



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.

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INDIVIDUAL INCOME TAXES

1 Credit for Tax Paid to California

Statutes: Section 71.07(7), Wis. Stats. (1991-92)

Wis. Adm. Code: Section Tax 2.955, April 1993 Register

Background: Section 71.07(7), Wis. Stats. (1991-92), provides that "If a resident individual, estate or trust pays a net income tax to another state, that resident individual, estate or trust may credit the net tax paid to that other state on that income against the net income tax otherwise payable to the state on income of the same year." The credit is allowed only if the income taxed by the other state is also considered income for Wisconsin tax purposes.

The State of California operates a State Disability Insurance (SDI) system which is funded entirely by contributions deducted from wages of nonexempt employees or from employer contributions made on behalf of employees. All employees who are not exempt must contribute to the SDI unless their employer establishes a suitable private disability plan which meets State requirements. For 1992, the SDI contribution was equal to 1.25% of the employee's gross wages, subject to a maximum amount.

In Rev. Rul. 81-194, the Internal Revenue Service indicates that amounts withheld from wages of employees for contributions to the California SDI system qualify as "income taxes" of a state and are deductible under sec. 164, IRC, as an itemized deduction. This Revenue

Ruling is consistent with the decision in *Anthony and Delia Trujillo v. Commissioner of the Internal Revenue Service*, 68 TC 651, August 3, 1977.

Facts and Question: The taxpayer is a full-year Wisconsin resident who works as an employee in California during the year. The taxpayer is required to contribute to the California SDI system based on his wages, which are taxable to both Wisconsin and California. May the taxpayer claim a credit for net income tax paid to other states on his Wisconsin income tax return for the amount paid to the California SDI system?

Answer: Yes, the California SDI system payment is eligible for the credit as "income tax" paid to another state. The tax is determined on the basis of a percentage of gross wages and is subject to a maximum wage limitation. The tax is paid "to another state" and is paid "on income taxed by the other state that is also considered income for Wisconsin tax purposes." □

2 Interest Received by a Nonresident From a Nonqualified Deferred Compensation Plan

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

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

Background: 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. Interest

income received by a nonresident individual shall follow the residence of the individual.

Wisconsin Administration 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 tax, regardless of whether the distribution may be attributable to personal services performed in Wisconsin. Distributions received by a nonresident of Wisconsin from a *nonqualified* retirement plan or *nonqualified* deferred compensation plan are taxable to Wisconsin if the payment is attributable to personal services performed in Wisconsin (see the tax release titled "Distribution From a Nonqualified Retirement Plan or Nonqualified Deferred Compensation Plan to a Nonresident of Wisconsin" in *Wisconsin Tax Bulletin* 82 (July 1993), page 28).

Facts and Question 1: A nonresident of Wisconsin receives a distribution from a nonqualified deferred compensation plan. The distribution consists of deferred wages from personal services performed in Wisconsin and interest income which was credited to the deferred compensation account. Is the interest income portion of the distribution from the nonqualified deferred compensation plan taxable to Wisconsin when received by a nonresident?

Answer 1: No, the interest income portion of a nonqualified deferred compensation plan distribution is not taxable to Wisconsin when received by a nonresident of Wisconsin. Only the portion of the distribution attributable to payment for personal services performed in Wisconsin is taxable to Wisconsin when received by a nonresident of Wisconsin.

Question 2: The balance in a nonqualified deferred compensation account may be distributed over a period of years. When a distribution received by a nonresident of Wisconsin consists of both income from personal services performed in Wisconsin and interest income, what portion of the distribution is interest income?

Answer 2: The interest income portion of a distribution from a nonqualified deferred compensation plan may be determined by using the following formula:

$$\begin{array}{l} \text{Amount distributed} \\ \text{from the nonqualified} \\ \text{deferred compensation} \\ \text{plan during the year} \end{array} \times \frac{\begin{array}{l} \text{Total interest credited to the} \\ \text{nonqualified plan for all years} \\ \text{minus the amount of interest} \\ \text{withdrawn in prior years} \end{array}}{\begin{array}{l} \text{Total value of the nonqualified} \\ \text{deferred compensation plan at the} \\ \text{end of the year plus amounts} \\ \text{distributed during the year} \end{array}}$$

Example 1: On January 1, 1993, Mr. X retired and became a resident of Florida. Mr. X had been a participant in his employer's nonqualified deferred compensation plan, and had deferred \$100,000 of wages earned in Wisconsin. As of January 1, 1993, a total of \$30,000 of interest had been credited to X's account. During 1993 an additional \$7,500 of interest was credited. The account balance on December 31, 1993 was \$123,500.

