



## 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:

### Corporation Franchise and Income Taxes

1. Wisconsin Treatment of Foreign Sales Corporations (p. 26)

### Sales and Use Taxes

2. Communication Cables and Networking (p. 27)

### CORPORATION FRANCHISE AND INCOME TAXES

#### 1 Wisconsin Treatment of Foreign Sales Corporations

**Statutes:** Sections 71.04(4) and 71.11(7r), Wis. Stats. (1985-86), and secs. 71.26(3)(j), (r), and (t) and 71.30(2) and (5), Wis. Stats. (1991-92)

**Note:** This tax release supersedes the tax release titled "Wisconsin Treatment of Foreign Sales Corporations and Domestic International Sales Corporations" that was published in *Wisconsin Tax Bulletin 70* (January 1991), page 21.

**Background — Federal Law:** Beginning after December 31, 1984, the Tax Reform Act (TRA) of 1984 generally replaced the system of Domestic International Sales Corporations (DISCs) with a new system of Foreign Sales Corporations (FSCs). Under the FSC system, a portion of the foreign trade income of a FSC is exempt from federal tax at the corporate level, provided it is derived from the foreign presence and economic activity of the FSC.

To qualify as a FSC, a corporation must meet the requirements of section 922(a)(1) of the Internal Revenue Code (IRC), which are designed to ensure that it has adequate foreign presence. If a corporation meets all of the requirements, and makes an election that complies with the procedural requirements of sec. 927(f)(1), IRC, it will be treated as a FSC by the Internal Revenue Service. The requirements are:

1. It must be incorporated under the laws of a qualifying foreign country or U.S. possession [Treas. Reg. § 1.921-2(a), Q&A 1(i)].
2. It must have 25 or fewer shareholders at all times [Treas. Reg. § 1.921-2(a), Q&A 1(ii)].
3. It can have no preferred stock [Treas. Reg. § 1.921-2(a), Q&A 1(iii)].
4. It must maintain an office in a qualifying foreign country or any U.S. possession and must maintain a set of permanent account books at its foreign office. At a minimum, these records must consist of invoices, quarterly

income statements, and a year-end balance sheet [Treas. Reg. § 1.921-2(a), Q&A 1(iv)].

5. It must maintain certain tax and accounting records within the United States to facilitate audits [Treas. Reg. § 1.921-2(a), Q&A 1(v)].
6. It must have at least one director who is not a resident of the United States [Treas. Reg. § 1.921-2(a), Q&A 1(vi)].
7. It cannot be a member of a controlled group of corporations that also includes a DISC [Treas. Reg. § 1.921-2(a), Q&A 1(vii)].
8. It must file an election to be treated as a FSC [Treas. Reg. § 1.921-2(a), Q&A 1(viii)].

In addition, the FSC must meet (a) foreign management and (b) foreign economic process tests.

The foreign management requirement is met if the FSC performs all three of the following activities:

1. Holds all board of directors and shareholder meetings outside the United States [Treas. Reg. § 1.924(c)-1(b)];
2. Maintains its principal bank account outside the United States at all times during the taxable year [Treas. Reg. § 1.924(c)-1(c)]; and
3. Disburses all dividends, legal and accounting fees, and salaries of officers and directors from a bank account outside the United States [Treas. Reg. § 1.924(c)-1(d)].

The foreign economic process requirement is met if the following two elements are met by either the FSC directly or by a contractual agent on the FSC's behalf:

1. The FSC, or its agent, must participate outside the United States in one of the following:
  - a. The solicitation (other than advertising) of sales;
  - b. The negotiation of sales; or
  - c. The making of a contract relating to an export transaction (referred to as the "making a sale" test) [Treas. Reg. § 1.924(d)-1(c)].
2. The "foreign direct costs" incurred by the FSC must be at least 50% of the "total direct costs" incurred by the FSC in certain direct cost categories. The direct cost categories are:
  - a. Advertising and sales promotion;
  - b. Processing of customer orders and arranging for delivery of export property;
  - c. Transportation from the time of acquisition by the FSC;
  - d. Determination and transmittal of a final invoice or statement of account and the receipt of payment (billing and collection); and
  - e. Assumption of credit risk.

