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 Deductibility of State and Local Taxes for Wisconsin Corporation Franchise and Income Tax Purposes

Statutes: Sections 71.26(3)(g), 71.34(1)(ag), and 71.45(2)(a)5, Wis. Stats. (1993-94)

Background: A corporation computes its Wisconsin net income under the Internal Revenue Code, with certain modifications prescribed in sec. 71.26(3), Wis. Stats. (1993-94). Sec. 71.26(2)(a), Wis. Stats. (1993-94). One of those modifications is sec. 71.26(3)(g), which modifies sec. 164(a)(3) of the Internal Revenue Code (IRC) so that state taxes and taxes of the District of Columbia that are value-added taxes, single business taxes, or taxes on or measured by all or a portion of net income, gross income, gross receipts, or capital stock are not deductible. Similar provisions are included in secs. 71.34(1)(ag) and 71.45(2)(a)5, Wis. Stats. (1993-94), relating to tax-option (S) corporations and insurance companies, respectively.

In addition to the taxes described in IRC sec. 164(a)(1) through (5), IRC sec. 164(a) provides for the deduction of other state and local taxes that are paid or accrued in carrying on a trade or business or an activity for the production of income under IRC sec. 212. However, any tax paid or accrued in connection with the acquisition or disposition of property must be capitalized and treated as part of the cost of the property. State and local sales and use taxes are deductible under this provision. Since sec. 71.26(3), Wis. Stats. (1993-94), does not modify this provision of IRC sec. 164(a), taxes such as state and local sales and use taxes and other local taxes incurred in carrying on a trade or business may be deductible for Wisconsin franchise and income tax purposes.

Facts and Question 1: Hawaii imposes a general excise or privilege tax on all business and other activities conducted within the state. The tax applies not only to sales of goods and services but to virtually every economic activity not otherwise exempt. The tax is imposed on gross income, gross proceeds, or values of products in the distribution chain at varying rates. Hawaii's complementary use tax is imposed on tangible personal property imported for use in the state or purchased from unlicensed sellers in the state. The incidence of the general excise tax is on the seller, service provider, or person conducting business and activities in the state, and any visible pass on of the tax to the consumer or purchaser is a matter of contractual agreement. Chapters 237 and 238, Hawaii Revised Statutes.

May a corporation deduct the Hawaii general excise and use taxes paid under chapters 237 and 238 of the Hawaii Revised Statutes for Wisconsin franchise and income tax purposes?

Answer 1: Yes, the Hawaii general excise and use taxes are deductible as sales and use taxes for Wisconsin franchise and income tax purposes. However, when the expenditure must be capitalized for federal income tax purposes, it must be capitalized for Wisconsin purposes.

Facts and Question 2: New Mexico imposes a gross receipts tax on persons engaged in business in New Mexico for the privilege of doing business in the state. The tax is imposed on the gross receipts of persons who sell property in New Mexico, perform services in New Mexico, lease property employed in New Mexico, or sell research and development services performed outside New Mexico, the product of which is initially used in New Mexico. The compensating (use) tax is imposed on persons for the privilege of using tangible personal property in New Mexico. Chapter 7, Article 9, New Mexico Statutes Annotated 1978, the Gross Receipts and Compensating Tax Act.

May a corporation deduct the gross receipts and compensating taxes imposed under the New Mexico Gross Receipts and Compensating Tax Act for Wisconsin franchise and income tax purposes?

Answer 2: Yes, the New Mexico gross receipts and compensating taxes are deductible as sales and use taxes for Wisconsin franchise and income tax purposes. However, when the expenditure must be capitalized for federal income tax purposes, it must be capitalized for Wisconsin purposes.

Facts and Question 3: Washington imposes a business and occupation tax for the act or privilege of engaging in business activities in Washington. The tax is based on the value of the products involved for extracting and manufacturing industries, gross proceeds of sales for retail businesses, and gross income for other business activities such as personal service businesses. The incidence of the tax is upon the business rather than upon the customer or consumer. Different rates apply to various classifications of business activities. Firms are taxable according to the activities they engage in and, therefore, may be subject to more than one tax rate. Chapter 82.04, Revised Code of Washington.

