



Wisconsin TAX BULLETIN



NCR Litigation Resolved

See article on this page and
report on litigation on page 18.

Vernon County Adopts County Tax

Effective January 1, 1997, the county sales and use tax will be adopted by Vernon County. This brings to 49 the number of counties that have adopted the ½% county tax.

The September 1996 *Sales and Use Tax Report*, a copy of which appears on pages 37 and 38 of this Bulletin, explains how the county tax applies to retailers and other persons. It includes a listing of the counties that have adopted the county tax. □

Form Changes for 1996

Following are brief descriptions of the major changes to the Wisconsin individual income tax forms for 1996.

- Check boxes and entry spaces relating to whether the taxpayer earned income from personal or professional services performed in Minnesota while a Wisconsin resident are removed from Forms 1, 1A, WI-Z, and 1NPR.

- Entry spaces are provided on line 5 of Form WI-Z to enable the taxpayer to compute the married couple credit on the front of Form WI-Z. In prior years, computation of the credit was done on a separate schedule on the back of Form WI-Z.

Preliminary copies of the 1996 Forms 1, 1A, WI-Z, and 1NPR and the homestead credit and farmland preservation credit claim forms, Schedule H and Schedule FC, are reproduced on pages 39 to 52 of this Bulletin. The copies are subject to further revision. □

Topical and Court Case Index Available

Are you looking for an easy way to locate reference material to research a Wisconsin tax question? The *Wisconsin Topical and Court Case Index* will help you find reference material to research your Wisconsin tax questions. This index references Wisconsin statutes; administrative rules; *Wisconsin Tax Bulletin* articles, tax releases, and private letter rulings; publications; *Sales Tax Reports*; Attorney General opinions; and court decisions.

The first part of the index, the "Topical Index," gives references to alphabetized subjects for the various taxes, including individual income, corporation franchise and income, withholding, sales and use, gift, inheritance and estate, cigarette,

tobacco products, beer, intoxicating liquor and wine, and motor vehicle fuel, alternate fuels, and general aviation fuel.

The second part, the "Court Case Index," lists Wisconsin Tax Appeals Commission, Circuit Court, Court of Appeals, and Wisconsin Supreme Court decisions. The cases are listed by type of tax, and then alphabetically by issue.

If you need an easy way to research Wisconsin tax questions, subscribe to the *Wisconsin Topical and Court Case Index*. The annual cost is \$18, plus sales tax. The \$18 fee includes a volume published in December, and an addendum published in May.

To order your copy, complete the order blank on page 55 of this Bulletin. The order blank may also be used for subscribing to the *Wisconsin Tax Bulletin* and for ordering the Wisconsin Administrative Code. □

NCR Litigation Resolved

This article explains the status of the NCR litigation.

Background

NCR Corporation (NCR) appealed a franchise tax assessment made by the Department of Revenue (DOR) for

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1996 Income Tax Changes

Following are brief descriptions of some of the Wisconsin law changes which affect individuals in completing 1996 Wisconsin income tax returns. See *Wisconsin Tax Bulletin 97* (July 1996) for additional information about laws enacted in 1996.

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- **Adoption expenses.** A deduction is allowed to an adoptive parent for adoption fees, court costs, or legal fees relating to the adoption of a child, for whom a final order of adoption has been entered by a Wisconsin court during the taxable year. The deduction is available to a full-year Wisconsin resident for up to \$5,000 of the amount expended during the taxable year in which the final order of adoption is entered and the prior two tax years.
- **Combat pay.** The combat pay exclusion is extended to certain members of the Armed Forces of the United States serving in a qualified hazardous duty area (Bosnia and Herzegovina, Croatia, or Macedonia). In addition, the combat pay exclusion for commissioned officers is increased. (For more information, see the following article titled "Changes in Federal Combat Pay Exclusion Also Apply for Wisconsin.")
- **Viatical settlement contracts.** Income received by the original policyholder or original certificate holder from the sale of a life insurance policy or certificate, or the sale of the death benefit under a life insurance policy or certificate, under a viatical settlement contract is exempt from Wisconsin income tax.
- **Credit for taxes paid to another state by a limited liability company (LLC).** A Wisconsin resident who is a member of an LLC that is treated as a partnership may claim a credit against Wisconsin net income tax for income and franchise taxes paid to another state by the LLC. The credit is allowed only if the income taxed by the other state is also considered income for Wisconsin tax purposes.
- **Earned income credit.** The percentages used in computing the Wisconsin earned income credit

