

# Wisconsin Tax Bulletin

April 2019 Number 205



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## Income and Franchise Tax Updates and Reminders

### Fort Atkinson Tax Return Preparer Charged with Stealing Tax Refunds and Filing False Tax Returns

David W. Zehnder, a Fort Atkinson accountant, was charged with four felonies for filing false income tax returns with fraudulent claims for credit and one felony charge for theft of customers' tax refunds.

According to the criminal complaint, Zehnder operated A-Z Productivity, Inc., a tax preparation firm. The complaint alleges that over the period of 2013 to 2017, Zehnder prepared and filed at least 83 fraudulent federal and Wisconsin income tax returns and, on many of those returns, he falsified the itemized deduction credits in order to increase customer refunds. The complaint also alleges that as part of the scheme, Zehnder stole, or attempted to steal, \$32,312 of his customers' refunds.

Criminal charges were filed in Jefferson County on February 22, 2019 by the Wisconsin Department of Justice, Attorney General's Office following an investigation by the Wisconsin Department of Revenue's Office of Criminal Investigation. If convicted, Zehnder could face up to 34 years in prison, a \$65,000 fine, or both.

## Entity-Level Tax Election Update for Partnerships and Tax-Option (S) Corporations

On Friday, December 14, 2018, Governor Scott Walker signed [2017 Wis. Act 368](#). The law provides an entity-level tax election available to partnerships for taxable years beginning on or after January 1, 2019, and tax-option (S) corporations for taxable years beginning on or after January 1, 2018.

**Caution** The entirety of Act 368, which authorized the pass-through entity-level taxation, is currently being challenged as unconstitutional in *League of Women Voters et al. v. Evers*, Case No. 2019CV84 (appeal of temporary injunction preventing enforcement of Act 368 filed Mar. 22, 2019 with Wisconsin Court of Appeals). A final decision from an appellate court is not expected for at least a few months. The Department is monitoring this case closely. Once a final decision is reached, the Department will evaluate the decision and determine what guidance is necessary.

Tax-option (S) corporations making an entity-level tax election for 2018, must compute tax on 2018 Schedule 5S-ET. A draft version of 2018 Schedule 5S-ET is currently available on the department's [website](#). However, tax-option (S) corporations making the election may not file a 2018 Form 5S until after the 2018 Schedule 5S-ET is finalized and programmed. The department estimates that 2018 Form 5S returns making the election may file on or after July 19, 2019.

Notice will be given through our email subscriber lists when the final 2018 Schedule 5S-ET is posted on our website and we begin accepting and processing returns with the election. If you would like to receive notification, [subscribe](#) to the Tax Professional, MeF Business e-Filer Developer, or MeF Individual e-File Developer electronic mailing list.

Additional information about the entity-level tax election is found in the following materials on the department's website at [www.revenue.wi.gov](http://www.revenue.wi.gov):

- Common Questions: Pass-Through Entity-Level Tax
  - [Partnerships](#)
  - [Tax-option \(S\) corporations](#)
- [Publication 125](#), *Credit for Tax Paid to Another State*
- 2018 Tax Forms and Instructions:
  - Draft [Schedule 5S-ET](#) and [instructions](#)
  - Draft [Schedule ET-OS](#) and [instructions](#)
  - [Schedule 5K-1 instructions](#) (see page 22)
  - Forms [1](#) and [1NPR](#) Instructions
  - Schedules [OS](#) and [WD](#) Instructions
  - [Form 2 Instructions](#)
  - Schedules [NR](#) and [2WD](#) Instructions

## Reporting Certain Franchise/Income Tax Credits As Income

Certain credits that you claim on your Wisconsin franchise or income tax return must be reported as income in either the year received/computed or the following year. These credits are reported as income even if all or a portion is carried forward. Credits from a pass-through entity should be reported as income by the pass-through entity. The following schedule lists franchise and income tax credits and whether the credit should be reported as income.

