

Wisconsin TAX BULLETIN

www.revenue.wi.gov

Number 158

October 2008



2009 Brings Paperless Resources

This is the last paper issue of the *Wisconsin Tax Bulletin* (WTB). In addition, the *Topical and Court Case Index* (TCCI) will no longer be printed, and Package WI-X has been discontinued. All of the information provided by these resources is available to you on the department's website at www.revenue.wi.gov. Forms and instructions for 2008 will be available in the "Forms" section, and the WTB and TCCI will be available in the "Publications" section.

An additional resource for tax professionals is the "Practitioners" section of the department's website. Look here for current news items, as well as other information of specific concern to software developers and tax practitioners. You can also sign up for the tax practitioner electronic mailing list to receive information and updates by e-mail, including notification when a new issue of the WTB is available or the TCCI has been updated. [🔗](#)

Baraboo, Lancaster, and Marinette Offices to Close

The Department of Revenue will close its Lancaster office effective the end of October 2008, and its Baraboo and Marinette offices effective the end of December 2008. Customer services for persons in these locations will be provided from the Madison, Appleton, and Green Bay offices. Assistance and information are also available on the department's website, www.revenue.wi.gov.

In addition, department staff will be providing income tax assistance during the upcoming filing season at libraries in the Baraboo and Lancaster communities. See the article titled "Libraries to Help the Department of Revenue Provide Assistance" in the next column. [🔗](#)

E-File Mandate Letters to Tax Return Preparers and Tax Preparation Firms

As part of the Wisconsin Department of Revenue's (DOR) efforts to increase electronic filing, DOR mailed e-file mandate letters to tax return preparers and tax preparation firms that prepare 100 or more paper individual income tax returns. The letter will require the tax return preparer or tax preparation firm to file individual income tax returns electronically, effective with tax returns filed on or after January 1, 2009 (Wisconsin Administrative Code section Tax 2.08(3)(b)).

(continued on page 3)

Libraries to Help the Department of Revenue Provide Assistance

Thanks to the cooperation of several libraries, income tax assistance will be provided during the upcoming filing season in 9 communities where a Department of Revenue (DOR) office has closed. Beginning in January of 2009, DOR staff will be providing assistance at libraries in the communities of Baraboo, Beaver Dam, Elkhorn, Grafton, Hayward, Kenosha, LaCrosse, Lancaster, and Sheboygan. Details as to the dates, times, and locations of assistance will be available by the end of December on DOR's website at www.revenue.wi.gov. [🔗](#)

TeleFile Discontinued for Individuals

Due to decreased usage and increased costs, the Department of Revenue is no longer allowing individual income tax returns to be filed by telephone using TeleFile. TeleFile will continue to be available for filing sales and use tax returns.

The number of persons filing an income tax return using TeleFile has steadily decreased. While 126,800 individuals used TeleFile to file a 2000 return, only 25,600 used it to file a 2007 return. The department will be contacting those individuals who filed a 2007 return using TeleFile to explain other available electronic filing options. [🔗](#)

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Tax Booklet Mailings to be Reduced for Individuals and Discontinued for Partnerships and Corporations

The Department of Revenue anticipates it will be reducing its annual mailing of Form 1, 1A and WI-Z, 1NPR, and Schedule H and H-EZ booklets for individual income tax by over 40% this year. A 2008 booklet will only be mailed to individuals who paper filed a 2007 income tax return or homestead credit claim using a department-printed form. In addition, the mailing of Form 3, 4, 5, and 5S booklets for partnership and corporate franchise and income tax has been discontinued. These decisions were made based on the department's finding that many individuals and the majority of businesses use either tax preparation software or the Internet to obtain their forms.

The department will be promoting electronic filing of 2008 partnership, corporate franchise and income tax, and individual income tax forms. Forms and instructions will continue to be available on the department's Internet site. [↗](#)



Your Comments About the *Wisconsin Tax Bulletin*

The *Wisconsin Tax Bulletin* (WTB) is produced to provide tax professionals with timely and useful information. Input from readers can be a valuable resource for improving the information provided in the WTB and how it is presented.

Do you have ideas, comments, or suggestions concerning the WTB? Please take a few moments to share them with us. Contact Dale Kleven by e-mail at isetchsvc@revenue.wi.gov or by phone at (608) 266-8253. We'd like to hear from you! [↗](#)

We Need You!



Volunteers are needed statewide for the Volunteer Income Tax Assistance (VITA) program of the Internal Revenue Service (IRS) and the Tax Counseling for the Elderly (TCE) program of the American Association of Retired Persons (AARP). The need is especially great in Milwaukee, where the VITA program is being expanded for the upcoming filing season to provide free tax preparation and electronic filing services for customers of 28 area libraries.

We know that tax time is already extremely busy, so even a few hours you could spare helping to prepare federal and state income tax returns for senior citizens and persons with low to moderate income would be greatly appreciated. To volunteer, or for more information concerning volunteer opportunities, contact Rick Dilley of the Wisconsin Department of Revenue at (608) 266-2606 or Richard.Dilley@revenue.wi.gov. [↗](#)



Please, No Staples

E-filing is the fastest, most secure way to file tax returns. If you or your clients choose to file on paper instead, please do NOT use staples. If you are concerned about holding documents together, use a paper clip. Removing staples requires extra effort; multiplied over thousands of returns, staples delay the processing of your clients' tax returns. [↗](#)

Wisconsin Tax Bulletin

Published quarterly by:

Wisconsin Department of Revenue
Income, Sales, and Excise Tax Division
Mail Stop 6-40
P.O. Box 8933
Madison, WI 53708-8933

E-File Mandate Letters to Tax Return Preparers and Tax Preparation Firms

(continued from page 1)


A tax return preparer or tax preparation firm can learn how to become an authorized Electronic Filing Originator (ERO) for the State of Wisconsin by visiting our website at www.revenue.wi.gov/eserv/e-ero.html. This website also provides a list of tax preparation software to purchase and use to prepare and electronically file federal and state income tax returns. For any questions, the tax return preparer or tax preparation firm can e-mail DOR at efiling@revenue.wi.gov; write to the Customer Service Bureau, Wisconsin Department of Revenue, Mail Stop 5-77, P.O. Box 8949, Madison, WI 53708-8949; fax us at (608) 264-7776; or call us at (608) 264-6886.

If the tax return preparer or tax preparation firm believes the requirement to file electronically causes an *undue hardship* for their business, the preparer or firm can write to Mandate Waiver Request, Wisconsin Department of Revenue, Mail Stop 5-77, P.O. Box 8949, Madison, WI 53708-8949. The preparer or firm

must clearly indicate why the requirement causes an undue hardship.

There are numerous advantages of electronic filing, direct deposit, and electronic funds transfer (EFT):

- Electronic returns are more accurate. The computer eliminates arithmetic errors.
- Electronic returns are more certain. E-filing acknowledges that an income tax return was received.
- Electronic returns mean better business. An individual receives their income tax refund by direct deposit within 5-7 business days.
- EFT allows an individual to pay any balance due on the day specified.
- Electronic returns and refunds/payments provide security and confidentiality for all transactions.


These efficiencies have never been more important than now, when businesses and government are trying to find ways to provide quality service at a reduced cost. 

Schedules OS and OS-E Consolidated for 2008

Effective for 2008 tax returns, the department will once again be using a single schedule for individuals, estates, and trusts claiming the credit for net tax paid to another state (TPOS). The 2008 Schedule OS is a consolidation of the 2007 Schedule OS and the 2007 Schedule OS-E, which was available to individuals filing electronically and claiming TPOS. A draft of the 2008 Schedule OS is available at:

www.revenue.wi.gov/forms/draft/index.html.

The 2008 Schedule OS is similar in format to the 2007 Schedule OS-E in that it requires the claimant to enter income information from the other state tax return(s). However, unlike with Schedule OS-E a copy of the other state tax return(s) must be submitted to the department.


With the consolidation of Schedules OS and OS-E, software developers and other tax professionals will have one less form to manage. In addition, with the new format of Schedule OS the department anticipates quicker processing of tax returns claiming TPOS, as fewer letters seeking clarification of the credit computation should be required. 

Reminders: Filing Wage Statements and Information Returns

The Department of Revenue (DOR) wishes to remind employers and other payers who will be filing 2008 wage statements and other information returns in 2009 of the following:

- DOR no longer accepts magnetic media.

- Unless an exception applies, electronic filing is mandatory for employers filing 250 or more wage statements, and for payers filing 250 or more of any one type of information return with DOR.

