Number 111 October 1998



Wisconsin TAX BULLETIN



Getting Ready for Next Tax Season

See articles on pages 1 to 6

New Laws

The following are brief descriptions of two new Wisconsin laws which make changes to the sales and use tax and alcohol beverages provisions administered by the Department of Revenue:

Late Filing Fee (1997 Act 314, amend sec. 77.60(2)(intro.), effective for returns filed for periods beginning on or after January 1, 1999.) This new law provides that the late filing fee which applies to Wisconsin sales and use tax returns shall not apply to returns not timely filed because of reasonable cause and not because of neglect. (Also see Section III, "Application of \$10 Late Filing Fee," in the *Sales and Use Tax Report* on pages 43 and 44 of this Bulletin, for additional information.)

Penalties for Providing Alcohol (1997 Act 337, create sec. 125.07(1)(b)6, effective July 16, 1998.) This new law limits the imposition of penalties for providing alcohol beverages to underage persons. The analysis prepared by the

Wisconsin Legislative Reference Bureau for this bill indicates the intent is to provide that penalties with respect to providing alcohol beverages to underage persons may be imposed against either a retail establishment or the individual who dispensed the alcohol, but not against both.

Eau Claire and Washington Counties Adopt County Tax

Effective January 1, 1999, the county sales and use tax will be adopted by Eau Claire and Washington Counties. This brings to 51 the number of counties that have adopted the 1/2% county tax.

Information explaining how the county tax applies to retailers and other persons will be sent to retailers in the December 1998 *Sales and Use Tax Report.*

Avoid Penalty — Pay Sales and Use Taxes on Time

Failure to timely pay sales and use taxes can result in a criminal conviction. You are guilty of theft if you collect state, county, and stadium sales and use tax moneys from a consumer, user, or purchaser, and you –

 intentionally fail or refuse to pay these tax moneys to the Depart-

- ment of Revenue by the due date for payment, or
- fraudulently withhold, appropriate, or use these tax moneys.

If the amount involved is more than \$1,000, the theft is a felony under sec. 943.20, Wis. Stats.

Payment to creditors in preference to the payment of the tax moneys to the Department of Revenue is prima facie evidence of an intent to fraudulently use these tax moneys.

Avoid the problem and pay your taxes by the due date. \Box

Sales and Use Tax Report Mailed

The September 1998 Sales and Use Tax Report (3-98) contains a number of articles regarding sales and use tax issues. This Report was sent in late September and early October to all persons registered for Wisconsin sales and use tax purposes. A copy of the Report appears on pages 43 and 44 of this Bulletin.

Form Changes for 1998

Following are brief descriptions of the major changes to the Wisconsin individual income tax forms for 1998.

• Form 1 is expanded to three pages to allow space for new

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credits and to expand entry areas.

- Schedules 1 and 2 for additions and subtractions, previously located on the back of Form 1, are eliminated. The various additions (e.g., state and municipal bond interest) and subtractions (e.g., state income tax refunds) are now on page 1 of the form.
- Schedules for computing the married couple credit and itemized deduction credit are moved to page 3 of Form 1.

- The area for entering tax district and school district information is moved to page 2 of Form 1.
- Check boxes are added to Forms

 1, 1A, WI-Z, and 1NPR for indicating whether the taxpayer earned wages in Illinois while a Wisconsin resident. Space is also provided for entering the amount of such income.
- A line is added to Forms 1, 1A, WI-Z, and 1NPR for claiming the working families tax credit.

- A line is added to Forms 1 and 1NPR for claiming the manufacturer's sales tax credit.
- The refund and estimated tax offset area on Forms 1, 1A, and 1NPR is revised to conform to the format used on the federal Forms 1040 and 1040A. Separate lines are provided for entering the total amount overpaid, the portion of the overpayment to be refunded, and the portion to be applied to the next year's estimated tax.
- Space is provided on Form 1 for taxpayers to enter their daytime telephone number.
- A line is added to Forms 1A and 1NPR for interest paid on student loans. This conforms to changes made on the federal forms.
- The temporary recycling surcharge is reduced to 0.2173% of net business income.
- The amount of qualified earned income used to compute the married couple credit is reduced to \$14,010, and the rate of credit is increased to 2.17%. This results in a maximum credit of \$304.

Preliminary copies of the 1998 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 45 to 58 of this Bulletin. The copies are subject to further revision.

Preliminary copies of other Wisconsin income tax forms are available from the department's Internet website at: http://www.dor.state.wi.us.



Do You Need a Speaker?

Are you planning a meeting or training pro-

gram? The Department of Revenue's Speakers Bureau provides speakers to business, community, and educational organizations.

Department representatives are available to speak on a variety of topics that can be targeted toward your group's particular areas of interest, including:

- New sales/use, income, and corporate tax laws.
- How sales tax affects contractors, manufacturers, nonprofit organizations, or businesses in general.
- What to expect in an audit.
- Common errors discovered in audits.
- Manufacturing property assessment.
- Homestead credit.

To arrange for a speaker, please write to Wisconsin Department of Revenue, Speakers Bureau, P.O. Box 8933, Madison, WI 53708-8933, or you may call (608) 266-1911. □

New Working Families Tax Credit

A new credit, called the working families tax credit by the Wisconsin Legislature, is available beginning on 1998 income tax returns.

The credit is available to full-year residents of Wisconsin who have Wisconsin adjusted gross income below certain amounts. Both single and married persons are eligible for the credit. However, the credit is not available to a person who may be

claimed as a dependent on another taxpayer's income tax return.

You do not have to have income from wages or be self-employed to qualify for the credit. You may qualify for the credit even if all of your income is from, for example, interest, dividends, or pensions and annuities.

The credit eliminates the tax for persons who have Wisconsin adjusted gross income of less than \$9,000 (\$18,000 if married filing a joint return). The credit is then phased out over the next \$1,000 of income so that persons who have Wisconsin adjusted gross income of \$10,000 or more (\$19,000 or more if married filing a joint return), are not eligible for the credit.

The credit may be claimed on the Wisconsin Form 1, 1A, WI-Z, or 1NPR individual income tax return.□

Manufacturer's Sales Tax Credit Available for 1998

Beginning with the 1998 taxable year, the manufacturer's sales tax credit is available to individuals (including partners and tax-option (S) corporation shareholders), estates, and trusts.

The credit is equal to the Wisconsin state, county, and stadium sales and use taxes paid on fuel and electricity consumed in manufacturing tangible personal property in Wisconsin. For partners or tax-option (S) corporation shareholders, the partnership or corporation must calculate the amount of the credit which may be claimed by each partner or shareholder.

There is a limit on how much credit may be claimed on the return each year. The credit may be offset only against the tax on the business operations in which the fuel and electricity were consumed. Unused credits may be carried forward and credited against taxes otherwise due for the following 15 years to the extent not offset by taxes otherwise due in all intervening years.

Lines are provided on the Wisconsin Forms 1 and 1NPR for claiming the credit. A new schedule, Schedule MS titled *Manufacturer's Sales Tax Credit*, must be completed by all claimants and attached to Form 1 or Form 1NPR. A copy of Schedule MS is reproduced on pages 59 and 60 of this Bulletin.

Motor Vehicle Dealers' Measure of Use Tax Increased to \$104

Wisconsin licensed motor vehicle dealers are permitted to report use tax on a certain dollar amount per plate per month for the use of motor vehicles assigned to certain employes.

Effective January 1, 1999, the amount subject to use tax is increased from \$102 to \$104 per plate per month. (Note: The use tax per plate per month is not \$104. Rather, \$104 is multiplied by the use tax rate [5%, 5.1%, 5.5%, or 5.6%] to arrive at the use tax due per plate per month.)

The reason for the increase to \$104 per plate is that sec. 77.53(1m)(a), Wis. Stats. (1995-96), as amended by 1997 Wisconsin Act 27, requires that the Department of Revenue annually adjust the amount subject to use tax to reflect the annual percentage change in the U.S. Consumer Price Index for All Urban Consumers, U.S. City Average, as determined by the U.S. Department of Labor for the 12 month period ending June 30. The percentage change

for the period July 1997 to June 1998 was 1.8% (\$102 x 1.018 = \$104 rounded to the nearest whole dollar).

Information or Inquiries?

Listed below are telephone numbers to call if you wish to contact the Department of Revenue about any of the taxes administered by the Income, Sales, and Excise Tax Division. A comprehensive listing of telephone numbers and addresses appears in *Wisconsin Tax Bulletin* 107 (April 1998), pages 35 to 38.

Madison — Main Office Area Code (608)

| Alea Code (000) |
|----------------------------------|
| Appeals |
| Audit of Returns: Corpora- |
| tion, Individual, |
| Homestead 266-2772 |
| Beverage |
| Cigarette, Tobacco Prod- |
| ucts |
| Copies of Returns 267-1266 |
| Corporation Franchise and |
| Income |
| Delinquent Taxes 266-7879 |
| Electronic Filing |
| Estimated Taxes |
| Fiduciary, Estate |
| Forms Request: |
| Taxpayers 266-1961 |
| Practitioners 267-2025 |
| Fax-A-Form |
| Homestead Credit 266-8641 |
| Individual Income |
| Motor Vehicle Fuel 266-3223 |
| Refunds |
| Sales, Use, Withholding 266-2776 |
| TTY |
| District Offices |
| Appleton (920) 832-2727 |
| Eau Claire |
| Milwaukee: (713) 830-2811 |
| General(414) 227-4000 |
| Refunds |
| |
| TTY (414) 227-4147 |

Paying Taxes by Electronic Funds Transfer

Administrative rules are being developed to make the Electronic Funds Transfer (EFT) automated payment method mandatory in 1999 for certain payments of corporation franchise and income tax, individual and fiduciary income tax estimated tax payments, income tax withholding, fermented malt beverages tax, distilled spirits and wine tax, tobacco products tax, cigarette tax, alternate fuels tax, general aviation fuel tax, motor vehicle fuel tax and petroleum inspection fees, and sales and use tax.

The EFT payment method may be voluntarily used now to pay all of the above-listed taxes except sales and use tax. The department plans to offer the EFT payment method for sales and use tax payments in 1999 and is working with the Department of Workforce Development to allow for unemployment insurance to be paid using EFT.

Advantages of using EFT

EFT eliminates the need for writing and processing paper checks and filling out payment vouchers. Funds and payment information are transferred electronically through the Automated Clearing House (ACH) network. Making a tax payment using EFT is as easy as a toll-free telephone call.

The payer has more control over the payment when EFT is used. There is no need to rely on the post office for timely delivery of the payment. When the transaction is initiated at least one business day before the due date, it will be received on time.

EFT is secure and safe. All transactions are governed by strict,

nationally established security procedures. EFT payments occur between financial institutions and only at the payer's request. Not one EFT payment has ever been lost, and a confirmation number is available immediately as proof of payment.

Additional information available

For more information about EFT, contact your financial institution, write to Wisconsin Automated Clearing House Association (WACHA), 16655 W. Bluemound Road, Suite 370, Brookfield, WI 53005, or call or e-mail WACHA at (414) 796-0252 or WACHA@execpc.com.

If you have questions specific to the department's EFT program, call the department's EFT information line in Madison at (608) 264-9918 or write to EFT Unit, Wisconsin Department of Revenue, P.O. Box 8912, Madison, WI 53708-8912.

To request EFT registration forms and instructions, write to Forms Request Office, Wisconsin Department of Revenue, P.O. Box 8903, Madison, WI 53708-8903, or call (608) 266-1961, and request the EFT registration packet. Provide your name, address, and federal employer identification number (FEIN), as the department plans to provide personalized registration materials in late 1998.

Wisconsin Publication 118, *Electronic Funds Transfer Guide*, provides information about the ACH Credit NACHA Format Requirements. For information about how to obtain this publication, see the article titled "Tax Publications Available" on page 8 of this Bulletin.

Guidelines for Substitute Tax Forms

Tax returns may generally be filed on forms that have been reproduced or on substitute forms that have been approved by the department. However, certain guidelines must be followed to ensure that the reproduced or substitute forms are compatible with the department's processing system.

A copy of the "Guidelines for Reproduced and Substitute Tax Forms" appears on pages 61 and 62 of this Bulletin.

Forms and Publications Available by Fax

The Wisconsin Department of Revenue offers a Fax-A-Form document retrieval system. This retrieval system enables taxpayers and tax practitioners to obtain tax forms and publications via their facsimile machine or fax modem.

What is Available Via Fax-A-Form?

Wisconsin individual income, homestead credit, farmland preservation credit, partnership, corporation, estate, fiduciary income, sales and use, withholding, and alcohol beverage tax forms are available, along with the instructions for the forms. In January 1999, tax forms for the years 1995, 1996, 1997, and 1998 will be available.

Publications published by the department are also available. See the article titled "Tax Publications Available" on page 8 of this Bulletin for a list of the publications.

The catalog of retrieval codes for the forms and publications is updated throughout the year as forms and

publications are added and revised. For updated information, order the current catalog using Fax-A-Form.

How Does it Work?

- From the handset on your fax machine or the touch-tone keypad of your fax modem call the Fax-A-Form telephone number (608) 261-6229 (at this point do not enter "start" on your fax machine).
- If you have a newer model fax machine without a handset, you may use the keypad by pressing the "Hook Button," if tones are transmitted; if tones are not transmitted you must connect a touch-tone telephone to your fax machine to retrieve a document.
- Follow the voice prompts, then use the touch-tone keypad on your fax machine or telephone to enter the proper retrieval codes for the items desired.
- Receive the items you select, via your fax machine, by pushing the "start," "send," or "copy" button of your fax machine (on most fax machines this is the "start" button). Fax modem users will need to click on manual receive for their software. The handset of your system must stay off the hook the entire time the forms are being faxed to you.

When Can Fax-A-Form Be Used?

The Fax-A-Form retrieval system is available 24 hours a day, 7 days a week.

How Much Does it Cost?

The Department of Revenue does not charge a fee for using the Fax-A-Form service. Your only costs are the normal telephone charges, plus fax machine operating costs, if applicable.

Questions?

If you have other questions about Fax-A-Form, you may call the department's Fax-A-Form coordinator, at (608) 267-2025. □

1998 Package WI-X Available in January

Wisconsin's Package WI-X will be available by January 31, 1999. Package WI-X will contain actual size copies of most 1998 Wisconsin individual and fiduciary income tax, corporation franchise and income tax, partnership, estate tax, motor vehicle fuel tax, sales and use tax, and withholding tax forms.

The cost of the 1998 Package WI-X is \$7.00 plus sales tax. It may be ordered on the bulk order blank (Form P-744). The bulk order blank is being mailed in October. See the following article titled "Tax Form Order Blanks Mailed," for more information on bulk orders.

If you do not receive an order blank and want to purchase copies of 1998 Package WI-X, mail your request indicating the number of copies, along with the amount due, to Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 53708-8903. □

Tax Form Order Blanks Mailed

During October, the department is mailing order blanks (Form P-744) to 9,000 tax preparers. Use these original order blanks (not copies) to request bulk orders of 1998 Wisconsin tax forms that require payment. Forms that do not require payment are not listed on the order blank.

Some of the forms you order will be accompanied by additional information. For example, your order will include instructions for the forms you request; Schedules 2K-1 and WD for Form 2 will be included with fiduciary Form 2 orders; and Schedules 3K-1 will be included with partnership Form 3 orders.

The department is also mailing order blanks (Forms P-744b and P-744L) to banks, post offices, and libraries for their use in requesting bulk orders of 1998 Wisconsin income tax forms. No charge is made for forms used for distribution to the general public (for example, in a bank, library, or post office).

If you do not receive an order blank by October 31, 1998, you may request one by: contacting any department office; writing to Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 53708-8903; or calling (608) 267-2025.

Place your order as early as possible after receiving the order blank. Orders are expected to be filled in late December and early January.

As an alternative to ordering forms, most forms in Package WI-X may be reproduced (see the "Guidelines for Reproduced and Substitute Tax Forms" on page 61 of this Bulletin for a listing of forms that may not be reproduced). Package WI-X will be mailed separately in late January.

Magnetic Media Filing Required for Some Forms

Employers and payors may be required to file wage statements and information returns on magnetic media with the Wisconsin Department of Revenue. Wisconsin magnetic media filing is required if all of the following apply:

- Comparable wage statements or information returns are required to be filed on magnetic media with the Internal Revenue Service or Social Security Administration.
- The income on the form is required to be reported to Wisconsin.
- The number of any one type of form required to be filed with Wisconsin is 250 or more.
- The Combined Federal/State Filing Program is not being used.
- No waiver has been granted by the department.

Wisconsin Publication 509, Filing Wage Statements and Information Returns on Magnetic Media, provides more information about magnetic media filing. For information about how to obtain this publication, see the article titled "Tax Publications Available" on page 8 of this Bulletin.

IRS 1998 Mileage Rates Apply for Wisconsin

The 1998 optional standard mileage rates specified by the Internal Revenue Service (IRS) for computing automobile expenses for business, charitable, medical, and moving expense purposes also apply for Wisconsin.

For 1998 the IRS increased the business standard mileage rate from 31.5ϕ per mile to 32.5ϕ per mile for all business miles driven. The 32.5ϕ per mile rate is allowed without regard to whether the automobile was previously considered fully depreciated.

If the standard mileage rate of 32.5¢ per mile is used, depreciation is considered to be allowed at 12¢ per mile for 1998, the same rate as for 1997. However, no portion of the 32.5¢ per mile rate is considered to be depreciation after the adjusted basis of the automobile reaches zero.

For 1998 the mileage rate allowed for calculating automobile expenses for charitable deduction purposes is increased from 12¢ per mile to 14¢ per mile. The rate for medical expense and moving expense deductions remains at 10¢ per mile.

Question and Answer

I put \$2,000 into a Roth IRA. Under federal law, the interest or dividends earned on the amount in the Roth IRA will be tax-free when I withdraw them, assuming I will meet certain conditions. Does this also apply for Wisconsin?

Yes. Wisconsin has adopted the Roth IRA provisions. A distribution from a Roth IRA that is exempt from federal income tax is also exempt from Wisconsin income tax.

I plan to roll over my ordinary IRA to a Roth IRA. I will make this rollover before January 1, 1999, so that even though the distribution from my ordinary IRA is taxable, I will be able to include the amount of the distribution in federal income ratably over a four-tax-year period. Does this also apply for Wisconsin?