Credit (Schedule/Form)	Taxable Income?		When to Report Credit as Income or Basis Reduction
	Corporation	Individual	
Agricultural credit (MA-A)	Yes	Yes	Income in the year following year computed
Angel investment (VC)	N/A	No	Credit reduces basis of investment in year computed
Armed forces member (Form 1 or 1NPR)	N/A	No	
Business development (BD)	Yes	Yes	Income in year computed
Capital investment credit (DC)	Yes	Yes	
Community rehabilitation program (CM)	Yes	Yes	
Development zones (DC)	Yes	Yes	
Early stage seed investment (VC)	No	No	Credit reduces basis of investment in year computed
Earned income (Form 1 or 1NPR)	N/A	No	
Economic development (ED)	Yes	Yes	Income in year computed
Electronics and information technology manufacturing zone (EIT)	Yes	Yes	
Eligible veterans and surviving spouses property tax (Form 1 or 1NPR)	N/A	No	
Employee college savings account contribution (ES)	Yes	Yes	Income in year computed
Enterprise zone jobs (EC)	Yes	Yes	Income in year computed
Farmland preservation (FC)	Yes	Yes	Income in year received
Farmland preservation (FC-A)	Yes	Yes	
Homestead (H or H-EZ)	N/A	No	
Itemized deduction (Form 1 or 1NPR)	N/A	No	
Jobs tax (JT)	Yes	Yes	Income in year computed
Low income housing credit (LI)	No	No	
Manufacturing credit (MA-M)	Yes	Yes	Income in the year following year computed
Manufacturing investment (MI)	Yes	Yes	Income in year computed
Married couple (Form 1 or 1NPR)	N/A	No	
Net income tax paid to another state (OS)	N/A	No	
Research (R)	Yes	Yes	Income in year computed
Research expense (R)	Yes	Yes	
School property tax (Form 1 or 1NPR)	N/A	No	

Credit (Schedule/Form)	Taxable Income?		When to Report Credit as Income or Basis Reduction
	Yes	No	
State historic rehabilitation (HR)	N/A	No	Credit reduces basis of investment in year computed
Supplement to the federal historic rehabilitation (HR)	No	No	In year credit computed, add the qualified rehabilitation expenses to basis of building and depreciate them using the straight-line method. In addition, you must subtract the credit computed from the basis of the building.
Technology zone (TC)	Yes	Yes	Income in year computed
Working families credit (Form 1 or 1NPR)	N/A	No	

## Third-Party Designee Authorization

A third-party designee may be identified on a Wisconsin tax return and granted authority by the taxpayer to discuss the taxpayer's Wisconsin tax return with the department.

A third-party designee is authorized to do all of the following:

- Discuss with the department any questions that may arise during the processing of a taxpayer's return
- Give the department any information missing from the return
- Call the department for information about the processing of the return or the status of the refund or payment(s)
- Respond to certain department notices about math errors, offsets, and return preparation

A third-party designee is **not** authorized to do any of the following:

- Receive any refund check
- Bind a taxpayer to anything (including any additional tax liability)
- Otherwise represent a taxpayer before the department

A third-party designee's authorization automatically ends by the unextended due date for filing the next year's tax return (e.g., a designee's authorization on a 2018 tax return ends by the unextended due date for filing the taxpayer's 2019 tax return, which is April 15, 2020, for most individual income tax filers).

### Note

- When processing or auditing a return, requests for additional information or clarification is first communicated to the taxpayer by letter. The department, similar to the Internal Revenue Service, does not make first contact with a taxpayer by phone or email without them first contacting us on an issue. If the third-party designee contacts the department, department staff will discuss the return or notice over the phone with the designee, provided the designee's authorization period has not ended.

- If the designee's authorization period has ended, or if the taxpayer is contacted for an audit for multiple tax years, the auditor will request Form A-222, *Power of Attorney*, to authorize the department to discuss the details of the audit with the third-party designee.

### Sales and Use Tax Updates and Reminders

#### Are Tariff Charges Included in Taxable Sales and Purchase Price?

Tariffs that are imposed directly on an importer and passed on to the importer's customer in a subsequent sale, are included in the importer's sales price and subject to Wisconsin sales and use tax, as provided in sec. 77.51(15b)(a)2., Wis. Stats. The tariff charge is included in the importer's sales price regardless of whether the importer separately states the tariff amount on the invoice to its customer.

