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 Distribution From a Nonqualified Retirement Plan or Nonqualified Deferred Compensation Plan to a Nonresident of Wisconsin

Statutes: Section 71.04(1)(a), Wis. Stats. (1991-92)

Wis. Adm. Code: Section Tax 3.085, June 1990 Register

Background: An employer may maintain a retirement or other deferred compensation plan that is either qualified (i.e., meets the requirements of a qualified plan under the Internal Revenue Code) or nonqualified (i.e., does not meet the Code qualification requirements).

Section 71.04(1)(a), Wis. Stats. (1991-92), provides that income from personal services of nonresident individuals shall follow the situs of the services. Wisconsin Administrative Code sec. Tax 3.085 provides that distributions from a qualified retirement plan or qualified deferred compensation plan received by a person while a nonresident of Wisconsin are exempt from Wisconsin income tax, regardless of whether the distribution may be attributable to personal services performed in Wisconsin.

Question: Is a distribution from a nonqualified retirement plan or from a nonqualified deferred compensation plan attributable to personal services performed in Wisconsin exempt from Wisconsin tax when received by a person who is a nonresident of Wisconsin?

Answer: No. Payments from a nonqualified retirement plan or nonqualified deferred compensation plan are taxable to Wisconsin when received by a nonresident of Wisconsin if the payment is attributable to personal services performed in Wisconsin.

For example, the employer maintains a nonqualified retirement plan. Under the plan, the employe will receive $2,000 for each year of employment with the firm. The employe retired after 30 years of employment. The employe was a Wisconsin resident and worked in Wisconsin for 20 years out of the 30-year period. For the remaining 10 years, the employe was an Iowa resident and performed services only in Iowa. After retirement the employe moved from Wisconsin and became a legal resident of Arizona. He received $60,000 from the nonqualified retirement plan while an Arizona resident. $40,000 ($2,000 per year x 20 years) of the distribution from the nonqualified retirement plan is attributable to services performed in Wisconsin and is taxable to Wisconsin. □

2 Gain or Loss on the Sale of a Partnership Interest by a Nonresident

Statutes: Sections 71.02(1) and 71.04(1) and (3), Wis. Stats. (1991-92)

Note: This tax release applies for a partnership's taxable year beginning on or after January 1, 1991, and the partner's taxable year as appropriate to conform the partner's treatment of the income from the partnership to the partnership's tax treatment. For taxable years beginning before 1991, see the tax release with the same title that was published in *Wisconsin Tax Bulletin* 68 (July 1990), page 22.

Background: Section 71.02(1), Wis. Stats. (1991-92), subjects nonresidents of Wisconsin to tax on income derived from the performance of personal services in Wisconsin and from property located or business transacted in Wisconsin, including income from a limited partner's distributive share of partnership income. Additionally, sec. 71.04(1)(a), Wis. Stats. (1991-92), provides that a nonresident limited partner's distributive share of partnership income follows the situs of the business. These provisions first apply for a partnership's taxable year beginning on or after January 1, 1991, and the partner's taxable year as appropriate to conform the partner's treatment of the income from the partnership to the partnership's tax treatment.

Facts and Question 1: Taxpayer X, an Illinois resident, was a general partner in ABC Partnership and a limited partner in DEF Partnership. Both partnerships operated solely in Wisconsin. In 1992, Taxpayer X sold his partnership interests in both partnerships. Under terms of the agreement for the sale of his interest in ABC Partnership, Taxpayer X received payment for a specified percentage of the value of the partnership's outstanding receivables plus an amount for selling his interest in the other partnership assets. Although DEF Partnership held inventory items which had substantially appreciated in value, no part of the selling price was specifically allocated to these items in the sale agreement.

For federal purposes, Taxpayer X must treat the sale of his interest in each of the partnerships as the sale of two separate assets as provided in sec. 751 of the Internal Revenue Code. ABC Partnership's receivables and DEF Partnership's inventory items are sec. 751 property that, upon sale, are treated as ordinary gain or loss for federal purposes. Taxpayer X's interest in each partnership's non-sec. 751 property, upon sale, is treated as a capital gain or loss for federal purposes.

Is either the ordinary gain or loss on the sale of the sec. 751 property or the capital gain or loss on the sale of the non-sec. 751 property that Taxpayer X realized on the sale of his general partnership interest in ABC Partnership or his limited partnership interest in DEF Partnership taxable income or a deductible loss for Wisconsin purposes?

Answer 1: No. Neither Taxpayer X's ordinary gain or loss on the sale of the sec. 751 property nor his capital gain or loss on the sale of the non-sec. 751 property of ABC or DEF Partnership is taxable income or a deductible loss for Wisconsin purposes. Both a general partnership interest and a limited partnership interest in a partnership are considered to be intangible personal property. In general, income or loss from intangible assets follows the residence of the taxpayer for Wisconsin purposes. Sec. 71.04(1)(a), Wis. Stats. (1991-92).