A Yes. The distribution from your ordinary IRA will be taxable by Wisconsin over the same four-tax-year period as for federal tax purposes. □

Focus on Publications: Retirement Benefits

Are retirement benefits exempt from Wisconsin income tax? Does Wisconsin tax social security benefits?

The new Wisconsin Publication 126, *How Your Retirement Benefits are Taxed*, answers these questions and many others.

A copy of Publication 126 appears on pages 63 to 74 of this Bulletin. For information about how to obtain department publications, see the article titled "Tax Publications Available" on page 8 of this Bulletin.

Adamczyk Guilty of Theft, Tax Fraud

Donna M. Adamczyk, 42, a former Wisconsin Electric Power Company employe in Milwaukee, pleaded guilty in August 1998, to two counts of theft for stealing more than \$775,000 from the company in 1996 and 1997. She also pleaded guilty to one count of filing a fraudulent income tax return. Adamczyk, who worked for the company for 23 years, faces up to 25 years in prison.

The tax charge concerns Adamczyk underreporting her 1996 income by more than \$218,400, thus shaving more than \$15,000 from her tax bill. For that year, Adamczyk listed her legal income from Wisconsin Electric at \$36,654, failing to disclose any of the stolen funds.

William J. Foley, 55, Milwaukee, was found guilty in August 1998, on seven counts of theft of Wisconsin sales taxes totaling \$13,237. Mil-

waukee County Circuit Court Judge Bonnie L. Gordon pronounced him guilty after he pleaded no contest to each count.

Foley founded Suburpia Submarine Sandwich Shoppes in the late 1960s and operated numerous restaurants in the Milwaukee and Madison areas throughout the 1970s, before the company went bankrupt in 1981. Foley's theft of state funds took place in 1991 and 1992 after he had resurrected the Suburpia business under the name of Culinary Gourmets, Inc. He operated five locations throughout the Milwaukee area.

During 1991 and 1992, Foley collected taxes from the sale of food and did not remit the money to the Department of Revenue. He also did not file state sales tax returns relating to this operation, which would have showed that he made sales of over \$264,000 during this time period.

Foley faced up to 63 months in jail and \$70,000 in fines. In addition to the criminal penalties, Wisconsin law provides for substantial civil penalties on the civil tax liability. Assessment and collection of the tax, penalty, and interest due follows the conviction for criminal violation.

Lori A. Krueger, 28, formerly of Medford and Hudson, was charged in August 1998, with five felony income tax violations. The criminal complaint alleges that she filed five fraudulent claims for earned income credit on original 1994, 1995, and 1996 Wisconsin income tax returns and amended 1995 and 1996 Wisconsin income tax returns.

According to the complaint, Krueger filed a 1994 claim for the earned income credit using false names and

a false wage statement, Form W-2. She filed fraudulent 1995 and 1996 claims for Wisconsin earned income credits in her own name, based on false Form W-2 documents. In addition, Kreuger filed amended 1995 and 1996 returns which still claimed earned income credits based on amended Form W-2s from the same fictitious employer.

If convicted on all five counts, Krueger faces a maximum penalty of up to 25 years imprisonment, fines of up to \$50,000, or both, together with the costs of prosecution.

Wesley Bryant, 38, Milwaukee, was charged in August 1998, by the Milwaukee County District Attorney's Office, with two counts of theft of state sales tax, two counts of failure to file Wisconsin income tax returns, and obstructing an officer. The criminal charges resulted from a joint investigation by the Fraud Unit of the Wisconsin Department of Revenue and the Milwaukee Police Department.

According to the criminal complaint, Bryant operated First Class Service, a business which purchased junk automobiles and resold them as scrap. A review of the records by the Department of Revenue showed that the business collected sales taxes in 1995 and 1996 but did not remit the taxes. In addition, the complaint alleges that Bryant failed to file Wisconsin income tax returns for 1995 and 1996, and that he had income in those years which required him to file returns.

If convicted on all five charges, Bryant faces a maximum penalty of five years imprisonment, fines of up to \$50,000, or both, together with the costs of prosecution.



Wanted: Your Comments About the

Wisconsin Tax Bulletin

The Wisconsin Tax Bulletin (WTB) is published to provide tax information to **YOU**, the readers. To make the WTB more useful, the department is seeking suggestions for items that may be of interest to you, and ways to make the WTB more valuable to you.

How could the department improve on the information it publishes? What topics do you want covered or expanded? Do you have particular likes or dislikes about the WTB? Do you have ideas, comments, or suggestions you'd like to share?

Please take a few moments to give us your comments or ideas, and be a part of improving *your* WTB. Send your comments or ideas to Mark Wipperfurth, Wisconsin Department of Revenue, Administration Technical Services, P.O. Box 8933, Madison, WI 53708-8933. If you prefer, you may fax your comments to him at (608) 261-6240, or you may call him at (608) 266-8253. We'd like to hear from you!

Make Your Research Easier

Are you looking for an easy way to locate reference material to research a Wisconsin tax question? The Wisconsin Topical and Court Case Index may be just what you need.

This two-part index will help you find reference material relating to income, franchise, withholding, sales/use, estate, and excise taxes.

The "Topical Index" portion lists by tax type, alphabetically by subject, references to Wisconsin statutes, administrative rules, tax releases, private letter rulings, publications, *Sales and Use Tax Reports*, Attorney General opinions, and *Wisconsin Tax Bulletin* articles.

The "Court Case Index" lists by tax type, alphabetically by subject, decisions of the Wisconsin Tax Appeals Commission, Circuit Court, Court of Appeals, and Wisconsin Supreme Court.

The Wisconsin Topical and Court Case Index is available by subscription for \$18 per year, plus sales tax. This includes a volume published in January and an addendum published in June. To order your copy, complete the order blank on page 75 of this Bulletin.

Wisconsin Tax Bulletin Annual Index Available



Once each year the *Wisconsin Tax Bulletin* includes an index of materials that have appeared in past Bulletins. The latest index available appears in *Wisconsin Tax Bulletin* 107 (April 1998), pages 43 to 69. It includes information for issues 1 to 102 (July 1997), except the court case section, which lists all cases summarized in issues 1 to 107.

Tax Publications Available

Listed below are nearly 60 publications which are available, free of charge, from the Department of Revenue. Copies are available at any department office, or by mail, fax, or (in many cases) the Internet.

By Mail

Write to Wisconsin Department of Revenue, Forms Request Office, P.O. Box 8903, Madison, WI 537088903; call (608) 266-1961; or fax a request to (608) 261-6239.

Via Your Fax Machine

Use the department's Fax-A-Form system by calling (608) 261-6229 from a fax telephone and entering the retrieval code "10" plus the publication number.

Via the Internet

Access the department's World Wide Website at http://www.dor.state.wi.us, and click

Income and Franchise Taxes

on "Forms and Publications."

- 102 Wisconsin Tax Treatment of Tax-Option (S) Corporations and Their Shareholders (12/97)
- 103 Reporting Capital Gains and Losses for Wisconsin by Individuals, Estates, Trusts (10/97)
- 104 Wisconsin Taxation of Military Personnel (10/98)
- 106 Wisconsin Tax Information for Retirees (10/98)
- 109 Tax Information for Married Persons Filing Separate Returns and Persons Divorced in 1997 (10/97)
- 112 Wisconsin Estimated Tax and Estimated Surcharge for Individual, Estates, Trusts, Corporations, Partnerships (11/97)
- 113 Federal and Wisconsin Income Tax Reporting Under the Marital Property Act (10/97)
- 116 Income Tax Payments Are Due Throughout the Year (12/95)
- 119 Limited Liability Companies (LLCs) (12/97)

- 120 Net Operating Losses for Individuals, Estates, and Trusts (11/97)
- 121 Reciprocity (12/97)
- 122 Tax Information for Part-Year Residents and Nonresidents of Wisconsin for 1997 (11/97)
- 123 Business Tax Credits for 1997 (12/97)
- 125 Credit for Tax Paid to Another State (11/97)
- 126 How Your Retirement Benefits Are Taxed (9/98)
- 600 Wisconsin Taxation of Lottery Winnings (10/97)
- 601 Wisconsin Taxation of Pari-Mutuel Wager Winnings (10/97)

Sales and Use Taxes

- 200 Electrical Contractors How Do Wisconsin Sales and Use Taxes Affect Your Business? (9/98)
- 201 Wisconsin Sales and Use Tax Information (7/98)
- 202 Sales and Use Tax Information for Motor Vehicle Sales, Leases, and Repairs (9/98)
- 203 Sales and Use Tax Information for Manufacturers (12/94)
- 205 Use Tax Information for Individuals (2/97)
- 206 Sales Tax Exemption for Non-profit Organizations (9/90)
- 207 Sales and Use Tax Information for Contractors (3/98)
- 210 Sales and Use Tax Treatment of Landscaping (5/94)
- 211 Cemetery Monument Dealers -How Do Wisconsin Sales and Use Taxes Affect You? (3/97)

- 212 Businesses: Do You Owe Use Tax on Imported Goods? (2/97)
- 213 Travelers: Don't Forget About Use Tax (2/97)
- 214 Businesses: Do You Owe Use Tax? (2/97)
- 216 Filing Claims for Refund of Sales or Use Tax (9/95)
- 217 Auctioneers How Do Wisconsin Sales and Use Taxes Affect Your Operations? (3/96)
- 219 Hotels, Motels, and Other Lodging Providers - How Do Wisconsin Sales and Use Taxes Affect Your Operations? (6/96)
- 220 Grocers How Do Wisconsin Sales and Use Taxes Affect Your Operations? (8/96)
- 221 Farm Suppliers and Farmers -How Do Wisconsin Sales and Use Taxes Affect Sales to Farmers? (4/97)
- 222 Motor Vehicle Fuel Users: Do You Owe Use Tax? (4/98)
- 223 Bakeries How Do Wisconsin Sales and Use Taxes Affect Your Business? (2/98)

Other Taxes and Credits

- 400 Wisconsin's Temporary Recycling Surcharge (12/97)
- 403 Premier Resort Area Tax (2/98)
- 410 Local Exposition Taxes (11/94)
- 503 Wisconsin Farmland Preservation Credit (12/97)
- 508 Wisconsin Tax Requirements Relating to Nonresident Entertainers (8/94)
- W-166 Wisconsin Employer's Withholding Tax Guide (3/96)

Audits and Appeals

- 501 Field Audit of Wisconsin Tax Returns (2/96)
- 505 Taxpayers' Appeal Rights of Office Audit Adjustments (6/96)
- 506 Taxpayers' Appeal Rights of Field Audit Adjustments (5/97)
- 507 How to Appeal to the Tax Appeals Commission (10/97)

Other Topics

- 111 How to Get a Private Letter Ruling From the Wisconsin Department of Revenue (10/97)
- 114 Wisconsin Taxpayer Bill of Rights (11/97)
- 115 Handbook for Federal/State Electronic Filing (12/97)
- 117 Guide to Wisconsin Information Returns (10/98)
- 118 Electronic Funds Transfer Guide (4/96)
- 124 Petition for Compromise of Delinquent Taxes (4/97)
- 130 Fax A Form (9/97)
- 401 Extensions of Time to File (11/97)
- 500 Tax Guide for Wisconsin Political Organizations and Candidates (1/97)
- 502 Directory of Wisconsin Tax Publications (6/98)
- 504 Directory for Wisconsin Department of Revenue (10/97)
- 509 Filing Wage Statements and Information Returns on Magnetic Media (3/94)
- 700 Speakers Bureau presenting . . . (2/93)



Over 1.8 Million Refunds Issued

More than 1.8 million income tax refunds were issued to taxpayers during January through July 1998 (primarily 1997 returns), for an average refund of \$331. The average refund for 1996 returns was \$313.

There were 2,744,800 Wisconsin individual income tax returns filed during the twelve months ending June 30, 1998. This compares to 2,612,900 returns for the prior year. The 2,744,800 returns, which included joint tax returns, were filed by 3,880,700 individuals.

An itemized deduction credit was claimed by 32% of the taxpayers on their 1997 returns. The average credit was \$431, compared to \$411 on 1996 returns.

There were 179,600 homestead credit claims filed during the year, and the average credit was \$448. This compares to 201,000 homestead credit claims averaging \$448 for the prior year. About 47% of the claimants were age 65 or older, 52% were renters, and 48% were homeowners.

About 22,600 farmland preservation credit claims, averaging \$936 per claim, were filed during the year ending June 30, 1998. During the prior year, 23,200 farmland preservation credit claims were filed, and the average payment was \$1,208. □

Taxpayers Designate \$312,000 to State Election Campaign Fund

Wisconsin income tax returns include a box for taxpayers to designate \$1 to the State Election Campaign Fund.

During July 1997 to June 1998 (primarily 1997 tax returns), taxpayers designated \$311,954 to the election campaign fund on their Wisconsin tax returns. This compares to \$295,232 for the prior year.

Endangered Resources Contributions Total \$547.000

The 1997 Wisconsin income tax returns included a line for taxpayers to designate a contribution to the Wisconsin Endangered Resources Fund. These contributions help protect and care for Wisconsin's endangered species, nongame wildlife, and rare plant and animal habitats.

Donations to the Endangered Resources Fund can be made on both paper filed tax returns and electronically filed returns.

During July 1997 through June 1998 (primarily 1997 returns), 42,424 taxpayers contributed \$547,462 to the Endangered Resources Fund. This compares with 1996 income tax returns, where 44,269 taxpayers contributed \$565,760.

Administrative Rules in Process

Listed below are proposed new administrative rules and changes to existing rules that are currently in the rule adoption process. The rules are shown at their stage in the process as of October 1, 1998, or at the stage in which action occurred during the period from July 2 to October 1, 1998.

Each affected rule lists the rule number and name, and whether it is amended (A), repealed (R), repealed and recreated (R&R), or a new rule (NR).

To receive up-to-date administrative rules of the Department of Revenue, you can use the order blank on page 75 of this Bulletin to order the Tax section of the Wisconsin Administrative Code.

Rules Sent to Legislative Council Rules Clearinghouse

- 11.09 Medicines–A (8/31/98)
- 11.28 Gifts and other advertising specialties–A (8/31/98)

Rules Sent to Revisor - Notice Published

11.56 Printing industry–A (8-31-98)

Rules Being Reviewed Following Publication of Various Notices

- 1.12 Electronic funds transfer NR
- 1.13 Power of attorney-A
- 11.03 Elementary and secondary schools and related organizations-A
- 11.11 Industrial or governmental waste treatment facilities-A
- 11.12 Farming, agriculture, horticulture and floriculture-A
- 11.19 Printed material exemptions–A
- 11.26 Other taxes in taxable gross receipts and sales price–A
- 11.32 "Gross receipts" and "sales price" –A
- 11.33 Occasional sales-A
- 11.41 Exemption of property consumed or destroyed in manufacturing–A
- 11.68 Construction contractors-A
- 11.70 Advertising agencies–A
- 11.83 Motor vehicles–A □

Wisconsin Department of Revenue

Guidelines for Reproduced and Substitute Tax Forms

Certain guidelines must be followed for reproduced or substitute Wisconsin tax forms (including schedules). The purpose of these guidelines is to ensure that the reproduced or substitute forms are compatible with the department's processing system and present information in a uniform manner.

A *reproduced* tax form is a facsimile of the official form produced by photo-offset, photo-engraving, photocopying, or other similar process. Reproduced tax forms that deviate from the official forms are considered substitute tax forms. If the guidelines are followed, the department will accept reproductions of official forms without prior approval, except as indicated below.

Exceptions – The following forms may not be reproduced without prior approval by the department:

- Form 1-ES, Estimated Tax Voucher (Individuals)
- Form 3S-ES, Partnership Estimated Surcharge Voucher
- Form 4-ES, Estimated Tax Voucher (Corporations)
- Form WT-6, Withholding Tax Deposit Report
- Form ST-12, Sales and Use Tax Return
- Form 3, Claim for Motor Fuel Tax Refund
- Form 1A, Wisconsin Income Tax Return
- Form WI-Z, Wisconsin Income Tax Return
- Form 8453W, Wisconsin Income Tax Declaration for Electronic Filing

A *substitute* tax form is a form, other than the official department form, that is commercially typeset and printed or computer produced or computer programmed. Substitute tax forms must be submitted to the department for approval each year before release to users.

Following are guidelines for substitute and reproduced tax forms and schedules.

Size Reproduced or substitute forms must be the same size as the official forms, except that official forms which are 8" x 10?" may be printed on 8½" x 11" paper.

Grade of Paper Reproduced or substitute forms must be on paper of substantially the same weight and texture, and of a quality at least as good as that used in the official form.

Color of Paper and Ink White paper may be used for any official form printed on colored paper. Black ink may be substituted for colored ink. Forms that are scanned may require

shading when using black ink. This will be addressed during the approval process if applicable.

Two-Sided Forms Reproduced or substitute forms may be printed on one side or both sides of the paper.

Rounding Most Wisconsin individual income tax forms do not have a cents line; decimal points are used instead. The use of rounding must be indicated by entering only a decimal point after the last digit amount or by entering a decimal point followed by two zeros (e.g., two thousand dollars would be indicated as \$2,000. or \$2,000.00).

Spacing Substitute forms must be arranged in the same manner with the same spacing as the official forms. The official forms leave a specific amount of white space at the bottom of the forms (top portion of the forms in the case of Forms 1A, WI-Z, and 3 for partnerships and Schedule H). This space is used by the department and must be maintained on all substitute forms.

Signature When returns are reproduced, all required signatures on returns filed with the department must be original, affixed subsequent to the reproduction process. (Under certain conditions a fiduciary may use a facsimile signature.)

OCR Forms Although the department will approve substitute estimated tax vouchers (Forms 1-ES, 3S-ES, and 4-ES), it is preferred that taxpayers use the preprinted vouchers sent by the department. The department-printed vouchers reduce the chance of error in posting payments to the taxpayer's account and cost less to process than substitute forms.

The estimated tax vouchers have an optical character recognition (OCR) scan line which must be printed in machine-readable font. As a result of this, the following strict specifications are required to be met for substitute vouchers.

