



## 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:

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### INDIVIDUAL INCOME TAXES

#### 1 Application of Statute of Limitations to Tax-Option (S) Corporation Shareholders

**Statutes:** Section 71.77(2) and (7)(b), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Section Tax 2.105, February 1990 Register

**Background:** The general statute of limitations in sec. 71.77(2), Wis. Stats. (1993-94), permits the Department of Revenue to issue assessments within 4 years after the date the franchise or income tax return was filed. However, one of the exceptions to this provision is sec. 71.77(7)(b), Wis. Stats. (1993-94), which states that if a taxpayer does not report federal audit adjustments to the department within 90 days after the federal determination is final, as required by sec. 71.76, Wis. Stats. (1993-94), the department may make an assessment against the taxpayer within 4 years after the department discovers the federal adjustments.

**Facts and Question:** A tax-option (S) corporation and its shareholders file Wisconsin franchise or income tax returns on a calendar-year basis. On February 1, 1995, an officer of the corporation notifies the department that the Internal Revenue Service (IRS) had previously audited the corporation's 1989 and 1990 federal income tax returns and adjusted several of the corporation's items of income and expense. Since the corporation is a pass-through entity, these adjustments affected items of income and expense that had passed through to and been reported by the corpora-

tion's shareholders on their individual income tax returns. Neither the corporation nor the shareholders reported the federal changes to the department within 90 days after the federal determination became final.

The corporation's 4-year statute of limitations expired March 15, 1994, for its 1989 return and March 15, 1995, for its 1990 return. For the shareholders, the 4-year statute of limitations expired April 15, 1994, for their 1989 returns and April 15, 1995, for their 1990 returns.

Does either the corporation's or the shareholders' general 4-year statute of limitations bar the department from issuing assessments against the shareholders within 4 years after the department discovers the corporation's federal audit adjustments?

**Answer:** No, neither the corporation's nor the shareholders' general 4-year statute of limitations bars the department from issuing assessments against the shareholders within 4 years of the department's discovery of the federal adjustments to the tax-option (S) corporation items. Therefore, the department has until February 1, 1999, to adjust the shareholders' 1989 and 1990 Wisconsin income tax returns for the federal adjustments made to tax-option (S) corporation items of income and expense. □

### SALES AND USE TAXES

**Note:** The following tax releases interpret 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 in *Wisconsin Tax Bulletin* 90 (January 1995), pages 39 to 42.

## 2 Applying Letters and Insignias on Motor Vehicles

**Statutes:** Sections 77.52(2)(a) and (2m) and 77.54(2), (6)(a), and (6m), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Sections Tax 11.39 and Tax 11.40, April 1994 Register, Tax 11.41, March 1991 Register, Tax 11.49, April 1993 Register, and Tax 11.67, November 1993 Register

**Background:** Section 77.52(2m)(b), Wis. Stats. (1993-94), provides that with respect to services subject to Wisconsin sales or use tax under sec. 77.52(2)(a)7, 10, 11, and 20, Wis. Stats. (1993-94), such as painting, producing, fabricating, processing, printing, or imprinting, all property physically transferred to the customer in conjunction with the selling, performing, or furnishing of these services is a sale of tangible personal property. As such, the person providing the service may purchase the property it transfers to the customer without Wisconsin sales or use tax as property for resale.

Section 77.54(2), Wis. Stats. (1993-94), provides, in part, an exemption for property that is consumed or destroyed or loses its identity in the manufacture of tangible personal property destined for sale.

Section 77.54(6)(a), Wis. Stats. (1993-94), provides that machines and specific processing equipment and repair parts or replacement parts thereof, exclusively and directly used

by a manufacturer in manufacturing tangible personal property, are exempt from Wisconsin sales or use tax.

Section 77.54(6m), Wis. Stats. (1993-94), defines "manufacturing" as the production by machinery of a new article with a different form, use, and name from existing materials by a process popularly regarded as manufacturing.

Section Tax 11.49(3)(b), Wis. Adm. Code, provides that a service station operator's purchases of sandpaper, masking paper, masking tape, buffing pads, paint, and lacquer thinner are subject to Wisconsin sales or use tax.

**Facts:** Company A has two major products it offers to customers. It paints signs on large pieces of wood according to a customer's specifications. It also applies letters and logos on motor vehicles owned by customers, using paint and/or adhesive-backed vinyl.

Company B contracts with Company A to have Company B's logo and name applied to its fleet of motor vehicles. Company A develops several ideas and designs. Company B selects several from the group including:

1. Adhesive logos and letters cut from adhesive-backed vinyl. The letters and designs are cut from the vinyl material with a plotting machine and are applied to the surface of the motor vehicle.
2. A design painted on the motor vehicle within a masking tape outline.
3. Letters painted on the motor vehicle with a stencil cut from adhesive-backed vinyl. The letters are cut from the material with a plotting machine and discarded. The resulting stencil is applied to

the motor vehicle prior to painting and removed and discarded afterwards.