If the importer's purchase is subject to Wisconsin sales or use tax (e.g., products are not purchased for resale), the tariffs are not included in the importer's purchase price if the tariffs are legally imposed on the importer and are separately stated on the invoice, bill of sale or similar document that the seller gives to the importer, as provided in sec. 77.51(12m)(b)3., Wis. Stats. Tariffs that are paid directly to the customs authority (i.e., U.S. Customs and Border Protection) are not included in the importer's purchase price that is subject to use tax.

#### Painting and Finishing Contractors - Are Your Sales Subject to Sales Tax?

##### *Sales by Contractor*

- The sale of tangible personal property is *taxable*, unless an exemption applies.

**Example** A contractor sells painted or stained trim and baseboards, without installation. This sale is subject to tax.

- The sale and installation of tangible personal property that becomes an addition or capital improvement of real property when installed\* is a *nontaxable* real property construction activity.

**Example** A contractor is hired to supply and install painted or stained trim and baseboards in a building. This sale is not subject to tax.

**\*Note** Tangible personal property installed in a commercial facility which primarily serves a business or process function retains its character as tangible personal property regardless of the extent that it is affixed to real property.

- The sale of a repair, service, alteration, fitting, cleaning, painting, coating, inspection, or maintenance of tangible personal property that is affixed to real property,\* or is installed by the contractor at the completion of the service, is a *nontaxable* real property construction activity.

**Example** A contractor is hired to stain rails and install them on a staircase. This sale is not subject to tax.

**\*Note** Although services to real property are generally not subject to tax, there are certain types of property that are treated as tangible personal property for purposes of repair or other service to that property. Repair and other services to these items are taxable, regardless of the extent that they are attached to or fastened to real property. A complete list of these "deemed items" can be found in Part 3.A of [Publication 207](#), *Sales and Use Tax Information for Contractors*.

- The sale of a repair, service, alteration, fitting, cleaning, painting, coating, inspection, or maintenance of tangible personal property that is not affixed to real property, or is not installed by the contractor at the completion of the service is a *taxable* service to tangible personal property.

**Example** A contractor is hired to paint trim and baseboards for another contractor who will then install the property in a building. This sale is subject to tax, unless an exemption applies.

### *Purchase of Materials by Contractor*

- A contractor selling or performing a service to tangible personal property may purchase materials transferred to the customer without tax for resale.
- A contractor selling or performing a real property construction activity must pay tax on the purchase of materials used in providing the real property construction activity, unless an exemption applies.

[Publication 207](#), *Sales and Use Tax Information for Contractors*, provides explanations and examples to help determine the tax treatment of services provided by contractors.

If you have questions about the sales or use tax treatment of a transaction, contact (608) 266-2776 or [DORSalesandUse@Wisconsin.gov](mailto:DORSalesandUse@Wisconsin.gov).

**Note** This article interprets provisions within secs. 77.51, and 77.52, Wis. Stats.; and sec. Tax 11.68, Wis. Adm. Code.

## 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 (generally 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."*

## Sales and Use Tax

### Out-of-State Retailer's Sales of Prepackaged Bars, Brownies, and Cookies

**Ruling Number: W1911005**

**December 10, 2018**

#### **Facts as Provided by You**

Company is a corporation with its operations located out-of-state. Company is the manufacturer and retailer of bars, brownies, and cookies in various sizes and flavors. All these products are fully cooked food

items which are individually wrapped, labeled and sold for human consumption. The food items are not sold heated and utensils are not included.

Company accepts orders for its products from Wisconsin residents through Company's own web page on the Internet, orders placed with \_\_\_\_\_, and from telephone at their out-of-state manufacturing facility. The products are then packaged in non-returnable containers and shipped to customers through a common carrier such as, \_\_\_\_\_. All goods are manufactured out-of-state and all merchandise shipped to customers originates from out-of-state.