1. Document Specifications

- a. Size: Form 1-ES must be 8?" x 3?"; Form 3S-ES or 4-ES must be 8?" x 3?".
- b. Paperweight must be 20 pounds/500 sheets.
- c. Smoothness between 65 and 200 Sheffield units on both sides.
- d. Bottom edge must be perpendicular to within 2 degrees to the right-hand and left-hand edges.
- e. No tears are allowed on the right-hand and bottom edges. Any perforations for a snapset or stub must be on the topside or left-hand edges of the document.

f. The paper must be white, highly opaque and have a flat finish.

2. Scan Line Specifications

- a. The OCR line must be printed in OCR "A" font at a pitch of 10 characters per inch.
- b. The OCR line must be printed on each form.
- c. The right edge of the last character in the OCR line must be ? inch from the right-hand edge of the form.
- d. Form 1-ES: The bottom of the OCR print line must be ½ inch above the bottom edge and must be parallel to the bottom edge. The OCR line must center in a "clear band" ½ inch high centered on the OCR print line which must be free of extraneous print, dirt, carbon residue, and all foreign matter. The line of characters to be read must be printed within the "printing band," which is located in the center of the clear band. The printing band is 0.22 inches high.
- e. Form 3S-ES or 4-ES: The bottom of OCR print line must be ½ inch above the bottom edge and must be parallel to the bottom edge.
- f. The ink in the printed character image must absorb light in the 550 to 950 nm wavelength range. The ink must not spatter or smear.
- g. The OCR print line includes unique numbers assigned by the department. To obtain these numbers, contact: Nancy Peters-Wilson at (608) 266-2588 (Form 1-ES) or Kristine Yager at (608) 266-0800 (Form 4-ES or 3S-ES).

3. Miscellaneous

Snap-sets are acceptable provided the carbon interleaf (or carbonless treatment) does not extend into the bottom one inch of the document and all other specifications are met. For department approval of carbon interleaf and carbonless copy forms, we will require five *sets* of the intact proposed form to determine whether standards have been met.

4. Required Testing

For bank approval, 100 forms with the OCR line must be run through the bank equipment to make sure the read rate of the documents is acceptable. The forms submitted for testing must be actual printed copies (photocopies are not acceptable). Test forms should be submitted to the appropriate addresses as listed under "Approval of Substitute Forms.

Approval of Substitute Forms Substitute forms must be submitted to the department for approval. Substitute forms, including the OCR forms required for testing,

should be mailed to Wisconsin Department of Revenue as follows:

Individual Forms –

Nancy Peters-Wilson Processing Bureau P.O. Box 8903 Madison, WI 53708-8903

Fiduciary Forms -

Ruth Ann Malcolmsom Audit Bureau P.O. Box 8904 Madison, WI 53708-8904

Corporation Forms and Partnership Surcharge Forms –

Kristine Yager Processing Bureau P.O. Box 8908 Madison, WI 53708-8908

Forms 1CNP, 1CNS, 1CNA, and 1CND –

Jennifer Jones Processing Bureau P.O. Box 8912 Madison, WI 53708-8912

Partnership Forms –

Kristine Yager Processing Bureau P.O. Box 8903 Madison, WI 53708-8903

Sales Tax Forms -

Cynthia Walton-Jackson Compliance Bureau P.O. Box 8902 Madison, WI 53708-8902

Withholding Tax Forms -

Ruth Hartman Compliance Bureau P.O. Box 8902 Madison, WI 53708-8902



Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher Court.

The following decisions are included:

Individual Income Taxes

Dependent credit

Timothy C. deWerff, and Timothy
C. and Terri L. deWerff (p. 11)

Marital property
Werner W. Brandt and Elizabeth
Brandt (p. 12)

Native Americans — reservation of another tribe

Joan La Rock (p. 12)

Nonresident alien — joint return, standard deduction Shan and Vatsula Sivakumaran (p. 12)

Homestead Credit

Household income — nontaxable individual retirement account distributions

Beverly A. Yirkovsky (p. 13)

Property taxes accrued — co-ownership
Credit offset against state agency debts

Harvard P. Watkins (p. 14)

Corporation Franchise and Income Taxes

Loss deductions (prior law)
Interest on assessments and refunds

Madison Gas and Electric Company (p. 15)

Transitional rules — federalization Lincoln Savings Bank, S.A., f/k/a Lincoln Savings and Loan Association (p. 15) Transitional rules — stock purchase treated as asset purchase — 1987 and thereafter Amortization deductions

GFG Corporation (p. 16)

Sales and Use Taxes

Boats, vessels and barges — nonresident purchase

Raymond and Patricia Wehrs (p. 18)

Common or contract carriers

Superior Hazardous Waste Group,
Inc., f/k/a Alliance Transportation
Services, Inc. (p. 18)

Exemptions — telephone company central office equipment

Ameritech Mobile Communications,
Inc. (p. 19)

Officer liability

Joseph A. Balestrieri (p. 19)

Retailer — defined

American Heart Association/ Wisconsin Affiliate, Inc. (p. 19)

Time-share property

Telemark Development, Inc. (p 20)

Sales and Use Taxes, and Withholding of Taxes

Officer liability *Lisa S. Green* (p. 20)

INDIVIDUAL INCOME TAXES

Dependent credit. Timothy C. de Werff, and Timothy C. and Terri L. de Werff vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 20, 1998). The issue in this case is whether the taxpayers are entitled to claim dependent credits for two of Mr. de Werff's children by a previous marriage, for 1992 through 1995, inclusive. This matter involves two separate assessments for additional income taxes, one against taxpayer Timothy C. de Werff and a second against both taxpayers.

Timothy C. de Werff and his former wife, Cynthia M. de Werff, were divorced by order of the Waukesha County Circuit Court (the "Court") as of April 7, 1989. However the judgment of divorce was not entered until January 31, 1992. At the time of the judgment, there were four minor children of the marriage: Christina, Sean, Michele, and Cassandra.

In an order entered September 4, 1991, and again in the divorce judgment, the Court, among other things, found that Timothy de Werff was current on his child support obligation, and awarded him dependent credits associated with Christina and Sean. On June 23, 1992, the Court entered an amended judgment of divorce which added the proviso that he could claim the exemptions only if all child support payments were paid on time in that year. However, following a hearing on July 28, 1992, the Court held that he was entitled to the dependent credits even if he was not current on his child support obligations. Furthermore, during the years at issue, Timothy de Werff was never delinquent on his child support obligations.

During each of the years at issue, the amount of support provided by Timothy de Werff has never been less than \$5,500 for the four minor children of the marriage. Timothy de Werff claimed dependent credits associated with Christina and Sean for 1993, and both taxpayers claimed the dependent credits for 1992, 1994, and 1995.

Cynthia M. de Werff claimed dependent credits for all four minor children of the marriage at issue for each of the four years at issue here. During each of the years at issue, she apparently refused to execute an IRS Form 8332 allocating to Timothy de Werff the dependent exemptions associated with Christina and Sean.

The department assessed both Cynthia M. de Werff and the taxpayers, in the alternative, for claiming dependent credits associated with Christina and Sean. Cynthia M. de Werff failed to appeal the assessment against her, and the assessment went delinquent. She may file a claim for refund until March 1999.

The assessments against the taxpayers disallowed dependent credits claimed by Timothy C. de Werff for 1993, and dependent credits claimed by both taxpayers for 1992, 1994, and 1995. The taxpayers filed a petition for redetermination objecting to both assessments, the department denied the petition for redetermination with regard to both assessments, and the taxpayers filed a timely petition for review with Commission.

The Commission concluded that the taxpayers, Timothy C. and Terri L. de Werff, are entitled to claim the

dependent credit for the years at issue for Christina and Sean because Timothy de Werff has paid more than \$600 toward the support of both children in each of the years at issue, and because the judgment of divorce, as amended, permits him to claim dependent credits for both children.

The department has not appealed this decision.

CAUTION: This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for the informational purposes only.

Marital property. Werner W. Brandt and Elizabeth Brandt vs. Wisconsin Department of Revenue (Court of Appeals, District I, February 17, 1998). This is an appeal by the taxpayers from a March 27, 1997 judgment of the Circuit Court for Milwaukee County, which affirmed an earlier decision of the Wisconsin Tax Appeals Commission. See Wisconsin Tax Bulletin 103 (October 1997), page 14, for a summary of the Circuit Court decision.

The only issue on appeal is whether Werner Brandt ("the taxpayer") is entitled to a capital loss carryforward for 1979, the year preceding his divorce from Melitta Brandt, because he and Melitta Brandt filed a joint return for 1979.

The taxpayer appeals from the Commission's determination that he was not entitled to certain capital loss carryforwards he had claimed on his tax returns for the years 1979 through 1989. The primary issue before the Commission was whether stock inherited by the taxpayer's former wife, Melitta Brandt, was jointly owned or individually owned by her. The Commission held that the stock was individually owned by

Melitta Brandt and disallowed the capital loss carryforwards.

On appeal, the taxpayer concedes that he was not entitled to the carry-forwards from 1980 through 1987 but argues that he is entitled to the capital loss carryforward for 1979.

The Court of Appeals concluded that the taxpayer is not entitled to a capital loss carryforward for 1979. Because he did not raise this argument before the Commission, he has waived his right to raise the argument. Before the Commission, the taxpayer never attempted to distinguish 1979 from the other years at issue. Rather, he argued that he enjoyed beneficial joint ownership of the stock when the stock was sold.

The taxpayers have not appealed this decision.

Native Americans—reservation of another tribe. Joan La Rock vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 11, 1998).

This decision was summarized in Wisconsin Tax Bulletin 110 (July 1998), page 14. That summary incorrectly stated that the taxpayer had not appealed the decision, which affirmed the department's assessment. The taxpayer has appealed the decision to the Circuit Court.

Nonresident alien — joint return, standard deduction. Shan and Vatsula Sivakumaran vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 22, 1998). The issues in this case are:

A. Whether the United States-Canada Income Tax Treaty applies to taxes imposed by Wisconsin. B. Whether Wisconsin statutes prohibiting nonresident aliens from filing a joint return and from claiming the standard deduction are unconstitutional under the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

The taxpayers are husband and wife, as well as citizens of Canada. They came to the United States in 1993, so that Mr. Sivakumaran could pursue his doctoral studies at the University of Wisconsin-Milwaukee (UWM). Mr. Sivakumaran has been employed as a Graduate Assistant at UWM; Mrs. Sivakumaran has been working for a private organization. They have two children.

In 1994, Mr. Sivakumaran earned \$10,616.31 income in Wisconsin, and Mrs. Sivakumaran earned \$10,802 income in Wisconsin. They filed separate 1994 Wisconsin and federal income tax returns, claiming \$10,000 exemptions under Article XV of the United States-Canada Income Tax Treaty. Each received a refund from the State of Wisconsin. Both taxpayers testified that their actions were based on advice from the Internal Revenue Service office in Milwaukee.

In 1995, Mr. Sivakumaran earned \$12,524.24 income in Wisconsin, Sivakumaran earned and Mrs. \$13,279.90. They filed separate reeach claiming \$10,000 turns. exemptions. About four months after filing their state returns, the taxpayers inquired about their expected refunds and learned that their returns were being audited. Thereafter, in September 1996, the taxpayers received an assessment from the department, which included taxes and interest from April 1995. The taxpayers promptly paid the amounts assessed but filed joint returns for 1994 and 1995, claiming a refund. The refund requests were denied, and they individually filed petitions for review with the Commission.

The Commission concluded as follows:

- A. The United States-Canada Income Tax Treaty does not apply to taxes imposed by the State of Wisconsin. Close examination of the text of the Treaty reveals that while the Treaty unquestionably affords protection to nonresident aliens subject to tax by either the United States or Canada, it does not apply to taxes imposed by American states or Canadian provinces unless those states or provinces have agreed to be bound by the terms of the Treaty. The taxes at issue here were not imposed by a Contracting State.
- B. Section 71.03(2)(d)2, Wis. Stats., which deprives a married person whose spouse is a nonresident alien the ability to file a joint return for income tax purposes, does not violate the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution because it follows the federal law, is rationally-based, and applies to American citizens and resident aliens as well as nonresident aliens. In addition. sec. 71.05(22)(b)1. Wis. Stats.. which deprives a nonresident alien of the ability to take the standard deduction for income tax purposes, does not violate that provision of the Constitution because it is rationallybased and follows federal law.

A presumption of constitutionality attaches to Wisconsin Statutes. The party challenging a legislative act must prove it unconstitutional beyond a reasonable doubt. All doubts as

to an act's constitutionality must be resolved in favor of upholding the act.

The presumption of constitutionality is particularly strong in the area of taxation. In this matter, with respect to nonresident aliens, Wisconsin law follows federal law on both joint returns and the standard deduction. Inasmuch as Wisconsin follows the relevant provisions of federal law on joint returns and standard deductions, and inasmuch as the federal provisions are long-standing and rationally conceived. the Commission could not find the Wisconsin provisions to be unconstitutional under the United States Constitution or the Wisconsin Constitution.

The taxpayers have not appealed this decision.

CAUTION: This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for informational purposes only.

HOMESTEAD CREDIT

Household income — nontaxable individual retirement account distributions. Beverly A. Yirkovsky, vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, June 23, 1998). The issue in this case is whether a nontaxable distribution from a nondeductible Individual Retirement Account must be included in housefor hold income purposes computing a Wisconsin homestead credit.

Beverly A. Yirkovsky ("the claimant") filed a 1996 Wisconsin income tax return which included Schedule H, indicating a homestead credit of \$516. The department disallowed the claimed homestead credit because the claimant had not included in her household income \$6,827 of nontaxable distributions which she received in 1996 from a nondeductible Individual Retirement Account (IRA).

The 1996 instructions for Schedule H specified that the following items, among others, must be added to Wisconsin adjusted gross income to determine household income for homestead credit calculation purposes:

Line 5 of Schedule 1 – Contributions to Individual Retirement Arrangements (IRAs) which were deducted or excluded from income on an income tax return.

Line 11e – The gross amount of all pensions and annuities received in 1996, including nontaxable IRA distributions.

The claimant relied on the instruction for line 5 in the 1996 homestead credit booklet rather than the instruction for line 11e when she filed her homestead credit claim. Instruction 5 specifies that nondeductible contributions to IRAs should not be included in the computation, but the claimant did not make a nondeductible contribution to an IRA in 1996. Instead, she received a nontaxable distribution from such an IRA, which is specifically covered by instruction 11e.

The Commission concluded that the department properly determined that the nontaxable distribution received in 1996 by the claimant from a non-deductible Individual Retirement Account was includible in her household income for purposes of computing the Wisconsin homestead credit.

The claimant has not appealed this decision.

CAUTION: This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for informational purposes only.

Property taxes accrued — co-ownership; Credit off-set against state agency debts. Harvard P. Watkins vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 29, 1998). The issues in this case are:

- A. Whether the department properly calculated the claimant's homestead credit for 1996.
- B. Whatever the size of the claimant's credit, whether it was properly intercepted and sent to the Wisconsin Department of Workforce Development instead of the claimant.

The claimant filed a 1996 homestead credit claim, which listed income of \$7,650 and property taxes of \$1,071.39; the claimant asserted that he had personally paid the property taxes. He claimed a homestead credit of \$860.

The department adjusted the claim to \$428, based on one-half of the property taxes, explaining that since his homestead was co-owned for 1996, he was allowed only his one-half share of the property tax. Moreover, the department applied the \$428 to the claimant's "delinquent account" with the Wisconsin Department of Workforce Development.

The claimant sent the department a timely petition for redetermination. This was denied in a Notice of Action which asserted that the claimant had failed to supply certain requested information. Thereafter, the claimant filed a timely appeal with the Commission.

In 1996 the claimant was married to Glennda M. Watkins, who was listed on official documents, including the property tax bill, as co-owner of the property. Glennda M. Watkins left the homestead and was not present there in 1996. Hence, the department was correct in asserting that because of his joint ownership, the claimant was entitled to claim only half of the property tax paid, even though he actually paid it all.

Wisconsin tax rules (sec. Tax 14.04(8)(b), Wis. Adm. Code) also permit the claimant to list as a "rent" payment 25% of the remaining half of the property tax paid. The department's calculation omitting this additional amount may have reflected a failure by the claimant to supply required information, but he has now provided evidence.

The department sent the \$428 credit to the Department of Workforce Development pursuant to a Tax Refund and Lottery Intercept. Hence, the claimant received none of the homestead credit personally. At the hearing, the claimant testified that he was not the father of children who precipitated the Tax Intercept order.

Although examining the legitimacy of Tax Intercept orders appears to be beyond the jurisdiction of the Tax Appeals Commission, the Commission did inquire about the basis of the Tax Intercept order. The Commission was informed by a case worker in Milwaukee County that in February 1998 a determination was made to lift the intercept because the claimant's liability was zero. The caseworker suggested that the claimant go to the Courthouse at 901 North 9th Street, Milwaukee, to make arrangements for getting a refund of the previously issued \$428 homestead credit.

The Commission concluded as follows:

- A. Unless the Commission has miscalculated the 1996 homestead credit, the claimant is entitled to an additional \$104 of homestead credit, based on allowable tax/rent of \$669.62, consisting of one-half of the property taxes, \$535.70, plus 25% of the balance as rent, or \$133.92.
- B. If, in fact, the tax intercept has been lifted, as noted, the additional credit should be forwarded directly to the claimant.

Neither the department nor the claimant has appealed this decision.

CAUTION: This is a small claims decision of the Wisconsin Tax Appeals Commission and may not be used as a precedent. This decision is provided for informational purposes only.

CORPORATION FRANCHISE AND INCOME TAXES

Loss deductions (prior law); Interest on assessments and refunds. Madison Gas and Electric Company vs. Wisconsin Department of Revenue (Circuit Court for Dane County, June 17, 1998). This is an appeal of the Wisconsin Tax Appeals Commission's December 15, 1997, decision. The first issue in this case is whether the department properly disallowed the taxpayer's deductions claimed in 1975, 1976, and 1977 concerning the line collapse in 1975. The second issue is whether the department erred when it failed to credit or offset the taxpayer's overpayment of 1978 taxes against amounts owed to the department as of the date of the overpayment. See Wisconsin Tax Bulletin 107 (April 1998), page 14, for a summary of the Commission's decision.

In an oral ruling, the Circuit Court held against the department and reversed the Commission's decision.