Additional information is available in Publication 509, *Filing Wage Statements and Information Returns Electronically*. Publication 509 is available on DOR's website at www.revenue.wi.gov/pubs/pb509.pdf. 

Guidance on New Requirement to Add Back Certain Related Entity Expenses

In 2007 Wisconsin Act 226, the Wisconsin Statutes were amended to require taxpayers to “add back” to their federal income certain expenses paid, accrued, or incurred to a related entity when computing their Wisconsin income. The Act provides that these “added back” expenses may then be subtracted if certain conditions are met. The expenses subject to this new law are interest expenses and rental expenses.

The new law provides that one of the conditions required to subtract related party interest or rental expenses is that the expense be disclosed on a separate form prescribed by the department in the manner prescribed by the department. The department has designated Schedule RT as the form to be used for this disclosure.

Wisconsin Tax Bulletin 157 (July 2008), page 13, provides more details of the Act 226 provisions regarding related entity expenses.

This Bulletin contains the first of a two-part series of frequently asked questions about this new law. Part 1 presents answers to frequently asked questions about the following topics:

- Taxpayers subject to the addback requirement
- Expenses subject to the addback requirement
- Conditions necessary to deduct expenses that were added back
- Nondeductible related entity expenses

Part 1 of the series starts on page 16 of this Bulletin. Part 2 of the series, which will appear in the January 2009 Bulletin, will present answers to frequently asked questions about Schedule RT. [✎](#)



Administrative Rules in Process

Listed below are administrative rules that are currently in the rule promulgation process. The rules are shown at their stage in the process as of October 1, 2008, and at each step where action occurred during the period from July 1, 2008, through October 1, 2008. The listing includes rule numbers and names, and whether a rule is amended (A), repealed and recreated (R&R), or a new rule (NR).

Emergency Rules Adopted and in Effect

- 8.03 Wine collectors – NR
- 8.05 Small winery cooperative wholesalers – NR

Scope Statement Published (August 31, 2008)

- 1.12 Electronic funds transfer – A
- 2.03 Corporation returns – A
- 2.04 Information returns and wage statements – A
- 2.08 Returns of persons other than corporations – A
- 4.001 Motor vehicle, alternate fuels, and general aviation fuel tax return and refund claim forms – NR
- 7.001 Fermented malt beverage tax return and refund claim forms – NR
- 8.001 Intoxicating liquor report, tax return, and refund claim forms – NR

- 9.001 Cigarette and tobacco products report, tax return, and refund claim forms – NR
- 11.01 Sales and use tax, local exposition tax, and premier resort area tax return forms – A

Reviewed by Legislative Council Rules Clearinghouse

- 8.03 Wine collectors – NR
- 8.05 Small winery cooperative wholesalers – NR

Public Hearing Held (August 26, 2008)

- 8.03 Wine collectors – NR
- 8.05 Small winery cooperative wholesalers – NR

To order up-to-date administrative rules of the Department of Revenue (DOR), you can contact the Document Sales and Distribution Section of the Wisconsin Department of Administration to obtain the Tax section of the Wisconsin Administrative Code. Additional information is available at: www.legis.state.wi.us/rsb/codinfo.html.

Information concerning administrative rules of DOR, as well as other state agencies, is also available at <https://apps4.dhfs.state.wi.us/admrules/public/Home>. Through this website you can search for rules, view the status of current rulemaking, view documents associated with rulemaking, submit and view comments on rules, and subscribe to receive notification of rulemaking. [✎](#)

Wisconsin Use Tax on Motor Vehicles

A person or business that buys a motor vehicle from a non-dealer must report the purchase price when registering the vehicle with the State of Wisconsin and pay the use tax owed. The Department of Revenue reviews 100 percent of the registrations for motor vehicles to determine if the buyer paid the correct amount of tax at the time the vehicle was registered. Approximately 20 percent of all vehicle registrations are selected for further audit. The two most common reasons for audit selection are:

1. The purchase price reported by the buyer at the time of registration is less than the average retail value for a vehicle of that make, model, year, and mileage, and
2. The validity of the exemption claimed is questionable.

For those registrations selected for audit, the Department of Revenue will send a letter (and a follow-up letter, if necessary) to the seller of a vehicle in cases where there is a possible purchase price discrepancy. A letter may also be sent to the buyer requesting verification of the purchase price. If the buyer does not respond, an assessment will be issued to the buyer based on the average retail value for a vehicle of that make, model, year, and mileage. The Department of Revenue will contact the buyer to question the validity of an exemption claimed by the buyer if this is the issue of the audit.

If the information furnished by the seller or buyer indicates that the buyer did not report the full purchase price of the vehicle or claimed an invalid exemption, the Department of Revenue will issue an assessment notice to the buyer. This notice will include additional tax and interest at 12% per year, computed to the due date of the assessment notice. **In addition, a 50% negligence (incorrect return) penalty may be assessed based on the additional tax due.** The annual revenue collected/assessed through this program each year is approximately \$1.2 million.

Common mistakes made when a vehicle is registered are:

- Subtracting the selling price of a vehicle sold through a separate transaction from the purchase price of the replacement vehicle. For example, if a vehicle is purchased from Party A and you sell your old vehicle to Party B, no trade-in subtraction

is allowed for the sale to Party B when you register the vehicle purchased from Party A.

- Not getting a bill of sale from the seller at the time of purchase. You should request a bill of sale (above and beyond the title) from the seller and keep it for at least 5 years from the date of registration, even if you sell the vehicle.
- An incorrect purchase price is listed on the registration form when the vehicle is registered. Make sure you know and enter the correct purchase price before you register your vehicle.
- County and/or stadium tax is not reported and paid when due. Make sure you know if the county in which the vehicle will customarily be kept has imposed a local tax.
- Math errors when calculating the tax. State tax is calculated by multiplying the purchase price by 5% (.05). County tax is calculated by multiplying the purchase price by 0.5% (.005). Baseball stadium tax is calculated by multiplying the purchase price by 0.1% (.001). Football stadium tax is calculated by multiplying the purchase price by 0.5% (.005). Remember, even if someone else completes the form for you, once you sign it, you are responsible.
- Registrant fails to enter their Social Security Number (SSN) or Federal Employee Identification Number (FEIN) and telephone number on the registration form. The SSN/FEIN is used to ensure the transaction and tax paid is posted to the correct account at the Department of Revenue. The telephone number can be valuable if a question arises during the processing of the registration form.
- An incorrect credit for tax paid to another state or the District of Columbia is taken. You may offset the state and local tax owed to Wisconsin by tax properly paid to another state/local jurisdiction or the District of Columbia. Another state's tax can be used to offset Wisconsin local tax. Credit for sales or use tax properly paid to another state or local jurisdiction is only allowed on an item-for-item basis. For example, if a state imposes a sales tax on a vehicle, but not on the extended warranty, the credit for tax paid to the other state would only be allowed against the Wisconsin sales or use tax on the vehicle and not on the extended warranty. Additional information about credits for taxes paid

to other states is provided in *Wisconsin Tax Bulletin* 157 (July 2008), on pages 28 through 49.

Example: Individual A purchased a vehicle in Michigan for \$10,000. An extended warranty was purchased for \$1,000. Individual A paid 6% Michigan state sales tax of \$600 (\$10,000 x 6%). Individual A registers the vehicle in Wisconsin. It will customarily be kept in Milwaukee County. The applicable tax rate in Milwaukee County is 5.6%. Individual A's Wisconsin tax liability is computed as follows:

Vehicle	\$10,000.00
Wisconsin Tax Rate	<u>5.6%</u>
Wisconsin Tax on Vehicle	\$560.00
Credit for Michigan Tax Paid on Vehicle	<u>\$560.00*</u>
Wisconsin Tax Due on Vehicle	0.00
Extended Warranty	\$1,000.00
Wisconsin Tax Rate	<u>5.6%</u>
Wisconsin Tax Due on Extended Warranty	\$56.00**

* The credit is limited to the amount of the combined Wisconsin state and local tax imposed on the purchase of the vehicle.

**Tax paid in Michigan on the vehicle cannot be used to offset tax due to Wisconsin on the extended warranty.

- An exemption is claimed using someone else's common or contract carrier (LC/MC/IC) exemption number. These numbers may not be used by an entity other than the one it was issued to.
- A farming exemption is claimed for a vehicle that is registered for highway use or when the buyer's activity does not qualify as a farming activity for sales and use tax purposes.

