WISCONSIN TAX BULLETIN

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CHECKS FOR ADDITIONAL 1983 HOMESTEAD CREDIT TO BE MAILED IN LATE AUGUST

One of the new laws passed by the Legislature in 1984 provides that each person who files a timely 1983 Homestead claim (Schedule H) will automatically receive a 25% increase in his or her homestead credit for 1983. This additional homestead credit will be paid to persons in a separate check. The credit will be equal to 25% of the credit computed by using the computation tables appearing in the instructions for the 1983 Schedule H. The maximum increase will be $220 ($880 × .25). If the amount of credit claimed is adjusted by the department, the 25% increase will be based on the adjusted credit.

A person does not have to file any additional form to receive this additional 25% credit. For those persons whose original 1983 homestead credit was paid or credited by the department before July 31, 1984, the separate check for the 25% additional credit will be mailed by the department during the last week of August, 1984. If the 1983 homestead credit was paid or credited on or after July 31, 1984, the separate check will be mailed within 90 days after the initial homestead credit was paid or credited.

To illustrate how much credit may be received, assume a person filed a 1983 Schedule H in March, 1984 claiming a credit of $500. A check for $500 was mailed to the person in April, 1984. During the last week of August, 1984, this person will automatically receive a check in the mail for $125 ($500 × .25 = $125).

IN THIS ISSUE

NEW LAWS WILL AFFECT 1984 HOMESTEAD CREDIT CLAIMS

The Legislature, in addition to the 25% additional credit for 1983 claims, also enacted other laws which will affect 1984 Homestead claims which are filed in 1985. A summary of these homestead credit changes follows.

1. The claimant's 1984 household income may not exceed $16,500. (For 1983 claims, the limit was $15,500.)
2. Claimants will be allowed 25% of rent paid for occupancy in 1984. (For 1983 claims, the percentage was 20%.)
3. Claimants who have a 1984 homestead which is part of a farm will be allowed to claim property taxes on their home and up to 120 acres of land adjoining it, including all improvements (e.g., buildings) on this same 120 acres. (For 1983 claims, only 35 acres were allowed.)
4. The amount of property taxes or rent constituting property taxes to be used in computing homestead credit for 1984 will increase to $1,200. (For 1983 claims, the limit was $1,100.)

In addition to the above changes, the formula for computing the credit was changed so that claimants with household income of $7,400 (prior law was $7,000) or less will receive a credit equal to 80% of their property taxes accrued and/or rent constituting property taxes accrued. If the income is more than $7,400 the credit will be 80% of the amount by which such taxes accrued exceed 13.187% (prior law 12.94%) of household income exceeding $7,400.

SOCIAL SECURITY PAYMENTS NOT TAXABLE FOR WISCONSIN

Although social security and railroad retirement benefits will be taxable for federal purposes in 1984 to persons whose income exceeds certain limitations, these amounts will not be taxable income for Wisconsin. The statutory provisions for not taxing these amounts were enacted in 1983 Wisconsin Act 212, published April 25, 1984.

The 1984 income tax forms (Form 1 and Form 1A) will include information to notify taxpayers that these benefits are not taxable for Wisconsin.

NEW LAW ALTERS RENUMBERING PROVISIONS OF 1983 WISCONSIN ACT 189

In the May, 1984 issue of the WTB (Number 37), it was reported that various tax law statutes had been renumbered by 1983 Wisconsin Act 189, effective May 10, 1984. A comparative listing of old and new statutory references was included on pages 35-37.

1983 Wisconsin Act 544, effective June 8, 1984, has modified the renumbering provisions of Act 189. This new act, passed during the Legislature's special session in late May, makes the following changes to the Act 189 provisions:

- The renumbering changes to Chapter 71 have been repealed. These statutes will continue to be numbered with the "Old Reference" number shown on pages 35 and 36 of WTB #37.
- The effective date of the renumbering changes for Chapter 77 (sales tax) has been delayed until January 1, 1987. (Originally, the new numbering was to become effective May 10, 1984.)

The renumbering changes which 1983 Wisconsin Act 189 made to the beverage and cigarette tax statutes were not altered by 1983 Wisconsin Act 544.

INHERITANCE AND GIFT TAX EXEMPTIONS INCREASED

The inheritance tax exemption for property transferred to Class A distributees other than spouses (e.g., son, daughter, parent, grandchild, grandparent, son-in-law, daughter-in-law) is increased from $10,000 to $25,000 for transfers because of deaths occurring from April 13, 1984 to June 30, 1985. This exemption will increase to $50,000 for transfers because of deaths occurring on or after July 1, 1985.

The lifetime exemption for gift taxes for property transferred to Class A donees other than spouses increased from $10,000 to $25,000 for transfers occurring from January 1, 1985 to December 31, 1985. This exemption increases to $50,000 for transfers occurring on or after January 1, 1986.

The annual gift tax exemption for all donees is still $3,000 for 1984; however, it will increase to $10,000 beginning for 1985. Also, gift tax returns will not have to be filed for 1985 and thereafter unless the total value of all gifts during the year from a donor to a donee exceeds $10,000.

PERSONS CONVICTED FOR FAILURE TO FILE RETURNS

A Milwaukee salesman has been ordered by Dane County Circuit Judge Moria Krueger to serve two years probation, pay $1,000 in fines and serve 60 days in jail for criminal violations of the Wisconsin state income tax laws. Christopher L. Niesl was charged with two counts of failing to file state income tax returns on gross income of more than $39,000 for 1980 and $38,000 for 1981. He was found guilty on both counts after a jury trial on November 23, 1983. Under the conditions of probation, he must also file valid Wisconsin state income tax returns for 1980 and 1981, pay the taxes, penalties and interest for those years, file any tax returns due while he is on probation and pay the taxes promptly.

Virgil J. Ivey of Pulaski, Wisconsin, was found guilty of failing to file Wisconsin state income tax returns on gross income of more than $13,000 for 1979, $10,000 for 1980 and $11,000 for 1981. Circuit Judge Mark A. Frankel withheld sentencing and ordered Ivey to serve four years probation, pay $750 in fines and serve 90 days in jail. He must also file Wisconsin state income tax returns for 1979, 1980, 1981, 1982 and 1983, pay the taxes and penalties for those years and file any tax returns due while he is on probation. Ivey has filed an appeal.

On May 24, 1984, Robert J. Ekberg of Sister Bay, Wisconsin, pled no contest to two counts of failing to file Wisconsin income tax returns. Circuit Judge John C. Jaekels ordered Ekberg to serve two years probation, pay $500 in fines and serve 30 days in jail. In addition, he must cooperate with the Wisconsin Department of Revenue in determining his income tax liabilities and in making payment of the income taxes due. Criminal charges were filed against Ekberg by the Brown County District Attorney's Office after an investigation by the Intelligence Section of the Wisconsin Department of Revenue. Ekberg was charged with failing to file state income tax returns on gross income of more than $23,000 for 1980 and $54,000 for 1981.

Failure to file a Wisconsin state income tax return is a crime punishable by a maximum fine of $500 or imprisonment not to exceed six months, or both. In addition to the criminal penalties provided by statute, Wisconsin law provides for substantial civil penalties on the civil tax liability. Assessment and collection of the additional taxes, penalties and interest due follows conviction for criminal violations.

NEW ISI&E DIVISION RULES AND RULE AMENDMENTS IN PROCESS

Listed below, under parts A and B, are proposed new administrative rules and amendments to existing rules that are currently in the rule adoption process. The rules are shown at their stage in the process as of July 1, 1984. Part C lists new rules and amendments which have been approved by legislative standing committees but are not yet effective. Part D lists new rules and amendments which have been adopted in 1984.

("A" means amendment, "NR" means new rule, "R" means repealed and "R&R" means repealed and recreated.)

A. Rules at Legislative Council Rules Clearinghouse

11.71 Automatic data processing-N

B. Rules at Legislative Standing Committees

11.03 Elementary and secondary schools-A
11.05 Governmental units-A
11.65 Admissions-A

C. Rules Approved by Legislative Committees But Not Yet Effective

11.05 Governmental units-A
11.08 Medical appliances, prosthetic devices and aids-A
11.09 Medicines-A
11.10 Occasional sales-A
11.11 Waste treatment facilities-A
11.12(4) Farming, agriculture, horticulture and floriculture-A
11.12(5) Farming, agriculture, horticulture and floriculture-A
11.13 Sale of a business or business assets-A
11.15 Containers and other packaging and shipping materials-A
11.17 Hospitals, clinics and medical professions-A
11.19 Printed material exemptions-A
11.27 Warranties-A

11.30	Credit sale, bad debt and repossessions-A
11.39	Manufacturing-A
11.45	Sales by pharmacies and drug stores-A
11.51	Grocer's guidelist-A
11.56	Printing industry-A
11.65	Admissions-A
11.67	Service enterprises-A
11.72	Laundries, dry cleaners and linen and clothing suppliers-A
11.79	Leases of highway vehicles and equipment-A
11.83	Motor vehicles-A
11.85	Boats, vessels and barges-A
11.86	Utility transmission and distribution lines-A
11.87	Meals, food, food products and beverages-A
11.94	Wisconsin sales and taxable transportation charges-A
11.95	Retailer's discount-A

D. Rules Adopted in 1984 (in parentheses is the date the rule became effective)

9.01	Definitions pertaining to cigarette tax-N (4/1/84)
9.08	Cigarette tax refunds to Indian tribes-N (4/1/84)
9.09	Cigarette sales to and by Indians-N (4/1/84)
11.15	Containers and other packaging and shipping materials-A (1/1/84)
11.16	Common or contract carriers-A (1/1/84)
11.19	Printed material exemptions-A (1/1/84)
11.26	Other taxes in taxable gross receipts and sales price-A (1/1/84)
11.32(3)	"Gross receipts" and "sales price"-A (1/1/84)
11.48	Landlords, hotels and motels-A (1/1/84)
11.50	Auctions-A (1/1/84)
11.52	Coin-operated vending machines and amusement devices-A (1/1/84)
11.68	Construction contractors-A (1/1/84)

REPORT ON LITIGATION

This portion of the WTB summarizes recent significant Tax Appeals Commission and Wisconsin court decisions. The last paragraph of each decision indicates whether the case has been appealed to a higher court.

The last paragraph of each WTAC decision in which the department's determination has been reversed will indicate one of the following: 1) "the department appealed", 2) "the department has not appealed but has filed a notice of nonacquiescence" or 3) "the department has not appealed" (in this case the department has acquiesced to Commission's decision).

The following decisions are included:

Income and Franchise Taxes

Thomas L. Adelman vs. Wisconsin Department of Revenue

Joseph Bromley vs. Wisconsin Department of Revenue

Dennis Culver vs. Wisconsin Department of Revenue

Gerald R. Hoeppner vs. Wisconsin Department of Revenue

Key Line Freight, Inc. vs. Wisconsin Department of Revenue

Douglas J. Kimball vs. Wisconsin Department of Revenue

Anthony D. Maglio vs. Wisconsin Department of Revenue

Eugene F. Mower vs. Wisconsin Department of Revenue

Roland Murphy vs. Wisconsin Department of Revenue

Wisconsin Department of Revenue vs. Overly, Inc.