May a corporation deduct the Washington business and occupation taxes paid under chapter 82.04, Revised Code of Washington, for Wisconsin franchise or income tax purposes?

Answer 3: Yes, the Washington business and occupation taxes are deductible for Wisconsin franchise and income tax purposes.

Facts and Question 4: The city of Everett, Washington, imposes business and occupation taxes patterned after the state business and occupation taxes. Chapter 3.24, Everett Municipal Code.

The city of Santa Ana, California, imposes business license taxes, which are gross receipts taxes on all business activities. Chapter 21, Santa Ana Municipal Code.

Arlington County, Virginia, imposes a business license tax and the city of Arlington, Virginia, imposes a city business tax certificate fee for the privilege of doing business in the county and municipality, respectively. Both of these taxes are based on gross receipts.

May a corporation deduct the Everett, Washington, business and occupation taxes, the Santa Ana, California, business license taxes, the Arlington County, Virginia, business license taxes, and the Arlington, Virginia, city business tax certificate fees for Wisconsin franchise and income tax purposes?

Answer 4: Yes, the Everett, Washington, business and occupation taxes, the Santa Ana, California, business license taxes, the Arlington County, Virginia, business license taxes, and the Arlington, Virginia, city business tax certificate fees are deductible for Wisconsin franchise and income tax purposes. All of these local taxes are incurred in carrying on a trade or business within the meaning of IRC sec. 164(a). Since the modification to IRC sec. 164(a)(3) by sec. 71.26(3)(g), Wis. Stats. (1993-94), relates only to state-imposed taxes, local business taxes paid by a corporation are deductible. □

2 Dividends Received Deduction – Ownership of Stock During Entire Taxable Year

Statutes: Sections 71.22(10) and 71.26(3)(j), Wis. Stats. (1993-94)

Wis. Adm. Code: Section Tax 3.03, December 1995 Register

Background: Under sec. 71.26(3)(j), Wis. Stats. (1993-94), a corporation may deduct from income dividends received from a corporation with respect to its common stock if the corporation receiving the dividends owns, directly or indirectly, during the entire taxable year at least 70% of the total combined voting stock of the payor corporation. For taxable years beginning before January 1, 1993, the corporation receiving the dividends was required to own at least 80%, rather than 70%, of the total combined voting stock of the payor corporation.

Facts: The Taxpayer is an affiliated group of corporations in a regulated industry. The corporate structure includes a multistate holding company based outside Wisconsin (Grandparent), a Wisconsin-based holding company (Parent), and a number of second tier wholly owned subsidiaries. The Taxpayer files its federal income tax returns on a calendar-year basis.

In order to operate more efficiently, the Taxpayer has applied for and received approval to combine virtually all of its separate second tier wholly owned subsidiaries together with Parent (Combining Event). Due to regulatory issues, Parent will not be the surviving entity. The combination of the various corporate entities of the Taxpayer will be income tax-free pursuant to the provisions of sec. 368, Internal Revenue Code (IRC).

The Combining Event will be effective on the same business day; however, a specific ordering of events is needed to satisfy the requirements of the regulatory authority:

1. All second tier subsidiaries slated for termination (Combining Entities) will be merged with a single second tier subsidiary (Survivor).

2. By operation of law, the Combining Entities will cease to exist and all operations will vest in Survivor.

3. Immediately following the completion of the second step, Parent will merge with Survivor, and Parent will cease to exist.

Although these steps will occur within seconds of each other on the same day, under corporate law each step is separate and deemed to occur in the designated order. Pursuant to federal Treasury Regulation sections 1.441-1T(b) and 1.443-1(a), the taxable year of Parent and the Combining Entities will run from January 1, 1996, through the date of the Combining Event.

During 1996, all of the second tier subsidiaries have paid dividends on their common stock to Parent. Parent has owned continuously from January 1, 1996, until the date of the Combining Event at least 70% of the total combined voting stock of each second tier subsidiary which has paid dividends. There is no preferred stock outstanding at the second tier subsidiary level.

Question: Is Parent considered to own at least 70% of the stock of the second tier subsidiaries during Parent's entire taxable year so that Parent will qualify for the deduction for dividends received from the second tier subsidiaries during 1996?