Many of the errors listed above are also commonly found on ATV, boat, snowmobile, and aircraft registration forms.

If you have additional questions regarding Wisconsin sales or use taxes, you may contact the Department of Revenue by phone at (608) 266-2776, by e-mail at sales10@revenue.wi.gov, or by mail at Wisconsin Department of Revenue, Mail Stop 5-77, P.O. Box 8949, Madison, WI 53708-8949. [☞](#)

Submit Form W-RA and Required Attachments Electronically

Looking for a way to better serve your clients? Make filing their income tax returns and homestead credit claims completely paperless by submitting Form W-RA and required attachments electronically through the Department of Revenue's website. It's fast, easy, and free!

Additional information and instructions for this application are available at www.revenue.wi.gov/eserv/w-ra.html. You may also contact the department at (608) 267-3327 or w2data@revenue.wi.gov. [☞](#)

Sales and Use Tax Report Available

The latest issue of the *Sales and Use Tax Report* became available in September. The *Sales and Use Tax Report* contains summaries of recent sales and use tax law changes in addition to other pertinent sales and use tax information. Topics covered in the September 2008 *Sales and Use Tax Report* (3-08) include:

- **IMPORTANT NOTICE:** The *Sales and Use Tax Report* is Going Paperless (January 2010);
- Clark County Adopts County Tax;
- Motor Vehicle Dealers' Measure of Use Tax Increased to \$140;

- Wisconsin Supreme Court Rules in Computer Software Case;
- Sales to Foreign Officials;
- Credit for Sales and Use Taxes Paid to Other States and Their Local Units of Government;
- Film Production Services Credit Clarified; and
- Filing Sales and Use Tax Returns Electronically.


The Report is available on the Department of Revenue's website at www.revenue.wi.gov/ise/sales/08-3.pdf. [☞](#)

Reminders: 2009 Withholding Tax Payments

If you will be making Wisconsin withholding tax payments in 2009, the Department of Revenue asks you to be mindful of the following:

- Withholding Deposit Report Booklets (Form WT-6 coupon booklets) will not be mailed in 2009.
- If your withholding deposits will be \$10,000 or more in 2008, you must make your 2009 withholding tax payments via electronic funds transfer (EFT). Please visit our website at www.revenue.wi.gov/eserv/eftgen.html for more

information about this payment method. If this requirement imposes an undue hardship, you may request a hardship waiver from the Secretary of Revenue, Wisconsin Department of Revenue, P.O. Box 8949, Madison, WI, 53708-8949. Clearly indicate why this requirement causes an undue hardship.

- If your withholding deposits will be less than \$10,000 in 2008, you are encouraged to use EFT to make your 2009 withholding tax payments. You may, however, create and submit a customized paper WT-6 by visiting our website at www.revenue.wi.gov/forms/with/index.html. 



Enforcement Report

Former Tax Preparer Sentenced to Jail

Tineka M. Brown, 31, of Milwaukee was ordered to serve 60 days in jail in August 2008 for filing fraudulent state income tax returns while she was employed as a tax preparer at Jackson Hewitt Tax Services. Milwaukee County Circuit Judge Richard Sankovitz also placed Brown on two years of probation and banned her from ever preparing taxes for anyone in the future.

According to the criminal complaint filed on January 30, 2008, Brown falsified the returns of at least six persons between 2004 and 2005, claiming \$31,909 in false refunds of state and federal tax monies.

In one instance, Brown electronically submitted a phony wage statement with a customer's return, falsely claiming employment at V&J Employment Service Inc. She listed fake amounts of state and federal taxes withheld in an attempt to get a refund of \$3,488.

In another instance, Brown told a customer she had a friend who was not working and had children that she was not claiming. Brown falsely told the customer he could claim the children on his tax return so he could get more money back. Brown also told the customer he had to pay her \$1,000 for each child used, and she would give this money to the mother of the children. The customer stated Brown also charged him an additional \$200 to prepare the return.

The complaint stated Brown also falsely listed unrelated children on the returns of persons who did not live with the children nor provide support for them.

Brown was prosecuted by the Milwaukee County District Attorney's Office after an investigation by the Wisconsin Department of Revenue.

Attorney Sentenced for Failure to File Tax Returns

Clifton G. Owens, 66, a Milwaukee area bankruptcy attorney, was found guilty in May 2008 of two counts of failure to file Wisconsin income tax returns for the years 2003 and 2004. On the first count, Milwaukee County Circuit Court Judge Dominic Amato sentenced Owens to 9 months in the House of Correction with Huber privileges. This is stayed until June 29, 2009, when the case will be reviewed. On the second count, Owens was sentenced to 30 days in the House of Correction with Huber privileges.

According to the criminal complaint, Owens shared an office with an association of attorneys in Milwaukee under the name Wilson, Broadnax, and Owens. An analysis of Owens' accounts at US Bank, Associated Bank, and HSA Bank showed deposits of cash, checks, cashier's checks, and money orders totaling \$93,437 in 2003 and \$71,986 in 2004. Owens received these fees from a variety of individuals, businesses, and bankruptcy trustees.

The complaint also stated Owens has a record of delinquent tax filings. During the 1980's, the Department of Revenue sent correspondence to Owens in attempts to have him file tax returns, and in 1994, Owens pled guilty to a criminal charge for not filing a 1990 Wisconsin income tax return. According to the criminal complaint, Owens owes over \$100,000 in delinquent taxes, interest, and penalties. He has not filed a Wisconsin income tax return since 1996.

Owens was prosecuted by the Milwaukee County District Attorney's Office after an investigation by the Criminal Investigation Section of the Wisconsin Department of Revenue.

Buffalo County Man Pleads No Contest to Theft

Jason R. Herrmann, 26, entered a no contest plea in September 2008 to one count of felony theft resulting from a scheme to claim fraudulent Wisconsin tax refunds. Herrmann was charged in July 2008 with two counts of felony theft and one misdemeanor count of filing false Wisconsin tax documents. Two charges were dismissed and read into the record for purposes of sentencing and restitution.

Buffalo County District Attorney Tom Clark asked that Herrmann be imprisoned for two years, have five years of extended supervision, and be ordered to pay restitution of \$24,906. Substitute Judge Robert Wing ordered a presentence investigation. Sentencing was to be scheduled for a later date.

The felony theft count to which Herrmann pled no contest was for an electronically filed 2006 Wisconsin tax return in which he claimed a refund of \$22,253. The refund was to be direct deposited to an account at Citizen's Community Federal in his name with his fiancée, Rose Hagenbarth, also authorized on the account.

A portion of the claimed refund, \$11,232.24, was intercepted to pay Herrmann's delinquent child support liability with Buffalo County and \$11,020.76 was deposited in Herrmann's account on March 19, 2007. By March 23, 2007, \$10,960 was withdrawn from the account in a series of transactions signed by Herrmann or Hagenbarth.

The Wisconsin tax return Herrmann filed in his name had three altered W-2 wage statements attached to it that showed inflated Wisconsin wages and Wisconsin withholding, which formed the basis for the fraudulent refund claim. One altered W-2 was from Dregney Painting and Tree Service, showing Wisconsin wages of \$64,076 and Wisconsin withholding of \$8,236. The W-2 Dregney actually issued to Herrmann reported Wisconsin wages of \$864 and Wisconsin withholding of \$18.50. A second altered W-2 was from Dollar General, showing Wisconsin wages of \$87,377 and Wisconsin withholding of \$13,390. The Dollar General W-2 actually issued to Herrmann showed Wisconsin wages of \$1,233.40 and Wisconsin withholding of \$20.69. The

third altered W-2 was from Bee Forrest LLC. It showed Wisconsin wages of \$99,027 and Wisconsin withholding of \$16,938. The W-2 actually issued to Herrmann by Bee Forest reported Wisconsin wages of \$5,825.12 and Wisconsin withholding of \$226.02.

During the investigation, Herrmann confessed to the electronic filing of the fraudulent return and altering the W-2 wage statements that accompanied the return.

The second felony theft count involved the electronic filing of a 2006 Wisconsin tax return in the name of Herrmann's fiancée, Rose Hagenbarth. This return claimed that Hagenbarth was due a refund in the amount of \$2,653. That refund was also supposed to be direct deposited to the account at Citizen's Community Federal; \$2,411.80 was deposited April 17, 2007. Three withdrawals totaling \$2,400 were made on April 17 and 18, 2007 by Rose Hagenbarth, and \$241.20 of the claimed refund was intercepted to pay a liability owed to the Buffalo County Clerk of Courts.