An alternative direct cost test is satisfied if the foreign direct costs incurred by the FSC are at least 85% of the costs attributable to activities in any two of the above five categories [Treas. Reg. § 1.924(d)-1(d)].

**Question:** What is the Wisconsin tax treatment of FSCs?

**Answer:** The Wisconsin Statutes provide no special tax treatment for FSCs. Section 71.26(3)(r) and (t), Wis. Stats. (1991-92), specifically excludes the federal tax treatment of FSCs.

The net income of a FSC is subject to taxation as a separate corporation if it has nexus in Wisconsin and is a viable corporation with substance.

In *Kimberly-Clark Corporation as successor to Kimtech Ltd. vs. Wisconsin Department of Revenue* (April 12, 1994), the Wisconsin Tax Appeals Commission concluded that Kimberly-Clark Sales Corporation (a FSC) was a separate corporation formed for substantial business reasons and which carried on substantial business activities. Kimberly-Clark Sales Corporation

- had its own officers and directors,
- had employees and offices, either directly or via service agreements,
- maintained substantial active bank accounts,
- conducted business activities in its own right,
- incurred and paid taxes, and
- paid its own organizational costs.

In both form and substance Kimberly-Clark Sales Corporation was a viable business enterprise. □

## 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 January 1995 issue of the *Sales and Use Tax Report*. A copy can be found on pages 39 to 42 of this Bulletin.

## 2 Communication Cables and Networking

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

**Wis. Adm. Code:** Section Tax 11.68(4)(b) and (6)(a)2, April 1994 Register

**Background:** Section Tax 11.68(4)(b), Wis. Adm. Code, provides that certain types of property have a variety of functions and may be tangible personal property in some instances and additions to real property in others. When the property is installed primarily to provide service to a building or structure and is essential to the use of the building or structure, it is a real property improvement. However, when similar property is installed to perform a processing function, it may retain its status as tangible personal property.

Section Tax 11.68(6)(a)2, Wis. Adm. Code, provides that communication equipment remains tangible personal property when it is installed in non-residential buildings.

**Facts:** A contractor is in the business of installing communication systems in nonresidential buildings. Part of its business involves the following services:

- a. Installation of copper or fiber cable inside the walls. Work performed consists of physically installing telephone and computer outlet wiring, along with connecting and cross-connecting them to distribution cables.
- b. Cross-connecting or changing input/output ports at the wire distribution panel. This includes physically moving customer owned telephones and computer terminals from one outlet to another outlet.

**Question 1:** Is the computer cable installed inside the wall real or personal property for purposes of installation?

**Answer 1:** The computer cable inside the wall is tangible personal property for purposes of installation in a non-residential building. The computer cable serves the process being performed within the building rather than the real estate. Therefore, the charge for the sale and installation of the communication cable is subject to Wisconsin sales or use tax.

**Question 2:** Is computer cable inside the wall real or personal property for purposes of repair and maintenance?

**Answer 2:** The computer cable inside the wall is tangible personal property for purposes of repair and maintenance in a nonresidential building. Since the cable is tangible personal property for installation, it retains its character as tangible personal property for purposes of repair and maintenance. Therefore, the charge for the repair and maintenance of the cable is subject to Wisconsin sales or use tax.

**Caution:** Computer cable as mentioned above does not include electrical wiring.

**Question 3:** Is the charge for moving, dismantling, and reinstalling a computer or telephone and related

computer or telephone cable from one wall or floor outlet to another, subject to Wisconsin sales or use tax?

**Answer 3:** No. Although computers, telephones, and cable from a wall or floor outlet to the computer and/or telephone are tangible personal property in both residential and nonresidential buildings, the dismantling, moving, and reinstalling of tangible personal property is not a service subject to Wisconsin sales or use tax under sec. 77.52(2)(a), Wis. Stats. (1991-92).

See the tax release titled "Moving Machinery" in *Wisconsin Tax Bulletin* 3, for more information on moving services. □