The department has appealed this decision to the Court of Appeals. \Box

Transitional rules federalization. Lincoln Savings Bank, S.A., f/k/a Lincoln Savings and Loan Association vs. Wisconsin Department of Revenue (Wisconsin Supreme Court, January 27, 1998). The taxpayer appealed a decision of the Court of Appeals, which reversed an order of the Circuit Court. The Circuit Court reversed a decision by the Wisconsin Tax Appeals Commission, which interpreted 1987 Wisconsin Act 27, sec. 3047(1)(a), to permit adjustment of bad debt reserves maintained by the taxpayer from 1962 until 1986, but not earlier, as a means of transitioning to the federalization of Wisconsin's income tax law. The Commission's interpretation upheld an assessment by the department of additional franchise taxes and interest against the taxpayer for the years 1987 to 1990, because the taxpayer had adjusted for bad debt reserves maintained before 1962. For summaries of the prior decisions, see Wisconsin Tax Bulletins 91 (April 1995), page 13, 95 (January 1996), page 27, and 101 (April 1997), page 15.

The material facts are not in dispute. Lincoln Savings Bank, S.A., formerly Lincoln Savings and Loan Association ("Lincoln"), is a state chartered savings bank and has been subject to an annual state franchise tax since 1962. Under this provision, every domestic or foreign corporation is required to pay an annual franchise tax based on its entire Wisconsin net income from the preceding taxable year. Lincoln became liable to pay the franchise tax after sec. 71.01(3)(a), Wis. Stats., was amended in 1961 to no longer ex-

empt savings and loan associations from taxation.

Thrift institutions like Lincoln maintain accounts known as bad debt reserves or allowances. Maintenance of a bad debt reserve is a system of income deferral and does not constitute a permanent income reduction. A thrift institution makes yearly additions or subtractions to its bad debt reserves utilizing a formula that accounts for prior writeoffs and reserve additions, and its current level of lending activity. Bad debt reserves form the basis for the bad debt deduction, the primary way in which thrift institutions have reduced their tax burden since 1951. when they lost their federal taxexempt status.

Both Wisconsin and federal tax laws permit thrift institutions to take bad debt deductions. The deduction amount is based on the amount of debt the thrifts can reasonably expect to become worthless during the tax year, and consequently lower their income tax liability. Prior to 1987, Wisconsin tax law established a specific mechanism for this deduction. Section 593 of the Internal Revenue Code contains the federal bad debt reserve deduction provision.

The federal bad debt reserve provisions for the years pertinent here allowed for the deduction of reasonable additions to the reserve at the discretion of the Internal Revenue Service.

Wisconsin's efforts to "federalize" its method of corporate income taxation affected the calculation of the bad debt deduction. The specific Wisconsin provision for deducting additions to bad debt reserves was repealed effective for the taxable year 1987 as part of the legislature's federalization of Wisconsin tax law. As part of the move to federaliza-

tion, the legislature defined corporate "net income" for Wisconsin income tax purposes as "gross income, as computed under the internal revenue code."

Prior to federalization, the method of applying bad debt reserves authorized by Wisconsin tax law was less favorable to the taxpayer than the method under the Internal Revenue Code.

Federalization of the corporate tax liability in Wisconsin resulted in changes in the tax treatment of items of income, loss, or deduction for all corporations, including Lincoln. The legislature enacted a transition mechanism to equalize those differences, but to avoid doing so abruptly. This nonstatutory transition rule, 1987 Wisconsin Act 27, sec. 3047, provides for adjustments over a 5-year period, beginning with 1987, unless the adjustment involved is \$25,000 or less.

The parties agree that Lincoln is a "corporation" as that word is used in sec. 3047(1)(a), and that the transitional rule required Lincoln to subtract the excess of its federal bad debt reserve over its Wisconsin bad debt reserve from Lincoln's Wisconsin tax liability. The parties only disagree as to whether Lincoln may subtract its pre-1962 balance of bad debt reserves for federal tax purposes, which accumulated before Lincoln was subject to the Wisconsin franchise tax.

The Wisconsin Supreme Court concluded that the plain language of the rule gives effect to the intent of the legislature. That intent was to create a mechanism whereby all corporations subject to income tax in Wisconsin at the time of enactment could equalize their items of income, loss, or deduction as maintained for federal tax purposes, with those items as maintained for Wisconsin

income tax purposes. The Commission's interpretation of the transitional mechanism, which effectively read in a limitation on which deductions could be equalized, contravenes the intent of the legislature as evidenced by the plain wording of the rule. Therefore, the decision of the Court of Appeals is reversed.

The department has not appealed this decision.

Transitional rules—
stock purchase treated as
asset purchase—1987 and thereafter; Amortization deductions.

GFG Corporation vs. Wisconsin
Department of Revenue (Wisconsin
Tax Appeals Commission, May 29,
1998). The issues in this case are as
follows:

- A. Did Wisconsin's corporate franchise or income tax law entitle the taxpayer to amortization deductions resulting from the stepped-up basis of its assets pursuant to an Internal Revenue Code section 338 election?
- B. Was the taxpayer entitled to amortization deductions for the cost of the Non-Competition Agreement even though Derlan Industries, Inc., not the taxpayer, made the payment under the Agreement?

GFG Corporation is a Wisconsin corporation with its principal place of business in Milwaukee. The tax-payer manufactures machines that coat certain steel products primarily for use in steel mills. The taxpayer controls 85% of the world market for coil coating and laminating machines and 50% of the world market for electrostatic spraying.

Derlan Industries, Inc. ("Derlan"), is a U.S.-based holding company. Derlan is a wholly owned subsidiary of Derlan Manufacturing, Inc., which is, in turn, a wholly owned subsidiary of Derlan Industries, Ltd., a Canadian public company ("Derlan Canada").

On September 28, 1988, Derlan purchased 85% of the common stock of the taxpayer from Richard F. Groseclose ("Groseclose"). Subsequent to the period at issue, Derlan acquired the remaining 15% of the taxpayer's stock.

At the time of acquisition, Derlan Canada was a holding company with 22 companies in Canada and the United States operating in 3 general areas: aerospace, specialty manufacturing, and construction products. None of these companies is in the taxpayer's line of business.

At no time has the taxpayer been liquidated or merged into Derlan. The taxpayer remains a separate and distinct corporate entity.

Under the terms of the purchase, Derlan paid Groseclose \$4 million for 1,275 shares of the taxpayer's common stock. Derlan also paid Groseclose \$1.5 million in consideration for delivering an executed Non-Competition Agreement at closing.

The Non-Competition Agreement executed by Groseclose had the following characteristics:

- 1. While the Agreement recites that it is a "Memorandum of Agreement made ... between [Derlan] and [Groseclose]" it is addressed to both Derlan and the taxpayer;
- The Agreement was in effect during Groseclose's employment with GFG and for three years thereafter;
- 3. In the Agreement, Groseclose agreed to refrain from (1) ac-

tivities that would compete with the taxpayer's business, (2) efforts to direct any of the taxpayer's suppliers or customers away from the taxpayer, (3) soliciting any of the taxpayer's employes away from the taxpayer, or (4) activities that would be detrimental to the taxpayer's business;

4. Both the taxpayer and Derlan have the right to enforce the Agreement and seek any remedy.

Execution and delivery of the Non-Competition Agreement was a precondition to Derlan's acquisition of the taxpayer's common stock. Groseclose's involvement the taxpayer's business following the acquisition by Derlan was necessary for the continued success of the taxpayer. In fact, Groseclose's strong managerial skill was one reason why Derlan purchased the taxpaver. Groseclose possessed significant engineering expertise in the products sold by the taxpayer. Groseclose also had strong and valuable relationships with the taxpayer's customers, suppliers, and employes.

It appears Derlan considered the \$1.5 million paid for the Non-Competition Agreement as a contribution of capital to the taxpayer. There is, however, no evidence that Derlan took any steps to transfer or assign the Non-Competition Agreement to the taxpayer or memorialize any such contribution of capital. The taxpayer did not list the Non-Competition Agreement as an asset on any balance sheet filed with the department.

The taxpayer's consolidated financial statements for the years 1988 through 1990 were prepared on an historic cost basis, and thus balances were not adjusted to incorporate the \$4 million paid for 85% of the tax-

payer's stock and the \$1.5 million paid for the Non-Competition Agreement. For example, these reports failed to report the increase in the basis of the taxpayer's assets as a result of the section 338 election. Nonetheless, these financial reports disclosed these transactions.

Due to an oversight by the taxpayer's accounting firm, the taxpayer failed to claim any amortization deductions for the Non-Competition Agreement on its Wisconsin corporate franchise or income tax returns for any year.

It appears that Derlan never claimed any amortization deductions for the Non-Competition Agreement on any state corporate franchise or income tax returns for any year.

At the time the taxpayer was acquired by Derlan, the taxpayer lacked the resources to pay Groseclose \$1.5 million for the Non-Competition Agreement.

The taxpayer was the primary beneficiary of the Non-Competition Agreement. While Derlan benefited from the Non-Competition Agreement, its benefit was solely as a shareholder of the taxpayer and based upon reaping the benefits of the taxpayer's continued profitability.

On June 15, 1989, Derlan filed with the Internal Revenue Service its election under section 338(g) of the Internal Revenue Code to treat the purchase of the taxpayer's common stock as an asset purchase. In accordance with Derlan's section 338 election, the taxpayer did not recognize any gain or loss on the sale of common stock to Derlan, and the taxpayer also reported a step-up in the basis of its assets to the allocated cost of the basis of the common stock purchase.

For its taxable years ending December 31, 1988, through December 31, 1991, inclusive, the taxpayer claimed amortization deductions on its Wisconsin corporate franchise or income tax returns resulting from the stepped-up basis of its assets.

During the department's audit of the taxpayer, the taxpayer's accounting firm discovered that the taxpayer had not claimed amortization deductions for the \$1.5 million paid to Groseclose for the Non-Competition Agreement. The taxpayer then filed a claim for refund prior to the final audit report, claiming amortization deductions over the life of the Non-Competition Agreement.

The department assessed the taxpayer additional corporate franchise or income taxes for the taxpayer's taxable years ending May 31, 1988, September 27, 1988, December 31, 1988, December 31, 1989, December 31, 1990, and December 31, 1991. Among other things, the assessment (1) reduced the taxpayer's amortization deductions to reflect disallowance of the section 338 election and (2) denied the taxpayer's claim for refund for the amortization deductions associated with the Non-Competition Agreement.

The taxpayer filed a timely petition for redetermination that was granted in part and denied in part. The taxpayer then filed a timely petition for review with the Commission.

The Commission reached the following conclusions:

A. The taxpayer is not entitled to amortization deductions resulting from the stepped-up basis of its assets pursuant to a section 338 election because section 3047(1)(c) of 1987 Wisconsin Act 27 did not authorize the taxpayer to use such treatment for

purposes of Wisconsin's corporate franchise or income tax law.

B. The taxpayer is entitled to amortization deductions under section 162 of the Internal Revenue Code for the cost of the Non-Competition Agreement, even though this cost was borne by Derlan, because the taxpayer was the primary beneficiary of the Agreement.

The taxpayer has not appealed this decision. The department has not appealed the decision, but has adopted a position of nonacquiescence regarding that portion of the decision permitting an amortization deduction for the cost of the Non-Competition Agreement. The effect of this action is that the Commission's conclusions of law, the rationale, and construction of statutes regarding that issue are not binding upon or required to be followed by the department in other cases.

SALES AND USE TAXES

Boats, vessels and barges — nonresident purchases.

Raymond and Patricia Wehrs vs. Wisconsin Department of Revenue (Circuit Court for Dane County, January 22, 1998). The Wisconsin Tax Appeals Commission issued a decision on June 2, 1997. See Wisconsin Tax Bulletin 103 (October 1997), page 18, for a summary of the Commission decision. The issue in this case is whether the taxpayer's boat is subject to Wisconsin sales or use tax.

The taxpayers are residents of Illinois. In July 1992, the taxpayers purchased a boat. On the day of the sale, the taxpayers were in Illinois, while the boat and its seller were in Florida. The boat was not titled or registered in Florida, nor was a Florida sales tax paid. The boat left

Florida almost immediately after the sale and, after a brief stop in Illinois, was brought to Wisconsin, where it was later registered.

The taxpayers contend that the Commission erred in determining that their boat was ineligible for the use tax exemptions provided in sec. 77.53(17m), Wis. Stats., and sec. Tax 11.85(2)(d), Wis. Adm. Code. The Commission previously held as follows:

- A. The department properly imposed use tax on the purchase of the boat. The boat at issue was not purchased in the state of Illinois, thus, taxpayers do not qualify for the exemption from use tax under sec. 77.53(17m), Wis. Stats.
- B. The boat at issue is not exempt from use tax under sec. Tax 11.85(2)(d), Wis. Adm. Code, because this exemption applies only to temporary use within Wisconsin, not to storage over a period of at least two months.

The Circuit Court vacated the decision of the Commission and remanded the case for further evidentiary proceedings. The application of the exemption requires that a record be made as to the history of the boat from the time it arrived in Wisconsin to the time it left for good.

Common or contract carriers. Superior Hazardous Waste Group, Inc., f/k/a/ Alliance Transportation Services, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, June 17, 1998). The issues in this case are:

A. Whether the taxpayer's purchases of trucks and accessories qualify for exemption from sales

- and use tax under sec. 77.54(5)(b), Wis. Stats.
- B. Whether sec. 77.54(5)(b), Wis. Stats., as applied to the facts of this case, violates the equal protection guarantees of the state and federal constitutions.

The taxpayer was licensed by the Wisconsin Department of Transportation as a contract carrier and held a Wisconsin contract motor carrier license number to haul goods of others for hire. In the normal course of its business, the taxpayer purchased trucks and accessories, attachments, parts, supplies, and materials. The taxpayer also paid for the repair, alteration, and maintenance of these trucks and accessories.

Virtually all of the materials transported by the taxpayer were classified as hazardous waste by the Environmental Protection Agency and/or the Wisconsin Department of Natural Resources. Approximately 65-75% of the wastes transported by the taxpayer had value to the generator and/or recipient of the waste and 25-35% of the waste transported had no value.

The Commission concluded as follows:

- A. The taxpayer's purchases of trucks, etc. *do not* qualify for exemption from sales and use tax under sec. 77.54(5)(b), Wis. Stats.
- B. The sales and use tax exemption found in sec. 77.54(5)(b), Wis. Stats., as applied to the facts in this case, *does not* violate the equal protection guarantees of the state and federal constitutions.

Section 77.54(5)(b), Wis. Stats., exempts from sales and use tax certain items "sold to . . . contract carriers

who use such (items) exclusively as . . . contract carriers . . . " This section does not define "contract carriers." In *Gensler v. Department of Revenue*, 70 Wis. 2d 1108 (1975), the Supreme Court held that in construing this exemption it was appropriate to rely upon the definitions set forth in sec. 194.01, Wis. Stats. This section defines contract carrier as:

"any person engaged in the transportation by motor vehicle over a regular or irregular route upon the public highways of property for hire."

Waste that has no value is not "property" within the meaning of sec. 194.01(2), Wis. Stats. Using 25-35% of the capacity of each truck for a use that is neither contract nor common carriage is not an incidental, non-exempt use; therefore, the trucks at issue were not used exclusively as contract carriers.

The taxpayer has not appealed this decision. \Box

Exemptions — telephone company central office equipment. Ameritech Mobile Communications, Inc. vs. Wisconsin Department of Revenue (Court of Appeals, District IV, October 2, 1997).

This decision was summarized in *Wisconsin Tax Bulletin* 106 (January 1998), page 21. That summary stated that the taxpayer had appealed the decision to the Wisconsin Supreme Court.

The Wisconsin Supreme Court denied the taxpayer's petition for review in February 1998. The case is closed.

Officer liability. Joseph A. Balestrieri vs. Wisconsin Department of Revenue (Wisconsin

Tax Appeals Commission, June 2, 1998). The issue in this case is whether the taxpayer is a responsible person under sec. 77.60(9), Wis. Stats., during December 1990 and January, February, March, May, June, and August 1991 ("the period under review").

The taxpayer was president and a director of Riverside Theatre, Inc. ("the corporation"). He managed the day-to-day operations of the corporation and had check signing authority on three corporation checking accounts. The taxpayer reviewed payment requests and directed payments to creditors. He signed checks to pay the corporation's creditors during the period under review.

In March 1994, the department assessed the taxpayer as an officer or other responsible person of the corporation, who wilfully failed to pay the corporation's sales taxes due during the period under review.

The Commission concluded that the taxpayer was a responsible person under sec. 77.60(9), Wis. Stats., and was personally liable for the unpaid sales and use taxes.

For personal liability to be established for sales and use taxes, the taxpayer must have had **authority** to pay the corporation's taxes, a **duty** to pay the taxes, and an intentional **breach of that duty**. The taxpayer was president of the corporation with signature authority on its checking accounts. He managed the operations of the corporation, directed payments to creditors, and signed checks; therefore, the taxpayer had the **authority** to pay the taxes. As an officer and director of the corporation, the taxpayer was duty-bound to see that the taxes were paid. The taxpayer intentionally breached that duty by signing checks and paying other creditors than the department.

The taxpayer has appealed this decision to the Circuit Court.

Retailer — defined. American Heart Association/
Wisconsin Affiliate, Inc. vs. Wisconsin Department of Revenue
(Wisconsin Tax Appeals Commission, July 24, 1998). The issue in this case is whether the gross receipts from the taxpayer's sales of literature are subject to Wisconsin sales tax.

The facts in the case are as follows:

- 1. The taxpayer is a non-stock, non-profit corporation which qualifies for tax exempt status under Internal Revenue Code sec. 501(c)(3).
- 2. Since its inception, the taxpayer has worked to reduce disability and death from cardiovascular disease and stroke by supporting medical research and providing education and community programs for health professionals and the general public. The taxpayer's home office, which is located in Milwaukee, is staffed by volunteers and paid employes.
- 3. During the audit period, the taxpayer's gross revenue was derived from the following sources:
 - a. contributions and bequests from individuals, businesses, and exempt organizations (48.9%);
 - b. admissions to fund-raising events, auction sales of donated merchandise at the fund-raising events, and sales of centerpieces at the fund-raising events (24.4%);

- c. contributions from federated campaigns (e.g., United Way)(12.8%);
- d. investment income (6.5%);
- e. sales of literature (3.8%);
- f. program service fees (e.g., seminar fees) (2.8%);
- g. governmental grants (0.5%);
- h. sales of memberships to members of the general public, nurses and allied health professionals, and physicians and health scientists (0.4%); and
- sales of coffee and soda to employes and others who visited the taxpayer's offices, and other miscellaneous revenue sources (0.1%).