Mr. X received a distribution of \$14,000 from the plan during 1993; \$3,818 of that amount represents interest and is not taxable to Wisconsin. The balance (\$10,182) of the distribution is attributable to personal services performed in Wisconsin and must be included in X's 1993 Wisconsin taxable income. The portion attributable to interest is computed as follows:

$$\$14,000 \times \frac{\$37,500}{\$137,500} = \$3,818^*$$

*portion attributable to interest

The following worksheet illustrates the use of the formula:

1. Amounts distributed from the nonqualified deferred compensation plan during the year . . . \$ 14,000
2. Total interest received by the nonqualified deferred compensation plan for all years minus the amount of interest withdrawn in prior years \$ 37,500
3. Total value of the nonqualified deferred compensation plan at the end of year plus amount on line 1 (\$123,500 + \$14,000) \$ 137,500
4. Divide line 2 by line 3. Enter decimal figure2727
5. Multiply line 1 by line 4. This is the amount of the distribution from the nonqualified deferred compensation plan which is considered interest \$ 3,818

Example 2: During 1994, the taxpayer in Example 1 received an additional distribution of \$14,000 from the nonqualified deferred compensation plan. Mr. X's account was also credited with \$6,500 of interest income for 1994. The account balance on December 31, 1994 was \$116,000.

A portion of the amount X received during 1994 (\$4,327) represents interest and is not taxable to Wisconsin. The

balance (\$9,673) of the distribution is attributable to personal services performed in Wisconsin and must be included in X's 1994 Wisconsin taxable income. The portion attributable to interest is computed as follows:

$$\$14,000 \times \frac{(\$37,500 + \$6,500) - \$3,818}{\$130,000} = \$4,327^*$$

*portion attributable to interest

The following worksheet illustrates the use of the formula:

1. Amounts distributed from the nonqualified deferred compensation plan during the year . . \$ 14,000

2. Total interest received by the nonqualified deferred compensation plan for all years minus the amount of interest withdrawn in prior years (\$37,500 + \$6,500 - \$3,818) . . . \$ 40,182
3. Total value of the nonqualified deferred compensation plan at the end of year plus amount on line 1 (\$116,000 + \$14,000) . . . \$ 130,000
4. Divide line 2 by line 3. Enter decimal figure3091
5. Multiply line 1 by line 4. This is the amount of the distribution from the nonqualified deferred compensation plan which is considered interest \$ 4,327

□

3 Medical Care Insurance Deduction

Statutes: Section 71.05(6)(b)17 and 18, Wis. Stats. (1991-92), as amended by 1993 Wisconsin Act 16, and sec. 71.05(6)(b)19 and 20, Wis. Stats., as created by 1993 Wisconsin Act 16

Note: This tax release applies only with respect to taxable years beginning on or after January 1, 1993.

Background: For taxable years beginning in 1993, sec. 71.05(6)(b)17, Wis. Stats. (1991-92), provides a deduction for 25% of the amount paid for medical care insurance by a self-employed person or by a person who is an employee if the person's employer pays no amount of money toward the person's medical care insurance for the person, his or her spouse, and dependents. The deduction is claimed as a subtraction from federal adjusted gross income when computing Wisconsin taxable income.

The deduction for 25% of the amount paid for medical care insurance is limited to the person's aggregate net earnings from a trade or business that are taxable to Wisconsin. A nonresident or part-year resident of Wisconsin

(a person not domiciled in Wisconsin for the entire year) must prorate the deduction by multiplying the amount by a fraction the numerator of which is the person's net earnings from a trade or business taxable by Wisconsin and the denominator of which is the person's total earnings from a trade or business.

"Medical care insurance" means a medical care insurance policy that covers the person, his or her spouse, and dependents and provides surgical, medical, hospital, major medical, or other health service coverage, and includes payments made for medical care benefits under a self-insured plan. "Medical care insurance" does not include hospital indemnity policies or policies with ancillary benefits such as accident benefits or benefits for loss of income resulting from a total or partial inability to work because of illness, sickness, or injury.

For taxable years beginning in 1994, the deduction will increase to 50% of the amount paid for medical care insurance for both a self-employed person and a person who is an employee whose employer pays no amount toward the person's medical care insurance. For taxable years beginning in 1995 and thereafter, the deduction will remain at 50% of the

amount paid for medical care insurance by a person who is an employee, but will increase to 100% for a self-employed person.