Company A uses ladders and paint applicators, such as rollers, brushes, air brushes, and spray paint machines, in applying the lettering and logos to the motor vehicles. This equipment is also used by Company A when it makes signs painted on large sheets of wood to be sold to customers.

Company A also uses paint thinner, sandpaper, masking paper, and other consumables in applying the lettering and logos to the motor vehicles.

**Question 1:** Are the gross receipts from the charge for applying signs to motor vehicles subject to Wisconsin sales or use tax?

**Answer 1:** Yes. Section 77.52(2)(a)10, Wis. Stats. (1993-94), imposes Wisconsin sales or use tax on gross receipts from the repair, service, alteration, painting, and coating of tangible personal property.

**Question 2:** Is Company A engaged in manufacturing when making the signs painted on large sheets of wood and when making the letters or stencils with the plotting machine?

**Answer 2:** Yes. Company A is using machinery to produce new articles with a different form, use, and name from existing materials by a process popularly regarded as manufacturing.

**Question 3:** Is Company A engaged in manufacturing when it applies lettering and insignias to motor vehicles provided by the customer?

**Answer 3:** No. Manufacturing is the production by machinery of a new article with a different form, use, and name from existing materials by a process popularly regarded as manufacturing. Company A is not produc-

ing a new article when it applies lettering and insignias to motor vehicles.

**Question 4:** Are Company A's purchases of ladders and paint applicators, such as rollers, brushes, air brushes, and spray paint machines exempt from Wisconsin sales or use tax as machines and processing equipment used exclusively and directly in manufacturing?

**Answer 4:** No. This equipment is subject to tax because it is not used exclusively in manufacturing. This equipment is used in the manufacturing operation of painting large pieces of wood, however, the equipment is also used to apply lettering and logos to motor vehicles, which is not manufacturing.

**Question 5:** Are Company A's purchases of adhesive-backed vinyl from which stencils are made subject to Wisconsin sales or use tax?

**Answer 5:** Yes. Section 77.54(2), Wis. Stats. (1993-94), provides an exemption for property that is consumed or destroyed or loses its identity in the manufacture of tangible personal property destined for sale. However, the stencils are not sold but, rather, are consumed by Company A when applying signs to motor vehicles.

**Question 6:** Are Company A's purchases of masking tape, paint thinner, sandpaper, masking paper, and other consumables used in applying lettering and insignias to motor vehicles provided by customers subject to Wisconsin sales or use tax?

**Answer 6:** Yes. These items are not physically transferred to Company A's customers. Company A is the consumer of the property used in providing the service and is subject to Wisconsin sales or use tax on its purchases of the property.

**Question 7:** Are Company A's purchases of adhesive-backed vinyl used to make letters that are applied to motor vehicles and paint that is applied to motor vehicles provided by customers subject to Wisconsin sales or use tax?

**Answer 7:** No. Since the adhesive-backed vinyl and paint are physically transferred to the customer, the purchase of these items by Company A is not subject to Wisconsin sales or use tax, provided Company A gives its supplier a properly completed exemption certificate. □

### 3 Definition of "State" in the Wisconsin Sales and Use Tax Statutes

**Statutes:** Chapter 77, Subchapters III and V, Wis. Stats. (1993-94)

**Question:** The word "state" is used throughout Subchapters III and V of Chapter 77, Wis. Stats. (1993-94). What does "state" mean when it applies to a state other than Wisconsin in Subchapters III and V of Chapter 77, Wis. Stats. (1993-94)?

**Answer:** "State," with one exception, has the same meaning as in sec. 990.01(40), Wis. Stats. (1993-94), which provides that "state" is states of the United States, including the District of Columbia, the Commonwealth of Puerto Rico, and the several territories organized by Congress. The exception is that in sec. 77.53(16), Wis. Stats. (1993-94), which allows a credit for sales tax paid to another state, "state" means states of the United States, including the District of Columbia, but not including the Commonwealth of Puerto Rico or the several territories organized by Congress.

**Example 1:** Company A purchased building materials in Puerto Rico, which it will use in real property

construction in Wisconsin. Company A paid Puerto Rico sales tax on the materials. Company A is not allowed a credit on its Wisconsin sales and use tax return under sec. 77.53(16), Wis. Stats. (1993-94), for sales tax it paid to Puerto Rico on building materials used in Wisconsin which are subject to Wisconsin use tax. Section 77.53(16), Wis. Stats. (1993-94), specifically excludes from the definition of state, Puerto Rico and other territories organized by Congress.