The Wisconsin tax return filed in Hagenbarth's name had one W-2 wage statement attached from Dollar General, showing Wisconsin wages of \$64,076 and Wisconsin withholding of \$6,254. The Dollar General W-2 actually issued to Hagenbarth listed Wisconsin wages of \$230 and Wisconsin withholding of \$3.60.

Herrmann confessed that he electronically filed this return and altered the Wisconsin wage and withholding information on the W-2 wage statement.

The misdemeanor count of filing a false tax document was due to a fraudulent refund claimed by Herrmann in the name of an unrelated third party. The electronically filed return requested a refund of \$4,850 to be direct deposited into a bank account in the name of Jason Herrmann at Associated Bank. That claim was not paid. The return also had altered W-2 information from an actual employer of the unrelated third party.

Herrmann admitted that he electronically filed the false return and altered the W-2 information that accompanied the return. Herrmann also stated that the unrelated third party was not involved in the filing of the false return.

The tax charges are the result of an investigation by the Wisconsin Department of Revenue's Criminal Investigation Section.

Convenience Store Owner Charged With Sales Tax Theft

Rajnish Patel, 38, registered agent for Laxmigas LLC, appeared in Marathon County Circuit Court in August 2008 to answer charges filed against him. He was charged with eight felony counts and one misdemeanor count of theft of state sales taxes.

The charges were brought by the Marathon County District Attorney's Office following an investigation by the Wisconsin Department of Revenue's Fraud Unit.

According to the complaint, Patel failed to remit \$38,737.38 in sales taxes to the state that he had collected from January 2007 through September 2007. Laxmigas LLC operates two convenience stores in Wisconsin, located in Rothschild and Brokaw.

If convicted, Patel could face up to 36 years and 3 months in prison, \$90,000 in fines, or both.

Arrest Warrant Issued for Man Accused of Tax Fraud

Marathon County Judge Gregory Huber issued an arrest warrant for Shawn M. Hoffman, 37, of Stratford when he failed to appear in court in September 2008. Hoffman was charged in July 2007 by the Marathon County District Attorney's office with four felony counts of filing fraudulent Wisconsin income tax returns. Judge Huber ordered Hoffman's \$20,000 signature bond to be forfeited.

According to the complaint, Hoffman filed Wisconsin income tax returns on which he reported \$0 tax liability on \$0 income. He attached correspondence to the returns in which he argued that the Internal Revenue Code does not define income nor establish an income tax liability and does not state that wages, salaries, or compensation for personal services are taxable income.

The complaint alleges that in the four years 2002 through 2005, Hoffman worked as a construction contractor and earned gross income of \$41,125, \$84,805, \$73,248, and \$101,906, respectively.

Hoffman worked for two Wisconsin companies in 2002. Midwest Siding and Windows issued a Form 1099 to Hoffman which reported income of \$16,047. Cover-All of Wisconsin issued a 1099 to Hoffman reporting \$25,078 of income. For the years 2003 through 2005, Hoffman's income was reported to him on Forms 1099 from Cover-All. The complaint states that Hoffman evaded Wisconsin income tax in excess of \$17,000 for the four years.

Information in the complaint disclosed Hoffman filed a typical Wisconsin income tax return for the year 1999 as proof that Hoffman was aware of the requirement to file and how to correctly file.

Hoffman pled not guilty to the charges in October 2007.

The charges are the result of an investigation by the Wisconsin Department of Revenue's Criminal Investigation Section. If convicted on all counts, Hoffman faces 24 years in prison and \$40,000 in fines. [!\[\]\(b4eeff342f60cc7bcd67d869b4fedca2_img.jpg\)](#)



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 decision is included:

Sales and Use Taxes

Exemption for Industrial Waste Treatment Facilities
City of De Pere. 10

SALES AND USE TAXES

 **Exemption for Industrial Waste Treatment Facilities.** *City of De Pere vs. Wisconsin Department of Revenue and Fox River Fiber Co., LLC* (Wisconsin Tax Appeals Commission, June 16, 2008).

The issue in this case is whether the total amount of the real estate and improvements at Fox River Fiber Co., LLC (“taxpayer”) is exempt from property taxation under sec. 70.11(21), Wis. Stats.

NOTE: Although this is a property tax case, the property tax treatment directly affects the Wisconsin sales and use tax treatment of certain transactions. Section 77.54(26), Wis. Stats., provides an exemption from Wisconsin sales and use taxes for tangible personal property which becomes a component part of an industrial waste treatment facility that is exempt from property tax under sec. 70.11(21), Wis. Stats. Please see Wisconsin Tax Bulletin 154 (December 2007), pages 33 and 34, for an explanation of tax law changes made in 2007 Wisconsin Act 19. This Bulletin can be accessed from the Department of Revenue’s website at www.revenue.wi.gov/ise/wtb/154law.pdf.

The taxpayer is a privately held company engaged in the business of using industrial wastepaper to produce a product usually referred to in the industry as wet lap recycled pulp, a form of wet lap pulp. Through its production process, the taxpayer recycles industrial wastepaper by removing contaminants and recovering fibers to produce the wet lap pulp, which is used by others to make paper products. The taxpayer sells such wet lap pulp to its paper manufacturer customers, who use it

to produce a wide variety of tissue and paper products such as facial tissue, toweling, office paper, and commercial printing paper.

On or about June 13, 2005, the State issued notices of real property and personal property assessments for the year 2005. The taxpayer timely objected to the 2005 assessments by filing objections to the property assessment with the State Board of Assessors. In its objections, the taxpayer asserted that, pursuant to the Dane County Circuit Court’s decision in *The Newark Group, Inc. vs. Wisconsin Department of Revenue* (January 31, 2005), its property qualified as a waste treatment facility and its real and personal property, therefore, were exempt from property tax. See *Wisconsin Tax Bulletin* 156 (April 2008), page 16, for a summary of *City of Green Bay vs. Wisconsin Department of Revenue and Green Bay Packaging, Inc.* (Wisconsin Tax Appeals Commission, December 21, 2007). This summary provides an explanation of the *Newark Group* case and can be accessed from the Department of Revenue’s web site at www.revenue.wi.gov/ise/wtb/156lit.pdf.

Like the facilities in *Newark Group* and *Green Bay Packaging*, the taxpayer’s facility is a paper recycling and manufacturing facility taxed under sec. 70.995, Wis. Stats., and is therefore eligible for exemption under sec. 70.11(21)(a), Wis. Stats. As in these prior cases, most of the taxpayer’s machinery is exempt under sec. 70.11(27), Wis. Stats. This case primarily involves the taxpayer’s land and buildings.

The parties offered essentially the same arguments in this case that the parties offered in *Green Bay Packaging*. Consequently, the Commission reaffirmed the interpretation of sec. 70.11(21)(a), Wis. Stats., that it adopted in *Green Bay Packaging*.

The Commission reaffirmed the central holdings of *Newark Group* and *Green Bay Packaging* to allow the exemption under sec. 70.11(21)(a), Wis. Stats., of a waste treatment facility that is located on property that is also used for other types of purposes or facilities. Applying this interpretation of sec. 70.11(21)(a), Wis. Stats., certain areas of the taxpayer’s property were determined to be exempt to the extent they were related to the functions of waste treatment processes. The remaining

portions of the property, such as the office and parking lot, were determined to not be exempt under that statute.

It was not known at the time of publication whether the taxpayer would appeal this decision.



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 in a tax release, the answers may not apply. Unless otherwise indicated, tax releases apply for all periods open to adjustment, and all references to section numbers are to the Wisconsin Statutes. (Caution: Tax releases reflect the position of the Wisconsin Department of Revenue, of laws enacted by the Wisconsin Legislature as of the date published in this Bulletin. Laws enacted after that date, new administrative rules, and court decisions may change the answers in a tax release.)

The following tax release is included:

Sales and Use Tax; Income and Franchise Tax

1. Customer Charges for Fuel and Electricity Used in Manufacturing..... 12

SALES AND USE TAX; INCOME AND FRANCHISE TAX

1 Customer Charges for Fuel and Electricity Used in Manufacturing

Statutes: Sections 71.07(3s)(b), 71.28(3)(b), 71.47(3)(b), 77.51(4)(a)2., (15)(a)2., (16), (20), and (23), 77.52(1), and 77.54(30)(a)6., Wis. Stats. (2005-06).