333 Enterprises, Inc. vs. Wisconsin Department of Revenue

Sales/Use Taxes

Kohler Company vs. Wisconsin Department of Revenue

The Mylrea Company, Inc. vs. Wisconsin Department of Revenue

Schuster Construction Company vs. Wisconsin Department of Revenue

Senior Golf Association of Wisconsin, Inc. vs. Wisconsin Department of Revenue

Shopper Advertiser, Inc., d/b/a Shopper Advertiser - Walworth County, and Shopping News, Inc., d/b/a Greater Beloit Shopping News, vs. Wisconsin Department of Revenue

Farmland Preservation Credit

Dorothy McManus vs. Wisconsin Department of Revenue

Withholding Taxes

William D. Kleiman vs. Wisconsin Department of Revenue

INCOME AND FRANCHISE TAXES

Thomas L. Adelman vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 15, 1984). The issue before the Commission is whether monies advanced by the taxpayer to A&H of Reedsburg, Inc. were loans to the corporation or contributions to capital, and whether the subsequent deduction should be treated as a business bad debt or capital loss.

A&H of Reedsburg, Inc. was incorporated in Wisconsin in 1973. The taxpayer was an officer and director of the corporation and held 50% of the common stock. On his 1980 tax return the taxpayer claimed a bad debt loss for loans made to A&H of Reedsburg, Inc. as follows:

1975	$ 7,500.00
1977	4,800.00
1979	20,000.00
TOTAL	$32,300.00

The findings of fact in this case include the following:

A. The taxpayer and the other 50% shareholder of the corporation made advances of equal amounts and at the same times to A&H of Reedsburg, Inc.

B. The taxpayer stated that there were no notes evidencing the loans nor was there anything in writing stating the terms of the loans.

C. All three advances were used to pay A&H of Reedsburg's bank loans which were past due.

D. The corporation did not establish a sinking fund to pay back the advances to the shareholders and there was no repayment schedule or fixed payment date.

E. The shareholders did not have any security interest in any of the assets of the corporation in exchange for the advances.

F. The taxpayer expected the corporation to repay the advances from its future profits when the business could afford it.

G. A&H of Reedsburg never made any repayment of the principal on these advances. The corporation paid interest on the advances in one year, 1977.

H. The taxpayer stated that the monies were treated as loans on the corporate books, but that the corporate books had been lost and were not available at the time of the hearing.

I. The corporation's franchise tax returns showed the corporation had losses of $93,704.05 for 1977, $133,000.00 for 1978, and $79,951.76 for 1979.

J. The taxpayer testified that other than the loans he and the other 50% shareholder made to the corporation, there were no additional infusions of capital to the corporation other than the initial investments of $15,000 each.

K. At some time during 1979 A&H of Reedsburg, Inc. was liquidated and dissolved.

L. In 1979 the corporation's building was sold and the proceeds went to settle the corporation's indebtedness to its bank and other creditors.

The department contends that the taxpayer's advances to A&H of Reedsburg, Inc. do not constitute a business debt that qualifies him to claim an employe business expense deduction for the year 1980. Further, the advances were contributions to capital and should be deductible as such.

The Commission's conclusions are that the advances were contributions to capital, and losses arising from such are capital losses under the Internal Revenue Code.

The taxpayer has not appealed this decision.

Joseph Bromley vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 12, 1984). During the period under review, 1977 and 1978, Joseph Bromley was a Michigan resident and the president and a shareholder of Key Line Freight, Inc., which was engaged in the freight business in Wisconsin. The issues are whether (1) Joseph Bromley is liable for the tax assessment by the department against Key Line Freight, Inc. as a transferee within the provisions of s. 71.11(21), Wis. Stats., (2) the department is estopped from asserting transferee liability upon the taxpayer, (3) the assessment notice against Joseph Bromley constitutes inadequate notice of claim against him and therefore violates the Due Process Clause of the United States Constitution, and (4) the department is estopped from asserting transferee liability upon the taxpayer by reason of him being only a 10% stockholder in Key Line Freight, Inc.

Joseph Bromley was chief operating officer and president of Key Line Freight, Inc. from 1969 until March, 1978. In addition, he was a 10% stockholder in Key Line and in 1978 he received $600,000 as his share of the liquidated assets of Key Line. In 1978 Daniel Darling, the majority stockholder in Key Line Freight, Inc., in conjunction with the minority stockholders decided to liquidate a solvent corporation (Key Line Freight, Inc.) and retire. On March 30, 1978 the corporation filed a liquidation plan in accordance with a 337 liquidation which was accepted on September 18, 1980. Notice was given to the known creditors at the time of the dissolution. A trust was set up in the amount of $400,000 to pay off creditors in the State of Michigan regarding claims. Due to unexpected claims in the Workers Compensation area, the trust funds were depleted and to date there are no funds in this trust. During the period under review, Joseph Bromley, as its chief operating officer, president and a shareholder in Key Line Freight, Inc., was required to report and pay income and franchise taxes to the State of Wisconsin. The taxpayer failed to pay over the taxes to the State of Wisconsin which was never included as a creditor when Key Line Freight, Inc. was dissolved.

On October 5, 1981, the department mailed an assessment notice to Joseph Bromley. The notice said:

> "In accordance with s. 71.11(21) of the Wisconsin Statutes, you are being assessed for the $26,644.36 of Wisconsin corporate franchise/income tax due from Key Line Freight, Inc. per our notice of July 30, 1981. You are being assessed as the last President of Key Line Freight, Inc."

The Commission ruled that assessments made by the department are presumed to be correct and the burden is upon the taxpayer to prove by clear and satisfactory evidence in what respects the department erred in its determination. The taxpayer failed to meet his burden of proof to show the department's assessment to be incorrect. During the period under review Joseph Bromley was the chief operating officer, president and shareholder of Key Line Freight, Inc., which was assessed franchise taxes in the State of Wisconsin; therefore, he is liable as a transferee under the provisions of s. 71.11(21n) of the Wisconsin Statutes for the Key Line Freight, Inc. unpaid tax as was assessed by the department. The assessment notice against Joseph Bromley constitutes adequate notice of claim against him and therefore did not violate the Due Process Clause of the United States Constitution. Laws enacted by the Wisconsin Legislature are presumed to be constitutional.

The taxpayer has appealed this decision to the Circuit Court.

Dennis Culver vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 15, 1984). The issue for the Commission is whether the taxpayer may properly deduct $19,085 in 1979 Schedule F farm expenses for amounts deposited from his individual funds into the joint checking account he maintained with his wife as "payment" for services performed for his farm.

During the period under review, there is no dispute as to the computations involved in the assessment issued by the department against the taxpayer. The payments are summarized as follows:

1979 Schedule F

1.40	Patsy Culver - Incentive Payment	$ 1,901.68
1.52	Pension and profit sharing plans - Bookkeeper	6,000.00
1.54	Patsy Culver, wife	11,184.00
	Total payments to Patsy Culver	$19,085.68

The department disallowed the $19,085 deduction to the taxpayer and credited such amount against the return of his wife who reported the amount as her income.

The taxpayer was engaged, together with his brother, in a fairly large dairy and beef cattle farm operation. He and his brother owned, as tenants in common, all farm land including acreage purchased from their father as well as from several third parties located conveniently nearby. Most of the other farm assets were owned by the brothers together. Gross farm profits such as milk checks were deposited in the brothers' joint checking account. The brothers assigned 25% of the milk checks to their father. There was no formal partnership agreement, oral or written, between the taxpayer and his brother, and each attempted to treat his "share" of the overall farm operation as a separate business.

In conjunction with implementing the farm operation, the taxpayer and his brother adopted an arrangement wherein each would employ their respective wives to perform two functions—bookkeeping and farm chores—for pay. The bookkeeping and farm chores were divided relatively equally between the two according to their training, ability, and preference to perform certain tasks. The taxpayer's wife's bookkeeping duties involved the maintenance, organization, actual payment of bills and logging of the payments, while his sister-in-law handled the brothers' joint checking account and did more of the "book work" proper, including work related to tax return preparation. Each wife did milking, barn and field work, with the sister-in-law handling the calves. The taxpayer's wife claimed to have worked an average of 20 hours per week at bookkeeping. However, no actual record of her time spent was kept, and based on the duties described and other hours spent on chores the claim is excessive.

For 1979, the taxpayer had contracted with his wife, Patsy, to pay her $6,000 yearly for bookkeeping work, based on an estimate of 20 hours per week. In addition, she was to be paid $6.00 per hour for farm chores. A yearly incentive payment was to be made in the amount of 25% of net farm profit from the joint farm operation of the taxpayer and his brother. The taxpayer and his wife recorded her hours spent performing farm chores.

His wife received her "compensation" in the following manner. He would periodically receive checks from the Culver Brothers (business) account which would represent his "share" of farm income less expenses. He would sign those checks (or occasionally checks to him from other sources) on the reverse side and give them to his wife, Patsy, without any specific endorsement. She would sign her name and deposit the amounts that they determined he "owed" her into their joint personal checking account. Any difference between the face amount of the check and the payment due her apparently would be taken as cash and given to the taxpayer. Although his wife claimed to be free to use the joint checking account money as she saw fit, she was responsible for certain family living expenses such as food. No evidence of the specific checks drawn on the joint account was offered, although apparently no payments were made for farm business purposes. There were no payroll checks issued to the taxpayer's wife and no taxes withheld from amounts representing bookkeeping or farm chore "earnings", nor was there any social security withheld. No self-employment returns were filed by his wife. No other payments such as unemployment compensation or worker's compensation were made. The funds she received remained legally at his disposal in their joint checking account and were used, at least in part, for payment of his family living expenses.

The Commission ruled that the record does not establish that the taxpayer had established an employer-employe relationship with his wife. The relationship was too informally structured; there was no employment agreement established at the outset of or during the period under review. Amounts deducted by the taxpayer as wages or salary paid to his wife are not properly so characterized. Transfers of his individual funds respecting his wife's performance of services in his farm business to a joint checking account shared with her under the circumstances did not constitute deductible payment of "wages" under Wisconsin law.

The taxpayer has appealed this decision to the Circuit Court.

Gerald R. Hoeppner vs. Wisconsin Department of Revenue (Circuit Court of Waukesha County, March 2, 1984). The taxpayer appealed the decision of the department, which was affirmed by the Wisconsin Tax Appeals Commission, that his mileage was a nondeductible commuting expense rather than a deductible transportation expense. (See WTB #29 for a summary of the Tax Appeals Commission's decision.)

The taxpayer, who resided in Milwaukee County, claimed a mileage deduction while working across the Milwaukee-Ozaukee county line in Port Washington. He claimed a deduction for only the twelve miles from the county line to the power plant in which he worked for a total of 130 days during 1978. No mileage allowance was paid by his employer, and in place of his incurring the expense of motels and meals in Port Washington, the company had him travel back and forth from his home in Milwaukee.