Answer: Yes, Parent is considered to own at least 70% of the stock of the second tier subsidiaries during Parent's entire taxable year. Therefore, Parent will qualify for the dividends received deduction.

For Wisconsin franchise tax purposes, the taxable year is the taxable period upon the basis of which the taxable income of the taxpayer is computed for federal income tax purposes. Sec. 71.22(10), Wis. Stats. (1993-94). For federal income tax purposes, in the case of a return made for a fractional part of a year, "taxable year" means the period for which such return is made. Sec. 7701(a)(23), IRC. In this case, short period returns will be filed for both the Parent and the second tier subsidiaries for the period from January 1, 1996, through the date of the Combining Event. □

INDIVIDUAL INCOME AND CORPORATION FRANCHISE AND INCOME TAXES

3 Expired Tax Credits Not Deductible

Statutes: Sections 71.01(13), 71.21, 71.26(2)(a), 71.34(1), and 71.45(2), Wis. Stats. (1993-94), and as affected by 1995 Wisconsin Acts 27 and 209

Background: In computing their Wisconsin net income, individuals, estates, and trusts must add to their federal adjusted gross income the development zones credits computed for the taxable year, even though the full amount of a credit cannot be used to offset tax for the current taxable year but must be carried forward to future taxable years. Sections 71.01(13) and 71.05(6)(a)15, Wis. Stats. (1993-94), as affected by 1995 Wisconsin Acts 27 and 209.

Partnerships, including limited liability companies treated as partnerships, must add to their federal net income the development zones credits computed for the taxable year and passed through to their partners or members. Section 71.21(4), Wis. Stats. (1993-94), as affected by 1995 Wisconsin Act 27.

Tax-option (S) corporations are required to add to their federal net income the development zones credits computed for the taxable year and passed through to shareholders. Section 71.34(1)(g), Wis. Stats. (1993-94), as affected by 1995 Wisconsin Act 27. In addition, tax-option (S) corporations must add back the amount of manufacturer's sales tax credit used by the corporation to offset tax for the current taxable year. Section 71.34(1)(e), Wis. Stats. (1993-94).

Corporations and insurance companies must add back to their federal taxable income the community development finance credit, manufacturer's sales tax credit, research credits, and development zone credits computed for the taxable year, even though the full amount of a credit cannot be used to offset tax for the current taxable year but must be carried forward to future taxable years. Sections 71.26(2)(a) and 71.45(2)(a)10, Wis. Stats. (1993-94), as affected by 1995 Wisconsin Act 27. For 1986 and prior taxable years, rather than requiring an addition for the manufacturer's sales tax credit computed, sec. 71.04(3), Wis. Stats. (1981-82), prohibited corporations from deducting sales and use taxes paid during the taxable year which could be used in computing the manufacturer's sales tax credit under sec. 71.043, Wis. Stats. (1981-82).

Facts and Question: A Wisconsin corporation, which files its franchise tax returns on a calendar-year basis, has manufacturer's sales tax credit carryovers dating back to the 1981 taxable year. The corporation will not have Wisconsin franchise taxes due for 1996. Since unused credits may be carried forward for up to 15 taxable years under sec. 71.28(3)(c), Wis. Stats. (1993-94), the 1981 credit will expire at the end of the corporation's 1996 taxable year. Pursuant to sec. 71.04(3), Wis. Stats. (1981-82), the corporation had not deducted the Wisconsin sales and use taxes paid on fuel and electricity consumed in manufacturing on its 1981 Wisconsin franchise tax return.

May the corporation claim a deduction on its 1996 Wisconsin franchise tax return for the unused 1981 manufacturer's sales tax credit that expires at the end of the corporation's 1996 taxable year?

Answer: No. The corporation may not claim a deduction on its 1996 Wisconsin franchise tax return for the expired 1981 manufacturer's sales tax credit since the Wisconsin Statutes do not provide for such a deduction. □

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 0.5% county and 0.1% stadium sales and use taxes may also apply. For information on sales or purchases that are subject to the county sales and use tax, refer to Wisconsin Publication 201, *Wisconsin State and County Sales and Use Tax Information*. For information on stadium sales and use tax, refer to the December 1995 issue of the *Sales and Use Tax Report*. A copy can be found in *Wisconsin Tax Bulletin* 95 (January 1996), pages 41 to 47.