Background: Section 77.54(30)(a)6., Wis. Stats. (2005-06), provides a sales and use tax exemption for “The **gross receipts** from the sale of... Fuel and electricity consumed in manufacturing tangible personal property in this state” (Emphasis added). This exemption is effective for sales or purchases made on or after January 1, 2006.

Section 71.28(3)(b), Wis. Stats. (2005-06), provides a corporation income or franchise tax credit for “...an amount equal to the **sales and use tax under ch. 77** paid by the corporation in such taxable year on fuel and electricity consumed in manufacturing tangible personal property in this state...” (Emphasis added). The credit

also exists for individual income taxes and insurance company income or franchise taxes. This credit is available for taxable years beginning before January 1, 2006.

Section 77.51(20), Wis. Stats. (2005-06), defines “tangible personal property” to include electricity.

Section 77.51(4)(a)2., Wis. Stats. (2005-06), provides, in part:

“...‘gross receipts’ means the total amount of the sale, lease or rental price, as the case may be, from sales at retail of tangible personal property, or taxable services, valued in money, whether received in money or otherwise, without any deduction on account of the following...The cost of the materials used, labor or service cost, interest paid, losses or any other expense.”

Section 77.51(15)(a)2., Wis. Stats. (2005-06), provides, in part:

“...‘sales price’ means the total amount for which tangible personal property is sold, leased or rented, valued in money, whether paid in money or otherwise, without any deduction on account of any of the following...The cost of the materials used, labor or service cost, losses or any other expenses.”

Section 77.51(16), Wis. Stats. (2005-06), provides:

“ ‘Sales tax’ means the tax imposed by s. 77.52.”

Section 77.51(23), Wis. Stats. (2005-06), provides:

“ ‘Use tax’ means the tax imposed by s. 77.53.”

Section 77.52(1), Wis. Stats. (2005-06), provides:

“For the privilege of selling, leasing or renting tangible personal property, including accessories, components, attachments, parts, supplies and materials, at retail a tax is imposed upon all retailers at the rate of 5% of the **gross receipts** from the sale, lease or rental of tangible personal property, including accessories, components, attachments, parts, supplies and materials, sold, leased or rented at retail in this state” (Emphasis added).

Section 77.53(1), Wis. Stats. (2005-06), provides, in part:

“...an excise tax is levied and imposed...on the storage, use or other consumption in this state of tangible personal property purchased from any retailer, at the rate of 5% of the **sales price** of that property...” (Emphasis added).

Facts: When selling fuel and electricity to a manufacturer, utilities charge the customer a “facilities,” “customer,” or “fixed” charge. The utility bills this charge separately from amounts charged for fuel and electricity. The charge is not for the rental of equipment by the utility to the customer (in other words, the customer does not have control of the equipment). The charge is mandatory to the customer in that the customer must pay the charge in order to purchase electricity from the utility.

The “facilities,” “customer,” or “fixed” charge is charged by utilities to collect their fixed costs. These fixed costs include a return on the utilities’ investments in its meters, transformers, and other equipment necessary to serve its customers, as well as the average cost of meter reading and billing.

Question 1: Does the sales and use tax exemption provided in sec. 77.54(30)(a)6., Wis. Stats. (2005-06), apply to the “facilities,” “customer,” or “fixed” charge, if the fuel and electricity is purchased by the customer on or after January 1, 2006 and is used in manufacturing?

Answer 1: Yes. The “facilities,” “customer,” or “fixed” charge is a part of the seller’s gross receipts from the sale of electricity under sec. 77.51(4)(a)2., Wis. Stats. (2005-06), and, for purchases on and after January 1, 2006, such charges are exempt if the fuel and electricity to which the charge relates qualifies for the exemption provided in sec. 77.54(30)(a)6., Wis. Stats. (2005-06).

For sales tax purposes, the exemption provided in sec. 77.54(30)(a)6., Wis. Stats. (2005-06), applies to the **gross receipts** from the sale of fuel and electricity consumed in manufacturing tangible personal property in Wisconsin.

For use tax purposes, the exemption provided in sec. 77.54(30)(a)6., Wis. Stats. (2005-06), applies to the **sales price** of fuel and electricity consumed in manufacturing tangible personal property in Wisconsin.

“Gross receipts” is defined in sec. 77.51(4)(c)2., Wis. Stats. (2005-06), to include the “any other expense.” Similarly, “sales price” is defined in sec. 77.51(15)(a)2., Wis. Stats. (2005-06), to include “any other expenses.” The “facilities,” “customer,” or “fixed” charges fall within the definitions of “gross receipts” and “sales price” because they are charges for the seller’s expenses.

Example: Manufacturer A consumes 70% of the electricity it purchases from Utility X in manufacturing tangible personal property in Wisconsin. On its billing to Manufacturer A, Utility X charges a “facilities charge.” In order to purchase electricity from Utility X, Manufacturer A must pay the facilities charge. The exemption for electricity consumed in manufacturing applies to 70% of Utility X’s charge for electricity and to 70% of Utility X’s facilities charge.

Question 2: May the “facilities,” “customer,” or “fixed” charge be included in the computation of the manufacturer’s sales tax credit, if the fuel and electricity purchased by the customer is used in manufacturing and sales or use tax is paid by the manufacturer in its taxable year beginning before January 1, 2006?

Answer 2: Yes. Because the manufacturer’s sales tax credit is based on the sales and use taxes under Chapter 77, the imposition and definition provisions of Chapter 77 apply for purposes of the manufacturer’s sales tax credit.

Because the sales tax is imposed on the **gross receipts** from certain sales and the use tax is imposed on the **sales price** of certain property, the Chapter 77 definitions of these terms apply in determining the amount of sales tax paid which qualifies for the manufacturer’s sales tax credit. “Gross receipts” and “sales price” are defined broadly in sec. 77.51(4)(a)2. and (15)(a)2., Wis. Stats. (2005-06), to include any other expense. The “facilities,” “customer,” or “fixed” charges fall within the definitions of “gross receipts” and “sales price” because they are charges for the seller’s expenses.

Note: If the utility’s charge is for the *rental* of facilities, rather than being a mandatory charge for the purchase of fuel or electricity, the charge does not qualify for the sales and use tax exemption provided in sec. 77.54(30)(a)6., Wis. Stats. (2005-06), and may not be included in the computation of the manufacturer’s sales tax credit.



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 ruling is included:

Sales and Use Taxes

Nontaxable service vs. inspection of tangible personal property
W 0820001 (p. 14)

✱ **W 0820001** ✱

February 25, 2008

Type Tax: Sales and Use Taxes

Issue: Nontaxable service vs. inspection of tangible personal property

Statutes: Section 77.52(2)(a)10, Wis. Stats. (2005-06)

Wis. Adm. Code: Section Tax 11.67(2)(c), Wis. Adm. Code (April 2000 Register)

This letter responds to a request for a private letter ruling dated August 10, 2007, and the subsequent submission of additional requested information.

Facts, as provided:

You are a Medical Physicist certified by the American Board of Radiology in Therapeutic Radiological Physics and Diagnostic Medical Physics. You work full time at

an area hospital and occasionally provide annual evaluations of mammography systems to allow the facility to have local medical physics support.

All mammography systems are required to have a qualified medical physicist provide at least an annual survey to assure image quality. In 1992, the Food and Drug Administration (FDA) passed regulations implementing the Mammography Quality Standards Act (MQSA) (21 CFR Part 900). This initiative was intended to provide consistent and quality images to improve the detection of breast cancer. The American College of Radiology is the accrediting body for the State of Wisconsin and they determined a specific set of tests to be performed by the medical physicist and the medical facility’s quality assurance technologist for a mammography system.

According to the Mammography Quality Control Manual, the tests are “...designed to assess the continuing performance of screen-film mammography equipment, comply with the Mammography Quality Standards Act (MQSA) ...” While other tests are included in the manual to provide a more complete assessment of the system performance, such tests are not covered under MQSA.

You provide a medical physics survey of radiology equipment to assess the image quality and radiation performance. During a survey of a system, you spend about three hours measuring radiation parameters and taking about 60 images. You spend at least another hour reviewing the site’s records (recorded over the prior year) of the required periodic quality assurance tests. You then spend another two hours at a later time in your office evaluating the data collected and writing a report. You provide a summary of your findings and list improvement recommendations, if any are necessary. Any corrections would be determined by the owner and made by site personnel, the equipment manufacturer, or equivalent, and not by you or another medical physicist.