The department contended that the crossing of county lines in and of itself is not determinative of what the general area of the taxpayer's regular place of employment is. Since the taxpayer's union contract provided a five-county area (including Ozaukee) to be an area for which no travel expense was payable by the employer, this fixed Port Washington as being within the taxpayer's general area of employment. The department also took the position that the taxpayer's employment in Port Washington was not "temporary", but instead "indefinite".

The taxpayer, on the other hand, pointed out that the Port Washington area is not considered as part of "Metropolitan Milwaukee", even in the Metropolitan phone book. The taxpayer testified that the Port Washington work assignment was to be for a period of five to six weeks.

The Court determined that the taxpayer had met his burden of proof that the Port Washington job was in fact "temporary" employment, not indefinite employment. However, the taxpayer failed to establish that the area involved was outside of his general work area.

The taxpayer has not appealed this decision.

Key Line Freight, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 12, 1984). During the period under review, 1977 and 1978, Key Line Freight, Inc. was a Michigan corporation doing business in Wisconsin. The issues are as follows: (1) whether the assessment against Key Line Freight, Inc. (Key Line) is barred by reason of the department not filing a claim against Key Line under the Michigan Statutes relative to corporate dissolution and the Full Faith and Credit Clause of the United States Constitution, (2) whether s. 71.337, Wis. Stats., violates the Equal Protection Clause of the United States Constitution, (3) whether the assessment against Key Line constitutes an unfair apportionment of Key Line's income and therefore violates the Due Process Clause of the United States Constitution, (4) whether the assessment against Key Line violates the Commerce Clause of the United States Constitution, and (5) whether Key Line's gain on the sale of its capital assets constitutes business income subject to apportionment within the meaning of ss. 71.07(1m) and (2), Wis. Stats.

Key Line Freight, Inc. was organized under the laws of Michigan and engaged in the business of the interstate motor transportation of general commodities throughout a number of midwestern states including Wisconsin. It had its principal offices in Grand Rapids, Michigan. In 1977 and 1978, Key Line filed Wisconsin franchise tax returns showing that approximately 13% of its total freight pick-ups occurred in Wisconsin and approximately 9% of the total miles its tractor trailers were driven occurred in Wisconsin. It leased terminal facilities in Milwaukee and Appleton, Wisconsin. In 1977, Key Line sold certain land, seven tractors, fourteen automobiles, an airplane, furniture and fixtures, and miscellaneous other equipment, all of which was used in Key Line's business activities. It realized a net gain of $7,406 on such sale and reported the gain on its 1977 Wisconsin franchise tax return as nonapportionable income.

In March, 1978, Key Line ceased business operations. On March 30, 1978, Key Line adopted a plan of complete liquidation under Section 337 of the Internal Revenue Code. In 1978, Key Line sold real property and its operating permit, both of which were used in its business activities. The proceeds of Key Line's liquidation were distributed to its shareholders, none of whom resided in Wisconsin. It realized a gain of approximately $50,000 on the real property and approximately $2,800,000 on the sale of its operating permit, but Key Line did not report this as income on its Wisconsin franchise tax return. On March 30, 1978, the shareholders of Key Line approved its dissolution and after proceedings under Michigan law, it ceased to exist September 17, 1980.

On July 30, 1981, the department mailed an assessment notice to Key Line assessing the gain on the sale of its land and other business assets in 1977 and the gain on the sale of its land and operating permit in 1978. A petition for redetermination was filed, which was denied by the department. During the period under review all income arising from the taxpayer's gain on the sale of its land and other business assets in 1977 and the gain on the sale of its land and operating permit in 1978 was part of the corporation's unitary business which was apportionable income under s. 71.07(1m), Wis. Stats., and taxable in the State of Wisconsin.

The Commission held that during the period under review, Key Line Freight, Inc.'s gain on the sale of its capital assets constitutes business income subject to apportionment within the meaning of ss. 71.07(1m) and (2), Wis. Stats. Therefore, the gain on the sale of business capital assets stated above is apportionable in the State of Wisconsin and should have been included in the taxpayer's corporate franchise/income tax return for the years under review. Key Line failed to meet its burden of proof to show the department's assessment to be incorrect. Laws enacted by the Wisconsin Legislature are presumed to be constitutional.

The taxpayer has appealed this decision to the Circuit Court.

Douglas J. Kimball vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 15, 1984). Under date of October 26, 1981, the taxpayer filed an amended return with the department reporting certain changes to his tax year 1979 by the Internal Revenue Service (IRS) and claiming a state tax refund of $2,171 in income tax. Under date of February 22, 1982, in an apparent denial of his claim for refund, the department issued an assessment for tax year 1979.

For the year 1979, the taxpayer was audited by the IRS. During the audit, he requested a change in his method of accounting for 1979 from the cash basis to the accrual basis. This resulted in an increase in his income by reason of the change in the method of $45,204.25. The IRS agreed to this change in accounting method. The taxpayer had certain options under the Internal Revenue Code relative to the year when the additional income must be taken into account. He decided to report as income the full $45,204.25 in the year 1979. His reason for reporting his income in this manner was to avail himself of an offsetting investment tax credit which he would otherwise lose. The taxpayer filed an amended Wisconsin income tax return (dated October 26, 1981) reporting the federal adjustments to income and reporting the $45,204.25 adjustment by a 10 year spread-forward method. His position on this matter is that the spread-forward should be for 6 years rather than 10 since he was only in business since 1974.

The issues to be determined by the Commission are whether the taxpayer is entitled to spread forward for 6 years an adjustment to income in 1979 occasioned by a change in his method of accounting under the Internal Revenue Code, and whether he waived such right by agreeing that all of such adjustments be recognized in 1979 for federal income tax purposes.

The taxpayer's position was:

> "Under the federal revenue code—if several options are open to the taxpayer—he had the right to choose the option that will give him the lowest tax or be to his best advantage.
>
> "It is my understanding that the Wis. Dept. of Revenue follows the federal revenue code except for specific stated exceptions of which the right to choose an option is not specified as not being available to the taxpayer.
>
> "In the case of Douglas Kimball which we are now considering, he had four options
>
> I) Take total increase in 1979
> II) Spread back equally to 1978 & 1977
> III) Re-calculate 1977 & 1978 using the new method
> IV) Spread Forward 6 years
>
> "I believe the option chosen on the federal tax return for good and sufficient reasons and facts does not preclude using a different option on the state tax return."

His authority for his position was a photocopy of 3 pages from a Commerce Clearing House publication containing Internal Revenue Code Section 481(a), (b) and (c); a part of IRS Regulation s.1.481-1 prior to the amendment of s. 481(b) by Public Law 94-455 (1976); and a portion of Internal Revenue Code Section 466 (e) and (f).

The Commission held that when a taxpayer has an election under the Internal Revenue Code, it is possible in some instances to make one election for federal income tax purposes and to make another election for Wisconsin income tax purposes. In this case, the taxpayer is not entitled to a spread-forward of income for 6 years as an adjustment to income on his 1979 Wisconsin individual income tax return as no such election is provided for in Internal Revenue Code Section 481 for the year 1979 as he asserts.

The taxpayer has not appealed this decision.

Anthony D. Maglio vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 15, 1984). In 1978, the taxpayer was ordered by the Milwaukee County Circuit Court to quitclaim all of his interest in his jointly-owned homestead to his wife, the other joint owner, pursuant to a judgment of divorce. The transfer was in lieu of alimony. The total fair market value of the homestead at the time of transfer was $60,000 and the total cost basis was $35,900.

On February 1, 1982, the department issued an income tax assessment against the taxpayer in which it assessed a $12,050 gain realized from the transfer of his one-half interest in the homestead in question. The gain was computed as follows:

One-half of fair market value	$30,000
Less one-half of adjusted basis	17,950
Taxable Gain	$12,050

On February 17, 1982, Mr. Maglio filed a petition for redetermination of the assessment with the department, which it denied on May 24, 1982. On June 17, 1982, the taxpayer appealed the denial to the Tax Appeals Commission.

The Commission held that the taxpayer was properly assessed on the tax for one-half of the appreciation that occurred prior to the transfer of his jointly-owned homestead to his ex-spouse.

The taxpayer has not appealed this decision.

Eugene F. Mower vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, January 20, 1984). The issue in this case is whether the taxpayer is the record owner of real estate transferred, and whether the gain from the real estate transfer may be excluded under the nonrecognition of gain provisions of Internal Revenue Code Section 351.

Prior to 1977 the taxpayer acquired a 1/3 interest as tenant in common in an apartment building located in Chippewa Falls, Wisconsin. In February of 1977 the taxpayer attempted to transfer his 1/3 interest in the property to the Mower Insurance Agency, Inc., a corporation in which he owned the controlling interest. The transfer was reported in the corporate minutes of Mower Insurance Agency but was not evidenced by a deed or other conveyance of record, or recorded with the Register of Deeds. The taxpayer did not report any gain or loss on the transfer on his 1977 individual income tax return.

In September of 1977 the taxpayer, as an individual, executed a warranty deed transferring his interest in the apartment building to the Treeline Corporation. This deed was recorded with the Chippewa County Register of Deeds. In exchange for the property the Treeline Corporation issued stock to Mower Insurance Agency. Mower Insurance Agency did not report the transfer on its 1977 franchise tax return. After the transfer neither the taxpayer nor Mower Insurance Agency was in control of Treeline Corporation.

The department assessed a $78,000 gain to the taxpayer on the transfer of real estate in 1977. The taxpayer contends that the gain on the transfer of the real estate is subject to the nonrecognition of gain provisions of Internal Revenue Code Section 351 which states, "no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control . . . of the corporation."

The Tax Appeals Commission concluded that title to real estate cannot be transferred by corporate minutes; thus, the taxpayer did not effect a valid transfer of his interest in the property to the Mower Insurance Agency. Nonrecognition of gain provisions under IRC Section 351 do not apply to the transfer to Mower Insurance Agency since this was not a valid transfer. Also, the nonrecognition of gains provisions do not apply to the transfer to Treeline Corporation because the Mower Insurance Agency, and not the taxpayer, received the stock of Treeline. The taxpayer held record title in the property at the time of its transfer to Treeline Corporation and must report the gain.

The taxpayer has not appealed this decision.

Roland Murphy vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, May 1, 1984). On the 1981 income tax return, the taxpayer had various properties that were depreciated under the ACRS provisions of the Internal Revenue Code. For federal purposes and for state purposes, these are considered tax preference items, and consequently, there are various minimum tax provisions that apply under the Internal Revenue Code and in the Wisconsin Tax Statutes. Section 71.60, Wis. Stats., defines tax preference items to mean items enumerated in Section 57(a) of the Internal Revenue Code, subsections (2), (3), (6), (8) and (11). Subsection (2) addresses accelerated depreciation. Subsection (12) addresses the specific type of accelerated depreciation under review here, the ACRS accelerated depreciation. The only question for determination is if the accelerated depreciation on the taxpayer's return, which is Section 57(a)(12) ACRS depreciation, is included as a general category of accelerated depreciation for purposes of including it in the minimum tax preference calculation.