4 Federal Preemption of Collection and Remittance of Local Taxes by Direct-to-Home Satellite Service Providers

Statutes: Section 77.52(2)(a)12 and (2)(am), Wis. Stats. (1993-94), and sec. 77.71(2), Wis. Stats., as amended by 1995 Wisconsin Act 56, effective October 27, 1995

Federal Law: Section 602 of Federal Public Law 104-104, effective February 8, 1996

Introduction: This tax release explains how sec. 602 of Federal Public Law 104-104 (Telecommunications Act of 1996), which exempts direct-to-home satellite service providers from the collection and remittance of local taxes, affects direct-to-home satellite service providers and purchasers of direct-to-home satellite service in Wisconsin. Federal Public Law 104-104 exempts the **provider** of the direct-to-home satellite service from the requirement to collect and remit local taxes. However, it does not exempt the consumer (customer) of the direct-to-home satellite service from liability for any applicable local use taxes. Even though direct-to-home satellite service providers are **not required** to collect and remit local taxes on direct-to-home satellite services, the providers may voluntarily collect and remit the local taxes for the convenience of their customers.

Background: *Federal Public Law –* Section 602(a) of Federal Public Law 104-104, states that "A provider of direct-to-home satellite services shall be exempt from the collection or remittance, or both, of any tax or fee imposed by any local taxing jurisdiction on direct-to-home satellite service."

"Direct-to-home satellite service" is defined in sec. 602(b)(1), Federal Public Law 104-104, to mean "...programming transmitted or broadcast by satellite directly to the subscribers' premises without the use of ground receiving or distribution equipment, except at the subscribers' premises or in the uplink process to the satellite."

"Provider of direct-to-home satellite service" is defined in sec. 602(b)(2), Federal Public Law 104-104, to mean "...a person who transmits, broadcasts, sells, or distributes direct-to-home satellite service."

"Local taxing jurisdiction" is defined in sec. 602(b)(3), Federal Public Law 104-104, to mean "...any municipality, city, county, township, parish, transportation district, or assessment jurisdiction, or any other local jurisdiction in the territorial jurisdiction of the United States with the authority to impose a tax or fee, but does not include a State."

Wisconsin Law

Section 77.52(2)(a)12, Wis. Stats. (1993-94), imposes a sales tax on "The sale of cable television system services including installation charges."

Section 77.51(2)(am), Wis. Stats. (1993-94), defines "cable television system" to mean "...any facility which, for a fee, regularly amplifies and transmits by wire, coaxial cable, lightwave or microwave, simultaneously to 50 or more subscribers, programs broadcast by television or radio stations or originated by themselves or any other party..."

Section 77.71(2), Wis. Stats., as amended by 1995 Wisconsin Act 56, effective October 27, 1995, provides that "An excise tax is imposed at the rate of 0.5% in the case of a county tax or at the rate under s. 77.705 in the case of a special district tax of the sales price upon every person storing, using or otherwise consuming in the county or special district tangible personal property or services if the property or service is subject to the state use tax under s. 77.53..."

Facts and Question 1:

- Company A, a direct-to-home satellite service provider, provides direct-to-home satellite service to Customer B, located in LaCrosse, Wisconsin.
- Company A charges Customer B the 5% Wisconsin state sales or use tax, but does not charge Customer B the 0.5% LaCrosse County sales or use tax.

What is the proper Wisconsin sales and use tax treatment of this transaction?

Answer 1:

Wisconsin Sales and Use Tax Treatment for Company A

Company A is required to collect and remit the 5% Wisconsin state sales or use tax on the charge to Customer B for the direct-to-home satellite service.

Company A is **not** required to collect the 0.5% LaCrosse County tax on the charge to Customer B, because the county tax is a "local tax" which, under sec. 602 of Federal Public Law 104-104, Company A is exempt from the requirement of collecting and remitting.

Wisconsin Sales and Use Tax Treatment for Customer B

Customer B is required to remit the 0.5% county use tax imposed under sec. 77.71(2), Wis. Stats., as amended by 1995 Wisconsin Act 56, to the Department of Revenue. Section 602 of Federal Public Law 104-104 only exempts the direct-to-home satellite service provider from the requirement to collect and remit local taxes on the direct-to-home satellite service. It does not exempt the purchaser (Customer B) from being required to remit the local use taxes on the direct-to-home satellite service.