Within your survey, you do not remove any covers (of the equipment) nor do you provide the owner of the radiology equipment with any tangible personal property, other than a report. You primarily evaluate the imaging portion of the system to determine if patients are receiving a quality radiation exam and verify that a system meets federal and state regulations for an x-ray system. You may recommend within your report that a medical facility have periodic system maintenance performed by

the manufacturer or equivalent, you do not have the qualifications for this service and do not perform it.

You have no involvement with the installation of tangible personal property and do not improve the value of the equipment. You are not involved in the sale, installation, repair, or maintenance of the equipment.

Question: Is the service that you are providing subject to Wisconsin sales and use tax?

Answer: Yes, unless an exemption applies (for example, you provide the service for a hospital that holds a Wisconsin certificate of exempt status). You are providing the taxable service of inspecting tangible personal property, which is subject to Wisconsin sales and use tax under sec. 77.52(2)(a)10., Wis. Stats. (2005-06).

Analysis: Section 77.52(2)(a)10., Wis. Stats. (2005-06), in part, imposes Wisconsin sales and use tax on "...the repair, service, alteration, fitting, cleaning, painting, coating, towing, *inspection*, and maintenance of all items of tangible personal property unless, at the time of that [the] repair, service, alteration, fitting, cleaning, painting, coating, towing, inspection, or maintenance, a sale in this state of the type of property repaired, serviced, altered, fitted, cleaned, painted, coated, towed, inspected, or maintained would have been exempt to the customer from sales taxation..." (Emphasis added.)

Section Tax 11.67(2)(c), Wis. Adm. Code (April 2000 Register), provides that "(i)f there is a single charge for

providing both taxable and nontaxable services, the entire charge is subject to the 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."

You are performing a number of analytical procedures to the radiology equipment and reviewing the output of the equipment to determine whether the equipment is functioning properly and within the parameters established by the FDA through the MQSA. Such services are the inspection of tangible personal property. The inspection of tangible personal property (that is, the radiology equipment) is subject to Wisconsin sales and use tax, as provided in sec. 77.52(2)(a)10., Wis. Stats. (2005-06).

Although you may also provide services other than the inspection of tangible personal property, the primary objective of the service that you perform is to determine whether the performance of the screen-film mammography equipment is in compliance with the standards set forth by the MQSA (that is, the service of inspection of tangible personal property)..

Wisconsin Department of Revenue

Frequently Asked Questions: Addback of Related Entity Interest and Rental Expenses

In 2007 Wisconsin Act 226, the Wisconsin Statutes were amended to require taxpayers to “add back” to their federal income certain expenses paid, accrued, or incurred to a related entity when computing their Wisconsin income. The Act provides that these “added back” expenses may then be subtracted if certain conditions are met.

The expenses subject to this new law are interest expenses and rental expenses. The law is effective for taxable years beginning on or after January 1, 2008.

Below are answers to frequently asked questions about the new addback provisions. The questions are broken down into four categories:

- A. Taxpayers Subject to Addback
- B. Expenses Subject to Addback
- C. Conditions Necessary to Deduct Expenses Added Back
- D. Nondeductible Related Entity Expenses

A. Taxpayers Subject to Addback

Question A1. “Related Entity.” Who is a “related entity?”

Answer A1: For purposes of the addback requirement, a “related entity” is a related person under section 267 or 1563 of the Internal Revenue Code (IRC). For relationships that involve ownership of stock, assets, or net profits, the constructive ownership rules of section 318(a) of the IRC apply. A “related entity” also includes certain real estate investment trusts (REITs) if they are not “qualified REITs.”

Section 267, IRC, provides that the following relationships are “related persons”:

- Members of a family, namely, brothers and sisters, half-brothers and half-sisters, spouse, ancestors, and lineal descendants.
- An individual and a corporation of which more than 50% of the outstanding stock is owned (directly or indirectly) by or for the individual.
- Two corporations which are members of the same controlled group as defined in section 1563(a), IRC, except that 50% is substituted for 80% wherever it appears in sec. 1563(a).

- A grantor and fiduciary of any trust.
- A fiduciary of a trust and a fiduciary of another trust, if the same person is the grantor of both trusts.
- A fiduciary of a trust and a beneficiary of such trust.
- A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts.
- A fiduciary of a trust and a corporation more than 50% of the value of which is owned (directly or indirectly) by or for the trust or the grantor of the trust.
- A person and an exempt organization under sec. 501, IRC, which is controlled directly or indirectly by the person or (if the person is an individual) the person’s family.
- A corporation and a partnership if the same persons own more than 50% of the outstanding value of the corporation’s stock and more than 50% of the capital interest or profits interest in the partnership.

- An S corporation and another S corporation if the same persons own more than 50% in value of the outstanding stock of each corporation.
- An S corporation and a C corporation if the same persons own more than 50% in value of the outstanding stock of each corporation.
- An executor of an estate and a beneficiary of such estate.

Question A2: “Qualified REIT.” A “qualified REIT” is not considered a related entity for purposes of the addback provisions. What is a “qualified REIT?”

Answer A2: A “qualified REIT” is any of the following:

- Any publicly traded REIT.
- Any REIT which is not owned (directly or indirectly) more than 50% by an entity taxable as a corporation. The 50% ownership test is based upon the voting power or value of any class of the beneficial interests or shares. If more than 50% of the voting power of any class, or more than 50% of the value of any class is held (directly, indirectly, or constructively) by an entity taxable as a corporation, then the REIT is not a qualified REIT under the statute.

Under the statute, the following are not considered entities taxable as a corporation:

- An entity exempt from federal and Wisconsin tax;
- An entity that is a “qualified REIT” itself;
- A qualified REIT subsidiary under sec. 856(i), IRC; or
- A foreign entity substantially similar to a “qualified REIT,” which is true if all of the following are true:
 - At least 75% of the entity’s total asset value consists of real estate assets, cash and cash equivalents, and U.S. Government securities;
 - The entity is not taxed at the entity level;
 - The entity annually distributes at least 85% of taxable income to shareholders;
 - The entity is not owned more than 10% by a single organization or individual or the entity is publicly traded; and

- The entity is organized in a country that has a tax treaty with the U.S.

Question A3: Partnership Interest Owned by Qualified REIT. If a qualified REIT is a partner of a partnership which owns a subsidiary treated as a taxable REIT subsidiary (TRS), are interest and rental expenses paid by the TRS to the partnership subject to the addback?

Answer A3: Interest and rental expenses paid, accrued, or incurred from the TRS to the partnership will generally be not subject to the addback to the extent the partnership income flows through to a qualified REIT. However, in cases where a flow-through entity does not have a legitimate purpose other than tax avoidance, lacks economic substance, or results in distortion of income or evasion of taxes, the Department of Revenue has authority under secs. 71.30(2) and 71.80(1)(b), Wis. Stats., to distribute, apportion, or allocate gross income, deductions, credits, or allowances in order to prevent evasion of taxes or to more clearly reflect the taxpayer’s income.

B. Expenses Subject to Addback

Question B1: “Interest Expenses.” What are “interest expenses” for purposes of the addback requirement?

Answer B1: For purposes of the addback requirement, “interest expenses” means interest that would otherwise be deductible under section 163 of the Internal Revenue Code (IRC) and otherwise deductible in the computation of Wisconsin income.

Expenses that are deductible as “interest expenses” under section 163, IRC, may include:

- All interest paid or accrued within the taxable year on indebtedness.
- Original issue discount.
- Nonseparately stated interest included in carrying charges for installment purchases.
- Redeemable ground rents, excluding amounts paid in redemption.
- Premiums paid or accrued for mortgage insurance.

Question B2: Capitalized Interest. Does the interest subject to addback include capitalized interest under section 263A of the Internal Revenue Code?

Answer B2: No. The interest expense must be deductible as an expense within the taxable year under section 163 of the Internal Revenue Code to be subject to the addback requirement.

Question B3: “Rental Expenses.” What are “rental expenses” for purposes of the addback requirement?

Answer B3: For purposes of the addback requirement, “rental expenses” means expenses for the use of (or the right to use) real property or tangible personal property in connection with real property, regardless of how computed and regardless of how reported for financial accounting purposes.

Services furnished or rendered in connection with rented property are also considered “rental expenses” if the services are furnished by a related entity in connection with property rented from a related entity. Such services would constitute “rental expenses” regardless of whether the same related entity furnished the services as rented the property.

Question B4: Capital Leases. If a lease from a related entity is treated as a capital lease for financial accounting purposes, does the lease result in “rental expenses” subject to addback?