The department imposed Wisconsin sales tax on the taxpayer's:

- 1. sales of coffee and canned soda to employes and visitors,
- 2. admissions to fund-raising events.
- auction sales of donated merchandise and sales of table centerpieces used at an event,
- 4. sales of literature.

The taxpayer consented (acquiesced) to pay sales tax on the 1) sales of coffee and canned soda; 2) admissions to fund-raising events; and 3) auction sales of donated merchandise and sales of the centerpieces.

The taxpayer sold a variety of educational literature on a daily basis regarding methods of reducing one's risk of incurring cardiovascular diseases and stroke. The literature included pamphlets, cookbooks, brochures, and technical papers for doctors. During the period under review, the taxpayer did not hold a Wisconsin seller's permit.

The Commission concluded that the taxpayer was not a "retailer" of literature; therefore, its sales of such literature are not subject to Wisconsin sales tax. The Commission stated that the taxpayer's acquiescence to other issues involving sales tax was not an admission that the assessment was correct nor that the taxpayer was required to hold a seller's permit.

In Kollasch v. Adamany, 104 Wis. 2d 552, 562 (1981), the Wisconsin Supreme Court ruled that "the type of transactions which make one a sec. 77.51(7)(a) retailer are mercantile ones." The Court made it clear in Kollasch that a nonprofit organization engaging in fundamentally nonmercantile transactions is not a "retailer."

The Commission determined that the taxpayer's sales of literature was a fundamentally nonmercantile activity. The taxpayer's mission was to reduce disability and death from cardiovascular disease and stroke. The nature and content of the literature established that the taxpayer's sales and distributions of such literature were an integral part of its mission.

The department has not appealed this decision.

Time-share property. Telemark Development, Inc. vs. Wisconsin Department of Revenue (Court of Appeals, District IV, April 30, 1998). The Wisconsin Tax Appeals Commission decision of October 28, 1996, was appealed to the Circuit Court, which issued a decision on July 22, 1997. See Wisconsin Tax Bulletins 101, (April 1997), page 17, and 106 (January 1998), page 22, for summaries of the Commission and Circuit Court decisions.

The issue in this case is whether the taxpayer's sales of time-share units for flexible use are subject to sales tax. Additional issues of the constitutionality of sec. 77.52(2)(a)1, Wis. Stats., under the Equal Protection and Uniformity of Taxation Clauses, were presented to the Circuit Court.

The taxpayer does not hold a seller's permit and did not collect sales tax on any of its sales of flexible timeshare units. The department assessed delinquent sales tax against the taxpayer after an audit. The taxpayer appealed to the Commission, and the Commission confirmed the assessment, concluding that the sale of flexible time-share units is taxable under sec. 77.52(2)(a)1, Wis. Stats.

The Court of Appeals concluded that the Commission's decision was a reasonable interpretation and application of the law. The Court also rejected the taxpayer's constitutional claims.

The taxpayer filed a petition for review, which was denied by the Wisconsin Supreme Court on July 24, 1998.

SALES AND USE TAXES, AND WITHHOLDING OF TAXES

Green vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, July 3, 1998). The issue in this case is whether the taxpayer is a responsible person who is liable for the delinquent withholding and sales taxes of Midtowne Auto Body Repair, Inc. ("the corporation") under sec. 71.83(1)(b)2, Wis. Stats. and sec. 77.60(9), Wis. Stats.

The taxpayer was employed by the corporation since 1992. The taxpayer prepared checks for signature by others, handled the mail, and kept a ledger of receipts and invoices.

The taxpayer's position with the corporation was described as "corporate secretary" and "office manager." The corporation's 1993 and 1994 tax returns were filed and signed by the taxpayer, and the taxpayer signed installment agreements with the department in 1993 on behalf of the corporation delinquent taxes. The taxpayer was given check writing authority in July of 1994, at which time her title was stated as vice-president.

The Commission concluded that the taxpayer was a responsible person

under sec. 71.83(1)(b)2, Wis. Stats. and sec. 77.60(9), Wis. Stats., and was personally liable for the corporation's unpaid withholding and sales taxes. The taxpayer had the **authority** and the **duty** to pay the corporation's withholding and sales and use taxes, and the taxpayer **intentionally breached that duty**.

The taxpayer served as the vicepresident and had **authority** to make financial decisions for the corporation. The taxpayer was a signatory on three of the corporation's checking accounts and signed installment agreements with the department. The taxpayer was aware of the corporation's tax problems and was **duty-bound** to address them. The taxpayer was directly involved in the payment of creditors and payroll (including the taxpayer and another officer); therefore, the taxpayer **intentionally breached her duty** to pay the corporation's delinquent taxes.

The taxpayer has not appealed this decision. \Box



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:

Individual Income Taxes

1. Gain on the Sale of Assets Used in Farming or Business Assets to Related Person (p. 21)

Homestead, Farmland Preservation, and Farmland Tax Relief Credits

2. Property Taxes Accrued – Refusal of Lottery Credit (p. 28)

Sales and Use Taxes

- 3. Key Making Machines (p. 29)
- 4. Prepackaged Combinations of Food, Food Products, and Beverages (p. 29)
- 5. Transportation Charges (p. 31)

INDIVIDUAL INCOME TAXES

1 Gain on the Sale of Assets Used in Farming or Business Assets to Related Person

Statutes: Section 71.05(6)(b)9, Wis. Stats. (1995-96), sec. 71.05(6)(b)25, Wis. Stats., as created by 1997 Wis-

consin Act 27, and sec. 71.83(1)(d), Wis. Stats., as created by 1997 Wisconsin Act 27 and as amended by 1997 Wisconsin Act 237

Note: This tax release applies only with respect to taxable years beginning on or after January 1, 1998.

Background: Section 71.05(6)(b)9, Wis. Stats. (1995-96), provides an exclusion for 60% of the capital gain on the sale or disposition of assets held more than one year. Capital gains and capital losses are netted before applying the percentage. Section 71.05(6)(b)25, Wis. Stats., as created by 1997 Wisconsin Act 27, provides a subtraction modification to individuals for gains not excluded from taxation under sec. 71.05(6)(b)9, Wis. Stats. (1995-96), on certain assets.

Conditions to Qualify for Subtraction Modification Provided by Sec. 71.05(6)(b)25

The subtraction for gain on the sale or disposition of assets by individuals applies if the following conditions are met:

1. The assets must have been sold or otherwise disposed of to persons who are related to the seller or transferor by blood, marriage, or adoption within the 3rd degree of kinship.

- 2. The assets must be assets which were used in farming or business assets.
- 3. Shares in a corporation or trust qualify if, at the time of the sale or disposition, the corporation or trust meets the following standards under sec. 182.001(1), Wis. Stats.
 - Its shareholders or beneficiaries do not exceed 15 in number. Lineal ancestors and descendants and aunts, uncles, and 1st cousins thereof count collectively as one shareholder or beneficiary, but this collective authorization shall not be used for more than one family in a single corporation or trust.
 - It does not have more than two classes of shares.
 - All its shareholders or beneficiaries, other than any estate, are natural persons.
- 4. The assets must have been held more than one year.
- 5. The subtraction applies only to capital gain as computed under the Internal Revenue Code which applies for Wisconsin purposes for the year of sale; it does not include amounts treated as ordinary income because of the recapture of depreciation or any other reason.

Penalty

If a person who purchases or otherwise receives assets used in farming or business assets, of which the gains realized by the transferor on the sale or disposition of such assets

are exempt from taxation under sec. 71.05(6)(b)25, Wis. Stats., as created by 1997 Wisconsin Act 27, sells or otherwise disposes of the assets within two years after the person purchases or receives the assets, the person shall be subject to a penalty. (Section 71.83(1)(d), Wis. Stats., as created by 1997 Wisconsin Act 27 and as amended by 1997 Wisconsin Act 237.)

The penalty is equal to the amount of income tax that would have been imposed on the transferor on the capital gain if the subtraction modification did not apply, multiplied by a fraction, the denominator of which is 24 and the numerator of which is the difference between 24 and the number of months between the date on which the person who is liable for the penalty purchased or otherwise received the assets and the month in which the person sells or otherwise disposes of the assets.

Definitions: For purposes of this tax release, the following definitions will apply.

"Business assets" means assets used in an activity carried on for a livelihood or in good faith to make a profit. The facts and circumstances of each case determine whether or not an activity is a business. Regularity of activities and transactions and the production of income are important elements. You do not need to actually make a profit to be in a business as long as you have a profit motive. You do need, however, to make ongoing efforts to further the interests of your business.

"Business assets" includes assets used in the performance of services by an individual as an employe and assets used in the conduct of a trade or business by an individual who is self-employed.

"Business assets" does not include investment or rental property unless the individual is subject to federal self-employment tax on the earnings from the activity.

"Farming" means the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity including the raising, shearing, feeding, caring for, training, and management of animals. Trees (other than trees bearing fruit or nuts) shall not be treated as an agricultural or horticultural commodity. (Note: Trees may qualify as a business asset.)

"Related person" means an individual related to the seller or transferor by blood, marriage, or adoption within the 3rd degree of kinship. This includes a X

- Child
- Grandchild
- Great grandchild
- Parent
- Brother or sister
- Nephew or niece
- Grandparent
- Great grandparent
- Aunt or uncle

Question 1: When computing Wisconsin taxable income, is a subtraction allowed from federal adjusted gross income for the entire gain on the sale of an asset used in farming or a business asset to a related person?

Answer 1: No. The subtraction applies only to the portion of the gain that is treated as a capital gain for federal income tax purposes. It does not apply to any portion of the gain

that is treated as ordinary income for federal income tax purposes due to the recapture of depreciation or for any other reason. In addition, the asset must have been held for more than one year.

Example 1: You purchased equipment for use in your business in 1994 for \$12,000. In 1998 you sold the equipment to a related person for \$4,000. You had previously claimed depreciation on the equipment of \$10,000. Therefore, you compute a gain on the sale of \$2,000. The en-\$2000 gain is due to depreciation deductions so you must report the gain as ordinary income on your federal income tax return. Because the entire \$2,000 gain is treated as ordinary income, no portion of the gain may be claimed as a subtraction for Wisconsin. The subtraction for gain on the sale of business assets sold to a related person only applies to gain which is treated as capital gain for federal income tax purposes.

Example 2: You sold raised dairy cattle to a related person for \$10,000. You had held the cattle for 20 months. Because you held the cattle for less than 24 months, the entire \$10,000 gain is reported as ordinary income on your federal income tax return. Even though you held the cattle for more than one year, you may not claim a subtrac-

tion for gain on the sale of assets used in farming to a related person because the gain is treated as ordinary income for federal income tax purposes.

Example 3: You sold farm equipment which you had owned for four years to a related person for \$50,000. You report a gain on this sale on your federal income tax return of \$10,000. You report \$6,000 of the gain as ordinary income and \$4,000 as capital gain. The \$4,000 capital gain qualifies for the subtraction for gain on the sale of assets used in farming to a related person.

Question 2: How is the amount of the subtraction for gain on the sale of assets used in farming or business assets to a related person determined?

Answer 2: For federal income tax purposes, capital gain (including capital gain from the sale of assets used in farming or business assets) which was originally reported on federal Form 4797, Sales of Business Property, is included on federal Schedule D, Capital Gains and Losses. The capital gains and losses are carried over to Wisconsin Schedule WD where they are netted and a 60% capital gain exclusion is applied to net capital gain on assets held more than one year.

You must first complete Wisconsin Schedule WD before you can determine your subtraction for gain on the sale of assets used in farming or business assets to a related person. All capital gains and losses must be netted on Schedule WD before you can determine the amount of your subtraction.

The amount of your subtraction for gain on the sale of assets used in farming or business assets to a related person is reported on line 11 of Form 1 or line 15 of Form 1NPR.

(**Note:** All line references are to the 1998 Wisconsin forms.)

Net losses You may *not* claim a subtraction for gain on the sale of assets used in farming or business assets to a related person if either of the following applies:

- The netting of all long-term capital gains and losses on Schedule WD results in a net long-term capital loss on line 15 of Schedule WD, *or*
- The netting of all short-term and long-term capital gains and losses on Schedule WD results in a net loss on line 16 of Schedule WD.

Example 1: Your Schedule WD shows the following amounts:

Long-term capital gain on the sale of business asset to a related person\$10,000Long-term capital loss on the sale of stock(12,000)Net long-term capital loss (line 15, Schedule WD)\$ (2,000)

You may not claim a subtraction for gain on the sale of the business asset to a related person.

Example 2: Your Schedule WD shows the following amounts:

Short-term loss on the sale of stock \$(20,000)

Long-term capital gain on the sale of asset used in farming to a related person

Net loss (line 16, Schedule WD) \$(8,000)

You may not claim a subtraction for gain on the sale of the asset used in farming to a related person.

Net gains If you have a net longterm capital gain on line 15 of Schedule WD and a net gain on line 16 of Schedule WD, your subtraction for gain on the sale of assets used in farming or business assets to a related person is one of the following:

 If the amounts reported in Parts I and II of Schedule WD consist only of capital gains (no losses), your subtraction is equal to 40% of the gain on the sale of the assets used in farming or business assets. Therefore, you will have subtracted 100% of the gain (60% as a capital gain exclusion and the remaining 40% as a subtraction).

Example 3: Your Schedule WD shows the following amounts:

| Short-term gain on the sale of stock | \$ 2,000 |
|---|----------|
| Long-term gain on the sale of stock | 5,000 |
| Long-term gain on the sale of business asset to a related person | 20,000 |
| Net gain (line 16, Schedule WD) | \$27,000 |
| Capital gain exclusion (60% of \$25,000 as shown on line 18, Schedule WD) | 15,000 |
| Taxable gain (line 19, Schedule WD) | \$12,000 |

You may subtract \$8,000 (\$20,000 x 40%) for gain on the sale of the business asset to a related person.

• If (1) the only gain reported on Schedule WD is from the sale of assets used in farming or business assets to a related person and (2) you show a loss on line

14, column (f) of Schedule WD and/or on line 7 of Schedule WD, your subtraction is equal to the amount on line 19 of Schedule WD. This is the amount

remaining after netting the capital gain and all long-term and short-term losses and applying the 60% capital gain exclusion.

Example 4: Your Schedule WD shows the following amounts:

| Net short-term capital loss (line 7, Schedule WD) | \$(4,000) |
|---|---------------|
| Total long-term capital loss (line 14, column (f) of Schedule WD) | (6,000) |
| Long-term gain on the sale of asset used in farming to a related person | <u>40,000</u> |
| Net gain (line 16, Schedule WD) | \$30,000 |
| Capital gain exclusion (60% of \$30,000 as shown on line 18, Schedule WD) | 18,000 |
| Taxable gain (line 19, Schedule WD) | \$12,000 |

You may subtract \$12,000 for gain on the sale of the asset used in farming to a related person.

• If (1) the only long-term gain reported on Schedule WD is from the sale of assets used in farming or business assets to a related person, (2) you show a total long-term loss on line 14,

column (f) of Schedule WD, and (3) you show a net short-term capital gain on line 7 of Schedule WD, your subtraction is equal to the amount on line 19 of Schedule WD less the amount

on line 7 of Schedule WD. This is the amount remaining after subtracting short-term capital gain from the net capital gain after applying the 60% exclusion.

Example 5: Your Schedule WD shows the following amounts:

| Net short-term capital gain (line 7, Schedule WD) | \$ 5,000 |
|---|----------|
| Long-term capital gain on the sale of business asset to a related person | 20,000 |
| Long-term capital loss carryover (lines 13 and 14, Schedule WD) | (6,000) |
| Net gain (line 16, Schedule WD) | \$19,000 |
| Capital gain exclusion (60% of \$14,000 as shown on line 18, Schedule WD) | 8,400 |
| Taxable gain (line 19, Schedule WD) | \$10,600 |

You may subtract \$5,600 (\$10,600 minus \$5,000 short-term capital gain) for gain on the sale of the business asset to a related person.

- If (1) you reported more than one long-term capital gain and (2) you show a loss on line 14, column (f) of Schedule WD and/or on line 7 of Schedule WD, complete the following worksheet to compute your subtraction.
- If (1) you reported more than one long-term capital gain, (2) you show a loss on line 14, column (f) of Schedule WD, and (3) you show a gain on line 7 of

Schedule WD, complete the following worksheet to compute your subtraction.