If Customer B holds a Wisconsin seller's permit, use tax registration certificate, or consumer use tax registration certificate, Customer B should report the LaCrosse County use tax due on its sales and use tax return.

If Customer B is not registered to collect and remit Wisconsin sales and use tax, Customer B should report the LaCrosse County use tax due as follows:

a) If Customer B is a corporation, partnership, limited liability company, or legal entity other than an individual, Customer B should report the LaCrosse County use tax due on the direct-to-home satellite service on Form UT-5, Consumer Use Tax Return.

b) If Customer B is an individual and is required to file a Wisconsin income tax return, Customer B should report the LaCrosse County use tax due on the direct-to-home satellite service on Customer B's individual income tax return on the line titled "Sales and use tax due on out-of-state purchases."

c) If Customer B is an individual and is **not** required to file a Wisconsin income tax return, Customer B should report the LaCrosse County use tax due on the direct-to-home satellite service on Form UT-5, Consumer Use Tax Return.

Since Company A collected the 5% Wisconsin state sales or use tax on the charges to Customer B, no additional **state** sales or use tax is owed by Customer B.

Facts and Question 2:

- Company C, a direct-to-home satellite service provider, provides direct-to-home satellite service to Customer D, located in Waukesha, Wisconsin.
- Company C charges Customer D the 5% Wisconsin state sales or use tax, but does not charge Customer D the 0.1% special district (stadium) sales or use tax.

What is the proper Wisconsin sales and use tax treatment of this transaction?

Answer 2:

Wisconsin Sales and Use Tax Treatment for Company C

Company C is required to collect and remit the 5% Wisconsin state sales or use tax on the charge to Customer D for the direct-to-home satellite service.

Company C is not required to collect the 0.1% stadium tax on the charge to Customer D, because the stadium tax is a "local tax" which, under sec. 602 of Federal Public Law 104-104, Company C is exempt from the requirement of collecting and remitting.

Wisconsin Sales and Use Tax Treatment for Customer D

Customer D is required to remit the 0.1% stadium use tax imposed under sec. 77.71(2), Wis. Stats., as amended by 1995 Wisconsin Act 56, to the Department of Revenue. Section 602 of Federal Public Law 104-104 only exempts the direct-to-home satellite service provider from the requirement to collect and remit local taxes on the direct-to-home satellite service. It does not exempt the purchaser (Customer D) from being required to remit the local use taxes on the direct-to-home satellite service.

Customer D should report the stadium use tax due in the same manner as explained for Customer B in Answer 1.

Facts and Question 3:

- Company E, a direct-to-home satellite service provider, provides direct-to-home satellite service to Customer F, located in Milwaukee, Wisconsin.
- Company E charges Customer F the 5% Wisconsin state sales or use tax, but does not charge Customer F the 0.5% Milwaukee County sales or use tax or the 0.1% special district (stadium) sales or use tax.

What is the proper Wisconsin sales and use tax treatment of this transaction?

Answer 3:

Wisconsin Sales and Use Tax Treatment for Company E

Company E is required to collect and remit the 5% Wisconsin state sales or use tax on the charge to Customer F for the direct-to-home satellite service.

Company E is not required to collect the 0.5% county tax or the 0.1% stadium tax on the charge to Customer F, because the county tax and the stadium tax are "local taxes" which, under sec. 602 of Federal Public Law 104-104, Company E is exempt from the requirement of collecting and remitting.

Wisconsin Sales and Use Tax Treatment for Customer F

Customer F is required to remit the 0.5% county use tax and the 0.1% stadium use tax imposed under sec. 77.71(2), Wis. Stats., as amended by 1995 Wisconsin Act 56, to the Department of Revenue. Section 602 of Federal Public Law 104-104 only exempts the direct-to-home satellite service provider from the requirement to collect and remit local taxes on the direct-to-home satellite service. It does not exempt the purchaser (Customer F) from being required to remit the local use taxes on the direct-to-home satellite service.

Customer F should report both the county use tax and the stadium use tax due in the same manner as explained for Customers B and D in Answers 1 and 2. □