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:

❋ W1648003 ❋

August 19, 2016

Type Tax: Income and Franchise Tax

Issue: Computing the Manufacturing & Agriculture Credit in an Interest Charge–Domestic International Sales Corporation (IC-DISC)

Statutes: Sections 71.26(3)(t), 71.28(5n), 71.30(2), and 71.30(5) Wis. Stats. (2013-14 updated through 2015 Wis. Act 392)

Re: How are commission expenses paid to, and dividend income received from, an Interest Charge-Domestic International Sales Corporation (IC-DISC) treated when computing the Wisconsin manufacturing and agriculture credit.

Dear Taxpayer:

We received your request for a private letter ruling dated April 11, 2016 in regards to accounting for commission expenses paid to, and dividend income received from, an IC-DISC when computing the Wisconsin manufacturing and agriculture credit for Company A. Although the request didn't specify the tax year(s), based on the Power of Attorney form included with the request, we will assume it is for taxable years 2013 through 2016.

BACKGROUND:

Company A, a Wisconsin tax-option (S) corporation, manufactures and sells products to customers within and without Wisconsin. Approximately XX% of the products are manufactured in Wisconsin on property assessed as manufacturing under sec. 70.995, Wis. Stats. (2013-14 updated through 2015 Wis. Act 392). The remaining YY% are manufactured entirely outside Wisconsin.

During 20XX, Company A created a C-corporation organized under Wisconsin law which elected to be treated as an IC-DISC for federal tax purposes pursuant to Internal Revenue Code (IRC) §992. The IC-DISC currently meets all federal requirements in order to operate as an IC-DISC. Company A pays a commission expense to the IC-DISC on qualified exports, and deducts the commission expense when computing ordinary income on the federal Form 1120-S. The IC-DISC distributes dividends back to Company A equal to the amount of commission expense paid. For federal purposes, Company A reports the dividend income and commission expense on Form 1120-S and the IC-DISC reports no taxable income. For Wisconsin purposes, the net income of the IC-DISC is combined and reported on Company A's Wisconsin corporate tax return - Form 5S.

QUESTION PRESENTED:

How should Company A treat the commission expense paid to, and dividend income received from, the IC-DISC when computing the Wisconsin manufacturing and agriculture credit?

ANSWER:

Assuming the IC-DISC is a paper corporation (as described in WTB 70, page 22), Company A's computation of qualified production activities income for purposes of computing the manufacturing and agriculture credit should not include the commission expenses paid to, nor the dividend income received from, the IC-DISC.

ANALYSIS:

Treatment of IC-DISC income:

Wisconsin does not follow the federal treatment related to IC-DISC's.

- Section 71.26(3)(t), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides that the income of a corporation shall be computed under the internal revenue code, except sections 991 to 994, 995 as amended by section 802 of P.L. 98-369, and section 999 as amended by section 802 of P.L. 98-369 (relating to domestic international sales corporations) are excluded.

Wisconsin requires the combination of income in certain instances, provided the combined reporting provisions of sec. 71.255, Wis. Stats., are not applicable:

- Section 71.30(2), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  Allocation of gross income, deductions, credits between 2 or more businesses. In any case of 2 or more organizations, trades or businesses (whether or not incorporated, whether or not organized in the United States, whether or not affiliated, and whether or not unitary) owned or controlled directly or indirectly by the same interests, the secretary or his or her delegate may distribute, apportion or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if he or she determines that such distribution, apportionment or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades or businesses. The authority granted under this subsection is in addition to, and not a limitation of or dependent on, the provisions of ss. 71.05 (6) (a) 24. and (b) 45., 71.26 (2) (a) 7. and 8., 71.34 (1k) (j) and (k), 71.45 (2) (a) 16. and 17., and 71.80 (23).

- Section 71.30(5), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  Disc income combining. In the case of a parent corporation, its DISC or affiliate, the net income of a DISC derived from business transacted with its parent shall be combined with the income of the parent corporation and the net income of a DISC derived from business transacted with the parent's affiliated corporation shall be combined with the net income of the affiliated corporation to determine the amount of income subject to taxation under this chapter for the DISC, the parent corporation or the affiliate of the parent corporation as separate taxable entities. The net income of the parent corporation shall not include dividends received from the DISC paid from income previously combined for taxation under this subsection. "DISC" (domestic international sales corporation) has the meaning specified in section 992 of the internal revenue code as amended to December 31, 1979. For purposes of this subsection, a corporation is affiliated if at least 50% of its total combined voting stock is owned directly or indirectly by its parent corporation.

Wisconsin Tax Bulletin 51, pages 4-5, relating to the decision in *Wisconsin Department of Revenue vs. Kohler Company, et al*, (Circuit Court of Sheboygan County, January 20, 1987), and Wisconsin Tax Bulletin 70, page 22, describe Wisconsin's treatment of IC-DISC's. If the IC-DISC is considered a paper corporation (it meets the minimum federal IC-DISC requirements but has no actual operations), the income is allocated to the entity that earned it. However, if the IC-DISC is not a paper corporation (it meets the minimum federal requirements but has activity sufficient so that it has business operations), the income is taxed to the IC-DISC like any other Wisconsin corporation.

