SERVICES. Fabricating and processing services, where materials are furnished directly or indirectly by the customer, that are subject to Wisconsin sales or use tax include, except as provided in sub. (1)(a) through (c):

(a) Application of coating to pipe.

(b) Assembling kits to produce a completed product.

(c) Bending glass tubing into neon signs.

(d) Bookbinding.

(e) Caterer's preparation of food for consumption on or off the caterer's premises.

(f) Cleaning used oil.

(g) Cutting lumber to specifications and producing cabinets, counter tops or other items from lumber for customers, often called "millending."

(h) Cutting or crushing stones, gravel or other construction materials.

(i) Drying, planing or ripping lumber.

(j) Dyeing or fireproofing fabric.

(k) Fabricating steel which may involve cutting the steel to length and size, bending and drilling holes in the steel to specifications of a particular construction job.

(l) Firing of ceramics or china.

(m) Heat treating or plating.

(n) Laminating identification cards.

(o) Making a fur coat from pelts, gloves or a jacket from a hide.

(p) Making curtains, drapes, slip covers or other household furnishings.

(q) Production of a sound recording or motion picture.

(r) Retreading tires.

(s) Tailoring a suit.

(t) Threading pipe or welding pipe.

(3) PURCHASES BY FABRICATORS OR PROCESSORS. Persons providing fabricating, processing and printing services, including those services listed in sub. (2), may qualify as manufacturers. If the service provider qualifies as a manufacturer as provided in s. 77.54(6m), Stats., the following items may be purchased by the service provider without Wisconsin sales or use tax:

(a) Machinery and equipment used exclusively and directly in manufacturing.