Worksheet for Gain on Sale of Assets to Related Person

(For use when there is more than one long-term capital gain)

| 1. | Amount from line 19 of Schedule WD | 1 |
|----|--|---|
| 2. | Net short-term gain, if any, from line 7 of Schedule WD | 2 |
| 3. | Subtract line 2 from line 1 | 3 |
| 4. | Long-term gain on the sale of asset to related person | |
| 5. | Total long-term capital gain from line 14, column (g) of Schedule WD 5. | |
| 6. | Divide line 4 by line 5. Fill in decimal amount | 6 |
| | Multiply line 3 by line 6. This is your subtraction for gain on the sale of assets to a related person | 7 |

| Long-term capital gain on the sale of business asset to a related person 1,000 | Example 6: Your Schedule WD shows the following amounts: | |
|--|---|---|
| Long-term capital gain on the sale of stock (Total long-term capital gain reported on line 14, column (g) of Schedule WD, is \$10,000.) | Long-term capital gain on the sale of business asset to a related person | \$9.000 |
| Long-term capital loss carryover \$3,000 Net long-term capital gain (lines 15 and 16, Schedule WD) \$7,000 \$2,2800 Taxable gain (line 19, Schedule WD) \$2,2800 Taxable gain (line 19 of Schedule WD. \$1, 2,800 \$2,2800 | | • |
| Net long-term capital gain (lines 15 and 16, Schedule WD) | (Total long-term capital gain reported on line 14, column (g) of Schedule WD, is \$10,000.) | |
| Capital gain exclusion (60% of \$7,000 as shown on line 18, Schedule WD) | | |
| Taxable gain (line 19, Schedule WD) \$2,800 | | · |
| The amount of your subtraction for gain on the sale of the business asset to a related person is \$2,520 computed as follows: Worksheet for Gain on Sale of Assets to Related Person (For use when there is more than one long-term capital gain) 1. Amount from line 19 of Schedule WD | | |
| Northead Worksheet For Gain on Sale of Assets to Related Person (For use when there is more than one long-term capital gain) | Taxable gain (line 19, Schedule WD) | \$2,800 |
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| CFOr use when there is more than one long-term capital gain 1. 2.800 | | |
| 1. Amount from line 19 of Schedule WD | | |
| 2. Net short-term gain, if any, from line 7 of Schedule WD 2 | (For use when there is more than one long-term capital gain) | |
| 2. Net short-term gain, if any, from line 7 of Schedule WD | 1. Amount from line 19 of Schedule WD | 1. 2,800 |
| 3. Subtract line 2 from line 1 | | |
| 4. Long-term gain on the sale of asset to related person | | |
| 6. Divide line 4 by line 5. Fill in decimal amount 6. 9 7. Multiply line 3 by line 6. This is your subtraction for gain on the sale of assets to a related person 7. 2,520 Example 7: Your Schedule WD shows the following amounts: Net short-term capital gain (line 7, Schedule WD) \$10,000 Long-term capital gain on sale of business asset to a related person 20,000 Long-term gain on sale of stock 5,000 (Total long-term capital gain reported on line 14, column (g) of Schedule WD, is \$25,000.) Long-term loss on sale of stock (6,000) Net gain (line 16, Schedule WD) \$29,000 Capital gain exclusion (60% of \$19,000 as shown on line 18, Schedule WD) \$11,400 Taxable gain (line 19, Schedule WD) \$17,600 The amount of your subtraction for gain on the sale of the business asset to a related person is \$6,080 computed as follows: Worksheet for Gain on Sale of Assets to Related Person (For use when there is more than one long-term capital gain) 1. Amount from line 19 of Schedule WD 1 1. 17,600 2. Net short-term gain, if any, from line 7 of Schedule WD 2. 10,000 3. Subtract line 2 from line 1 . 3 7,600 4. Long-term gain on the sale of asset to related person 4. 20,000 5. Total long-term capital gain from line 14, column (g) of Schedule WD 5. 25,000 6. Divide line 4 by line 5. Fill in decimal amount 6. 8. Multiply line 3 by line 6. This is your subtraction for gain on the sale of | | |
| 7. Multiply line 3 by line 6. This is your subtraction for gain on the sale of assets to a related person | | |
| 7. Multiply line 3 by line 6. This is your subtraction for gain on the sale of assets to a related person | 6. Divide line 4 by line 5. Fill in decimal amount | 69 |
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Question 3: Does the subtraction for gain on the sale of assets used in farming or business assets to a related person have to be claimed on the original return for the taxable year?

Answer 3: No. The subtraction may be claimed on an amended return (Form 1X) filed within four years of the unextended due date of the original return.

Example: You sold assets used in farming to a related person in 1998. The subtraction for gain on the sale of the assets may be claimed either on your original 1998 Wisconsin income tax return (due April 15, 1999) or on an amended 1998 return filed on or before April 15, 2003 (four years from the unextended due date of the original return).

Question 4: If a taxpayer claimed on his or her original return the subtraction for gain on the sale of assets used in farming or business assets to a related person, may the taxpayer later file an amended return on which the subtraction is not claimed?

Answer 4: Yes, an amended return may be filed if a taxpayer decides not to claim the subtraction.

Question 5: Wisconsin law limits the deduction for farm losses. Disallowed farm losses may be carried forward for up to 15 years. The losses which are carried forward may be claimed to the extent they do not exceed the net profits or net gains from the sale or exchange of capital or business assets in the current taxable year from the same farming business or portion of that business to which the limits on deductible farm losses applied in the loss year.

May a taxpayer claim a subtraction for both the gain on the sale of assets

used in farming to a related person and for the farm loss carryforward?

Answer 5: Yes, a subtraction may be claimed for both the gain on the sale of assets used in farming to a related person and for the farm loss carryforward.

Example: You have a farm loss carryforward from 1995 of \$100,000. During 1998, you sell the farm to a related person realizing a gain of \$150,000, of which \$50,000 is reported as ordinary income on your federal income tax return and \$100,000 is reported as capital gain. Assuming you did not report any other capital gains or losses on Schedule WD, on your Wisconsin income tax return you may claim (1) a capital gain exclusion of \$60,000, (2) a subtraction of \$40,000 as gain on the sale of assets used in farming to a related person, and (3) a subtraction of \$100,000 as a farm loss carryforward.

Question 6: The subtraction for gain on the sale or disposition of assets used in farming or business assets to a related person includes gain on the sale or disposition of shares in a corporation or trust (see "Background" on the first page of this tax release for standards the corporation or trust must meet). Wisconsin law also provides a subtraction for gain on the sale or disposition of small business stock (see the tax release "Exclusion of Capital Gains on Small Business Stock" on page 21 of the October 1995 Wisconsin Tax Bulletin 94 for information on small business stock requirements). If gain on the sale of stock qualifies as both gain on the sale of assets used in farming or business assets to a related person and gain on the sale of small business stock, may a double deduction be claimed?

Answer 6: No, a taxpayer may claim either the subtraction for gain

on the sale of assets used in farming or business assets or the subtraction for gain on the sale of small business stock. A double deduction is not allowed.

Question 7: The subtraction for gain on the sale of assets used in farming or business assets to a related person first applies to taxable years beginning on or after January 1, 1998. If business assets or assets used in farming were sold to a related person before 1998 and the gain on the sale is being reported using the installment method, will the capital gain which is being reported on the 1998 and subsequent year returns qualify for the subtraction?

Answer 7: Yes, capital gain on an installment sale of assets used in farming or business assets to a related person which occurred prior to 1998, but is being reported on a 1998 or subsequent year income tax return, qualifies for the subtraction.

Example: You sold business assets to a related person in 1995. The gain is being reported on the installment method. On your 1998 federal income tax return, you report capital gain of \$10,000 from this installment sale. You may claim a subtraction on your 1998 Wisconsin income tax return for gain on the sale of business assets to a related person. (See Question and Answer 2 for information on computing the amount of the subtraction.)

Question 8: The subtraction is available for gain on the sale or disposition of assets "used in farming" to a related person. Does the asset have to be "used in farming" directly by the seller?

Answer 8: No. The "used in farming" requirement may be satisfied by either the seller's or another person's use of the asset in farming while the asset is owned by the seller.

Example: You own a farm in Wisconsin but are not engaged in farming. You have been renting the land, buildings, and equipment to another person who is engaged in farming. You receive a cash rental payment each year which is reported as rental income on federal Schedule F. Because the farm and equipment are "used in farming" by the renter while the asset is owned by the seller, any capital gain on a sale of the assets to a related person qualifies for the subtraction.

Question 9: You sell residential rental property to a related person. You owned the property since 1988 and have reported all of your rental income and expenses on federal Schedule E. Does the gain on the sale qualify for the subtraction?

Answer 9: No. Gain on the sale of this residential rental property does not qualify for the subtraction. Rental property is not considered a "business asset" unless the seller is engaged in a business and reports all rental income and expenses on federal Schedule C and income from the rental activity is subject to self-employment tax.

Question 10: A penalty is imposed on the related person who purchases or otherwise receives business assets or assets used in farming if the assets are disposed of within a two-year period. If the related person dies within the two-year period, is the penalty imposed on either the person who inherits the assets or on the estate of the related person?

Answer 10: No. The penalty is not imposed on either the person who inherits the assets or on the estate of the related person. The transfer of the property to the estate and/or beneficiaries of the deceased is not considered a disposition subject to the penalty imposed by sec. 71.83(1)(d), Wis. Stats., as created

by 1997 Wisconsin Act 27 and as amended by 1997 Wisconsin Act 237.

HOMESTEAD, FARMLAND PRESERVATION, AND FARMLAND TAX RELIEF CREDITS

Property Taxes Accrued - Refusal of Lottery Credit

Statutes: Sections 71.07(3m)(a)6, 71.28(2m)(a)6, 71.47(2m)(a)6, 71.52(7), and 71.58(8), Wis. Stats. (1995-96), and sec. 79.10, Wis. Stats. (1995-96), and as amended by 1997 Wisconsin Act 27

Note: This tax release applies only to homestead credit, farmland preservation credit, and farmland tax relief credit for taxable years 1997 and thereafter.

Background: Section 79.10, Wis. Stats., provides for a lottery credit, in the form of a reduction of property taxes assessed on Wisconsin property. The lottery credit is funded through proceeds from the Wisconsin Lottery.

Changes were made to the lottery credit provisions in sec. 79.10, Wis. Stats., by 1997 Wisconsin Act 27. These changes are effective for lottery credits used to reduce 1997 property taxes due in 1998 (claimed in computing 1997 homestead, farmland preservation, and farmland tax relief credits).

As a result of the changes to the lottery credit, the application/ certification process for homeowners, where the homeowner could choose whether to claim or not claim the lottery credit, is eliminated. In addition, a lottery credit is automatically allowed on taxable personal property (for example, a mobile home on another person's land), and on every parcel of taxable real property (for example, commercial property, resi-

dential property, and parcels consisting of land only - no buildings).

Property taxes accrued, for purposes of determining a homestead credit, farmland preservation credit, or farmland tax relief credit, are defined as property taxes levied under chapter 70, Wis. Stats., less the tax credit, if any, afforded in respect of the property by sec. 79.10, Wis. Stats. Sections 71.07(3m)(a)6, 71.28(2m)(a)6, 71.47(2m)(a)6, 71.52(7), and 71.58(8), Wis. Stats. (1995-96).

Facts and Question 1 - Homestead Credit: Claimant X receives a 1997 property tax bill (payable in 1998) for his homestead, which shows a net amount due before lottery credit of \$1,400, a lottery credit of \$90, and net taxes due of \$1,310. For personal reasons, Claimant X objects to receiving a benefit from the lottery. Therefore, rather than paying the net taxes due after lottery credit, \$1,310, he pays the higher amount shown on the property tax bill, \$1,400 (i.e., the amount due before the \$90 lottery credit deduction).

May Claimant X claim the amount he actually paid, \$1,400, in computing his 1997 homestead credit?

Answer 1: No. The allowable property taxes on Claimant X's 1997 homestead credit claim are \$1,310, which are the net 1997 property taxes after the lottery credit has been deducted. The allowable property taxes are those levied under ch. 70, Wis. Stats., less the credit afforded under sec. 79.10, Wis. Stats.

Facts and Question 2 - Farmland Preservation Credit: Claimant Y receives three 1997 property tax bills (payable in 1998) for his farm. Each tax bill has a lottery credit. The property tax bills show net amounts due before lottery credit of \$2,400,

\$1,000, and \$900 respectively (\$4,300 total), a lottery credit of \$100 on each tax bill, and net taxes due of \$2,300, \$900, and \$800 respectively (\$4,000 total). For personal reasons, Claimant Y objects to receiving a benefit from the lottery. Therefore, he pays \$4,300, the amount due before the lottery credit deductions, rather than \$4,000, the net taxes due after lottery credits.

May Claimant Y claim the amount he actually paid, \$4,300, in computing his 1997 farmland preservation credit?

Answer 2: No. The allowable property taxes on Claimant Y's 1997 farmland preservation credit claim are \$4,000, which are the taxes levied under ch. 70, Wis. Stats., less the lottery credit afforded under sec. 79.10, Wis. Stats.

Facts and Question 3 - Farmland Tax Relief Credit: Assume the same facts as in Facts and Question 2, except that Claimant Y also wishes to claim a 1997 farmland tax relief credit, based on the property taxes for his farmland only. One property tax bill includes taxes for both farmland and buildings, and the other two are for farmland only.

May Claimant Y claim the total amount he actually paid (prorated for the farmland only) in computing his 1997 farmland tax relief credit?

Answer 3: No. The property taxes allowable in computing Claimant Y's farmland tax relief credit are the taxes levied under ch. 70, Wis. Stats., for the farmland, less the lottery credit afforded under sec. 79.10, Wis. Stats.

Note: The lottery credit attributable to farmland taxes on the property tax bill with buildings is the ratio of the assessed value of the farmland to the total assessed value of farmland and buildings.

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 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 or stadium sales and use tax, refer to Wisconsin Publication 201, *Wisconsin Sales and Use Tax Information*.

1 Key Making Machines

Statutes: Section 77.54(6)(a) and (6m), Wis. Stats. (1995-96)

Wis. Adm. Code: Section Tax 11.39(1), Wis. Adm. Code, October 1997 Register and Section Tax 11.40(1) and (2), Wis. Adm. Code, April 1994 Register

Background: Section 77.54(6m), Wis. Stats. (1995-96) 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 77.54(6)(a), Wis. Stats. (1995-96), provides an exemption from Wisconsin sales and use tax for "Machines and specific processing equipment and repair parts or replacements thereof, exclusively and directly used by a manufacturer in manufacturing tangible personal property and safety attachments for those machines and equipment."

Facts:

- Company A purchases a key making machine.
- The key making machine is used as follows:

- 1) Customer Z brings in a key that he would like duplicated.
- Company A's machine operator chooses an uncut "blank" that a duplicate can be made from.
- 3) Using Customer Z's key as a model, the machine cuts the blank to copy the original.
- 4) The new key can be used in the same manner as Customer Z's original key.

Question 1: Does the process of duplicating Customer Z's key qualify as manufacturing under sec. 77.54(6m), Wis. Stats. (1995-96)?

Answer 1: Yes. The process of duplicating the key meets the six elements of manufacturing:

- 1) Production by machinery,
- 2) of a new article,
- 3) with a different form,
- 4) with a different use,
- 5) with a different name, and
- 6) by a process popularly regarded as manufacturing.

Question 2: Does Company A's purchase of the key machine qualify for the manufacturing exemption under sec. 77.54(6)(a), Wis. Stats. (1995-96)?

Answer 2: Yes, provided the machine is used exclusively and directly in the manufacturing process. □

Prepackaged Combinations of Food, Food Products, and Beverages

Statutes: Section 77.54(20), Wis. Stats. (1995-96), sec. 77.51(4)(a)(intro.) and (15)(a)(intro.), Wis. Stats. (1995-96), as amended by 1997 Wis. Act 237, and secs. 77.51(4)(cm) and

(15)(cm) and 77.54(20)(bg) and (20m), Wis. Stats., as created by 1997 Wis. Act 237, effective August 1, 1997

Wis. Adm. Code: Section Tax 11.51(2)(c)5, Wis. Adm. Code, December 1996 Register

Note: This tax release supersedes the tax release titled "Prepackaged Combinations of Food, Food Products, and Beverages Constitute Meals," which was published in *Wisconsin Tax Bulletin* 102 (July 1997), page 20.

Background: Section 77.54(20)(intro.), Wis. Stats. (1995-96), provides an exemption from Wisconsin sales and use tax for the gross receipts from sales of, and the storage, use, or other consumption of certain food, food products, and beverages for human consumption.

An exception to this exemption is found in sec. 77.54(20)(c)2.a, Wis. Stats. (1995-96), which provides that sales of "meals" and "sandwiches" are subject to Wisconsin sales or use tax.

Section 77.54(20)(bg), Wis. Stats., as created by 1997 Wis. Act 237, defines "meal" and "sandwich" as follows:

"Meal" includes, but is not limited to, a diversified selection of food, food products, or beverages that are customarily consumed as a breakfast, lunch, or dinner, that may not easily be consumed without an article of tableware and that may not conveniently be consumed while standing or walking. "Meal" does not include frozen items that are sold to a consumer, items that are customarily heated or cooked after the retail sale and before they are consumed, or a diversified selection of food, food products, and beverages that is packaged together by a person other than the retailer before the sale to the consumer.

"Sandwich" means food that consists of a filling; such as meat, cheese, or a savory mixture; that is placed on a slice, or between 2 slices; of a variety of bread or something that takes the place of bread; such as a roll, croissant, or bagel. "Sandwich" includes, but is not limited to, burritos, tacos, enchimichangas, chiladas. sandwiches, gyros, and pocket sandwiches. "Sandwich" does not include hors d'oeuvres, canapes, egg rolls, cookies, cakes, pies and similar desserts and pastries, and food that is sold frozen.

Sections 77.51(4)(cm) and (15)(cm), as created by 1997 Wis. Act 237, provide that "gross receipts" and "sales price" mean "the portion of the sales price attributable to taxable goods if exempt food, food products or beverages are packaged with other goods by a person other than a retailer before a sale to a final consumer and if less than 50% of the sales price of the goods packaged together is attributable to goods that are exempt under s. 77.54 (20)."

Facts 1:

- ABC Company offers for sale a combination of meat, cheese, and crackers in one package.
- Each packaged combination contains 6-8 crackers, 6-8 slices of cheese, and 6-8 slices of meat.
- The packaged combination is advertised as constituting a meal and is sold for a single price.
- The packaged combination is packaged together by someone other than ABC Company.

Facts 2:

- DEF Company offers for sale a combination of meat, cheese, crackers, a fruit drink, and a small candy bar in one package.
- Each packaged combination contains 6-8 crackers, 6-8 slices of cheese, 6-8 slices of meat, a fruit drink, and a small candy bar.
- The packaged combination is advertised as constituting a meal and is sold for a single price.
- The packaged combination is packaged together by someone other than DEF Company.
- 50% or more of the sales price of the packaged combination is attributable to goods that are exempt from Wisconsin sales or use tax.

Facts 3:

- GHI Company offers for sale a combination of pizza crusts, shredded cheese, sliced pepperoni, a small package of pizza sauce, a fruit drink, and a small candy bar in one package.
- Each packaged combination contains 3-4 mini pizza crusts, shredded cheese, several slices of pepperoni, a small packet of sauce along with a plastic utensil for spreading the sauce, a fruit drink, and a small candy bar.
- The packaged combination may be eaten heated or unheated.
- The packaged combination is advertised as constituting a meal and is sold for a single price.
- The packaged combination is packaged together by someone other than GHI Company.
- 50% or more of the sales price of the packaged combination is attributable to goods that are

exempt from Wisconsin sales or use tax.