During the period under review, ACRS of $17,637 is subject to the minimum tax on tax preference items pursuant to IRC Section 57. The taxpayer has calculated this amount and appropriately set it forth on Form 4625 at Line 1(a)(2). This line is designated "accelerated depreciation on ACRS property—other real property that is nonrecovery property or 15-year real property." In filing the minimum tax counterpart for Wisconsin, Form MT, the taxpayer excluded the $17,637 of ACRS on 15-year real property. The department has added this amount to the Form MT for purposes of calculating the appropriate minimum tax.

The Commission ruled that the taxpayer's 1981 return follows the Code as of December 31, 1980 for Wisconsin tax purposes. Wisconsin's minimum tax is calculated on items enumerated in Sections 57(a)(2), (3), (6), (8) and (11) of the Internal Revenue Code plus adjusted itemized deductions and capital gains deductions under the 1980 Code. During the period under review Section 57(a)(2) of the 1980 Internal Revenue Code addressed accelerated depreciation on Section 1250 real property. This accelerated depreciation on real property is subject to the minimum tax pursuant to s. 71.60(2), Wis. Stats., 1981.

The taxpayer has not appealed this decision.

Wisconsin Department of Revenue vs. Overly, Inc. (Circuit Court of Winnebago County, March 26, 1984). The department petitioned for review of a decision of the Wisconsin Tax Appeals Commission, which determined that receipt of the proceeds of life insurance did not constitute "other items of Wisconsin income" within the meaning of s. 71.06(1), Wis. Stats., and therefore was not an appropriate offset against the net business loss claimed by the taxpayer in computing its loss carryforward. (See WTB #34 for a summary of the Tax Appeals Commission's decision.)

The taxpayer received the proceeds of life insurance upon the death of a corporate officer. The corporation sustained a net business loss for the year in which the proceeds were received and attempted to carry that loss forward as provided in s. 71.06, Wis. Stats., to which the department objected. Such life insurance proceeds, by s. 71.03(2), Wis. Stats., are exempt from taxation.

In Midland Financial Corp. v. Department of Revenue, 116 Wis. 40 (1983), the Supreme Court held that the term "other items of Wisconsin income" in s. 71.06(1), Wis. Stats., was ambiguous. The Supreme Court, in Midland, found that the legislature intended a mere deduction should not be used to reduce the loss carryforward. An exemption appears to present an even stronger indication of intent.

The Circuit Court accordingly concluded that the legislature, in using the language "not offset by other items of Wisconsin income in the loss year", did not intend to include, as other items of income, insurance proceeds received.

The department has not appealed this decision.

333 Enterprises, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, December 29, 1983). On December 27, 1982, the department issued a Notice of Amount Due in the total amount of $496.89 as an addition to tax due relating to an underpayment of estimated tax for the fiscal year ending August 31, 1982. The taxpayer filed a petition for redetermination of this assessment which the department denied.

For the fiscal year ending August 31, 1981, the taxpayer's net tax liability was $2,997. For the fiscal year ending August 31, 1982, the taxpayer made four equal installment payments of $750 on a timely basis, for a total of $3,000. For the fiscal year ending August 31, 1982, the taxpayer reported on its return a net tax liability of $11,489 which failed to include the 10% surtax for fiscal years ending after July 1, 1982. The taxpayer's total net tax liability for the fiscal year ending August 31, 1982 was $12,673. The taxpayer's total estimated payment for the fiscal year ending August 31, 1982 was less than 60% of the tax shown on the return for that year.

The Commission held that pursuant to ss. 71.22(10)(a) and (b), Wis. Stats., the taxpayer did not qualify for the exceptions provided therein to the imposition of the addition to tax with respect to the taxpayer's underpayment of estimated taxes for the fiscal year ending August 31, 1982 in that his total estimated payment in said year was less than 60% of the tax shown on the return filed. The taxpayer does not come within the provisions for any other exception to the imposition of the addition to taxes under s. 71.22, Wis. Stats.

The taxpayer has not appealed this decision.

SALES/USE TAXES

Kohler Company vs. Wisconsin Department of Revenue (Circuit Court of Dane County, February 15, 1984). The taxpayer manufactures plumbing products which it sells to its authorized distributors. These distributors, in turn, sell the products to building and plumbing contractors. To boost sales, Kohler has designed a number of promotional displays featuring its products in modern kitchen or bathroom environments. Typical displays include a Kohler bathtub, sink, toilet or combination thereof along with decorative materials such as flooring, false walls or potted plants.

A review of the 1976 Kohler display catalogue shows that these promotional displays are easily divisible into three categories. The first category contains displays which may be purchased by the distributor for the net price of the Kohler products in that display. According to the catalogue, any decorative materials in that display are included at "No Charge". Thirty-three displays listed in the 1976 catalogue fall into this first category. The second category contains displays which may be purchased by a distributor for a charge in addition to the net price of the Kohler products in the display. This additional charge ranges from $24.95 to $175.00. The 1976 catalogue lists ten displays in this category. The final category contains displays that do not have Kohler plumbing products in them. These displays range in price from $8.40 to $65.00. There are three displays in this third category.

For the period in question, 1973 through 1976, Kohler purchased the decorative materials (the potted plants, etc.) from suppliers inside and outside of Wisconsin. On purchases from Wisconsin suppliers, Kohler did not pay a sales tax. Instead, Kohler gave the supplier a resale certificate as allowed by s. 77.52(13), Wis. Stats. In 1980, the department decided that Kohler was giving the decorative materials to its distributors, not reselling them. This gift by Kohler to its distributors made the sale of decorative materials by the Wisconsin suppliers to Kohler a taxable sale under s. 77.51(4)(k), Wis. Stats. Thus, the department assessed $15,091.70 tax on Kohler for those purchases. The Wisconsin Tax Appeals Commission unanimously affirmed the assessment and found that in most cases, the display materials were supplied at no additional charge when the distributor bought the Kohler fixtures at net. As a conclusion of law, the Commission found that the display materials were given, not resold, to the distributors. The issue, then, is whether the decorative materials purchased by Kohler from Wisconsin suppliers were given or resold to its distributors.

In dealing with the first category of displays, "net price" as used in Kohler's catalogue equals the normal distributor wholesale price. Thus, a distributor buying a display from this first category receives the decorative materials and the Kohler products for the normal price of the products alone. Under Department of Revenue v. Milwaukee Brewers, 111 Wis. 2d 571 (1983), and common sense, the decorative materials were given to the distributor; there truly was no charge for them.

In dealing with the second category of displays, those purchased for a charge in addition to the net price of the included Kohler products, it is necessary to analyze s. 77.51(4), Wis. Stats. The key phrases in that section are "without valuable consideration" and "distributed gratis". A distributor wanting to purchase display #76-88 from the 1976 Kohler catalogue would pay $175.00 in addition to the net price of the included plumbing products. For #75-12, he would pay $149.00 additional. Other displays require additional payments of $125.00 or $115.00. Thus, for these displays, the transfer of decorative materials is not "without valuable consideration" and certainly not "gratis". It may be true that Kohler lost money or, at best, broke even on the sale of decorative materials to its distributors. But lack of a subsequent profit does not serve to make the sale from the supplier to Kohler taxable. The decorative materials in these displays were resold by Kohler to its distributors and Kohler properly used resale certificates to exempt its purchases of the materials from tax.

The third category of displays, those not containing Kohler plumbing products, is easily dealt with. Kohler's tax liability in this case is based on a projection of a two-month sample of display sales. The sample, and thus the projection, does not contain any sales of displays in this category. Therefore, none of Kohler's tax liability stems from the sale of these displays to distributors; they are irrelevant to this case.

The Circuit Court affirmed the Tax Appeals Commission in as much as it held Kohler liable for tax on purchases subsequently given to its distributors, but reversed the decision regarding the purchases resold by Kohler.

The taxpayer has appealed this decision to the Court of Appeals. The department has not appealed the portion of this decision which is adverse to the department.

The Mylrea Company, Inc. vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, March 16, 1982). In WTB #29 it was indicated that the department appealed the Tax Appeals Commission's March 16, 1982 decision on The Mylrea Company, Inc. vs. Wisconsin Department of Revenue to the Circuit Court. The department did not appeal the Tax Appeals Commission's decision.

Schuster Construction Company vs. Wisconsin Department of Revenue (Circuit Court of Dane County, April 18, 1984). This is an action to review a decision of the Wisconsin Tax Appeals Commission in which the Commission affirmed an earlier assessment of additional taxes, interest and penalties against the taxpayer. The taxpayer contends that the Commission erred in holding: (1) that it had jurisdiction to review only the penalty portion of the assessment, and (2) that the penalty was properly assessed.

With respect to jurisdiction, the Commission held that it was without authority to review any matter not previously raised in the taxpayer's petition for redetermination under s. 71.12, Wis. Stats. Since the taxpayer's request for redetermination specifically requested review only of the penalty assessment, the Commission held that its jurisdiction was correspondingly limited. The taxpayer contends that this ruling was improper in two respects. First, it argues that the Commission was in error as to the scope of its authority. While ss. 71.12(6) and 73.01(5), Wis. Stats., specifically require that all disputed issues be disclosed in a petition to the Commission, there is no corresponding statutory requirement for petitions for redetermination. Second, the taxpayer asserts that consideration should have been given to the fact that the person who prepared the petition for redetermination was not a lawyer who should be expected to possess well-developed pleading skills.

The Circuit Court disagrees on both counts. As to the scope of the Commission's authority, the taxpayer's argument ignores the fact that submission of a petition for redetermination by the Department of Revenue is prerequisite to an appeal to the Commission. In addition, s. 71.12(1)(c), Wis. Stats., authorizes appeals to the Commission for taxpayers who are "aggrieved by the department's redetermination." Section 73.01(5), Wis. Stats., authorizes such appeals for those who "filed a petition for redetermination" and are "aggrieved by the redetermination of the department." It is difficult to see how a taxpayer may be considered "aggrieved" by a redetermination which the department did not, and was not requested to make. As a result, the court concurs in the Commission's view of its authority.

In support of its contention that consideration shall have been given to the fact that it was not represented by counsel when it submitted its petition for redetermination, the taxpayer has cited Rowe v. WDR, Docket No. I-8801, in which the Commission did consider an issue of domicile which had not been explicitly raised in either the petition for redetermination or the petition for review by the Commission. In this case, however, there can be no question of liberal versus strict construction because the petition for redetermination is explicit. The petition not only fails to request redetermination of matters other than the penalty, it expressly disavows any interest in redetermination of the tax itself. It simply cannot be construed as a request to review the entire assessment. As a matter of law, however, the fact that a party to a proceeding chooses to appear pro se cannot automatically excuse every action the party might later come to regret. For these reasons, the court is unable to find that the Commission committed error in confining its review to the matter of the penalty.

As regards the merits of the penalty assessment, the taxpayer contends that it should not be penalized for underreporting its use tax because in computing that tax initially it used a method which the department itself had used in an earlier audit and which the taxpayer felt was acceptable to the department. The taxpayer also argues that some of the tax would not have been due at all but for an accounting error which caused it to pay for certain purchases which should have been charged to a sister corporation, in which case the purchases would have been tax exempt. Third, the taxpayer asserts that it should not be subject to a penalty for its underreporting of taxable sales because of its reliance on what turned out to be invalid resale certificates as well as representations by its purchasers that the sales were exempt.