are changed. The credit is equal to 14% of the federal earned income credit if the claimant has two qualifying children and 43% if the claimant has three or more qualifying children. If the claimant has one qualifying child, the Wisconsin earned income credit remains at 4% of the federal credit. (Note: This change is the result of a Wisconsin law change enacted in 1995, and is not described in *Wisconsin Tax Bulletin 97*.) □

Changes in Federal Combat Pay Exclusion Also Apply for Wisconsin

For federal tax purposes, Public Law 104-117, enacted March 20, 1996, provides that members of the U.S. Armed Forces performing services for the peace-keeping efforts in a "qualified hazardous duty area" are treated as if the area were a combat zone. A "qualified hazardous duty area" means Bosnia and Herzegovina, Croatia, or Macedonia during the period in which any member of the U.S. Armed Forces is entitled to special pay for duty subject to hostile fire or imminent danger.

In addition, Public Law 104-117 increased the combat pay exclusion for commissioned officers from \$500 per month to the sum of (1) the highest rate of basic pay for that month payable to an enlisted member of the U.S. Armed Forces in the highest enlisted pay grade (currently \$4,254.90 but \$4,158.60 for 1995), and (2) the amount of special pay for duty subject to hostile fire or imminent danger.

For federal tax purposes, these provisions in Public Law 104-117 apply retroactively to service performed on and after November 21, 1995.

For Wisconsin tax purposes, the changes in the combat pay provisions were adopted by 1995 Wisconsin Act 380, *effective at the same time as for federal tax purposes (i.e., November 21, 1995)*.

The U.S. Army, U.S. Navy, U.S. Air Force, and U.S. Coast Guard will issue Form W-2c, Statement of Corrected Income and Tax Amounts, to all members of the U.S. Armed Forces who served in the qualified hazardous duty area in 1995 (for any period on or after November 21, 1995).

A taxpayer who receives the Form W-2c can use it to file his or her 1995 Wisconsin income tax return if it has not been filed. If the taxpayer previously filed a 1995 Wisconsin income tax return, he or she should file an amended 1995 return (Form 1X) to claim a refund. □

Some Federal Law Changes Do Not Apply For Wisconsin

Two federal laws enacted during 1996 result in a difference in the Wisconsin and federal tax treatment of numerous items. These two new federal laws are the Small Business and Job Protection Act of 1996 (Public Law 104-188 enacted on August 20, 1996), and the Health Insurance Portability and Accountability Act of 1996 (Public Law 104-191 enacted on August 21, 1996).

Many of the provisions in these new federal laws apply retroactively to taxable years beginning before 1997 (i.e., 1996 and prior tax years). Under current Wisconsin law, these provisions do not apply for 1996 or prior years for Wisconsin income and franchise tax purposes.

The following is a listing of some of the new federal provisions enacted in

1996 which do not apply for Wisconsin purposes for 1996 and prior years:

- Exclusion for up to \$5,250 of employer-provided educational assistance benefits (effective federally for taxable years beginning after December 31, 1994)
- Deduction for business use of a residence for expenses allocable to space used to store product samples (effective federally for taxable years beginning after December 31, 1995)
- Repeal of the \$5,000 employee death benefit exclusion (effective federally with respect to decedents dying after August 20, 1996)
- Treatment of property acquired to replace investment or business property involuntarily converted as a result of a Presidentially declared disaster (effective federally for disasters for which a Presidential declaration is made after December 31, 1994, in taxable years ending after that date)
- Treatment of lessor improvements abandoned at termination of lease (effective federally for leasehold improvements disposed of after June 12, 1996)

In addition to the five provisions listed above, there are many other provisions in these two federal laws that do not apply for Wisconsin for 1996 or prior years. The department is currently reviewing these laws and will provide a comprehensive listing of the differences in the January 1997 *Wisconsin Tax Bulletin*.