Answer B4: Yes. The method used to compute the expense and the manner in which it is reported for financial accounting purposes have no effect on whether the expense is a “rental expense” under the addback statute. Although amounts expensed attributable to capital leases may not be called “rental expenses” in the financial accounting records, they are considered “rental expenses” for purposes of the addback requirement.

C. Conditions Necessary to Deduct Expenses Added Back

Question C1: General Conditions (i., ii., and iii.). Under what conditions may interest or rental expenses added back to income be deducted on a Wisconsin return?

Answer C1: All taxpayers who wish to deduct an interest expense or rental expense paid, accrued, or incurred to a related entity must disclose the expense on Wisconsin Schedule RT as prescribed in the instructions to Schedule RT. Additionally, the expense must meet one of three conditions provided in sec. 71.80(23)(a), Wis. Stats., which are presented below (described here as Condition i., Condition ii., and Condition iii.)

Condition i. The expense meets Condition i. (sec. 71.80(23)(a)1., Wis. Stats.) if **either** of the following is true:

- The taxpayer paid, accrued, or incurred the expense to a related entity which paid, accrued, or incurred that expense to an unrelated entity during the same taxable year (in other words, the related entity merely acted as a conduit).
- The taxpayer paid, accrued, or incurred the expense to a bank holding company under 12 USC 1841(a), a savings bank holding company under 12 USC 1841(l), or a savings and loan holding company under 12 USC 1467a(a)(1)(D) or direct or indirect subsidiary of such company. However, as set forth below, interest paid, accrued, or incurred to bank investment subsidiaries does not qualify for deduction under Condition i. unless it qualifies under the previous bullet point.

Expenses Specifically Ineligible for Condition i. Section 71.80(23)(a)1., Wis. Stats., provides that the following expenses are never eligible to meet Condition i.:

- Interest expense in connection with any debt that is used to acquire the taxpayer’s own stock or assets under section 368 of the Internal Revenue Code.
- Interest expense or rental expense paid, accrued, or incurred directly or indirectly to any entity organized under the laws of another jurisdiction and that primarily holds and manages investments of a bank, subsidiary, or affiliate.

For more information on Condition i., see Questions C2 and C3.

Condition ii. The expense meets Condition ii. (sec. 71.80(23)(a)2., Wis. Stats.) if **both** of the following are true:

- The expense was paid, accrued, or incurred to a related entity that included the corresponding interest income or rental income in its tax base for any tax on (or measured by) its net income or receipts in Wisconsin or another state, U.S. possession, or foreign country, and
- The related entity's "aggregate effective tax rate" applied to that corresponding income was at least 80% of the taxpayer's "aggregate effective tax rate." The "aggregate effective tax rate" is the sum of the entity's effective tax rates for each applicable state, U.S. possession, or foreign country. The "effective tax rate" is the maximum tax rate imposed by the state, U.S. possession, or foreign country, multiplied by the entity's apportionment percentage in that jurisdiction. Special rules apply in determining an entity's aggregate effective tax rate.

For more information on Condition ii. and an explanation of the special rules, see Questions C4 through C9.

Condition iii. The expense meets Condition iii. (sec. 71.80(23)(a)3., Wis. Stats.) if the taxpayer establishes any other conditions the department considers relevant, based on the facts and circumstances, to determine that **all three** of the following are true:

- The primary motivation for the transaction was one or more business purposes other than the avoidance or reduction of state income or franchise taxes;
- The transaction changed the economic position of the taxpayer in a meaningful way apart from tax effects; and
- The interest expenses or rental expenses were paid, accrued, or incurred using terms that reflect an arm's-length relationship.

For more information on Condition iii., see Questions C10 and C11.

Question C2: "Taxable Year" for Taxpayer Using Related Entity as a Conduit. For purposes of determining if the related entity paid, incurred, or accrued the expense to an unrelated entity in the same taxable year, what is considered the same taxable year?

Answer C2: For purposes of applying Condition i., "taxable year" refers to the taxable year of the taxpayer who wishes to claim the deduction for the expense paid, accrued, or incurred to the related entity. The department will consider an expense the related entity pays, accrues, or incurs to an unrelated entity by the unextended due date of the taxpayer's income or franchise tax return to be paid, accrued, or incurred within the taxpayer's "taxable year." However, such expenses that occur after the end of the taxpayer's tax year may not then be counted again as occurring in the subsequent taxable year.

Answer C2 Example:

- Corporation A, the taxpayer, borrows money from related Corporation B. No portion of the debt was used to acquire the taxpayer's own stock or assets under section 368, IRC. In order to obtain the funds to loan to Corporation A, Corporation B borrows money from unrelated Bank C.
- Corporation A is a calendar year taxpayer, while Corporation B is on a fiscal year beginning July 1 and ending June 30.
- During the calendar year 2008, Corporation A accrued \$100,000 of interest expense attributable to the loan from Corporation B. Corporation B accrued \$90,000 of interest expense attributable to the loan from Bank C during that same time period (January 1, 2008 through December 31, 2008).
- During the period of January 1, 2009 through March 15, 2009, Corporation B accrued \$10,000 of interest expense to Bank C.
- For purposes of determining if Condition i. applies to Corporation A's interest expense, Corporation B may be considered to have accrued \$100,000 of interest expense (\$90,000 + \$10,000) to Bank C in Corporation A's 2008

taxable year. However, in Corporation A's 2009 taxable year, it cannot consider the \$10,000 of interest expense accrued by Corporation B to Bank C during the period of January 1, 2009 through March 15, 2009 to be accrued during its 2009 taxable year.

Question C3: Allocation of Expenses Passed Through to Unrelated Entity. What happens if the taxpayer and affiliated companies pay interest or rental expenses to a related entity, and that entity passes some, but not all, of those expenses through to an unrelated entity during the same taxable year?

Answer C3: A pro rata share of the taxpayer's expense is considered paid, accrued, or incurred to the unrelated entity.

Answer C3 Example:

- Taxpayer A made a \$200,000 interest payment to Related Entity B. No portion of the underlying debt was used to acquire the taxpayer's own stock or assets under section 368, IRC.
- Related Entity B received a total of \$800,000 of related entity interest income during Taxpayer A's taxable year. \$200,000 of this amount was from Taxpayer A and \$600,000 was from other related entities.
- In Taxpayer A's taxable year, Related Entity B paid \$400,000 of interest expense to unrelated third parties.
- In this case, \$100,000 ($(\$200,000/\$800,000) \times \$400,000$) of the interest Taxpayer A paid to Related Entity B would be considered paid, accrued, or incurred to an unrelated entity in Taxpayer A's taxable year.

Question C4: Documentation of Aggregate Effective Tax Rate. To substantiate that Condition ii. applies, do I need to submit my aggregate effective tax rate computation with Schedule RT?

Answer C4: No, you are not required to submit your aggregate effective tax rate computation to the department with Schedule RT. However, if you claim on Schedule RT that the expense is deductible because it

meets Condition ii., you must maintain supporting schedules to substantiate your deduction.

Question C5: Related Entity Is a Pass-Through Entity. How are pass-through entities treated in the aggregate effective tax rate computation?

Answer C5: Only taxes imposed at the entity level that are on (or measured by) net income or receipts may be included in the pass-through entity's effective tax rate for a particular jurisdiction. For example, Wisconsin's recycling surcharge, which is imposed on partnerships and tax-option (S) corporations in sec. 77.93 (1), (3), and (5), Wis. Stats., may be included in the Wisconsin effective tax rate of a pass-through entity.

Withholding taxes paid on income distributable to members may be considered entity-level taxes if the state, U.S. possession, or foreign country imposes the withholding as a tax on the income of the pass-through entity. For example, sec. 71.775, Wis. Stats., imposes a withholding tax on a pass-through entity for the privilege of doing business in Wisconsin or deriving income from property located in Wisconsin. The tax is equal to each nonresident member's share of Wisconsin distributable income multiplied by the highest tax rate applicable to the nonresident member.

A pass-through entity's aggregate effective tax rate cannot include taxes imposed on the entity's members. If a pass-through entity elects to file a composite return in a state on behalf of some or all of its members, the tax rate applicable to that composite return cannot be included in the entity's effective tax rate for that state.

Question C6: Related Entity Files Combined or Consolidated Return. For purposes of determining the related entity's aggregate effective tax rate, what happens if the related entity includes the interest or rental income in a combined or consolidated return in a particular state?