Facts 4:

- JKL Company offers for sale a combination of a sandwich, a bag of pretzels or potato chips, and cookies in one package.
- The packaged combination is advertised as constituting a meal and is sold for a single price.
- The packaged combination is packaged together by someone other than JKL Company.
- 60% of the sales price of the packaged combination is attributable to goods that are subject to Wisconsin sales or use tax.

Question:

Are the sales of the packaged combinations described in Facts 1 through 4 above subject to Wisconsin sales or use tax?

Answer:

Facts 1 through 3 - No. None of the sales of the packaged combinations described in Facts 1 through 3 above are subject to Wisconsin sales or use tax because (1) the combinations were packaged by someone other than the retailer before the final sale to the customer and (2) more than 50% of the sales price of each of these combinations is attributable to goods that are exempt from Wisconsin sales and use tax under sec. 77.54(20), Wis. Stats.

Facts 4 - Yes. Sixty percent of the sales price of the packaged combination is subject to Wisconsin sales or use tax because less than 50% of the sales price of the goods packaged together by a person other than the retailer is attributable to goods that are exempt from Wisconsin

sales and use tax under sec. 77.54(20), Wis. Stats. \Box

Transportation Charges

Note: This tax release supersedes the tax release by the same title that appeared in Wisconsin Tax Bulletin 107 (April 1998), pages 26 to 29. Part C of Answer 1 in the previous tax release has been removed because the answer may differ based on facts in written or oral contracts and agreements between the buyer and the seller and between the seller and the carrier. Because these facts may differ on a case-by-case basis. encompassing answer cannot be adequately addressed in a tax release.

Statutes: Sections 77.51(4)(a)3, (14r), and (15)(a)3 and 77.52(2)(a), Wis. Stats. (1995-96)

Wis. Adm. Code: Section Tax 11.94 (June 1991 Register)

Background:

Law

Section 77.51(4)(a)3 and (15)(a)3, Wis. Stats. (1995-96), provides that gross receipts and sales price, for purposes of imposing Wisconsin sales or use tax, include the total amount of the sale, valued in money, whether received in money or otherwise, without any deduction for the cost of transportation of the property prior to its sale to the purchaser.

Section 77.51(14r), Wis. Stats. (1995-96), provides that a sale or purchase involving the transfer of ownership of property shall be deemed to have been completed at the time and place when and where possession is transferred by the seller or the seller's agent to the purchaser or the purchaser's agent. A

common carrier or the U. S. Postal Service shall be deemed the agent of the seller, regardless of any f.o.b. point and regardless of the method by which freight or postage is paid.

Section 77.52(2)(a), Wis. Stats. (1995-96), provides that various services are subject to Wisconsin sales or use tax. Transportation services are not services specifically subject to tax under sec. 77.52(2)(a), Wis. Stats. (1995-96).

Court Decisions

In the cases of Rhinelander Paper Company, Inc. vs. Wisconsin Department of Revenue (97 CV 1051, December 18, 1997) and Trierweiler Construction and Supply Co., Inc. vs. Wisconsin Department of Revenue (97 CV 1444, December 12, 1997), the Circuit Court held that transportation costs are not part of the sales price of tangible personal property subject to Wisconsin sales or use tax when the buyer arranges for the transportation with a carrier independent of the retailer, and the buyer pays the cost of transportation directly to the independent carrier.

The Department of Revenue did not appeal these decisions. The questions and answers below reflect these Circuit Court decisions.

Question 1: When are transportation charges subject to Wisconsin sales or use tax, and who is responsible for paying the tax to the Department of Revenue?

Answer 1:

A. Seller Contracts With Carrier and Buyer Pays Seller for Transportation of Taxable Tangible Personal Property — Delivery by Common Carrier, Contract Carrier, U.S. Postal Service, or Seller's Vehicle

Example: Seller A hires a common carrier to ship its taxable product to Buyer B. The common carrier charges Seller A \$40 for transportation. Seller A charges Buyer B \$1,000 for the product, plus \$50 for transportation.

1. Carrier

The common carrier is not subject to Wisconsin sales or use tax on its \$40 charge to Seller A for transportation because it is providing a service that is not subject to Wisconsin sales or use tax under sec. 77.52(2)(a), Wis. Stats. (1995-96).

Note: In this example, the carrier is not subject to Wisconsin sales or use tax on its sale of the transportation service, regardless of whether the carrier is a common carrier, a contract carrier, or the U.S. Postal Service.

2. Seller

Seller A's total charge of \$1,050 to Buyer B (including the \$50 transportation charge) is subject to Wisconsin sales or use tax. The sale of the taxable product occurs when Buyer B takes possession of the product from the common carrier. Since the transportation occurs before the sale of the property by Seller A to Buyer B, the \$50 transportation charge is included in gross receipts subject to sales tax.

Note: In this example, Seller A's gross receipts subject to Wisconsin sales or use tax include the \$50 charge for transportation, regardless of whether delivery is made by a common carrier, a contract carrier, the U.S. Postal Service, or the seller's own vehicle.

3. Buyer

If Seller A does not charge Buver B Wisconsin sales or use tax on the sale of the taxable product, Buyer B is subject to Wisconsin sales or use tax on Seller A's total charge of \$1,050 (including the \$50 transportation charge). The sale of the taxable product occurs when Buyer B takes possession of the product from the common carrier. Since the transportation occurs before the sale of the property by Seller A to Buyer B, the \$50 transportation charge is included in the sales price subject to sales or use

B. Buyer Contracts With Carrier and Buyer Pays Carrier for Transportation of Taxable Tangible Personal Property — Delivery by Common Carrier, Contract Carrier, or U.S. Postal Service

Example: Seller A charges Buyer B \$1,000 for a taxable product. Buyer B hires a common carrier to pick up the product from Seller A and ship it to Buyer B. The common carrier charges Buyer B \$40 for the transportation.

1. Carrier

The common carrier is not subject to Wisconsin sales or use tax on its \$40 charge to Buyer B for transportation because it is providing a service that is not subject to Wisconsin sales or use tax under sec. 77.52(2)(a), Wis. Stats. (1995-96).

Note: In this example, the carrier is not subject to Wisconsin sales or use tax on its sale of the transportation service, regardless of whether the carrier is a com-

mon carrier, a contract carrier, or the U.S. Postal Service.

2. Seller

Seller A is subject to Wisconsin sales or use tax on its \$1,000 charge to Buyer B. Seller A does not include the \$40 charge for transportation in gross receipts subject to Wisconsin sales or use tax because Seller A does not have any gross receipts from transportation.

Note: In this example, Seller A's gross receipts subject to Wisconsin sales or use tax do not include the \$40 charge for transportation, regardless of whether delivery is made by a common carrier, a contract carrier, or the U.S. Postal Service.

3. Buyer

The buyer is not subject to Wisconsin sales or use tax on the \$40 transportation charge as a result of the *Rhinelander Paper* and *Trierweiler Construction* cases, because Buyer B, independent of Seller A, arranged for the transportation with an independent carrier and paid the costs directly to the carrier.

Question 2: If a seller charges a purchaser for transportation and the transportation is for both taxable and nontaxable tangible personal property, is the entire charge by the seller for transportation subject to Wisconsin sales or use tax?

Answer 2: No. Only that part of the transportation charge that relates to the sale or purchase of **taxable** tangible personal property is subject to Wisconsin sales or use tax. A reasonable allocation of the total transportation charge is required to determine the taxable and nontaxable transportation charges.

Example: Company J sells office supplies to Company K. Company K will use 20% of the office supplies at its headquarters in Wisconsin. The remaining 80% of office supplies will be resold by Company K. Company K issues a resale certificate to Company J, indicating that 80% of the office supplies are exempt from Wisconsin sales or use tax because they are for resale.

Company J hires a common carrier to transport the office supplies and other tangible personal property to Company K.

Company J bills Company K \$1,000 for the office supplies, plus \$100 for transportation.

Transportation charges may be allocated between taxable and nontaxable based on the selling price of the of the items transported. Therefore, of the \$1,100 that Company J charges to Company K, \$200 of the office supplies plus \$20 of transportation charges are subject to Wisconsin sales or use tax. The \$800 of office supplies that will be resold and \$80 of the transportation charges are exempt from Wisconsin sales or use tax. This method of allocating the \$100 transportation charge is as follows:

\$200 (charge for taxable office supplies) \div \$1,000 (total charge for office supplies) = 20%.

20% x \$100 total transportation charge = \$20 taxable transportation charge.

Note: If you have questions about the sales and use treatment of transportation charges that are not addressed in the Background and Questions above, write for a ruling from the Department of Revenue at P.O. Box 8933, Madison, WI 53708-8933. Copies of contracts and invoices between the buyer and the seller and the seller and carrier should be provided with the request for a ruling.



Private Letter Rulings

"Private letter rulings" are written statements issued to a taxpayer by the department, that interpret Wisconsin tax laws based on the taxpayer's specific set of facts. Any taxpayer may rely upon the ruling to the extent the facts are the same as those in the ruling.

The ruling number is interpreted as follows: The "W" is for "Wisconsin"; the first four digits are the year and week the ruling becomes available for publication (80 days after it is issued to the taxpayer); the last three digits are the number in the series of rulings issued that year. The date is the date the ruling was issued.

Certain information that could identify the taxpayer has been deleted. Additional information is available in Wisconsin Publication 111, "How to Get a Private Letter Ruling From the Wisconsin Department of Revenue."

The following private letter rulings are included:

Sales and Use Taxes

Computer software – programs (canned vs. custom) W9831006 (p. 33)

Computer software – programs (canned vs. custom) W9832007 (p. 35)

Exemptions – personalty vs. realty Exemptions – governmental unit W9838008 (p. 38)

* W9831006

May 11, 1998

Type Tax: Sales and Use

Issue: Computer software – programs (canned vs. custom)

Statutes: Sections 77.51(20) and 77.52(1), Wis. Stats. (1995-96)

Wis. Adm. Code: Section Tax 11.71 (April 1993 Register)

This letter responds to your request for a private letter ruling.

Facts

DEF, Inc. (DEF) licensed to ABC Company (ABC) XYZ software. The XYZ software consists of approximately ten standardized modules of which ABC uses six. The cost of the software licensed by ABC was a small piece of ABC's planned new operating system.

DEF's standard Software License and Support Agreement provided for the license of the XYZ software and maintenance and support. An addendum to the standard agreement provided that "software" for purposes of the agreement meant "the computer software modules and related components. . . and any modifications and new versions

thereof and substitute programs there for provided by DEF under this Agreement and the Professional Services Agreement entered into between the parties contemporaneously with this Agreement."

The total charge for the XYZ System based on the number of users was \$1,651,483.52, excluding maintenance and support. Maintenance fees were 15% of DEF's list price for the software. Support services were provided at \$250 per hour for the first hour and \$100 for each hour thereafter.

The Professional Services Agreement provided for the following types of services that were billed on a time and materials basis plus reasonable travel and living expenses:

- 1. General professional services which included:
 - a. Conducting application learning labs (\$382,950)
 - b. Planning and preparation (\$75,800)
 - c. Implementation (\$208,250)
 - d. Pre-migration service, including system simulation and issue review assistance and migration planning (\$25,600)
 - e. Conversion guidance and assistance (\$40,750)
 - f. Migration (\$62,100)
 - g. Implementation (\$62,100)
- 2. Enhancements done in a general fashion, but also taking into account ABC requirements, usable by other DEF customers. Such enhancements related to order processing and purchasing for which \$19,225 was paid.

3. Optional ABC specific customizations

A description of the customizations to the software provided by DEF and the estimate of mandays to accomplish is as follows:

 a. Geographic restriction. The system will prohibit the shipping of a product to a restricted location upon order entry.

20 man days

b. Billing agent and transfer receivables. Provides the ability for ABC to act as a billing agent for certain transfers.

45 man days

 c. Credit management. Provides the ability for ABC to purchase receivables from distributors and calculate customer interest and payment schedule.

32 man days

d. Credit check services. Provides an interface with credit check organizations.

7 man days

e. Multiple cost items on quote. A requisitioned item will pull all additional charges as additional line items for purchases from a vendor.

36 man days

f. Mass updates.

20 man days

g. Electronic fax. Provide ability to create a fax file from information in XYZ.

15 man days

h. Direct ship. Turn orders requiring direct/drop ship automatically into purchase orders.

35 man days

i. Quote system.

10 man days

j. "Bread man" standing orders functionality. Requires a receipt that automatically triggers an evaluated receipt payment.

16 man days.

Annual maintenance and support fees were increased to 20% of the original fee paid by ABC in order to receive customization of the software.

Several hundred modifications were made to the software by DEF for ABC, with the aid of ABC employes and consultants. The core of the software was significantly modified as summarized above. DEF personnel were on site at ABC for nearly two years coordinating changes to the core modules.

The department had issued an informal ruling to DEF that the software it licensed in general was not custom software and, therefore, charges for the license and installation of the software were subject to Wisconsin sales or use tax. DEF had indicated in its request for the ruling that it made no modifications to the software licensed to its customers. The only customizations consisted of enabling and disabling standard features of the software.

The general nature of the software licensed by DEF can be distinguished from the software licensed to ABC as follows:

1. The largest overseas volume user of the DEF software proc-

esses the same number of transactions in a year that ABC processes in a week.

- 2. ABC has over 50,000 sales order lines a day. No other company using DEF software has this volume of activity.
- 3. Modifications to the six modules resulted in more lines of code than comprised the original six modules. (Note: The Professional Services Agreement provided that ABC had the right to contract with third parties to aid in making custom modifications to the software with cooperation from DEF. ABC contracted with several outside consultants to aid in the project who also significantly modified the software. However, modifications by DEF alone were still significant.)
- 4. Speed, in some areas of the system, was enhanced by 25 times.
- 5. Modifications were so significant that DEF no longer supports the substantial changes made to the product for ABC.

Request

You ask whether charges by DEF to ABC for software and related support and professional services are subject to Wisconsin sales or use tax.

Ruling

Gross receipts from the (1) license of computer software by DEF to ABC and (2) furnishing of related support and professional services for that software are not subject to Wisconsin sales or use tax.

Analysis

Section 77.52(1), Wis. Stats. (1995-96), imposes a Wisconsin sales tax on sales of tangible personal property and taxable services at retail in Wisconsin.

"Tangible personal property" for purposes of imposing Wisconsin sales tax is defined in sec. 77.51(20), Wis. Stats. (1995-96), to include computer programs, except custom computer programs.

Section Tax 11.71(1)(e), Wis. Adm. Code (April 1993 Register), defines "custom programs" to mean utility and application software which accommodate the special processing needs of the customer. The determination of whether a program is a custom program shall be based upon the facts and circumstances, including the following:

- 1. The extent to which the vendor or independent consultant engages in significant presale consultation and analysis of the user's requirements and system.
- 2. Whether the program is loaded into the customer's computer by the vendor, and the extent to which the installed program must be tested against the program's specifications.
- 3. The extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation.
- 4. The extent to which the enhancement and maintenance support by the vendor is needed for continued usefulness.
- 5. There is a rebuttable presumption that any program with a cost of \$10,000 or less is not a custom program.

- 6. Custom programs do not include basic operational programs or prewritten programs.
- 7. If an existing program is selected for modification, there must be a significant modification to the program by the vendor so that it may be used in the customer's specific hardware and software environment.

The significant presale consultation and analysis, training, and modifications furnished by DEF and installation of the software by DEF leads to the conclusion that the software licensed by DEF to ABC is custom software. Custom computer software is not tangible personal property and therefore, the license of and service to such software is not subject to Wisconsin sales or use tax.

※ W9832007

May 19, 1998

Type Tax: Sales and Use

Issue: Computer software – programs (canned vs. custom)

Statutes: Sections 77.51(20) and 77.52(1) and (2)(a), Wis. Stats. (1995-96)

Wis. Adm. Code: Sections Tax 11.67 (November 1993 Register) and 11.71 (April 1993 Register)

This letter responds to your request for a private letter ruling and incorporates the additional information you provided in subsequent letters.

Facts

GHI Corporation (GHI) operates several television and radio stations in Wisconsin and Minnesota. GHI licensed computer software consisting of various modules from JKL, Inc. (Vendor).

The software is a "traffic system" which schedules and keeps track of all programs and advertising spots shown on a number of television stations. In addition, the software provides a billing mechanism for all advertising charges and tracks accounts receivable and collections of those charges.

Additional facts are as follows:

- The initial term of the license agreement is 66 months. Total license fees for the 66-month period are in excess of \$325,000.
- Much of what Vendor did under the license agreement relates to installation, system setup, user training, technical support, and ongoing operations support. While not related to writing custom software, it is a related service requiring extensive people hours by skilled Vendor personnel. These services are not billed separately, but instead comprise a large portion of the contracted monthly payments included in the "Software License Agreement."
- Hardware was purchased separately, and sales tax was paid on that purchase.
- An evaluation of GHI's needs and requirements was done by Vendor prior to sale in excess of 100 hours. This evaluation, in addition to determining software needs, also encompassed the network/hardware needs of GHI.
- Modules with various individual functions were provided under the license agreement: maintenance, parameters, traffic management, billing, operator functions, and data exchange interface. The modules existed at the time of license.

There were no program code changes to the software; however, the following services provided relate to the modules licensed by Vendor:

- The software was adapted for network configuration. Because of frame technology and interaction between stations, complex configurations to the software were necessary to accommodate each of GHI's locations. Software which controls the network protocols (not Vendor software) was modified, including networking software.
- Modifications were made to allow for special format requirements for confirmation documents and billing invoices that transferred to a laser printer at each location. Time spent making this modification was one man week.
- User specific data categories and category codes were established that applied to each transaction. Queries were then written to group transactions by category codes and by salesperson and/or national sales office, presenting data in a format not provided by the standard Vendor reports. Queries also allowed for grouping data over date ranges other than the standard broadcast and calendar months of Vendor. Time spent making these program set-up changes was three man weeks. Time spent on support for such functions after installation is estimated at one or two days per month.

The queries are conceptually similar to macros in LOTUS, however, the skill level required to make these queries work is higher. Establishing the query requires setting up a set of parameters which is beyond the scope of normal system usage.