The method of calculating use tax to which the taxpayer refers involves averaging the cost of cement used in its projects. The department used this method in an earlier audit of the taxpayer in which unpaid use tax was also in issue only because of a dearth of information in the taxpayer's records as to the actual cost of cement used by the taxpayer. In the opinion of this court, the Commission acted well within its authority in rejecting the taxpayer's profferred explanation.

With respect to the bookkeeping error, the court considers it quite irrelevant that a different method of accounting would have rendered some of the taxpayer's purchases tax exempt. Neither the error itself nor the taxpayer's failure to recognize its consequences even approaches "good cause" within the meaning of s. 77.60(3), Wis. Stats. The taxpayer's error was clearly negligent.

Finally, the court must also reject the taxpayer's claimed reliance on invalid resale certificates and representations by its purchasers as a justification for its underreporting of taxable sales. There is simply no basis in the record for a conclusion that this reliance was reasonable. Without such evidence, the court cannot find error in the Commission's rejection of this argument.

For all the foregoing reasons, it is the view of the Circuit Court that the decision of the Commission is affirmed.

The taxpayer has appealed this decision to the Court of Appeals.

Senior Golf Association of Wisconsin, Inc. vs. Wisconsin Department of Revenue (Circuit Court of Dane County, March 9, 1984). The issue presented by this appeal is if the membership dues and initiation fees collected by the taxpayer are taxable under s. 77.52(2)(a)2, Wis. Stats., if the dues and fees are used exclusively for administrative costs, and membership provides members with the opportunity to use private golf courses free of charge. The Wisconsin Tax Appeals Commission determined that the association's initiation fees and annual dues are taxable under s. 77.52(2)(a)2, Wis. Stats., because membership to the taxpayer's social organization provides access to or use of private golf facilities. (See WTB #32 for a summary of the Tax Appeals Commission's decision.)

The taxpayer contends that members are not given present, enforceable rights to the use of or access to the golf facilities used in tournaments for consideration given. Therefore, it should not be required to pay sales tax on the dues and fees, and taxes paid during 1977 through 1980 should be refunded.

The sales tax statute's meaning and purpose is well understood. Further explanation of its operation is found in Wis. Adm. Code section Tax 11.65(1)(b). The department correctly states that the Wisconsin sales tax intends to tax gross receipts of a sale of tangible goods and services rather than tax just the sale's net receipts or profits. Recently, the Wisconsin Court of Appeals reviewed the Dane County Circuit Court case cited by both parties, City of Racine v. Wisconsin Dept. of Revenue, 115 Wis. 2d 510 (1983). In that case, the court reiterated the legislature's intent to tax gross receipts and concluded that administrative costs are included in gross receipts. The issue in this sort of sales tax, stated the court, is not how the seller uses the collected fees but rather whether a participant is required to pay to gain access to or use of the facility. Moreover, the fact that the sports facilities are not owned by the seller is immaterial. Therefore, the Circuit Court's only concern is if the department incorrectly determined that membership to the taxpayer association was necessary to gain access to or use of the private clubs hosting the taxpayer's golf tournaments.

The department, through the five-member Tax Appeals Commission, found that the association's membership dues and fees entitled members to access to various private country club golf courses through the golf tournaments arranged by the taxpayer. Phrased negatively, one could not participate in the tournaments and have free use of the host golf courses unless he was a member of the taxpayer organization. The department found, as did the court in City of Racine, that the "no pay - no play" membership effect essentially means members pay for access to private golf courses up to seven times a year. As a result, the membership dues and fees are subject to state sales tax under s. 77.52(2)(a)2, Wis. Stats., and Wis. Adm. Code section Tax 11.65(1)(b). The fact that the private country clubs are not owned by the taxpayer is of no consequence and neither is the fact that membership dues did not directly pay for green fees. Finally, the fact that the association used the dues to defray administrative costs is also inconsequential in this sales tax inquiry.

Therefore, the Circuit Court affirmed the Wisconsin Tax Appeals Commission's decision that the taxpayer's membership dues and fees are subject to state sales tax under s. 77.52(2)(a)2, Wis. Stats.

The taxpayer has appealed this decision to the Court of Appeals.

Shopper Advertiser, Inc., d/b/a Shopper Advertiser - Walworth County, and Shopping News, Inc., d/b/a Greater Beloit Shopping News, vs. Wisconsin Department of Revenue (Wisconsin Supreme Court, February 28, 1984). The issues presented on appeal are whether (1) the proper venue for judicial review of a decision of the Tax Appeals Commission is in the county where the petitioner-taxpayer resides, as specified in s. 227.16(1)(a), Wis. Stats., or in Dane County, as specified in s. 77.59(6)(b), Wis. Stats., and (2) if venue was in Dane County, the action was properly transferred, pursuant to s. 807.07(2), Wis. Stats., from the Rock County Circuit Court, where the action was originally filed, to the Dane County Circuit Court. (See WTB #25 for a summary of the Circuit Court's decision.)

The Supreme Court ruled that the running of the thirty-day time limit for appeal in this case was tolled when the action was filed in the Rock County Circuit Court, which had subject matter jurisdiction over the matter. Once the matter was before a court with subject matter jurisdiction, the action for review was timely filed. The subsequent transfer to Dane County—the court of proper venue—was not affected by the statutory time limits for appeal under s. 227.16(1)(a), Wis. Stats., which were satisfied in this case. The Supreme Court reversed the Court of Appeals' holding that the Dane County Circuit Court had no jurisdiction to decide the action for review and its holding that the Rock County Circuit Court erred in transferring the action to the Dane County Circuit Court. Because the Court of Appeals decided the action was barred on jurisdictional grounds, it did not reach the merits of the appeal from the judgment of the Dane County Circuit Court. Accordingly, the Supreme Court remanded the case to the Court of Appeals for consideration of all previously undecided issues.

FARMLAND PRESERVATION CREDIT

Dorothy McManus vs. Wisconsin Department of Revenue (Wisconsin Tax Appeals Commission, January 20, 1984). The issue for review by the Wisconsin Tax Appeals Commision is whether the taxpayer must include her spouse's income as "household income" for purposes of claiming the Farmland Preservation Credit.

In 1978 the taxpayer owned a farm in Wisconsin in joint tenancy with her spouse. During the period under review she resided with her spouse in a "household" within the meaning of s. 71.09(11)(a)4, Wis. Stats. The taxpayer filed a 1978 Farmland Preservation Credit claim on which she reported only her income as "household income". This claim was denied by the department because the inclusion of her spouse's income in the calculation of "household income" resulted in an excess of $38,429 and therefore in no available Farmland Preservation Credit. The applicable portion of s. 71.09(11)(a), Wis. Stats., reads as follows: "5. 'Household income' means all of the income of the claimant, the claimant's spouse and all minor dependents attributable to the income year while members of the household."

The Commission concluded that the taxpayer's "household income" includes her spouse's income and exceeds the limits prescribed under Wisconsin statutes for the Farmland Preservation Credit. The department acted properly in denying the taxpayer's 1978 Farmland Preservation claim.

The taxpayer has appealed this decision to the Circuit Court.

WITHHOLDING TAXES

William D. Kleiman vs. Wisconsin Department of Revenue (Circuit Court of Dane County, April 3, 1984). The issue in this case is whether the taxpayer's wages are subject to withholding for Wisconsin income tax purposes. The taxpayer contends that the state has no authority to tax personal income received in the form of wages in violation of his "Common Law Right of Contract".

On May 13, 1981, the Wisconsin Department of Revenue notified the taxpayer and his employer that it was voiding his Wisconsin Withholding Exemption Certificate (W-4). The employer was required to withhold state income taxes from the taxpayer's wages pursuant to s. 71.20(1), Wis. Stats. The taxpayer filed a petition for redetermination with the department, asserting that he was entitled to the exemption because withholding from wages amounted to a violation of his constitutional and common law contract rights. The department denied the petition for redetermination. The Wisconsin Tax Appeals Commission granted the department's motion for summary judgment and dismissed the taxpayer's petition for review.

The Circuit Court held that taxation of the taxpayer's wages is clearly permissible under the federal and state constitutions, and withholding is a constitutionally legitimate means for collecting taxes. Therefore, the decision of the Tax Appeals Commission is affirmed.

The taxpayer has appealed this decision to the Court of Appeals.

TAX RELEASES

("Tax Releases" are designed to provide answers to the specific tax questions covered, based on the facts indicated. However, the answer may not apply to all questions of a similar nature. In situations where the facts vary from those given herein, it is recommended that advice be sought from the Department. Unless otherwise indicated, Tax Releases apply for all periods open to adjustment. All references to section numbers are to the Wisconsin Statutes unless otherwise noted.)

Income and Franchise Taxes

INCOME AND FRANCHISE TAXES

1. Imputed Interest

Background: Section 71.04(15)(h), Wis. Stats. (created by Chapter 20, Laws of 1981), provides a deduction from gross income to corporations for any portion of the purchase price of property which is treated as interest under Section 483 of the federal Internal Revenue Code. Section 71.04(15)(h) is effective for purchases made in taxable year 1981 and thereafter. This Tax Release explains the provisions of Section 483 of the Internal Revenue Code as they relate to Wisconsin corporate purchasers of property as well as Wisconsin individuals, estates and trusts who compute their Wisconsin taxable incomes under the provisions of the Internal Revenue Code.

Unstated interest is the amount of interest that the law imputes as included in the contract price when property is sold under a deferred payment or installment arrangement that fails to specify any interest, or that specifies interest at a rate less than the amount prescribed in the federal regulations under Section 483 of the Internal Revenue Code.

A payment under a contract for the sale or exchange of property, which constitutes part or all of the selling price and which is due more than 6 months after the date of such sale or exchange, is deemed to include unstated interest for all purposes of the Internal Revenue Code if none of the exceptions provided in the Code are met and if all of the following facts exist:

A. Property is sold under a deferred payment contract where the selling price exceeds $3,000. For purposes of determining the selling price, the downpayment and amount of any unstated interest are included but the amount of any stated interest is excluded.

B. Some or all of the payments are due more than one year after the date of the sale or exchange.

C. There is total unstated interest under the contract (see below).

Any payment under a contract for the sale or exchange of property is *not* subject to imputed interest if one of the following facts exists:

A. The selling price of the property is $3,000 or less.

B. The payment is made pursuant to the sale or exchange of a patent.

C. The payment is made under an annuity, endowment, or life insurance contract.

D. In the case of the purchaser, the tax treatment of the amount paid is determined under Section 163(b) of the Internal Revenue Code. This section provides for the tax treatment of personal property and educational services purchased under a contract which provides that a part or all of the purchase price is to be made in installments, and in which carrying charges are separately stated but the interest charge cannot be determined.

E. In the case of the seller, all of the gain, if any, on the sale or exchange of the property would be considered ordinary income.