Currently, Company does not have any offices, employees, inventory or property located in the State of Wisconsin. However, Company is aware of the new economic nexus standards that were enacted, which affect out of state retailers who sell to customers located in Wisconsin.

### **Ruling Requested by You**

**Question 1:** Are sales of prepackaged bars, brownies, and cookies that are sold unheated, without utensils, exempt from Wisconsin sales and use tax?

**Answer 1:** Yes. Prepackaged bars, brownies, and cookies that are sold unheated and without eating utensils, are sales of food and food ingredients that are exempt from Wisconsin sales and use tax under sec. 77.54(20n)(a), Wis. Stats.

**Analysis:** Wisconsin law provides an exemption for food and food ingredients, as defined in sec. 77.51(3t), Wis. Stats., unless the food product is candy, a soft drink, a dietary supplement, or prepared food. The bars, brownies, and cookies are not a soft drink or a dietary supplement.

"Candy" is defined in sec. 77.51(1fm), Wis. Stats., as "a preparation of sugar, honey, or other natural or artificial sweetener combined with chocolate, fruit, nuts, or other ingredients or flavorings in the form of bars, drops, or pieces. 'Candy' does not include a preparation that contains flour or that requires refrigeration."

Based on the ingredients listings for brownies, sprites and morsels, cookies, and bars from Company's website, all items that Company sells contain flour and therefore, do not meet the definition of candy.

Prepared food, as provided in sec. 77.51(10m)(a)2., Wis. Stats., includes food and food ingredients heated by the retailer, unless an exception in sec. 77.51(10m)(b), Wis. Stats., applies. Bakery items made by the retailer, as provided in sec. 77.51(10m)(b)3., Wis. Stats., are an exception and are excluded from being prepared food. Bakery items include breads, rolls, pastries, buns, biscuits, bagels, croissants, donuts, danish, cakes, tortes, pies, tarts, muffins, bars, cookies, and tortillas. Therefore, Company's sales of bars, brownies, and cookies (i.e., bakery items) that are sold unheated without eating utensils, are not prepared food and exempt from Wisconsin sales and use tax.

**Note** If there are products sold or that will be sold by Company for which product ingredients are not listed on Company's website above, or such products are not bakery items, those products are not included in this ruling. Company must make a determination whether such items are subject to Wisconsin sales or use tax.

**Question 2:** Is Company required to register for Wisconsin sales and use tax?

**Answer 2:** No. Since Company's only sales into Wisconsin are sales of exempt food and food ingredients (i.e., prepackaged bars, brownies, and cookies as described in the answer to *Question 1*), Company is not required to register for Wisconsin sales or use tax.

**Question 3:** How does the United States Supreme Court's decision in *South Dakota v. Wayfair, Inc.*, affect Company's sales into Wisconsin?

**Answer 3:** Because all Company's sales into Wisconsin are sales of exempt sales of food and food ingredients (i.e., prepackaged bars, brownies, and cookies as described in the answer to *Question 1*), the decision has no effect on Company's current sales.

**Analysis:** The United States Supreme Court's decision in *South Dakota v. Wayfair, Inc.*, provides that an out-of-state retailer with no physical presence in Wisconsin is required to collect and remit Wisconsin sales or use tax on sales of taxable products and services beginning on or after October 1, 2018, unless the retailer qualifies for Wisconsin's small seller exception. However, since Company does not make sales of taxable products or services into Wisconsin, based on the facts provided, Company is not required to register, collect, or remit Wisconsin sales or use tax.

### Report on Litigation

Summarized below are recent significant Wisconsin Tax Appeals Commission (WTAC) and Wisconsin Court decisions.

#### Individual Income Tax

##### Itemized Deduction Credit - Limitation on Itemized Deductions

*L. William Staudenmaier vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, January 22, 2019).

The issue in this case is whether the federal overall limitation on itemized deductions should be taken into account when computing the Wisconsin itemized deduction credit (IDC).