- Vendor, as part of the license, was responsible for installing and providing training for up to 35 man weeks. Vendor actually provided about 45 man weeks for installation and 45 man weeks for training. Initial installation and training estimated to be 35 man weeks at a separate charge of \$1,500 per week or a total of \$52,500 with expenses. Additional training and follow-up after installation is available for an additional charge.
- Vendor, during the period of the license, provides telephone support, changes in program logic, system refinements, and enhancements. Vendor has established a communications link directly, which allows diagnosis and recommendations in the event of a system crash. Telephone support is also provided where, questions are directed to Vendor's communications center. This particular service relates to all aspects of the network system, but primarilv system software crashes.

Request

You ask whether the traffic software system acquired from Vendor by GHI qualifies as custom software for purposes of the Wisconsin sales and use tax, such that all monthly license charges and installation and training fees are not subject to Wisconsin sales or use tax.

Ruling

The computer software licensed by Vendor to GHI is not custom software. The monthly charge that relates to the license and installation of the software, configuration of existing software and hardware, and enhancement and maintenance of such software and hardware is subject to Wisconsin sales or use tax.

Separate charges for telephone support (i.e., answering questions by telephone) and training are not subject to Wisconsin sales or use tax.

Analysis

Section 77.52(1), Wis. Stats. (1995-96), imposes a Wisconsin sales tax on sales of tangible personal property and taxable services at retail in Wisconsin.

"Tangible personal property" for purposes of imposing Wisconsin sales tax is defined in sec. 77.51(20), Wis. Stats. (1995-96), to include computer programs, except custom computer programs.

Section Tax 11.71(1)(e), Wis. Adm. Code (April 1993 Register), defines "custom programs" to mean utility and application software which accommodate the special processing needs of the customer. The determination of whether a program is a custom program shall be based upon the facts and circumstances, including the following:

- 1. The extent to which the vendor or independent consultant engages in significant presale consultation and analysis of the user's requirements and system.
- 2. Whether the program is loaded into the customer's computer by the vendor, and the extent to which the installed program

must be tested against the program's specifications.

- 3. The extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation.
- 4. The extent to which the enhancement and maintenance support by the vendor is needed for continued usefulness.
- 5. There is a rebuttable presumption that any program with a cost of \$10,000 or less is not a custom program.
- 6. Custom programs do not include basic operational programs or prewritten programs.
- 7. If an existing program is selected for modification, there must be a significant modification to the program by the vendor so that it may be used in the customer's specific hardware and software environment.

Although significant presale consultation, maintenance, enhancement, and training were provided when looking at the entire system licensed to GHI, only a portion relates solely to the Vendor software in question. The department does not consider that portion relating only to the software licensed by Vendor to be significant. More importantly, no significant modifications were made to the program by the vendor.

Document formats were created and queries were set up using the software. Configurations to the software were necessary. However, the program code or language, which existed prior to the license to GHI, was not changed to make it useable by GHI. The department does not consider the document formats, queries, and configurations to be

significant modifications to the software.

Section 77.52(2)(a)10, Wis. Stats. (1995-96), provides that the service or maintenance to tangible personal property is subject to Wisconsin sales or use tax. Vendor, in providing installation of, and maintenance and enhancement to, the computer network (e.g., computer hardware and computer software, except custom), is providing a service to tangible personal property that is subject to Wisconsin sales or use tax

Training services are not subject to Wisconsin sales or use tax under sec. 77.52(2)(a), Wis. Stats. (1995-96). Similarly, charges for telephone support that results only in a technician answering questions for a customer, where the customer performs the service as instructed by the technician, are not subject to Wisconsin sales or use tax. The technician has not serviced, repaired, or maintained the software, which is a service subject to tax under sec. 77.52(2)(a)10, Wis. Stats. (1995-96). The technician has provided only training services, while the customer has actually serviced the software based on the technician's instruction.

Telephone support charges relating to installation, configurations, inspection, and other services to computer hardware and computer software, except custom software, that are performed directly by the technician either on the customer's site or off-site through use of a modem, are subject to sales tax under sec. 77.52(2)(a)10, Wis. Stats. (1995-96).

Section Tax 11.67(2)(c), Wis. Adm. Code (November 1993 Register), provides that if there is a single charge for both taxable and nontaxable services, the entire charge is

subject to tax, unless it is determined by the department that another method, such as allocation or primary purpose of the transaction, more accurately reflects the tax. If the charges for taxable and nontaxable services are separately stated on an invoice, the tax applies only to the charge properly attributable to the taxable services, unless it is determined by the department that the primary purpose of the transaction method for computing the tax more accurately reflects the tax.

₩ W9838008

June 25, 1998

Type Tax: Sales and Use

Issue: Exemptions – personalty vs. realty; Exemptions – sales to governmental unit

Statutes: Section 77.54(9a), Wis. Stats. (1995-96)

Wis. Adm. Code: Section Tax 11.68 (October 1997 Register)

This letter responds to your request for a private letter ruling, regarding whether the water purification equipment and property described in the facts below retains its status as personal property when installed. Thank you for the additional information you have submitted.

Facts

The joint venture of MNO, Inc. (MNO) and PQR, Inc. (PQR) has been engaged by the City of X Department of Public Works ("DPW") to construct two water purification plants ("Projects"). As provided in the contract, MNO/PQR will provide all labor, material, equipment, professional design services, administration, and supervision required for the complete design, permitting, procurement, construction, testing, and commissioning of

the complete ozonation system at the water purification plants.

The contract can be segregated into two primary aspects: first, the construction of new buildings; and second, the installation of the ozonation system. The ozonation system is the subject of this request.

Description of system and process. In general terms the ozonation system includes liquid oxygen storage tanks and related equipment, ozone generation equipment, ozone fine-bubble diffusion equipment, cooling water system, off-gas destruction equipment (ozone destruct system), ozone residual control equipment, harmonic mitigation equipment, instrumentation control systems, safety, monitoring and control equipment, start-up services, all performance testing, all acceptance testing and all required support systems including equipment and operations buildings, contact tanks, raw water pump modifications, electrical systems, HVAC systems, and process piping and plumbing systems.

The ozonation process itself begins when raw water pumps bolted to concrete pads draw water from a specific Body of Water. The water is pumped into contact basins for treatment with ozone gas. Cooling water for the ozone generators and power supply units is pumped by booster pumps bolted to concrete pads into water bath vaporizers. These vaporizers are tanks bolted to concrete pads. Ozone gas is generated and conveyed to fine-bubble diffusion systems located in the contact basins. Supplemental air is provided by compressed air systems also bolted to concrete pads. This process disinfects the water. The ozone is generated on-site from liquid oxygen stored on-site in 20,000 gallon storage tanks. The ozone generators and power supply units are bolted to concrete pads.

Once the water is purified, an ozone destruct system consisting of blowers and catalytic destruct units connected to the contact basins removes the ozone from the air above the water surface. These items are also bolted to concrete pads. The purified water is then conveyed into the balance of the existing treatment plant and subsequently piped into DPW's distribution systems for delivery to commercial and residential customers.

As part of the process monitoring system, the residual control equipment is used to check the performance of the ozone disinfection system and is also used to set the dosage rate for the hydrogen peroxide. The hydrogen peroxide dissipates any remaining ozone in the water at the end of the ozone treatment process.

The harmonic mitigation equipment is used to condition the electric power which is used in the ozone generation process.

Throughout the process, piping and tubing connect the processing equipment described above. The flow of water and chemicals through this tubing is regulated by valves and slide gates controlled by various instrumentation, gauges, and computers.

Description of Tanks. There are three types of tanks being provided for this project. One type is called an ozone contactor, another type is hydrogen peroxide storage tanks, and the third type is liquid oxygen (LOX) storage tanks.

The ozone contactors are reinforced concrete structures constructed on site, partially buried, the remainder extending above grade. The above grade portions are faced with brick masonry or native stone. The contactors also have a reinforced concrete flat slab roof. The contactors will be used to disinfect the untreated Body of Water water by serving as the point of application for the ozone gas and as a holding tank to allow sufficient time for the ozone gas to react with the contaminants. There are four contactors holding approximately one million gallons each at the Plant Y plant site and two contactors holding approximately 800,000 gallons each at the Plant Z plant site.

The hydrogen peroxide tanks are used for bulk storage and feed pump storage of this chemical which is used to neutralize any remaining ozone gas in the water before it leaves the ozone contactors. There is one system at each plant site. The bulk storage tanks are constructed of aluminum, and the feed pump storage tanks (day tanks) are constructed of stainless steel. Both the bulk storage tanks and the day tanks are mounted on concrete pads inside the operations buildings. The bulk storage tanks contain 1,000 gallons at Plant Z and 1,500 gallons at Plant Y and the day tanks contain fifty gallons each. Both the bulk storage tanks and the day tanks are fabricated off site and shipped to the job site for installation.

The cryogenic liquid oxygen storage tanks are made of double wall, insulated construction, the inner vessel is constructed of stainless steel and the outer vessel of carbon steel. There are two 20,000 gallon tanks located at each plant site. They are fabricated off site, shipped to the job site, and mounted in exterior locations on reinforced concrete cradles. These tanks are used to store the liquid oxygen until it is vaporized into gaseous oxygen and then converted to ozone gas by the application of electrical energy.

Functions of HVAC systems. There are two principle functions. The first is to provide normal heating and ventilating of the OCCIIpied/equipment spaces the in buildings. The second is to provide emergency, high rate exhaust of these areas to the outside atmosphere should a leak develop in the ozone system. Devices are placed throughout these areas to monitor the presence of ozone gas.

There is also a "process" system which exhausts air from the ozone contactors to remove any lingering ozone gas which may accumulate in the space above the water surface, below the roof slab. This air is processed through an ozone destruct system before being released into the atmosphere. This system operates on a continuous basis.

Description of Process Piping. There are two types of "process" piping. The major process piping consists of large diameter (48 inch through 120 inch) prestressed concrete and steel pipe. The piping carries the water being treated throughout the plant sites. Most of this piping is buried except where access is required within reinforced concrete vaults or inside the buildings, to equipment installed in the piping such as flow meters, valves, and monitors.

The other types of "process" piping are smaller diameter (less than 8 inches), generally exposed inside the buildings, and convey the following:

Liquid Oxygen:

From the LOX storage tanks to vaporizer equipment.

Gaseous Oxygen:

From the vaporizers to the ozone generation equipment.

Ozone Gas:

From the ozone generation equipment to banks of diffusers located inside the ozone contactors.

Sample Water - 1:

From the ozone contactors to dissolved ozone monitoring equipment which provides feedback on the process for control purposes (at both plants).

Sample Water - 2:

From the large effluent piping at Plant Y to the laboratory for monitoring chlorine levels in the finished drinking water.

Chemical Piping - 1:

To convey hydrogen peroxide from storage tanks into the effluent of the ozone contactors (at both plants).

Chemical Piping - 2:

To convey chlorine, ammonia, fluoride, and phosphoric acid from existing equipment to the new feed points (at Plant Y only).

Compressed Air:

To convey compressed air from new compressors into the ozone gas system to supplement ozone gas and to convey air to operate chemical sump pumps.

Plumbing:

Other systems convey building and service water from existing plant storage to the new buildings, collect drainage and convey to disposal and or collect storm water from roofs and surface areas and convey to disposal off site.

Description of Electrical Systems. There are various levels of electrical systems. At each plant, there are primary power (480 volt) feeds from the plant substation to the new transformers at the ozone generation operations buildings. In addition, at the Plant Y site, a new plant wide

(27.6 kV) power feed is being provided consisting of a major substation.

There are also power systems which convey power from the motor control lineup to each major piece of equipment such as the power supply units for the ozone generators, pumps, HVAC equipment, air compressors, ozone destruct units, etc.

A motor control lineup or motor control center (MCC) is an electrical enclosure containing multiple circuit breakers and motor controllers (starters). Typically, one or two electrical power feeds are brought to the MCC. These are typically referred to as a "main(s)" or "incoming line(s)." Inside the MCC, the electrical power provided by the mains or incoming lines is divided among the circuit breakers and motor starters. The circuit breakers and motor starters are used to distribute the power to equipment requiring electricity, such as HVAC fans, air compressors, pumps, etc.

Some of the electrical loads fed from the MCC are furnished with their own controls. Air compressors, for example, typically are provided with a control panel that controls the operation of the compressor. This type of equipment will be fed by a circuit breaker in the MCC.

Motor starters are used when the loads require the electrical power feed to be controlled. Pumps are a good example. Pumps are operated by turning electrical power to the motor on and off. The electrical power to the motor is controlled at the motor starter. Control switches, value interlocks, and supervisory control and data acquisition systems are connected to the motor starter to control the electrical power feed to the motor and, as a result, control the operation of the pump.

There is also equipment to equipment wiring, such as from the power supply units to the ozone generators.

Another electric system provides volt service, such as lighting, some sump pumps, and certain HVAC equipment.

In addition to power electrical systems, there are also systems for instrumentation and control of the water treatment process equipment.

The major electrical service from the substations on site is conveyed through underground duct banks. Inside the buildings, major duct banks are buried beneath floor slabs, however, there are portions of this which are exposed in conduits leading to the ozone generation and other major equipment.

Startup Services. MNO/PQR is providing training and startup assistance for DPW staff consisting of formal training classes and onsite instructions.

Performance Testing. As part of MNO/PQR's contract with DPW, MNO/PQR has certain performance guarantees which set minimum power, liquid oxygen, and cooling water consumption for various levels of ozone gas feed. This effort will be performed after the project meets the substantial completion requirements of the contract.

Acceptance Testing. As part of the installation, MNO/PQR is providing functional acceptance testing to ensure that the systems are operating as intended. This consists of a prescribed series of simulations and checks to verify that the equipment and overall systems operate as intended. This work must be completed to meet substantial completion requirements.

Support Systems. Support systems consist of building lighting, HVAC, plumbing, etc.

Raw Water Pumping Modifications. At the Plant Y plant, MNO/PQR is intercepting the Body of Water water before it enters the existing treatment plant and conveying it to the new ozonation facilities. To do this, some of the existing raw water pumps must be modified to provide sufficient additional pressure to convev water to the new contactors. This work consists of modifying two of the existing pumps by providing new impellers within the pump, new motors, and new power feed equipment. While the modifications are being made, the pumps will also be provided with other miscellaneous upgrades. The other pumps do not need this modification.

Plumbing Systems. Plumbing systems at each plant site consist of restroom facilities, floor drainage, roof drainage, and washdown/ service water systems. In addition, there are drainage systems for the ozone contactors.

The drainage system for the ozone contactors is a combination of above and below ground piping. Most of the drainage system is, however, buried beneath the floor slabs of the contactors or underground.

Much of the plumbing for drainage of floor slabs is buried beneath the floor slabs. Roof drainage is supported from the underside of roof slabs or decks.

Request

Does the processing equipment and property described in the facts above retain its status as personal property when installed in the water purification plants, thereby qualifying for the resale exemption when acquired by MNO/PQR, and also qualifying

as an exempt sale to a governmental entity when sold to and installed at DPW?

Ruling

The following tax treatment applies, depending on whether the property installed becomes real property or remains tangible personal property:

1. Real Property (R)

MNO/PQR is the consumer of tangible personal property used in making the real property improvement. Therefore, MNO/PQR is subject to Wisconsin sales or use tax on its purchase of the property.

The sale of the real property improvement (labor and materials) by MNO/PQR to DPW is not subject to Wisconsin sales or use tax.

2. Tangible Personal Property (P)

MNO/PQR may purchase the tangible personal property it installs that remains tangible personal property without tax, because it is for resale.

The sale and installation of the tangible personal property (labor and materials) is exempt from Wisconsin sales and use taxes under sec. 77.54(9a), Wis. Stats. (1995-96).

The following property as described in the facts above, for purposes of installation by MNO/PQR, is classified as noted below:

Note: The classifications below do not apply to concrete foundations. Concrete foundations become a part of real property when installed.

- 1. Tanks
 - a. Ozone contactors P
 - b. Hydrogen peroxide storage tanks **P**
 - c. Liquid oxygen storage tanks and related equipment **P**
- 2. Ozone Generation Equipment **P**
- 3. Ozone Fine-Bubble Diffusion Equipment **P**
- 4. Cooling Water Equipment (Booster Pumps and Water Bath Vaporizers) P
- Off-Gas Destruction Equipment
 P
- 6. Ozone Residual Control Equipment P
- 7. Harmonic Mitigation Equipment P
- 8. Instrumentation and Control Systems P
- 9. Safety, Monitoring, and Control Equipment **P**
- 10. Equipment and Operations Buildings **R**
- 11. Raw Water Pump Modifications P

12. Electrical Systems:

- a. Primary power feeds from plant substation to new transformers at ozone generation operations building R
- b. Substation at Plant Y site -R
- c. Power feeds from plant substation to motor control center **R**

- d. Power system to convey power from motor control lineup to:
 - (1) Power supply units for ozone generators **R**
 - (2) Pumps **R**
 - (3) HVAC equipment **R**
 - (4) Process piping and plumbing systems **R**
- e. Equipment to equipment wiring **P** (Assumes equipment is personal property.)
- f. Electrical system to provide volt service, such as lighting, some sump pumps, and certain HVAC equipment R
- g. Systems for instrumentation and control of water treatment process equipment P (Assumes wiring is equipment to equipment wiring.)

13. HVAC Systems

- a. System for normal heating and ventilating of the occupied/equipment spaces in the buildings and emergency, high rate of exhaust of these areas R
- b. "Process" system to remove lingering ozone gas **P**

14. Process Piping

- a. Above ground process piping carrying water being treated throughout the plant sites P
- b. Underground process pipingR

- c. Other process piping:
 - (1) Liquid Oxygen P
 - (2) Gaseous Oxygen P
 - (3) Ozone Gas P
 - (4) Sample Water 1 **P**
 - (5) Sample Water 2 **P**
 - (6) Chemical Piping 1 **P**
 - (7) Chemical Piping 2 **P**

(8) Compressed Air - P

(**Note**: Answers to items 14. c. (1) to (8) above assume the piping is above ground.)

15. Plumbing - R

Analysis

Section Tax 11.68(4)(b), Wis. Adm. Code (October 1997 Register), provides that certain types of property that have a variety of functions may be 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 personal property. The property listed above as tangible personal property is property which serves a process function. The property listed as real property is installed primarily to provide service to a building or structure and is essential to the building or structure.□