Total unstated interest means, with respect to a contract for the sale or exchange of property, an amount equal to the excess of:

a. The sum of the payments constituting the selling price which are due more than 6 months after the date of the sale or exchange under the contract, over

b. The sum of the present values of such payments and the present values of any stated interest payments due under the contract.

To determine whether there is total unstated interest, the present values of the payments due under the contract are determined as of the date of the sale or exchange by discounting the payments at the interest rates prescribed in federal regulation 1.483-1(d)(1)(ii). For payments on account of a sale or exchange of property entered into on or after July 1, 1981, the test rate is 9 percent per annum simple interest. Tables are available in federal regulation 1.483-1(g)(2) to compute the present value of a deferred payment.

Once it is determined that there is total unstated interest (regardless of amount) with respect to a contract in the above computation, the actual unstated interest must be computed. The present values of the payments due under the contract must be recomputed by discounting the payments at an interest rate that is one percentage point higher than the rate used for testing whether unstated interest exists. These interest rates are prescribed in federal regulation 1.483-1(c)(2)(ii). For payments on account of a sale or exchange of property entered into on or after July 1, 1981, the imputed interest rate is 10 percent per annum, compounded semiannually.

Example 1: On January 1, 1983, A sells property to B under a contract that provides that B is to make payments of $2,500 ($2,200 sales price plus $300 interest), $2,600 ($2,200 sales price plus $400 interest), and $2,700 ($2,200 sales price plus $500 interest), such payments being due, respectively, 1, 2 and 3 years from the date of sale.

Since the property is sold under a deferred payment contract where the selling price exceeds $3,000, some or all of the payments are due more than one year after the date of the sale or exchange, and none of the exceptions to imputing interest are met, it is necessary to determine whether there is total unstated interest under this contract.

Sum of payments to which imputed interest rules apply		$6,600.00
Less:		
Present value of $2,500 due January 1, 1984 ($2,500 × .91743 factor from Table VII, Col. (a) in federal regulation 1.483-1(g)(2))	$2,293.58	
Present value of $2,600 due January 1, 1985 ($2,600 × .84746 factor from Table VII, Col. (a) in federal regulation 1.483-1(g)(2))	2,203.40	
Present value of $2,700 due January 1, 1986 ($2,700 × .78740 factor from Table VII, Col. (a) in federal regulation 1.483-1(g)(2))	2,125.98	6,622.96
Test for unstated interest		$ 0

Since the sum of the payments constituting the selling price under the contract ($6,600) are less than the sum of the present values of such payments and the present values of the stated interest payments ($6,622.96), there is no unstated interest under this contract.

Example 2: On August 25, 1983, C sells property to D under a contract that provides that D is to make three payments of $1,500 each, such payments being due on August 25, 1983 (downpayment), March 1, 1984 and September 1, 1984. No interest is provided for in the contract.

Unstated interest exists in this contract because there is no specified rate or amount of interest. Since the property is sold under a deferred payment contract where the selling price exceeds $3,000, some or all of the payments are due more than one year after the date of the sale or exchange, and none of the exceptions to imputing interest are met, it is necessary to compute the actual unstated interest.

Sum of payments to which imputed interest rules apply		$3,000.00
Less:		
Present value of $1,500 due March 1, 1984 ($1,500 × .95238 factor from Table VII, Col. (b) in federal regulation 1.483-1(g)(2))	$1,428.57	
Present value of $1,500 due September 1, 1984 ($1,500 × .90703 factor from Table VII, Col. (b) in federal regulation 1.483-1(g)(2))	1,360.55	2,789.12
Total unstated interest		$ 210.88

Only those payments which are due more than 6 months after the date of sale under the contract are considered in this computation.

Example 3: On December 31, 1982, E sells his personal residence to F under a contract that provides that F is to make a downpayment of $40,000 and additional payments as follows:

January 1, 1984	$ 5,000
January 1, 1985	$ 5,000
January 1, 1986	$10,000

Simple interest at 10 percent per annum is to be charged on the final 2 payments. In order to sell the residence, E agreed to charge no interest on the payment due on January 1, 1984.

Since the property is sold under a deferred payment contract where the selling price exceeds $3,000, some or all of the payments are due more than one year after the date of the sale or exchange, and none of the exceptions to imputing interest are met, it is necessary to determine whether unstated interest exists.

In a contract which provides for interest of an amount equal to or in excess of the test rate specified in federal regulation 1.483-1(d)(1) (simple interest of 9 percent per annum on a sale or exchange of property entered into on or after July 1, 1981), unstated interest cannot exist if the stated interest is payable on *each* installment of principal when due. This example does not provide for interest of an amount equal to or in excess of 9 percent simple interest on *each* installment, and therefore, it is necessary to determine whether unstated interest exists.

Sum of payments to which imputed interest rules apply		$20,000.00
Less:		
Present value of $5,000 due January 1, 1984 ($5,000 × .91743 factor from Table VII, Col. (a) in federal regulation 1.483-1(g)(2))	$ 4,587.15	
Present value of $6,000 ($5,000 principal + $1,000 stated interest) due January 1, 1985 ($6,000 × .84746 factor from Table VII, Col. (a) in federal regulation 1.483-1(g)(2))	5,084.76	
Present value of $13,000 ($10,000 principal + $3,000 stated interest) due January 1, 1986 ($13,000 × .78740 factor from Table VII, Col. (a) in federal regulation 1.483-1(g)(2))	10,236.20	19,908.11
Test for unstated interest		$ 91.89

Since the above computation indicates that unstated interest exists, it is necessary to compute the actual unstated interest.

Sum of payments to which imputed interest rules apply		$20,000.00
Less:		
Present value of $5,000 due January 1, 1984 ($5,000 × .90703 factor from Table VII, Col. (b) in federal regulation 1.483-1(g)(2))	$4,535.15	
Present value of $6,000 due January 1, 1985 ($6,000 × .82270 factor from Table VII, Col. (b) in federal regulation 1.483-1(g)(2))	4,936.20	
Present value of $13,000 due January 1, 1986 ($13,000 × .74622 factor from Table VII, Col. (b) in federal regulation 1.483-1(g)(2))	9,700.86	19,172.21
Total unstated interest		$ 827.79

Allocation of Payments: To compute the amount of interest included in each payment which constitutes part or all of the selling price and which is due more than 6 months after the date of sale or exchange of the property, the payment must be multiplied by a fraction, the numerator of which is the total unstated interest under the contract, and the denominator of which is the sum of all payments subject to the imputed interest rules which are due under the contract.

In Example 2, the imputed interest included in each payment on March 1, 1984 and September 1, 1984 is computed as follows:

$$\$1{,}500 \times \frac{\$\ 210.88}{\$3{,}000.00} = \$105.44$$

In Example 3, the imputed interest included in each payment on January 1, 1984 and January 1, 1985 is computed as follows:

$$\$5{,}000 \times \frac{\$\ 827.79}{\$20{,}000.00} = \$206.95$$

The imputed interest included in the payment on January 1, 1986 is computed as follows:

$$\$10{,}000 \times \frac{\$\ 827.79}{\$20{,}000.00} = \$413.90$$

Transfers of Land Between Related Parties: In the case of a sale of land by an individual to a member of such individual's family (brothers and sisters, spouse, ancestors and lineal descendants), the maximum imputed interest rate is 7 percent, compounded semiannually, on payments made after June 30, 1981 on sales or exchanges after such date. This interest rate does not apply to any qualified sale between these individuals made during any calendar year to the extent that the aggregate sales prices of such sales between such individuals exceeds $500,000.

2. Installment Sales - Accounting for Difference between Wisconsin and Federal Basis of Property Acquired by Inheritance

Facts and Question: A and B own real estate as joint tenants. In 1983 A dies and B inherits this property. For federal estate tax purposes the entire value of the property is includable in A's estate. Thus, B acquires a federal basis equal to the full fair market value of the property. In other words, B acquires a "stepped-up" basis for the entire property.

On the Wisconsin inheritance tax return only one-half of the property is determined to be includable for inheritance tax purposes. Thus, B's basis for Wisconsin purposes under the provisions of s. 71.05(1)(g), Wis. Stats., is one-half of the original cost plus one-half of the fair market value on the date of A's death. B acquires a stepped-up basis for only one-half of the property for Wisconsin purposes.

Section 71.05(1)(g) of the Wisconsin Statutes provides that the resulting difference between the Wisconsin and federal basis must be treated as an addition or subtraction to federal income, as appropriate.

Example: A and B acquire real estate in their joint names at a cost of $80,000. When A dies the property has a fair market value of $190,000. For federal income tax purposes, B acquires a basis of $190,000 in this property (the full value of the property was includable in the federal estate tax return filed for A). For Wisconsin inheritance tax purposes, one-half ($95,000) of the value of the property was reportable. Thus, under s. 71.05(1)(g), Wis. Stats., B has a Wisconsin basis of $135,000 ($40,000 original cost plus $95,000 included in Wisconsin inheritance tax return). The difference between the Wisconsin and federal basis is $55,000 ($190,000 minus $135,000).

In the same year the property is inherited, B sells it in an installment sale for $195,000. Payments of principal received in the year of sale total $10,000.

What is the amount of the addition modification to be reported, if this installment sale is B's only capital gains transaction?

Answer: The $55,000 difference in basis may be reported based on the installment sales proceeds actually collected each year. Since $10,000 was received in 1983, $2,821 of the difference in basis would be allocated to 1983. This adjustment is computed:

$$\frac{\$\ 10{,}000 \text{ Proceeds received}}{\$195{,}000 \text{ Selling price}} \times \$55{,}000 \text{ Basis difference}$$

$$= \$2{,}821 \text{ Basis adjustment for 1983}$$

Additional basis adjustments would be required in subsequent years as the balance of the installment sale contract price is received.

Section 71.05(5), Wis. Stats., provides that effective for the 1983 tax year and thereafter, the difference in the basis of assets must be combined with other long-term or short-term capital gains and losses to determine the amount of capital gain exclusion or capital loss deduction. Although the basis adjustment for 1983 is $2,821, the addition modification required is $1,692. Since only 60% of a long-term capital gain is taxable in 1983, the modification is 60% of $2,821, or $1,692.

Note: If B has other capital gain or loss transactions, a revised federal Schedule D should be prepared on which the $2,821 basis adjustment is combined with other capital gains or losses to determine the amount of gain or loss reportable.

3. Wisconsin Foreign Earned Income Exclusion

Background and Law: For the 1983 taxable year, Wisconsin taxable income is computed under the provisions of the federal Internal Revenue Code (IRC) in effect as of December 31, 1982 with the exceptions specified in s. 71.02(2)(b)9, Wis. Stats. One of these exceptions is the taxation of foreign earned income. Wisconsin follows IRC s. 911(c) in effect as of December 31, 1977 in taxing foreign earned income and Wisconsin does not follow the foreign earned income exclusion and foreign housing cost exclusion or deduction provided in IRC ss. 911 and 119(c) as amended and added by ss. 111 and 113 of P.L. 97-34 (Economic Recovery Tax Act), effective for taxable years beginning after December 31, 1981 for federal tax purposes.