The department issued an assessment against William Staudenmaier on July 21, 2016, that revised the amount of charitable contributions claimed for the IDC on his 2015 Wisconsin individual income tax return. The taxpayer timely filed a petition for redetermination with the department objecting to the assessment, which was denied by the department by notice dated November 28, 2016. The taxpayer timely filed a petition for review with the Commission appealing the department's denial.

The taxpayer argued that as a result of the decision in *Colton v. Dep't of Revenue*, he did not need to reduce the amount of itemized deductions by the federal overall limitation under sec. 68, of the Internal Revenue Code (IRC). The taxpayer also argued that reading sec. 68, IRC, into sec. 71.07(5), Wis. Stats., constitutes an illegal tax on the U.S. government interest income, imposes an improper tax on Social Security income, and could create an improper tax related to state tax refunds.

The taxpayer argued that the department is interpreting sec. 71.07(5), Wis. Stats., in a manner inconsistent with the decision in *Colton* in its instructions to the 2016 tax forms published post-*Colton*. The taxpayer also argued that the department violated sec. 227.01(13), Wis. Stats., by issuing a "rule" without public notice and public hearing, and the department's change in previously issued written guidance only allows the department to apply the change prospectively under sec. 73.16(2), Wis. Stats.

The Commission concluded that for tax year 2015, the Wisconsin statutory definition of "federal internal revenue code" in sec. 71.01(6)(j)1., Wis. Stats., included sec. 68, IRC. To the extent a taxpayer is subject to the sec. 68, IRC, overall limitation on itemized deductions for federal income tax purposes, the amounts



allowed as itemized deductions for purposes of calculating the Wisconsin IDC under sec. 71.07(5), Wis. Stats., are subject to the sec. 68, IRC, overall limitation. The Commission also concluded that for tax year 2015, the taxpayer's federal itemized deductions were subject to the sec. 68, IRC, overall limitation because the taxpayer paid federal regular income tax to which the limitation applies.

### Corporation Franchise and Income Tax

#### Credit Carry-Forwards – Research Credit Carry-Forward Beyond Four-Year Statute of Limitations

*The C. A. Lawton Co. vs. Wisconsin Department of Revenue* (Wisconsin Tax Appeals Commission, February 1, 2019).

The issue in this case is whether the Wisconsin research credit must be computed and reported to the department within four years of the unextended due date of the tax return for which the credit is calculated for any unused research credit to be carried forward and deducted in subsequent years.

The department issued an assessment against The C. A. Lawton Co. (Petitioner) on November 23, 2016, that denied Petitioner's claim for carry-forward research credit from years 2002 through 2006 on Petitioner's 2011 and 2012 returns on the grounds that the research credit was not calculated on Petitioner's originally filed tax returns for the years 2002 through 2006, and the department had not received any amended returns for those years. Petitioner timely filed a petition for redetermination with the department objecting to the assessment, which was denied by the department by notice dated September 8, 2017. Petitioner timely filed a petition for review with the Commission appealing the department's denial.

Petitioner argued that sec. 71.28(4)(f), Wis. Stats., dictates that the research credit can be carried forward up to 15 years from the year the expenses are incurred as long as they are eventually reported on a tax return which is filed within four years of that tax return's unextended due date.

Petitioner asserted an argument regarding equitable recoupment. Petitioner claimed that, even if the research credit claims are stale, Petitioner should be able to use the research credits to offset the 2011 and 2012 assessments.

The Commission concluded that for a research credit to be carried forward, the underlying "claim therefor" must be filed within four years of the unextended due date of the tax return for the tax year in which the qualified research expense is incurred. Once so claimed, unused portions of the research credit qualify for carryover as a carry-forward credit, which may be used up to 15 years from the year in which the qualified expense was incurred. Petitioner's research credit claims based on expenses incurred in 2002 and 2003 were not claimed within four years, so no research credit claims were allowed for those years. Consequently, there are no credits to be carried forward. The Commission also concluded that any carry-forward research credits claimed in tax years 2011 and 2012, which did not arise from expenses incurred in 2011-2012, may not be resurrected through a theory of equitable recoupment.