Other provisions in these new laws, such as changes in the rules relating to S corporations, first apply for federal purposes to taxable years beginning in 1997. Whether or not these provisions will be adopted for

Wisconsin tax purposes will be considered by the Wisconsin Legislature in their 1997 session. It likely will not be known until mid-1997 whether any of these federal provisions will be adopted for Wisconsin for taxable years beginning in 1997.

In addition, the federal Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Public Law 104-193) was enacted into law on August 22, 1996. This new federal law makes various changes to the earned income credit.

For example:

- Individuals not authorized to work in the U.S. are not eligible for the earned income credit (effective for returns due more than 30 days after enactment)
- Earned income credit phaseout based on modified adjusted gross income rather than adjusted gross income (effective for taxable years beginning after December 31, 1995)
- Capital gains and passive activity income count as investment income that can trigger loss of earned income credit (effective for taxable years beginning after December 31, 1995)

The changes to the earned income credit apply for computing the Wisconsin earned income credit at the same time as for the federal earned income credit. The reason these changes apply is because Wisconsin law, for purposes of computing the Wisconsin earned income credit, follows current federal law. □

Educational Assistance Payments

The Small Business and Job Protection Act of 1996 (Public Law 104-188) was enacted August 20, 1996.

One of the provisions in this Act retroactively restores for taxable years beginning after December 31, 1994, the federal exclusion for up to \$5,250 of employer-provided educational assistance under section 127 of the Internal Revenue Code (IRC).

For a specific tax year, Wisconsin generally follows the federal IRC as amended to December 31 of the previous year. For example, for taxable years beginning in 1996, under existing law Wisconsin follows the IRC as amended to December 31, 1995. Because the federal extension of the exclusion for employer-provided educational assistance was enacted during 1996, it does not apply for Wisconsin for taxable years beginning in either 1995 or 1996.

Effect of Wisconsin Not Following Federal Law

Taxable years beginning in 1995 — Although certain employees may file an amended 1995 federal return to obtain a refund of federal tax previously paid on educational assistance benefits, a refund may not be claimed for Wisconsin. The retroactive exclusion for educational assistance benefits does not apply for Wisconsin. Therefore, an amended return should not be filed for Wisconsin purposes.

Exception: If an employee files an amended federal return and the reduction in federal adjusted gross income affects the federal earned income credit, this will also affect the Wisconsin earned income credit. The Wisconsin earned income credit is a percentage of the federal earned income credit. Therefore, any change in the federal earned income credit will result in a change in the Wisconsin earned income credit. To claim any additional credit available for Wisconsin, a 1995 Wisconsin

amended return (Form 1X) should be filed.

Taxable years beginning in 1996 — For Wisconsin, educational assistance payments do not qualify for the \$5,250 exclusion under IRC section 127. As a result, for Wisconsin purposes employers must treat educational assistance payments made in 1996 as additional wages to the employee, unless the payment qualifies as a “working condition fringe benefit,” as explained below.

Employees who receive educational assistance benefits treated as wages must include the amount of the benefits in taxable income on their 1996 Wisconsin income tax returns.

Working Condition Fringe Benefit Not Treated as Wages

IRC section 132(d) defines a “working condition fringe benefit” as property or services provided to an employee which, if paid for by the employer, would be deductible by the employer as a trade or business expense. Educational expenses of employees are generally deductible as trade or business expenses if they (1) maintain or improve skills required in the employee’s current employment, or (2) are required by the employer or by law as a condition of retaining the employee’s job, status, or salary. However, educational expenses are not deductible if they are for education that (1) is needed to meet the minimum requirements for the job, or (2) are part of a program of study which leads to a new trade or business.