For the 1978 through 1982 taxable years, Wisconsin followed IRC s. 911(c) in effect on December 31, 1977 on the taxation of foreign earned income. Wisconsin did not recognize amendments made to this section of the IRC after December 31, 1977 by P.L. 95-615 (foreign earned income exclusion for employees who resided in hardship area camps) and P.L. 97-34 (foreign earned income exclusion limits and housing cost exclusion or deduction). Wisconsin also did not recognize IRC s. 913 which was created by P.L. 95-615 and provided for a deduction for excess living costs.

A United States citizen who is a Wisconsin resident and receives compensation for personal services performed in a foreign country is liable for Wisconsin taxes. However, for the 1978 through 1983 taxable years, a Wisconsin foreign earned income exclusion of up to $15,000 ($20,000 for employees of qualified U.S. charitable organizations) is allowed for an individual who is a bona fide resident of a foreign country or who is present in a foreign country for a specified period of time.

Definition of a Foreign Country: For purposes of claiming the foreign earned income exclusion, a foreign country is an area outside of the United States, its possessions, Guam, Puerto Rico, the Virgin Islands, the Northern Marianas Islands and the Antarctic region (Fed. Publication 54, "Tax Guide for U.S. Citizens Abroad").

Definition of a Qualified U.S. Charitable Organization: A qualified United States charitable organization is a nonprofit group organized in the United States, or under the laws of the United States, any State or the District of Columbia, for charitable, religious, educational or other certain purposes (IRC ss. 911(c) (1)(D) and 501(c)(3), 12-31-77).

Qualifications for Wisconsin Foreign Earned Income Exclusion: A United States citizen who is a bona fide resident of a foreign country or who is present in a foreign country for a specified period of time may exclude from gross income a limited portion of the earned income attributable to services performed in the foreign country (IRC ss. 911(a)(1) and (2) and 911(c)(6), 12-31-77; Fed. Reg. 1.911-2(a) and (b), 12-31-77).

A. *Bona Fide Resident of Foreign Country.* An individual who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year is eligible for a foreign earned income exclusion. Bona fide residence is determined according to each individual case, taking into account such factors as intention or the purpose of the trip, and the nature and length of the stay abroad. Bona fide residence is not necessarily the same thing as domicile. An individual's domicile is his or her permanent home, the place to which the individual always returns or intends to return.

Example: A Wisconsin domiciliary who travels to London for vacation or on a business trip has not established bona fide residence in London. But a Wisconsin domiciliary who goes to London to work for an indefinite or extended period and who sets up permanent quarters for himself and his family may establish a bona fide residence in London, even though he intends to return ultimately to his Wisconsin domicile.

An individual is not a bona fide resident of a foreign country if he or she makes a statement to the authorities of that country that he or she is not a resident and, therefore, the individual is not subject to the income tax of that country. An individual does not automatically acquire bona fide resident status merely by living in a foreign country, or countries, for one year. During the period of bona fide residence in a foreign country, an individual may leave the country for brief or temporary trips back to the United States or elsewhere for vacation or business as long as the individual returns to the foreign residence from such trips.

B. *Physical Presence in Foreign Country.* An individual who is physically present in a foreign country for at least 510 full days during any 18 consecutive months is eligible for a foreign earned income exclusion. The type of residence established, the intentions about returning from the foreign country and the nature and purpose of the trip abroad are disregarded in this case. Presence in the foreign country does not have to be exclusively for employment purposes. Some of the qualifying foreign-presence time may consist of vacation time in foreign countries. However, the requirement of at least 510 days on foreign soil within the 18-month period is unconditional.

The following principles must be considered in computing the 18-month period:

1. Any period of 18 consecutive months may be used, provided that the 510 qualifying days on foreign soil fall within that period. A qualifying day means a period of 24 consecutive hours beginning at midnight.
2. The 18-month period does not have to begin with the first qualifying day in a foreign country and the period does not have to end on the day of departure.
3. In determining the qualifying 18-month periods falling within an extended period of absence from the United States, any 18-month period may overlap another 18-month period.

Example: A construction worker arrived in Ecuador on January 15, 1982 and returned to the United States on June 10, 1983. He was physically present in Ecuador for 510 full days and therefore met the physical presence test. If the construction worker filed his 1982 Wisconsin income tax return before he qualified for the foreign earned income exclusion, he could file a 1982 amended tax return (Wisconsin Form 1X) claiming the allowable exclusion on the date he met the physical presence requirement.

Income Qualifying for Exclusion: An exclusion of up to $15,000 per year ($20,000 for employees of qualified U.S. charitable organizations) of earned income from foreign services may be excluded from Wisconsin gross income by qualified individuals (IRC s. 911(b), 12-31-77; Fed. Reg. 1.911-2(c) and (d), 12-31-77).

Foreign earned income is income that is

A. For services performed in a foreign country during the part of the tax year that an individual meets either the bona fide residence or physical presence tests, regardless of the place or manner of payment,

B. Not paid by the U.S. government or any of its agencies including the U.S. Armed Forces,

C. Not pension or annuity income, and

D. Not received after the close of the tax year following the tax year in which it is earned.

Wages, salaries, professional fees and other amounts received for personal services actually rendered in a foreign country (and paid by sources other than the U.S. government) qualify for the exclusion. Earned income does not include income from a business unless personal services produce the entire business income. However, if services and capital are income producing factors, a reasonable allowance for personal services (up to a maximum of 30% of net business profit) can be considered as earned income. Earned income includes allowances or reimbursements received for the cost of living, overseas differential and living quarters. It also includes the fair market value of noncash remuneration furnished by an employer such as a home or automobile.

Unearned income (for example, interest, dividends, capital gains, rent and royalties, annuities, etc.) does not qualify for the earned income exclusion.

Limitations on Amounts Excludable: The allowable foreign earned income exclusion is computed on a daily basis at an annual rate of $15,000 ($20,000 for employees of qualified U.S. charitable organizations). For married taxpayers, each spouse may claim an exclusion if both qualify (IRC s. 911(c)(1), (2) and (4), 12-31-77; Fed. Reg. 1.911-2(a), (b) and (d), 12-31-77).

If an individual meets either the bona residence or physical presence requirement and the individual qualifies for an exclusion for only part of a particular tax year, the maximum $15,000 (or $20,000) exclusion must be prorated based on the number of days in the qualifying period.

Example 1: A wage earner was physically present in Germany from January 1, 1982 through July 31, 1983. She received foreign earned income of $35,000 in 1982 and $25,000 for the first seven months in 1983. The amounts excludable from Wisconsin income in 1982 and 1983 are computed as follows:

Year		Limitation on Exclusion
1982	365 days ÷ 365 days × 15,000	$15,000
1983	212 days ÷ 365 days × 15,000	$ 8,712

An individual may not claim an exclusion for an amount in excess of the foreign income actually earned during the qualifying period.

For purposes of determining the foreign earned income excludable, compensation is allocated to the year in which the services are performed even though non-excludable compensation is reported in the year received by a cash basis taxpayer. To exclude income earned abroad, the income must be received no later than the tax year after the tax year it is earned.

Example 2: An employee of a qualified U.S. charitable organization qualified for the bona fide residence exclusion for the years 1982 and 1983. During 1982 the excludable earned income was $18,000. During 1983, the employee received earned income of $19,000 for services rendered in 1983 and a bonus of $5,000 for services rendered in 1982.

1982

Exclusion allowable	$20,000
Amount actually excluded	18,000
Remainder of available exclusion	$ 2,000

1983

Income earned in 1983 and excluded	$19,000
Amount of bonus earned in 1982 that may be excluded in 1983	2,000
Total amount to be excluded in 1983	$21,000

Example 3: An executive of a private Wisconsin corporation is assigned to the corporation's Canadian subsidiary. The executive established residence abroad as of December 31, 1979 and returned to the United States on January 1, 1983. The executive received an annual salary of $12,000 and, in addition, received a bonus of $6,000 on January 15, 1983, shortly after returning to the United States. The executive qualified for a Wisconsin foreign earned income exclusion for the entire 3-year period and could exclude the salary earned each year.

The $6,000 bonus must be allocated equally over the years 1980, 1981 and 1982 when the bonus was earned for purposes of determining the foreign earned income excludable. The amount of bonus excludable is limited to the $2,000 allocable to 1982. The remaining $4,000 ($2,000 allocable to each of the years 1980 and 1981) does not qualify for exclusion, since it was received later than the close of the tax year after the tax year in which the services were performed.

Claiming Exclusion on Wisconsin Tax Return: Wisconsin Form 1 must be filed by any individual claiming a Wisconsin foreign earned income exclusion. Complete copies of the individual's federal income tax return and supporting schedules, a computation of the Wisconsin foreign earned income exclusion and a Wisconsin Schedule I must be attached to the Wisconsin Form 1.

Schedule I is used to convert the federal adjusted gross income from an individual's federal tax return to the amount that is reportable for Wisconsin tax purposes. Once the Wisconsin foreign earned income exclusion is computed, the excludable amount is entered on line 5, Col. II of the 1983 Wisconsin Schedule I. The federal foreign earned income exclusion and any foreign housing cost exclusion or deduction that was claimed on the federal tax return is entered on line 5, Col. I of the 1983 Wisconsin Schedule I. The difference in the amounts entered on line 5, Col. I and Col. II, is entered on line 5, Col. III. This difference must be added to federal adjusted gross income per the instructions on line 6 of Schedule I.

Deductions Related to Excludable Foreign Earned Income: Expenses directly attributable to foreign earned income must be allocated when part of the income is excludable and part is taxable in a particular tax year. An individual may not deduct expenses, losses, and other items that went into producing the *excludable* income. Only those expenses that are attributable to *taxable* income are deductible. This limitation only applies to expenses directly connected with excludable earned income. It does not apply to other deductions, such as those for medical expenses, interest or alimony (IRC s. 265, 12-31-82 and Fed. Reg. 1.911-2(d)(6), 12-31-77).

Example 1: A Wisconsin resident employed in a foreign country qualifies for the physical presence exclusion for the entire 1983 tax year. Foreign earned income for the year is $30,000 of which $15,000 is excluded from gross income. Included in allowable itemized deductions are employee business expenses for safety equipment of $224 and union dues of $450. These expenses are directly attributable to foreign earned income and, therefore, the part of the expenses allocable to the excluded income is not deductible. Since 50% of the foreign earned income is excludable, 50% of the employee business expenses, or $337 is not deductible.

Example 2: A management consultant was self-employed in a foreign country and personal services produced the business income. The consultant is a U.S. citizen and meets the physical presence test for the entire 1983 taxable year. Gross business income was $75,000, business expenses were $50,000 and net profit was $25,000. Since the first $15,000 of gross income is excluded, only $60,000 or 80% of the gross income is reported on the 1983 Wisconsin tax return. The consultant can deduct only 80% of the expenses attributable to gross income, or $40,000.

Nondeductible expenses, losses and other items attributable to the excludable Wisconsin earned income must also be accounted for on line 5 of the 1983 Wisconsin Schedule I.