**Example 2:** A nonresident of Wisconsin purchased an aircraft in England and paid all appropriate England taxes. The aircraft is hangered in Wisconsin. The storage, use, or consumption of the aircraft in Wisconsin is subject to Wisconsin use tax. The exemption under sec. 77.53(17r), Wis. Stats. (1993-94), does not apply because the aircraft was not purchased in another "state" as defined in sec. 990.01(40), Wis. Stats. (1993-94). □

### 4 Manufacturing — Equipment and Consumables Used in Quality Control

**Statutes:** Section 77.54(2) and (6)(a), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Sections Tax 11.39 and 11.40, April 1994 Register, and Tax 11.41, March 1991 Register

**Background:** Section 77.54(6)(a), Wis. Stats. (1993-94), exempts from Wisconsin sales or use tax, machinery and equipment used exclusively and directly by a manufacturer in manufacturing tangible personal property.

Section 77.54(2), Wis. Stats. (1993-94), exempts from Wisconsin sales or use tax, tangible personal property which is consumed or destroyed or loses its identity in the manufacture of

tangible personal property destined for sale.

Section Tax 11.39(2), Wis. Adm. Code, provides that testing or inspection throughout the production cycle is a part of a step-by-step manufacturing process.

**Facts:** Company A manufactures tangible personal property for sale to customers. At several points in the step-by-step manufacturing process, incomplete and completed products are removed from production and taken to Company A's quality control department for testing. Company A's quality control department is exclusively devoted to testing completed and incomplete products from its manufacturing process.

The quality control department tests the products with a variety of equipment. X-ray imaging of certain products is included in the testing program. Company A develops the X-ray film itself.

**Question 1:** Are Company A's purchases of equipment for its quality control department subject to Wisconsin sales or use tax?

**Answer 1:** No. The equipment used by the quality control department is exempt from Wisconsin sales or use tax under sec. 77.54(6)(a), Wis. Stats. (1993-94). The equipment is used exclusively and directly in the step-by-step manufacture of tangible personal property.

**Question 2:** Are Company A's purchases of X-ray film used in its quality control department and chemicals used to develop the film subject to Wisconsin sales or use tax?

**Answer 2:** No. The X-ray film used in Company A's quality control department and the chemicals used to develop the film are exempt from Wisconsin sales or use tax. Since the

X-ray testing is part of the manufacturing process and the film and chemicals are consumed or destroyed in that testing, the exemption under sec. 77.54(2), Wis. Stats. (1993-94), applies.

**Question 3:** Are Company A's purchases of equipment used in its quality control department to develop the X-ray film subject to Wisconsin sales or use tax?

**Answer 3:** No. The equipment used to develop the X-ray film is exempt from Wisconsin sales or use tax under sec. 77.54(6)(a), Wis. Stats. (1993-94), as machinery and equipment used exclusively and directly in manufacturing. The developing of the film is an integral part of the testing process which has been determined to be manufacturing. □

## 5 Manufacturing — Testing Incoming Parts for Quality

**Statutes:** Section 77.54(6)(a), (6m), and (6r), Wis. Stats. (1993-94)

**Wis. Adm. Code:** Sections Tax 11.39 and 11.40, April 1994 Register

**Background:** Section 77.54(6)(a), Wis. Stats. (1993-94), exempts from Wisconsin sales and use tax, the purchase of machines and specific processing equipment used exclusively and directly by a manufacturer in manufacturing tangible personal property.

Section Tax 11.39(2), Wis. Adm. Code, provides that manufacturing includes the assembly of finished units of tangible personal property and packaging when it is a part of an operation performed by the producer of the product or by another on the producer's behalf. It includes the conveyance of raw materials and supplies from the plant inventory to the work point of the same plant,

conveyance of work in progress directly from one manufacturing operation to another in the same plant, and conveyance of finished products to the point of first storage on the plant premises. It includes testing or inspection throughout the production cycle.

**Facts:** Manufacturer A purchases tangible personal property (i.e., parts) which will become components of products made in its manufacturing process. The receiving department sends the parts to Manufacturer A's quality control department. The parts are tested by the quality control department to verify that the vendor made them to Manufacturer A's specifications.

Parts that fail to meet Manufacturer A's specifications are returned to the vendor. Those that are within specifications are sent to the inventory department for eventual withdrawal by the production department. The production department withdraws the parts when they are needed in the manufacturing process.

The quality control department is also responsible for testing products throughout the production cycle.

The quality control department uses a variety of equipment to test the items.

**Question:** Are Manufacturer A's purchases of equipment used in its quality control department subject to Wisconsin sales or use tax?

**Answer:** Yes. The testing equipment used in Manufacturer A's quality control department to test incoming parts and work in progress is subject to Wisconsin sales or use tax. Since some of the testing performed takes place prior to conveyance of parts from plant inventory to the work point, the testing equipment is not used exclusively in the manufacturing process. Therefore, the testing equip-