Assuming the IC-DISC created by Company A is a paper corporation, the net income earned by the IC-DISC is combined and reported on Company A's Wisconsin Form 5S, as provided by sec. 71.30(2), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392).

Manufacturing and Agriculture Credit:

In order to claim the manufacturing and agriculture credit, a corporation must have eligible qualified production activities income for the taxable year (sec. 71.28(5n), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392)).

- Section 71.28(5n)(a)8., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  "Qualified production activities income" means the amount of the claimant's production gross receipts for the taxable year that exceeds the sum of the cost of goods sold that are allocable to such receipts, the direct costs that are allocable to such receipts, and the indirect costs multiplied by the production gross receipts factor. "Qualified production activities income" does not include any of the following:

  a. Income from film production.
  b. Income from producing, transmitting, or distributing electricity, natural gas, or potable water.
  c. Income from constructing real property.
  d. Income from engineering or architectural services performed with respect to constructing real property.
  e. Income from the sale of food and beverages prepared by the claimant at a retail establishment.
  f. Income from the lease, rental, license, sale, exchange, or other disposition of land.

- Section 71.28(5n)(a)6., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  "Production gross receipts" means gross receipts from the lease, rental, license, sale, exchange, or other disposition of qualified production property.

- Section 71.28(5n)(a)9.a., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  "Qualified production property" means tangible personal property manufactured in whole or in part by the claimant on property that is assessed as manufacturing property under s. 70.995.

- Section 71.28(5n)(a)3., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  "Direct costs" includes all of the claimant's ordinary and necessary expenses paid or incurred during the taxable year in carrying on the trade or business that are deductible as business expenses under the Internal Revenue Code and identified as direct costs in the claimant's managerial or cost accounting records.

- Section 71.28(5n)(a)4., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  "Indirect costs" includes all of the claimant's ordinary and necessary expenses paid or incurred during the taxable year in carrying on the trade or business that are deductible as business expenses under the Internal Revenue Code, other than cost of goods sold and direct costs, and identified as indirect costs in the claimant's managerial or cost accounting records.

Company A generates production gross receipts from the sale of products that it manufactures in whole or in part on property assessed as manufacturing in Wisconsin. For purposes of computing Company A's qualified production activities income, the following applies:

- Production gross receipts does not include the dividend income received from the IC-DISC as such income is not from the lease, rental, license, sale, exchange, or other disposition of tangible personal property.

- Production gross receipts does not include receipts from the sale of property manufactured entirely outside Wisconsin. In addition, the cost of goods sold and direct costs associated with such receipts are not included in the credit computation.

- Production gross receipts includes the sale of property manufactured in part in Wisconsin on property assessed as manufacturing property under sec. 70.995, Wis. Stats. (2013-14 updated through 2015 Wis. Act 392). <u>In such instances, multiplying</u> qualified production activities income by the manufacturing property factor under sec. 71.28(5n)(a)5., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), excludes income derived from manufacturing activities outside Wisconsin from eligible qualified production activities income.

- Section 71.28(5n)(a)5.a., Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  "Manufacturing property factor" means a fraction, the numerator of which is the average value of the claimant's real and personal property assessed under s. 70.995, owned or rented and used in this state by the claimant during the taxable year to manufacture qualified production property, and the denominator of which is the average value of all the claimant's real and personal property owned or rented during the taxable year and used by the claimant to manufacture qualified production property.

- Cost of goods sold, direct costs, and indirect costs do not include the commission expense paid to the IC-DISC by Company A because such expense is disregarded from the computation of Company A's taxable income under sec. 71.26(3t), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), which provides that the federal treatment related to IC-DISCs does not apply for Wisconsin.

- Cost of goods sold and direct costs associated with production gross receipts are included in the computation of qualified production activities income.

- All indirect costs of Company A are also included in the computation of qualified production activities income.

Because Company A is a tax-option (S) corporation, it may not claim the credit. However the eligibility for, and the amount of, the credit are based on Company A's qualified production activities income as described above. The shareholders of Company A may claim the credit in proportion to their ownership interests.

- Section 71.28(5n)(c), Wis. Stats. (2013-14 updated through 2015 Wis. Act 392), provides:

  Limitations. Partnerships, limited liability companies, and tax-option corporations may not claim the credit under this subsection, but the eligibility for, and the amount of, the credit are based on their share of the income described under par. (b). A partnership, limited liability company, or tax-option corporation shall compute the amount of credit that each of its partners, members, or shareholders may claim and shall provide that information to each of them. Partners, members of limited liability companies, and shareholders of tax-option corporations may claim the credit in proportion to their ownership interests.