Answer C6: Section 71.80(23)(a)2., Wis. Stats., specifically provides that any state, U.S. possession, or foreign country where the taxpayer or related entity files a combined or consolidated report or return may not be included in the computation of the aggregate effective tax rate if the combined or consolidated re-

turn results in eliminating the tax effects of the transaction between the taxpayer and the related entity.

Question C7: Related Entity Has Loss or Credit Carryforwards. For purposes of determining whether a related entity's interest or rental income is included in its tax base for any tax on (or measured by) its net income or receipts in a particular state, what happens if the related entity pays no tax in a state because it has loss carryforwards or credit carryforwards?

Answer C7: The income is still considered to be included in the entity's tax base in that state. The maximum statutory tax rate and the entity's apportionment percentage in that state may be included in the computation of the aggregate effective tax rate.

Answer C7 Example: Taxpayer A makes a \$500,000 interest payment to Corporation C, a related corporation. Corporation C has no other income and is engaged in business only in State X. Corporation C has a \$1,000,000 loss carryforward in State X and uses this carryforward to offset the \$500,000 related entity interest income from Taxpayer A. Therefore, Corporation C owes no tax to State X. State X has a maximum corporation income tax rate of 6.2%. Corporation C's aggregate effective tax rate would be 6.2%.

Question C8: Related Entity Eligible for Dividends Paid Deduction. For purposes of determining whether a related entity's interest or rental income is included in its tax base for any tax on (or measured by) its net income or receipts in a particular state, what happens if the related entity is eligible for a dividends paid deduction in that state?

Answer C8: If the related entity is not taxed on some or all of its income in a state or jurisdiction because the entity is eligible for a dividends paid deduction under the laws of that jurisdiction, the amount considered to be included in the entity's tax base is the amount taxable to the entity after application of the dividends paid deduction. If the dividends paid deduction is less than 100% of the total income of the entity, a pro rata share of the interest or rental expense is deemed to be excluded from the related entity's tax base in that jurisdiction.

However, sec. 71.80(23)(a)2., Wis. Stats., provides that interest or rental expense paid to a REIT that does not meet the definition of a "qualified REIT" (i.e., interest or rental expenses paid to a "captive" REIT) cannot be deducted under Condition ii. for any amount of interest or rental expenses paid to the REIT.

Question C9: Aggregate Effective Tax Rate for Differing Taxable Years. For purposes of determining the related entity's aggregate effective tax rate, what happens if the related entity's taxable year is different than the taxpayer's?

Answer C9: Determine the related entity's aggregate effective tax rate based on the related entity's most recently ended taxable year. If the related entity is on a taxable year that ends after the taxpayer's taxable year, the taxpayer may not know what the related entity's apportionment percentages and taxing states will be. In this case, the aggregate effective tax rate may be determined as follows:

- If in the related entity's most recently ended taxable year it was subject to a tax on or measured by net income or receipts in a state, U.S. possession, or foreign country, the related entity's aggregate effective tax rate may be computed based on the related entity's most recently ended taxable year.
- If the related entity was not subject to such tax for its most recently ended taxable year, you may modify the computation of the aggregate effective tax rate as shown below.
 - Use 100% as the related entity's apportionment percentage.
 - Use the statutory tax rate of the state where the related entity is incorporated, organized, formed, or (if the related entity is an individual), where the individual resides.

Question C10: Factors Relevant to Determining Deductibility. For purposes of determining if sec. 71.80(23)(a)3., Wis. Stats. (Condition iii.) applies, what factors will the department consider relevant to establish that the primary motivation for the transaction was a business purpose(s) other than state tax avoidance, that the transaction changed the economic position of the taxpayer in a meaningful way apart from tax effects, and that the expenses

were paid, accrued, or incurred using terms that reflect an arm's-length relationship?

Answer C10: Following is a list of factors that the department may deem relevant in determining if a related entity interest or rental expense may be deducted under sec. 71.80(23)(a)3. *This list is not all-inclusive.* In general, if one or more of these factors are present, it is more likely that a deduction may not be allowed:

- 1) There was no actual transfer of funds from the taxpayer to the related entity, or the funds were substantially returned to the taxpayer, either directly or indirectly.
- 2) If the transaction was entered into on the advice of a tax advisor, the advisor's fee was determined by reference to the tax savings.
- 3) The related entity does not regularly engage in similar transactions with unrelated parties on terms substantially similar to those of the subject transaction.
- 4) The transaction was not entered into at terms comparable to arm's-length as determined by Treas. Reg. 1.482-1(b).
- 5) There was no realistic expectation of profit from the transaction apart from the tax benefits.
- 6) The transaction resulted in improper matching of income and expenses.
- 7) An expense for the transaction was accrued under FIN 48.
- 8) The taxpayer is not sufficiently capitalized or has no reasonable expectation to make payment on the debt underlying the interest expense.
- 9) There is no written contract that reflects an arm's-length interest rate.
- 10) Interest expense is attributable to any of the following:
 - An unpaid charge that is not an allowable expense, such as an expense that may have any of the characteristics of 1) through 9) above or 11) in the next column.

- A loan from a "captive" insurance company.
- A dividend note.
- A loan from a related entity with net operating loss carryforwards.
- A loan from a related entity that is an intermediary set up in a jurisdiction that imposes no corporate-level income tax.

- 11) Rental expense is paid, accrued, or incurred to a "captive" REIT.

Question C11: Documentation to Support Deduction. What documentation must I provide to the Department of Revenue to prove that a related entity interest or rental expense is deductible under sec. 71.80(23)(a)3., Wis. Stats. (Condition iii.)?

Answer C11: You are not required to submit specific documentation with your return (other than a properly completed Schedule RT) to substantiate a related entity interest or rental expense. However, you must maintain adequate documentation to be able to substantiate your deductions. Specific evidence that adequately supports that a deduction is allowable under sec. 71.80(23)(a)3., Wis. Stats., will vary based on the facts and circumstances.

Question C12: Safe Harbors and Department's Authority. If I qualify for a deduction for related entity interest or rental expenses under one of the three specific conditions provided in sec. 71.80(23)(a), Wis. Stats., and properly file Schedule RT, could the Department of Revenue still challenge the deduction?

Answer C12: In general, if a taxpayer meets one of the conditions specified in sec. 71.80(23)(a)1., 2., or 3., Wis. Stats., the department will allow the deduction. However, the Department of Revenue has express statutory authority in secs. 71.30(2) and 71.80(1)(b), Wis. Stats., to distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among two or more related entities in circumstances where it is necessary to prevent evasion of taxes or to clearly reflect the income of the related entities. This authority is in addition to, and not a limitation of or dependent upon, the provisions requiring addback of related entity interest and rental expenses.

D. Nondeductible Related Entity Expenses

Question D1: Similar Expenses Deducted In Tax Years Before 2008. If I have related entity interest or rental expenses in 2008 that are not eligible for a deduction, and I had deductions from substantially identical transactions in prior years, will the deductions reported in those prior years be allowed since they took place before the addback provisions were effective?

Answer D1: The department would generally disallow those same expenses for prior years under its express statutory authority in secs. 71.30(2) and 71.80(1)(b), Wis. Stats. Thus, if you have related entity interest or rental expenses in 2008 which are ineligible for a deduction under the addback provisions, and you had substantially identical transactions in prior years, you should amend your returns for those prior years under voluntary disclosure. See *Wisconsin Tax Bulletin* 151 (April 2007), page 30, for a description of the department's voluntary disclosure program.

Question D2: Adjustment to Related Entity's Income. If a related entity expense is not deductible to a taxpayer because it does not meet the necessary

conditions for deduction, can the related entity exclude the corresponding income from its Wisconsin income?

Answer D2: Yes, if a taxpayer cannot deduct an interest or rental expense paid to a related entity because it does not meet any of the conditions required in sec. 71.80(23)(a), Wis. Stats., the related entity may subtract the corresponding income from its Wisconsin income.

Question D3: Documentation for Adjustment to Related Entity's Income. If a taxpayer (the payee) is subtracting income from Wisconsin income because it corresponds to an expense that couldn't be deducted by a related entity (the payor), what documentation does the payee need in order to substantiate the subtraction from income?

Answer D3: The payee must file Schedule RT-1 as an attachment to its Wisconsin return. Schedule RT-1 is completed by the payor and provided to the payee as supporting documentation for the subtraction. Additionally, the payee should maintain its own supporting documentation to permit the department to verify the Schedule RT-1, which will vary depending on the facts and circumstances.