Because Taxpayer X is a nonresident and his partnership interests are intangible personal property, his sales of his interests in ABC and DEF Partnerships are not reportable for Wisconsin income tax purposes. Each sale is considered to be one transaction consisting of the sale of the partnership interest, regardless of whether separate payments are made for partnership receivables or inventory items which have substantially appreciated in value. *Wisconsin Department of Revenue v. William B. Riley*, No. 79-CV-127, Dane County Circuit Court, November 27, 1979, CCH ¶201-534 and ¶201-749.

Facts and Question 2: Taxpayer Y, a Texas resident, is a general partner in GHI Partnership and a limited partner in JKL Partnership. Both partnerships have been operating solely in Wisconsin. In 1992, both partnerships sold all of the partnership assets located in Wisconsin, including land, buildings, office equipment, and goodwill.

Is Taxpayer Y's distributive share of the gain or loss realized by either GHI or JKL Partnership on the sale of its assets taxable income or a deductible loss for Wisconsin purposes?

Answer 2: Taxpayer Y's distributive share of the gains or losses realized by GHI and JKL Partnerships, other than on the sale of their goodwill, is taxable income or a deductible loss for Wisconsin purposes. A partnership that sells its assets passes through any gain or loss realized on the sale to its partners. The income or loss from the sale of property of a nonresident follows the situs of the property. Sec. 71.04(1)(a), Wis. Stats. (1991-92). Because the property was located in Wisconsin, Taxpayer Y's distributive share of GHI Partnership's and JKL Partnership's gains or losses on the sale of their tangible property is taxable or deductible by Wisconsin.

Taxpayer Y's share of the gain or loss from the sale of each partnership's goodwill is not taxable income or a deductible loss for Wisconsin purposes. Goodwill is an intangible asset. In general, income or loss from intangible assets follows the residence of the taxpayer for Wisconsin purposes. Sec. 71.04(1)(a), Wis. Stats. (1991-92). Because the goodwill is intangible personal property, Taxpayer Y's share of the gain or loss from its sale is not taxable by Wisconsin. □

3 Wisconsin Income Tax Treatment of Nonresident Limited Partners

Statutes: Sections 71.02(1) and 71.04(1)(a), Wis. Stats. (1991-92)

Note: This tax release applies for a partnership's taxable year beginning on or after January 1, 1991, and the partner's taxable year as appropriate to conform the partner's treatment of the income from the partnership to the partnership's tax treatment. For additional information, see the tax releases titled "Limited Partnership Loss — Carryforward of Loss From Taxable Years Beginning Before January 1, 1991," published in *Wisconsin Tax Bulletin* 76 (April 1992), page 10, and "Gain or Loss on the Sale of a Partnership Interest by a Nonresident," published in this *Wisconsin Tax Bulletin*.

Facts and Question 1: Taxpayer A, a nonresident of Wisconsin, is a limited partner in a partnership that conducts 100% of its business in Wisconsin. The taxpayer's investment in the partnership was $25,000. In years prior to 1991, Taxpayer A's distributive share of the partnership losses was $100,000. On his federal and resident state's returns for years prior to 1991, Taxpayer A deducted $25,000 of the losses under the federal at-risk rules. On January 2, 1991, the partnership sells its assets and terminates. Taxpayer A's distributive share of the income is $75,000 of ordinary income due to depreciation recapture. He receives no cash distributions.

For both federal and his resident state's income tax purposes, Taxpayer A must report $75,000, his distributive share of the partnership ordinary income. He can then deduct the $75,000 at-risk loss carryover. Thus, his net partnership income is zero. He will have no gain or loss on termination of the partnership since his basis in the partnership is zero. Over the life of the partnership, Taxpayer A will have reported a loss of $25,000, the economic loss of his original investment.

What must Taxpayer A report in 1991 for Wisconsin income tax purposes?

Answer 1: Taxpayer A must report $75,000 of partnership income for Wisconsin income tax purposes. Wisconsin adjusted gross income is computed by starting with federal adjusted gross income and making the modifications prescribed in sec. 71.05(6) to (12), (19), and (20), Wis. Stats. (1991-92). One of the prescribed modifications is to add to federal adjusted gross income the $75,000 of pre-1991 partnership losses. Since Taxpayer A is a nonresident of Wisconsin, he had the right under his resident state's tax laws to deduct such losses, permitting him to shelter otherwise taxable income.

Any gain or loss on the termination of Taxpayer A's partnership interest is not included in his Wisconsin adjusted gross income. His partnership interest is intangible personal property, and gain or loss on such property follows the taxpayer's residence.

Facts and Question 2: Taxpayer B, a nonresident of Wisconsin, is a limited partner in a partnership that conducts 100% of its business in Wisconsin. Taxpayer B's investment in the partnership was $50,000. In years prior to 1991, Taxpayer B's distributive share of partnership losses was $40,000, which he deducted on both his federal and his resident state's tax returns. As a result, his basis in the partnership was reduced to $10,000. On January 1, 1991, Taxpayer B becomes a Wisconsin resident. In March 1991, the partnership sells its assets and terminates. Taxpayer B's distributive share of the income is $100,000. Taxpayer B receives a cash distribution of $110,000.