For example, payments for review courses to prepare for the bar examination or the certified public accountant (CPA) examination, and courses required as part of an apprenticeship program, do not qualify as a “working condition fringe benefit.” Ex-

penses for these courses are not deductible as a trade or business expense because the courses qualify the person for a new profession (in the case of the bar and CPA examination courses), or are needed to meet the minimum requirements for the job (in the case of the apprenticeship program).

Employer-provided educational assistance benefits which qualify as a "working condition fringe benefit" are **not** treated as wages to employees. This applies regardless of whether the employer pays the expenses directly to the educational organization or reimburses the expenses to the employee.

Notify Employee on W-2 Wage Statements

Employer educational assistance payments made during 1996 which represent additional wages to an employee for Wisconsin purposes, can be reported to employees by either: (1) including the amount which is taxable for Wisconsin purposes (but not taxable for federal purposes) in Box 17 of Form W-2, or (2) providing employees with a supplemental "Wisconsin only" W-2 with the taxable educational assistance benefits shown in Box 17.

The employee is required to include taxable educational assistance payments in taxable income on his or her 1996 Wisconsin income tax return. If the employee receives such payments and the taxable amount is different for Wisconsin and federal, the employee should use Wisconsin Schedule I (titled "Adjustments to Convert 1996 Federal Adjusted Gross Income And Itemized Deductions To The Amounts Allowable Under the December 31, 1995 Internal Revenue Code"). □

NCR Litigation Resolved

(continued from page 1)

tax years 1975 through 1980. There were two principal issues in contention, which are described below. The Wisconsin Tax Appeals Commission (WTAC) ruled in favor of NCR on both issues. The DOR appealed the WTAC's decision to the Circuit Court for Dane County. The Circuit Court ruled for NCR on the dividends issue and for the DOR on the apportionment treatment of income from foreign subsidiaries issue. Both the DOR and NCR appealed the Circuit Court's decision to the Court of Appeals. The Court of Appeals declined to issue a ruling, but instead certified the case to the Wisconsin Supreme Court on July 31, 1996. For a summary of the Court of Appeals action, see page 18 of this Bulletin.

The two issues in this case are as follows:

1. Dividends Received Deduction

For tax years beginning before January 1, 1993, a corporation could deduct dividends received from a payor corporation that (a) was subject to Wisconsin franchise or income tax law, (b) filed a Wisconsin tax return, (c) did not deduct the dividends in computing its net income, and (d) used 50% or more of its net income or loss for the prior tax year in computing its Wisconsin taxable income.

Both the WTAC and the Circuit Court held that it was unconstitutional to grant NCR a deduction for dividends received from Wisconsin-based payor corporations, without also granting a deduction for dividends received from out-of-state payor corporations. Accordingly, all of the dividends received by a corporation are deductible in computing

Wisconsin franchise or income tax for tax years beginning before 1993. The law was changed for tax years beginning January 1, 1993, and thereafter to correct the unequal tax treatment of dividends received.

2. Apportionment Treatment of Income From Foreign Subsidiaries

Under Wisconsin law, a corporation doing business in and outside Wisconsin generally must use the apportionment method to determine its income taxable by Wisconsin. Under the apportionment method, a corporation multiplies its apportionable income by a 3-factor apportionment percentage. Apportionable income includes interest and royalties received from foreign subsidiaries.

The apportionment percentage is the weighted average of the following 3 ratios:

- (a) Wisconsin tangible property to total company tangible property,
- (b) Wisconsin payroll to total company payroll, and
- (c) Wisconsin sales to total company sales (this ratio is double-weighted).

NCR claimed that it was unconstitutional to include the interest and royalties it received from its overseas subsidiaries in its Wisconsin apportionable income. Alternatively, if this foreign-source income was apportionable, NCR should be entitled to "factor relief" by including the property, payroll, and sales of its foreign subsidiaries in the denominators of its apportionment factors.

The Circuit Court ruled in favor of the DOR's position that NCR's foreign-source income was apportionable income and concluded that NCR had not proven that the