Facts and Question 1: The taxpayer is employed by ABC Corporation. ABC Corporation pays 90% of its employees' basic health insurance premiums. ABC Corporation also offers a catastrophic health insurance plan for which it does not pay any portion of the cost.

During 1993, the taxpayer pays a total of \$600 for medical care insurance. The \$600 includes \$500 as the taxpayer's share of the cost of the basic health insurance (\$4,500 paid by ABC Corporation) and \$100 for the catastrophic health insurance. Does the taxpayer qualify for the deduction for 25% of medical care insurance costs?

Answer 1: Yes, however the deduction is based only on the amount paid for the catastrophic health insurance. The qualification for the deduction is determined on a policy-by-policy basis. The \$500 paid by the taxpayer for the basic health insurance premium cannot be used in computing the deduction because the employer paid a portion of the premium. Because the employer did not pay any portion

of the premium for the catastrophic health insurance, the entire amount paid by the employee for this insurance (\$100) can be used in computing the deduction. The taxpayer may claim \$25 ($\$100 \times .25$) as the medical care insurance deduction.

(Note: The amount of medical care insurance claimed as a deduction cannot be used as a medical expense when computing the Wisconsin itemized deduction credit.)

Question 2: Does the cost of dental insurance qualify as "medical care insurance"?

Answer 2: Yes. Insurance that pays dental expenses is considered "medical care insurance."

Question 3: Can Medicare premiums paid be used in computing the deduction for 25% of medical care insurance costs?

Answer 3: Yes, premiums paid for Medicare B coverage by persons age 65 or over are payments for medical care insurance and can be used in the computation of the deduction, assuming all other qualifications are met. The Medicare B premium for an individual was \$36.60 per month for 1993.

Caution: Medicare tax deducted from an individual's wages or paid by a self-employed individual is not considered a payment of medical care insurance and may not be used in the computation of the deduction.

A person who is not covered under social security (or was not a government employee who paid Medicare tax) may voluntarily enroll in Medicare A. In this situation, the premiums paid for Medicare A are considered medical care insurance premiums.

Question 4: In computing federal adjusted gross income on their personal returns, certain shareholders of

S corporations and partners of partnerships are required to include as income medical care insurance premiums which the S corporation or partnership paid on their behalf. Can such shareholders or partners claim the Wisconsin deduction for 25% of the medical care insurance premiums included in their federal adjusted gross income?

Answer 4: Yes, assuming all other qualifications are met. An S corporation shareholder or partner is considered to have paid the premium in this situation.

Facts and Question 5: Taxpayer X's employer paid a portion of her medical care insurance during January and February 1993. Taxpayer X paid \$200 toward the cost of her insurance during these 2 months. Taxpayer X changed jobs on March 1, 1993. The new employer did not provide any medical care insurance coverage. Taxpayer X obtained her own medical care insurance and paid premiums totaling \$1,800 during March through December 1993. Can Taxpayer X claim the Wisconsin deduction for 25% of the medical care insurance premiums she paid during 1993?

Answer 5: Taxpayer X may claim a deduction of \$450, based on the medical care insurance costs paid during March through December, 1993 ($\$1,800 \times .25 = \450). Premiums for medical care insurance for January and February (\$200) may not be used to compute Taxpayer X's deduction as her employer paid a portion of the premiums during that time. □

4 Preservation or Rehabilitation Project for the State Historic Rehabilitation Credit

Statutes: Section 71.07(9r), Wis. Stats. (1991-92), as amended by 1993 Wisconsin Act 16

Background: Section 71.07(9r)(a), Wis. Stats. (1991-92), provides a tax credit to individuals for 25% of the costs of preserving or rehabilitating certain historic property located in Wisconsin. The credit may not exceed \$10,000, or \$5,000 for married persons filing separately, *for any preservation or rehabilitation project.*

To qualify for the credit, the claimant must meet the following conditions:

1. The costs must be incurred by the owner of the property.
2. The costs must relate to preservation or rehabilitation work done to any of the following:
 - (a) the exterior of the historic property,
 - (b) the interior of a window sash if work is done to the exterior of the window sash,
 - (c) structural elements of the historic property,
 - (d) the heating or ventilating systems, or
 - (e) electrical or plumbing systems, but not electrical or plumbing fixtures.
3. The property must be an owner-occupied personal residence.
4. The State Historical Society must certify that:
 - (a) the property is listed on the National or Wisconsin Register of Historic Places or is located in a historic district and is of historic significance to the district,
 - (b) the proposed preservation or rehabilitation plan complies with the Historical Society's standards, and
 - (c) the completed preservation substantially complies with the proposed plan.