For federal and his resident state's income tax purposes, Taxpayer B must report $100,000, his distributive share of the partnership income. He will have no gain or loss on termination of his partnership interest because the cash distribution is equal to his basis in the partnership. Over the life of the partnership, Taxpayer B will have reported net income of $60,000, the economic income on his original investment.

What must Taxpayer B report in 1991 for Wisconsin income tax purposes?

Answer 2: Taxpayer B must report $100,000 of partnership income for Wisconsin income tax purposes. He may not carry forward the $40,000 of pre-1991 losses that he had the right under his resident state's tax laws to deduct against otherwise taxable income and offset them against the 1991 Wisconsin income.

In addition, Taxpayer B will have no gain or loss on the termination of the partnership, the same as for federal purposes. Section 71.05(12)(a), Wis. Stats. (1991-92), provides that the Wisconsin basis of an asset acquired before an individual became a Wisconsin resident is the federal adjusted basis. □

SALES AND USE TAXES

Note: The following tax release interprets the Wisconsin sales and use tax law as it applies to the 5% state sales and use tax. The ½% county sales and use tax may also apply. For information on sales or purchases that are subject to the county sales and use tax, refer to the December 1992 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 80 (January 1993), page 45.

4 Oil Inspection Performed by Department of Industry, Labor and Human Relations

Statutes: Sections 77.51(4)(a) and (14)(intro.) and 77.52(2)(a)10, Wis. Stats. (1991-92)

Background: Section 168.12(1), Wis. Stats. (1991-92), provides that the Wisconsin Department of Industry, Labor and Human Relations (DILHR) shall demand and receive within 2 weeks after demand, from the owner or other person for whom it inspects any petroleum product, an inspection fee. Before July 1, 1994, the fee is 2 cents for each gallon from which the sample was taken, with certain exceptions.

Facts and Question 1: Company A, an oil company, sells oil to distributors and others. Company A receives a shipment of oil by barge or pipeline. Ten thousand gallons of oil are inspected by DILHR at the time Company A transfers the oil into storage tanks. This oil will be resold to distributors and individuals. DILHR charges Company A an inspection fee of $200 (10,000 gallons X $0.02).

Is DILHR's $200 oil inspection charge to Company A subject to Wisconsin sales or use tax?

Answer 1: No. DILHR's $200 charge to Company A for oil inspection is not subject to Wisconsin sales or use tax.

Section 77.52(2)(a)10, Wis. Stats. (1991-92), provides that the inspection of tangible personal property, which includes oil, is subject to Wisconsin sales or use tax. However, if the sale of the property being inspected is not subject to Wisconsin sales or use tax at the time of being inspected, the inspection charge is not subject to Wisconsin tax. Since the sale of the oil is a sale for resale that is not subject to Wisconsin sales or use tax, the oil inspection charge is also not subject to Wisconsin sales or use tax.

Company A should provide DILHR with a properly completed resale certificate.

Facts and Question 2: The 2 cents per gallon oil inspection charge that Company A pays to DILHR is passed on to Company A's customers with the sale of the oil. Some of the oil Company A sells is subject to Wisconsin sales or use tax, while some of the oil Company A sells is not subject to Wisconsin sales or use tax because it is resold or an exemption applies.

Is the 2 cents per gallon oil inspection charge Company A pays and passes on to its customers with the sale of the oil subject to Wisconsin sales or use tax?

Answer 2: If the sale of oil is subject to Wisconsin sales or use tax, the 2 cents per gallon oil inspection charge that Company A pays and passes on to its customers with the sale of oil is subject to Wisconsin sales or use tax.

If the sale of oil is not subject to Wisconsin sales or use tax, the 2 cents per gallon inspection charge Company A pays and passes on to its customers with the sale of oil is not subject to Wisconsin sales or use tax.

Section 77.51(4)(a), Wis. Stats. (1991-92), provides that gross receipts, for purposes of imposing Wisconsin sales tax, means the total amount of the sale from sales of tangible personal property without any deduction for service cost or any other expense. If the sale of the oil is subject to Wisconsin sales or use tax, the gross receipts subject to Wisconsin sales and use tax include the oil inspection charge Company A passes on to its customers who buy the oil.

Example 1: Company A sells 5,000 gallons of oil to Company B. Company A charges Company B $0.56 per gallon plus a 2 cents per gallon inspection fee. Company B provides Company A with a properly completed resale certificate. Company A's charge to Company B of $0.58 per gallon ($0.56 + $0.02) is not subject to Wisconsin sales or use tax.

Example 2: Assume the same facts as in Example 1, except that Company B does not provide Company A with a resale or exemption certificate. Company A's charge to Company B of $0.58 per gallon ($0.56 + $0.02) is subject to Wisconsin sales or use tax. □

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 delet-