4. Wisconsin Tax Treatment of Safe Harbor Leases

Background: The Economic Recovery Tax Act of 1981 (ERTA) enacted by the United States Congress provided "safe harbor" lease rules (Section 168(f)(8) of the Internal Revenue Code) under which certain transactions, applicable to property placed into service on or after January 1, 1981, were treated as leases for federal income tax purposes whether or not the transactions otherwise would qualify as leases under pre-ERTA federal guidelines.

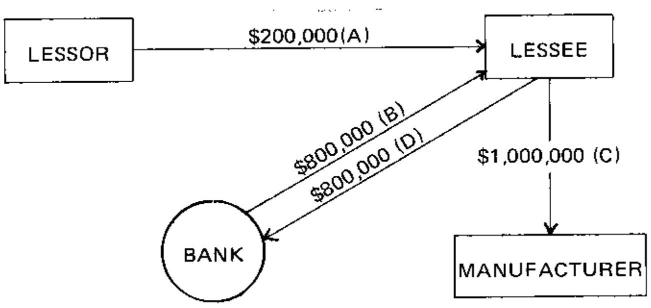
The Wisconsin Statutes—ss. 71.01(4)(g)5, 6 & 7, 71.02(1)(a)6, 7 & 8, and 71.04(15)(b)—were modified to deny corporations use of these special federal safe harbor lease rules, effective for taxable year 1981 and thereafter. (A brief summary of the effect of these federal rules on individuals, estates and trusts for Wisconsin income tax purposes is found near the end of this Tax Release.)

There are two general types of leases covered by the federal safe harbor lease rules—namely, "straight leases" and "sale-leasebacks". Only the latter type is discussed in this Tax Release.

Facts and Question: In taxable year 1981 Seller/Lessee Corporation purchased equipment from a manufacturer for $1,000,000 and then "sold" (but did not transfer title to) the equipment to Purchaser/Lessor Corporation for $200,000 in cash plus an $800,000 nonrecourse note receivable from Purchaser/Lessor bearing interest at the market rate and payable over nine years in equal annual principal and interest payments of $168,000. The $200,000 was the agreed upon price of the Seller/Lessee's tax benefits consisting of its depreciation deductions and investment tax credit on the equipment. Purchaser/Lessor Corporation simultaneously "leased" the equipment back to the Seller/Lessee for nine years (90% of its useful life) for annual rental payments of $168,000 which are due on the same date and exactly offset the principal and interest payments Purchaser/Lessor must make to Seller/Lessee under the note. The only money changing hands between Seller/Lessee and Purchaser/Lessor was the $200,000 payment in 1981 for the tax benefits. Seller/Lessee used the $200,000 as a down payment to the equipment manufacturer and financed the remaining $800,000 with a financial institution.

The following diagram illustrates the flow of the various payments in the above example:

SALE-LEASEBACK AGREEMENT



(A) Represents the $200,000 payment made by the lessor to the lessee under the safe harbor lease agreement for some of the lessee's tax benefits.

(B) Represents the $800,000 the lessee borrowed from the bank for the purchase of the equipment.

(C) Represents the $1,000,000 payment made by the lessee to the manufacturer for the purchase of the equipment.

(D) Represents the repayment by the lessee of the $800,000 loan over a period of years.

What is the Wisconsin franchise/income and sales/use tax treatment of the various components of this transaction?

Answer: The following summarizes the Wisconsin tax treatment of each aspect of the transaction. This treatment applies to corporations engaged in business solely in Wisconsin as well as to multi-state corporations reporting to Wisconsin on the apportionment or separate accounting methods.

A. *Sale of Equipment by Seller/Lessee.* Sale is not recognized.

B. *Initial $200,000 Payment by Purchaser/Lessor to Seller/Lessee.*

(1) The transfer of federal tax benefits for $200,000 is considered to be the sale of such benefits.

The Seller/Lessee Corporation must recognize income of $200,000 in taxable year 1981. (It is allowed the entire $1,000,000 cost of the equipment as basis for depreciation purposes. This payment, accordingly, does not constitute a reduction of the underlying asset account for Wisconsin tax purposes.)

(2) The Purchaser/Lessor Corporation may not deduct the $200,000 cost of these benefits since the law contains no provision for such deduction.

C. *Depreciation of Equipment.* Seller/Lessee corporation deducts depreciation using a basis of $1,000,000.

D. *Rental Expense/Income.* Neither Seller/Lessee nor Purchaser/Lessor recognizes rental expense or income.

E. *Interest Expense/Income.* Seller/Lessee may deduct interest it pays to the financial institution on the $800,000 loan. However, neither Seller/Lessee nor Purchaser/Lessor recognizes interest income or expense on the $800,000 nonrecourse note the two parties executed.

F. *Apportionment Basis Taxpayers - Effect upon Property and Sales Factors.* Seller/Lessee includes the equipment in the property factor at its $1,000,000 cost. Rental payments under the safe harbor agreement are not considered rental payments for purposes of the property factor.

The Purchaser/Lessor may not include the property in its property factor.

The manufacturer includes $1,000,000 in its sales factor; the Seller/Lessee, however, may not include the $1,000,000 in its sales factor.

G. *Wisconsin Sales/Use Tax.* The sale of equipment by the manufacturer to Seller/Lessee Corporation is a taxable sale unless a specific exemption applies to the transaction, such as the farming or manufacturing exemptions in ss. 77.54(3), (3m) or (6)(a). The Seller/Lessee Corporation may not give the manufacturer a resale certificate, since there is not an actual resale to the Purchaser/Lessor Corporation.

The $200,000 received by Seller/Lessee is not taxable for sales tax purposes because it represents proceeds from the sale of intangible tax benefits.

Other offsetting principal, interest and rental amounts recognized for federal income tax purposes have no Wisconsin sales or use tax consequences.

H. *Nexus Issues.* The Purchaser/Lessor Corporation will not have nexus with Wisconsin for franchise or income tax purposes if its only "activity" in Wisconsin is the safe harbor "rental" property located in Wisconsin.

The presence of this property in Wisconsin, however, will cause the Seller/Lessee to have Wisconsin nexus for franchise/income and sales/use tax purposes (if it does not already have such nexus).

To summarize, for Wisconsin corporation franchise/income tax purposes the sale-leaseback transaction is treated as the purchase of equipment by the Seller/Lessee and the taxable sale of some of its federal income tax benefits. The cost of such benefits is not deductible by the Purchaser/Lessor. The federal income tax treatment of the equipment "sale" and "leaseback" aspects of the transaction have no application for Wisconsin corporation franchise/income or sales/use tax purposes.

Individuals, Estates and Trusts: For federal income tax purposes, individuals, estates and trusts may qualify as *lessees* under the safe-harbor lease rules; lessors, however, must always be corporations.

For 1981, individuals, estates and trusts did not qualify for safe harbor treatment for Wisconsin income tax purposes because they computed their income and deductions under the December 31, 1980 Internal Revenue Code. For 1982, they were subject to the Internal Revenue Code in effect on December 31, 1981. Therefore, individuals, estates and trusts on their 1982 Wisconsin income tax returns could receive full benefits of the safe harbor leasing provisions that became effective for federal income tax purposes in 1981. For 1983, however, they must follow the provisions of TEFRA enacted in 1982 since Wisconsin individual income tax law, as applied to these leases, is the Internal Revenue Code in effect on December 31, 1982.

Finance Leases Replace Safe Harbor Leases: The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) enacted by the U.S. Congress effectively ends safe harbor leasing for property placed in service after December 31, 1983, and imposed many limitations and restrictions on the benefits from safe harbor lease agreements entered into between July 1, 1982 and December 31, 1983. TEFRA also created an entirely new category of lease rules known as "finance lease" rules that apply to leases entered into after December 31, 1983 and to leases of up to $150,000 of farm equipment entered into from July 1, 1982 through December 31, 1983.

These new federal "finance lease" rules are also contained in Section 168(f)(8) of the Internal Revenue Code. Therefore, under the Wisconsin corporation franchise/income tax law as of December 31, 1983—ss. 71.01(4)(g)5, 6 & 7, 71.02(1)(a)6, 7 & 8, and 71.04(15)(b), Stats.—the new federal treatment of finance leases, including the lease of farm equipment from July 1, 1982 through December 31, 1983, does not apply to corporations.

Information: Questions relating to Wisconsin treatment of safe harbor leases should be addressed to:

Wisconsin Department of Revenue
P.O. Box 8906
Madison, WI 53708
Attn: Jerry Hendrickson

Example of Tax Return Adjustments on Federal Schedule M-1 and Wisconsin Schedule L

The following federal Schedule M-1 (with required Wisconsin adjustments thereto) and Wisconsin Schedule L illustrate the adjustments that should appear on the tax returns of a taxpayer who had entered into a sale-leaseback transaction with the facts set forth in the foregoing example.

FEDERAL SCHEDULE M-1 AND WISCONSIN SCHEDULE L ADJUSTMENTS FOR A SALE-LEASEBACK TRANSACTION (FIRST YEAR)

	Seller/Lessee		Purchaser/Lessor	
	Initial Payment Booked to Income	Initial Payment Not Booked to Income	Initial Payment Booked to Expense	Initial Payment Not Booked to Expense
Federal Schedule M-1 (with required Wisconsin adjustments thereto)				
Book Income (Loss)	$(4,800,000)	$(5,000,000)	$9,800,000	$10,000,000
Schedule M-1 Adjustments:				
Rental Expense	(168,000)	(168,000)		
Rental Income			168,000	168,000
*Interest Income	120,000	120,000		
Interest Expense			(120,000)	(120,000)
**Depreciation Expense	150,000	150,000	(150,000)	(150,000)
Initial Payment	(200,000)		200,000	-0-
Federal Taxable Income	$(4,898,000)	$(4,898,000)	$9,898,000	$ 9,898,000
Required Wisconsin Adjustments:				
Rental Expense	168,000	168,000		
Rental Income			(168,000)	(168,000)
*Interest Income	(120,000)	(120,000)		
Interest Expense			120,000	120,000
**Depreciation Expense	(150,000)	(150,000)	150,000	150,000
Initial Payment	200,000	200,000	*** -0-	-0-
Wisconsin Net Income	$(4,800,000)	$(4,800,000)	$10,000,000	$10,000,000
Wisconsin Schedule L				
Book Income (Loss)	$(4,800,000)	$(5,000,000)	$ 9,800,000	$10,000,000
Schedule L Adjustment:				
Initial Payment		200,000	200,000	
Wisconsin Net Income	$(4,800,000)	$(4,800,000)	$10,000,000	$10,000,000

Contract Date - January 1, 1981

*Interest rate of 15% × $800,000 note = $120,000 first year interest

**Depreciation Expense at 15% for first year of contract ($1,000,000 × 15% = $150,000)

(This assumes ACRS depreciation was booked; if a different method of booking depreciation was used, then the Schedule M-1, Required Wisconsin and Schedule L depreciation adjustments would be different from those above.)

***Federal adjustment not reversed because initial payment is not deductible for either federal or Wisconsin tax purposes.

The above chart illustrates the point that every adjustment made for federal tax purposes is reversed for Wisconsin tax purposes with the exception of the initial payment made by the lessor to the lessee for the tax benefits.